



Foreign and Commonwealth Office

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*Fascinating - but more talk than action*  
*met. An interesting account.*  
*Prime Minister*  
*C D P 207i*

I enclose a report prepared by Rodric Braithwaite after his talks in Moscow on 7/8 January about problems of reform of the Soviet political economy. The Foreign Secretary found this report compact and illuminating. He thought that you and the Prime Minister might find it useful in relation to the forthcoming visit.

*Yours ever,*  
*A C Galsworthy*

(A C Galsworthy)  
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## REFORMING THE SOVIET POLITICAL ECONOMY

"In capitalist society variety, quality and volume of production are controlled by the market. Can we not use this instrument in our Socialist economy?"

Letter to Pravda, 23 August 1964

1. I went to Moscow in the second week of January to talk with the Ministry of Foreign Affairs and to people in the economic institutes about problems of the world economy. I expected the usual polemical exchanges with the Foreign Ministry officials about COCOM, the North-South dialogue, and other contentious matters. But I hoped that the Russians would nevertheless be willing to have the odd word about the debate on economic reform initiated by Gorbachev.

2. The event far exceeded my expectations. Even the Foreign Ministry officials were willing to speak - in front of one another - with a frankness that I have not previously experienced in dealing with Russians. Apart from one minor incident there was no attempt to score propaganda points. They were barely interested in the world economy; but they were bubbling over with anxiety to tell me about their internal debates. They willingly fielded questions not only on the technicalities of reform, but on far more sensitive matters, such as the role of the Party and Russian attitudes to work. One could have had such discussions in Poland after 1956. But in the Soviet Union they would, I was told in the Embassy, have been impossible even six months ago.

3. My interlocutors were Obminsky, the new head of the Foreign Ministry's International Economic Affairs Department; Academician Bogomolov, the head of the Institute of the World Economic Socialist System; Abalkin, head of the Institute of Economics; and Korolev, the new head of the Institute for the World Economy and International Relations (IMEMO). They did not differ much in their analysis of what is wrong with the Soviet economic system. I do not however think that this was because they were speaking to a line centrally laid down. Their analysis was similar to that put forward by the more sophisticated Soviet economists during the great debate under Khrushchev. And it is pretty much the same as the analysis which is made in the West.

4. For all that I came away most sceptical that all the talk of reform will in fact lead to fundamental change in the Soviet system.

5. The essence of what I was told was:

a) The Soviet economy is stagnating: it risks falling behind the West, perhaps irreversibly.

b) The economic structure must therefore be fundamentally restructured. This includes recognising its interdependence with the rest of the world economy. But this restructuring (perestroika) must not be allowed to undermine the essence of Socialism.

c) The restructuring of the economy cannot succeed without a parallel restructuring of the political system - greater openness, industrial democracy, and the withdrawal of the Party from economic management.

d) Nor would it work without a transformation of traditional Russian attitudes to work.

e) All these changes would take place slowly and deliberately: the new laws that were being passed would be supplemented by further measures in the light of experience.

#### THE NATURE OF THE PROBLEM

6. The weaknesses of the Soviet economy are well known: the reliance on management by administrative fiat; the emphasis on quantitative rather than qualitative planning indicators; the arbitrary pricing system; the absence of any system of genuine financial responsibility. In Khrushchev's day the relationship between enterprises, their suppliers of raw materials, and their intermediate or final customers, was governed by the directives of the planners and not by the pressures of supply and demand. Factory managers maximised production whatever the quality of their goods and whether or not there was a use for them. Financial incentives to work harder had little effect because of the shortage of consumer goods worth buying. The system did work after a fashion - not least because of the existence of a network of complex and often corrupt devices for bypassing the planners' intentions.

7. Various suggestions were made for correcting these weaknesses: from shooting corrupt factory managers through the setting up of small-scale private and cooperative enterprises to introducing some kind of more rational "Socialist market" (the ideas associated in the West with Liberman). Throughout the Khrushchev era the Soviet Union was in a state of perpetual administrative reorganisation.\* But the pressures for reform fizzled out under Brezhnev, and twenty five years later the analysis is the same.

8. My Russian interlocutors insisted that things could not continue this way. The Soviet Union was falling behind the West, perhaps fatally. Radical measures were inescapable: what Gorbachev had called the "second revolution". They would be adopted, and they would work, because everything else had been tried and had failed.

#### PROPOSALS FOR REFORM

9. The following are some of the highlights of our discussion (details are in Mr Chrimes' notes).

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\* In Tvardovsky's satirical "Terkin in the underworld", published in 1963, there is a "Committee for Perpetual Perestroika": another example of how little things change.



