

CONSEIL DE L'ATLANTIQUE NORD
NORTH ATLANTIC COUNCIL

EXEMPLAIRE N° 305
COPY

~~NATO~~ CONFIDENTIAL

ORIGINAL: ENGLISH
15th September 1980

DOCUMENT
C-M(80)49

ECONOMIC REFORMS IN THE USSR AND EASTERN EUROPE

Note by the Secretary General

The attached report was prepared by the Economic Committee on the basis of contributions and remarks presented during a meeting with experts from capitals and takes into account subsequent comments and information provided by national delegations.

2. This document is forwarded to the Council for information.

(Signed) Joseph M.A.H. LUNS

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This document includes: 4 Annexes

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ECONOMIC REFORMS IN THE USSR AND
EASTERN EUROPE

REPORT BY THE ECONOMIC COMMITTEE

I. SUMMARY

Recent economic reforms in the USSR and Eastern Europe have been oriented principally toward stimulating economic growth. The differing approaches which have been used to achieve this end might be grouped into two categories: steps to improve administrative structure and functioning, including planning; and efforts to promote the effectiveness of the profit motive, largely through price adjustments and changes in incentives.

2. Administrative reforms in industry have centered principally on improving planning, organization and management, and investment. To improve planning procedures, plan time-spans have gradually been increased, computers have been increasingly utilized, and more sophisticated plan indicators have been introduced. Hungary has taken the approach of relying on indicative planning, rather than prescriptive planning to achieve its economic goals.

3. To shorten the chain of command and achieve economies of scale, enterprises in the USSR and Eastern Europe have increasingly been merged into larger organizations, as a rule directly responsible to ministerial control. To promote efficiency and uniformity, specialized functions such as price-setting, materials supply, and research and development have been given to high ranking state agencies, which operate more or less independently of the ministries. To improve management, measures have been effected for managerial retraining, and institutes have been established for higher-level management.

4. In both the USSR and Eastern Europe, investments are decreasingly financed from state budgets and increasingly from the profits and funds of individual firms and industrial groupings. Nonetheless, decisions on the volume and types of investments remain tightly controlled by the planning authorities, whose control appears in some instances to be strengthening.

5. No far-reaching reforms have been undertaken in agriculture since 1965. In the USSR there have been recent moves to give greater support to private plots and to erect more grain storage units. In Eastern Europe, there has been a trend toward greater farm autonomy and the creation of larger production units.

6. Administrative foreign trade reforms in the USSR and Eastern Europe have been oriented primarily to increasing export competitiveness on world markets. Export producing enterprises have been brought into more direct contact with foreign trade operations,

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compensation arrangements have been emphasized, and foreign joint ventures have increasingly been formed. Hungary in particular has applied measures, both administrative and economic, to make exporting firms more keenly feel the effect of world price levels.

7. In addition to attempting to promote increased output by better administrative and organizational arrangements, the USSR and Eastern Europe have attempted to encourage more efficient production through price and wage incentives and disincentives. Wholesale price reforms have generally been aimed at giving substance to related administrative reform measures, and more specifically at forcing enterprises to use capital and raw materials more efficiently. Although retail prices have remained relatively stable in most of the countries throughout the past decade, they have been raised on selected items to bring demand into line with domestic production capabilities, to reduce demand for exportable goods, or to alleviate ever-growing state price subsidies.

8. As a result of price increases, both those officially sanctioned and those generated by private and black market activities, consumers in both the USSR and Eastern Europe have experienced a considerable amount of price inflation in recent years, which has tended to diffuse the effectiveness of various wage incentives, on which the Eastern economies rely heavily to promote labour productivity. Since the economies of the USSR and Eastern Europe are likely to experience declining growth in the 1980s, they may find themselves hard put to provide the consumer goods necessary to convince the population of the efficacy of the economic incentives, and to motivate it to make them work.

9. CMEA economic integration efforts include planning coordination, production specialization, and joint capital investment projects, the latter most often located on Soviet soil and oriented to guaranteeing future deliveries of raw materials and energy to Eastern Europe. Long-range target programmes have been drafted to guide joint development efforts during the 1981-1990 period in five main industrial areas, including the production of consumer goods. The East European states generally resist further integration efforts, however, because they are reluctant to become too involved in arrangements which might interfere with their own national development plans, and because their artificial price systems and currency exchange rates prevent the advantages of economic integration from being fully felt in any case.

10. Giving convertibility to the transferable ruble, the unit of account used in intra-CMEA trade, has been discussed as a means of promoting trade integration, promoting greater harmony in intra-CMEA domestic prices, and exerting the disciplinary effects of world market prices on CMEA enterprises engaged in foreign trade. It is unlikely that the transferable ruble will become completely convertible in the foreseeable future, however, largely because of national vested interests in favour of preserving its presently restricted status.

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11. In retrospect, a noticeable trend of reform measures since 1965 has been to devolve decision-making regarding various production activities away from the central authorities to levels closer to actual producing units. While progress toward devolved decision-making has probably reached its limit in the USSR, it appears to be continuing in Eastern Europe, after a hiatus in the mid-seventies.

12. Eastern Europe may conceivably introduce a number of reforms in the eighties embodying market-oriented mechanisms. It is unlikely that the Soviet Union will follow suite, however, because its managerial cadres are not experienced in market environments, its mammoth development problems may best be solved by strongly centralized programmes, and political and ideological conservatism will militate against liberal economic experiments.

13. On balance, it can be said that reform measures in the USSR and Eastern Europe over the past 15 years have achieved both positive and negative results. On the positive side, they have tended to improve planning methods and evaluation, and to encourage enterprise directors to make somewhat better use of investments, raw materials, and manpower. Negatively, they have not offered incentives attractive enough to overcome inherent managerial and labour inertia, and the fact that plan fulfilment remains essentially a bargaining process between enterprise directors and planning authorities. Efforts to stimulate labour productivity are hindered by the fact that labour is in short supply, and so cannot be readily dismissed for inadequate performance. Incentives to better management are often negated by bureaucratic restrictions to prevent "unjust" gains.

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II. INTRODUCTION: THE SIGNIFICANCE OF REFORM

14. Since its establishment over a half century ago, the state-controlled economy of the USSR has been subjected to a number of so-called "reforms"(1). The most important and far-reaching in recent years were instituted in 1965, and to a lesser extent, in 1979. Similarly, the East European economies experienced a wave of reforms in the 1960s, which had largely subsided by the mid-1970s, although in Hungary, and to a lesser extent in Czechoslovakia and the GDR, the reformist urge cautiously picked up momentum again toward the end of the decade. The latest reform measures in the CMEA economies have been taken in the face of declining economic growth, rising raw materials and investment costs, and foreign trade pressures.

15. Broadly speaking, recent reforms have had a dual motivation: political and economic. On the political side, they have often been instituted to implement the philosophies of certain political factions, or alternatively, to dissociate the policies of new political groupings from those of their predecessors. The Soviet reforms of 1965, for example, can be seen as an attempt by the new régime of Brezhnev to reinforce its power on the basis of an economic policy at variance with discredited Khrushchevian approaches.

16. From an economic point of view, the reforms have been aimed primarily at improving the quality and efficiency of production, in order to achieve maximum economic growth. By stimulating growth, the Communist régimes have hoped not only to broaden their countries' productive and export capabilities, but also to enlarge their means of satisfying consumer demand. The economic motivation thus also has political overtones: to increase the economic power of the state, and to broaden the base of popular support.

17. A study of the reforms undertaken by the CMEA régimes is useful in at least three different ways. First, it provides an idea of the amount of concern attached by the leaderships to dealing with perceived problems in the functioning of their economies. Second, it reveals approaches and areas of emphasis in economic development, such as in the level of priority given to agriculture, investment, or the construction industry. Finally, according to the degree of success which the reforms are judged capable of achieving, they serve to indicate the probable future strength of the economies, including their capabilities for defence spending and for consumer goods production.

(1) The word "reform" is used in this paper to indicate any measure instituted by the government to affect the functioning of the economy. Broadly speaking, administrative reforms affect supply arrangements, and price reforms serve principally to control demand, although they are also effected to stimulate production of desired items.

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C-M(80)49III. AREAS OF RECENT ADMINISTRATIVE REFORMA. Industry(a) Planning

18. Political considerations aside, most recent reform measures in the USSR and Eastern Europe apparently have been devised to solve specific economic problems, one of which is planning: throughout the area it suffers delays and contradictions from over-bureaucratization, lack of inter-ministerial co-ordination, and conflicts from large, priority, projects and although increasingly sophisticated planning methods are used, many decisions are still ultimately based on the volume of past output to which percentage increases are arbitrarily assigned.

19. Ongoing reforms in the USSR can be seen as a continuation of a broad series of reform measures introduced in 1965 - the so-called "Kosygin reforms". The primary objective of the reforms was to increase production through decentralised management, increased incentives and more emphasis on profits. In addition reforms were intended to produce a breakthrough in planning by (i) extending the time horizons for plans, (ii) raising their "scientific" basis through extensive use of computers and mathematical optimizing and forecasting techniques, and (iii) concentrating on important development projects or solutions to major problems, and carefully integrating these approaches into the overall plans for economic development. Progress to date has fallen short of objectives.

20. To extend plan time spans and to force enterprises to plan on a longer-term basis, the Five-Year Plan has been made directive and legally binding as an operating basis in the USSR and in Eastern Europe, within which annual plans are to be drafted. In addition, in the USSR, a series of some 200 "technological development programmes" covering the period up to 1990 have been drawn up by the Academy of Sciences and the State Committee for New Technology to guide the drafting of the Five-Year Plans starting from 1976.

21. Because planning delays and frequent plan changes necessitated by economic conditions have continued to render largely ineffective the ordered supremacy of the Five-Year Plan, the Soviet government in 1979 decreed(1) strict time limits by which plans must be drafted and approved. In addition, work continues on the drafting of a 15 year plan for the period 1976-1990, to give additional direction to the formulation of the component Five-Year Plans; but differences of view over approaches to, and the final form of, this plan appear to have prevented its completion.

(1) "Decree on Improving Planning, Increasing Impact of Management on Production Efficiency and Quality", No. 695 of the Communist Party Central Committee and the USSR Council of Ministers, adopted 12th July 1979.

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22. To help improve the planning process increasing use is made of computers. About half the calculations involved in the Soviet 1978 national economic plan were made with such aid, although some three-fourths of the problems solved related only to accounting and statistics, and computers are still little used to improve planning through optimizing calculations. The amounts of data and computer programming needed for calculating balances between production and allocation of goods have not yet been compiled and coordinated on a wide scale; consequently, of the 15,500 planned commodity groups in the USSR, the number of balances worked out by GOSPLAN for the 1976-1980 Plan was still only 233, and the number worked out by GOSSNAB 106(1).

