[SUBCOMMITTEE PRINT]

THE FIAT-SOVIET AUTO PLANT
AND
COMMUNIST ECONOMIC REFORMS

A REPORT

PURSUANT TO

HOUSE RESOLUTION 1043, 89TH CONGRESS, 2D SESSION

FOR THE

SUBCOMMITTEE ON INTERNATIONAL TRADE

COMMITTEE ON BANKING AND CURRENCY
HOUSE OF REPRESENTATIVES

MARCH 1, 1967

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[1] Richard L. Ottinger, New York, resigned from committee Oct. 18, 1966.

LETTER OF TRANSMITTAL

FEBRUARY 28, 1967.

Hon. WRIGHT PATMAN,
Chairman, Banking and Currency Committee,
House of Representatives,
Washington, D.C.

DEAR MR. CHAIRMAN: Transmitted herewith is my report as chairman of the Subcommittee on International Trade. The report is in two parts: (1) proposed Eximbank extension of credit for purchase of U.S. machine tools for the FIAT auto assembly plant in the Soviet Union, and (2) our evaluation of current progress of economic reforms in Yugoslavia, Hungary, Czechoslovakia, and the Soviet Union.

This study was undertaken pursuant to House Resolution 1043 of the 89th Congress.

Three other members of the subcommittee participated in this study. They were Representatives James Harvey, Chester L. Mize, and Thomas M. Rees, together with Richard K. Cook of the committee staff. Between December 7 and 19, 1966, we traveled to Italy, Yugoslavia, Czechoslovakia, Hungary, and the Soviet Union. The appendix lists the names of those with whom we met during our trip.

The information contained herein, however, is the product of more than 3 months of intensive study.

This report represents the combined opinions of the four members who conducted the study. It does not necessarily represent the views of any other members of the Subcommittee on International Trade.

Sincerely yours,

THOMAS L. ASHLEY,
Chairman, Subcommittee on International Trade.

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APPENDIX

PART I. THE FIAT-SOVIET AUTO PLANT

Observations and Summary of Findings

On October 7, 1966, before the National Conference of Editorial Writers in New York City, President Johnson announced that "the Export-Import Bank is prepared to finance American exports for the Soviet-Italian FIAT auto plant." Because we were in the final weeks of a congressional election campaign, the significance of this statement in terms of overall U.S. trade policy may have been overlooked.

The House Committee on Banking and Currency has legislative jurisdiction over the Export Control Act, the application of which will determine whether or not the U.S. Government finally approves export licenses for U.S. machine tools to be installed in the proposed FIAT-Soviet plant. Our committee also oversees the operation of the Export-Import Bank. While specific congressional authority is not required, there are ample legislative avenues available to those in the Congress who might prefer to have Eximbank credits for these machine tools denied.

With this in mind, we undertook to study this proposal as thoroughly as possible. It was our considered judgment that the size of the undertaking as well as its possible ramifications demanded a thorough study and public airing. If controversy were to develop at a later time, we thought that it would be far better for all concerned that such arguments rest upon a factual foundation.

Once embarked upon this course, we received the full cooperation of all interested executive departments and agencies including the Departments of State, Commerce, and Defense as well as the Central Intelligence Agency. Equally important was the cooperation we received from the FIAT Co., Istituto Mobiliare Italiano, and the Italian Government itself.

It is, therefore, the purpose of this section of the report to inform the Congress of our findings. We will not attempt to advise our colleagues in the Congress on the desirability of U.S. participation in this project from the standpoint of international politics. Those of us who conducted this study are all agreed that day-to-day conduct of trade relations and foreign policy properly belong to the President. Moreover, our opinions and findings in this regard could be greatly colored by rapidly changing international developments.

On the other hand, we do not underestimate the significance of an undertaking of this size in terms of future United States-Soviet relations.

At the outset, it might be useful for us to summarize findings, some of which are drawn from the more detailed material that follows:

(1) We are confident that the Export Control Office of the Department of Commerce carefully will evaluate every application for

export licenses for all U.S. machine tools requested by FIAT for installation in the proposed plant.

In a letter of October 20, 1966, to a member of our committee, the Director of the Office of Export Control said: "We consider the machine tools normally required for the manufacture of civilian automobiles to be peaceful goods, and license applications for such equipment are likely to be given favorable consideration. Some of this equipment, however, still might also have important strategic uses. Approval of export licenses for such equipment would, of course, be less likely. The formulation of this policy involved the active participation and concurrence of the Departments of State and Defense, as well as other interested agencies."

We realize that there are special licensing problems raised by machine tools that have well-established civil uses but can also be used for strategic purposes. We are assured that Commerce would weigh a variety of factors before taking action on any such tools. The availability of comparable equipment abroad and the effectiveness of the denial of a license would be determined. The likelihood of the tools being diverted from automobile production to strategic uses would be very carefully assessed. Bearing on this would be the degree to which the equipment is an integral part of a large package. The demand for such tools by U.S. industry for use in filling defense orders also would be a prime consideration. Additionally, the Department would take into account the quantity of the equipment involved and the significance of any incorporated technology that might be extractable.

In the final analysis, all approvals would be subject to a determination that the shipment of the equipment to the Soviet Union would not have an adverse impact on our requirements for such equipment in the United States, nor make a contribution to the U.S.S.R. that would be in any way detrimental to U.S. national security and welfare.

We are mindful of the responsibilities of our committee with regard to the administration of the Export Control Act. Because of the magnitude of this proposed arrangement, we would expect the Subcommittee on International Trade to take an active interest in the evaluation procedure of export license applications for U.S. machinery scheduled for installation in the FIAT auto assembly plant.

It would be entirely appropriate for the subcommittee to call before it representatives of the Export Control Office in order for it to review the manner in which these license applications are being evaluated. We have been further assured by the Acting Secretary of Commerce that our subcommittee would have the full cooperation of the Office of Export Control should it feel the need for conducting such hearings.

(2) Although it has been said that FIAT could purchase the needed machine tools from other sources if U.S. export licenses are denied, there is no question that FIAT prefers to purchase a substantial amount of the total plant machinery from the United States, U.S. affiliates and licensees.

We are advised by FIAT by letter received February 1, 1967, that:

> A number of machine tools and equipment items which FIAT plans to suggest to the Soviets for purchase in Italy and other European countries are, in fact, currently manufactured by European subsidiaries or licensees of U.S. manufacturers.

The final cost of said machine tools and equipment items is contingent upon the decisions of the Soviet agencies handling the actual purchase orders.

If such agencies will adopt the list of equipment suggested by FIAT it can be expected that the largest share of the purchases will be related to forging and body stamping presses manufactured in Italy on U.S. license, as well as to component parts of plant material handling conveyors manufactured in Italy and/or in Great Britain, also on U.S. license.

It would appear, therefore, that U.S. machine tool technology may play a larger role in the proposed auto plant than had been forecast earlier. While direct purchases from the United States may total $50 million, additional machine tools may be purchased from European firms operating under license arrangement with American companies.

Machine tools ordered by FIAT from foreign subsidiaries or licensees of U.S. firms, to the extent they are under international embargo because of their highly strategic character, would be controlled under Coordinating Committee (CoCom) rules. The United States, as a participating country, would have a voice in any CoCom licensing determination respecting such equipment.

Foreign-made tools not covered by CoCom restrictions would be controllable by the United States under present regulations to the extent that U.S.-origin materials or component parts are involved in their manufacture or unpublished U.S. technology is essential to their operation and maintenance.

(3) While it might be tempting to jump to the conclusion that construction of such a huge auto assembly plant signals an abrupt change in allocation of Soviet resources toward consumer products, such a conclusion would be premature at this time. Nevertheless, this is a huge undertaking and one that could lead to further expansion of Soviet consumer goods industries at a later time.

(4) Spokesmen for the U.S. machine tool industry have indicated to us that there is no domestic shortage of automotive machine tools of the type likely to be installed in the FIAT plant. Domestic supply is an important and key consideration in the application of the Export Control Act. Currently the backlog of orders to U.S. firms is considered to be normal.

(5) We have been assured by the highest levels of the Italian Government that only a small percentage of the total cost of this deal to the U.S.S.R. will be repaid through so-called barter arrangements.

(6) We are confident that the FIAT Co. has not blindly conceived a new competitor to its own foreign markets. Some exports from this plant may develop but we are convinced they would be small. The types of FIAT automobiles to be produced will be specially adapted to peculiar Soviet needs in terms of road and weather conditions and would have limited sales appeal elsewhere. Moreover, internal demand in the U.S.S.R. far exceeds current and proposed production goals.

(7) Any Export-Import Bank credit guarantees will be between Eximbank and Istituto Mobiliare Italiano (IMI) and not between Eximbank and the Soviet Government. Since 1947, the Export-Import Bank has extended credits of some $650 million to IMI for financing U.S. exports, including credits aggregating about $50 million for the use of FIAT. All of these credits have been repaid, many of them some years before they were due.

We have been advised by the Export-Import Bank that no credits will be extended to IMI for the purchase of any machine tools produced by wholly or partially owned foreign subsidiaries of U.S. firms or from foreign firms working through license arrangements with U.S. companies.

Background

On December 7, 1966, at our meeting in Rome with officials of Istituto Mobiliare Italiano (IMI) and Fabbrica Italiana Automobili Torino (FIAT), the president of FIAT, Senator Vittorio Valletta, supplemented much of the previously known history and background leading up to the July 1965 agreement between FIAT and the Soviet Union to construct the auto assembly plant. We were impressed with the candor and cooperative attitude of Senator Valletta in describing to us the intricate background leading up to the consummation of this agreement.

Keeping in mind certain privileged remarks, we can nevertheless state that as early as 1962 Senator Valletta discussed the possibility of U.S. participation in an auto assembly plant with several U.S. Government leaders, including President Kennedy. According to the President of FIAT, he was encouraged by the United States Government to pursue such a deal on the theory that vastly increased Soviet automotive production might switch at least some Soviet economic resources toward consumer goods industries.

In the meantime, in 1962 numerous conversations and extensive negotiations were held between FIAT and the U.S.S.R. for the installation of farm tractor and other auto engineering facilities. These negotiations, however, did not result in any signed agreements.

In the years 1962–65 there were 46 Soviet trade and technological visits to Italy and at least two personal meetings between Alexei N. Kosygin and the president of FIAT. Senator Valletta informed us that because of the size of the auto plant proposal and prior dealings with the U.S. Government, he considered it "his duty" once again to travel to the United States in 1965 and explain all that had transpired up to that time.

According to Senator Valletta, the U.S. reaction in 1965 was that a transaction of this kind was not against the interests of the West. It was during his trip to the United States in 1965 that Senator Valletta thought "it logical" for him to raise the prospect of the employment of a certain percentage of U.S. heavy machine tools in the proposed plant because of FIAT's traditional use of U.S. machine tools within its own domestic plants.

As a next step, following his U.S. visit in 1965, Senator Valletta advised Soviet officials that he had spoken to Washington of the desirability of including at least some U.S. machinery in the Soviet plant and asked the Soviets if they had any objection, to which he was told there was none.

In his discussion with our subcommittee members, Senator Valletta emphasized that those with whom he had spoken in Washington had, throughout these informal soundings, stressed that no U.S. machine tools approved for export could carry any strategic use whatsoever.

With this in mind, in drawing up its tentative plans, FIAT did include in its negotiations with the Soviet Union the possible inclusion of U.S. machine tools—but "with a question mark" as to their final approval by appropriate U.S. agencies.

Consequently, in July 1965 an agreement on cooperation in automobile production was signed in Moscow between Vittorio Valletta, President of FIAT, and K. N. Rudnev, Chairman of the U.S.S.R. State Committee for Science and Technology. In addition to provisions for cooperation in research, the agreement envisaged the construction of a FIAT auto plant in the U.S.S.R.

After a year of negotiations on details, a final contract between FIAT and the Soviet Union was signed on August 15, 1966, which provided for the construction of a plant with an annual capacity of 600,000 automobiles. The total cost of this plant, exclusive of supporting facilities such as rail lines and housing for workers, has been estimated at approximately $800 million. This figure includes $300 to $400 million of imported machinery and equipment.

Under a financial agreement signed between the Italian export credit organization Istituto Mobiliare Italiano (IMI) and the Soviet Ministry for Foreign Trade, the Italians granted the Soviet Union a credit of approximately $320 million to cover the cost of the imported machinery. This credit is to be repaid in 17 semiannual installments beginning 6 months after the scheduled completion of the plant in about 1970. Following the signing of these agreements, it was announced that the plant would be built at Togliatti, a town on the middle Volga near Kuibyshev.

Why U.S. Machine Tools?

Although FIAT would be able to construct the Soviet plant without any U.S. machine tools and entirely from European sources of supply, Senator Valletta made it clear in his conversation with us that this was not the ideal course. He stressed that FIAT preferred to have freedom to shop in the United States because of "quality" considerations.

In the past, FIAT plants have relied upon the U.S. machine tool industry for many plant components and, quite naturally, a technological relationship has developed over the years. We presume that not only FIAT but also Soviet technicians recognized that the most up-to-date and advanced design automotive assembly facility might include at least some U.S.-built or U.S.-designed machine tools. Moreover, the widest shopping area produces the most competitive bidding situation with regard to technology, prices, delivery schedules and servicing.

At our Rome meeting on December 7, Senator Valletta made available to us a December 1966 list of U.S. equipment desired for installation in the FIAT-Soviet auto plant. The list details the equipment which FIAT thinks it proper to recommend for the Soviet factory at the present stage of engineering study and layout planning. The list included both the types of tools desired and the U.S. companies most likely to be in a position to supply them. In accord with our understanding with FIAT, for business reasons the list will not be included in this report in that it might be modified at a later point and publication might upset normal commercial relationships.

Nevertheless, for the purpose of informing Members of Congress, and without violating any confidence, it can be noted that the suggested machines would be installed in production lines for which FIAT has worked out the operation sheets and has designed tooling and fixtures to mass produce two cars of the FIAT line belonging to the small and

medium European size class (engine displacement, respectively, 73 and 85 cubic inches).

Nearly all the contemplated machines could be used solely for the above production (2,000 small- and medium-size cars a day).

1. Foundry machines and heat-treating equipment

The foundry machines contemplated as U.S. supply are chiefly flask and core molding machines. They must insure a high and steady production of cast iron and aluminum parts of comparatively light weight and small dimensions (the heaviest iron casting to be produced is the cylinder block weighing about 85 pounds).

Similar considerations apply to the heat-treating furnaces: They would be used for high and continuous rates of production of small mechanical parts.

The total estimated cost for the machines under this class is about $7 million.

2. Machines for engine manufacture

These are, in particular, transfer lines for pistons (4 lines), lathes and grinding machines for 4-cylinder engine crankshafts, boring and honing machines for cylinder liners and shaft housings.

These machines would be specifically designed and tooled for the components of the two cars designed by FIAT and could not be used to manufacture parts of other design or dimensions because they have fixed distances of spindle axes.

The total estimated cost for the machines under this class is about $13 million.

3. Machines for other mechanical car components

The machines made in the United States considered under this item are the following: Transfer lines for the machining of the differential carrier and housing, automatic lathes, machine tools for the production of gears, transmission sliding sleeves, splined shafts and hubs, etc. In this case, too, they are high-production machines, intended only for the machining of passenger car components. For instance, the maximum diameter of the ring bevel gear to be produced is 6½ inches.

The total estimated cost for the machines under this class is about $17 million.

4. Machines for production of car bodies

These are, in particular, presses for stamping body panels, and pertinent auxiliary machines, such as metal sheet straighteners and the like. These machines are designed for processing thin-gage, large-size sheets, such as those used in the automotive industry. This class also includes special parts for painting installations, upholstery processing equipment, etc.

All the listed items are designed for the peculiar needs of the automotive field.

The total estimated cost of the machinery under this class is about $7 million.

5. Components of material-handling equipment, machines for maintenance and inspection instruments

The parts of the material handling equipment referred to above are components of the overhead twin rail Webb-type conveyors. The size

of such conveyors is suitable only for automotive production (handling of car mechanical assemblies and/or passenger-car bodies within the factory). In FIAT's case these components would be used for the various assembly and storage lines (engines and other mechanical units, bodies, etc.).

Among the U.S. machines recommended by FIAT for maintenance operations are many special tool sharpeners required for the various automatic machines from different origins to be installed in the factory.

Also the inspecting devices would be specifically designed for the automotive industry, such as surface roughness measuring instruments, paint, fabric and plastic material wear meters and the like.

The total estimated cost for the machinery under this section is about $6 million.

The overall cost of the above equipment recommended by FIAT for procurement from the United States is about $50 million.

After studying the list of machine tools that might be purchased in the United States, supplied to us in December by FIAT, we further inquired of FIAT the extent to which U.S. machine tool technology might be employed in the plant through purchases of tools from U.S. foreign subsidiaries and/or licensees. In this regard, we were also interested in learning if any such tools might be on the CoCom restricted list.

In response to our inquiry, in the letter of February 1, 1967, FIAT listed the following items that might be purchased through license arrangement:

> Foundry and forging machinery, such as core moulding machines, hot forging presses, aluminum melting furnaces, sand blasting machines; metal sheet stamping and auxiliary machines, including diemaking and maintenance equipment, flattening, blanking and other machines for bodymaking operations and diesinking; machines for mechanical operations, such as transfer lines, boring, grinding, broaching machines, multispindle lathes, gearcutting machines for cylindrical gears; parts and components for various plant installations, such as electroplating, painting, etc.

At this time, we are still uncertain the extent to which FIAT purchases of machine tools from U.S. European subsidiaries or licensees might be in addition to or part of the $30 to $50 million in direct purchases from machine tool firms in the United States.

As to the question of the number of tools that would require clearance under CoCom restrictions, in the February letter FIAT had this to say:

> An itemized analysis of the situation with respect to machines requiring CoCom clearance for export to the Soviet Union can be done only after the appropriate Soviet agencies will have decided which machines they actually want to buy from Western sources.
>
> In due course, FIAT will make arrangements with the involved suppliers for the export clearance applications to be submitted through the respective government channels. It is believed, anyway, that there will be very few equipment items to be so cleared.
>
> Tentatively, on the basis of the International Lists dated September 9, 1966, it is expected that the problem will be limited to the following items:
>
> A few numerically controlled machines for body diesinking and similar manufacturing fixtures, and numerically controlled profile checking equipment; diodes, transistors and electrolytic condensers permanently incorporated in control circuitry of a number of different machine tools; dressing diamonds and diamond lined grinding wheels fitted on some grinding machines.

The Soviet Automobile Program

In conducting a study such as this it is always advantageous for members of the legislative branch to have, to the maximum extent possible, full knowledge of all aspects of the matter under study. We were pleased, therefore, that the Central Intelligence Agency released to us prior to our trip its analysis of present and future prospects for Soviet automotive capabilities and goals.

In view of what we learned it would be tempting, though foolish, to jump to the conclusion that the FIAT-Soviet auto plant deal or any other recent developments signal an abrupt change in Soviet economic goals. As we mentioned earlier in this report, however, we would not underestimate the impact of installation of an auto assembly plant which by itself is capable of quadrupling current Soviet passenger automobile production.

When it was decided that the matter before us warranted a report to Congress, we requested CIA to release its study for inclusion in this report. We would not have done so had we not been convinced that our conversations with FIAT, IMI, and Soviet officials underscored the accuracy of many of the conclusions and forecasts reached in this Directorate of Intelligence study.

We appreciate the cooperation of the CIA in making available the following:

CIA/RR ER 66-13
JULY 1966

INTELLIGENCE REPORT

USSR: ABOUT TO ENTER THE AUTOMOTIVE AGE?

DIRECTORATE OF INTELLIGENCE

USSR: ABOUT TO ENTER THE AUTOMOTIVE AGE?

SUMMARY

The widely publicized Soviet decision to boost production of automobiles* brings the USSR one step nearer the automotive age. However, announced plans are not so grandiose as to require a significant alteration in traditional Soviet economic priorities, and would leave military and space programs unimpaired. Even with the usual slippage in Soviet construction plans, output of automobiles probably could accelerate to 460,000 by 1970 and to 1.1 million by 1975. This would provide the Soviet Union with an automobile stock roughly equal to that of the United States in 1917, and, on a per capita basis, about 5 percent of the current US inventory. Perspective can be gained by projecting Soviet per capita availabilities to 1975 and comparing them with the inventories that already exist in Western European countries; in each case, the Soviet expectation is a small fraction of the realized Western level.

Essentially, the new Soviet program is designed to produce automobiles for the bureaucratic and managerial elite, not for the average citizen. By the early 1970's, perhaps half of the automobiles produced will be available for public purchase, rather than for government use. It seems certain that, within the next decade at least, the Soviet leadership not only has no plans to mass produce automobiles in imitation of the West, but would strenuously resist internal pressure to do so. Although the USSR may some day join the circle of nations that provide automobiles for the average citizen, that day is not now in sight.

Direct investment needed to fill the present Soviet program will be about $1.2 billion,** of which $800 million is planned for the construction of a Fiat automobile plant in the USSR. The French firm of Renault may play a role in reconstructing the present Moskvich plant; other facilities will be expanded by the USSR itself. Through 1970,

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* The term *automobile* as used throughout this report refers to passenger automobiles; the term *motor vehicles* includes not only automobiles but also trucks and buses.

** Expressed in current US dollars, unless otherwise indicated.

the investment will represent less than ½ of 1 percent of all Soviet investment in industry and 4 to 5 percent of machine building investment. Even these data overstate the burden, for repayment on the Fiat contract will stretch well into the 1970's.

Indirect investment required for the supporting facilities for the production of steel, gasoline, and tires has not been fully calculated, but appears to be on the order of $400 million—substantially less than the direct investment.

So-called tertiary investment—in highways, gasoline stations and service facilities, motels, and the like—also needs to be added to the bill. An examination of Soviet plans for highway development during the next five years reveals that these call for only a modest increase over the previous five years—about 20 percent in terms of kilometers, or an expenditure of about $1.2 billion a year. Road density in the USSR by 1975 will be considerably below that of most Western European countries and the United States. Furthermore, Western experience demonstrates that for several decades after a country begins the acceleration of automobile production, the tempo of supporting investments increases only slowly. Not until there is a large, widely distributed stock of automobiles does a rapid acceleration take place.

Some amelioration in the Spartan level of service and maintenance facilities will be needed. At present, there are only eight gasoline stations and eight garages in Moscow. If the Soviet regime increases the number of such facilities at the same rate as in the past, the cost by 1975 would be about $175 million. The lack of adequate maintenance facilities is reflected in the fact that approximately one-fifth of the automobiles in the Soviet motor inventory are normally out of service, awaiting repairs.

I. Plans and Feasibility

For production of automobiles, the Soviet five-year plan (1966-70) implies an average annual rate of increase of 28 to 32 percent in contrast to the rate of 7.7 percent achieved during the past five years (1961-65). For the first time, a Soviet plan calls for a greater output of automobiles than trucks, as shown in the following tabulation.

	Production (Thousand Units)	
	1965	1970 Plan
Automobiles	201.2	700 to 800
Trucks	379.6	600 to 650
Buses	35.6	60
Total	*616.4*	*1,360 to 1,510*

Although the USSR appears ready to commit more investment to the automobile branch of the motor vehicle industry, it seems unlikely that the 1970 goal of 700,000 to 800,000 automobiles will be reached before 1972 (see Table 1).

The plant to be built in the USSR by the Fiat company will be capable of producing 600,000 automobiles a year when operating at capacity and will be the single most important source of increased production of automobiles. (For the schedule of the Fiat plant, see the chart, Figure 1.) Other significant output increases could come from a planned modernization of the Moskvich automobile plant in Moscow, from a new automobile plant at Izhevsk that is to begin

Table 1

Estimated Production of Automobiles in the USSR [a]
1966-75

Thousand Units

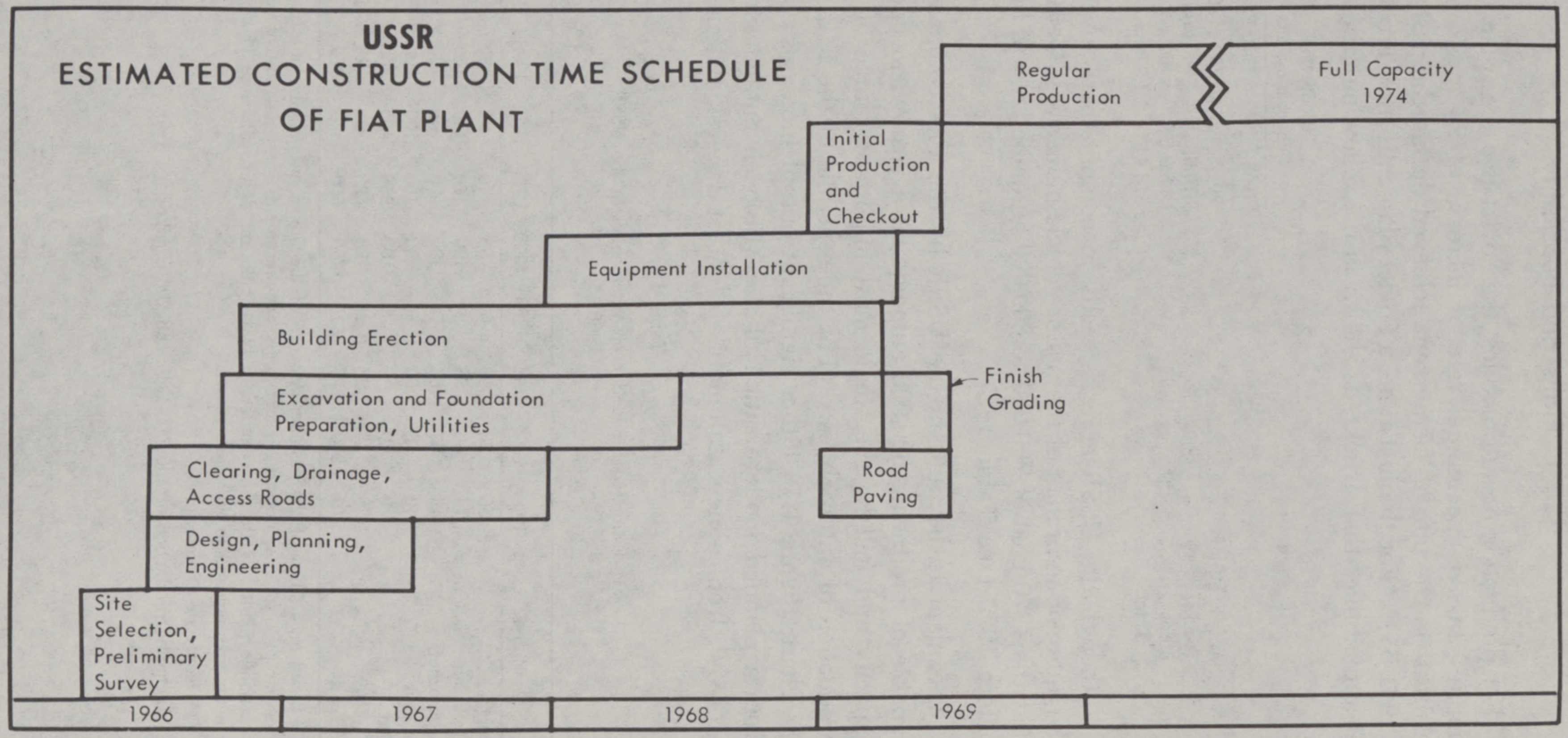
Model	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
Volga	56	58	60	63	66	70	75	80	85	90
Moskvich	74	83	88	90	100	120	140	160	180	200
Zaporozhets	48	57	67	76	84	90	95	100	100	100
Izhevsk	0	8	30	50	80	100	100	100	100	100
Fiat	0	0	0	5	100	250	400	500	600	600
GAZ 69 [b]	28	28	28	28	28	28	28	28	28	28
Total [c]	*210*	*230*	*270*	*310*	*460*	*660*	*840*	*970*	*1,100*	*1,100*

[a] Based on a study of the past performance of the Soviet automobile industry, the current five-year plan for the industry, recent press announcements, and a study of the individual automobile plants. Data are rounded to two significant digits. Because of rounding, components may not add to the totals shown.

[b] A jeep type of vehicle.

[c] Including production of 100 ZIL-111's and 200 Chaika's per year.

Figure 1


USSR
ESTIMATED CONSTRUCTION TIME SCHEDULE
OF FIAT PLANT
Regular Production
Full Capacity 1974
Initial Production and Checkout
Equipment Installation
Building Erection
Finish Grading
Excavation and Foundation Preparation, Utilities
Clearing, Drainage, Access Roads
Road Paving
Design, Planning, Engineering
Site Selection, Preliminary Survey
1966
1967
1968
1969

production of the Moskvich 408 later this year, and from the planned modernization of the Gor'kiy motor vehicle plant.

There are several reasons for estimating that the USSR will not achieve its 1970 goal for automobile production. It is well documented that Western builders experience long delays when working in the Soviet bureaucratic and technical environment. The Fiat plant is not expected to be completed until mid-1969 and will probably not be producing at capacity until 1974. In addition, the modernization and expansion of present automobile plants and the start of production at Izhevsk is not likely to move with the speed necessary to achieve the 1970 goal—Soviet planners have always been slow in starting new production. Finally, extensive renovation of the Moskvich plant will cause protracted disruptions in production.

II. The Automobile in Soviet Society

The USSR has only a toehold in the automotive age. Steady increases in Soviet automobile production in the last decade boosted output to 201,200 units in 1965, but judged in relation to demand in the USSR as well as production in other industrially advanced countries, such a level of output is minuscule. The production and inventory of automobiles in the USSR in comparison to other selected countries is shown in Table 2. (For models of Soviet automobiles, see Figure 2.)

The small size of the automobile industry in the USSR is clearly the result of calculated neglect by Soviet policymakers, both under Stalin and later under Khrushchev. Indeed, Khrushchev was fond of pointing out that the mass production and distribution of automobiles was a "weakness" of capitalism which the USSR had no intention of emulating. Instead, he advocated the establishment of rental-car services in the major cities—a policy that has worked very poorly in the few cases where it has been tried.

Khrushchev's attitude undoubtedly stemmed in large part from a conviction that the USSR could not afford to provide its people with automobiles if it was to meet priority commitments in the development of heavy industry, military weaponry, and space technology. Noneconomic explanations for this neglect were probably equally im-

Table 2

Production and Stock of Automobiles in Selected Countries
1964

	Production	Stock of Automobiles [a]	Automobiles per Million Population [b]
Argentina	114,617	800,000	36,400
Australia	340,614	2,599,000	234,000
Belgium	327,899	201,000	21,400
Canada	560,678	5,122,000	265,000
France	1,390,312	7,960,000	164,000
Italy	1,028,930	4,632,000	90,600
Japan	579,660	1,672,000	17,300
South Africa	143,373	1,023,000	58,500
Spain	119,000	652,000	20,800
Sweden	160,106	1,666,000	217,000
United Kingdom	1,867,640	8,436,000	156,000
United States	7,745,492	71,950,000	375,000
USSR	185,200	919,000	4,000
West Germany	2,650,183	8,100,000	144,000

[a] Based on automobile registrations, except for Soviet data, which are estimated.

[b] Based on midyear population.