## Foreign Trade

10. My interlocutors made no bones of the fact that they now regard the Soviet Union as an integral part of the world economy. The Russians therefore no longer have an interest in "the final collapse of capitalism" (a major ideological concession). The Soviets wanted to join the GATT for two main reasons: a dislike of being excluded from a major international institution; and a need to expose the Soviet economy to the disciplines of the international market. I said that we were reluctant to see the Russians in GATT, among other reasons, because it was quite unclear how tariffs operated in the Soviet economy. Western negotiators could not be sure that any concessions they made would be matched by real economic concessions on the other side. I did not see how this could change unless the workings of the Soviet economy became much more transparent, and until the Soviet price system reflected economic rather than administrative considerations.

11. The Russians did not deny this. But they claimed that the proposed reforms would indeed make the whole process more transparent and provide the clarity that Western negotiators and Western businessmen needed. For their part the Russians needed the exposure to Western economic realities that would come with the opening up of the Soviet economic system to foreign trade. Soviet factory managers would develop a real interest in exporting, and would have to improve their products accordingly. This would have a beneficial effect on standards in the Soviet economy as a whole.

## Joint Ventures

12. Obminsky and Bogomolov said that the Soviets had studied the experience of other Socialist countries. The Soviet partner in a joint venture would have a majority of the shares (this could be less than 51% if there were more than one foreign partner). The Soviet interest would be to acquire management expertise and technological know-how, and hard currency from the sale abroad of the product.

13. I pointed out that foreign partners would only be attracted if they could make and remit profits, and if they could open up a market inside the Soviet Union which would otherwise be closed to them. Joint ventures in other Socialist countries had not always worked well. There was a risk that the interests of the partners would not converge. I wondered how a joint venture, which would be operating outside the planned economy, could be sure of getting its raw materials. Would not the planners be tempted to give preference to enterprises inside the planned sector? How would the joint venture be able to recruit skilled Soviet workers away from established enterprises? How would the economics of the venture be calculated, given the artificiality of Soviet prices and the non-convertibility of the rouble?

14. The Russians said that many of the practical difficulties would have to be sorted out in negotiations

between the potential partners. About 200 joint ventures might eventually be set up. They would be only a small part of the Soviet economy as a whole. It would be perfectly feasible to give them priority over raw materials. Since Soviet citizens in a joint enterprise would find themselves having to work two or three times as hard as in a Soviet enterprise, it would be reasonable to pay them accordingly. That would take care of the recruitment problem. There were precedents: workers in the defence industries were already paid more than those in the civilian economy (an unusual admission). Access to the internal market and the remittance of profits earned there might be more of a problem: perhaps the solution was to allow the foreign partner to convert rouble profits into hard currency if the goods produced would otherwise have to be imported.

### Prices and the new enterprise law

15. Underlying the discussion about the Soviet Union and its foreign trade partners was the issue of the way prices are formed in the Soviet system, and the signals that these prices send to Soviet factory managers. The intention of the new law on the enterprise, which is to be published shortly, is to increase the financial independence and responsibility of the factory manager. His planned targets are to be set in qualitative and financial, not quantitative terms, and he will be judged in future by whether his product finds a buyer. If he fails to make ends meet financially, there will be a number of possible consequences. The factory may be given new tasks; it may be closed down temporarily for re-equipment; or it may be closed down permanently and the workforce dispersed. Bogomolov cheerfully described this last as "bankruptcy", though Abalkin said that they still didn't much like using such words in the Soviet Union.

16. Obviously the way prices are formed will be crucial under the new system. The answers I was given were almost entirely unconvincing. All agreed that it would be unreasonable to force an enterprise into bankruptcy because the prices at which it bought its inputs and sold its product had been arbitrarily but wrongly set by the planners. Obminsky and Bogomolov thought that under the new arrangements there would be more intense negotiation over price between Soviet and foreign firms and between Soviet enterprises themselves. As result of this process prices would eventually come in some mysterious way to reflect economic rather than administrative realities. They did not at all explain how this would happen, except that it would come about "step by step". I did not find this impressive, though I may be being unfair since I have not followed the technical debate in the Soviet press..