23. For the CMEA area as a whole broad "target programmes" in five areas (energy, industrial machinery, agriculture, transport, and consumer goods) were finally completed in 1979 to guide and coordinate the planning of the individual member states up to 1990. Under the CMEA ten-year target programmes, on the other hand, the only clearly defined project yet agreed is one for the joint construction of nuclear power plants in Eastern Europe and the Soviet Union. Clearly, then, measures to lengthen plan time-spans in the USSR and Eastern Europe have been slow in taking effect.

24. In the individual East European countries, moreover, results from attempts to extend planning periods have also not been particularly successful. In Czechoslovakia, for instance, the so-called "Ler Experiment", which instituted planning and evaluation of enterprise performance on a three-year basis for a limited number of firms starting in 1978, seems to have had no notable effect in stimulating industrial output, although certain of its features have reportedly been extended to other areas of industry.

(1) "Problemy razrabotki novoi metodiki sostavleniya narodno-khozyaistvennykh planov", in Planovoe Khozyaistvo, No. 7, 1977, p. 115, as quoted by D.A. Dyker, School of European Studies, University of Sussex. Many planning data are beginning to be computerized, however. In this connection, starting in 1968 the Soviets began setting up a nationwide system of computer centres and information storage and transmission systems, so that some 54% of statistical data is now processed on computers at the nationwide level of planning administration, and 40% of the statistics collected on a republic-by-republic basis are computerized. There is a problem in coordinating the data among the various planning agencies, however, as well as with the respective ministries. Data and computer processing systems are frequently incompatible, and the problem is compounded by the continuing introduction of new computer types.

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25. Another approach to improve the planning process has been the use of more sophisticated planning indicators. Measures announced in Romania in January 1979 and in the USSR in July 1979, for instance, stress that the value of a firm's output be reported in terms of net value added, as opposed to the formerly emphasized indicators of gross production and gross sales. Hence, firms should be discouraged from using large amounts of raw materials inputs to inflate the value of their gross production. Moreover, if they are not allowed to raise their sales prices to reflect the increasing costs of raw materials and energy, they will have a positive interest in conserving on materials inputs, in order to maintain existing levels of wages and profits.

26. Hungary remains the only CMEA country which continues to rely on indicative planning, rather than prescriptive planning, to achieve its economic goals. Instituted in 1968 and reaffirmed in 1977, the reform replaces direction of the economy by command (in which the plan is broken down into myriads of compulsory indices and targets, and further broken down by individual enterprises and economic units) by specifying only desired economic trends and targets for the country as a whole. In place of more detailed and sophisticated planning indicators, the Hungarian reform relies for its effectiveness on correct decision-making at the enterprise level, where planning information is most accessible and economic interest most immediate. Government policy guides management to make desired decisions essentially through the application of various "regulators" on wages, prices, enterprise finances, credit, foreign trade, and other areas.

(b) Organization and Management

27. In the USSR, attempts to improve the administration of the economy have often involved industrial reorganization. After 1965, the ministerial system of control was restored, replacing the Khrushchevian network of regional economic councils. At the same time, three new state committees at ministerial level were set up to centralize the administration of prices, industrial supplies, and research(1). As a result of the re-establishment of the ministerial authority, the overwhelming majority of ministries at both the national (all-union) and republic level are economic in orientation, and have rapidly expanded their bureaucracies(2).

28. With the establishment of GOSSNAB and its regional subordinate units, the ministries were gradually to give up their function of distributing rationed producer goods throughout the economy. Moreover, for further distributive efficiency, a system of wholesale trade in producer goods was to progressively replace

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- (1) The new organizations were: GOSTSEN, or the State Committee for Prices, to fix and monitor prices; GOSSNAB, or the State Committee for Material-Technical Supply, for the rationing of materials and equipment to producers; and GOSTEKHNIKA, or the State Committee for New Technology, for the overall management of the research and development effort.
- (2) During the 1966-1977 period, the Soviet administrative bureaucracy grew by 57%, as compared with only a 38% increase for state employment as a whole.

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rationing, by widespread use of direct contracting arrangements between suppliers and client enterprises. At present, however, GOSPLAN still plans the distribution of 70-80% of industrial output, and in 1976 GOSSNAB still was handling only about half the total value of rationed producer goods. By 1976, direct contracting arrangements accounted for only slightly over one-tenth of the trade; and a decree in 1978 implied that many of the contracting arrangements are not adhered to with respect to quantity, quality, and delivery terms.

29. A further aim of Soviet administrative reforms has been to shorten the chain of command from ministries to individual factories. To this end, individual enterprises have been merged increasingly into larger units which, at the same time, have been intended to reap gains from specialization, obtain economies of scale, and save on administrative costs. Many ministries have held back from rapid implementation of mergers, however, and even in those which have proceeded to effect them, the wide variety of groupings formed has tended both to create confusion as to spheres of authority and to promote financial irresponsibility. Hence, in 1973 the USSR passed a resolution establishing only three types of groupings: industrial associations, production associations, and science-production associations(1).

30. In 1978, the various production associations in the USSR numbered 3,857, compared with 1,101 at the beginning of 1973 and accounted for around 45% of both sales and total employment in the Soviet economy. The reorganization, however, remains incomplete, especially with respect to smaller enterprises. At the beginning of 1978, the average production association contained only 4.5 units, and nearly half of these units remained legally independent and financially autonomous. The reorganization is scheduled for completion in industry by the end of 1980 when production and science-production associations are to number 5,000 and account for about three-fourths of total Soviet industrial output.

(1) Industrial associations, essentially transformations of former ministerial main administrations, were given the right to collect fees from subordinate industrial organizations, over which they maintain control through contractual arrangements; the industrial associations hence have a certain autonomy from the state budget, and also possess the means to undertake initiatives in research, application of new technology, export promotion, and financial aid to subordinate entities. Production associations, which may be subordinate either to industrial associations or directly to industrial ministries, bring together individual enterprises into a single legal entity under one parent organization, which also maintains a certain financial autonomy through receipts from its branches. Science-production associations, designed to hasten the application of the results of pure research to actual production, are grouped under independent research institutes which control the union's use of funds.

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31. In Eastern Europe similar production associations were established under various names(1) in the 1970s in each country except Bulgaria. To prevent the newly created groupings from undermining the plans, strict central controls were also reaffirmed, with the effect that ministries with increased powers began to interfere in the day-to-day workings of individual enterprises. Only in Hungary were local firms given considerable autonomy, although with strict controls on their commitments to export, to force managers to think in terms of meeting the needs of Hungary's highly important foreign trade. In Poland, heads of groups of enterprises were briefly given more latitude in the planning process in the early 1970s; but the ministries quickly re-established control when it appeared the move would have adverse political effects.

32. Despite continuing trends toward industrial agglomeration throughout Eastern Europe, in Hungary recent official support has emerged for a revival of small enterprises, i.e. those employing less than 50 persons. Such enterprises, it is argued, can act much more quickly than large ones to produce goods in short supply because of planning priorities, or in temporary high demand because of new market conditions. A small enterprise can also help to ease the chronic shortage of spare parts, with its small-series production capabilities, which in addition adapts more readily to the quick development and application of inventions. However, there is no evidence yet that this thinking will be put into practice in Hungary or elsewhere in the CMEA.

33. In the USSR, on the other hand, besides going in for giantism and mergers as a means of administrative improvement, reformers have also expanded programmes for training managers in modern skills. On the basis of a November 1977 resolution of the Communist Party Central Committee(2), ministries and lower-level bodies are to develop annual and Five-Year Plans for retraining managers at least once every six years. In addition, in May 1978 the Academy of the National Economy was established, primarily to provide longer-term high-level management training for senior executives, mainly officials of associations and large enterprises. A similar organization, representing all CMEA countries and called the International Scientific Research Institute on Management, was opened in Moscow in 1977.

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- (1) Kombinats (Combines) in the GDR, Trusts in Czechoslovakia, WOG - Wielka Organizacja Gospodarcza (Large Economic Organizations) in Poland, and Centrale in Romania.
- (2) The resolution was entitled "On Further Improving the System of Advanced Training for Managers and Specialists".

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(c) Investment

34. Since 1965 the USSR has officially had as its goal the full self-financing by the industrial ministries of all of their activities, including investment, but little progress has yet been achieved. At the end of 1978 only four national ministries, all dealing with industrial machinery(1), were operating to any significant extent on this basis, and three of them still received budgeted state funds for new investment.

35. In both the USSR and Eastern Europe, however, the tendency has been for investments to be financed decreasingly from budgeted state funds and increasingly from the profits and amortization funds of individual firms and industrial groupings. Despite this decentralization of the financing of investments, decisions on the volume and types of investment remain tightly controlled by the planning authorities; sizeable investments can be made only if they are inscribed in the national economic plan. Individual enterprises are thus still left with little decision-making powers in investment and can only choose, once an investment has been approved, on how it is to be implemented and financed - i.e. by the firm's own funds or by loans from the state bank. In the latter case, the state bank's lending policies act as an additional restraint on investment.

36. In some instances, centralized controls on investment appear to be strengthening, rather than weakening. Under the 1979 measures adopted by the USSR, enterprise investments must be part of a coordinated national investment scheme; and in the GDR, although the kombinats have increasing powers in the fields of research and product development, their latitude in investment matters remains sharply curtailed by centralized controls.

B. Agriculture

37. In the USSR, although huge sums are annually invested in agriculture - 27 per cent of all state investment funds in 1979 - no major reforms have been undertaken since Khrushchev's abortive "virgin lands" campaign of the sixties. Since private plots provide such an important part of total agricultural output, official statements in the past two years have increasingly pronounced in favour of encouraging them and giving them more material support. In addition, storage facilities for feedgrains, the lack of which makes the USSR especially vulnerable to years of bad harvests because of low reserves, are to be improved in 1982-1983.

(1) They are: Ministry of Instrument Making (Automation Equipment and Control Systems); Ministry of Heavy and Transport Machinery; Ministry of Tractor and Agricultural Machinery; and Ministry of Power Machinery.

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38. In Eastern Europe, agricultural reforms since 1965 have concentrated mainly on the granting of greater autonomy to state and collective farms, and on the creation of larger production units. In Czechoslovakia and the GDR such measures have succeeded in encouraging greater productivity by allowing considerable farmer participation in decision-making and enterprise profits. In Bulgaria, the creation of vast agro-industrial complexes embracing all stages of food production and processing has not seemed to promote agricultural productivity to any significant extent, partly because of bureaucratic and transport inefficiencies. There is currently discussion of giving the complexes more latitude by diminishing the number of indicators they must fulfil and allowing them to retain a greater portion of their export earnings; in addition, farmers' pay may be linked more closely to actual agricultural output.