MODELS OF SOVIET AUTOMOBILES

Figure 2

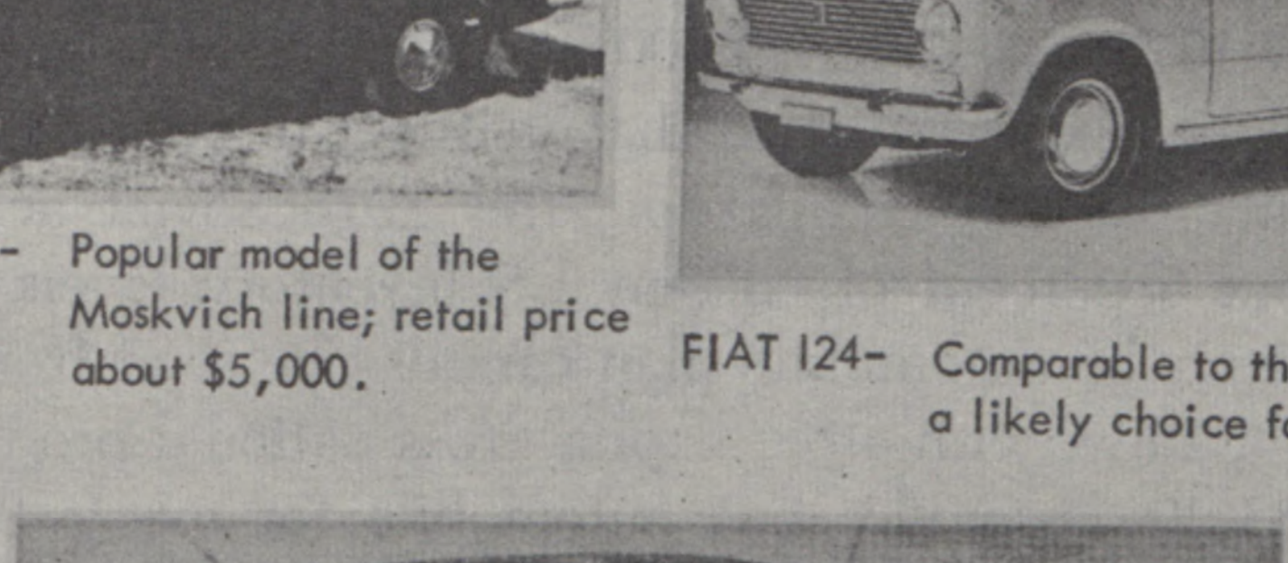
VOLGA- Largest car available to the public; retail price $6,000 plus.

ZAPOROZHETS- Smallest and most unpopular Soviet car; retail price about $1,500.

MOSKVICH 408- Popular model of the Moskvich line; retail price about $5,000.

FIAT 124- Comparable to the Moskvich 408; a likely choice for the Fiat plant.

ZIL III



CHAIKA

Prestigious models produced in limited quantities exclusively for the Soviet elite; no quoted prices.

portant to Khrushchev—for example, the problems of political control and the potential dangers of sociological changes that have been considered anathema to the Communist leadership.

Kosygin's views on the automobile are not revolutionary but suggest some catering to the bureaucratic elite and to the aspirations of Soviet consumers in the upper middle class. This does not mean a program that will lead to an automobile for every Soviet family. Kosygin's speech to a meeting of the State Planning Committee on 19 March 1965 is the most complete statement thus far issued from Moscow on the reasons behind the plan to boost automobile production:

> You know how staunchly the idea was imposed that there was no necessity in our country to develop the production of passenger automobiles on a large scale. Let all people ride only in buses, so to speak. Everything has been done to deprive even the leaders of big enterprises and economic organizations of the right to use passenger cars. Is this correct? The result has been that many leaders have been compelled to use trucks unlawfully for their official rides. An apparent saving was made on transport costs, but in fact damage was inflicted on our economy.

The plans thus far released by the Soviet leader appear to confirm the viewpoint implicit in this quotation. In 1965 there were 4,350 automobiles per million population; it is estimated that there will be about 7,000 by 1970 and about 17,000 by 1975. The Soviet inventory in 1975 would be about equal to that in the United States in 1917. On a per capita basis of comparison, this 1975 Soviet achievement would be about 5 percent of current US inventory levels. The restricted nature of the automobile plan can also be seen from the fact that, at present, Italy, with a per capita gross national product (GNP) of less than $1,200, provides one automobile for every 10 persons. In comparison, by 1975 the USSR, even with a projected per capita GNP of $1,900, will provide only one car for every 60 persons.

III. Automobiles on the Road, 1966-75

At present, the Soviet inventory of automobiles, publicly and privately owned, is estimated to be about 1 million automobiles (see Table 3). By 1970, the inventory probably will be 1.7 million. Despite the planned increase in numbers of automobiles by 1975, few Soviet citizens will have their own. A large share of total production per year will continue to go for official use—that is, publicly owned cars operated by administrative personnel, factory managers, the military, and taxi services (see Table 4). Approximately one-fifth of the inventory is normally out of service, awaiting repairs.

Table 3

Estimated Stock of Automobiles in the USSR [a]
1966-75

Thousand Units

	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
Starting inventory	1,000	1,100	1,200	1,300	1,400	1,700	2,100	2,500	3,100	3,700
Production	210	230	270	310	460	660	840	970	1,100	1,100
Exports [b]	47	54	63	72	110	150	190	220	250	260
Imports [c]	2	2	2	2	2	2	2	2	2	2
Scrappage [d]	80	87	94	100	110	130	160	200	250	290
Year-end inventory	1,100	1,200	1,300	1,400	1,700	2,100	2,500	3,100	3,700	4,200

[a] Data are rounded to two significant digits. Because of rounding, components may not agree with the totals shown.

[b] Assumed to be constant at 23 percent of production—the same level as 1961-64.

[c] Assumed to be constant at 2,000 units.

[d] Assumed to be constant at 8 percent of the starting inventory.

Table 4

Estimated Number of Newly Produced Automobiles
Available for Private Use in the USSR [a]
1966-75

Thousand Units

	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
Production	210	230	270	310	460	660	840	970	1,100	1,100
Exports [b]	47	54	63	72	110	150	190	220	250	260
Imports [c]	2	2	2	2	2	2	2	2	2	2
Official and commercial use	77	87	100	120	160	200	230	240	240	210
Private use [d]	84	95	110	130	200	310	410	510	610	660

[a] Data are rounded to two significant digits. Because of rounding, components may not agree with the totals shown.

[b] Assumed to be constant at 23 percent of production—the same level as 1961-64.

[c] Assumed to be constant at 2,000 units.

[d] For 1966-69, the number of automobiles available is assumed to be constant at 52 percent of the figure arrived at when exports and imports are netted out of production. After 1969 the percent of net production increases by 4 percentage points per year, reflecting a larger share of automobiles available to the public.

IV. Primary Investment

If the USSR is to produce 1.1 million automobiles annually by 1975 (see Table 1), approximately $1.2 billion will have to be invested in plant buildings, equipment, and direct manufacturing support facilities. The following tabulation presents estimates of the investment needed to modernize and increase the output of the existing plants as well as to build the two new plants proposed by Soviet planners:

Plant	Production (Thousand Units)		Investment Required (Million US $)
	1966	1975	
Gor'kiy	56.0	90	44
MZMA	74.0	200	190
Zaporozh'ye	48.0	100	78
Izhevsk (to be built)	0.1	100	130
Fiat [a] (to be built)	0	600	800
Total			*1,242*

[a] Tol'yatti, formerly Stavropol', on the Volga.

Approximately $900 million of the $1.2 billion total investment will have to be spent prior to 1970 if the estimated levels of production are to be attained by 1975. The $900 million is about 0.5 percent of expected total Soviet investment in industry and 4 to 5 percent of total investment in machine building for 1966-70. The USSR is capable of allocating this small share of total new investment funds to the automobile industry without resorting to any significant shifts in present investment allocation plans, including those for the military or space program. The financial burden on the USSR is eased by the extended repayment terms of the Fiat agreement—terms of nine years following completion date.

Most of the total investment of $1.2 billion needed by 1975 will go into the proposed Fiat plant. An official of a large US automobile company estimates that the total cost of direct manufacturing equipment and buildings in such a plant would be $522 million. With supporting facilities, the total cost would probably be within the range of the $700 million to $800 million estimated by Fiat. Although the details of the project have not yet been finally settled, a breakdown of estimated costs of the Fiat plant and the degree of Italian, Western European, and US participation is shown in Table 5 (for the costs of specific parts of the plant, see the Appendix).

The total cost to the USSR of a fully operating automobile plant to produce 600,000 cars per year will exceed $800 million. Training

expenses will be considerable for the 30,000 to 40,000 employees needed to operate the facility. Unless the major new plant is erected in a large city, dwellings, schools, and other facilities will have to be built. In addition, smaller investments will be required in industries supplying raw materials and semimanufactured goods directly to the automobile industry as well as in those industries supplying goods and services to automobile users.

The details of other Soviet plans to modernize and expand existing plants and to construct other new plants for the automobile industry have not yet been fully disclosed. Renault of France may sign an agreement to enlarge the dilapidated and outmoded Moskvich plant. Expanding this plant to a capacity of 200,000 automobiles per year would be tantamount to building a new plant and would cost approximately $190 million. Renault might follow its previous practice in dealing with Communist countries and reduce costs by supplying used equipment from its French plants.

In addition, the USSR is preparing to start production of Moskvich automobiles in Izhevsk in the western Urals. This plant will require an additional investment of about $130 million before the proposed capacity of 100,000 units can be reached. The USSR probably will also increase automobile production in its Gor'kiy and Zaporozh'ye facilities by a total of about 86,000 units per year between 1966 and 1975, requiring about $122 million more in new investment.

Table 5

Soviet, Italian, Western European, and US Participation in the Estimated Costs of the Fiat Plant to be Constructed in the USSR

		Million US $
Building (all to be supplied by the USSR)		167
Machinery and equipment		355
Supplied by Fiat from Italian, Western European, and US sources	255	
Supplied by the USSR	100[a]	
Other supporting facilities[b]		278
Supplied by Fiat	65	
Supplied by the USSR	213	
Total cost of Fiat plant		800
Total supplied by the USSR	480	
Total supplied by non-Soviet sources	320[c]	
Italy	195 to 235[d]	
Other Western European	40 to 90	
United States	30 to 50	

[a] Some commentators have suggested that the USSR would supply no equipment. It is most unlikely, however, that the USSR, with the world's largest machine tool industry, would not participate in equipping such a plant.

[b] Other supporting facilities include costs of external transportation connections; Fiat-supplied training, engineering, plant layout, and powerplant; and plants for paint, gaskets, nuts, bolts, radiators, and other assorted hardware.

[c] Midpoint of the range.

[d] Including an engineering fee of $65 million.

V. Secondary Investment

A. INTRODUCTION

The production of from 7 million to 9 million automobiles annually in the United States affects virtually every branch of US industry. One out of every seven wage earners is connected with some phase of the automobile world. One out of every six businesses in the United States depends on the manufacture, distribution and servicing, or use of motor vehicles. Automobile, truck, and bus production in the United States in 1963 accounted for the following shares of various materials:

Material	Percent of Domestic Production
Domestically consumed steel	23
Cold rolled sheet and strip	46
Gray iron castings	19
Malleable castings	57
Natural rubber	65
Synthetic rubber	60
Nickel	14
Zinc	35

The automotive support industries—fuel, accessories, and the like—have grown rapidly in the United States and now almost equal one-half of the value of retail sales of new automobiles, as shown in the following tabulation:

	Million US $
Automobiles	46,000
Tires, batteries, and accessories	2,900
Gasoline, repair, and maintenance	20,000
Total	*68,900*

In the USSR, in contrast, automobile production has little impact on industrial production. In 1959, total production of motor vehicles (automobiles, trucks, and buses) used less than 4 percent of the gross value of the output of ferrous metals. The share of inputs consumed by the motor vehicle industry in 1959 is shown in the following tabulation:

Material	Percent of Gross Output
Ferrous metals	3.4
Nonferrous metals	3.8
Metal products (nuts, bolts, and the like)	3.8
Glass	1.6
Bearings	11.1
Tools and instruments	1.2
Electrotechnical (generators, electric motors, batteries, and the like)	1.0

B. FERROUS METALS REQUIREMENTS

In view of planned increases in iron and steel production, automobile production will not significantly increase its claim on total Soviet output of ferrous metals through 1975 (see Table 6). The Soviet metallurgical industry, however, will have some problems in producing steel products according to specifications in all the required shapes and grades. The metallurgical industry must supply the automotive industry with substantially increased quantities of cold rolled sheet, bars, pipe and tubing, various shapes or profiles, plates, cold finished bars, and tubes.

Table 6

Production of Selected Ferrous Metals and the Share Required for Production of Automobiles in the USSR [a]
1965, 1970, and 1975

	1965		1970		1975	
	Ferrous Metal Production (Million Metric Tons)	Share Required for Automobile Production (Percent)	Ferrous Metal Production (Million Metric Tons)	Share Required for Automobile Production (Percent)	Ferrous Metal Production (Million Metric Tons)	Share Required for Automobile Production (Percent)
Castings	16.5	0.2	24	0.4	31	0.8
Gray iron and malleable	12.6	0.2	17	0.4	22	0.8
Steel	3.8	0.02	6	0.03	9	0.05
Rolled steel	70.9	0.3	97 [b]	0.5	125	0.9
Cold rolled sheet	3.6	3.3	7	4.5	12	6.7

[a] Excluding production of spare parts. Because of rounding, components may not add to the totals shown.

[b] Midpoint of the range of 95 million to 99 million tons.

The USSR has encountered particular difficulty in expanding the output of cold finished steel products. Soviet production of 3.6 million tons* of cold rolled sheet in 1965 was far less than the target figure of 6.5 million tons. Because of the lag in the production of cold rolled steel, the USSR has been negotiating since mid-1965 with manufacturers of metallurgical equipment in several Western countries to buy a cold rolled sheet plant. One possible transaction, estimated at about $190 million,** calls for the annual production of 600,000 to 800,000 tons of cold rolled steel—enough steel for 1 million automobiles and several million washing machines and refrigerators. Such a plant would increase Soviet production of cold rolled steel by 17 to

* Tonnages are given in metric tons.

** Including the cost of equipment to roll tin plate and galvanized sheet and estimated building costs.

22 percent. The USSR has manufactured several continuous cold rolling mills, but the mills are much less advanced technologically than those available in the industrial West. The USSR recognizes that Western builders could supply a technologically superior cold rolling mill at less cost and with less delay than could Soviet industry.

C. MACHINE TOOLS

The need of the Soviet automobile industry for dependable high-performance specialized machinery is a key reason why the USSR has turned to the industrial West to equip its new plant. Soviet machine tool builders have always emphasized long production runs of general-purpose machine tools that are often used instead of more expensive specialized machine tools in Soviet industry. Consequently, the USSR has inadequate capacity for manufacturing complex, specialized, and highly precise machine tools. In addition, the USSR recognizes the absolute cost and quality advantages that the industrial West has in the production of automotive machine tools. The USSR, however, can be expected to produce domestically most of the required equipment of a nonspecialized nature for its expanding automobile industry.

As more automobiles are produced, specialized machinery will be needed for continuing new investment, replacement, and automotive support industries, and, therefore, it will become more profitable for the USSR to produce domestically more of the specialized equipment required by its automobile industry. Thus expanded automobile output probably will have a greater effect on the Soviet machine tool industry after 1970.

D. TIRES

The new five-year plan for tire production in the USSR calls for a production increase by 1970 roughly equivalent to the increase achieved in the seven-year period 1959-65. Output of tires (26.4 million in 1965) is scheduled to rise to between 38 million and 40 million by 1970. Automobile tires will probably account for a growing percentage of total tire output—the estimated production for 1966 and 1970 compared with 1960 follows:

	Million Units
1960	2.2
1966	4.0
1970	7.0

At least four new Soviet tire plants are to be built in 1966-70, and a number of existing plants are to be expanded. The capacities of the new plants will be on the order of 2 million to 3 million tires each, although at least some of these plants will not reach full operation until after 1970.

The increase in tire plant capacity will cost about $40 million. Additional supporting investment in carbon black, tire cord, and synthetic rubber production could boost total investment $100 million more for 1966-70.

E. GASOLINE

The additional requirements for motor gasoline through 1975 will place no special burden on the petroleum industry, which by 1975 may be outproducing the United States in crude oil. The industry, however, will have to emphasize more the production of gasoline in the higher octane ranges—72 octane and above. At present, the USSR produces about 5 million tons per year of such gasoline—17 percent of the total gasoline yield. If the production of crude oil continues to grow through 1975 at the rate planned for the next five years, as much as 75 million tons of motor gasoline may be produced in 1975, of which about 37 million tons could be of high octane. By contrast, the additional automobiles that are to be on the road in 1975 (excluding trucks and buses) will need only about 4 million tons per year of high-octane gasoline.

One refinery with a capacity of 12 million tons could produce the required 4 million tons if oriented toward that goal. Such a refinery might cost between $290 million and $360 million, of which no more than $100 million would be assigned to provide the facilities required to produce the high-octane gasoline.

VI. Tertiary Investment

A. USSR

1. Introduction

The USSR will almost certainly have no desire and little need to duplicate in the foreseeable future the heavy tertiary investments that have been fostered by the automobile in Western Europe and the United States. Plans thus far released for the period through 1970 indicate that Moscow has felt under no compulsion to accelerate basic highway construction, much less construction of service stations and motels. Soviet planners have long believed that a well-developed railroad system best suited the USSR's needs for hauling freight. Almost all large industrial plants in the USSR are served by railroad sidings that provide door-to-door rail service. Trucks have been used in the USSR primarily for short-haul intracity shipments, and no change in this pattern is discernible.

2. Highways

As a result of the emphasis on railroads and the vast size of the country, only a rudimentary highway network exists in the USSR. Of 1,340,000 kilometers of roads in 1964, only about 350,000 kilometers, or about one-fourth, was surfaced in any way, and less than 120,000 kilometers, about 9 percent, was paved with concrete or asphalt. The length of paved roads in the USSR about equals the paved highway system in the state of Michigan. The historic backwardness of the Soviet highway system is illustrated in Table 7, which compares the length of Soviet and US highways for selected years.

During 1960-64 about 20,100 kilometers of surfaced highways, including 10,600 kilometers of paved highways, were built annually in the USSR. By contrast, the United States built over 32,000 kilometers of major (Federally-aided) highways in 1964.

As shown in Figure 3, Soviet highway construction has not accelerated in recent years, and no dramatic changes are expected in the expansion of the Soviet highway network during 1966-70. The new five-year plan (1966-70) calls for the construction of 63,000 kilometers of paved roads, an increase of about 20 percent over the length of roads constructed in the five-year period 1960-64. There will be some increased emphasis on construction and reconstruction of badly

Table 7

Length of Highways in the USSR and the United States
1940, 1950, and 1960-64

	USSR [a]				United States [b]		
	Thousand Kilometers				Thousand Kilometers		
		Surfaced [c]					
	Total [d]	Total	Paved	Percent Surfaced	Total	Surfaced	Percent Surfaced
1940	1,531	143	7	9	4,855	2,200	45
1950	1,550	177	19	11	5,322	3,121	59
1960	1,366	271	77	20	5,707	4,147	73
1961	1,336	290	87	22	5,750	4,165	72
1962	1,336	311	97	23	5,794	4,260	74
1963	1,332	330	108	25	5,826	4,334	74
1964	1,340	352	118	26	5,864	4,394	75

[a] Public roads under jurisdiction of highway departments.
[b] Rural, state, municipal, and county roads.
[c] Including gravel surfaced roads.
[d] The reduction in the total is due to decreased importance of some dirt roads.

needed rural (farm-to-market and railhead) roads. Some important intercity highways will be completed or improved during 1966-70, including the Moscow-Bryansk-Kiev highway, the Moscow-Tambov-Volgograd highway, and the Moscow-Kuybyshev-Ufa highway. Most of Central Siberia and the Far East, except for short stretches in the vicinity of the major population centers, will remain completely without a system of paved roads.

Despite the secondary importance of highways in the USSR, the vastness of the country, combined with the past neglect of the highway system, means that significant investment allocations are required even for a fairly minimal expansion effort. This conclusion is supported by the following estimates of the annual cost of new construction in the USSR for 1966-70:

	Annual Cost (Million US $)
Paved	840
Other hard surfaced highways	400
Total	*1,240*

By contrast the United States awarded $5.04 billion in contracts for new highway construction in 1965, and contracts for 1966 will total approximately $6 billion.

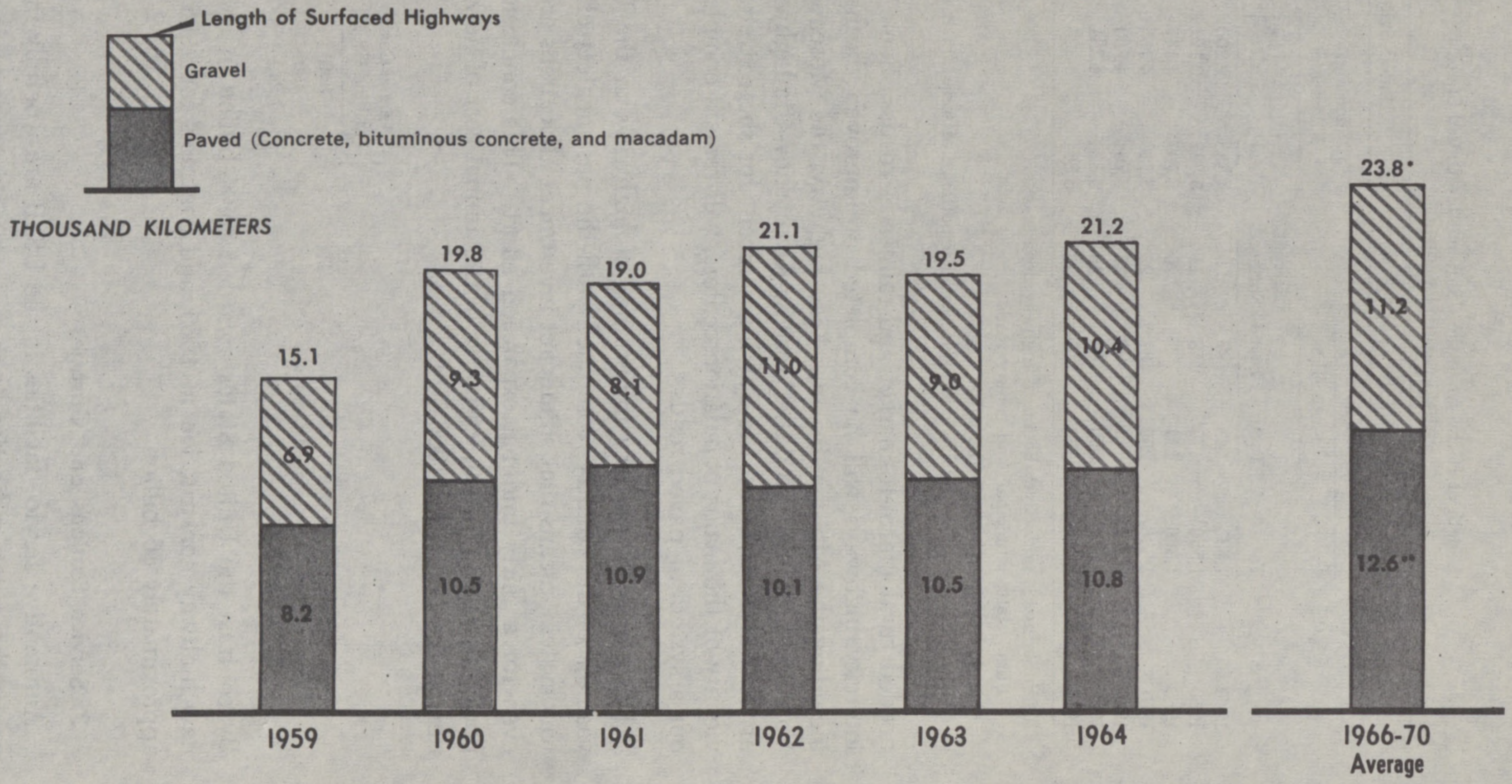
3. Service Stations and Garages

Automotive service facilities in the USSR are woefully inadequate, nor is there any indication that the regime intends to improve this situation in the immediate years ahead. In Moscow there are eight

Figure 3

USSR: CONSTRUCTION OF SURFACED HIGHWAYS

1959-64 and 1966-70 Average



*Estimated on the basis of the past relationship between surfaced roads and paved roads (1959-64 average).

**Planned

gasoline stations and eight garages, only three of which service all makes of Soviet automobiles. In Leningrad there are three gasoline stations and only one garage. Outside the major cities, service stations and garages are even harder to find, as shown in the tabulation below:

Route	Distance (Kilometers)	Gasoline Stations	Garages
Moscow-Minsk	705	5	1
Moscow-Leningrad	724	5	2
Moscow-Khar'kov	734	7	2
Moscow-Gor'kiy	995	3	0
Khar'kov-Kiev	478	3	1
Moscow-Kalinin	161	0	0

In contrast to the 211,000 gasoline stations in the United States, which perform necessary economic functions, especially with respect to maintenance and repair, the total number of stations in the USSR in 1963 was 1,500 to 1,600. If the present ratio of automobiles to filling stations is maintained, during 1966-75 the USSR would have to build additional filling stations,* as indicated in the following tabulation:

		Thousand US $	
	Number	Equipment Cost	Total Cost
1966-70	1,300	6,500	22,100
1971-75	4,800	24,000	81,600
Total	*6,100*	*30,500*	*103,700*

The USSR has not announced any plans for expanding repair facilities, but some indication that the plans are quite modest in scope was suggested by a recent news item in a Moscow newspaper which stated that during the next five years two service facilities, each capable of handling 12,000 vehicles annually, will be built. In addition, an unspecified number of other repair facilities will be built, with a total capacity of only 72,000 vehicles annually. The following tabulation gives estimates of the additional number of garages likely to be built in the next 10 years**:

		Thousand US $	
	Number	Equipment Cost	Total Cost
1966-70	430	4,300	15,000
1971-75	1,600	16,000	56,000
Total	*2,030*	*20,300*	*71,000*

* Estimated from the ratio of automobiles in use (844,100) to service stations (between 1,500 and 1,600) in 1963.

** Estimated from the ratio (1 to 3) of garages to service stations in the USSR in 1962.

4. Social Considerations

Apart from these strictly economic considerations there are other reasons for expecting the Soviet regime to move cautiously in encouraging investments that would promote the expanded use of automobiles beyond the city limits. For example, the USSR is one of the most security conscious nations in the world and the movements of its citizens are carefully monitored through a system of police registrations. The regime probably would not be willing to accept the economic and political costs of expanding such a system to manage the major increase in mobility that would certainly follow an unrestricted expansion of the facilities for long-distance travel. No matter how appealing the prospect of suburban and rural living is to the Soviet urbanite, presently confined to an inadequate city apartment, the regime may be expected to resist a proliferation of private rural housing as both costly and poorly suited to the Soviet conception of the social needs of its citizens.

B. THE EXPERIENCE OF THE UNITED STATES AND WESTERN EUROPE

1. The United States

The Soviet planner, even though intellectually committed to increasing the importance of the automobile in the USSR, must look with considerable trepidation at data that show how the US economy was revamped by mass production and use of the automobile. After the United States took to wheels, there was a vast inner migration which led to modern multilaned highways, vast suburbs, and more and more consumer durables. To support 82 million motor vehicles (69 million automobiles and 13 million trucks and buses) in 1963, the United States had the following:

	Number	Sales (Billion US $)
Automotive wholesalers [a]	22,883	6.7
Franchised automobile dealers	33,349	37.4
Automotive repair	114,459	3.6
Gasoline service stations	211,473	17.7

[a] A wholesale distributor of automobile parts—from tires to engine blocks.

It should be borne in mind, however, that the enormous investment in superhighways and sprawling suburbs in the United States today was not a feature of the US automotive history during 1910-20—the time period most analogous to the present Soviet position (Phase A in Figure 4). The mass-production age of automobiles began in the United States in about 1910 (181,000 automobiles were produced during that year). By 1912 the stock of automobiles totaled close to

a million, about the same as the Soviet inventory today. By 1917 the US stock had grown to 4.7 million automobiles; the USSR probably will need 10 more years to increase its inventory by this amount. In the 1910-20 period the US stock of automobiles increased annually by an average of 33 percent, but total highway expenditures and the total length of surfaced highways increased much more slowly (see Figure 5). Total expenditures on roads increased 9 percent annually and the length of surfaced highways 6 percent.

Highway construction in the United States has long received an impetus from the growing requirements for both passenger and freight traffic. The early urban car owner in the United States was anxious to drive into the countryside, and the farmer pressed for farm-to-market roads. But it was not until about 1946 that the United States, having a stock of nearly 30 million automobiles and having been released from the pressures of war and depression, substantially accelerated tertiary investment and entered the Phase C of the automobile age, as described in Figure 4. The long-run relationship between the stock of automobiles and highway expenditures in the United States is shown in Figure 6.

More specifically, not until 25 years after the United States had left Phase A—the phase that the USSR is just now entering—did the US automotive age finally induce greater increases in service facilities, superhighways, modern motels, supermarkets, shopping plazas, and the mass migration to the suburbs. Although the dispersal of the population from the central city has been underway in the United States since the turn of the century, the major trend toward suburban development has taken place since World War II. In the last decade, more than three-quarters of the new dwelling units, measured by value or number, in the major metropolitan areas were constructed outside the central cities.

