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The Rt. Hon. William Waldegrave MP  
House of Commons,  
London SW1A 0AA

*Prime Minister*  
*A fascinating*

- 1) Minister letter.
- 2) Soviet Dept. *CBP*
- 3) Research Dept. *1/3*
- ERD*
- for Comms Dept*

*Dear William,*

If you were serious in what you said about helping HMG advise the Soviet Union how to achieve some economic success I would of course be happy to do whatever I can.

It is, however, a most intractable problem. The obvious solution - to eliminate socialism - can hardly be the message which Mr. Gorbachev wishes to receive or which it would be diplomatic for HMG to convey (even Sakharov's manifesto falls well short of that). It might, however, be possible to dismantle parts of socialism. The Soviet Communist Party would then have to rely on economic or political compartmentalisation to protect the rest of their empire from catching the freedom virus.

I do not believe the problem can be tackled from a mainly economic standpoint. The macro-economic levers which we try to pull in the West (money supply, deficit budgeting, etc.) are pretty ineffective even here, where we are constantly confronted with a combination of instrument fog and unexpected effects. To attempt to use such mechanisms in the Soviet Union, where there is, so far as one can tell, no effective economy at all, would lead to abject failure. Thus the approach must be (a) politico-economic and (b) commercial.

It is tempting to try to draw on the Chinese experience, but this would be unsound. The Chinese are culturally homogeneous and have three dynamic capitalist communities with a combined population of over 25 million bordering directly on mainland China - Taiwan, Hong Kong and Macau. As a result South East China has a rapidly growing natural trade and is becoming a profitable low-cost production base for goods chiefly designed and marketed by Hong Kong. None of these features apply to the U.S.S.R., the nearest equivalent being Finland, which is not culturally homogeneous with Russia and whose external trade is 1/5th that of Hong Kong's and Taiwan's combined (whereas the USSR's is three times that of China - a "weight" discrepancy of 15 times).

Thus the Comecon has acted historically not just as a military buffer but as an economic screen, distancing the Soviet Union from contact with the West and substituting as trading partners (on what is effectively an enforced bartering basis) states which are themselves inefficient. It is the perfect recipe for poverty. This role of the Comecon might, of course, change if Central Europe were to evolve along pluralistic lines and to become associated with the Common Market - an evolution which would have major political consequences.

Returning to the idea of de-socialisation, it would in my judgement be more effective to dismantle parts of the system almost in toto than to dismantle it partially across the board. Agriculture seems the obvious place to start, since it makes few demands on innovation, marketing, competitiveness or organisation - Nature performs most of the capitalist role. The return of the land to the people would lead to a massive increase in production which would more than

compensate for any higher open market prices. Moreover, without wishing to re-open the controversy between Mao and Stalin over the revolutionary potential of the countryside, I would think the Party might regard farmers as relatively "safe", if only because they would be dispersed, busy and concentrating on making money.

I have read superficially of Gorbachev's proposals for agricultural tenancies but I have no independent opinion as to their likely effectiveness. My cast of mind would be sceptical on the grounds that they probably fail to go to the root of the matter, i.e. ownership. Be that as it may, once farm productivity is increased, the problem of distribution will remain - how to get the produce into the cities. Clearly private ownership of trucking, warehousing, food processing and shops would go a long way towards solving this difficulty, but then the compartmentalisation of socialism would be jeopardised; and to this I have no answer.

A second relatively separable area is foreign exchange. Since the Soviet external account is largely a balanced book - i.e. a quota system for imports matching the commodity value of exports - it would cost virtually nothing to float the ruble and make it convertible.

The ruble would doubtless drop like a stone, but this would price some Soviet goods into export markets and contribute to the rationing of imports by price allocation (i.e. the market) rather than by official planning; this would improve efficiency considerably. A collapsed ruble might also lead to some foreign investment in the U.S.S.R.

A third useful act of dismemberment would be the freeing of the Baltic States, except for defence and foreign policy. (By "freeing" I mean progressively allowing the Baltic States their own currency, banking system, legal system, economic arrangements and political system). This would bring to the

North West of the USSR the prospect of something akin to the Chinese success. However, the political ramifications are presumably extremely radical. I don't know enough to be able to judge whether the taste of independence in the Baltic might lead to the break-up of the Soviet Union. Certainly Gorbachev's recent remarks in Moscow suggest that there is great reluctance to move in this direction.

An approach which is sometimes advocated is joint ventures. These, however, are full of problems. Those which work best in China are the ones which are just over the border, where the Hong Kong parent can influence the production efficiency and the quality of the output and where the foreigner is effectively paid in product (which could be anything from lifts to ice-cream) rather than dividends.

All this is difficult enough in China; the absence of law is, for example, a drawback. In Russia, with long distances, a recalcitrant workforce and language problems, it would be harder still.

Nor do I see much prospect for itinerant labour, which has built a number of infrastructure projects in the Middle East and elsewhere, the method being to import a re-exportable army of, e.g., Korean building workers - among other examples are the Turkish "guest-workers" in Germany. The success of this approach owes everything to the fact that the host countries have spare cash and no labour, whereas the U.S.S.R. has no spare cash and demoralised, but abundant, labour. (There are, moreover, depressing Soviet precedents with Gulag-type overtones, the latest being the forced labour of Vietnamese deportees).

The fashionable approach nowadays is what might be called "capitalism within anti-capitalism" - the notion of introducing incentives, redundancies, profitability,

management accountability and other trappings of an open economic society without changing the basic framework of Planning, KGB and Party control, Residence Permits, Price Controls and State ownership. In my opinion this approach stands little chance of success. It is like introducing fish without water. Free market business practices need a free society in which to operate. I should think such policies will backfire badly, discrediting both their authors and the very idea of a more open society. I realise that this is a pessimistic prognosis for Gorbachev's central strategy of Perestroika, but it is what I believe.

Finally, there are Western loans. These arouse passion disproportionate to their importance. To create a net benefit to the U.S.S.R. they would have to be invested in Soviet projects (or the easing of bottle-necks) earning foreign currency at a rate of over 12% on capital, which I dare say is rather marginal, not to say unlikely. It would not be surprising if a fair amount of such loans found their way into subversion; on the other hand, the Soviets have long been punctilious payers, and they tend to regard foreign loans as being as much a burden as a help.

The more one considers the question, the more one comes back to human and ideological elementals. People will not work for corrupt land or property owners backed by authoritarian regimes, which explains the failure of Latin America; still less will they work for corrupt bureaucracies embodying totalitarian regimes, which explains the failure of Eastern European communism. To say anything different is to fudge the issue beyond repair. On this analysis, the central question is how quickly and how comprehensively the U.S.S.R. can pull back from socialism and what cover story can be concocted for pretending that something different is happening. There should, at least, be no shortage of experts in creating legends.

I have not in this letter dealt with a variety of peripheral, but related, matters such as freedom of travel and scholarships abroad, nor have I dealt with sub-forms of ownership, such as co-operatives, partnerships and joint stock companies. In any event, I feel fairly sure I will now have effectively disqualified myself from any role at all. Nevertheless, I do gladly repeat the offer to help.

Yours,

Rodney

Rodney Leach