C. Foreign Trade

39. As foreign trade has assumed increasing importance in the Soviet economy in the 1970s, a measure of restructuring has been undertaken in foreign trade organizations to promote their efficiency and responsiveness to world market conditions. Following a resolution of the Central Party Congress in 1976, the Soviet Union's foreign trade machinery began to be reorganized in 1978, with the effect of linking it more closely to the various industrial ministries and lessening the control of the Ministry of Foreign Trade. This has been accomplished by greater representation on the trade boards of industrial ministries and enterprises, and to give these boards control over additional incentive and export-promotion funds. In addition, exporting and importing organizations have been combined to provide for greater coordination of operations, and a number of special export-oriented industries are being set up, at least on a pilot basis, concentrated in the machine building and transport sectors.

40. To further facilitate the entry of Soviet exports into foreign markets the USSR has had recourse, to an increasing extent, to compensation agreements and to the formation of joint stock companies abroad. As a result, Soviet firms have entered over 60 compensation arrangements with Western firms, which may earn a total of \$4 billion for the USSR by 1985 from the sale of products manufactured under Western licences or know-how agreements. In addition, at the end of 1977 the Soviet Union participated in more than 84 joint stock companies in 26 countries, principally in fishing ventures, merchant shipping enterprises, and banking operations. By its lending policies and through its foreign subsidiaries, the Soviet State Bank is taking an increasingly more active rôle in encouraging Soviet industries to orient themselves toward foreign trade.

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41. The East European countries, more dependent on foreign trade for their economic well-being, continue to take small steps to give their export enterprises and industrial groups more direct participation in foreign trade. Hungary understandably leads the way in foreign trade reform because its trade turnover equals more than 40% of estimated GNP. It is currently discussing the simplification of its ad hoc export subsidy system through the introduction of a sales tax rebate scheme similar to that used with the value added tax in Western Europe, primarily to orient its exporting enterprises more closely to world price levels. In addition, it is moving toward a unified exchange rate, combining both commercial and tourist rates, in order to bring the Hungarian currency closer to de facto convertibility. Finally, it is expanding the number of enterprises directly participating in foreign trade.

IV. PRICE ADJUSTMENTS AND INCENTIVES,
AND THEIR EFFECTS

42. In addition to attempting to promote increased output by better administration and organization of the various sectors of their economies, the USSR and Eastern Europe have tried to encourage more efficient production through various price and wage incentives and disincentives. The effect has been generally to increase costs to both producers and consumers more rapidly than corresponding increases in output and productivity. To prevent a deterioration of consumer welfare, therefore, the governments have been faced with providing additional wages or subsidies on consumer goods and services.

A. Price Reforms

43. Since prices are centrally administered and controlled, they do not impel enterprise managers to adjust production to demand, nor do they indicate real production costs, in terms of relative scarcities of resources used. Nonetheless, prices can serve as instruments of economic reform by being manipulated to encourage or discourage certain types of production, or to discourage use of scarce resources.

44. Wholesale price reforms in the USSR and Eastern Europe in recent years have generally been aimed at giving substance to related reform measures, and more specifically, at forcing enterprises to use capital and raw materials more efficiently. The measures announced by the USSR in July 1979, for instance, emphasizes using the concept of "net value added" as a principal indicator of a firm's success, as opposed to the previously stressed indicators of gross physical production or gross sales, which did not penalize a firm for excessive use of labour, capital, and raw materials. To encourage economic efficiency, however, input costs must reflect relative scarcities and prices involved in the calculation of net value added must reflect the desirability and economic usefulness of the goods produced. Because these relative values have changed since the last wholesale price revision of 1967, institution of the 1979 measures has had to be accompanied by similar extensive wholesale price changes, announced in 1980.

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45. Besides attempting to force enterprise managers to make desired production decisions, wholesale price reforms in recent years in Hungary, Poland, and Czechoslovakia have attempted to adjust price structures to world markets, so that international competition will limit the ability of individual enterprises to raise their prices at will. In Hungary during the 1970s these principles, which were an important part of the "New Economic Mechanism" inaugurated in 1968, were gradually discarded in favour of administrative pricing measures, in an attempt to insulate the Hungarian economy from the world inflation which followed the 1973-1974 oil price rises. These measures, however, made Hungarian enterprises increasingly dependent on state subsidies, which has meant that the relative profit rates of various enterprises do not reflect their relative efficiency, and that resources have become increasingly misallocated, in terms of their world market costs. To correct these difficulties, on 1st January, 1980 Hungary introduced a comprehensive adjustment to its system of price formation intended to increase the rôle of world market forces, and to make a wide range of Hungarian industrial output subject to the principles of international price competition(1).

46. Although retail prices in the USSR remained relatively stable during the major part of the seventies, they were raised between 1977 and 1979 on selected consumer items still considered "luxuries" in Soviet society, such as jewellery, furs, coffee, carpets, imported furniture, automobiles and gasoline. Part of the reason for the retail price increases was to bring demand for the items affected more nearly into line with Soviet domestic production capacity or desired import levels. The increases also helped to reduce domestic demand for goods embodying materials readily exportable for hard currency, such as gold and petroleum. Partially as a result of these price increases, the cost of living in the USSR is estimated to have risen by at least 1-2%.

47. Retail price reforms have also been instituted, especially in Eastern Europe, to help reduce ever-growing state subsidies for many consumer goods, or at least to help balance out subsidies on basic goods kept at a low price for political expediency, by raising prices on other goods less rapidly available or in high demand. This approach can be seen, for instance, in Poland's and Czechoslovakia's raising of prices for alcoholic spirits in 1978, and Poland's creation of a two-tiered price system for meat after its abortive retail price reforms of 1976. As a result of its meat price system, Poland has reduced somewhat its state food subsidies, which amounted to 15% of the state budget in 1977; but at the same time, higher meat costs contributed to an 8% increase in the official cost-of-living index in 1978, or double the increase of the previous year.

(1) For a fuller description and analysis of the Hungarian price reform, see Annex III.

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B. Effects of Inflation

48. Inflation, or prices rising faster than increases in productivity, occurs in the USSR and Eastern Europe for reasons in addition to official wholesale and retail price changes. One of these is rapidly increasing prices on private agricultural markets, which account for a considerable portion of farm produce sales throughout the area, especially in Poland, Hungary, and the USSR(1). Meat prices in private farmers' markets in these countries have approximately doubled in the past few years.

49. In addition to officially sanctioned private agricultural markets, illegal or semi-legal private activities in the USSR and Eastern Europe also probably contribute to inflation. Because these "black" markets sell goods in high demand and short supply, they tend to fetch exorbitant prices. It is difficult to estimate the extent of such "second economy" activities, and so it is correspondingly hard to assess their impact on cost-of-living increases. At a minimum, however, they are judged to distort Western calculations of GNP significantly, and if calculated would probably have a perceptible inflationary effect on national income growth(2). One recent estimate is that they might inflate national income by as much as 6% annually and distort its reported yearly growth by 1%(3).

50. Another source of inflation in the socialist economies, which both distorts the effects of price reforms and makes further reforms necessary, is the introduction of "improved" products on the market and reductions in product weight or size. By introducing a product which incorporates only minor modifications to a formerly produced item, a manufacturer is often able to obtain permission to charge a disproportionately higher price, and so make greater profits. On the other hand, by reducing the weight of materials contained in a product, the manufacturer is able to produce more of the item from his allotted amount of raw materials, thus gaining greater income from additional sales.

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- (1) In the USSR, for instance, the private sector (holding approximately 4% of the agricultural land), accounts for 30-40% of total production of meat, milk, and eggs. In Poland, private farmers, holding 80% of the arable land, produce around three-quarters of all cattle and pigs, and over 90% of eggs, fruit, and vegetables.
- (2) See Gertrude E. Schroeder and Rush T. Greenslade, "On the Measurement of the Second Economy in the USSR", Association for Comparative Economic Studies Bulletin, Vol. XXI, No. 1 (Spring 1979), Bloomington, Indiana.
- (3) Peter Wiles, LSE.

51. On balance, such covert price increases, along with price reforms which usually adjust prices upward, have caused considerable inflation in the Soviet and East European economies. It is difficult to assess the degree to which these phenomena individually contribute to inflation, although it is estimated that the "new product" phenomenon in the USSR has caused an increase in prices in general of 2-3% each year in recent years, and 18% for industrial machinery. Total inflation in Poland in 1978 is estimated to have amounted to around 12%, considering that the cost of housing alone rose by as much as 15%. Prices are estimated to have increased by 7-8% in the GDR annually over the past three years, and by 4.5% in Hungary in 1978 alone. Overall, consumer price inflation may currently amount to 5-10% a year in the USSR and 10-15% annually in Eastern Europe.

C. Labour Productivity and Incentives

52. Besides trying to promote the efficient and productive use of material resources through price adjustments, recent economic reforms in the USSR continue to strive to stimulate greater labour productivity largely through wage incentives, at least in part related to a firm's profits and output according to previous indicators. Under the Soviet 1979 Decree, for instance, bonuses now account for approximately 40% of wages paid, and are dependent on plan fulfilment under more stringent indicators. Moreover, through the establishment of labour ceilings individual plants will be prevented from simply using more labour to obtain additional output, and consequently greater profits and bonuses.

53. Czechoslovakia has taken another approach of squeezing firm profits to promote labour productivity in decreeing, as of 1st January 1979, that any portion of enterprise output which gives rise to complaints from customers will not be credited toward the production figure upon which wages and bonuses are calculated. Hungary, on the other hand, has recently tried to promote labour productivity through a system of reducing firm subsidies and taxing wage increases which significantly exceed state set norms, thus encouraging enterprises to lay off redundant labour. In Hungary, only wage increases resulting from cuts in material input or labour costs - that is, the number employed - are taxed at a favourable rate; all other wage increases are taxed at rates up to 300%. As a result, some Hungarian enterprises have dismissed substantial numbers of workers while, nonetheless, achieving gains in output. The dismissed workers are penalized only to the extent that they have to find other jobs, since the government, although it does not pay unemployment benefits, remains committed to full employment. By its present policy, however, it encourages labour reallocation to presumably more efficient enterprises.

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54. Although not encouraging labour reallocation, the Soviet Shchekino experiment, first introduced at the large Shchekine Chemical Combine in 1967, also seeks to allow enterprises to grant larger bonuses using savings obtained through meeting output plans with an unchanged or reduced labour force. As of mid-1978, only about 1,200 enterprises, concentrated in the chemical, petrochemical, paper and pulp, and maritime industries, had adopted the Shchekino method. The principal reasons for its slow spread and limited success appears to be a combination of bureaucratic resistance, supply failures, conflicts with other incentive arrangements, and penalization of the "excessively" high wage and enterprise earnings resulting from the experiment. In April 1978 a new set of regulations was promulgated shifting responsibility for evaluating the Shchekino method from the ministries to associations and enterprises. Nonetheless, the experiment's impact on industrial efficiency has been minimal thus far.