2. Western Europe

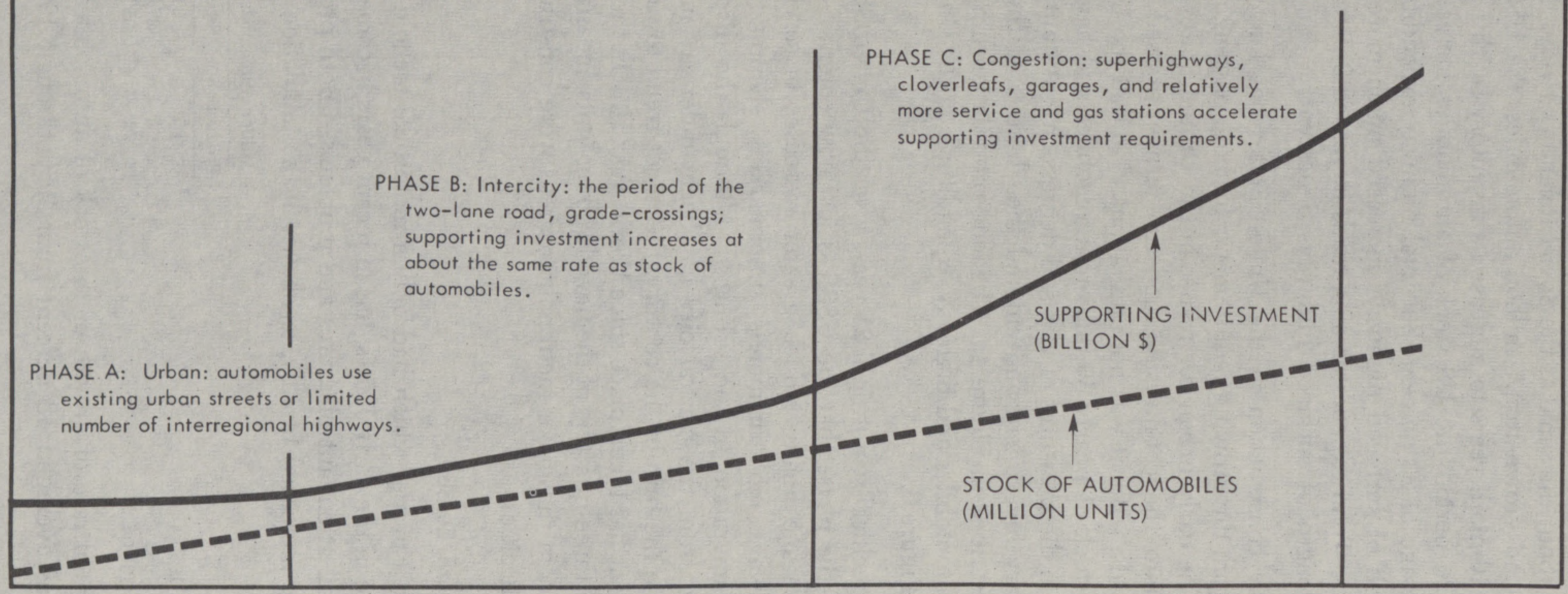
Western Europe, which had only a motorbike toehold in the automotive age in the early 1950's, has in recent years become a full member with all attendant pleasures and problems. Both production and stock have increased rapidly, as shown in the tabulation below:

	Million Automobiles	
	Production	Stock
1950	1.1	6.0
1962	6.7	27.8
1964	7.0	35.1

The annual rate of growth of the stock of automobiles in Western Europe has averaged 13 percent from 1950 through 1964, a higher

Figure 4

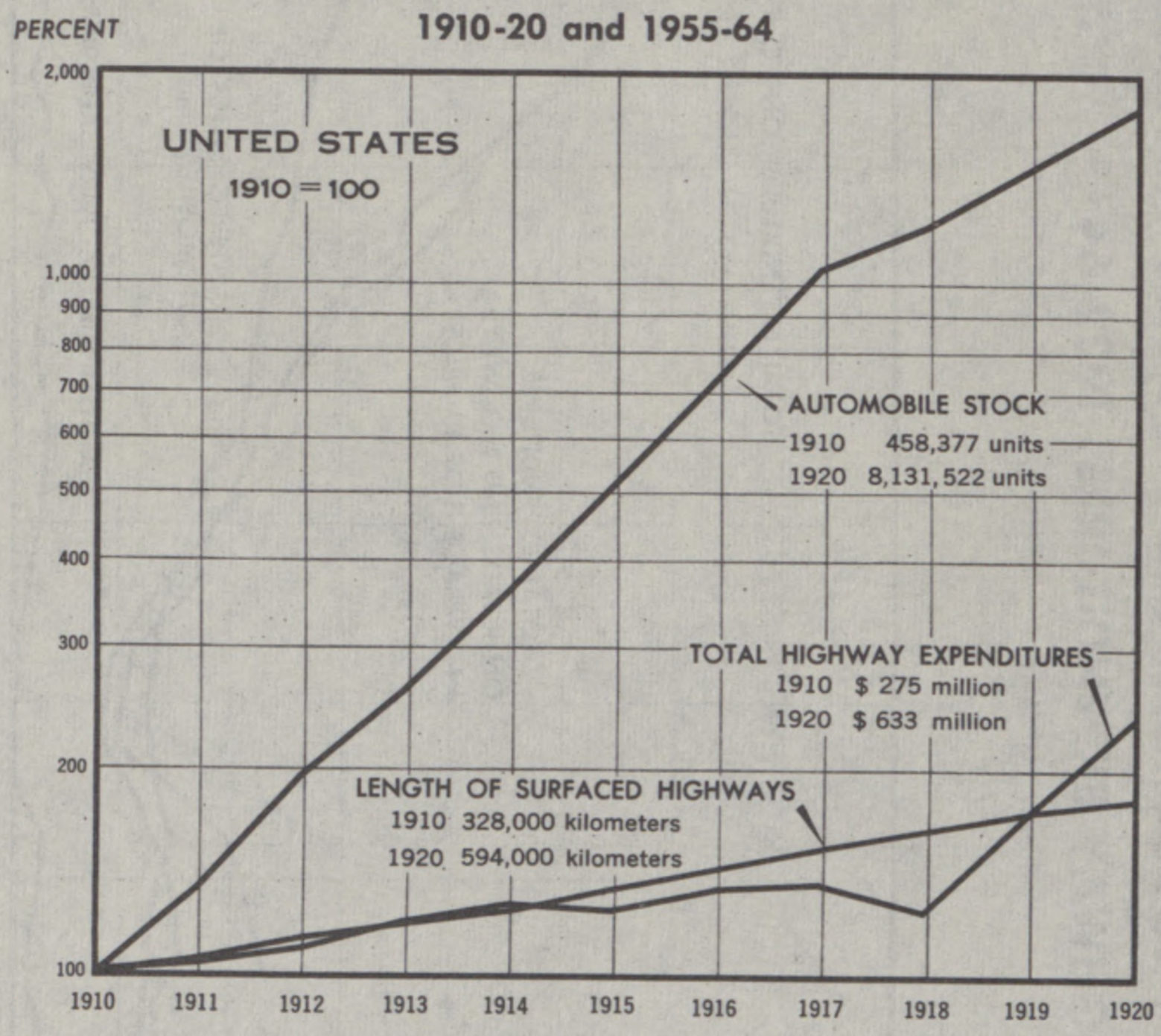
HYPOTHETICAL RELATIONSHIP BETWEEN STOCK OF AUTOMOBILES AND SUPPORTING INVESTMENT



The overall shape of the supporting investment curve will be dependent on the total area and population of the country, its geography, and distribution of automobiles between rural and urban ownership. Present Soviet plans still place the USSR within PHASE A. Western Europe is entering PHASE C. The US as a whole is within PHASE C, but parts of the East Coast of the US are within PHASE D.

Figure 5

UNITED STATES AND WESTERN EUROPE: COMPARATIVE INDEXES OF AUTOMOBILE STOCK AND HIGHWAY EXPENDITURES



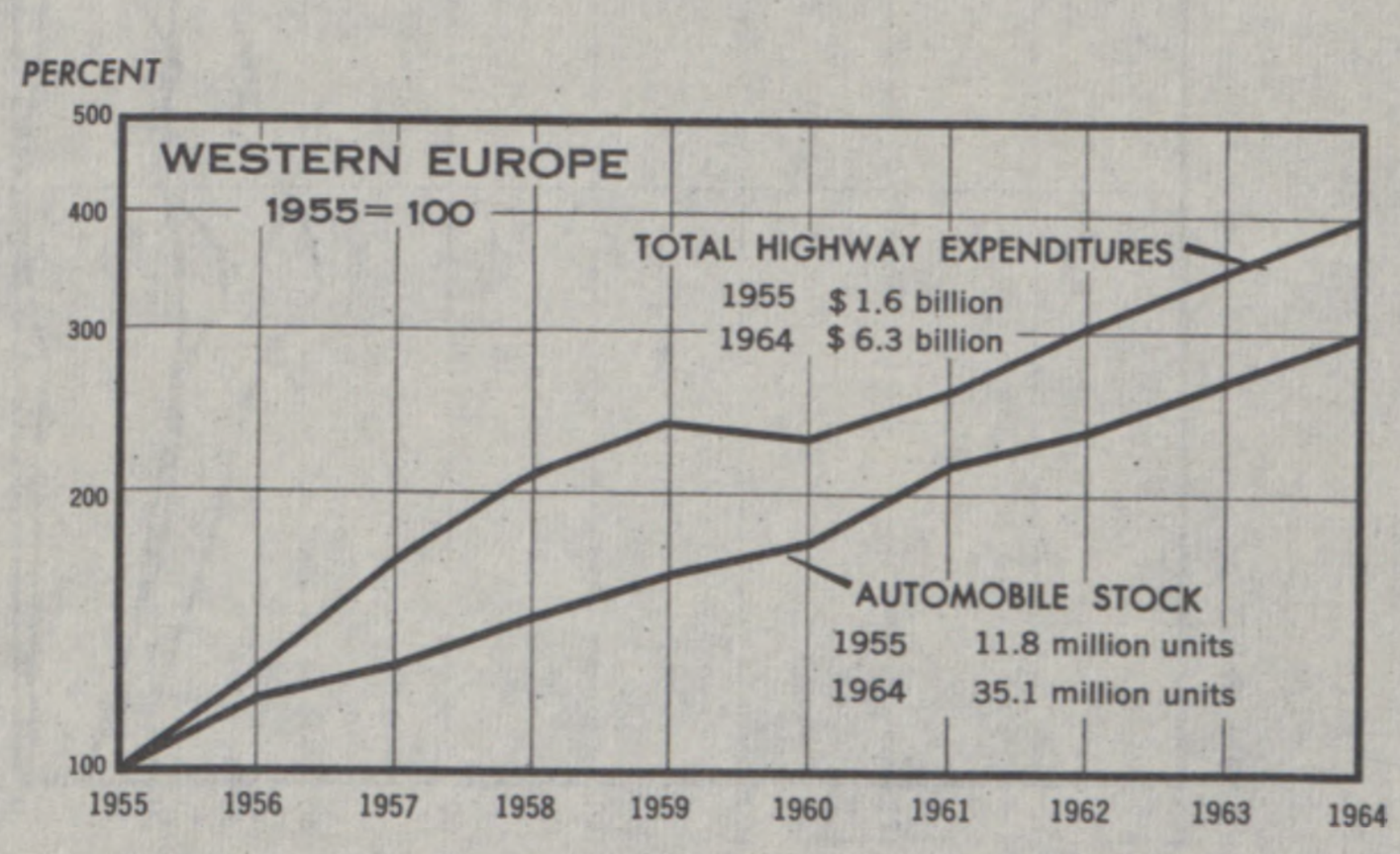
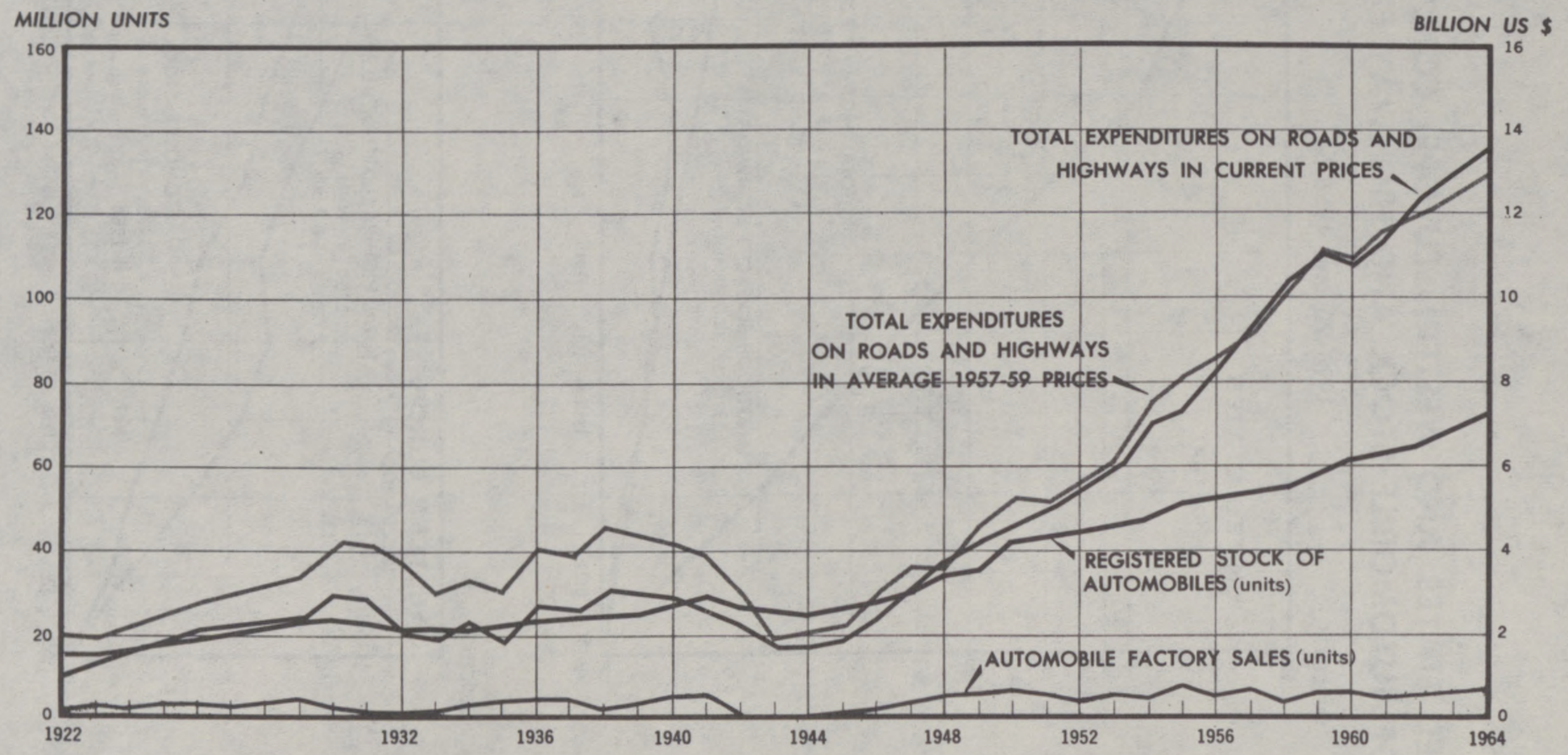


Figure 6

UNITED STATES: ANNUAL PRODUCTION AND STOCK OF AUTOMOBILES AND HIGHWAY EXPENDITURES, 1922-64



growth rate than GNP, which rose at an average annual rate of about 9 percent (in current terms).

In the past decade Western Europe has devoted, as shown in the tabulation below, an increasing share of its resources to the development of roads and highways.

	Total Highway Expenditures (Billion US $)	Percent of GNP
1956	2.0	0.8
1964	6.3	1.4
1970	9.7 [a]	2.0

[a] Estimated by the International Road Federation.

Yet, despite the rapid increase in highway expenditures in Western Europe and the present existence of about 5 million kilometers of roads, the present highway system is considered inadequate for the traffic it must bear. The turnpike or thruway is virtually unknown in Europe outside Germany. In France in 1964 there were only 348 kilometers of such superhighways. The heavy investments in bypasses, freeways, and beltways are yet to be borne by most of the countries of Western Europe. As shown above, Western European highway expenditures as a share of GNP have increased but are still significantly lower than in the United States.*

Western European experience indicates, as does US experience, that a widespread increase in automobile ownership eventually induces large amounts of other tertiary investments. Much of this investment—restaurants, motels, service stations, and shopping centers—caters to the increased mobility given the population by the automobile. Much of the investment in public works—cloverleafs, turnpikes, and freeways—is required when the density of automobile traffic threatens to destroy the very mobility that the automobile has introduced. The United States today is becoming increasingly aware of the major investments and revamping of cities and countrysides that are needed to live with the automobile. Western Europe is well into the automobile age, entering Phase C (see Figures 4 and 5), but has not yet completely faced up to the heavy investments needed to live with the automobile.

Ultimately the Soviet economy may have to pay the costs—the superhighways and underground parking—of enjoying the convenience of the automobile. Western experience, however, shows that it will be decades before the automotive expansion forces the Soviet economy to cater to the induced investment engendered by the automobile rather than the preferences of the hierarchy.

* By contrast, highway expenditures in the United States for the past decade have consistently been about 2.2 percent of GNP.

APPENDIX

ESTIMATED COSTS OF BUILDINGS AND EQUIPMENT OF THE FIAT PLANT

Facility and Types of Equipment	Area (Million Square Feet)	Cost of Building (Million US $)	Cost of Equipment (Million US $)
Press shop: 25 major press lines, 150 small and intermediate press units	0.75	25	50
Subassembly and body construction plant: welding equipment and booths, transformers, fixtures, and the like	1.1	20	20
Assembly plant: conveyors, spray booths, ovens, body phosphate equipment, dynamometers, pneumatic hand tools, and the like	2.1	35	40
Soft trim plant: equipment for cutting and sewing cloth and vinyl	0.5	7.5	7.5
Engine plant: 2 transfer lines each for head and block, 3 transfer lines for crankshaft, 30 camshaft grinders, other single and multipurpose machine tools for pistons, rods, pins, and other engine parts	0.6	17	33
Foundry: all cast parts, 600 tons per day	0.5	10	20
Transmission, drive shaft, front suspension, axle, and steering plant: 2 transfer lines each for transmission case and axle, automatic assembly lines, conveyor lines, washers, degreasers, and automatic machine tools for gears and other parts	1.3	21	44
Wheel and bumper manufacturing and plating plant: two press lines for bumpers, one plating line, and wheel forming presses	0.25	5	11
Glass plant: complete facilities to manufacture automobile window glass—glass furnaces and rolling and cutting equipment	0.5	12	28
Battery plant	0.1	1.5	4.5
Starter, generator, heater, horn, carburetor, distributor, and miscellaneous electric parts plant: general and special-purpose machine tools, heat treatment furnaces, washers, degreasers, paint equipment, and conveyors	0.8	13	27
Special tooling: fixtures, dies, tooling, gauges, and the like—nearly all would have to be replaced at model change			70
Total	*8.5*	*167*	*355*

The FIAT Contract and the Current Economic Scene in the U.S.S.R.

The leaders of the Soviet Union find themselves at present under intense pressure from two sources. They are under pressure, in the first place, from the economically more efficient countries of Western Europe and the other advanced industrial nations. It has come as something of a shock to the doctrine-bound leaders of Russia to find that, despite all their own dire predictions to the contrary, the "capitalist" countries of the outside world have prospered and grown in strength and self-confidence since the end of World War II. The countries of the West have, in defiance of the Marxist economic analysis, maintained their stability, security, and prosperity by means of their inherited democratic institutions and, at the same time, succeeded in expanding consumer goods available to their own citizens from year to year.

The democratic countries, moreover, are now effectively pressing the Soviet Union to open its borders to more goods, tourists, and ideas from the outside world. They are also continuing to set ever higher standards of personal consumption, a fact which, under modern methods of communication—however well managed—is very difficult to conceal from the Russian people. A reported familiar reaction on the part of the Russian man in the street, whenever he hears an official spokesman boast about new Soviet achievements in modern weaponry or space technology, tends to be something to this effect: "If we are so smart, how come we are so poor?"

The leadership is also under pressure within the country. As a society, the Soviet Union today is no longer the frozen, immobile mass of inert, pliable subjects it was two decades ago. Behind the facade of political conformity and ideological rigidity, a great many subtle changes are now underway. Personal incomes are rising and at the same time becoming more differentiated. While the vast majority of the population still earns little more than enough to sustain a bare existence, a large number of families belonging to the bureaucratic and technical elite are provided by the regime with purchasing power to spare. They are, furthermore, rapidly acquiring the tastes and habits of the affluent society beyond the frontiers of Russia. Gradually, knowledge about the outside world is improving, and as a result, expectations at home are rising.

The leaders of the country no longer seem to be either willing or able to continue to repress economic discontent indefinitely and indiscriminately. Above all, they have become aware that they cannot afford to remain indifferent to the mood among those groups of citizens that are contributing importantly to the growing fund of scientific, technical, and economic power at the disposal of the state. These are persons and groups with their own unique frame of reference. They know their own worth to the regime, and they are also fairly well informed about the style of life enjoyed by their peers in the modern industrial society around the world.

Like it or not, the privately owned automobile has emerged as something of a symbol of the standard of living of the modern industrial man. As long as they could, the Soviet leaders tried to ignore the fact, or to pronounce it irrelevant to their own unique

values and social conditions. They have tried hard, as we know, to delay the coming of the private automobile as long as possible.

Alternatively, they have attempted to find their own distinctive "socialist" response to the strong popular urge for personal transportation. After his visit to the United States in 1959, Khrushchev returned home with a message to this effect: "We will turn out a lot of cars, but not now. We want to establish a system for the use of automobiles that will differ from the one in capitalist countries." Accordingly, he proposed a kind of municipal rent-a-car service, under which each city would own a fleet of automobiles and make them available to its citizens, on a rental basis, for vacation or weekend trips. Under pressure from the top, such a service was tried out in a few cities, but it turned out to have worked very poorly for a number of reasons.

We all tend to repeat rather often the generalization that the Soviet Union today is the second largest industrial producer, with an annual output roughly equal to half of our own. But we are inclined to forget that this rough-and-ready quantitative statement measures not only the distance that the Soviet Union has covered during the past five decades but also the length of the road that still remains to be traversed. We have to continue to remind ourselves that Russia's population is 20 percent larger than that of the United States. Russia's requirements in both productive capacity and in finished goods, therefore, remain to this day largely unfulfilled. The Soviet Government cannot but continue to work on the assumption that the basic industrial plant of the country is still largely unfinished. There are still new productive capacities that have to be added in order to make it possible to expand the scale of production in a wide range of primary commodities—fuels, electric power, petroleum, metals, machinery, and chemicals—as well as to broaden the nation's capabilities in construction and transportation.

What this means, in practical terms, is that the Soviet Government is now prematurely being pushed into the first stages of the automobile age by a variety of pressures largely against its own will. We may assume that the high command of the Communist Party must be undergoing a certain amount of agony on this score. Soviet planners must have on their desks many more "essential" investment projects in basic industry on which to devote the estimated $1.2 billion they will have to spend on the first phase of expanding the production of a "luxury product" such as the automobile. Soviet critics of this investment decision can muster a wealth of evidence with which to document the possible impact of such a shift in policy with respect to heavy industry. We may be certain that they are likely to warn their colleagues that this "diversion" of capital funds could slow down the expansion of the heavy industrial base of the econmy and, to that extent, impede the growth of the country's basic capabilities to support the needed defense establishment.

The national leadership, however, seems to have made a firm determination to go ahead with this modest initiative in the direction of consumer welfare. Given the scale of operations announced thus far, we may assume that what is involved here is not an effort to produce enough automobiles to supply the entire consumer public of the U.S.S.R. One million passenger cars (by 1975) will not go very far toward meeting the needs of the mass of consumers. The Soviet leaders know this, and we may assume that this, moreover, is precisely

the pace at which they intend to proceed to supply this scarce and prestigious item.

Soviet doctrine, incidentally, has a built-in justification for a scale of production that is designed to meet the needs of the elite consumer group only. Official ideology, it will be recalled, defines the present phase of the political order in the U.S.S.R. as "socialism." During this phase, the individual citizen is paid according to his work. Wages, in other words, are differentiated in accordance with the quantity as well as the quality of a person's contribution to society. It is a matter of some importance to the regime to be able to demonstrate to the ambitious and capable young men of the country that their higher wages, paid in return for a greater effort and skill at their jobs, will bring them within reach of the most scarce of all consumer commodities in the land.

It may be in order at this point to consider why the Soviet Government has decided to bypass altogether its own 40-year-old automobile industry when it was confronted by the need to manufacture the production equipment and to design the models for the new and expanded plants now on the horizon. There has been no official explanation on that score. But the decision to go to the West to acquire this equipment and know-how does imply something. It implies, in our opinion, a negative Kremlin judgment on the modernity of its own automobile technology. In addition, it also suggests a new mood of pragmatism on the part of their leadership. The present leaders of the U.S.S.R. no longer are willing to pretend, as they would have a decade or two ago, that their technology in any field of industry was, by definition, superior to any capitalist technology in a similar line of production.

The question as to why they turned to Italy for this equipment is also a matter worthy of our attention. To answer this question on the basis of purely commercial considerations, the critical fact in this case is that Italy has emerged in recent years as a stable trade partner with an active and growing interest in Soviet fuels in general and in crude oil in particular. Italy is now Russia's largest customer for crude oil outside the Soviet bloc (7 million tons per year during 1964–65). For the past 2 years, moreover, Russia has enjoyed a comfortable export surplus in its balance of payments with Italy. This gives her the needed assurance that the problem of repayment will not present any insuperable obstacles in the immediate future (see tables, pp. 96–98).

In the present commercial climate, however, it is reasonable to expect that the Russians will want to protect their delicate balance of payments with the West as a whole by placing a major purchase order of this kind within an appropriate credit arrangement. Such credits, extended on the part of the supplier, are now standard procedure, and where major transactions of the size of the FIAT contract ($300 to $350 million) are concerned, the duration of such credit tends to be generally extended for periods ranging between 7 and 10 years. In such cases, furthermore, the national government of the supplying firm in the West is almost always involved, whatever the nominal form of the immediate source of the credit. Recent experience has shown that private firms or banks are unlikely to extend such large credits without the explicit or implicit support of their own government.

The fact that the Italian automobile industry has a close working relationship with the toolmakers in this field in the United States may be taken as another factor that must have entered into the making of the present decision. Russia's technical experts have a healthy respect for the men and ideas that govern the U.S. automobile and machine tool industries. They are aware of the costly and superior research effort that goes into the product turned out by our industries, of the intense pressure for innovation under which we operate, as well as the economies of scale from which we benefit as a result of the size of our own domestic market.

From the standpoint of the United States, an export of this kind has to be viewed in light of the following facts: (*a*) machine tools of this type, however, sophisticated in design, are special-purpose equipment that will represent a considerable expense and will have to be assigned directly to automotive production; (*b*) these tools will be utilized to help broaden the commitment of the Soviet Union to the production of a resource-intensive, highly popular consumer product; (*c*) direct Soviet expenditures on the expansion of auto production must be recognized as perhaps only the beginning of that Government's involvement in an enlarged outlay of resources in the consumer sector.

Beyond the initial outlay, related to building the plants and the equipment of the first expansion phase of the industry, the Soviet Government is certain to be drawn into additional avenues of investment of a secondary and tertiary character. They will find it impossible to avoid the added costs that will be incurred, as a first step, in connection with the building of the new highways to carry the increased traffic generated by the flow of greater numbers of automobiles from the assembly lines of the new plants. This secondary stage of investment, in turn, will increase the pressure for more construction expenditures, such as fuel stations, garage networks, highway restaurants and motels. Every new round of added automotive capacity, thereafter, would again engender a new round of expenditures on the costly infrastructure required to support the mass-produced automobile in the style to which it had become accustomed in the modern age.

In short, we are dealing here with equipment of a particular character. It is not the kind of equipment that can be used in the Soviet Union to replace less productive installations, and thereby achieve a net gain in efficiency, with favorable repercussions in the defense sector of the economy. Rather, we seem to have an opportunity in this instance to contribute by means of this equipment toward *a shift of resources*, however modest at the outset, in the direction of a pattern of expenditures that is distinctly novel in Soviet economic practice and fraught with pressure for still greater outlays to come.

Export-Import Bank Credits

After the President's speech of October 7, 1966, when it was announced that Eximbank would extend credits for purchase of U.S. machine tools for the FIAT-Soviet plant, quite naturally there was increased congressional interest.

In a series of letters to senior Members of the House and Senate, several aspects of the proposed U.S. participation were further clari-

fied. In October, the First Vice President and Vice Chairman of the Eximbank, Mr. Walter C. Sauer, made clear that any financing Eximbank may undertake in connection with the plan would be in the form of a loan to IMI, an Italian financial institution, for the benefit of FIAT. The Bank would not be extending credit to or in any way be dealing with the Soviet Union or any of its entities.

He further pointed out that since 1947, the Export-Import Bank has extended credits of some $650 million to IMI for financing U.S. exports, including credits aggregating about $50 million for the use of FIAT. All of these credits have been repaid, many of them some years before scheduled repayment.

Mr. Sauer said that shortly after FIAT had been awarded the contract by the Soviet Government to design and construct an automobile plant in the Soviet Union, IMI asked the Bank whether in principle the Bank would consider extending credit to enable it to finance the purchase by FIAT of U.S. machinery. The Bank was told that FIAT was quite prepared to fulfill its contract to build the plant whether or not U.S. financing was available; the point being made that the necessary equipment and machinery was available in Europe if FIAT chose to buy there.

According to Mr. Sauer, after consulting with other executive agencies, the Bank informed IMI that it was prepared to receive an application for a loan for the purpose mentioned. It was understood that the loan would not exceed the amount of the purchases which FIAT made in the United States and which were then estimated at approximately $50 million. It was further understood that the loan would be for a medium term; that is, repayment over a period of about 5 years beginning in 2 or 3 years from the shipment of the equipment being financed.

Parenthetically, this might be regarded as 7- to 8-year credit terms, more in line with the 8½-year terms being extended by IMI than might otherwise be thought at first glance.

According to the Eximbank, the matter was left on the note that when FIAT determined how much and what specific items of U.S. equipment it wished to purchase, IMI would file a definite application for the loan, passing on the particular purchases proposed. As of the time that this report is being written, this stage has not yet been reached.

Also in late October, Secretary of State Rusk explained that the administration's position with regard to the FIAT deal was that it would be in our national interest to encourage increased production of consumer goods in the Soviet Union; that the equipment which would be purchased by FIAT in the United States for use in their plant in the U.S.S.R. would not contribute to Soviet military capability. Moreover, the Secretary pointed out that the plant would be a positive factor in our declining balance-of-trade surplus. More important perhaps was the fact that Secretary Rusk for the first time made it clear to Members of Congress that the Department of Defense is on record as favoring the loan by the Eximbank for FIAT. He said:

> It is the judgment of the Defense Department, shared by General Wheeler of the Joint Chiefs of Staff, that a loan that would induce the Soviet Union to devote greater resources to the production of consumer goods at the expense of applying those resources to military purposes is in our national interest.

About this same time, the Deputy Secretary of Defense, Cyrus Vance, in a communication to a senior Member of the House, said that the FIAT deal would support the increased emphasis which the U.S.S.R. is putting on using its resources to produce consumer goods. He pointed out that the United States must recognize that the greater the amount of GNP which the Soviet Union places on consumer goods, the less they can devote to military hardware, forces and facilities. Mr. Vance revealed that the FIAT project was fully discussed at the senior interdepartmental group meeting in May 1966. He further stated that the Chairman of the Joint Chiefs of Staff, General Wheeler, fully shared his views on the proposed FIAT deal.

In yet another letter to a ranking House Member in October 1966, Eugene V. Rostow, Under Secretary of State for Political Affairs, emphasized that the equipment which would be purchased by FIAT in the United States for use in their plant in the U.S.S.R. would not contribute in any way to Soviet military capability. In concert with other high ranking administration officials, Mr. Rostow also stated that the Department of Defense is on record as favoring a loan by the Export-Import Bank for FIAT.

Our study was undertaken with the thought in mind that the congressional subcommittee with legislative jurisdiction over the Export-Import Bank and the Export Control Act should independently appraise these executive department opinions.

Conclusion and Recommendation

Recognizing the executive branch's authority and constitutional prerogatives in the conduct of our Nation's trade relations and foreign policy, we are further impressed by the solid support given to the President by various departments and agencies.

The Departments of Defense, State, Commerce, and the Export-Import Bank all have publicly stated that they favor U.S. participation in the FIAT proposal. The Central Intelligence Agency, while not a policymaking body, has served these Departments in an advisory capacity in their final determinations. To our knowledge, the CIA has voiced no objections.

Furthermore, we have been assured that more than adequate safeguards will be established to insure that no equipment or tools will be provided by the United States that would be contrary to our Nation's best interests and security. In this respect, we fully intend to establish congressional review on all action taken by the Export Control Office so that we may also judge the manner in which all license applications are being evaluated.

For all of these reasons, we have no objections to the Export-Import Bank implementing the President's decision to permit U.S. participation in the proposed FIAT-Soviet auto assembly plant.