### POLITICAL OBSTACLES AND POPULAR ATTITUDES

17. Everyone I talked to, even in the Foreign Ministry, said that the economic reforms could not succeed unless they were matched by political reforms. Both Bogomolov and Abalkin spoke of the need for "democratisation". I asked what that meant. They were vague, and mumbled something about the workers electing enterprise managers. That, I remarked, had

not worked in Yugoslavia. I added that the 1964 reform had run into the sand because Party officials had seen it as a threat to their power: why should they be more cooperative this time? Abalkin said that the Soviet Union was a uniquely vast and diverse country: it was not easy to hold together and the Party had fulfilled that role both politically and in the economy. Party officials had naturally wanted to hold on to their power. But it was not an appropriate role for them and other means would have to be devised. Probably the local authorities would have to be given greater responsibility for economic management.

18. Both Bogomolov and Abalkin said that wage differentials would have to be increased to get people to work harder: for a while at least the differentials might need to be a good deal wider than they were in the West. The trouble, said Bogomolov, was that the Russian people did not like work, nor did they like to see others prosper. This was a very old tradition: it reflected the egalitarian sentiments of the pre-Revolutionary village commune. I commented that the only time in Russian economic history when this had begun to change had been under Stolypin before the First World War. By "backing the strong" (stavka na krepkikh) he had encouraged the more enterprising peasants to enrich themselves, if necessary at the expense of the incompetent. The new policies seemed to be pointing in the same direction. I wondered if they would be any more manageable politically today than under the Tsar.\*

19. Abalkin said that people used to think that it was the bureaucracy which had stifled the Soviet economy. If that had been so, the solution would be simple: just get rid of the bureaucrats. But the opposition to change came from the bottom as well. The workers had been keen enough when people had talked of giving them new rights. But now they had gathered that the new rights would be accompanied by new obligations, and they were distinctly less enthusiastic.

20. Bogomolov asked if we in the West had similar problems over popular attitudes to enterprise and success. I said that we did indeed have such problems in Europe, though not in America. In England we called it "the politics of envy": the attitudes involved were rooted in the very beginning of our industrial revolution. The miners' strike showed how hard it was to change such attitudes.

#### CONCLUSION

21. The current analysis of the Soviet Union's economic ills is not new. Neither are most of the remedies proposed. What

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\* Stolypin's policies were opposed both by the Social Revolutionaries and by the reactionaries around the Tsar, and he was assassinated before they could bear fruit. I understand that the Stolypin reforms are nevertheless the subject of renewed interest in the Soviet press.

does seem to be new is the public discussion of the need to change fundamental attitudes. The apparent recognition in some Soviet press and TV comment that the experiment could fail is also unusual. Past Soviet "campaigns", like Queen Victoria, have usually not entertained the possibility of defeat. Either the leadership really do want to encourage genuine discussion; or those who oppose the reformers are influential enough to get their ideas into the press.

22. Gorbachev is almost certainly right to think that a genuine reform of the Soviet economy requires the most far-reaching transformation of fundamental attitudes. He clearly sees this as the key in other areas as well, and is prepared to take considerable risks accordingly - witness Alma Ata, the release of Sakharov, and even Reykyavik.

23. But the risk is indeed great. Russia's rulers have traditionally feared that by relaxing discipline they will unleash the "elemental forces" in Russian society. Their fears have been justified over the centuries by rebellions and revolts of which Alma Ata is only the latest. His irresponsible attitude to the "elemental forces" was one of the main counts against Khrushchev after he fell. Bogomolov, Abalkin, and the others are almost certainly correct in their analysis. But they are not responsible for running the country. The Party officials and economic managers who are may be less articulate. But they are bound to be more cautious, and not only because they want to keep their jobs. The political risk of change - especially failed change - is obvious; and so far the economists have not even come up with convincing answers to the practical problems which change will entail.

24. Moreover it is wrong to say, as the reformers do, that there is no alternative to the changes they propose. The Soviet Union is making economic progress, however slow. Despite its inadequacies, the system has succeeded in enabling the Soviet Union to match the military might of the United States. Moscow and its people are considerably more prosperous than they were twenty years ago (so of course they ought to be). It is not unreasonable for the conservatives to argue that the risks involved in trying to change attitudes through open debate and "democratisation" are not worth the candle; and that it is both preferable and practicable to proceed as before, tinkering with the system, maintaining internal discipline, building up the armed forces, and giving whatever crumbs remain to the patient Soviet consumer.

25. The people apparently share this scepticism. The Moscow taxi drivers are said to think that Gorbachev is a "decent" man (despite his success in rising to the top of the Soviet political system); but that his reforms will succeed, if at all, only under his successor. The jury on the economic reforms is likely to remain out for a long time. I suspect that, when it returns, its answer to the anxious Pravda reader of 1964 will still be: "No".

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