55. Another experiment to promote labour productivity in the USSR has been the increasing use of the "brigade" system, whereby groups of workers, under the guidance of party disciplinarians, contract with enterprises to fulfil specified tasks. So far the brigade system, while being widely adopted and enjoying a certain degree of success in the construction industry, has not spread particularly to other industrial sectors.

56. Yet another current approach to obtaining greater labour productivity in the USSR is to put more emphasis on balancing the use of investment capital and labour by region, as opposed to the policy instituted in 1965 of investing heavily in some regions, regardless of labour supply. Whether this approach will show significant results will depend, foremost, on the quality of management in the regional production complexes.

57. On balance, many of the reforms undertaken in the CMEA economies to promote labour productivity are hindered by the difficulties of providing wage incentives without corresponding increases in the amount of assortment of available consumer goods. In many of the economies wages have been regularly increased, only to result in greater accumulations of consumer savings, which appear to be periodically drawn down in years of bad harvests. The CMEA governments can soak up part of the savings through such devices as raising prices on selected consumer goods, requiring prepayment and stiffening lending terms for cars and other consumer durables, or giving the various black markets more latitude to operate. None of these approaches, however, directly attacks the problem of a lack of consumer goods, which dampens the effectiveness of various wage and incentive reforms.

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58. Specialized stores selling items in strong demand at high prices serve partially to ration scarce consumer goods and possibly to give some effect to wage incentives. In Poland, for instance, PKO stores are widely used, and in the GDR heavy patronage of the Intershop system prompted a reform in 1979 requiring purchases to be made with coupons obtained through the banks; the reform does not seem to have affected the rate of Intershop purchases, however. In addition to these hard-currency stores, the GDR maintains a system of Delikat and Ekskwisit shops to ration popular consumer goods. The widespread existence and use of such shops throughout the CMEA countries, however, in addition to contributing to inflation, appear to encourage private "moonlighting" for hard currency or exorbitant prices as much as they may give substance to various wage and incentive reforms. If the shops promote labour productivity, it appears to be mainly through "black market" or "second economy" activities.

D. Consumer Welfare

59. A common shortcoming of many of the recent reform measures in the USSR and Eastern Europe is that they too often emphasize increasing the output of all goods without giving sufficient attention to whether the consumer goods produced actually meet popular needs and demand. Of course it can be argued that increasing the production of all goods, not necessarily consumer goods, must ultimately improve the material welfare of at least certain segments of the population, directly or indirectly(1). But the population at large is not likely to be convinced of the efficacy of reforms, nor be motivated to make them work, unless it can see visible improvement of the quality and variety of consumer goods or the provision of personal services.

60. Aware of this fact, CMEA officials frequently advocate increasing consumer goods supplies, and to a certain extent incorporate such goals into national economic plans. Nonetheless, the consumer goods markets in most countries is still characterized by erratic availabilities, hoarding in anticipation of shortages or sudden price jumps, and large pools of consumer savings, suggesting shortages of desired items.

61. Whether the USSR and the countries of Eastern Europe can substantially correct these shortcomings in the 1980s is open to serious doubt, especially since their economies appear to be entering a period of declining growth and rapidly rising costs associated with other development priorities. In the USSR in particular, programmes and plans for the production of consumer goods still tend to be given secondary importance; moreover, in the long-term target programmes for the 1980s for all the CMEA countries, it is evident that those concerning energy development, metallurgy, and machine-building are being given first priority. But it is significant that at least two of the long-term programmes concern themselves with increasing the production of consumer and agricultural goods.

(1) For instance, by providing for defence needs

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62. If improved selections of consumer goods are not provided in the CMEA countries in the 1980s, the hoped-for effects of many economic reform measures may be lessened. Popular discontent might translate itself into work slowdowns, increased absenteeism, or even strikes, and so cut into desired productivity gains.

63. On the other hand, however, it would probably be wrong to expect uncontrollable disturbances resulting from possible shortages of consumer goods in the CMEA countries in the 1980s. In the past, popular reaction to unfavourable economic developments has most frequently been one of resignation, because of continuing tight political and police controls. Declines in real incomes of only a few percentage points, moreover, might not be noticed immediately. Finally, because the CMEA states collectively control such large economic resources, they could probably move relatively rapidly under consumer pressures to improve supplies of certain goods, even if the real income of the populations as a whole declines. None the less, disturbances which occurred in Poland in mid-1980 in response to higher consumer goods prices, and which were reported to have taken place in the USSR as a result of food shortages, indicate consumers' widespread sensitivity to changes in their welfare.

V. INTEGRATION MEASURES AND THE RÔLE OF THE TRANSFERABLE RUBLEA. Economic Integration

64. In promoting increased output, either through joint planning or project construction efforts, or furthering economic specialization and division of labour, integration of the CMEA economies serves the same purpose as economic reform. Although the USSR has consistently supported mutual CMEA planning, most integration efforts so far have resulted only in the co-ordination of national plans and in mutual delivery commitments.

65. Principles for the co-ordination of economic plans among CMEA members were laid down in 1954; but in fact such co-ordination remained purely formal until 1975. For the 1976-1980 period the CMEA countries adopted a "Concerted Plan of Multilateral Integration Measures" which specified a number of projects to be jointly constructed, areas for specialization and co-production, and scientific research to be carried out in common(1).

(1) Among the 11 large joint capital investment projects were: a paper plant at Ust' Ilim (USSR); an asbestos plant at Kiembai (USSR); ferrous-alloy units at Nikopol' and Yermak (USSR); uranium enrichment facilities at Mikhailov, Dneprov, and Stoilen (USSR); a nickel factory in Cuba; the Orenburg gas pipeline from the USSR to Eastern Europe; and the Vinnica-Albertisa high-voltage power line from the USSR to Hungary, the first link to the European CMEA countries of a projected high-voltage power grid. Altogether the projects required investments of 9 billion transferable rubles; an additional 600 million rubles were to be spent on mutual scientific research projects in 17 fields. See Annex IV for a full listing of current CMEA joint investment projects.

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66. In 1978 and 1979 five long range target programmes were adopted to guide joint development efforts, including planning during the 1981-1990 period in five main areas:

- production of fuels, raw materials, and energy;
- specialization and joint arrangements in machinery production;
- production of basic food products;
- production of industrial consumer goods;
- transport and communications.

Investments required for the completion of these programmes will amount to an estimated 15-20 billion rubles, in current prices. Specific arrangements have been worked out so far only in the area of energy, which will provide Eastern Europe with an additional two-fifths of its 1978 electrical energy generating capacity.

67. Although the programmes cover broad industrial areas and demand increasing investment sums, they may represent a step backward in the CMEA integrated planning process, in that they allow greater latitude to the member-countries to do as they wish in areas not covered by the agreements. Nonetheless, they do call for increasing economic specialization in several areas. The USSR, for example, is to step up its output of iron ore, and deliver much of the increase in production to other CMEA-member countries. Similarly, Cuba is to concentrate on expanding production of nickel, bananas, and coffee, and Poland on increasing output of coal and tomatoes; presumably much of the expanded production will be delivered to other CMEA-member countries.

68. Since 1971 the CMEA countries have concluded a number of agreements for specialization in the production of certain industrial products, such as computers, numerically controlled machine tools and particular types of trucks. Under these agreements, interested CMEA countries undertake to mutually research, plan, and programme the production of designated items for the CMEA area as a whole, so as to prevent duplication and waste, to speed product development through mutual research, and to allow economies of scale on the basis of guaranteed markets. A barrier to the more rapid expansion of these types of arrangements is the tendency for each country to try to be the actual producer of products which will bring it the greatest national economic advantage, either because of the advanced technology the product may embody or the possibilities of future sales of the product to the West, even though on the basis of cost the production monopoly might best be given to another CMEA-member country. Another difficulty is the tendency for other CMEA

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countries to continue production of items assigned to another participating country, so as either not to lose out on related technological advances which might come from developing the product, or to guard against the possibility of non-delivery by the monopoly producer country, which might divert contracted production to fulfilling national plan goals(1).

69. On balance, CMEA integration efforts are still confined mainly to joint investment in projects often on Soviet soil and oriented to guaranteeing future deliveries of necessary raw materials and energy to Eastern Europe, which remains heavily dependent on the USSR for these items. Beyond this, the East European states generally resist further integration efforts, because they are reluctant to depend on finished items being produced outside their national borders, and because their artificial price and currency systems prevent the advantages of economic integration from being fully felt in any case.

B. Rôle of the Transferable Ruble

70. The transferable ruble is essentially an accounting unit used in connection with planned trade among the CMEA countries; it is convertible neither into their national currencies nor into Western currencies, with which it is only formally linked for the sake of comparison by an arbitrarily assigned gold content. Nonetheless, it has frequently been discussed as a potential instrument of foreign trade reform, which would be effected by giving it full monetary status and convertibility. In this rôle, it is argued, it might serve to bring the varying price structures of the individual CMEA countries more nearly into line, and so promote greater price rationality; moreover, by being convertible into Western currencies, the transferable ruble could bring world market pressures to bear more directly on CMEA enterprises engaged in foreign trade, thus encouraging them to use imported raw materials more carefully and to adapt more readily to foreign demand.

71. Convertibility for the transferable ruble was discussed in CMEA's Complex Programme for Economic Integration adopted in 1971, and certain measures have been taken more recently which imply limited movement in this direction. CMEA's International Bank for Economic Cooperation (IBEC) can now hold transferable ruble accounts for non-members, and its International Investment Bank (IIB) has extended transferable ruble credits to Yugoslavia. These developments suggest possibilities for using the transferable ruble in ways other than strictly in connection with balancing bilateral planned trade accounts.

(1) Similar motives were seen at work in difficulties experienced with attempts at multi-country production of larger items, such as automobiles. As in the case of single-country production, arrangements have often bogged down in haggling to secure the greatest possible national economic and political advantages, and failure to agree on the mutual production and delivery of required components.

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72. A number of considerations make the eventual complete convertibility of the transferable ruble unlikely, however. First, since transferable ruble credits arise essentially from planned goods trade, which still accounts for 90% of intra-CMEA transactions, there are generally few additional goods available for non-planned deliveries, even if the transferable ruble credits can be applied to them. Secondly, certain CMEA countries, which generally carry negative account balances with respect to their other CMEA trading partners, have an interest in maintaining the non-convertibility of the transferable ruble; as long as this unit of account cannot be readily translated into demand for payment in other currencies or goods, a debit balance represents an interest-free export loan which does not affect a country's import plans. Thirdly, if the transferable ruble became a monetary unit, it would have to be backed by reserves of convertible currencies or goods; individual CMEA countries would be reluctant to provide these, however, since they can readily be used in each country's foreign trade. Finally, the USSR continues to favour planned bilateral arrangements as the basis of inter-CMEA trade both as a means of economic integration and as a lever for political control.