PART II. THE COMMUNIST ECONOMIC REFORMS

Unlike our study of the FIAT-Soviet auto plant, where we were able to conduct a comprehensive and detailed study, our review of Czechoslovak, Hungarian, Yugoslav, and Soviet economic reforms was but preliminary in nature.

We do not presume to be experts on these economic reforms. Obviously, a series of 1- to 3-day visits, together with hurried rounds of meetings and conferences with various Communist and U.S. officials, could not qualify us as experts in the field. We did, however, come away with some definite impressions which we would like to convey to our colleagues.

With the exception of some comprehensive analyses in various academic journals, there has been little information made available on what constitutes the oft-mentioned "winds of change" in the Soviet Union and Eastern Europe. Regardless of one's views as to the sincerity and reach of the announced economic goals, all of us must recognize that various acts and expressions of Congress might affect their development, one way or another.

Also included in this part of our report is an article reprinted from the November-December issue of Problems of Communism, entitled, "Economic Reforms: A Balance Sheet." The author, Prof. Gregory Grossman of the University of California, seems to have come away from his travels and studies with impressions strikingly similar to our own. We have chosen to reprint this article in full with the author's permission not only because we were impressed with his work but because the author is a recognized authority on Communist economic reform and writes from a wealth of experience and many years of painstaking study. Professor Grossman's article appears at the conclusion of our brief analysis.

The Yugoslav Economic Reform

Economic reform in Yugoslavia has a connotation significantly different from its meaning in the other countries of Eastern Europe. In those countries, the system variously described as Stalinist, command economic, or administratively controlled, has been in operation since the 1940's; in Yugoslavia, this system was abandoned in 1948–50. The basic feature of a command economy is that investment and distribution decisions are made by fiat of a central planning board; money is used in transactions between the state-owned economy and its workers, but not, except as a unit of account, among the state-owned enterprises themselves. Command of money only gives command of

goods to the extent that these are available; it has no influence on production or investment decisions.

After Yugoslavia was expelled from the Cominform in 1948 because Tito refused to turn over control to the Soviet Union, the country rapidly dismantled its ministerial apparatus and adopted, at least in principle, a market economy. But it was a market economy without private ownership of the means of production (except in agriculture, where forced collectivization was abandoned in 1953). At the same time, the Yugoslavs introduced the system of "workers' self-management," under which factories and other enterprises, though owned by society as a whole, were turned over to the "working collectives" for operation.

In theory, all the prerogatives of management were exercised by the workers' collective, through an annually elected workers' council and its executive organ, the managing board. Investment decisions, however, were still left under central control; a planning board allocated funds—not physical objects as under a command economy—and organized new enterprises. Decisions for major expansions of existing enterprises came under the same central control.

It should be noted that even 12 years ago the Yugoslavs made the fundamental decision which the other Communist countries of Eastern Europe are just now beginning to discuss. They abandoned the physical allocation of resources and replaced it with financial allocations; they made the dinar money, in a sense in which no other Communist country's unit of currency is money—if you had it, you could do economically significant things with it.

In theory, at least, the Yugoslavs were advocates of a free market in goods of all types—consumer goods and investment goods alike. Prices, instead of being set by fiat as in command economies, were to be formed freely on the market.

But, of course, the transition was by no means as easy as all that. The system of workers' management never took hold to the extent that the workers really made significant managerial decisions. On the whole, the managers who had been installed under the ministerial system remained. The workers' council itself was never intended to do more than set policy; it, and the managing board, were not immune to party control. It met too infrequently, and, it is charged, had too little interest in day-to-day operations to exercise a decisive influence on the course of events. Managers originally selected by the ministries continued to run the enterprises with varying success, depending on their individual capacities.

A very serious limitation on the functioning of the market was imposed by administrative controls of one sort or another. Believing that in their underdeveloped condition Yugoslav enterprises could not compete with foreign products, and that the financial condition of the country made exchange controls necessary, the policymakers shielded

the "infant industries" very carefully from the cold winds of international competition.

Serious efforts were made, it is true, to set up a system of rules and regulations which would harmonize, in something like the same way as Adam Smith's "invisible hand" was believed to work, the individual interests of the various enterprises with the common good. The League of Communists of Yugoslavia was supposed to make sure that the necessary coordination took place. The result was often termed "administrative interference" with the economy and condemned, although such actions were more often criticized than resisted.

Nevertheless, enterprises in Yugoslavia have been for a decade and a half independent in a sense which even now is not even being advocated for the other countries of Eastern Europe, much less put into practice.

There have been several experiments with price controls, and no one would argue that the Yugoslav market is or has been as free as is normal in other free market economies. Nor have the controls been imposed, as has been the case in Western countries in wartime, on a free-market economy; what has happened, rather, is that a certain amount of freedom has grown up within state controls. It is striking that the controls are never defended as ends in themselves; rather, they are rationalized as temporary necessities. But the various, constantly changing frameworks of controls have never attained their stated, and probably their real, purpose: the setting in motion of an economic machine which could be allowed to run with relative freedom, subject only to a framework of generally accepted rules.

For some years the Yugoslav economy expanded at a rapid rate under this system. Certainly more attention was paid to consumer needs and desires than has been the case in other Marxist countries. More scope was left for private enterprise, not only in agriculture, but also in handicrafts and services, though the entrepreneurs were harassed and taxed and, like the peasants, regarded by the true Communist believers as undesirable necessities. Foreign assistance played a significant role, both in cushioning the shocks of adjustment and in making possible the high rate of investment which kept economic activity running at a high and growing rate.

But by July 1965, it was painfully clear that something new had to be done. Too many enterprises, especially in Croatia and Slovenia, with their longer tradition of industrial and economic progress, were chafing at the restraints. Too many people in the underdeveloped regions were demanding more investments, while many in the more developed areas were vocally resentful of the diversion of resources to the backward regions. Foreign debts were coming due and the balance of payments was not showing the surplus needed to pay them. Despite constant criticism, there continued to be administrative inter-

ference with the economy. The growth rate was slowing and it was becoming clearer that the country was living beyond its means.

And so in 1965 the Yugoslav Government adopted a program of reform which can perhaps best be described by saying that this time they meant to do what in theory they had been doing since 1950. Briefly, it was proposed to liberalize imports as fast as the country could afford; to decentralize the banking system and make it the source of investment capital, free of governmental interference; to encourage the entry of foreign capital, with the management and technical skills which would accompany it; to free prices from administrative control as quickly as possible (while imposing a price freeze to prevent too rapid readjustments); in short, definitely to get the Government (and the party) out of business.

It was a part of the program that the rate of investment should be curtailed. Perhaps for the first time in history, a ruling Communist Party said that it had been doing too much for the future and not enough for the present generation.

The implications of "we really mean it this time" are far reaching. In particular, the Yugoslav Communist Party is openly and publicly facing the question of its own role, and Yugoslav leaders are repeating that the reform is as much a sociological as an economic phenomenon. That it has political implications as well is obvious and did not really need demonstration through the unprecedented resignation of a Communist government (in Slovenia, in December 1966) because it was defeated in a Communist legislature. Encouragement of local initiative and responsibility naturally implies conflicting points of view and makes impossible the standard Leninist pretense that there is only one "correct" position on every question.

As an indication of their serious intentions, as well as for very practical reasons, the Yugoslavs applied for full membership in the General Agreement on Tariffs and Trade, and obtained it in August 1966. This international commitment to free trade and to a market economy put the country on record internationally and laid on it enforceable obligations toward other countries, thus giving the reform international status. It also enabled the Yugoslavs to bargain for better treatment of their exports on international markets.

Yugoslavia has long been a member of the International Bank and the International Monetary Fund; the first of these has loaned the country over a quarter of a billion dollars for various development projects and the latter has assisted Yugoslav efforts to improve its financial position for many years. Most recently, the Fund has granted Yugoslavia two substantial standby arrangements to support the current reform and has in the course of its regular consultations assisted the country with technical advice. Yugoslavia has made good use of the expertise available from the Fund and has cooperated with it fully, furnishing information and participating in its deliberations in the same way as avowedly non-Communist countries.

Recent developments in Yugoslavia, themselves not part of the reform, show the kind of impact the reform measures can have. For

example, Yugoslav workers can freely go abroad to work and some 400,000 have done so. Yugoslavia wants, eventually, to attract them back to Yugoslavia, though they are glad at the moment to relieve their unemployment problem and to gain foreign exchange in this way. But they refuse to consider the use of police methods to restrict immigration.

Similarly, the Yugoslav effort to earn hard currency through tourism has led, not only to contact between Yugoslavia and foreigners to an extent no other Communist state would tolerate, but to a steady reduction in the amount of redtape needed to enter and leave the country. Yugoslavia has already abolished the visa requirement for visitors to countries which do not require visas for Yugoslav citizens. This year, the government intends to abolish all visas for tourists. The erosion of police authority which this development has brought with it has been a significant gain for individual liberty.

Developments on the economic front since July 1965 have not yet provided a definite answer to the question of the reform's success or failure. The reform meant, initially, a sharp drop in living standards and a rise in unemployment as enterprises felt the pressure of curtailed credit and moved to cut payrolls. In principle, enterprises are to be forced to compete successfully or go out of business, generally through merger with a more successful enterprise. But these latter have been, at least in some cases, reluctant to take on economically unsound firms.

Price stability was maintained until the last quarter of 1966, when wages and prices began to rise more sharply than had been expected. Imports, too, climbed during 1966 more than exports, putting in doubt the success of the reform in righting the balance of payments. Industrial production continues to rise, though at a slower pace than in the early sixties.

The major liberalization measures, those affecting imports and banks, came into effect only January 1, 1967, and there has accordingly not been time for their effects to be measured. The long-delayed legislation permitting foreign participation in Yugoslav enterprises has not yet materialized. Its introduction appears to depend, in considerable degree, on the answer to another question—the conditions under which one Yugoslav enterprise may invest in another and what degree of management rights such investment will imply. While this problem is to some extent optical and even theological, it does touch on two major tenets of Yugoslav socialism: the social ownership of the means of production and workers' self-management.

With the reform some 18 months old, the impatient no doubt would expect to be able to pronounce a final judgment. But, for the reasons set forth earlier, there is a sense in which Yugoslav communism can be said to be in permanent revolution, or at least permanent reform.

But the process which has already made Yugoslavia unique among Communist countries appears to be continuing with gathering momentum. It has already made Yugoslavia the most free of the Communist countries possessing the most desirable economic climate from the standpoint of the consumer.

Economic Reforms in Hungary

The economic reform program of Hungary is scheduled to be profound and far reaching. Its major components are due to come into force on January 1, 1968, a year after those in Czechoslovakia and modifications are therefore possible, based on observation of the early successes and failures of the Czechoslovak effort.

In most important respects the two countries are following a parallel course. The aim of Hungarian economists is greater price rationality, higher productivity through the use of material incentives, and the attainment of competitiveness in the world market.

As in the case of other Eastern European countries, the question arises in Hungary as to why it is necessary to have economic reforms which may involve serious economic and political dislocations. In the immediate postwar period and, in fact, until about 1957 the Hungarian economy was one characterized by a seller's market in nearly all commodities. The demand existed for anything that could be produced and in a situation of universal shortage, rational allocation of investment funds was a matter of very low priority. Almost any investment was bound to produce satisfactory and visible results. Furthermore, with everything in short supply raw materials were necessarily centrally allocated. The price mechanism was not used to allocate resources among competing uses. Quantity of output was maximized without regard to the existence of markets which were assumed to be present for anything that could be produced. It was assumed in the area of foreign trade that the Soviet Union represented an inexhaustible source of raw materials and an equally inexhaustible market for the products of Hungarian industry.

What has now happened in Hungary, as in other countries of Eastern Europe, is that the seller's market is disappearing as the basic wants of consumers are increasingly satisfied and they begin to pick and choose in a search for higher quality and better value in the products they buy. On a larger scale the same thing is true in the area of foreign trade where Hungary's most important customers—the Soviet Union and the other members of the Council for Economic Mutual Assistance (CEMA)—are showing an increasing awareness of shortcomings in the quality and variety of the goods which the old system has been producing. The Soviet Union is also showing a growing awareness of the costs of opening up new sources of raw materials as the older and richer deposits of minerals and petroleum are becoming depleted. The result of these trends is a new emphasis upon marketability of production and quality control which can best be achieved with flexible prices and decentralized managerial authority at the plant level. The goals of the economic reforms are a more rational price system, more rational investment policies, and a quasi-market economy which will serve as an automatic allocator of available resources. The outcome, it is hoped, will be a far more efficient and productive economy in which growth patterns automatically will follow market demand both internal and in the field of foreign trade.

The tools by which these goals are to be approached are to be largely economic rather than administrative. Central planning is to be strengthened by confining it to long-range developmental plans and to determining the direction of major new investments. The detailed annual plan with its myriad regulations hampering the free-

dom of individual plant managers is to be replaced by a much looser set of guidelines based on profit as a success indicator and these profits are, at least in theory, to be earned competitively in the marketplace.

While it is doubtless a step forward to devolve responsibility for genuine decisionmaking on individual plant managers and tell them to maximize profits, this action cannot result in also maximizing the real value of total output unless the price structure of inputs bears a fairly close correlation to at least their relative value. The reform of wholesale prices is, therefore, an indispensable step in the Hungarian plan. The fact that present producers' prices are set arbitrarily helps one to appreciate the importance of achieving a closer approximation of price to scarcity value before effectively abandoning the system of allocation through rationing which has prevailed until now. Scarce and expensive raw materials have been in some instances priced for internal consumption at figures below those of relatively more abundant locally produced materials.

While the details of the new price structure are still being worked out, it can be assumed that an effort will be made to equate the cost of imported goods with their foreign exchange cost times a realistic multiplier. At the same time, locally produced raw materials presumably will be revalued at or near their cost of production (including a fair profit margin). While political necessity will prevent the setting of true equilibrium prices in some scarce goods, it should be possible to reach a much closer approach to equilibrium than the present severely distorted structure permits. A major difficulty can be seen, however, in maintaining sufficient flexibility after the initial price shifts. Managers will bring understandable pressure to have the prices of their particular inputs kept low and stable while changing conditions of supply and demand, now to be given freer rein, will keep real value fluctuating.

One of the most interesting phenomena in economic reforms in Hungary and throughout Eastern Europe is the trend away from "collective consumption." Collective consumption in the Marxist lexicon is the name given all forms of state-subsidized activity ranging from the state subsidy to education, the performing arts, and scientific research common to the West as well, to the heavy subsidies to housing, utilities, and public transportation characteristic of Communist regimes. Until recently, the fact that rents were nominal in Eastern Europe, usually not enough to cover maintenance much less depreciation, was proudly pointed out as evidence of the state's regard for the workers. Ideologically, the growth of collective consumption was described as progress toward the eventual goal of elimination of private property when all consumption could be collective—"to each according to his needs."

This trend is now being reversed without apology. It has been perceived that whatever ideology may say on the subject, heavy subsidies and unrealistically low prices merely stimulate unlimited and insatiable demand for such scarce and expensive commodities as housing. Raising the price to economic or near-economic levels, it is hoped, will both curtail demand and stimulate a livelier appreciation and care of what is available. What makes this sort of move difficult, however, is that subsidized goods and services have come to be regarded as a right, and unless arrangements can be made for an equal

and simultaneous rise in personal disposable income, rent increases will be bitterly and vocally resented. The same applies with equal force to public utilities or public transportation. Nevertheless, in Hungary as elsewhere, the more economical consumption patterns which will prevail at higher prices apparently have been adjudged to be worth the political risks.

Turning from price policy to investment, it is perceived that rationality in investment in terms of minimizing the capital-output ratio is almost wholly dependent on a rational price structure. While planners' preferences will continue to play a major role, unless domestic and foreign prices are brought into some identifiable and reasonably regular correlation, massive misdirection of scarce capital resources is likely to persist. The decentralization of a portion of investment decisions to individual enterprises would serve to promote efficient reinvestment of some enterprise profits and stimulate technical innovation. But, in the absence of a true capital market, profit reinvestment may not prove the most efficient use of capital and effects of this will be magnified by any distortions in prices.

So far, there is no indication of any channel by which retained profits of one enterprise may be invested in another. In the absence of such a mechanism, a strong incentive will remain for the state to tax off the bulk of profits and redirect them into what the planners perceive as the most efficient use. It will not be surprising to see decentralized investments restricted to near the level of depreciation, although in January 1967 it was announced that about 55 to 60 percent of all investments would be decentralized under the new plan. There is an understandable tendency of managers to use profit increases to raise wages and worker benefits to the maximum extent possible. As in Yugoslavia, decentralized investment probably will show a marked tendency to concentrate on new workers' housing rather than new productive facilities. A major role in allocating investment capital will be played by the Central Bank, which by varying its terms and conditions effectively would be evaluating not only the economic but the relative social desirability of competing investment proposals. Depending on the efficiency of the enterprise and the rapidity with which it turns over its inventory, the Bank's interest rate is expected to vary from 5 percent to a maximum of 18 percent.

Part of the new reforms is reexamination of the role of the workers in the new economic structure. Hungary is fully aware of the role of the Yugoslav workers' councils and their legal ownership of the individual manufacturing enterprises in that country. The Hungarians also appear worried about the conflict between worker democracy on the one hand and the authority of the plant manager on the other. Whatever Marxist doctrine may say, it is certainly true that the two seldom perceive their self-interest in the same light. To prevent agitation for worker democracy on the Yugoslav pattern it appears that it has been decided to strengthen the role of the official trade union movement which has up to now served largely as a transmission belt for central directives and a means of dispensing fringe benefits such as cheap prepaid vacations, theater tickets, and the like. It may prove difficult for the old regime's appointed labor leaders to adjust to the idea of having genuinely to represent labor interests against those of management.

On paper, the Hungarian reform program is one of the most daring now projected anywhere in Eastern Europe, excluding, of course, the special case of Yugoslavia. Unless severely modified before its inception next January 1, it should have a profound effect on the thinking and daily life of every Hungarian and could have far-reaching results in accelerating the decline of economic dogmatism.

While the new system is by no means a return to capitalism, the interesting point is that neither is it recognizable as communism—at least by any of the definitions applied up to now.

Czechoslovak Economic Reforms

The economic reforms instituted in Czechoslovakia on January 1, 1967, have two basic objectives. First, regeneration of public interest and stimulation of individual initiative. Second, reintroduction of the fundamental economic law of comparative advantage into Czechoslovak trade by using the international market to influence Czechoslovak production and investment. This may force a reduction in the number of products produced in Czechoslovakia and concentration on production of those which are competitive internationally, resulting in increased trade and improved "terms of trade." Since the contribution of trade to the Czechoslovak GNP is high—more than three times higher than the CEMA average—improved terms of trade have an immediate relevance to the Czechoslovak standard of living. In essence, this decision involves nothing less than the reintegration of the Czechoslovak economy with the world economy.

In the early years of Communist control in Czechoslovakia the command economy was introduced with certain features which helped disguise the exploitation of the economy by the Soviet Union in the interest of rebuilding the war-damaged economy of the Soviet Union and achieving other Communist objectives. This was done by shielding Czechoslovak production and investment decisions from the pressures of the international market through the simple device of isolating internal and foreign trade.

The mechanism was simple. The Foreign Trade Corporations (FTC) paid Czechoslovak producers the same crown wholesale price paid by domestic purchasers. The FTC set its foreign price in foreign currency at a level to make the product competitive. The state budget then paid deficits incurred when the FTC sold goods abroad at prices which, when converted to crowns at a fixed rate, turned out to be lower than the wholesale prices the FTC had paid to the manufacturer. However, the state budget also received profits from the domestic sale of imports. (Actually, the crown profits and losses were accepted by the state budget for both imports and exports.) The Ministry of Foreign Trade in turn gave guidance to the FTC designed to maintain adherence to bilateral trade agreements and to keep the balance of payments in equilibrium. The demise of cost accounting was furthered by domestic wholesale prices which were set by such general criteria as the social desirability of developing a particular industry because of the need to work for a "balanced economy."

The fundamental consequence of frustration of the law of comparative advantage was that limited resources were used inefficiently. To buy raw materials at 10, process them, and sell at 12 (sometimes less) leaves little room for wage growth and modernization of plant and equipment. If we add to this an excessively wide range of production, forfeiting the gains of mass production and an excessive dispersal of research and development, for a country of 14 million inhabitants, the stage is set for progressive technological obsolescence of production and lower export prices. These factors, along with the sustained non-market-oriented investment pattern, completed the circle of decreasing effectiveness in all phases of economic activity. Such a system can be maintained, but only at the cost of real growth and a decreasing standard of living. Since the rest of the world was not standing still, the contrast became too great to be longer denied.

Now the command economy is being dismantled. The role of the central authorities in determining production has been reduced. Ministries will play a smaller role in day-to-day operations. Production will respond to the world market through the introduction of flexible prices and by the pressure of imports on domestic prices. Enterprises will produce to make a profit rather than to fulfill centrally determined targets. (Initially, some profits may be illusory because some raw material inputs are subsidized by the entire economy.) This is entailing a rebirth of cost accounting.

New investment will be largely made from enterprise profits or from loans approved by the State Bank in coordination with the Central Planning Commission. Loans from the State Bank will bear interest rates, working from a prime rate of 6 percent, which will reflect the Bank's estimate of the soundness of the proposed investment. Should the Bank not be willing to make a loan, an enterprise may proceed from its own funds.

When enterprises cannot make a profit they must nevertheless pay workers a minimum wage. State subsidies to cover wage deficits, tax deficits and loan arrears will be on a selective basis for limited periods. Enterprises which cannot make a go of it must close and their resources (labor, capital, equipment) must be shifted to profitable use. This introduces the capitalist concept of "business failure" and "frictional unemployment" to the Communist world.

On January 2, 1967, a coal mine and two coke ovens in Bohemia were closed on grounds of unprofitability. Some of their workers are to be retrained and some absorbed into more efficient mines as part of a program which is designed to ease the frictions of shifting labor into more efficient uses. The official trade union movement has been given responsibility for being prepared to retrain over 50,000 workers a year.

Although equalization of the conditions under which the enterprises will operate through uniform tax rates and interest rates is accepted in principle, the possibility for differentiated treatment exists. This may be used to thwart natural economic development or simply to cushion the dislocations resulting from the shift of economic resources. In general, loan availability, tax rates and interest rates will be used to guide the economy, if the reformers have it their way, with Keynesian moderation.

In the future bonuses and to some extent wages will depend upon enterprise profits rather than upon meeting centrally determined targets. The old system encouraged enterprises to strive for low targets and to exceed them by only modest amounts. It also encouraged production of shoddy goods, high-cost goods, and unwanted goods.

Differentiation of wages will be institutionalized. Mental work will be upgraded and superior work will receive superior pay. Rationing by means of price mechanism will give new incentives to increase earnings.

In theory, some change in the evaluation of political loyalty as well as ability will be accepted in determining advancement. The present system of giving top enterprise posts to individuals whose basic qualification is party position is essentially a retrogression to an aristocratic principle since it makes membership in an establishment the key to preference in all areas of community life. As a system, it is out of step with the mainstream of social development and is a burden to any society where it is practiced. The local party functionaries are being instructed to keep their hands off local enterprises.

Any one of a number of factors may work to impede the progress of the reform program. Possibly, supplies and near-future earnings of hard currency will be insufficient to finance the imports needed to make the new system work. High-level political support for the reforms tends to waiver whenever the pressure is off. There may be a growth of grassroots opposition to the dislocations resulting from plant shutdowns as resources are shifted. Long-term trade agreements and arrangements for the procurement of raw materials limit flexibility in adapting trade to purely commercial pressures. Many rank and file officials in ministries, party and enterprises are benefiting from the present system and are bitterly opposed to innovation.

Despite the uncertain outcome of the reforms, their adoption is in itself highly significant. A basic national issue—organization of the economy—has been made public property and publicly debated. It is now possible to trace the evolution of thinking on the part of leading Czechoslovak officials.

In 1964 some 72 percent of Czechoslovak trade was with Communist countries. Czechoslovak statements have proclaimed that this trade will stabilize at about 68 percent. This seems unlikely. If the reform is implemented, the possibility exists for a significant decrease in the percentage of Czechoslovak trade with Communist countries.

The possibility of importing raw materials from non-Communist countries, made possible by increased earnings of hard currency from these countries, could allow Czechoslovak economic policy decisions to be made in an atmosphere of greater independence.

Domestically, there could be a growth and dispersal of initiative, the creation of other roads to privilege than party patronage, and a retreat of the heavy hand of the party from involvement in many areas of daily life.

The reform is being implemented and it may be far reaching. The tendency of recent years has been to cope with problems pragmatically rather than rely on ideological guides, although orthodox phrases often embroider the operating paragraphs. As far as the reformers are concerned, the only thing they are not prepared to touch is the collective

ownership of the means of production. A large portion of Communist theory and practice thus has been jettisoned because experience has proven them irrelevant to the successful operation of a modern industrial society.

Implementation of the reform almost certainly will bring with it serious problems for the maintenance of the primacy of the party. The party, however, will be alert to cope with these problems and this in turn will likely mean that the final result will be somewhat different than either the reformers or party expect.

Nevertheless, the insights which have been developed during the Czechoslovak economic debate on the self-defeating character of the command economy make it impossible for that system to be again accepted by Czechoslovak Marxist economists.

Status of the Soviet Economic Reform

After a prolonged public debate and a period of experimentation in a small number of enterprises, the Soviet Union, in September 1965, launched a reform of its industrial management and planning, designed to increase productive efficiency and to reverse the declining trend of overall economic growth which has caused increasing concern to the Soviet leadership in recent years. The reform reflects the cautious approach by the new leadership to its economic problems. It is a compromise combining both elements of tighter central controls (epitomized by the reestablishment of the system of industrial ministries) and concessions to the initiative of industrial managers on the operating level. Principal among the latter is the reduction in the number of economic indicators planned for each enterprise by the central authorities, and increased decisionmaking powers granted enterprise directors in day-to-day operations. The reform also establishes a new criterion for judging the enterprise's performance—substituting profit and the volume of sales for the index of gross volume of production which encouraged wasteful use of resources.

An important feature of the reform is its provision for increased material incentives for both managers and workers which are to be financed from special funds which the enterprises will establish and maintain by deductions from their profits, profits which heretofore have been almost wholly siphoned off by the state. The aim of the new incentive system is to promote technological innovations, economizing on inputs, optimum use of investment resources, adaption of production to demand, improvement in the quality of production, and efficiency generally.

Soviet economic reform stops far short of the liberalizing measures introduced or contemplated by some of the U.S.S.R.'s East European neighbors. One plausible explanation for the less adventurous bent of the Soviet regime in this area seems to be that, after a half century of Soviet power, economic conservatism is more deeply ingrained in the U.S.S.R. than in the other countries. Another appears to lie in the U.S.S.R.'s international position: to maintain it, the Soviet leadership feels obliged to keep a firm hold on its economy, a hold which would weaken if market forces were given freer play.

Yet even the relatively limited reforms in the U.S.S.R. continue to face obstacles in their implementation. The Soviet press has pub-

lished a substantial amount of evidence attesting to bureaucratic foot-dragging and to unwarranted interference by both government and party organs with the day-to-day operations of industrial enterprises. Partly as a result of these developments, the implementation of the reforms has fallen considerably behind the original schedule. As of the beginning of 1967, only 673 industrial enterprises, encompassing some 10 percent of the industrial labor force (about 2.5 million) and accounting for some 12 percent of industrial output had been shifted to the new system; the initial schedule called for a transfer of enterprises employing some 10 million workers (one-third of the industrial labor force) to the new system by that date.

It is too early at this stage to attempt an assessment of the reform's impact on industrial performance. The number of enterprises under the new system is still too small to produce an appreciable overall impact. While official Soviet statements claim a much better than average performance for the enterprises under the new system in terms of profits, sales and productivity, it should be noted that this would have been the case even under the old system because only the most efficient enterprises have been transferred so far. The crucial test for the reform will come when all enterprises, including the inefficient ones, are transferred to the new system. The transfer is scheduled to be completed in 1968.

An integral and crucial part of the broader economic reforms is the revision of industrial wholesale prices. Last September, Moscow finally announced the time schedule for the introduction of new prices which has been postponed several times and which has held back the pace of introduction of other reforms as well as the calculation of the final version of the current 5-year plan (1966–70). The new prices in heavy industry are to go into effect July 1, 1967, while those in consumer goods producing industries are to be introduced prior to that date. The official announcement emphasized that retail prices will not be affected.

The new wholesale prices will be based, as heretofore, on average rather than marginal costs, but they assertedly will be brought closer to the level of full production costs, including capital charges which did not previously figure as an element of price. Direct subsidies of less efficient enterprises will therefore continue, but the number of such enterprises is expected to be substantially reduced. The capital charges as well as profitability rates (calculated as a ratio of the enterprise's ruble profits to the value of its total capital stock) will be differentiated rather than uniform with the aim of giving each enterprise within a given branch an approximately equal opportunity to set up and maintain its incentive funds—a feature amounting to a form of indirect subsidy of the less efficient ones. A major stated aim of the price reform is to promote improvements in product quality and technological innovation.

The main focus of the reform of heavy industry wholesale prices is on basic commodities, such as fuels, some basic chemicals, and metals, the production of which has been heavily subsidized. The aim is to make most enterprises in these branches profitable by raising the prices for their products. A related aim is to set relative prices in a way that would promote specific major objectives of the regime's industrial policy. Thus, while coal prices are scheduled for a large

increase (75 percent on the average), those for gas will increase less (55 percent) and those for gasoline and diesel fuel are to remain practically unchanged to stimulate more extensive use of nonsolid fuels. While prices for metals are to increase by 35 to 40 percent, those of chemicals are slated for much smaller changes to stimulate greater use of chemical substitutes for metals.

The new structure of industrial wholesale prices, now in process of preparation, will provide the authorities with a better tool for making rational economic decisions than they now have. Its chief merit lies in the fact that it will be based on current costs rather than those of more than a decade ago (the last general price revision took place in 1955), albeit with some important exceptions. A notable improvement is its provision for capital and (on a limited scale) rent charges, which will make prices a more realistic reflection of full production costs. The reform will also introduce more rational relative prices than now exist, particularly in the sphere of "substitute commodities" where errors in pricing are most readily apparent and most easily remedied. As a result, such regime policies as the promotion of wider use of nonsolid fuels, the substitution of chemical products for metals and agricultural materials, and, in general, reorienting the economy toward wider use of chemicals, will be furthered.

Nevertheless, as it now stands, the wholesale price reform—like the broader economic reform—is essentially a product of indecision, improvisation and compromise among those who have fashioned it rather than of strictly economic calculations. The announcement of the reform and related official statements make it plain that while the leadership has made certain basic decisions on the methodology of price formulation, there are still a number of "questions of principle" which remain unresolved. The announced admission of serious lags in the pace of fixing the new prices in a number of important areas raises doubts whether the final version of the current 5-year plan (1966–70), apparently bogged down by other problems as well, will be ready before the latter half of 1967.

Much of the rationality of the price reform is vitiated by the numerous built-in safeguards or "shock absorbers" and exceptions, all of which add to its complexity. These largely take the form of differentiated rather than uniform capital charges and profit rates, direct and indirect subsidies, and "accounting prices"—all of which amount to setting different rules for different players of the same game and which are intended essentially to preserve the existing industrial structure intact, with changes to be introduced only gradually and by administrative fiat rather than via the price system.

More important, the wholesale price reform carefully avoids any concession to spontaneity in the formation of prices, making it clear that the latter shall remain the sole preserve of the central authorities. Nor will prices be allowed to serve any regulatory function such as the elimination of inefficient producers or the allocation of resources. The latter will in the main continue to be determined centrally and on political rather than economic grounds, although an improved price system will enable the authorities to make more rational economic choices among alternative ways of accomplishing a given objective.

[From Problems of Communism, November-December 1966, pp. 43–55]

Economic Reforms: A Balance Sheet

(By Gregory Grossman)

The year 1965—like 1953 and 1956—was a memorable landmark in the postwar history of Communist Europe: it was the year of economic reform. Anticipated quietly by East Germany in 1963—and, of course, by Yugoslavia a decade earlier—nearly all the countries of Eastern Europe succumbed within a span of 12 months, one after the other, like so many dominoes, to the winds of economic change: Czechoslovakia in January 1965, Poland in July, the Soviet Union in September, Hungary in November, and Bulgaria in early December.[1] Just a fortnight before the year ran out, East Germany tinkered further with its "New Economic System." And as though to insure its reformist lead on its neighbors to the east and north, Yugoslavia took another long forward step in July 1965. Only internally rigid Rumania, still too successful with Stalinist economic methods to fully realize their defects, and tiny Albania, defiant in Balkan manner behind its Chinese wall, have so far escaped the epidemic of economic reform.

The East German "New Economic System" is the sole reform system functioning at this time. In all the other cases the reforms have proceeded no further than stated intentions on the part of the ruling regimes, or at best some preliminary steps in the promised direction. The next 2 to 3 years will test each regime's capacity and resolution to do the job. How far and how fast the reforms will eventually go is still largely a matter of conjecture—fascinating conjecture, given the welter of economic, political, ideological, and international factors impinging on their progress. We shall take a brief look at some of these factors in the present essay. But from the outset we must recognize that if each country's announcement of an economic reform represents the end of one era of political struggles and doctrinal debates, it also marks the beginning of a new era that will produce clashes no less intense. In what follows we are concerned with the U.S.S.R. and other Soviet-type economies, and only incidentally with Yugoslavia.

Problems and causes

The readers of this journal—and especially of the series of articles on "Economics and Politics" in its recent issues—need hardly be reminded of the main problems associated with the traditional Soviet-type "command" economy, and hence of the considerations that have prompted some sort of reform in all the countries in question. Very poor articulation of demand and supply; accumulation of unwanted goods; highly wasteful use of resources in production; a relatively low share of the national product going to the consumer and, within the limits of this share, poor attention to his interests; generally low quality of products, which among other things affects the competitiveness of exports on the world market; undistinguished performance of the agricultural sector: these are some of the well-known "static" defects of the Soviet-type economy. On the "dynamic" side, we note considerable declines in the traditionally high rates of growth in all the countries in question after the turn of the decade; corresponding declines in annual rates of increase of labor productivity and consumption levels; disappointing—though in themselves often quite respectable—rates of technological progress, in part owing to opposition to innovation from below; falling increments in product per unit of investment, and so forth.

Underlying these negative phenomena are such institutional causes as overcentralization of decisions and correspondingly overextended lines of communication; exceedingly complicated administrative structures; primitive methods of planning; reliance on crude physical indicators; information that is at once excessive in volume and poorly adapted to sophisticated decisionmaking; faulty signals, chiefly owing to irrational pricing practices; a rigid system of materials allocation; suppression of initiative and impairment or misplacement of incentives; political interference at all levels of the economy; dogmatically rooted impediments, such as evidenced in pricing principles and in the opposition to virtually any private enterprise, even where it would be clearly beneficial to eco-

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[1] The cited months refer to the meetings of the central committees of the respective parties at which the initial decisions to proceed with the reforms were taken.

nomic performance. These causes, no less than their effects, are well known both to outside students of the Soviet economic system and to domestic critics.[2]

Yet the picture must not be painted in unduly dark tones. With some notable exceptions—such as the total halt in Czechoslovakia's growth rate in 1962–64, and the chronic ills of agriculture in most of the countries—the European Communist economies are continuing to grow at respectable rates, albeit less rapidly than before. Consumption levels are continuing to rise, and technological standards are advancing. The point is that these increases are inadequate from the standpoint of both the regimes and their populations. At the same time, it would be shortsighted to see the case for reforms as resting on economic grounds alone. There is little doubt that at this juncture in history the pressure for reform in Communist countries is rooted not only in economic expectations but also in political and moral aspirations. The decentralization of the economic structure is undoubtedly favored by some of its partisans as a step toward the eventual democratization of political and social life, as well as for its economic benefits.

External influences

A number of forces from the outside world have also given a push to the reform movement. The importance of the Yugoslav example—"Socialist" and Marxist, but with a fundamentally different institutional system—can hardly be exaggerated. However wanting Yugoslav reality may be in relation to its own ideal or to the more advanced and sophisticated economies of the industrial West, its strengths often lie precisely where the major weaknesses of the Soviet-type economies and societies are to be found. Its market mechanism permits the suppleness and the dispersed initiative that the command economy lacks. There is greater acceptance of small-scale private enterprise. Its system of workers' self-government strives at that measure of industrial democracy which is conspicuously lacking in other countries proclaiming themselves to be Socialist. Nor has Yugoslavia had to pay a price for these advantages in terms of economic growth, for its growth rate compares favorably with those of its more orthodox neighbors. Last but not least, Yugoslavia's economic reforms have been accompanied by some (if so far quite limited) liberalization and democratization in the cultural and political spheres. The party's role is society has become more circumscribed. In sum, by its mere existence Yugoslavia serves as an example of a workable, and in many respects attractive, form of Socialist economy and society.

If the capitalist economies of the West do not represent an alternative for the Soviet-type countries in the same sense in which Yugoslavia does, they nonetheless provide forceful examples of technological modernity and consumer well-being that are not lost on either the regimes or the populations of Eastern Europe. At the same time, Western economics—especially that part of it which concerns itself with the maximization of social objectives through rational resource utilization—has made a profound impact on at least a part of the economics profession in the Communist countries. Being largely apolitical, this body of Western economics is in principle easily transferable into a Socialist context, where it has a high potential impact because of its profound implications for rationalizing, planning, and management. Moreover, its arrival in the East tends to deideologize and dedogmatize the Communist political economy, thus smoothing the way for pragmatically motivated institutional changes.

Lastly, the importance of foreign trade in preparing the ground for the reforms must not be underrated. All the European Communist countries have continuously faced serious shortages of foreign exchange, and for all of them, except the Soviet Union, rapid industralization without relatively large importations of goods—whether raw materials of highly fabricated goods (especially machinery), or both, depending on the particular country—is impossible. Extensive credits are difficult for them to obtain. Thus, they must export on a large scale, both to the East and to the West. In doing so they submit their goods to a severe competitive test in terms of quality and technological modernity; and their economic institutions undergo a similar test in terms of adaptability to changing external conditions and overall effectiveness. Frequently they have found both

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[2] For an extensive analysis of the problems faced by the Soviet economy, see "New Directions in the Soviet Economy," pts. I–V, report of the U.S. Congress Joint Economic Committee, Washington, D.C., U.S. Government Printing Office, 1966. For an excellent shorter treatment of the subject, see Robert W. Campbell, "Economics: Roads and Inroads," Problems of Communism, November-December 1965, pp. 28–33.

their goods and their institutions to be seriously wanting on these scores. In all the countries, with the exception of the U.S.S.R., a major argument for thoroughgoing economic reform has been the need to render their economies more effective in both the "capitalist" and the "Socialist" world markets.

But the influence of foreign trade on reformist thinking does not stop here. The "Socialist world market," in which the European Communist countries transact about two-thirds of their external trade, is after all a market. As such, it has served as a school, and a very compelling one at that, in which the logic of market relations among Socialist entities was inevitably learned by the regimes in question. Among other things, they learned in this school that rational economic decisions cannot be based on irrational price structures, and that every resource use has its opportunity cost—elementary verities of economics that all too often have been overlooked by Communist leaders and planners when not subjected to the discipline of the external market and the relentless need to earn foreign exchange.

Furthermore, a country which desperately needs to earn foreign exchange soon begins to think of it as a main objective of economic policy. Because foreign exchange is a relatively simple, quantifiable, and even almost unidimensional criterion[3] of national-economic success (compared, say, to such domestic objectives as industralization or the improvement in living standards), it can be easily incorporated into formal theories or mathematical expressions that purport to specify the conditions of efficient resource allocation. One thousand more dollars (or marks, or pounds, or even foreign trade rubles) is always better than 1,000 less when foreign exchange is desperately scarce, and therefore a pattern of resource use that earns the extra thousand is clearly better than one that does not. From this point on the rational economic calculus can take over. Hence, the chronic shortage of foreign exchange was a kind of blessing in the guise of a crisis—at least in the sense of opening the door to the intrusion of rational methods into Communist political economy and to the slow exit of scholasticism and dogma. This is just what has been happening in Eastern Europe since the mid-1950's, when formal theories of "foreign trade efficiency" began to make their appearance.[4] There is thus a direct intellectual link between the primitive formulas for foreign exchange maximization that appeared in Hungary in 1954 and the elaborate theoretical and philosophical underpinning of that country's far-reaching economic reform a decade later.

The reform proposals

Since the syndrome of economic malfunctioning is largely the same in all Soviet-type countries, it is not surprising that the remedial measures proposed by the current reforms consist of essentially the same ingredients, though often mixed in different proportions. To indicate the main ingredients we can do no better than to reproduce a list that was prepared by the research staff of the United Nations Economic Commission for Europe:

(i) Broad directives seeking to improve central planning techniques, requiring, in particular, greater reliance on the medium- and long-term plans which are regarded as devices for achieving greater stability in the conditions under which enterprises operate;

(ii) Changes and reductions in the centrally planned targets that are mandatory for the enterprise, together with greater emphasis on gross income (i.e., net value added), profit, and rate of profitability as criteria for judging the enterprise's success;

(iii) The expansion of decentralized investment funds available to enterprises and the larger economic units, and a greater use of bank credits;

(iv) The introduction of a capital charge on the fixed assets of enterprises, which will play an increasingly important role in transferring a proportion of profits to the budget;

(v) A strengthening of economic incentives (amounting in some cases to changes in the wage system) by establishing closer ties between the remuneration of employees and the enterprise's performance;

(vi) The promotion of direct contracts between economic units which, in contrast with the old system, are no longer conceived simply as instruments

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[3] What prevents it from being a unidimensional criterion is the earning of nonconvertible currencies, an important qualification in the case of the Communist countries since most of their trade is with each other; i.e., in nonconvertible currencies.

[4] Cf., Frederic L. Pryor, "The Communist Foreign Trade System," Cambridge, Mass., MIT Press, 1963, pp. 106 ff.

for the implementation of national plans, but rather as a means of guiding the plan itself;

(vii) Price reforms, which include changes in the determination of prices and in the price structure;

(viii) The concentration of industrial enterprises into larger units (sometimes accounting for a whole branch of industry) * * * [having] administrative responsibilities but being called upon to operate to a greater extent as economically accountable organizations; and

(ix) The streamlining of the administrative apparatus responsible for the management of industry, and/or various administrative changes having more specific objectives.[5]

The basic thrust of all the reforms is in the direction of decentralization, which is natural considering that the ills of the traditional system have been largely ills of overcentralization. But the various reforms differ greatly in the extent and comprehensiveness of the decentralizing measures. On this, more presently. One feature should be noted here, however. In all the reforms except the most conservative, the Soviet, and the most daring, the Hungarian, the decentralization is in large measure not to the level of the individual enterprise but to that of the newly created (or strengthened) "associations" into which the enterprises of whole industries have been or are being combined. (See item (viii) above.)[6] This is important.

One reason given for creating powerful "branch associations" is that they can take over much of the burden of centralized planning, coordination, and management from the national planning agencies, and thus allow the latter to concentrate on broader and more basic problems. The associations are closer to the enterprises and can plan and manage them more effectively than can the top planners. The second reason for emphasizing the associations is that they have some distinct advantages over enterprises in terms of economies of scale: insuring large production runs where possible, centralizing research for the industry, standardizing technology and design, dealing with foreign buyers. We may add a third reason: it is easier for central authorities to maintain economic and political vigilance over 100-odd associations than over thousands of enterprises, especially if some devolution of decisionmaking power is to take place.

But what remains unclear in all reforms that place heavy emphasis on the branch associations—including the East German case where the new system has been in effect for several years—is how the coordination between branches is to be achieved without depriving the associations of their autonomy. If the reforms stop short of creating a workable market mechanism, there is always the danger of either permitting the associations to develop into autarkic empires, with consequent loss of efficiency and progressivity, or, to avoid these defects, backsliding into the old-style command economy by recentralizing to the top level. On the other hand, should a market mechanism be introduced, the Socialist country would enter the new era with a structure of supermonopolies, with all that again implies for efficiency and progressivity. Of course, insofar as the associations will be marketing abroad, they will be in salutary competition with foreign producers. But their domestic markets are likely to remain well protected, if only because foreign exchange shortages—which are sure to persist for a long time yet—will forestall active competition on the side of imports.

It is also necessary to take note of what the announced reforms are not to change—even on paper, let alone in the process of their realization:

(1) They assuredly are not intended to overturn the political monopoly of the party, the exclusive power of the regime, the basic commitment to a Socialist system, or the proclaimed advance toward full communism and further rapid industrialization.

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[5] United Nations Economic Commission for Europe, "Economic Survey of Europe in 1965," pt. 1, p. 57.

[6] In East Germany there are some 90 such branch associations (designated as VVB—Vereiningungen volkseigener Betriebe), while in Czechoslovakia there are about 100 "concerns" (vertically integrated large enterprises) and "trusts" (horizontally grouped enterprises in a given branch). In his speech announcing the Soviet reform (Sept. 27, 1965), Mr. Kosygin spoke of the creation of a "net" of branch associations on a level between the ministry and the enterprise, but it is not clear what is being done on this score. (The proposed "branch" associations are not to be confused with the firmy—horizontal groupings of relatively smaller enterprises—that have been created by the hundreds in recent years in the U.S.S.R.)

(2) The reforms do not challenge the principle of central planning of all the important "proportions" of the economy and of its speed and direction of development. Even should some of the reforms go so far as to establish Socialist market systems, they will continue to be subject to comprehensive national planning and central control and regulation.

(3) Moreover there is little indication that the resources of each country will cease to be under great pressure. While the national plans in the future may be less ambitious—not to say fanciful—than in the past, they will most likely continue to call for the highest degree of resource utilization. A corollary is that sellers markets are likely to persist.

(4) Because of this, and because of fear of inflation and uncontrolled redistribution of income, prices on all or nearly all important producer goods are likely to remain under control for some time. (We shall return to the question of prices at a later point in this essay.)

(5) The physical allocation (rationing) of producer goods (materials and equipment) continues in all the countries, and—in part because of points (3) and (4) above—is likely to continue for some time. There is talk, even in the U.S.S.R., of eventually abolishing materials allocation and going over to "wholesale trade" in producer goods, and the talk itself represents a significant change. But for some time it is likely to remain talk.

(6) The functionaries of both the Government and the party on levels above the enterprise remain largely the same, although they may change offices and "hats." And their mental habits remain the same. This is surely one of the more important reasons to expect a conservative bias in the implementation of the reforms.

(7) The principle of "one-man" management in the enterprise is not being significantly diluted, and the manager is still accountable only upward, not downward. In other words, the Yugoslav institution of "workers' self-management" is not being adopted. This is not an oversight; rather, it is a deliberate decision, common to all the regimes in question, to retain political as well as economic power where it now resides.[7] More on this below.

(8) Lastly, so far the institutional reforms have touched agriculture only marginally if at all, although in some of the countries (especially the U.S.S.R. and Hungary) additional resources in the form of higher prices and larger capital allocations have been channeled into the agricultural sector with the aim of improving its performance.[8]

The lineup of forces

The question of economic reform has been one of the most intense political issues to arise in Eastern Europe in the last several years. It has been as widely debated in professional journals, in the daily and specialized press, in academic forums, and in high councils, as any economic measure in any part of the world in recent history. It has profoundly divided the economic profession (though not in equal measure in different countries), and it could not help but cause deep division within the leaderships as well. Yet we know relatively little of the political side of the coin.

We do know that some of the most ardent advocates of reform—that is, of some reform of a decentralizing and rationalizing nature—have been academic economists (including those affiliated with research institutes) rather than the economic experts involved in actual planning or administration. But we also know that there have been, and continue to be, great differences in approach and opinion within the profession, ranging from preference for relatively mild tinkering with prices and organizational structures in advocacy of a Socialist market economy that is highly decentralized, at least for current production decisions and a portion of investment. Academic economists—some of them young and quite mathematically (or at least "Western") oriented in their economics—seem to have played an especially significant role in working out the

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[7] True, there has been considerable discussion of the augmented role of the official trade unions and of the intraenterprise "production conferences" (or similar worker-management councils). But these appear to be token moves; no serious step in the direction of Yugoslav-type worker self-management is to be inferred. In fact, in Hungary, the "factory councils" (which succeeded the autonomous "workers' councils" of 1956 vintage) are now being dissolved. (For a summary survey see "Economic Reform and the Changing Trade Union Role," Research Department of Radio Free Europe, Aug. 3, 1966, mimeographed.)

[8] On recent policy regarding agriculture in the U.S.S.R. see the contributions by J. F. Karz and Keith Bush in "New Directions in the Soviet Economy," supra, pt. II-b, sec. 3.

blueprints of the two most far-reaching reforms, those of Czechoslovakia and Hungary. In the Soviet Union, where the generational pattern was more severely imposed by the preceding decades of Stalinism, the division among economists has been in good measure along age lines. But even there, some of the abler and more vocal proreform leaders belonged to a venerable generation: the late V. Nemchinov, V. Novozhilov, A. Vainshtein, and (the somewhat younger) Ye. Liberman.

Much of the discussion among economists has been characterized by polemical intensity, which is not unusual for economic debates conducted in the shadow of political and ideological authority. The would-be reformers show a missionary zeal that is compounded of deep dissatisfaction with the status quo and faith in newly discovered (or resuscitated) economic truths. Their opponents have reacted to the challenge of their traditional axioms and habitual modes of thinking with predictable immoderation. Such, however, is the sweep of economic reformism in Eastern Europe (except in Rumania and Albania) that the Stalinist model seems to be no longer openly defended.

We know from their writings and from other evidence that some of the managers have been proreform, or at least in favor of lightening the weight of the superordinate bureaucracy and doing away with some of the irrationalities and inefficiencies of the existing system. But it would be overly hasty to assume that the vast majority of managers were in favor of the reforms, let alone of thoroughgoing decentralization. After all, the managers of today are the ones who succeeded under the old system by virtue of appropriate abilities or right connections. They are part of the Communist "establishment." Must we assume that they would overwhelmingly favor a change in the rules of the game?

What the man in the street or at the workbench has thought of the reforms while they are being debated in the press, after their announcement, and during the initial phases of their implementation, we simply do not know. Some may welcome the reforms for their promise of higher living standards. But many may fear for their jobs. In countries—notably Czechoslovakia—where, for incentive purposes, greater wage differentials have been advocated by the proponents of reform, the average (or below average) man may well feel apprehension. But we might also guess that having seen many a reform under the Communist regime in the past, the average citizen is prone to take an agnostic if not a cynical view.

Information on this score is fragmentary, but it seems that the chief opponents of the reform, and the chief obstructionists to their successful implementation at this stage, are to be found in the intermediate and upper layers of the party and governmental bureaucracy. The reasons, no doubt, are complex: fear of losing position or status, fear of opening a Pandora's box, ideological rigidity, and so forth.[9]

Comparisons and contrasts

Since the reforms in the individual countries have already been discussed in separate articles of the present series, we shall restrict ourselves here to pointing out the considerable range in the degree of "reformism" that the various measures—or, at this point more correctly, their language—represent. The most conservative, those of Poland and the U.S.S.R., bear a resemblance which seems to derive as much from shared caution or indecision as from anything else. Since the Polish reform was only recently discussed at some length in this journal by Professor Smolinski, we shall concentrate here on the Soviet reform as an example of a conservative measure.[10]

The Soviet reform consists of two distinct, if interrelated, parts: (1) the abolition of Khrushchev's sovnarkhozy (regional economic councils) and the reestablishment of "branch" ministries on the pre-1957 model; and (2) the reform "proper," which amounts to some vertical decentralization, together with related measures in the realms of prices, incentives, and management.

The reversion to a ministerial organization—a move of some significance but not of central importance for our present discussion—was carried out imme-

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[9] Cf. J. M. Montias, "Economic Reform in Perspective," Survey, April 1966, pp. 58–60.

[10] The Soviet economic reform was discussed by Michel Tatu in the January-February 1966 issue of this journal, but is reviewed here for comparative purposes. Leon Smolinski's article "Reform in Poland" appeared in July-August 1966. For analyses of the East German and Bulgarian reforms—which appear to be intermediate in their degree of "reformism"—see Dorothy Miller and Harry G. Trend, "Economic Reforms in East Germany," March-April 1966, and J. F. Brown, "Reforms in Bulgaria," May-June 1966.

diately upon its enactment in early October 1965, even without waiting for the end of the plan year. This haste is rather difficult to understand; it must have caused considerable confusion for a while.

The Soviet reform "proper" is being put into effect much more slowly, and by stages. It is to be fully implemented only after the revision of the price structure is completed—supposedly by 1967–68. The main features of the reform are:

(a) replacement of the "gross value of output" target by the "value of sales" target as the chief success indicator for enterprises;

(b) an enhanced role for profit as a criterion of successful operation, although at this point it is unclear to what extent it will challenge the primacy of the sales target in this regard;

(c) a reduction, but apparently not a drastic one, in the number of physical production targets;

(d) somewhat more freedom for management in the selection of inputs (labor, materials, equipment) and in inventory holdings;

(e) the shift of production planning toward more reliance on mutual orders among enterprises (so-called direct links);

(f) greater freedom for industrial enterprises to decide their own investment and to finance it from internal funds or bank credit, rather than from budgetary allocations;

(g) financing of some new projects by bank credit rather than budgetary allocations;

(h) charging of interest (though not under this name) for all the capital invested in an enterprise; and

(i) use of a part of the profit earned by an enterprise for bonuses to its management and staff, linking the bonuses to the amount of profit earned.

Many of these measures—particularly those giving management somewhat greater leeway as well as a financial inducement to economize—are so commonsensical that one wonders why it took 35 years to introduce them. The substitution of the sales target for the gross output target will presumably eliminate or reduce the ridiculous but not infrequent situation of enterprises producing utterly unsalable goods. (On the other hand, it may in some cases only enhance the producers' efforts to pass on their low-quality wares.) Perhaps the most reformist of the features is the granting of considerable autonomy to enterprises in the realm of investment, especially for modernization and rationalization. By 1967, a quarter of gross fixed investment in industry will supposedly have been "decentralized" in this fashion. The catch here, however, is whether the enterprises will be able to obtain the necessary materials and equipment, which continue to be tightly rationed, and whether they will have the requisite incentives to undertake the investment. Moreover, the economic rationale of decentralized investments, even if profit-motivated, remains under a cloud until the price structure is rationalized.

The Soviet reform is qualified here as a conservative one because it retains (1) most of the physical production targets, and (2) the rigid system of materials allocation. Both of these holdovers from the past will present serious handicaps to attempts by enterprises to adjust production to demand and to select economical input mixes, even if the role of the profits target under the new system is less equivocal than it seems to be. Lastly, the same functionaries staff the new ministries and bureaus, and complaints are already being voiced in the Soviet press that the bureaucracy refuses to give up its habitual modes of operation.

Some 700 industrial enterprises were converted to the "new system" by mid-1966. It was said in March that by the beginning of 1967 one-third of all industrial workers would be brought under the system, though it is not clear whether the conversion of enterprises implies adoption of all or only some of the above-enumerated changes. The crucial test will come, however, in regard to the revision of the price structure. It is here that much of the current discussion and struggle is centered. Should the price revision follow orthodox lines—eliminating most subsidies but paying little heed to the equilibration of demand and supply—as now seems likely,[11] then (as we shall presently argue) it will be very difficult, even with the best will in the world, to get rid of materials allocation and physical production targets, with the result that no major decentralization can take place.

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[11] See the contribution by Morris Bornstein in "New Directions in the Soviet Economy," supra, pt. I.

At the other extreme of the spectrum are the Czechoslovak and Hungarian reforms.[12] The former entered its first phase of implementation at the beginning of 1966; the latter is about to be launched. In both cases, the accompanying rhetoric is more impressive than the institutional reforms themselves. In Czechoslovakia—where growth had ground to a halt and other economic difficulties were pressing—the dominant tone of published economic opinion swung from deep orthodoxy to extreme liberalism (in the Communist context) within a matter of months during 1963–64. In Hungary, economic opinion shifted more slowly and over a longer period, but by now has arrived at a frontier of liberalism similar to the Czechoslovak.

The current rhetoric in these two countries consists of scorn for orthodox, Soviet-type economic institutions (though with a bow to their contribution to "extensive" growth in the early postwar period) and lavish praise for the market mechanism, profitmaking, and competition. To be sure, the profitmaking and competition are of the Socialist variety, and the market is to be a handmaiden of the national plan. But nonetheless it is hard to believe that statements like "the market is the final touchstone of the social usefulness of expended labor," [13] or the "uniform and single criterion [for economic decision] is profit," [14] emanate from Communist economists writing in official publications. The infatuation with the market—now evident among economists all over Eastern Europe and in the U.S.S.R., as well as in the two countries mentioned—may be an understandable and even salutary reaction to its former dogmatic rejection; yet this optimism will doubtless be followed in time by a swing toward the center, when it is realized that the market raises its own difficult problems.

The actual reform measures adopted in Czechoslovakia and Hungary do not fully share the economists' infatuation with the market. These reforms—though far reaching, in comparison to the system they aim to supersede—are much more cautious and compromise-ridden. The leitmotif is of course decentralization. We have already noted the agglomeration of Czechoslovak industry into 100-odd concerns and trusts, leaving little prospect for domestic competition. Physical production targets are not entirely eliminated; they remain (in Czechoslovakia) for several dozen commodities of key importance, such as items for which there are definite export commitments.[15] Insofar as this writer is able to discover, the rationing of some scarce producer goods is likely to continue into the near future. Lastly, most producer-goods prices are to be either fixed or subject to ceilings (which amounts to the same thing, since pressure on them is likely to be upward).[16]

The formal introduction of the Czechoslovak reform began almost a year ago, and some useful lessons are already discernible. One of the most significant lessons is that the reforms are destined to have rough sledding, just as they have had even in the far less radical Soviet case. Usually blame is attached to deliberate sabotage or resistance on the part of the hostile and entrenched bureaucracy. (Similar charges have been continually made in Yugoslavia, culminating in the purge of Ranković and his associates in mid-1966.) Quite possibly, this is where most of the blame belongs. Yet, we should also realize that decentralized decisionmaking simply cannot do a proper job when the signals (prices) are still faulty and the economy is still ridden with scarcities. Under such conditions there may be very good social reasons to keep close rein on the enterprises and the trusts. And a way to discredit the reform would be to decentralize too fast, before prices were properly revised.

Pricing problems

It is often said in relation to the East European reforms that their success is predicated on the establishment of rational price structures. This is not

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[12] The Czechoslovak reform is covered in detail by Harry G. Shaffer and Vaclav Holesovsky in "Problems of Communism," September-October 1965; on the Hungarian reform, see Joseph Held's article in this issue.

[13] Zdyslav Shults, "Creative Development of Marxist Economic Thinking," Problems of Peace and Socialism, June 1965.

[14] József Bognár, "Overall Direction and Operation of the Economy," the New Hungarian Quarterly, spring 1966, p. 13.

[15] The number of compulsory targets in the national economic plan is said to have been reduced from 1,200 to 67.

[16] In Czechoslovakia, free wholesale prices are to account for only 7 percent of the value of industrial output, and free retail prices for only 11 percent of retail sales. See useful summaries in Economic Survey of Europe in 1965, supra, pt. 1, p. 65, and Ekonomicheskaia gazeta, No. 9, 1966, p. 41. In Hungary, free wholesale prices are to apply to 29 percent of (all?) goods, Pravda, June 20, 1966, p. 3.

quite correct, if in this context "rational prices"[17] mean what they usually mean to economists; namely, a set of prices which—together with appropriate managerial rules and incentives, and in the light of society's resources and technological knowledge—will maximize some kind of index of social welfare. Of course, in an authoritarian society this index is largely defined, if only implicitly, in an authoritarian way.

Needless to say, prices in no actual economy are "rational" in this theoretical sense. An economy can function quite well, albeit at less than 100 percent theoretical efficiency, if the actual prices deviate moderately from the theoretical norm; and many do.[18] To be sure, the price structures of the Communist economies probably deviate more than "moderately" from the theoretical norm. If the efficiency of the economies is to be raised substantially, the price structures will have to be revised to conform more closely to a rational norm—even though complete coincidence is not to be expected.

What is meant by the reforms succeeding, however, is usually something else; namely, that the decentralizing and initiative-stimulating measures survive an initial test period, and that the economy performs in a reasonably satisfactory fashion thereafter. Insofar as prices are concerned, the crux here is that the price structure should not be such as to force major recentralization of economic decisions, and this is achieved by the use of equilibrium prices. By "equilibrium prices" we mean prices which serve to equate demand and supply for each individual commodity, service, or resource. In the abstract model of a perfectly efficient economy, rational prices are also equilibrium prices. But in practice they are not the same, as attested to by every market economy without price control.

To see why equilibrium prices come close to being a necessary condition for the success of the reforms—in the sense in which we have just interpreted "success"—we need only inquire what will happen if the Soviet-type economies are organizationally decentralized, but prices are fixed at levels substantially deviating from equilibrium levels. Since these economies are likely to be experiencing high overall demand in relation to their productive capacity; i.e., inflationary pressure, the fixed prices soon become too low to equate demand and supply. (As we shall presently see, a main reason for price fixing is precisely to resist inflationary pressure.) For the sake of simplicity, let us focus on producer-goods prices at wholesale.

Because prices are too low and demand exceeds supply, all important goods must be allocated (rationed) to reserve them for higher priority purposes, as indeed will continue to be the case under the reforms. As a result, enterprises are severely constrained in their efforts to maximize profits by using the best (i.e., cheapest) combinations of inputs, and one of the chief aims of the reforms is thereby already frustrated.

Moreover, to allocate materials effectively the authorities must take care that the expected supplies are forthcoming. Yet the fixed prices may render the production of some goods unprofitable. Hence, there will be a strong temptation on the authorities' part to keep direct control of production, which means to assign physical production targets to enterprises. (If instead prices should be manipulated to elicit the requisite supplies, which is what the market mechanism would call for, then the objective of a stable price level would be endangered and the specter of inflation would loom larger.) But physical production targets have a well-known tendency to proliferate—and before long most important decisions in the economy are recentralized.[19] Even if a reform had gone so far as to establish a market mechanism, the retention of tight materials allocation and other physical controls would tend to undermine the "market" progressively, until finally the command economy was reestablished.