73. Thus, although some of the East European countries appear to desire an extension of the rôle of the transferable ruble toward multilateral convertibility(1), it appears instead they will have to take the approach of improving foreign trade payments adjustments. Indeed, Hungary, through a combination of price and foreign exchange adjustments, and a gradual reduction of foreign trade subsidies, has already come nearer to de facto convertibility of its own currency.

VI. PAST AND POTENTIAL REFORM TRENDSA. Centralization-Decentralization

74. Reforms undertaken in the CMEA economies can point to possible trends in economic and political developments. One such trend is from a centralized economy to one less centrally controlled, or vice-versa(2). Between 1965 and 1975 efforts were made in all the CMEA countries to devolve decision-making on various questions regarding production activities away from the central authorities

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- (1) Hungary and Poland, for instance, advocate an efficient intra-CMEA currency system with interest rates functioning on a basis of profitability, and at least partial convertibility of transferable ruble credits into gold and convertible world currencies.
- (2) It should be noted that decentralization of economic control does not necessarily imply greater use of market mechanisms, or even decision-making at the enterprise level. The point is discussed by D.A. Dyker in a paper entitled "Decentralization and the Command Principle - Some Lessons from Soviet Experience", presented at the Annual Convention of the AAASS, 10th-13th October 1979, and again at the London School of Economics, Academics/Officials Conference, 14th December 1979.

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to levels closer to the actual producing units. The moves were in response to the perennial problem of the central planners' often not being in the best position to determine such things as optimal prices, production programmes, and employment allocations at the enterprise level. In order to maintain desired control of the economy while allowing more decision-making at lower levels, each of the CMEA countries took the approach of concentrating its producing enterprises organizationally under intermediate organizations (combines, production associations, centrale), which consequently gained more power at the expense of the ministries.

75. The purpose of the moves toward decentralization was to eliminate some of the inefficiencies and misallocation of resources that resulted from rigid central planning. Strict centralized accounting and economic levers were looked to as means of overall verification and control by the central authorities. One of the frequently used controls of the 1966-1975 decade, for instance, was to establish a closer link between internal and external economic activities, with the foreign trade sector undergoing in many cases the most thorough reorganization: in the end, however, it continued to be industrial middlemen who served as the most efficient instruments of making the whole system work, through informal supply and sales arrangements outside established channels.

76. The Soviet reform measures of 1979 in certain respects continue the trend towards limited decentralized decision-making. While emphasizing the use of economic levers and more stringent accounting controls to stimulate economic growth, the measures also reassert the principle of allowing a certain amount of price-adjusting and employee allocation initiative to lower enterprise or association levels. On the other hand, however, in establishing even stronger centralized controls, they mark a partial reassertion of economic centralization.

77. In Eastern Europe, after a hiatus in the mid-seventies, limited moves toward devolving decision-making at least to the intermediate level appear to be continuing. In the GDR, for instance, certain price-setting powers and foreign trade rights have been given to the kombinats, and in Poland attempts have been made to delegate a certain amount of decision-making in the textile industry. Hungary still leads the way in allowing enterprise initiative, relying on prices and profits to force managers to greater efficiency. If the Hungarian experiments prove to be successful in promoting greater efficiency and productivity, they may determine the course of reform in the rest of Eastern Europe in the 1980s. On the whole, the economic structures are tending to decentralize in Eastern Europe, although political barriers, internal and external, continue to work against thoroughgoing decentralization.

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78. It is unlikely, however, that there will be further decentralization of economic powers in the USSR. For one thing, the uncertainty of who will succeed Brezhnev makes the prospect of any radical measures, including decentralizing ones, unlikely. Moreover, the 1979 reforms must be given time to be implemented and evaluated - probably until 1983 at the earliest. Finally, unless current difficulties in promoting economic growth become especially pronounced, which may well happen eventually in the 1980s, the centralized administrative bureaucracy is unlikely to yield to pressures which might reduce its influence.

B. Outlook for Future Reforms

79. In the USSR radical reform akin to the NEP of the 1920s is unlikely, because of the extent of vested interests in the present economic system. Rather than attempting to change the system, reforms within the next few years will probably continue merely to improve its functioning and efficiency. Such measures will most likely not achieve their anticipated results, however, as long as incentives continue to be linked to plan fulfilment, which remains in essence a process of adjusting plans to meet current production levels, rather than vice-versa. As long as the system allows factory managers to operate on this basis, they will have little interest in responding to whatever incentives or authority given them to meet actual demand, which also carries with it the risk of operating in an uncertain economic environment, outside of criteria of success linked to plan fulfilment.

80. A change in the Soviet leadership could of course lead to more radical economic reforms, partly to differentiate a new régime from its predecessor; in addition, a new leadership would have more latitude for the widespread administrative and managerial personnel changes probably needed for thoroughgoing reform. But any new régime would probably not move hastily into the area of economic reform, except in the case of grave economic difficulties, until it was sure of its bases of political power; and moreover, any profound economic reforms would require at least two years to implement because of the time needed to prepare administrative norms and documents. In the absence of radical change, therefore, the best indications of future directions of Soviet economic reforms can probably be found in Soviet regional economic journals, in discussions of minor adjustments to the existing economic system.

81. Eastern Europe will probably continue to be a laboratory for potential future economic reforms within the CMEA. Because of the smaller magnitude of the Eastern European economies potential adverse effects of ill-considered or mis-applied reforms cannot be so extensive. If the Hungarian reforms emphasizing price adjustments to conform more nearly to world-wide demand are successful, for instance, they will probably be copied more extensively in the other CMEA countries.

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82. Political and ideological conservatism will probably tend to hold back adoption of even successful East European economic reforms in the Soviet Union, however, if they should be oriented towards a market economy. In contrast to those in Eastern Europe, Soviet managerial cadres have not worked under market economy conditions; hence, they might not be able to respond effectively, without costly re-training, to market oriented reforms which could conceivably be introduced in Eastern Europe. Moreover, the nature of Soviet economic development problems is different from those of Eastern Europe. For instance, the exploitation of the Eastern regions of the USSR demands enormous investment which might be more efficiently marshalled under strongly centralized control, since central authorities might be in a better position to decide on fund allocations among conflicting priorities(1).

83. In the absence of unexpected developments, therefore, the reform measures introduced in the Soviet Union in 1979, which are themselves basically a reassertion of earlier approaches, may prove to be little more than a step to mark time until another leadership assumes power. The current régime will probably not take bolder reforms because of a fear of thereby causing political and economic instability and a potential loss of control, especially at a time of an impending leadership change. In the meantime, it will continue the widespread introduction of computers for the extensive analysis and control of the Soviet economy. Although the first phase of using computers to run the Soviet economy has produced few positive results, a second more extensive stage of computer use is to be applied in the early 1980s. If successful, it would probably have the effect of increasing the centralization of economic control, if not decision-making, in the Soviet Union. On the other hand, operational decision-making might at the same time become more decentralized through a reinforcement of the powers of the industrial and production associations, along the lines of the kombinats in the GDR. On balance, however, there appears to be little immediate prospect for reform within the USSR which would bring the forces of supply and demand into more direct contact, other than in the not inconsiderable private and "black" markets. The continued functioning of the so-called "second economy" will itself serve to diffuse the need for instituting more exact supply-demand relationships in the rest of the economy.

VII. CONCLUSIONS

84. Economic reforms in the USSR and Eastern Europe in the past 15 years, although they have varied as to degree, have not fundamentally changed existing systems, and they have had probably

(1) However, it has also been argued that this development might be carried out most efficiently through regional administrative organizations which would bring together the often ill-co-ordinated jurisdictions of the various national ministries. A debate is currently going on in the Soviet Communist Party on this very issue.

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only marginal effects on stimulating economic growth and productivity. None the less, within these limits they can be said to have achieved certain positive accomplishments. First, they have tended to extend planning periods to allow for more thorough project preparation and more balanced evaluation of economic performance: these developments might encourage enterprise directors to make investments in useful projects without immediate returns, but promising on a long-term basis. Secondly, the reforms have tended to bring about a realignment of wholesale prices to reflect more accurately economic scarcities, and so to encourage more careful use of resources and equipment. Finally, various measures have improved the system of planning itself, which in turn has probably promoted productivity through more efficient allocation of resources and manpower.

85. On the negative side, reform measures have often not achieved their intended effects for a number of reasons. One important problem has been that no reform has provided attractive enough incentives to convince factory managers that the advantages of production innovation outweigh the risks of not meeting plan goals, even though meeting these goals is essentially a bargaining process with higher authorities. In the foreign trade sector in particular, where perhaps the most extensive reform reorganization has been undertaken, the incentives offered have not been proportionate to the risks of venturing further into world markets. Hungary may be the one exception to this rule, although even its foreign trade enterprises are still protected to a certain extent from world market forces by various subsidies. Moreover, the application of various reform sanctions has also not been particularly successful in stimulating industrial production, foreign trade, or labour productivity because of possibilities of bureaucratic evasion and the fact that labour is operating throughout the area in a situation of short supply, and so does not feel threatened by the possibility of unemployment.

86. Political factors present the greatest barrier to successful economic reforms. Although sometimes introduced to reinforce a particular political line, reform measures must never appear to be so radical as to threaten the tenets of the existing political system. Moreover, an ideological need to promote equality causes the bureaucracy to reduce gains which might accrue to managers responding effectively to some new incentive system. In the end, it could be said that the principal reason many of the reforms have not achieved their intended results is that they have not been allowed to work long enough before some new bureaucratic tinkering has distorted them or robbed them of their intended effects.

(Signed) J.N. GIBault
Chairman

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ANNEX I to
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BRIEF COUNTRY SURVEY OF ECONOMIC REFORMS
IN THE USSR AND EASTERN EUROPE

USSR

1. To combat widespread inefficiency in the use of labour and capital resources, the USSR in 1965 introduced the so-called "Kosygin reforms", which essentially tried to use more refined indicators of enterprise output to promote improved economic performance. The reforms were largely completed in industry and some other sectors by 1970, and have been continuously tinkered with since then. They have proved ineffective for the most part, simply because the economic indicators are too numerous: enterprise directors can always take refuge in the fact that they have met some of the indicators, even if their total output, as measured by other indicators, fall below plan goals.

2. On balance, the effect of the reform process has been that enterprise directors have been able to get by with fulfilling their plan obligations through sheer quantities of items produced, ignoring often unacceptable quality and large-scale wastage of heretofore relatively cheap inputs of labour and raw materials.