Furthermore, the complex and arduous process of price fixing in itself strengthens the hand of the bureaucracy, diverts the attention and efforts of

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[17] Also known to the economist as "efficiency prices." In the current terminology of Soviet economics they are often referred to as "prices of the optimal plan," and are a close kin to L. V. Kantorovich's "objectively determined valuations" or V. V. Novozhilov's "differential costs."

[18] It has been lately argued by a number of Western economists that the deleterious effects of price distortion through resource misallocation are very small, at least in some market economies. See, for example, Harvey Leibenstein, "Allocative Efficiency Versus 'X-Efficiency,'" American Economic Review, June 1966, pp. 392–415.

[19] I have discussed elsewhere the penchant of the command economy for "creeping recentralization." See Gregory Grossman, "Notes for a Theory of the Command Economy," Soviet Studies, October 1963, p. 114.

enterprises away from production and selling, and retards the depoliticization of economic life (which is one of the desirable corollaries of the market). Even with more or less equilibrium prices, the authorities and the bureaucrats might not wish to relinquish materials allocation, either because they want to hold on to their power or because they fear (in part justifiably) that the market alone will not be able to insure the satisfaction of national priorities. But without equilibrium prices, there is little chance that materials allocation will be dismantled.

Thus, equilibrium prices are a necessary—or almost necessary—condition of the success of the decentralizing reforms. Yet, it does seem that in any of the countries in question the impending price revision will result in bringing wholesale prices of producer goods to equilibrium levels, or at least in leaving them there for a critically lengthy period of time. First, as we have noted, in all cases price revisions will hardly depart from the traditional principle of fixed prices. Second, while lipservice is often given to the equilibration of demand and supply through prices—especially in the case of Czechoslovak, Hungarian, and (more recently) East German materials—the more concrete and authoritative statements offer little hope on this score.[20] Rather, the usual formulation is that "prices must be fixed for all important commodities that are still in short supply," which is to say that prices are to be fixed at below-equilibrium levels. Third, in any case it is very hard to compute in advance what the equilibrium level of any price will be while all prices are changing at the same time (and the ground rules of economic behavior as well). And those prices that are set too low are likely to be kept there as the authorities strain to hold the general price line. Which brings us to the fourth point. While much lipservice is also paid to some minimal price flexibility, the arduousness of price calculation, the complexity of the procedure, the desire to hold the line against inflation and the "politics" of the matter—all these considerations rather suggest that once prices are revised they will tend to remain fixed for lengthy periods. Which is to say that even if producer-goods prices start at or near equilibrium levels, they are not likely to stay there very long as supply-demand conditions change.

But why fix producer goods prices? Why not let them fluctuate freely? The reasons are many. The ideologically conservative are repelled by the idea of the "chaos" of freely fluctuating prices under socialism. The top leaders and planners are reluctant to forswear what will become in the process of the reforms a most important instrument of control over the economy. (We may recall here, for example, the danger of monopoly inherent in the newly formed or strengthened "associations.") Bureaucrats do not wish to deprive themselves of their functions, power, and jobs. Some managers may fear the uncertainty that would accompany freely moving prices. It must be noted that price uncertainty is now much more unsettling to enterprises than before, given the enhanced role of profit as a success indicator, as a source of personal income for management and staff, and as the chief determinant of internal investment funds.

Still another major reason for opting for fixed prices is the fear of inflation. Communist governments have always been sensitive on this issue, although—or because—their record on this score is none too strong. There is a good deal of validity to the fear of inflation at the present juncture. Reforms or no, the pressure of overall demand on resources is likely to continue to be strong. In the labor-short countries (Hungary, Czechoslovakia, and East Germany), the tightness of the labor market will continue to put upward pressure on labor costs. In the labor-surplus countries, rural-urban migration will continue to be rapid, continuing to swell money incomes. Relative wages and other incomes may have to be readjusted—for this is one of the rationalizing aspects of the reforms—but the days when it was politically possible to readjust relative incomes by pushing some money incomes down are long gone in the countries in question. Thus, the danger of cost inflation by dint of an upward drift in wages and other incomes casts a long shadow on the reforms, even allowing for their expected boost to efficiency. Not surprisingly, wage and salary rates remain generally under central control in all the reforms. But control of wage rates and even of total wage payments is not enough because of the profit-sharing features of the reforms. Hence, there is also an argument for simultaneously

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[20] Cf. Bornstein, loc. cit., and "Economic Survey of Europe in 1965," pt. 1, pp. 56 ff. An example of the equivocating approach to price revision that apparently prevails in high places can be found in Béla Czikós-Nagy (head of the Hungarian Price Office), "Die Ungarische Preisreform," Osteuropa-Wirtschaft, No. 3, 1966, pp. 209–219.

fixing prices. The effects of an inflation of producer-goods prices (in the Socialist sector) would be serious, even in the Socialist economy, and especially after the reforms. It might lead, via a "cost push," to inflation of consumer-goods prices, with likely negative political effects. It might also bring about an undesired redistribution of income via the profit-sharing schemes. And it would likely distort the direction of investment to the extent that investment is now decentralized.

As we have just noted, wage and salary rates will, as a rule, continue to be centrally set under all the reforms in question. However, as a means of checking inflation this control is imperfect, since the central authorities cannot oversee the classification of each employee, a matter which remains dependent in part on individual bargaining between employee and employer. Thus there is reason to limit or restrain the total outpayment of wages and salaries by each enterprise. The reforms provide a range of techniques. In the more conservative reforms, such as the Soviet, the old practice of assigning a maximum wage fund to each enterprise is preserved, although the fund is no longer to be broken down into subdivisions for specific categories of workers and employees. At the other extreme, in Czechoslovakia, there is apparently no such limit on each enterprise, but wages are taxed (via a tax on so-called gross income) and new "stabilization payment" is being introduced, which is a 30-percent tax on wage payments above a stipulated minimum.[21]

In sum, the need for rigid physical controls would be lessened, price flexibility would more likely be allowed, and hence the decentralizing reforms would be more likely to succeed, if the overall pressure on resources—which is to say, the ambitiousness of the national plans and goals of the countries in question—were to be restrained. To some extent the ambitiousness of the national goals is a delayed response to the long-repressed material aspirations of the population. But the pressure on resources also derives in large measure from more traditional Communist objectives—rapid industrialization, military power, etc. In this regard it is worth noting that an improvement in the international climate might well have a significant effect both directly and indirectly on the course of the reforms.[22]

The question of viability

How viable are these reforms on purely economic grounds? It has already been noted that the "blueprints" of the reforms vary considerably along the scale of liberalization in terms of the decentralization of production and investment decisions—but that everywhere prices and wage rates are to remain under rather tight control, and that (most significantly) materials allocation is to be continued. Clearly the more conservative reforms, especially the Soviet and Polish, fall far short of envisioning anything like a functioning Socialist market economy. The Czechoslovak and Hungarian blueprints, in both language and design, come much closer to instituting a market mechanism, at least for current production decisions.

We must bear in mind that the implementation of every reform, however liberal or conservative on paper, is likely to suffer from a conservative bias. This is so because, first, the detailed implementation is inevitably in the hands of the bureaucracy and party apparat—that is, largely in the hands of the reforms' opponents. But, secondly, there are also good "objective" reasons for the bias. In the course of implementation there will be innumerable specific, detailed problems to be resolved. They will mostly be problems of coordinating separate activities and insuring harmony between the dispersed decisions and the national goals. As a rule, such specific problems can be resolved only by centralizing certain particular decisions and actions, not by leaving them to be handled at the enterprise level.

Thus, the implementation of the reforms is likely to fall short of the decentralizing reach of their blueprints. Will the resultant halfway or quarterway solutions be viable? One wonders. If the market mechanism is not strongly enough established—and most of the reforms do not even intend to establish it—then the burden of coordination among the millions of economic decisions and activities will largely remain with the central authorities. To do this job—

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[21] See East Europe, September 1966, p. 53. The "stabilization payment" is a two-edged sword. It may hold wage payments down. But it may also contribute in part to the "cost push" and thus to inflation.

[22] See this author's "Soviet Economy and the Waning of the Cold War," in Robert A. Goldwin, "Beyond the Cold War," Chicago, Rand McNally & Co., 1966.

and to protect its own positions—the bureaucracy is likely to resume the process of centralization. In this it will be strongly abetted by the persistence of materials allocation and by the fear of inflation, as has already been argued. Moreover, the partial decentralization of investment in the absence of a suitable price system may well channel resources into directions that the central authorities deplore and that they will therefore attempt to thwart by administrative means. In general, effective decentralization in a centrally administered economy can take place only when carried out on a very broad front all at once, which requires intervention from higher quarters and calls for big political battles. Centralization, however, can and often does proceed in little steps, virtually unnoticed but important in aggregate impact.

Of course, many of the sensible features of the present reforms are likely to survive the recentralizing process. Such measures as the substitution of the sales target for the gross output target, the charging of interest and economic rent, a moderate amount of profit sharing, need not fall victim to recentralization.

To sum up, the more conservative reforms involve relatively little liberalization to begin with, and to the extent that they do, they are soon likely to begin drifting back toward the status quo ante (at least in the absence of additional broad decentralizing measures). The countries with more liberal reforms are also likely to experience recentralizing tendencies soon after the new institutions make their appearance. But here—which is to say, primarily in Hungary and Czechoslovakia—the repudiation of the old system has gone so far that the result is more likely to be a lengthy epoch of drift rather than a substantial reversion to the former extremely centralized setup—unless, of course, more resolute liberalization is decreed from above to establish a viable, market-bound alternative to the command economy.

It should be noted that the chances of such resolute liberalization do not seem to be high for the foreseeable future. No doubt voices will continue to be raised in favor of a fuller role for the market mechanism. The struggles and debates will go on. But, by having gone as far as it has already, "by consenting to reform the old bankrupt planning system, the regime hopes to gain a new lease on life, not to abdicate."[23] Economic liberalization is pregnant with political risks—the more liberalization, the higher the risks—and the first imperative of each regime is to retain power, not to endanger it for the sake of better economic performance. In this it has the more-than-willing support of the bureaucracy and the apparat. On the other hand, it would be foolhardy to exclude altogether the prospect of "marketization" of the present command economies. Yugoslavia has accomplished a form of it, although under very specific conditions. The Soviet world is in flux and ferment; the chain of surprises has not yet come to an end. There may be a lesson in the fact that few competent observers would have predicted 3 or 4 years ago that the cautious Czechoslovak and Hungarian regimes were about to sanction their economic reforms, even if only on paper.

Political implications

What, then, of the future? We noted at the start that economic decentralization should not be confused with sociopolitical democratization. True, in all East European countries the launching of the reforms was preceded by a remarkable broadening of the limits of economic discussion. Some extension of the bounds of permissible discussion also occurred in other social sciences (sociology and law) and in cultural affairs. Yet the launching of the reforms themselves need not at all imply further liberalization in the intellectual and cultural spheres. Indeed, the opposite may happen, should the regimes feel that the potentially centrifugal effect of the economic reforms ought to be contained by stricter ideological and social controls; or should bargains be struck between various factions in the leadership, in the sense that the "price" of economic liberalization becomes retrenchment on other fronts. Such seems to have been the case in the U.S.S.R., as evidenced by the divergent lines laid down at the 23d Party Congress (March 1966), where the economic reforms of the preceding autumn were reaffirmed, together with a distinct hardening of ideological and cultural positions. A similar trend has also been evident in Hungary. Nor need we expect that the purely economic successes of the reforms—if they materialize—must perforce increase freedom and democratize political life in

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[23] Holesovsky, op. cit., p. 45.

the Communist countries. Greater economic freedom for managers is not yet political freedom for everyone, and improvement in material conditions of life can come without the multiparty ballot.

It would be convenient to leave the argument at this point, but much too easy. For one thing, a successful decentralization of the economy—should it occur despite the various handicaps that have been outlined above—would tend to change the role of the party in society. Today, the lower and intermediate party levels owe their functions and powers in the economy precisely to the failure of economic institutions. So far, these levels of the apparat have had a job to do because of inadequate incentives, improper signals, imperfect coordination within the economy, conflicting goals and standards, shortages of all sorts, and other functional defects. In all such cases the party has had to step in to keep the wheels of the economy turning. But if the economic mechanism itself is so improved as to provide adequate and proper signals, incentives, and coordination, then most of the party's economic functions at the intermediate and lower levels disappear. The basic question of what role the party is playing in society, already looming on the horizon, will become even more apt and timely. Will the parties in the other Communist countries be prepared to restrict their day-to-day economic roles as the Yugoslav party has done?

Seen otherwise, the political implications of the reforms depend largely on the extent to which economic decentralization survives the initial test—about which we have already expressed considerable doubt—and proves capable of creating alternate nodes of power that in some measure escape the full control of the regime. The great autonomy of enterprises (or "associations") creates some measure of power that—almost by definition—is not under the close control of the party leaders. But whether this can contribute to the growth of meaningful political pluralism remains to be seen. On the other hand, enterprise autonomy may stimulate the appearance of labor organizations such as workers' councils (as distinct from the regime-controlled trade unions) with which to confront management "from below." Any such institutions would be potentially significant sources of power in that they would be relatively independent not only of management but of the existing political authority. Enterprise autonomy is conducive to labor autonomy, and it is the latter that poses by far the greater challenge to the existing order. Could the conservative opposition to economic reform be motivated in part by fear of this possibility? If so, the Yugoslav experience with workers' "self-management" offers nothing to allay the conservatives' apprehensions.

That the present European Communist regimes (except Yugoslavia) have little liking for autonomous workers' councils is clear. Where such councils arose spontaneously—in Poland and Hungary in 1956—they were quickly suppressed or subverted after the new regimes reestablished internal control. They are most conspicuously absent from all the blueprints of economic reform, although some token gestures are made in the direction of worker participation in decisions at the enterprise level. Yet it is hard to believe that in time the issue of autonomous workers' councils and meaningful workers' "self-management" will not come to the forefront. When it arises, it will be inevitably linked with the issue of more meaningful enterprise autonomy, for without the latter, workers' councils or "self-management" lack substance. And at that juncture the political implications of economic reform will become much more profound than now.

APPENDIX

The following is a list of the names and titles of foreign government and private individuals with whom members of the Subcommittee on International Trade conferred between December 7 and 17, 1966. It does not include the names of U.S. Embassy officials with whom the group met.

ROME, ITALY—DECEMBER 7

Istituto Mobiliare Italiano

Stefano Siglienti, president.
Dr. Silvio Borri, director general.
Giorgio Cappon, vice director general.
Astorre Oddi Baglioni, general manager.

FIAT

Prof. Vittorio Valletta, president.
Mr. De Regibus, secretary general.

BELGRADE, YUGOSLAVIA—DECEMBER 9–12

Dr. Slavko Komar, President, Commission for the Banking and Credit System.
Nikola Miljanic, Governor, Yugoslav National Bank.
Milenko Bojanic, General Director, Yugoslav Investment Bank.
Srdja Prica, Counselor to the State Secretary of Foreign Affairs.
Nikola Dzuverovic, Federal Secretary for Foreign Trade.

BUDAPEST, HUNGARY—DECEMBER 13

Janos Nyerges, Chief, Department of International Organizations, Ministry of Foreign Trade.
Janos Fekete, Managing Director, Hungarian National Bank.
Odon Kallos, president, chamber of commerce.
Dr. Janos Meszaros, Director, Hungarian National Bank.
Endre Kovacs, commercial counselor, Hungarian Embassy, Washington, D.C.
A. I. Lengyel, desk officer, U.S. Ministry of Foreign Trade.

PRAGUE, CZECHOSLOVAKIA—DECEMBER 14–16

Vladimir, Babacek, Deputy Minister of Foreign Trade.
Dr. Frantisek Kriegel, Chairman, Foreign Affairs Committee, National Assembly.
Dr. Zdenek Trhlik, Chief, Sixth Section, Ministry of Foreign Affairs.

Richard Dvorak, Minister of Finance, member of the Central Committee.
Dr. Otakar Pohl, Director, Czechoslovak State Bank.
Dr. Jaroslav Nydrle, deputy general manager, Commercial Bank.
Dr. Jaromir Balcar, vice president, chamber of commerce.
Dr. Milan Kubat, Director of Engineering, Ministry of Heavy Engineering.
Dr. Jaroslav Jirasek, Director, Institute of Management.
Josef Keller, Director, Ministry of Foreign Trade.
Otto Kykal, United States-Canadian Affairs, Ministry of Foreign Trade.
Zdenek Matousek, deputy general manager, Centrotex.
Egon Busch, editor-in-chief, International Politics.
Frantisek Lebenhart, editor-in-chief, Czechoslovak Life.
Emil Sip, foreign editor, Rude Pravo.
Karel Kyncl, foreign editor, Mlada Fronta.
Milan Weiner, foreign news editor, Czech Radio.
Arnost Vrajik, journalist.
Prof. Ota Sik, director, Institute of Economics, Academy of Sciences.
Josef Karlik, director, Czechoslovak Airlines.
Dr. Josef Stastay, Chief, Department for Foreign Affairs, Ministry of Finance.
Karel Doudera, foreign editor, Rude Pravo.
Milan Bretys, chief, foreign news department, CTK.

SOVIET UNION—DECEMBER 17

N. D. Komarov, Deputy Minister, Ministry of Foreign Trade.
V. N. Sushkov, Chief of the Main Administration for Import of Machinery from Capitalist Countries, Ministry of Foreign Trade.
A. N. Manzhulo, Chief of the Administration for Trade with Western Countries, Ministry of Foreign Trade.
N. V. Zinoviyev, Deputy Chief of the Administration for Trade with Western Countries, Ministry of Foreign Trade.
V. I. Khazanov, Chief of the American Section, Ministry of Foreign Trade.
V. M. Ivanov, Deputy Chief of the Foreign Exchange Administration, Ministry of Foreign Trade.
V. A. Salimovskiy, chairman of Litsenzintorg.

[From Business Abroad, May 30, 1966, pp. 30–31]

FIAT Maps a New Route in World Business

ITALIAN AUTOMAKER'S PACT TO MAKE CARS FOR MOSCOW ACCELERATES EAST-WEST TRADE ACTIVITY; OTHER FIRMS ALSO LINING UP TO TALK WITH RUSSIANS

Milan.—FIAT's $900 million Soviet deal concluded early this month is an economic landmark for both Italy and the Soviet Union. It also has broad implications for world business.

Five years in the making, the agreement was signed in Turin by Soviet auto industry Minister Alexander M. Tarasov and FIAT's just-retired 82-year-old President, Vittorio Valletta. It calls for FIAT to build a plant in the Soviet

Union capable of turning out 2,000 cars a day—roughly 600,000 a year—a little less than the 1965 output of the Buick Division of General Motors. It is the biggest deal ever made between a private company and the Russians.

The car to be manufactured is the new FIAT 124, modified for Russian weather and roads (less window glass, far tougher suspension, and a 1,400 cc. engine instead of the standard 1,200 cc.). Most likely sites are Moscow (where assembly plants already operate), Minsk, Gorki, or Zaporozhe, an island in the Dnieper.

For FIAT, the deal means building a plant almost two-thirds as big as its sprawling Mirafiori works at Turin—a complex which accounts for 3,200 of FIAT's 4,000-car-per-day capacity. And this means business for many companies besides FIAT.

"Construction of a plant two-thirds the size of Mirafiori is a $1 billion job," says one Italian banker. "It can't be done for less." And, he adds significantly, "FIAT can't do it all."

An Italian industrial engineering consultant familiar with FIAT's production line agrees. "This deal will mean lots of business for non-Italian firms * * *. There's an awful lot of non-Italian equipment in FIAT.

"The Orinoco steel mill in Venezuela, also built by Italians, is a good example of how this works. The prime contractor there was Innocenti, but a good 35 to 45 percent of the job was handled by non-Italian companies—mostly American, but everybody got into the act—and that project was only half the size of this one."

Soviet consumers gain

For the Soviets it will mean quadrupling annual auto output from 200,000 to 800,000 by 1970 and a giant first step toward a consumer economy. (At the start of 1965 the U.S.S.R. had only 926,000 passenger cars, one for every 235 persons, compared to one for every two persons in the United States.) At the same time, by dealing with FIAT the Soviets avoid the embarrassment of teaming with a firm from a country that is a traditional enemy (West Germany), a potential foe (the United States), or a political question mark (France).

A real consumer revolution in the Soviet Union would, of course, have significance far beyond the business pages, and it is therefore easy to overstress moves in that direction. The Soviets' decision to commit nearly $1 billion in foreign exchange to establish an auto industry does prove, however, that Government emphasis on the consumer sector is going far beyond mere words. And experience suggests that the consumer—American, Italian, or Russian—becomes more eager for goods as his standard of living rises.

Experience in Poland shows that auto owners forgo necessities for the luxury of a car. A study by the Polish Main Statistical Office shows that car owners spend 37 percent less on food than carless families of similar income.

The FIAT deal also confirms the Soviet policy of using scarce foreign exchange to buy manufacturing plants and sophisticated capital goods that cannot be produced in the U.S.S.R. The consumer revolution will have to go a long way before large-scale importation of Western consumer products is likely.

Italy looks East

For Italy, the deal means a big headstart in the race for East Europe's auto market and a shot in the arm for the entire Italian economy. It also shows Italy's growing role as an international financier. Istituto Mobiliare Italiano and Mediobanca are reported extending $200 to $300 million of the credit, at terms estimated as long as 7 years. This follows IMI's $74 million contract awarded to the Italian consortium to construct the giant Rio Montaro dam project in Peru.

The Italians are making up for lost time in East Europe. FIAT is also expanding its Yugoslav plant, negotiating to build two plants in Rumania, and is expected to take over a medium-sized assembly plant in Poland.

Last December Montecatini signed a $112 million contract to build six chemical plants in the U.S.S.R. Sant' Andrea of Novara, heading a consortium, picked up a $25.6 million order to supply the Soviets with a wool textile complex. Pirelli has deals for a $6 million rubber regenerating plant and a $1.3 million latex glove factory. Chatillon (of the Edison Group) put up a rayon textile mill. Other Italian firms have supplied the Russians with plants to make everything from hosiery and chocolates to spaghetti.

Another Italian heavy machinery and machine tool manufacturer busily talking to the Russians is Innocenti of Milan. One of the first Italian companies to look East for additional business, it has been a steady supplier of milling and boring machines and presses of all types to the Soviet Union since 1961. The most recent shipment included special machines for stretching seamless tubes.

Innocenti's new sales director, Dr. Gianfranco Rodocanachi, who just this month concluded another round of talks with Soviet economic officials here for the FIAT deal, smiles mysteriously and says: "We're doing lots of talking * * * have quite a few things on the fire."

Firms which have not yet tied up deals with the Russians are queuing up at the door. Olivetti, apart from whatever side benefits it may get from the Soviet-FIAT deal, has its hands full already. Olivetti signed a technical collaboration protocol with the Soviets last December, and is now working to turn it into something really big—like supplying the electronic data processing systems for the Soviet Union's new and expanding consumer industries.

If that deal matures, it would also be a coup for General Electric, a partner with Olivetti in its EDP activities.

[From Business Week, May 14, 1966]

How FIAT Sold Moscow

THE ITALIAN AUTOMAKER'S DEAL TO HELP MAKE CARS IN RUSSIA WILL GIVE $320 MILLION BOOST TO ITALIAN INDUSTRY. NOW FRANCE'S RENAULT AND JAPAN'S TOYOTA MAY FOLLOW ITS LEAD

It was about quitting time for factory workers in Turin, Italy, last Wednesday when a peppery little Italian industrialist and a rotund Russian bureaucrat decided to sign their contract and do business together. Then, FIAT's honorary president, Vittorio Valletta, and Soviet Automotive Industry Minister Alexander Tarasov toasted each other with champagne.

Each had reason to grin. With a stroke of his pen, Tarasov thrust the Soviet Union further into the automotive age than it has ever been. For his part, Valletta plunked FIAT right in the middle of the biggest industrial deal the Russians have ever made with Western companies. It could lead to more of them in Eastern Europe.

FIAT contracted to help engineer and set up a plant in Russia capable of producing 2,000 cars daily, or about 600,000 a year. The cars will be versions of FIAT 124's, reportedly modified with a larger engine (1,400 to 1,500 cc.), more rugged frame, less glass area, and better battery shielding as protection against Russia's primitive motoring conditions and harsh climate.

Impressive

While the secretive Russians didn't want to talk publicly about money, the deal by any standard is a whopper. Estimates of total cost run as high as $800 million, although slightly more than half of this may be local expenditures.

Certainly, the Italians came up with attractive financing. Istituto Mobiliare Italiano, the Italian state financing organization, agreed to finance $320 million of the deal, the part to be spent in Italy. The loan is repayable in 8½ years after delivery of goods at about 6½ percent interest. About 65 to 75 percent of the $320 million will be spent to buy machine tools and other equipment from Italian companies besides FIAT (Tarasov visited the Innocenti machine tool plants and the headquarters of Pirelli, Italy's biggest tiremaker). Other orders may be placed with other European and perhaps even some American companies for supply of additional machinery.

Construction of the plant probably will begin next year, with the first cars rolling off the line by 1969 and full capacity output probably several years later. No announcement of the plant's location was given, but Moscow sources mentioned as possible sites the Moscow area, Gorki, and Zaporozhe. All three are currently centers of vehicle production; Zaporozhe, in the Ukraine, also has a steel mill. An estimated 2,000 Italian technicians will be sent to Russia to oversee engineering and construction of the plant.

New outlook

The FIAT deal reflects a changed Soviet attitude toward the passenger car in recent years. Both Stalin and Khrushchev were against private passenger cars

on principle on the grounds that they tended to promote a private enterprise mentality and that they wasted resources. Premier Alexei Kosygin, however, has said it is wasteful for Soviet officials to ride around in trucks and commercial vehicles. In any case, he ordered Soviet passenger car production increased from about 200,000 a year currently to about 800,000 by 1970. Some of the new cars will become taxis and a few will go to private use, but there is no indication yet that the Kremlin will devote sizable resources to mass construction of roads, service stations, and repair facilities typical of motorized societies in the West.

Since the FIAT plant won't go into quick production, it is expected that the Russians also will expand existing plants—and possibly contract to buy others in the West to reach an output of 800,000 cars by 1970. They have been dickering with France's Renault for a plant with the approximate capacity of the FIAT plant; a Renault mission is to leave Paris for Moscow later this month. Japan's Toyota Motor Co. has had preliminary talks with the Russians on a plant capable of producing 300,000 to 400,000 units a year, and the company is drawing up plans to submit to the Russians this summer. Renault may at least get some of the equipment for the FIAT plant.

The origin

FIAT clinched the Soviet deal after 4 years of trying. In 1962, Valletta flew to Moscow to open a large FIAT exhibit at an Italian trade exhibit there. Valletta met Khrushchev, and the two talked about possibilities for plants to manufacture cars, tractors, or both.

Subsequently, Valletta hosted delegations of Soviet technicians visiting FIAT factories in Turin. Last July, Valletta and Khrushchev's successors signed a protocol for the joint study of scientific and technical problems. While the language was obscure, it was widely believed that FIAT and the Russians were working on a deal for building plants to make autos and tractors.

Nothing more was said about the deal until mid-April when Tarasov went to Italy at the head of a big technical delegation. Almost immediately, Italian sources hinted the deal was close to completion and that the Russians were mainly concerned about technical aspects of the car model and financing. FIAT. according to Italian sources, offered the Russians the 124 model, a new five-passenger four-door sedan with an engine in the 1,200 cc. range.

But the Russians wanted a bigger engine. They also didn't like the large expanse of glass, possibly because it would be harder to seal out the Russian cold, and in general they wanted the car to be more rugged. They eventually got what they wanted. Says an Italian auto executive: "The result will only be a second cousin to the 124 model that we know."

Built on experience

FIAT has had considerable success dealing with Communists. Its smallest car is made under license in Yugoslavia, and it has had other experience selling in Eastern Europe. But there may have been other factors in FIAT's success: Italians buy about 20 percent of Russian oil exports annually, and they are known to have been talking with Moscow for some time about the possibility of importing natural gas from the Ukraine. In any case, the Russians are in a good position in service credits because of their mounting trade surplus with Italy (nearly $100 million last year).

The deal stirred a flurry of interest in the United States, although none of the big three auto companies—General Motors, Ford, or Chrysler—showed any immediate desire to inquire about the possibilities for following in FIAT's tracks. For one thing, present U.S. policy is to limit credits to Eastern European Communist countries to 5 years. U.S. trade with Russia is too small to make a FIAT-sized business deal plausible now. Beyond this, the Russians have made no bones of their reluctance to improve relations with the United States in any field as long as the Vietnam war goes on. For the same reason, U.S. companies would be wary of making deals with the Soviet Union which could be used against them by their competitors.

Still, U.S. participation in the Soviet automotive industry has a precedent; in the 1920's, Ford sold thousands of trucks and tractors to Russia and later cooperated with the Russians in setting up a large automotive factory at Gorki as well as a smaller assembly plant in Moscow. Many Ford engineers visited the Soviet Union and Russians visited Dearborn, Mich., in those days.

[From Forbes, Oct. 1, 1966, pp. 19–20]

To Russia—Without Love

NOT MANY PEOPLE WANT TO TALK ABOUT IT, BUT THE FACT IS THAT U.S. INDUSTRY HAS A MAJOR ROLE IN THE SOVIET UNION'S PLANS FOR A VAST NEW AUTOMOBILE INDUSTRY

This is the story behind the story that appeared in the New York Times of May 5.

It's true, as the Times and other newspapers reported, that Italy's FIAT automobile company has made a deal with Alexander M. Tarasov, the Soviet Minister for Automotive Production, to help the Soviet Union build a modern automobile plant with a capacity of about 600,000 small- and medium-sized cars a year.

What they didn't report was that FIAT will be serving as a middleman for the U.S. machine tool industry.

Three-quarters of the machinery that FIAT installs for the Russians will come from the United States, either directly or indirectly through European subsidiaries and licensees of American firms. It will really be the United States that puts the Russians on wheels.

Until now, the U.S. Government has refused to permit the export of U.S. machine tool technology to Iron Curtain countries on the grounds that it would help them build up their armed forces. However, this arrangement has the approval of both the State Department and the Department of Commerce. Prof. Vittorio Valletta, FIAT's 83-year-old former chairman and managing director, cleared the political roadblocks in advance in conferences with Secretary of State Dean Rusk and Secretary of Commerce John T. Connor in Washington early this year. The Office of Export Control stands ready to issue export licenses to U.S. machine tool manufacturers who participate in the deal. About 30 are expected to eventually.

Millions involved

The bait is tempting: big money—really big money. The plant is expected to cost $887 million. Of this, FIAT's share will be $322 million. How much of the $322 million the American manufacturers get cannot yet be estimated. It will depend on how much of the machinery FIAT buys directly from the United States and how much it buys indirectly. The only certainty is that it will run to a substantial amount.

Some U.S. machine tool makers already have agreed to supply FIAT with machinery for Russia. Among them is Cleveland's TRW, Inc., which makes steering linkages and sodium-cooled valves. Says John Corson, TRW's sales director for international automotive equipment: "We're supplying them with steering linkages but I'm not sure about the sodium valves." Corson cleared TRW's participation in the deal with State and Commerce "even before we talked with FIAT." He says TRW's motive in supplying equipment for the Soviet plant is not so much the money it will make but fear that, unless it did go into the deal, it might lose FIAT's future business.