3. To counter consumer demand for other sought-after items still in short supply, the Soviet government on 1st January 1979, 1st March 1978 and 1st July 1979, announced price increases on such things as automobiles, gasoline, jewellery, and certain types of furniture. The USSR has not attempted to institute a far-reaching consumer price reform, however, and claims that consumer prices for such items as housing and basic foodstuffs have remained virtually stable for the past 20 years. By having to pay more for imported items and marginally "improved" products, however, Soviet consumers have experienced a price inflation of the order of perhaps 2-3% annually in recent years.

4. To curtail wastage in industrial production, the USSR on 28th June 1979 announced a resolution taken by the Central Committee and the Council of Ministers aimed at improving the planning process, more tightly controlling capital investments, and providing more material incentives for efficient, high-quality work. The resolution, which concerns itself primarily with the next Five-Year Plan beginning in 1981, operates again largely on the basis of refined planning indicators. By being required to report the value of their output in terms of net value added, as opposed to the formerly stressed indicators of gross production and gross sales, firms will no longer have an

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interest in using large amounts of raw materials to inflate the value of their gross production. Moreover, if they are not allowed to raise their prices to reflect the increasing costs of raw materials and energy - and planners' current attitudes suggest that they will generally not be permitted to do so - they will have a positive interest in conserving on materials inputs, in order to maintain existing levels of wages and profits. To stimulate production in the past, plant managers have frequently misused wage funds either to pay unauthorized bonuses or to hire additional workers for end-of-month "storming"; the resolution attacks this practice by emphasizing the reporting of firm profits, and by rigidly stipulating that workers' pay and bonuses be in terms of real (constant price) output produced.

5. It is obvious that, in order to be effective, the new planning practices will require careful controls of enterprise accounting practices and against product "innovations" which are merely slight modifications without significant economic benefit. Whether such extensive checking can be accomplished in a society which has shown considerable ability to get around even the most complicated of controls, remains open to question. Similar attempts at planning reform in the sixties bogged down simply because they became involved with too many controls.

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BULGARIA

6. It is notable that the most subservient country in the Eastern bloc, and the one where the virtues of central planning have consistently been stressed - particularly in the local version of plan-computomania - has also embarked in a string of reforms conducive of opposite results. Indeed, if the 1976 agricultural reorganization - creation of the National Agricultural Complex, the agro-industrial complexes, and the industrial-agricultural complexes - point to further centralization, a series of piecemeal measures taken this year seem to restore better conditions for private activities. It is not unlikely that Bulgaria might serve as a test-ground for the USSR, although it does not seem that Moscow directly suggested any of these decisions. Certainly, Sofia is looking for an escape out of its increasing economic difficulties (high external debt and debt service, acute shortage of manpower, lack of raw materials, and energy problems which all translate into a slow-down in labour productivity increases and, therefore, in sluggish NMP growth). More centralization, which some still view as a possible solution, has not worked as a remedy in recent years, and those Bulgarian "reforms" which allow for a certain decentralization are too limited to have a real impact.

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CZECHOSLOVAKIA

7. Since 1968, Czechoslovakia has always taken its cue from the Soviet Union as to the institution of economic reform measures. Its reforms have been extremely timid and centred primarily around manipulation of wholesale and retail prices, the latest of which, in November 1978, raised the cost of cars and alcoholic drinks, and in 1979, the price of gasoline.

8. Beginning on 1st January 1978, the Czechoslovak government also instituted measures (collectively known as the "Ler experiment", after Finance Minister Ler) to encourage enterprise planning autonomy and efficiency by means of being able to manipulate prices to a limited degree. Around 150 industrial enterprises, employing around 14% of the industrial work force and accounting for 13% of total industrial output, are participating in the experiment, which lasts until the end of 1980. Participating enterprises are given the authority, under the direction of the larger production units to which they belong, to plan production on a three-year basis rather than on the traditional one-year quota, and to raise or lower the prices of their goods by as much as 30%, with the approval of the State Price Office. In addition, enterprises which overfulfil their hard-currency export targets are allowed to retain up to one tenth of their above-goal earnings, to invest in such items as imported capital goods or licenses. Despite considerable publicity given to the experiment within Czechoslovakia, it does not seem to have achieved any particularly notable effects in stimulating Czechoslovak exports or boosting worker productivity.

9. To make the Ler reforms more effective, as of the beginning of 1979, gross production is no longer used to measure plan fulfilment. In its place, enterprises will have to meet targets as to deliveries to the domestic market, exports, major investments, production costs, profits, and technical and economic standards, among others.

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GERMAN DEMOCRATIC REPUBLIC

10. Economic reforms in the GDR in the seventies have alternated between giving more decision-making authority to enterprise managers and instituting tighter central controls. The latest phase, beginning in 1974, emphasizes the binding authority of the annual and Five-Year Plans. At the same time, directors of the large multi-firm economic "combines" have been given increasing authority to make decisions concerning investments and production arrangements, in order to eliminate the interference of the bureaucracies attached to industrial ministries in the day-to-day working of industrial enterprises. The latest step in this direction is that, as of 1st January 1980, general directors of industrial combines can set the costs and preliminary prices of new goods coming into production within their organizations after that date. The move may lead to a considerable amount of inflation in East Germany, since combine directors will be interested in putting as high as possible a value on their organizations' output. The East German régime may favour such a development, in any case, so it can ask for higher prices for East German exports to the Soviet Union.

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HUNGARY

I. BACKGROUND TO ECONOMIC REFORM MOVEMENT

11. The principles of the New Economic Mechanism (NEM) of 1968, which were once considered too "liberal" and largely shelved in 1974, are now quietly being brought back to overcome Hungary's economic difficulties and restore an "economic equilibrium". These problems have been the result of deteriorating terms of trade following the oil crisis of 1973-1974. However, there was a certain planning tendency to ignore the impending impact of a world economic slowdown. At the same time Hungarian per capita income, inventories and investment, and imports and net indebtedness, ran well above Plan while exports, agriculture and national income fell below forecasts with 1979-1980 forecasts indicating that the Five-Year Plan overall targets will not be met(1). By 1978 it was obvious that fundamental change in the practice of economic management was needed and planners have never needed the old NEM proposals. At the same time, Hungarian efforts are being monitored and may possibly presage the direction economic reform is to take in the 1980s by the rest of COMECON.

II. INTERNAL "REFORM" CHANGES

12. One of the first major steps towards "reform" began with the 1978 announcement that the complex socialist system of traditionally beloved consumer subsidies had to be phased out. More realistic prices geared to market values have led to price increases of up to 100% for petrol and a number of consumer goods. In addition, tax reform now in preparation will bring in a value-added tax system by the end of 1980. The government has also stressed that only high-quality profitable enterprises should be supported with "social appreciation" and, in case of need, financial support. Beginning in January 1979, a programme of "natural selection" is to begin. Enterprises will be asked to remedy their problems first by relying on their own material and managerial resources and without undue interference from state authorities. Those still unable to earn at least 1-2% return on their capital investment may have to be closed down in "the national economic interest". Greater competition in industry is envisaged by setting up more "industrial co-operatives" (in reality private firms). The 800 or so big state firms will be encouraged to sub-contract specialized work to these co-operatives, as well as to some private sector enterprises. Wage increases will also be linked to enterprise profitability rather than a general aim of wage equality in force up to 1979.

(1) See ED/EC/79/17, page 9

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III. FOREIGN TRADE

13. Evolutionary ideas have been pushed in the vital foreign trade sector. Since 1977, the government has actively encouraged joint ventures between Hungarian and foreign firms both in Hungary and abroad. At the same time, Hungary has shown considerable willingness to comply with various CSCE regulations; Western businesses report the relative ease of making commercial contacts. In order to counter the external trade shocks in order to prevent undue shifts in income and economic dislocation, Hungary has revised, from time to time, fixed or officially regulated prices. It has been slowly working towards currency reform as discussion on the transferable rouble continues. It has been the only COMECON country to consistently revalue/devalue its currency (the non-commercial forint) against other currencies in an effort to increase its hard currency earnings from the socialist industry. On the other hand, Hungary has not improved the commercial forint rate, indicating the serious Hungarian commitment to putting the whole economy on a more realistic financial footing, tied more directly to world market prices and conditions and leading to the unification of the commercial and non-commercial rates and the convertibility of the forint by the end of 1980.

IV. OUTLOOK

14. Hungary has sensed, perhaps before other East European countries, the economic danger signals of "harmful equalitarianism". All reform and change is now to be directed to achieve an "economic equilibrium". Economic reform may not be early implemented. Consumer items are certainly to cost more as subsidies are phased out and consumers will require a corresponding rise in real income in order to tolerate the changes. There is also the difficulty of interest groups within the government. The Hungarian National Bank has always supported NEM style reform policies against opposition lobbies in the Ministry of Finance, some sectors of the Party, and the trade unions. The Union Leader(1) would disapprove strongly, especially if redundant labour is let go by efficient minded enterprises and wages are linked solely to profitability.

(1) Sandar Gaspar who has a seat in the Politburo.

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POLAND

15. In 1977, the Polish authorities introduced what they called the "economic manoeuvre". This consists in changing the direction of economic policy in order to limit expansion and to achieve more balanced growth by concentrating on the elimination of imbalances in foreign trade and in the consumer sector.

16. It would appear, however, that action has been taken on a sectorial basis only and has consisted primarily of short-term measures (such as freezing of investment in certain branches of industry).

17. The application of these measures has resulted in a trend towards the tightening of administrative controls over investment decisions and foreign trade. Examples of this trend include:

- the creation at the end of 1978 of a new State body, the "State Commission for Investment Expertise" which is responsible to the Council of Ministers and whose function it is to screen and follow-up priority investments; this body can exercise considerable influence on the transfer of resources from one project to another and on the approval of new investment projects;
- in the case of foreign trade, the introduction of a policy of greater selectivity with respect to imports from the West through greater stringency in the allocation of convertible currencies and import licences as well as through the establishment, in certain cases, of a closer correlation between imports and export performance. In an effort to reduce excessive imports, an administrative system will shortly be introduced under which firms failing to incorporate equipment imported from the West in their production processes by a given date will be penalized in terms of convertible currencies.

18. Noteworthy among the changes made in the organization of foreign trade are the partial re-establishment in 1977 of the "major foreign trade organizations" and of the link which exists between import results and the remuneration of the work-force.

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19. New measures were introduced early in 1979 which modified and amplified the 1976 law on "joint ventures" between Western and Polish firms. Among these are the widening of the scope for the creation of such ventures in the manufacturing industries, the lengthening of the duration of the agreements (from 10 to 15 years) and new regulations on the repatriation of profits.