Another U.S. company already participating in the deal is U.S. Industries, Inc. Its Clearing Division automated stamping machine presses are sold around the world under license by such companies as Innocenti of Italy and Vickers-Armstrong of England. Says Chairman Clarence J. Plisky: "We'll be supplying the major portion of the presses for the Soviet plant, but it's not clear yet whether it will be through Innocenti or some other licensee of ours in Europe."

Gleason Works, of Rochester, N.Y., will supply gear cutting and heat treating equipment for the plant through FIAT. "This is just a pure business deal as far as we're concerned," says Irving W. Peachey, vice president in charge of sales. "It's just a straightforward business deal, that's all. We have competitors overseas. If we don't supply the Russians, they will."

New Britain Machine Co. will contribute automatic lathes. Says Chairman Julian C. Pease: "Most of the automotive machine tools, not only at FIAT but throughout Europe, are from this country either directly or indirectly through European subsidiaries. FIAT is heavily U.S. tooled because U.S. equipment is just more productive. Now the U.S.S.R. wants American machine tool technology, too."

Says J. C. Danly, president of Chicago's Danly Machine Specialties, Inc., the Nation's largest manufacturer of automotive presses: "We haven't yet been ap-

proached by FIAT to supply presses for the U.S.S.R. facility, but we sure would—as long as the Office of Export Control said it was OK." He added: "As far as presses are concerned, regardless of where they might actually be manufactured, I'm sure that at least 75 percent would have originated in this country. We have the technology."

Dissenting opinions

Not all U.S. machine toolmakers are this eager to get into the deal. Says John F. Herkenhoff, president and chairman of Minster Machine Co., of Minster, Ohio: "There's just too much intrigue in this deal for us. It's for the big boys in this business that have been after the [Soviet] market for years."

Russell A. Hedden, president and general manager of Sheffield Corp., which manufactures automotive gaging equipment, thinks that business is business and the subterfuge sheer stupidity. "I think we should be in this FIAT deal directly," he says. "If not, then it's just a case of letting our European subsidiaries have the business, using our technology. In other words, we'll let them pick our brains and then sell to the Russians, agreeing to settle for less for our technology. That's ridiculous."

State and Commerce Department officials have kept the U.S. role in the FIAT deal as hush-hush as possible. They were shocked when they heard Forbes had learned of Valletta's conversations with Rusk and Connor. They are frankly scared that, as the real story of the deal emerges, a clamor will arise to prevent U.S. firms from participating. The Department of Defense still could block the export of machine tools by declaring it against the national interest.

The Russians, in contrast, are quite talkative. Sergei A. Shevchenko, chief commercial counselor of the Soviet Embassy in Washington, frankly told Forbes that his Government was perfectly aware of the fact that a great percentage of the machine tools would come "from sources other than FIAT."

State's rationale

In off-the-record conversations, State Department officials defend the decision to let the Soviet Union get the machine tools by saying that it will help make the Russians more consumer goods minded. They reason in this fashion:

In years past, the Soviet Union has been able to devote an extraordinary amount of its gross national product to defense production by keeping consumer production to a minimum. Steel that might have gone into autos, for example, went into tanks and guns. The Soviets have been turning out a mere 201,000 cars a year at two antiquated plants in Moscow and Gorki. Only one Russian in every 250 owns a car. The figure in the United States is nearly one in every two.

By not producing automobiles, the Government has been able to cut down on many other expenditures, diverting the money to defense. There are less miles of paved highway in the Soviet Union than in California and Illinois. Along one 1,000-mile stretch of road, there are only six motels. In Moscow, a city of nearly 7 million people, there are only eight garages. While the armed forces burn up gasoline, a Russian citizen has to stand in line at his city hall for a coupon book.

The State Department officials believe the Soviet Union is due for an "automobile explosion." It's clear the Kremlin in a sharp reversal of policy, now wants its citizens to have cars, they say. Not only has it made the deal with FIAT, it also has asked Renault to help it expand and modernize the Moscow plant. By 1970, that plant will be turning out 600,000 cars a year, too. And there is reason to believe the Russians want the Ford Motor Co. to expand the Gorki plant, which was built by Ford in the thirties. President Arjay R. Miller recently visited the Soviet Union. The company denies that he talked business there, but a Soviet source told Forbes that he spent a good deal of time with the Soviet Minister of Foreign Trade.

As the Soviet newspaper Izvestia editorialized recently, "The desire of the people for automobiles is as irresistible as technical progress." So the people are going to get them.

A State Department official said: "The psychological and economic impact of the decision to mass produce automobiles is hard to overestimate. Look at what has happened in this country."

More to come?

The psychological and economic impact of the U.S. Government's decision to permit the export of machine tools to Russia is also hard to overestimate, for it could set a precedent that would throw wide open the gates to East-West trade. If U.S. machine tool manufacturers can export to Russia through FIAT, why

couldn't General Electric, for example, do the same with its computer technology, using Olivetti as its middleman? Olivetti has a joint-venture agreement with GE for European computer sales.

Commented one machine tool manufacturer: "Throw the gates wide open? Hell, this might tear them off their hinges." A bad trend? Perhaps. But will the United States really gain by refusing to deal with the Russians in something that they are going to accomplish even without us?

[From Economic Survey of Europe 1965, Economic Commission for Europe (U.N.), Geneva, Switzerland, Oct. 10, 1966, pp. 56–70]

Institutional Developments

Actual or contemplated changes in the systems of economic planning and management continued to preoccupy governments in 1965. This move toward economic reform, which had originated in Poland and Hungary in 1956 and 1957, has since spread to all countries of the region with the exception of Rumania and Albania, and, more recently was adopted in a particularly far-reaching fashion in highly industrialized and foreign trade dependent Czechoslovakia and Eastern Germany. The general nature of the changes tends to be similar, irrespective of levels of development and economic size, but the detailed measures adopted in particular fields vary considerably from one country to another. The first part of this section lists the major developments of 1965 and discusses the general features of the reform,[1] while the second part reviews the changes carried out or contemplated in individual instances.

General features

Following the prolonged discussion and series of experiments reported in last year's Survey, the adoption of an outline for a reform of the planning and management system was announced in the Soviet Union. This outline was submitted by Mr. Kosygin, as part of a general report, to the plenary session of the Central Committee held at the end of September. In Bulgaria, where some experiments had been conducted with almost no publicity, the basic principles of a new economic system were prepared by the political bureau of the party and published on December 4.

In countries where the broad principles for economic reforms had been previously adopted or where, as in Poland and Hungary, the original system had been experiencing gradual modification for some time, new moves were also witnessed. The broad outlines of the Czechoslovak reform adopted in January 1965 were formulated in greater detail, and the proposed changes which could be implemented at an early stage were introduced. In Poland, a 5-year program for improving the system of planning and management was adopted and published by the Central Committee of the party, indicating that it is the Government's intention to deal with the relevant problems in a more systematic way. A brief review of the present Hungarian system and a rather general outline of the changes envisaged was submitted to a session of the Central Committee by Mr. Nyers (Secretary of the Central Committee) in November. Progress was also reported in the implementation of the new economic system in Eastern Germany.

With the announcement of the economic reforms undertaken by the Soviet Union and Bulgaria, and with more information available about the measures taken or to be taken in other Eastern European countries, the common logic and features of these various attempts to improve methods of planning and management systems are emerging with greater clarity. Each of these governments seems to be genuinely concerned to formulate and adhere to those principles which are born out of its own experience and adapted to the prevailing internal conditions. Nevertheless, their common basic objectives combined with more or less the same points of departure—in the form of the old systems—lend considerable similarity to the basic issues and the main lines of action. Broadly speaking, all the governments aim at establishing a more appropriate balance between centralized and decentralized decisions in order to give greater

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[1] See Economic Survey of Europe in 1964, ch. I, sec. 7, for developments in the preceding year, and "Economic Planning in Europe," Economic Survey of Europe in 1962, pt. 2. especially ch. VI, for an analysis of the evolution of the systems of planning and management and the early moves toward economic reform.

scope to the initiative and responsibility of enterprises whilst preserving those central controls—that increasingly take the form of indirect policy measures—that are deemed necessary for the guidance of the economy. By implication, the scope of central planning is to be reduced, but improved planning techniques, a better coordination of planning at all levels (frequently requiring greater use of econometric methods), the concentration of industrial units and a more efficient administrative framework should all help to raise the effectiveness of central planning.

In order to attain these objectives, a list of measures or proposed modes of action to be undertaken at various levels of the economy has been formulated in each country. Some of these are rather specific and apply only to certain countries, but the principal measures, constituting the general framework of the reforms, are virtually the same in all countries. An attempt to generalize about the type of action which has been undertaken leads to the following list:

(i) Broad directives seeking to improve central planning techniques, requiring, in particular, greater reliance on the medium- and long-term plans which are regarded as devices for achieving greater stability in the conditions under which enterprises operate.

(ii) Changes and reductions in the centrally planned targets, that are mandatory for the enterprise, together with greater emphasis on gross income (i.e., net value added), profit and rate of profitability, as criteria for judging the enterprise's success.

(iii) The expansion of decentralized investment funds available to enterprises and the larger economic units, and a greater use of bank credits.

(iv) The introduction of a capital charge on the fixed assets of enterprises, which will play an increasingly important role in transferring a proportion of profits to the budget.

(v) A strengthening of economic incentives (amounting in some cases to changes in the wage system) by establishing closer ties between the remuneration of employees and the enterprise's performance.

(vi) The promotion of direct contracts between economic units which, in contrast with the old system, are no longer conceived simply as instruments for the implementation of national plans, but rather as a means of guiding the plan itself.

(vii) Price reforms, which include changes in the determination of prices and in the price structure.

(viii) The concentration of industrial enterprises into larger units (sometimes accounting for a whole branch of industry), with administrative responsibilities but being called upon to operate to a greater extent as economically accountable organizations.

(ix) The streamlining of the administrative apparatus responsible for the management of industry, and/or various administrative changes having more specific objectives.

In addition to these common types of action, there is also a great degree of uniformity in the general approach to economic reform and its implementation. As reported in the Survey for 1964, discussions and experiments of varying depth and scope preceded the formulation and adoption of the principles of the reforms almost everywhere; and in all the countries in question, the process of elaborating and implementing the principles adopted is to proceed by stages that are phased over a period of years, partly reflecting the time that is required to carry out the necessary price reforms.

Within this common framework, the actual solutions adopted in individual countries differ significantly. The choice and number of the centrally fixed targets are nowhere the same. There will be significant differences in the relative shares of the decentralized investment funds, and probably also, at least at the outset, in the actual freedom with which enterprises can dispose of these funds. The principles on which the concentration of industrial establishments is based are far from uniform in all the countries; nor will the role assigned to the new composite economic units be the same. Approaches to wage and price policies differ between countries, but there are certain important common features. These two fields are particularly relevant to the main objectives of the reforms and, at the same time, give rise to a number of complicated problems of a more general nature.

Differences between countries are more apparent in the case of wage policies than in that of price policies, since there seems to be a certain hesitancy on the

part of the authorities in most countries to tackle the price problem in a more definitive way.[2] The latter may reflect not only reluctance to depart radically from systems employed in the past but also fears that, in certain circumstances, enterprises (and the associations) may tend to take advantage of monopolistic and oligopolistic conditions, should prices be left to any significant degree to the free play of market forces. However, it is interesting to note that those countries which are prepared to abandon the central control of wages also intend to grant enterprises a certain degree of freedom in the determination of prices.

In all the countries reviewed in the present section, workers and employees will continue to be paid within the main accounting period according to the basic wage and salary scales established centrally. However, the total amount paid (i.e., the basic wage fund) may or may not be subject to direct central control. Where such control is retained, profit (or the rate of profitability) tends to be considered as a most important criterion of enterprise performance. This criterion is replaced by "gross income" (profits plus basic wages) in countries where direct central control has been abandoned, though profits may also be used as an indicator. In both cases, basic wages will be supplemented by payments of premiums and bonuses at the end of the relevant accounting period in accordance with the economic results achieved by the enterprises. The absence of any central control of the basic wage fund tends to increase the freedom of enterprises in respect of decisions about both current production and investment. However, the authorities are also concerned with maintaining a balance between consumers' income and supplies. Such considerations were responsible for the Soviet authorities' decision to retain the basic wage fund as a mandatory indicator and to establish conditions for the payment of bonuses and premiums out of realized profit. On the other hand, in Czechoslovakia where such control has been surrendered, the growth of wage payments will be kept in check by fiscal measures.

The nature of the price reforms reflects both the greater emphasis being placed on gross income and/or profit criteria and the disparities which exist between the relative price and cost structures. All countries seem to adhere to the principle that prices should correspond to "the cost of socially necessary labor" but there are no generally accepted views about how prices should be constructed. Other questions that are the subject of discussion and which give rise to different solutions are the degree of stability which is appropriate for individual prices and the respective merits of centralized and decentralized price fixing. All governments seem to favor stable and centrally determined prices for the most important commodities such as basic raw materials and foodstuffs, but some countries intend to introduce a system by which certain prices may be fixed by enterprises within certain limits established by the authorities whilst others are left entirely free. Other countries favor central price fixing, subject only to minor exceptions (e.g., in the case of outdated products), but this does not necessarily exclude a certain flexibility for adjusting prices to market conditions. In any case, the establishment of direct links between enterprises and, in particular, between producing and trading enterprises should promote a more efficient adjustment of supply to demand.

The extent to which profits or gross income can be meaningfully employed as important indicators of enterprise performance and as a base for rewards depends not only on the price system in operation but also on the circumstances of individual enterprises. Assuming similar prices for similar products, it cannot be expected that an enterprise, operating with obsolete capital[3] and enjoying only limited "external economies," can perform as well in terms of profit or gross income as a modern enterprise engaged in the same type of production and working under favorable external conditions. In some countries, attempts are being made to solve these problems, by establishing a system under which producers receive different prices as determined by the associations concerned. Of course, the associations may also take action to eliminate the need for such price differentials by the appropriate use of their investment funds and other measures.

An intercountry comparison based on the official documents at present available gives the impression that the economic reform in Czechoslovakia represents

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[2] This summary of wage and price policies does not refer to a number of important details which are examined below in the individual country sections.

[3] It is very unlikely that the capital charge could entirely offset the "objective differences in conditions of production" that exist between enterprises.

more radical departures from the old system than is the case in other countries of the area, especially the Soviet Union where the scope for decentralized decisions may well continue to lie within fairly narrow limits. However, a hasty conclusion at such an early stage could quite easily be misleading. Despite all the care with which the economic reforms have been formulated and the experience acquired in the course of various experimental schemes, such large-scale departures from a long-established system are bound to give rise to unexpected problems and difficulties. It would be unrealistic to expect that the changes will proceed smoothly according to predetermined schedules, and it is almost certain that certain decisions will eventually need to be reconsidered in the light of later experience, even if the general direction of the changes remains undisturbed. The attitudes adopted by the domestic bureaucracy may also have an impact on the implementation of the reforms, particularly so, since some individuals or groups are not unlikely to have vested interests in the old system. The behavior and the general attitude of the managerial staff will need to adapt itself to the new conditions. Some of the managers reared under the old system may find themselves unable or even unwilling to assume the responsibilities which the new system will require, and they will have to be replaced by newly trained cadres. But at the same time it is questionable whether, at least in some countries, the rules of the new system will provide sufficient latitude for all the decisions which managements may deem necessary in order to allow the enterprise to meet its greater obligations successfully. The balance envisaged between centralized and decentralized decisions may sometimes prove inappropriate, and further shifts may be required in order to allow the management to assume full responsibility for conducting the necessary business activities.

In these circumstances, it will not be surprising if, in the course of implementing the reforms, a country where the process had started earlier and/or with greater intensity happened to be overtaken by other countries which in the beginning had tended to lag. In this context, it should be noted that the extent of the changes contemplated by the various countries is not necessarily the same in each of the fields covered by the reforms. A country where the general attitude toward change may appear to be relatively conservative can nevertheless produce more radical solutions in certain specific fields. The changes provided for in the outline of the Bulgarian reform, for instance, may on the whole appear rather modest, but the abolition of direct control of the wage fund may well have important implications. The outline of the Soviet reform also contains provisions which, if consistently applied, may set in motion dynamic forces that lead to additional changes. In particular, the development of horizontal ties between economic units—strongly emphasized in Mr. Kosygin's report—has potential implications for a simplification of the system of planning and management envisaged for the future. A wide network of relations between enterprises established on the basis of contracts will probably gradually render some of the central controls maintained by the present reform superfluous while, on the other hand, a smooth functioning of a system of horizontal ties, based on the principles of profitability and accountability, may itself require that a new line be drawn between centralized and decentralized decisions.

The Soviet Union

According to the report [4] presented by Mr. Kosygin and approved by the Central Committee, the economic reform aims at improving the scientific efficiency of state planning procedures, increasing the independence and initiative of the enterprise, and strengthening economic incentives by means of changes in prices, bonuses, premiums, credits, etc. These objectives, which were emphasized in the report, were formulated with a view to remedying certain shortcomings of the planning procedure which had become apparent in the past. These shortcomings had led to the disturbance of the prescribed structural balance between the various branches of the economy and, in particular, to a lagging of output in the agriculture and consumers' goods industries, which inevitably had adversely affected the growth of the population's real income and material incentives. Output per ruble of fixed assets had also tended to decline, largely owing to delays in new investments reaching full capacity production. In present conditions, characterized by rapid technological development, slow rates of construction can often make new equipment obsolete even before it is used. In order to

[4] Pravda, Sept. 28, 1965.

avoid such problems, the planners have been requested to improve the scientific efficiency of planning procedures by paying particular attention to the following points:

(i) The rates of growth of production and of national income together with the basic proportions provided for in the national economic plans should insure the best and most effective use of available resources;

(ii) Planning should provide for the latest achievements of science and technology to be rapidly assimilated into industrial processes;

(iii) The plans should pay due attention to the prospects for scientific and technical progress;

(iv) The role of the long-range plans should be emphasized more; and

(v) A system of scientifically substantiated planning normatives should be formulated.

The improvements in planning methods are to be accompanied by measures which seek to enlarge the rights of the enterprise; develop the initiative of, and incentives for, management and working collective; and to reinforce the principle of accountability both within and between individual economic units. Proposals concerning changes in the status of the enterprise, in fact, constitute the hard core of the reform. However, in order to present a true picture of the new system, certain proposed changes in the administrative machinery concerned with industrial planning and management must receive due attention. As indicated in the introduction to this section, such changes are also envisaged in other countries, but in the case of the Soviet Union the relevant measures seek to reaffirm the branch principle for guiding industry, as well as to strengthen the discipline of vertical planning in a situation in which more independent decisions at the enterprise level and direct ties among economically accountable units are expected to become more important features.

The first group of measures directly affecting the position of the enterprise consists mainly of changes in the system of the centrally planned indicators that regulate the enterprise's activity. In place of the large number of previous indicators which had varied between enterprises, henceforth the management of the enterprise will be required to observe only eight mandatory targets, the others being left to its own decisions. The eight centrally determined indicators are:

(i) The volume of sales of output;

(ii) Production assignments (in physical terms) for the most important products;

(iii) The wage fund;

(iv) Profits and the rate of profitability;

(v) Payments into, and appropriations from, the budget;

(vi) The volume of centralized investment and the operation of productive capacity and fixed assets;

(vii) The basic assignments for the application of new techniques; and

(viii) Indicators relating to material and technical supplies.

A significant step toward the enjoyment by the enterprise of greater autonomy has been made by replacing a number of centrally fixed targets pertaining to labor by a single one. Under the old system, the enterprise was required to observe four mandatory targets, relating to the wage fund, the average wage, the number of employees, and labor productivity; in the future, only the size of the wage fund will be determined outside the enterprise. Mr. Kosygin stated that the possibility of abandoning even the centrally planned wage fund has been seriously contemplated, but it was decided that with present conditions, which still require that money incomes of the population be carefully balanced against the quantity of consumers' goods available, such a step would be premature. The question will be reexamined in the future and, when conditions are suitable, the centrally planned wage fund will be abandoned first in the consumers' goods industries.

The report presented by Mr. Kosygin is also quite explicit in the case of production assignments. In future, this indicator will be restricted to the "most important nomenclature" of goods and the number of goods covered will be gradually reduced until, finally, production targets will be expressed in terms of groups of products, not individual goods.

The volume of sales of output is a new indicator which has replaced global output—the main performance indicator under the old system. Prior to the reform, with emphasis placed on production rather than on sales, the plan could be fulfilled almost irrespective of the quality of output and the pattern of demand. In future, enterprises will have to pay more attention to their customers' re-

quirements. This development will be reinforced by the forging of direct ties between productive and trading enterprises.[5]

The shift in emphasis from production to sales suggests that, in general, enterprises will have greater independence than hitherto in deciding the volume, assortment, and quality of their output. However, the freedom of the management in this respect will continue to be limited by central control of the wage fund, by central allocation of certain types of equipment and material and, to some extent at least, by central supervision of the distribution of other supplies which, as will be shown later, is to be the responsibility of a new institution. On the other hand, a greater reliance on direct ties between enterprises, taken in conjunction with rising production, is likely to offer scope for a gradual reduction in the extent of central planning and central control of supplies, particularly in the case of consumers' goods industries. The need to evolve a network of relationships between economic units, based on the material responsibility for the fulfillment of contractual commitments, was stressed more than once in the report, and reiterated by Professor Liberman in a more recent article, where he defined the direct ties between enterprises as "the horizontal complement of vertical, central planning."[6] Account should also be taken of the experimental scheme of 1964 and 1965 which appears to have produced highly satisfactory results. As reported in the Survey for 1964,[7] this scheme is based on contracts drawn up between producers and trading organizations, which enables the latter to order goods of a specified quality and variety whilst giving the directors of the producing enterprises some latitude in formulating their plans for dealing with the volume of output and the use of production factors. It has not yet been announced in the central press whether or not further elaboration of this scheme is being contemplated, but it may be assumed that the experience gained to date will influence the pattern and nature of future relationships between enterprises.

The second set of measures affecting the enterprise is concerned mainly with changes in the investment system. The need to strengthen the principles of the accountability and responsibility of management and to reinforce their interest in making better use of the enterprise's productive assets requires that the enterprise should rely more on its own decisions and means in this particular field. The reform provides for the creation within each enterprise of a development fund to be used by the management for investment purposes. The fund will be financed by allocations from the profits made by the enterprise and it will also absorb the funds set aside for the replacement of fixed assets, which previously could only be used with the approval of the central authorities.[8] Second, the system of centralized investment based on grants from the state budget is to be gradually converted into a system of long-term credits, and the grants for additional working capital will also be replaced by credits.[9] A capital charge on both the fixed and working capital of the enterprise is to be introduced. The norms for this charge, which will probably be differentiated by industrial branches (though not stated explicity in the report), are to be established for periods of several years in such a way that the "normally" operating enterprise, after the payment of the charge, will possess sufficient resources for building up its various funds and meeting planned expenditure. In the long run, the new capital charge is to become important as a means of channeling the enterprise's contribution to the budget, whilst other payments—for example, the turnover tax—will be gradually reduced.

The third group of measures aims at strengthening those material incentives which heighten the interest of the workers in the enterprise's results and forge a closer link between the size of their earnings and profits. Part of the profit of the enterprise will be used to create a material incentive fund, divorced en-

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[5] However, the effects of the new indicator on the quality of output may vary greatly according to the market situation. Where there is a buoyant sellers' market, quality improvements, at least in the case of certain specific products, may not be very significant.

[6] Pravda, Nov. 21, 1965.

[7] Ch. I, pp. 55–56.

[8] The size of the resources for net investment at the disposal of enterprises under the new system should not, however, be overestimated. According to Mr. Kosygin, outlays from the enterprises' funds in 1964 for the introduction of new technology and development amounted to 120 million rubles which, together with bank credits, gave a total of 720 million rubles. Under the new system, development funds are expected to amount to some 4 billion in 1967 but out of this 2.7 billion represent depreciation charges.

[9] The new system of long-term credits will first be applied to investment in enterprises already in operation. In the case of entirely new projects this system will be introduced if the repayment period is expected to be relatively short.

tirely from the wage fund. The amounts to be paid for high work performance,[10] in the form of bonuses in the course of, and/or rewards at the end of the year, will be determined by the enterprise, whereas increases in basic wage and salary rates will continue to be regulated centrally. In order to discourage the long-standing device, by which enterprises deliberately sought to obtain relatively modest targets, the incentives paid for overshooting the profit target will be lower than those for fulfilling the plan. Allocations to the incentive fund are to be based on norms which will be stable for several years and differentiated by branches. Their size should be proportionate to the volume of sales or to the profit and profitability levels stipulated in the plans. A fund for social and cultural purposes (housing, rest homes and sanatoriums, etc.) is also to be established in each enterprise.

The importance of improving the price system was also emphasized in Mr. Kosygin's statement, though it seems fairly clear that this particularly thorny problem will continue to be handled with the utmost caution. While some of the participants in the discussions which preceded the reform (in particular, the late Academician Nemchinov) advocated a more flexible system of price fixing, roughly similar to the Czechoslovak reform, it seems unlikely that any departures from the traditional system of centrally fixed prices are being contemplated at this stage. A state committee for prices has been set up, and its basic proposals are to be drafted by the beginning of 1966, whilst the introduction of new prices is to be spread over the next 2 years. Mr. Kosygin's few general observations on prices do tend to suggest, however, that, contrary to previous practice, prices will assume a more active role in reinforcing the accountability and developing the initiative of enterprises. Prices, it is stated in the report, must reflect expenditure on the socially necessary labor, and must cover the cost of production and distribution so as to insure adequate profits for normally operating enterprises. Moreover, they should be such that they stimulate enterprises to improve the quality of their output and to develop new products. This seems to suggest that, when fixing the prices of new or improved products, development expenditure as well as the additional benefits derived by the consumers will be taken into account, though the appearance of new high-quality goods may, in fact, also create conditions which are conducive to a decrease in the prices of "old" products. New administrative measures will also include the state certification of the quality of products.

In the case of the reorganization of the state machinery for regulating industrial planning and management, the report reaffirms that the branch principle provides the most suitable method for achieving unity of guidance in production, technological changes, and economic and scientific research. The economic councils established in 1957 had the effect of dispersing the branches between the numerous regional units. They are, therefore, to be abolished and a number of industrial ministries, vested with all the powers necessary for guiding industrial branches and responsible for their development, are to be created.[11] These ministries, to be manned by a small number of highly competent people (in order to avoid an undue increase in the size of the administration), will undertake the necessary planning to guide production and take decisions about technical policy, material and technical supplies, financing, labor and wages. Within each branch, economic associations will guide their own enterprises directly. The activities of economic associations are to be increasingly based on accountablity, though it is not intended that this shall interfere with their strict adherence to state planning discipline. The ministries will rely heavily on the economic associations which gradually are to assume some of the operational functions of the former.

The above measures are supplemented by a few other changes affecting the organizational framework which also seek to strengthen its vertical structure. The State Planning Committee, formerly controlled by the U.S.S.R. Supreme

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[10] In order to "stabilize cadres," the length of uninterrupted service with the enterprise will also be taken into account when determining the size of bonuses and rewards.

[11] The new ministries correspond to the following branches: (*a*) At the all-Union level: heavy, power and transport machine manufacture; construction machinery, roadbuilding machinery and civil engineering machinery; tractor and farm machine manufacture; motor vehicle industry; electrical equipment industry; instrument making, automation and control systems; chemicals and petroleum machine manufacture; machine tool and tool industry; machine building for light industry; food industry and production of household appliances; (*b*) at the Union-Republics level: ferrous metallurgy; nonferrous metallurgy; coal industry; chemicals industry; petroleum extracting industry; petroleum refining and petrochemicals industry; lumber, pulp and paper and wood processing industry; building materials industry; light industry; food industry; meat and dairy industry.

Council of the National Economy, will be placed under the direct jurisdiction of the U.S.S.R. Council of Ministers. With the abolition of economic councils, the responsibility for regional planning will now be assumed by the State Planning Committees of the Union Republics. The U.S.S.R. State Planning Committee will also control the distribution of the centrally allocated supplies (to ministries and through these to enterprises), while the distribution of other supplies, to be increasingly carried out by enterprises themselves through the medium of a network of contracts, will be supervised and guided by a committee specially established for this purpose, under the direct control of the U.S.S.R. Council of Ministers.

Bulgaria

The "basic principles" of the Bulgarian reform, published in December 1965,[12] have their origins in a process which had started some years previously. In 1963 preliminary experiments with a new system were conducted in several selected enterprises. By April 1964, 52 enterprises were operating very much in the manner defined by the new "basic principles," and since April 1965 the number of enterprises covered by the experimental scheme has been constantly increasing. The experimental scheme is to be terminated by the end of the current year, so that 1967 could see the new system being implemented throughout the economy.

One of the main objectives of the new system is to endow the enterprise with more independence, and thereby to instill the management and the workers' collective with more interest in its performance. Thus, the "basic principles" provide for a sharp reduction in the number of the centrally fixed targets, emphasizing the need for a greater degree of initiative at the enterprise level and the importance of direct ties between economic units. Out of the maze of mandatory indicators which existed under the old system, only five now remain, though there is a proviso that a number of other targets, defined as "calculative" indicators, should be fixed by the enterprise itself. The five centrally determined targets are:

(i) Production assignments in physical terms for the most important products;[13]

(ii) The upper limit for the amount of capital investment and operation of new production capacity;

(iii) Limits concerning the use of certain important materials;

(iv) The exports targets, expressed in foreign currency, and the amount of foreign currency to be placed at the disposal of the enterprise for the purchase of imports; and

(v) A list of the most important construction projects and the territorial distribution of productive resources, in the case of projects of a nationwide and/or regional importance.

Other targets such as global output, the proportion of total output destined for the market, the variety of products, total profits, reductions in the cost price and the changes in labor productivity are all to become the subject of "calculative" indicators.[14] Once these have been determined by the enterprise in the light of certain control figures received from the central authorities, they are passed to higher level organizations as informative material for the preparation of the national plan.

The new Bulgarian system is intended to improve the traditional pattern of material incentives tied to the fulfillment or overfulfillment of the various specific norms and targets. Earnings are to be split into two parts: the first, to be paid during the main accounting period, is intended to reflect individual effort and qualifications, etc. (as provided for in the wage-scale system), and the results expected for the enterprise; the second, to be paid at the end of a given period, will depend entirely on the results finally obtained. In other words, it is intended to evolve a system which will stimulate the workers' active interest not only in particular aspects of the enterprise's performance, but also in anything which can affect the enterprise's income. It is also hoped that the "pro-

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[12] Rabotnichesko delo, Dec. 4, 1965.

[13] According to the temporary statutes of the enterprises working under the new system, the number of items for which production assignments will continue to be fixed centrally will be 124.

[14] The gross income of the enterprise seems to be considered a particularly important indicator of the enterprise's activity, but it is supplemented by two additional criteria: distribution of gross income between the enterprise and society, and the ratio between the wage fund and net income (profit). Notwithstanding the importance attached to gross income, profit is described as "the most synthetic indicator of the way in which the means of production and the labor force are being used in each individual enterprise." The relative weights attached to these indicators, therefore, are not altogether clear.

duction committees," to be established under the new system and which will include workers' representatives, will reinforce the expected incentive effects of the new wage system.