20. In July 1979, new arrangements were made in the distributive fields under the aegis of the "Committee for Domestic Market Affairs" which had been set up in the previous year to supervise the distribution of consumer goods. These arrangements which for the present only affect a limited number (about 100 at the end of the year) of shopping centres have been followed by an apparently substantial increase in managerial autonomy and responsibilities at these centres, particularly as regards staff, wages policy, the fixing of selling prices and supply policy.

21. While the Polish leadership seems to be aware of a certain number of obstacles to economic development, among them over-rigid planning, it is none the less true that they have not so far taken the action which would be required, nor have they made any really significant changes in the system. Preparations for the Party Congress scheduled for early 1980, do not suggest that any radical overhaul is in the offing. The authorities are faced with the problem of establishing a compromise between the pressing economic need for reforms and the Party's conservative politico-ideological outlook. Furthermore, from a strictly economic point of view, it is to be wondered whether, discipline being what it is, both among the work-force and at management level, measures designed to achieve genuine decentralization and regional planning could be effectively applied.

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ROMANIA

22. No basic reform has even taken place in Romania, and the economic mechanism still corresponds closely to that inaugurated by the Soviets in the early thirties and transplanted in Eastern Europe in the late forties. Such systems have proved to be effective in steering the country out of its original state of backwardness, although alternative systems could have done the job just as well with less sacrifice for the populace. Even if reforms are of limited scope - such as the introduction, two years ago, of net production as the basic indicator in industry, without superseding gross production altogether - there seems to be a definite movement towards higher consumer welfare. It can easily be maintained that the "programme for the improvement of the standard of living" currently under implementation in Romania does represent an innovation if not a real reform in the usually static, grey, frankly Stalinist Romanian socio-economic landscape.

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CHRONOLOGY OF SELECTED REFORM AND
INTEGRATION MEASURES

USSR

- 1965 "Kosigin Reforms": Ministerial system for administering the economy restored. All ministerial economic activities to be put on self-financing basis. Industrial enterprises merged into large associations.
- 1967 Wholesale prices generally revised, as part of implementation of Kosigin Reforms.
- 1973 Decree on federal and republican industrial associations standardizes contractual relations among industrial branches and establishes basis of self-financing.
- 1974 Decree establishes legal basis for production associations (combines): enterprises engaged in manufacture of specified products retain certain autonomy in management but no juridical or financial independence. Industrial ministries to produce specific timetables for merging subordinate enterprises into production associations by 1980.
- 1978 Decrees published reorganizing Soviet foreign trade procedures, with the effect of linking foreign trade organizations more closely to the industrial ministries.
- 1979 Decree "On Improving Planning and Intensifying the Influence of the Economic Mechanism in Raising the Effectiveness of Output and the Quality of Work" introduces more stringent plan performance indicators (notably "net value added"), tighter controls on capital investments, and additional material incentives for efficient, high-quality work.
- 1977-1979 Prices substantially raised on selected State-produced consumer goods and services in high demand and generally low supply.

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BULGARIA

- 1965 Decentralization, market-type reforms and simultaneous introduction of "State Economic Associations" (SEA).
- 1968 After abandonment of market-type reforms, the SEA take on a more important rôle and become horizontally integrated management units (Decree of the Council of Ministers on the "New System of Management of the Net Economy", 6th November, 1968).
- 1970 The SEA is made the basic form of the economy and the existing 97 SEA's are amalgamated into 64 larger SEA's.
- 1974 The Decree of the Council of Ministers of 28th February, 1974 introduced a variety of organizations in addition to the SEA: State Economic Combines, United Economic Enterprises, State Economic Complexes, and Territorial Industrial-Agricultural Complexes. The establishment of "National Economic Complexes" had been studied since December 1972 and on 1st January, 1974 and 1st April, 1974 the National Transport Complex and the National Construction Complex were created.
- 1976 The Decree of 5th August establishes the National Agro-Industrial Complex.
- 1977 The National Trade, Tourism and Public Services Complex is set up in January.
- 1979 Reform of retail prices.
- 1980 Reform of wholesale prices.

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CZECHOSLOVAKIA

- 1953 Installation of centralized planning system.
- 1958-
1963 Semi-decentralized system (hybrid involving a stable medium-term plan and a new set of decentralized rules governing inter-industrial transactions and managerial incentives.
- 1965 Introduction of VHJ (výrobné hospodářské jednotny) to consolidate industry and improve management.
- 1967 Role of market demand strengthened; enterprises exposed to internal and external competition..
- 1970 Return to centralization and authority of the plan.
- 1974 VHJ's supplemented by "koncern" which strengthened intermediate level of management.
- 1977 Price reform in foreign trade instituted to discourage use of costly raw materials imports, provide export incentives.
- 1978 "Ler Experiment" instituted: planning targets extended to three-year basis for participating enterprises and evaluated on basis of net revenue and their profit indicators, rather than on basis of physical units produced; production units authorized to manipulate prices to certain extent and given more latitude in investments, wage incentives.
- 1980 "Set of Measures to Improve the System of Planned Management of the National Economy after 1980": Five-Year Plan given more emphasis; Plan indicators changed to strengthen efficiency, technical standards, and quality of industrial production. Measures instituted to improve balancing of supply and demand at central planning level. Wholesale prices adjusted to reflect international conditions and terms of trade. Subsidies reduced to producing enterprises; self-financing emphasized. Greater pay differentials established, based on performance.

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GERMAN DEMOCRATIC REPUBLIC

- 1963 "New Economic System of Planning and Administration" introduced to promote industrial efficiency through monetary levers and administrative reform.
- 1964-
1967 Industrial price reform undertaken to align prices to actual production costs.
- 1969-
1971 Measures introduced to promote industrial self-financing, automatic price responsiveness to reduced costs.
- 1972 Combines established to simplify, shorten chain of industrial management.
- 1974 Foreign Trade Act gives Ministry of Foreign Trade direct control over most foreign trade transactions - particularly imports and exports of investment funds.
- 1979-
1980 Dissolution of middle-management level consisting of the Associations of State-owned Enterprises (VVB), leaving two-tiered system of Industrial Ministries and of enterprises and combines.

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HUNGARY

- 1956 Partial changes in the administration of the economy. Introduction of value planning along with physical planning.
- 1961 Increase in prices of agricultural products subject to compulsory deliveries.
- 1963 Regroupment of enterprises to reduce the work of the planners.
- 1965 Abolition of the system of compulsory deliveries in agriculture.
- 1966 Work starts on the New Economic Mechanism (NEM), a system to make production decisions sensitive to world price levels.
- 1968 The NEM is put into operation.
- 1979 After a decade of artificial price adjustments, the NEM is returned to its original basis, beginning with a widespread and large-scale adjustment of consumer goods prices.
- 1980 Adjustment of producer goods prices.

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POLAND

- 1973 WOGs (large economic organizations) established, giving merged enterprises thus formed considerable autonomy, in particular in the field of remuneration.
- 1976 WOG system suspended. From the beginning of 1976 all remunerations were determined by a new concept. - Norm 0 - representing a planned ratio of growth in wages to productivity growth.
- 1977 WOGs partially re-established. The modified system includes further moves to encourage producers to export by linking part of the manager bonuses to exports and giving the WOG a share in the proceeds of their exports.
- 1978 In order to further tighten administrative control over investment, the "State Commission for Investment Expertise" was established with a decisive voice in shifting resources from one project to another or in approving proposals for new investments.
- 1980 Enterprises producing for export are to be given greater independence and responsibility under a reform announced at the beginning of the year. In particular, the enterprises will be able to increase levels of employment and wage funds if they exceed their export targets. Initially, the new principles are to be introduced on an experimental basis in 15 industrial associations and combines.

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ROMANIA

- 1967 Following a series of experiments, the Party's National Conference of December 1967 approves the "Directives on Perfecting Management and Planning the National Economy", establishing Industrial Centrals.
- 1973 Development of the "Single National Socio-Economic Plan" and reorganization of ministries, centrals and enterprises leading to greater rôle for the latter two types of bodies.
- 1978 "New Economic Mechanism" adopted, which combines principles of Workers' self-management with economic and financial self-management. These measures contemplate: (a) greater financial discipline; (b) improved system of indicators, and particularly the introduction of net output in place of gross output as the basic indicator to which enterprises bonuses will be linked; (c) greater rôle of material incentives, closely related to work performed; (d) profit-sharing; and (e) greater enterprise responsibility for drafting own "economic and social development plans".

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CMEA INTEGRATION

- 1954 Principles of plan coordination elaborated at Fourth CMEA Council Session (Moscow).
- 1971 "Comprehensive Programme for the Extension and Improvement of Cooperation and the Development of Socialist Economic Integration" adopted at Twenty-Fifth Council Session (Bucharest). Procedures established for mutual consultation on methods of planning, and economic administration, for long-term planning and for joint national production arrangements, including research and planning.
- 1975 "Concerted Plan of Multilateral Integration Measures" adopted at Twenty-Ninth Council Session (Bucharest). Programme established for mutual construction of specific projects in 1976-1980, for effecting specialization and co-production arrangements, and for research to be carried out in common.
- 1976-1979 Long-range "target programmes" adopted in five industrial areas to guide joint development efforts, including planning, to 1990 and beyond.

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THE NEW PRICE SYSTEM AND RECENT PRICE
CHANGES IN HUNGARY

The New Price System

The New Economic Mechanism (NEM) which was introduced in 1968, after intense and careful study of the problems of the Hungarian economy and the ways and means of remedying these, had four broad goals(1):

1. to modernise the economy, which was woefully backward technologically and structurally;
2. to ensure long-term economic growth;
3. to ensure a gradual, but constant increase in the standard of living;
4. to improve and strengthen the legitimacy of the Party leadership - a constant goal of Kadar's ever since the 1956 Revolution.

It can be said that, in general terms, the following principles were set to reach these goals:

- Prescriptive planning was to be replaced by indicative planning.
- The principle of enterprise autonomy was to be set.
- Market forces were to be utilized to guide the managers to the right decisions, while quality standards were to replace the old quantitative criteria of successful performance.
- Extensive growth was to give way to intensive growth (i.e. greater productivity of land, labour and capital).

These principles could be only partly observed, especially after 1971 in order to avoid inflation, unemployment and a stagnation or decline in the living standard.

The state of the economy, however, compelled the HSWPCC to return to the basic principles of NEM and further adopt new long-term principles for foreign economic policy and the re-organization of the production structure. The document adopted at this October 1977 meeting clearly stated, among other things, that domestic prices should reflect world market prices and that subsidies must be drastically reduced. Following this resolution,

(1) William F. Robinson, RAD Background Report/275, 13th December 1979.

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a comprehensive adjustment to the system of price formation which intends to increase the rôle of market forces was introduced, effective as of 1st January 1980.

The new price system presents a return to competitive pricing principles in line with the NEM(1). The main features of the new price regulations are summarized below:

Input prices: The domestic prices of raw materials will be determined by the prices that would have to be paid if such inputs were imported from the West. The prices of electric power and fuel will be fixed but will be changed if the import prices change. The importers and producers of raw materials will be encouraged to follow an independent price policy which will enable them to allocate resources to "enterprise price difference reserve accounts" with the intention of developing a long-term price policy while reducing the impact of short-term import price variations(2).

Producer prices: The prices will be under three separate pricing categories: Competitive prices (world market prices, i.e. the price which would be obtained if the goods were exported to the West); proportional prices (based on competitive prices but containing some markup on the competitive price); normative production cost prices (enterprises base their prices on average cost plus some subjective or socially just markup).

Consumer prices and turnover taxes: The existing consumer price system is to be preserved (see footnote on page 4). The prices of sixty per cent of the consumer products, however, will fall under "free prices" category. The consumer prices should also exceed producer prices so that the state collects more turnover tax rather than providing subsidies.

Recent Price Changes in Hungary

In line with this policy and following the price increases of 21st July 1979, the prices of several items ranging from diesel oil to woollen cloth were changed, effective as of 1st January 1980.

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- (1) For details see RAD Background Report/280, 17th December 1979.
- (2) Some measures were taken in the exchange rate policy to ensure effectiveness of the price adjustments in promoting economic efficiency. The forint was revalued against the dollar (\$1 = forint 34 versus \$1 = forint 38). The most important aspect of the new exchange policy however is the intention of the Government to use it in the service of price stability and not to promote exports.

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The main motives behind these changes as reported in Nepszabodsag of 22nd July 1979 in Hungarian Deputy Prime Minister Istvan Huszar's words, were: "Price development is not only a political consideration or a matter for state decisions, in essence it is determined by strict economic rules, i.e.:

Prices must reflect actual costs;
A rational and thrifty utilization and development of labour, material, and energy, must be encouraged;
A better balancing of domestic and foreign demand should be pursued."

According to Huszar, in 1978 the sum for consumer price subsidies on products and services already exceeded 40,000 million forints, which represented 13% of consumption and considerably surpassed the state revenue from turnover tax.

The state therefore, according to various Hungarian sources, within the context of NEM had to make price adjustments in view of the above mentioned justifications.

The price increases of last July were by far the most comprehensive rise in consumer prices in recent years. Although prices were almost always adjusted at the beginning of each year all these increases were limited with the exception of a 30% increase in the price of meat in July 1976.

In July the emphasis was on food and mainly on other necessities affecting the family budget directly. The increases effective from 1st January were intended to complement these earlier adjustments.

The state, on the other hand, brought in some compensatory measures. The regularly employed get an extra 180 forints monthly, employees of agricultural co-operatives receive an extra 140 forints, and the family allowance per child is increased by another 130 forints per month. The families who were not entitled to a family allowance (with one child only) also started to receive 130 forints per month since July 1979.

These "compensatory measures" are however far from being compensatory. The price increases will have lowered the level of real income of the population, acceding to the criticism raised by some that Hungary lives beyond its capacity.

According to the communiqué of the National Materials and Price Control Office announcing the recent price adjustments, only a 3.7% increase is expected in overall consumer prices in 1980.

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That is composed of a 0.8% increase which took effect in January and the expected 2.9% increase in the sector of freely priced items(1).

A look at the effects of the 23rd July price increases shows that this may not however be the case. In June 1979, before the price increases, the official consumer price index was 105.2% corresponding to the same period in 1978 (100). In August it became 112.9%, in September 113.3%, in October as much as 114.0%. This means that between June and September the consumer price index rose by 8.1 percentage points(2).

Also, taking into consideration that most producer items are freely priced, the percentage allowed for this sector does not seem realistic. Since these prices are linked to world market prices, any change in the world market prices should affect them, causing a chain reaction of increasing prices. According to some observers, all this could end in double digit inflation such as Hungary experienced in the last six months of 1979.

Although it is too early to prophesize a double digit inflation, this line of thought cannot be put aside in view of Hungary's apparent determination to make use of market forces as much as possible and operate her own economy in line with the state of the world economy. However, if the recent price increases push up the producer prices so that Hungarian goods become less competitive in the world market, they may have to consider some measures including the devaluation of the forint.

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- (1) In the Hungarian system there are three categories of consumer prices:
- a. Authorities fix the prices.
 - b. Authorities establish minimum-maximum limits and the prices are allowed to fluctuate within these limits following supply and demand.
 - c. Prices follow market fluctuations. This is the sector which is called "the sector of freely priced items".
- (2) RFE Situation Report, 22nd January 1980, page 9.

N A T O C O N F I D E N T I A L

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NATO UNCLASSIFIED

LES INVESTISSEMENTS EN COMMUN DU CAEM
(en cours de construction et en projet*)

ANNEX IV to
C-M(80)49

	URSS	Bulgarie	Hongrie	Pologne	RDA	Roumanie	Tchécos- lovaquie	Mongolie	Cuba	Yougo- slavie
Centrales nucléaires (puissance prévue)										
Khmel'nickij (4 000 MW).....	0		X	X			X			
Konstantinovka (4 000 MW).....	0		X	X			X			
Kozloduj (1 860 MW).....	X	0								
Paks (1 760 MW).....	X		0							
Zarnowiec (1 880 MW).....	X			0						
"Bruno Leuschner" Lubmin (3 520 MW).....	X				0					
Jaslovske Bohunice (880 MW).....	X						0			
Dukovany (880 MW).....	X						0			
Cienfuegos (1 700 MW).....	X								0	
Centrales hydro-électriques (H) et thermiques (T) (puissance prévue)										
Gabcikovo-Nagymaros (H - 1 026 MW).....			0				0			
Drave (H - 400 MW).....			0							0
Portes de Fer-Djerdap I et II (H - 748 MW).....						0				0
Nikopol-Turnu Magurela (H - 800 MW).....		0				0				
Stinka-Costesti.....	X					0				
Bicske (T - 2 000 MW).....	X		0							
Marica-Iztok (T - 840 MW) - Varna (T - 1 260 MW).....	X	0								
Boxberg (T - 3 520 MW).....	X		X	X	0					
Pinos (T).....	X								0	
Hagenwerder (T).....	X		X	X	0					
Novy Dvor (T).....				0			X			
Markersbach (T - 1 050 MW).....				X	0		X			
Lignes de transmission										
Vinnica-Albertirsa (750 KV) (860 km).....	0	X	0	X	X		X			
Röhrsdorf-Hradec (400 KV) (80 km).....					0		0			
Rybnik-Nowice (400 KV).....				0			0			
Khmel'nickij-Rzeszow (750 KV) (390 km).....	0		X	0						

* 0 - Localisation du chantier
X - pays participant

NATO UNCLASSIFIED

N A T O U N C L A S S I F I E D

ANNEX IV to
C-M(80)49

	URSS	Bulgarie	Hongrie	Pologne	RDA	Roumanie	Tchécoslovaquie	Mongolie	Cuba	Yougoslavie
Bulgarie-Roumanie (750 KV) (730 km).....		0				0				
Timisoara-Argad-Szeged (750 KV).....			0			0				
GAZ (G) - Pétrole (P)										
Družba (P - 5 500 km).....	0		0	0	0		0			
Fraternité-Bratstvo (G).....	0		0	0	0		0			
Hongrie-Yougoslavie (G).....			0							0
Transit - Consortium (G).....	X						0			
Gazoduc Iran-URSS (G - 1 400 km).....	X			X			X			
"Sojuz" Orenburg (G - 2 750 km).....	0	X	X	X	X	X	X			
Polock-Biržaj-Mažejkaj (P - 442 km).....	0			X						
Adria (P - 130 km).....			0				X			0
URSS-Bulgarie (G).....	0	0				0				
Beregdaroc-Leninvaros (P - 130 km).....	X		0							
Schwedt-Leuna (P - 336 km).....				X	0					
Industrie minière										
Lignite (Turow).....				0	X					
Soufre (Tarnobrzeg) - Cuivre (Lubin).....				0			X			
Lignite (Hagenwerder).....				X	0					
Sel gemme, sel de potasse (URSS).....	0			X						
Charbon (Bobov Dol).....	X	0	X	X						
Nickel, cobalt (Las Camariocas, Punta Gorela).....	X	X	X	X	X	X	X		0	
Charbon (Baga Nur).....	X							0		
Sidérurgie - Métallurgie - Constructions mécaniques										
Kursk (transformation du minerai de fer).....	0	X		X	X		X			
Nikopol' et Jermak (ferro-alliages).....	0	X	X	X	X		X			
Novovolynsk (équipements pour l'électrotechnique).....	0			X	X					
Pernik (équipements lourds).....	X	0				X	X			
Medet (enrichissement du cuivre).....		0					X			

0 = Localisation du chantier
X = pays participant

N A T O U N C L A S S I F I E D

ANNEX IV to
C-M(80)49

	URSS	Bulgarie	Hongrie	Pologne	RDA	Roumanie	Tchécos- lovaquie	Mongolie	Cuba	Yougo- slavie
<u>Chimie - Pétrochimie</u>										
Kingisepp (phosphates).....	0		X	X	X	X	X			
Devnja (carbonate de soude anhydre).....	X	0	X							
Bulgarie (oléfines).....		0				X				
Bulgarie (fibres synthétiques).....	X	0								
Leninvaros (pétrochimie).....	X		0	X			X			
Szeged (traitement du gaz).....	X		0							
Böhlen (oléfines).....					0		X			
Savinesti (fibres synthétiques).....	X	X	X	X	X	0	X			
Roumanie (soude caustique).....	X					0				
Oltenitsa (caoutchouc poly-isoprène).....	X	X	X	X	X	0	X			
Roumanie (éthylène).....		X				0				
Tchécoslovaquie (produits pharmaceutiques).....	X						0			
Zaluzi (pétrochimie).....	X						0			
Cuba (furfurol).....				X					0	
<u>Matériaux de construction</u>										
Kiembaj (asbeste).....	0	X	X	X	X	X	X			
<u>Industrie du bois</u>										
Ust-Il'm (pâte à papier).....	0	X	X	X	X	X				
Komi (abattage des arbres).....	0	X								
Arkhangel'sk (pâte à papier).....	0	X								
Brafla (pâte à papier).....				X	X	0	X			
Santa Cruz Norte (carton).....				X					0	
Mongolie (meubles).....						X		0		
<u>Industrie légère</u>										
Cuba (transformation des agrumes).....				X					0	
Mongolie (viande) (tapis).....					X			0		
Moldavie (tapis).....	0				X					
Cuba (textiles).....	X								0	

• 0 - Localisation du chantier
X - pays participant