The wage scales will continue to be determined centrally. Moreover, it is required that the growth of the total wage bill (including payments out of profits) should not exceed the growth of productivity. Subject to these qualifications, decisions concerning the wage bill are left to the enterprise, implying that direct central control of the wage fund has been surrendered. In exchange, fiscal and price policies and instruments are to be used to influence the decisions taken by enterprises in respect of wages; and, in addition, long-term normatives (to be centrally determined and varied between industrial branches and groups of enterprises) will be established for the relative growth of productivity in wages.

As in other countries of the area where economic reform is proceeding, decentralized investment is to become more important in Bulgaria. The growth fund, as well as others [15] at the disposal of the enterprise, will be enlarged, and enterprises will also be authorized to apply to the banks for interest-bearing loans when in need of additional fixed and working capital. A capital charge on the fixed and working assets of the enterprise—amounting to 2 percent in extractive industries, construction, trade, and the procurement of materials, and to 5 percent in other branches—will be introduced.

The "basic principles" do not deal systematically with the problem of prices, but they nevertheless indicate that in a number of cases enterprises will enjoy a certain amount of scope for independent decisions. While the prices of goods that are considered to be of decisive importance for domestic output and the consumption of the population will continue to be determined centrally, three new categories of prices will be introduced: first, there will be prices (for products outside the scope of interenterprise contracts) determined by the enterprises within limits set by the state; second, prices to be agreed by enterprises when drawing up contracts—again within centrally fixed limits; and third, prices of goods mainly of minor importance to be determined in the course of contractual negotiations between the producing units and the trading organizations.

The reform also provides for the creation of economic associations, both of the vertical and horizontal types, which in some cases may also engage in trade activities. At the same time, and as already indicated, the development of direct contracts between economic units is expected to be very important. It is true that such contracts are by no means new, but under the old system they were conceived primarily as an instrument for the implementation of the plan. In the future, however, enterprises will be allowed to enter into contracts on the basis of control figures only (which are of an indicative character), and the conclusion of contracts is to become part of the process of the formulation of national plans.

Czechoslovakia

During the course of 1965, a program was prepared for the implementation of the basic principles of the Czechoslovak reform that had been published in January.[16] The implementation is divided into three stages: the first, which was considered completed by the end of the year; the second, to be completed by the end of 1968; and the third, which is planned to start in 1969.

The concentration of enterprises into branch units which took place about mid-1965 was a major step toward the introduction of the new system of indus-

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[15] Enterprises will have at their disposal the following funds:

(i) The growth and technical improvement fund (for capital repairs, the introduction of new techniques, etc.) which, in addition to allocations from profits, will absorb between 40 and 70 percent (and, in the case of cooperative enterprises, up to 100 percent) of depreciation allowances;

(ii) The social and cultural undertakings fund (for increasing collective material incentives in the form of housing, recreation facilities, etc.) financed by allocations from income for consumption and assets available for nonproductive activities, etc.; and

(iii) The reserve wage and salary fund (to be used in periods of depressed activity) financed by 0.3 to 0.5 percent (according to the branch) of income available for individual distribution.

In commercial and cooperative enterprises (with the exception of public catering) a fund for the regulation of retail prices will also be established. This fund will be used mainly to enable the enterprise to reduce the prices of old-fashioned goods and those which, for one reason or another, do not sell easily. Contributions to the fund will come from deductions from the enterprise's income for distribution from allocations by the Ministry of Trade and from the sales of fruit and vegetables at prices which are above the calculative ones.

[16] See the Survey for 1964, ch. I, pp. 49–52.

trial management. Vertical combinations (concerns) were established in mining, metallurgy, and, to some extent, in the metalworking and chemicals industries, whereas mainly horizontal forms of amalgamation were introduced in other branches.[17] In November, a few changes also took place at the ministerial level. A number of ministries responsible for individual basic industries was abolished and replaced by two bigger administrative units—the Ministry of Mining and the Ministry of Heavy Industry. In addition, a state commission for finance, prices, and wages, intended to assume a wide range of responsibilities in this domain, has been established.

While these changes in the organizational setup were proceeding, a special commission formulated the practical measures necessary for the implementation of the economic reform. After receiving Government approval, the results of this work were published in August. The practical measures contain a whole set of rather elaborate directives addressed to the planning and management bodies of all levels, but they do not pretend to include a detailed elaboration of the system. Further refinements and changes in some of the decisions already taken by the Government may be expected in the course of the implementation of the reform

According to the directives, future national plans will assume three different forms: long-term plans, medium-term plans, and operative annual (or biannual) plans. The enterprises and the directorates of the newly established branch units (concerns and trusts) will also be requested to formulate their own long-term projections which the central planning authorities must take into account when preparing national plans.

The centrally planned targets (to be given to the directorates of the branch units) will be reduced to the following:

(i) Production assignments for the most important commodities (52 items in 1965 compared with 1,300 in earlier years);

(ii) The major centrally financed investment projects;

(iii) Export targets for specific products (in addition to the global export figure);

(iv) Research and development activity; and

(v) Defense needs.

If any of the centrally fixed targets should prove instrumental in causing economic losses to the enterprise, the latter will be entitled to compensation from the central authorities.

In addition to the above targets, the directives provide for a few centrally fixed upper limits, concerning: the volume of total investment carried out by branch directorates, research expenditure, consumption of certain imported materials or those which are in short supply, the number of employees (in some cases only); and in exceptional cases, when wage disbursements cannot be effectively controlled through indirect policy measures, the wage fund.

Other targets are not mandatory. If the views of the enterprise on any of these should differ from the views of the central authorities, the enterprise is obliged to inform the latter so that appropriate action may be quickly taken.

The capital charge on the value of total fixed assets net of depreciation (including also the net value of investment left unfinished at the end of the plan period) has been fixed at 6 percent. Apart from the capital charge, allocations, partly for the state budget, and partly for the directorate of the branch unit, from the gross income (that is, global value of output less material costs and depreciation) of the enterprise, will comprise two parts: a fixed sum computed on the basis of income in the preceding year and a percentage of the increase in income. At present, these allocations, with rates ranging from 42 to 70 percent, will be varied between branches and enterprises, but it is thought that the implementation of the price reform will create conditions conducive to uniform treatment.

After these deductions from the gross income and certain other miscellaneous payments (credit installments and contributions to social insurance) have been made, the residue will be divided among the following funds: the reserve fund, the risk fund (in retail trade establishments where activities are subject to seasonal fluctuations), the renewal fund (which will also appropriate part of depreciation charges), the social and cultural purposes fund, and the wage fund.[18]

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[17] A few figures help to assess the progress achieved in 1965. The original 236 economic production units were converted into 102 branch units, with an average gross value of output of Kčs2,100 billion, and an average number of employees of 30,000. Three of the biggest units (the Ostrava-Karvina Coal Mines, the iron foundries and the Czechoslovak Automobile Works) each have a labor force of over 100,000.

[18] The share of the wage fund in the gross income is estimated at 59 percent for 1966; that of the deductions for the state budget at 26 percent.

The portion of the enterprise's income accruing to the branch directorates will be used for paying the staff's salaries and for building up certain funds intended for the whole branch; namely, the reserve fund (for assisting enterprises in periods of major difficulties), the investment fund (which will also absorb a part of depreciation allowances and can be further enlarged by bank credits), and the development fund for research activities (which can also count on contributions by the state).

The new wage system is based on considerations similar to those in Bulgaria, but has a few distinctive features of its own. As previously indicated, with certain exceptions, decisions about the wage fund will be left to the enterprise. The share of the wage fund in gross income (after the payment of certain deductions and the fulfillment of other obligations) is a matter for discussion between management and trade union representatives in the enterprise, the outcome being written into a collective agreement. The fund itself, however, will be divided into two parts: the basic wage fund, out of which the basic wages, based on centrally determined scales, and premiums for individual achievements are paid; and the premium fund for rewarding the whole working collective in proportion to the overall results of the enterprise.[19] It is estimated that in the first year of implementation of the new system the share of the premium fund will probably amount to some 30 percent of the total in most enterprises, but it may increase further in the years to come. The enterprise is committed to pay its employees at least 92 percent of their average individual earnings (basic wages plus individual premiums) over the last 3 years. Should the enterprise have insufficient finance for this, recourse may be had to the reserve fund and, if necessary, to the financial resources of the branch unit directorates. In such cases, however, the enterprises should be strengthened and subjected to further control and it will be required to enforce any measures prescribed by the higher authorities. On the other hand, wage increases in successful enterprises will be restrained by a special, highly progressive tax to be paid by the enterprise, which will be based on the difference between the actual wage fund (comprising both parts referred to above) and a hypothetical one equivalent to the number of employees multiplied by the average earnings of 1965.[20] The tax is such that it will automatically place an upper limit on the rate at which wages can rise.[21] At the same time, management is free to negotiate with the trade union representatives the question of whether or not to aim for a faster growth of wages, involving a heavy tax incidence, or a slower growth combined with the enlargement of some of the other enterprises' funds (particularly the renewal fund).

Under the new system, centralized investment financed entirely by the state will embrace only the most important projects, and its relative share in total investment outlays will be considerably reduced. Branch investment, the responsibility of the branch unit directorates (the larger projects will be subject to approval by the central authorities) and financed by their own resources and bank credit,[22] will become the largest category; investment undertaken by

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[19] This means that, as in Bulgaria, this variable part of workers' earnings can be finally determined only at the end of a stipulated period. However, a proportion of the planned premium fund, not exceeding 25 percent, may be paid in advance to the workers by resorting to bank credit.

[20] The experiments conducted in 1965 revealed that enterprises with a good financial record tended to increase their remuneration funds rather than their reserve and renewal funds. This led to the introduction of the above tax, and thus to the establishment of upper limits for permissible wage increases in the transitional period.

[21] The incidence of the tax is shown in the following table:

[In percent]

Cumulative rates of growth of average yearly earnings (based on 1965)			Tax rate
1966	*1966–67*	*1967–68*	
0– 6	0–10	0–14	0
6– 8	10–12	14–16	20
8–10	12–14	16–18	50
10–12	14–16	18–20	100

[22] In the year 1966, however, branch investment will still be financed predominantly by the state budget.

enterprises, and financed by the renewal fund and credits, will also grow in importance.[23]

The financing and implementation of research and development activities will be organized along similar lines. An interesting innovation in this particular field is the requirement that, in future, enterprises must pay for the use of any results stemming from research activities that have been financed by the state.

The role of the two banks (the State Bank for internal, and the Commercial Bank for external financial operations) will be enlarged. The State Bank will offer short-term credits (to finance stocks of materials, semifinished and finished products) and long-term (investment) credits. The interest rate has been fixed at 6 percent for short-term and at 8 percent for long-term credits. The operations of the bank are to be coordinated with those of the state plan and especially with the centralized investments plan, but the bank is also required to check the economic position of enterprises, and has the right to refuse or to stop credits and to raise or to lower the interest rate. From 1966, the Commercial Bank is permitted to extend credits in the form of foreign currency to enterprises should these be needed to increase the output of export goods. At the same time the enterprise will also participate (by 5 to 30 percent) in any benefits deriving from additional exports, from higher prices that are attributable to the better quality of exports, and from reductions in import requirements.

The price reform scheduled for the second half of 1967 and 1968 has not yet been formulated in any detail. At present, profit margins in wholesale prices are being determined as a fixed proportion of production costs, but it seems that a new formula, by which profit is defined as a fixed proportion of the net value of all fixed assets including stocks, will be adopted. However, while discussion on the structure of prices continues, it has been decided to introduce three categories of prices in 1966.

The first of these categories comprises centrally fixed prices, which in 1966 will cover 64 percent of the total industrial output. The second category referred to as "flexible" prices, with centrally determined maximums and, in some cases, both maximums and minimums, will embrace 29 percent of output.[24] Prices for the remaining 7 percent will be determined by the enterprises themselves.[25] For the following reasons, the scope for decentralized decisions in the field of prices will probably be rather limited in 1966: first, there is a rather general feeling that conditions of supply and demand in the markets of a number of commodities do not yet allow any significant departures from the system of centrally fixed prices; secondly, it seems that some of the enterprises in which the new system has been experimentally introduced took advantage of the situation and raised prices in an attempt to obtain a higher income.

Improved price statistics will be introduced in 1966 and the procedure for determining centrally fixed prices simplified. Prices of a number of commodities will be gradually changed, and the turnover tax will be calculated in a different way. Under the existing practice, the turnover tax is quoted as a specific sum for each commodity or group of similar commodities. In future, the tax will be expressed as a proportion of the wholesale price, and it should provide a link between changes in wholesale and retail prices. It is also intended to reduce substantially the gap between the two sets of prices attributable to the high turnover tax.

It is not expected that the price system will be changed substantially during the next 2 years.[26] In the transitional period it is intended to reduce indirect taxes gradually and to use subsidies, account being taken of the fact that with existing prices profitability may vary significantly from one line of production to another, and that a number of enterprises may not be in a position to attain a satisfactory income. The subsidies from the state budget will be paid to the branch units which, in turn, will be responsible for channeling them to enterprises. With the implementation of the price reform subsidies will be abolished. The directorates of the branch units are also entitled to set different prices for a given commodity, where producing enterprises operate under different technical conditions.

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[23] In 1966 the relative share of centralized investments in total investments will be about 16 percent, and that of branch investments about 21 percent.

[24] Flexible prices having upper limits only will cover 14.7 percent of industrial output; those with both upper and lower limits, 14.3 percent.

[25] The corresponding figures for retail prices are: 78 percent, 11 percent, and 11 percent.

[26] Shortly before the publication of this Survey it was announced that a decision had been taken to accelerate work on price reform. The new prices (which are to be worked out with the aid of econometric methods and electronic computers) are expected to be introduced with effect from January 1967—a development which may strongly influence the bringing into force of the economic reform.

Poland

The guidelines for an improvement in the planning and management system over the next 5 years, adopted by the Central Committee of the Party in July 1965,[27] contain a vast number of measures which—although to a large extent interdependent—may be classified as follows: (a) a greater role for associations in the exercise of operative planning functions; (b) greater reliance on horizontal ties and a shift in emphasis from the central allocation of supplies to the principle of free commercial relationships between the interested parties; (c) a refinement of the system of performance indicators; (d) a raising of enterprise participation in investment whilst insuring greater bank control over the volume of investment outlays; and (e) improvements in the methods of plan formulation and the achievement of greater continuity and flexibility in overall planning.

While a move to strengthen the role of associations has been evident for some time, the current tendency is to make associations the main decentralized decisionmaking units. In principle, associations are to cover industrial branches or lines of production although, in some cases, geographical proximity or vertical interdependence may also be among the factors influencing their membership. Their internal organizational structure, to be elaborated in special statutes, may range from a multiplant enterprise to a looser type of amalgamation, depending on the character of the branch in question. As a minimum, however, associations will be responsible for establishing the combined financial balances of the enterprises under their supervision and for all financial transactions with the state budget. Associations will have the right to represent their members before the ministry and the central planning organs and decisions made by their boards will be final in all questions related to interenterprise coordination.[28] They will allocate production tasks among the enterprises and can transfer resources from one enterprise to another.[29]

The associations will participate in the profits of the enterprises and out of these sums they will establish a fund which should enable them to undertake investment and development programs on a significant scale.[30] In addition to responsibility for the activities of subordinated enterprises, the main producing association will need to coordinate the operation of enterprises producing technologically related products, even if the latter are not directly affiliated to the association. When preparing drafts for the national economic plans, the principal association will formulate, in addition to its own draft plan, development programs prescribing production targets for the whole branch, having previously obtained agreement within the branch. Thus, the leading association will become responsible for initiating and guiding the development of the branch or line of activity with which it is concerned, and will be expected to offer organizational and technical assistance to nonmember enterprises participating in branch agreements, if necessary by utilizing a branch fund specially created for this purpose.

The number of mandatory indicators which the associations must adhere to, and those used in coordinating the activities of enterprises is to be gradually reduced. In particular, the number of indicators relating to the volume and assortment of goods specified in the plan is to be curtailed. In addition to this, greater consistency between the operational plans of the various economic units and improved coordination between supply and demand will be achieved by developing the system of interbranch agreements[31] to the point where it becomes

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[27] See Trybuna Ludu, Aug. 1, 1965.

[28] Associations will be headed by directors appointed by the ministry of the given industry. The directors will have the right to appoint and to discharge the directors of the affiliated enterprises. The guidelines are not specific on the rules relating to the composition of the association's board of managers.

[29] The transfer of fixed assets between enterprises that are members of the same association will take place without any payments, but transfers of inventories will be matched by money flows in the opposite direction.

[30] The administrative expenses of associations are to be met from special contributions of the subordinated enterprises, forming part of their regular operating cost. Among the funds to be created out of profits transferred to associations are: the investment fund, the technological and economic progress fund and the contingency fund. In addition to these resources the association will have "wage fund reserves" which, together with the contingency fund, can be used for various current assignments.

[31] Although the practice of entering into supply agreements was introduced in Poland as early in 1957 up until now it has not had the desired effect. One difficulty was connected with enforcing such agreements, although the financial penalties for nonfulfillment were usually high. This stems from the emphasis placed on achieving high levels of production to the neglect of the level of retained profits. A further difficulty was the frequent lack of coordination between agreements and centrally approved plans.

the main element of production planning. In this connection an important measure is the proposed wider adoption of the practice now prevalent in light industry, by which enterprises are free, after due notification, to revise the production plan when a discrepancy arises between the plans and the interbranch agreements. The decision to allow associations and enterprises considerable leeway in their choice of trade partners, while at the same time making them bear full responsibility for the coordination of supply and demand, constitutes another step in the same direction.

The most important measure of the performance of associations and enterprises is to be the index of profitability, defined as the ratio of profits to labor and material costs; for certain branches the rate of profit, that is the ratio of profits to the value of fixed assets and working capital, is proposed. To facilitate a more effective use of these indexes, "factory prices," that is wholesale prices less turnover taxes plus subsidy elements, are to become more flexible. When determining these prices, account will be taken "much more than heretofore of the utility value of the goods concerned and particularly their qualitative characteristics." [32] It is not expected, however, that the centrally guided price system can be made sufficiently flexible to be adapted to the pattern of demand so that performance indicators other than profitability have been retained (though in a less rigid form than hitherto).[33] The guidelines that have been adopted require that the weighted indexes of "global" and "commodity" output should be discarded, and that instead indexes that are more sensitive to labor inputs introduced. These will vary according to the prevailing technological and marketing conditions within each branch, except where homogeneity of production or stability of assortment permits the application of more standard measures.

Together with greater emphasis on the role of profits the reform provides for a closer relationship between the fulfillment of the profit plan and the material remuneration of employees. However, in spite of the greater role allotted to material incentives, the central regulation of the wage fund is to be retained, except in enterprises providing consumer services and those rendering services to agriculture. Centrally prescribed employment limits, however, will gradually be abandoned.[34]

As in other countries of the area, the system of financing and controlling investment activity is to be considerably modified. The changes include more participation by enterprises and associations in the investment process and the assignment of a more important role to bank credit in the financing of fixed investment. Bank credit will be used on a large scale to finance not only decentralized investment but also central investments other than those involving expenditures on large priority projects. Credits extended to enterprises for financing centrally determined projects will be covered, after completion, by budgetary grants. Those extended to enterprises for financing their own projects will eventually have to be covered from earned profits. In all cases financial settlements will be directly between the investor and the construction organization and take place on completion of the whole project; it will fall to the investor to ascertain that the original costs estimates are not exceeded. If the cost of the project exceeds the planned figure, the bank must charge additional interest on the credit.[35] On the other hand, should the actual cost be smaller than envisaged, part of the saving remains at the disposal of the enterprise and can be used for investment purposes. The enterprise's development fund, hitherto available for financing only a part of the fixed investment outlays, will become a source of finance for both fixed and working capital. But an enterprise will be able to use this fund for investment purposes only after its working capital requirements are covered. If an enterprise's funds are insufficient for covering its working capital requirements, it may have recourse to bank credit, a relatively higher rate of interest being charged on credits

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[32] Op. cit. In addition to making the factory price of a given product a better reflector of market conditions, the program also provides for the introduction of interbranch accounting prices. Within the framework of associations, factory prices are to be differentiated, if necessary, between enterprises in order to assure that they reflect the technological conditions of each producer without making a change in the average necessary. Together with the interest rate on fixed assets, they will also help to neutralize the impact on profitability of differences in natural and technological conditions.

[33] See S. Jedrychowski's closing speech, Trybuna Ludu, July 31, 1965.

[34] See S. Jedrychowski in Zycie Gospodarcze, No. 50, 1965.

[35] Credits for centrally determined projects will be interest free up to the amount of the approved cost estimate.

used to finance higher than normal inventories. Another modification is the creation in enterprises of a special fund to finance the cost of capital repairs. This fund will be fed by the depreciation allowances, the latter no longer financing investment outlays except for the proportion channeled into the association's investment fund.[36]

Under the new system, allocations to the enterprise fund are to be related to the degree the planned profitability index is realized in a given year, thereby avoiding the complicated procedure used previously. In order to provide stronger incentives for a careful planning of profits, failure to achieve the planned profitability target will result in a progressive reduction in allocations into the enterprise fund; on the other hand, if the profitability is higher than indicated in the plan, allocations will increase but at a decreasing rate. Additional transfers to the fund are permitted where enterprises can be credited with the development of new products or technological processes, and improvements in quality, or in export performances, etc. The rules by which the enterprise fund is distributed among individual employees are also modified by the adoption of a point system similar to that applicable to the distribution of the premiums fund, and introduced earlier.[37]

The guidelines provide for the introduction of a capital charge on the fixed assets of all industrial enterprises. This charge, which is to be paid into the budget, will be calculated at a rate that varies between different branches, and is applied to the net value of the assets. The charge will be introduced gradually, beginning with the branches where the present profit margin is sufficient to accommodate it. Currently designed as an item of profit distribution, the charge will eventually be incorporated into the structure of industrial costs.

Great stress has been placed on improving the flexibility of operations in enterprises engaged in producing exports.[38] Foreign trade targets expressed in quantities will be drastically reduced; only in the case of selected basic commodities will such targets—that fix a minimum limit for imports and a maximum limit for exports—be retained. Rather than prescribe, as hitherto, production targets for export goods couched in terms of domestic prices, such targets will henceforth be specified in terms of foreign exchange zlotys. Thus, in most cases, the producing and trading organizations will have the power to determine the items to be exported, provided that they meet the overall target value, in order to insure that the exports "mix" is acceptable when evaluated in terms of production costs, measures of profitability are to be formulated which, together with the value of the foreign trade receipts, will provide criteria for distributing premiums. Such premiums are to be financed from a newly established fund, allocations from which will be made on the basis of principles which apply to producers and traders alike.[39] It is hoped to improve cooperation between producing and trading organizations by extending the operations of the "Advisory Branch Committee," whose task will be to coordinate production and investment plans with export requirements. Direct contacts between domestic producers and customers and foreign markets are to be strengthened by encouraging enterprises to enter into foreign trade contracts, and by creating special export or import departments in domestic producing or trading enterprises.

The measures described, in particular the greater operative autonomy enjoyed by associations, the greater reliance placed on horizontal ties within the system and the more important role assigned to profitability and incentives for guiding economic activity, imply, of course, that the overall plan will have to be less rigid. Production targets given to associations will be couched mainly in value terms and will serve as general guidance and a point of departure for the formulation of their own plans. Only after the conclusion of interbranch agreements will plans become more detailed and binding although, even at this stage, certain modifications may be possible. In these circumstances, the role of the central authorities may, in fact, diminish to that of surveillance of the overall proportions. For this purpose it would retain direct control in four major areas: prices, investment, wages, and foreign trade.

A major item in the proposed measures is the creation of inventory and currency reserves to meet exigencies arising in connection with weather fluctuations, changes in the external trade situation, unpredicted shifts in the size

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[36] This means that the former practice of channeling unused depreciation allowances into the budget will be discarded.

[37] See the Survey for 1964, ch. I, p. 58, footnote 185.

[38] The need to promote exports and increase the effectiveness of foreign trade was discussed at the Political Bureau Plenary Meeting in December 1965.

[39] Until now, export premiums received by producers were not alined with similar premiums allocated to the foreign trade organizations, and were based on different criteria.

and structure of internal demand, etc. In addition to the creation of such reserves, it has been suggested that "capacity reserves" be created in manufacturing industry, construction, and transport, their role being to render the system more adaptable to unforeseen changes.[40] Following the example of some other countries, the guidelines call for a greater continuity in planning. The preparation of annual plans is to be accompanied by the fixing of the main targets for more than 1 year ahead, and 5-year plans are to be drafted with the additional perspective of 2 years. The drafting of a long-range plan covering the next 15 to 20 years is to be resumed, and when completed the plan will be extended at 5-year intervals.

A rough timetable has been drawn up under which the financial system of enterprises and associations assumes its new form—including adherence to the new regulations applicable to the financing of centrally planned investments—at the beginning of 1966. By the middle of the year, most of the new statutes for the individual associations should be drawn up, while the preparation of lists of factory prices is to be carried out in the course of 1967. The Plenum resolution also recommends that preparatory work on the new production indicators should be finished by the end of 1968. In order to narrow differences in profitability between various branches, prices of some chemical raw materials and semi-processed items are being reduced from January 1966. A similar correction is to be applied to machinery prices in January 1967.

Although these reforms represent a considerable overhaul of the existing system, it has been recognized officially that in many ways the measures are inadequate and that a sustained search for new solutions is required. Accordingly, an outline for further exploration and experiment has been proposed, in order to prepare and test further modifications which might be adopted on a larger scale in the future.

Eastern Germany

In Eastern Germany, the principles of a new economic system were propounded and adopted as early as mid-1963. Various measures have been formulated and gradually put into effect, but the actual stage reached by the reform cannot yet be assessed with much precision. Some of the new measures have only partial applicability, some are of a more or less experimental nature, and a number of the proposed changes are still under discussion. However, according to official sources, it would appear that the implementation of the reform has now reached a second phase.

The Association of State Industrial Enterprises (VVB's) has been transformed into units operating on the basis of autonomous economic accounting principles and enjoying full responsibility for the profitability of their respective industrial branches. The contract law and the regulations for the settlement of accounts between enterprises have been revised, and the 1964 decisions relating to decentralized investment have been partially implemented. In addition, the first two phases of the reform of industrial prices, which were preceded by a revaluation of fixed assets and the introduction of revised amortization rates, have been completed. On the other hand, the application of the capital charge to the production funds of enterprises is still in the experimental stage.[41]

The scope of central planning has been defined in more precise terms. The intention is that the state planning commission should concentrate primarily on the "optimization" of the economy (described as the achievement of a maximum increase in national income by furthering the profitable activity of the branches), while relaxing, to some extent, its direct control over the enterprises. On the basis of fewer centrally fixed indicators and less direct economic guidance by the central authorities, the VVB's and enterprises will be requested to prepare their own output plan and to rely increasingly on their own financial resources.

Those targets which will continue to be determined centrally have not yet been chosen, but it seems that their number will be small. As in Poland, it has been decided that profit should become the most important indicator. Production assignments and the central allocation of supplies will be retained for those commodities that are considered as particularly important to the economy. The remaining indicators having general applicability will be concerned with the degree of utilization of production capacity, foreign trade activites, and the wage fund.[42]

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[40] See Polityka, May 5, 1965.

[41] The delay is mainly attributable to the uncompleted price reform. In the course of 1966 this charge will be levied on branches where the price reform has already been implemented.

[42] Annex to Die Wirtschaft, No. 1, 1966.

Decentralized investment will continue to gain in importance, so that the VVB's and the enterprises will need to have more frequent recourse to their own financial resources supplemented by credits. At a later stage, centrally allocated investment resources will have to be repaid, except in the case of projects of high priority. In addition, new directives were recently issued by the central committee requiring, inter alia, the utmost care in the preparation of investment projects (which should pay due regard to the utility effect and the need for full utilization of the capacity of the branch as a whole), that greater emphasis be placed on rationalization investment and that better use be made of foreign trade for furthering technical progress.[43]

Foreign trade also continues to be a major concern of the authorities, especially as the difficulties in implementing the new system in this particular field appear to be greater than originally envisaged. The problem consists mainly of evolving a system of economic tools which would force the VVB's to expose their products to world market conditions, especially in respect of costs and prices. Success in this field obviously depends on the implementation of a number of other measures provided for in the outline of the new system—especially price reform—but, in addition, it would seem that the Ministry of Foreign Trade has been rather tardy in conducting experiments scheduled for 1965 and which should have suggested solutions to the conflicting interests between the VVB's, on the one hand, and the foreign trade agencies on the other.

So far, however, the efforts of the authorities seem to have been largely concentrated on the price problem since it was considered that the choice of profit as the main indicator of enterprise activity would not be very effective without appropriate changes in the price system. According to official reports, new prices will soon be established for goods and services which, in all, account for some 65 percent of industrial commodity production in 1965.[44] It is expected that these prices will enable all industrial branches to accumulate sufficient financial funds from their own profits to allow state subsidies to be abandoned. After the completion of this third phase of the price reform, a new round of adjustments for the prices of certain commodity groups (introduced in the two earlier phases) is being envisaged.

However, it should be pointed out that, as in other countries of the area, the question of the price structure and, more particularly, the manner in which the profit element should be determined has not yet been solved at this stage, though experts agree that the cost of capital outlays ought to be given greater weight than hitherto. Another important question, still under discussion, is whether all prices, or only some of them, should continue to be determined centrally. At present, it seems most likely that a solution similar to the Czechoslovak reform will be adopted, though probably with certain modifications. The three categories of prices now being contemplated are:

(a) Centrally fixed prices (to be continuously reexamined) for products of national economic importance (such as basic materials) and those which have a direct impact on the real income of the population (for example, food);

(b) Maximum prices, which must be approved by the price offices, but which can be reduced in contracts by the mutual agreement of enterprises; and

(c) Free prices, to be determined in contracts between enterprises, which will be particularly important where enterprises need a rapid decision and the economic consequences cannot be of major importance.

Certain changes in the administrative machinery announced toward the end of 1965 should also be mentioned. A decision taken at the meeting of the Central Committee of the Party on December 17 abolished the National Economic Council, which was made responsible in 1961 for the whole management of industry, its industrial departments being replaced by industrial ministries.[45] At the same

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[43] Following these directives, which were issued in December 1965, some of the investments previously planned in basic industries have been abandoned, and the resources in question switched to other branches, especially to the metal-using industry which is expected to expand exports to Western countries.

[44] Out of a value of 80 billion MDN of goods whose prices are to be changed. The reform comprises the total commodity output of the engineering industry (about 22 billion MDN), the processing stages of the textile industry (17 billion MDN), some sections of the building materials industry and the construction industry (10 billion MDN), and the food industry (28 billion MDN). Neues Deutschland, Dec. 17, 1965.

[45] The new ministries correspond to the following branches or group of branches: basic industries, mining and metallurgy, electrotechnical industry and electronics, heavy engineering, processing machinery and motor industry, and light industry.

time, a ministry for material supplies, and a ministry for locally administered industry and the food industry, have been established. On the surface it would seem that these changes are rather similar to those announced in the Soviet Union. And, indeed, to the extent that, parallel with the Government's efforts to broaden the scope for decentralized decisions, they also aim at strengthening central planning and control in certain strategic fields—particularly in investment and foreign trade—they reflect a fundamentally similar attitude toward central planning. But on the other hand, less emphasis is placed on reaffirming the branch principle as a method of guiding industry in the case of the East German reform. According to official statements, the extent to which the functions of the state planning commission and the National Economic Council concerned with the planning of industry ran parallel to each other had given rise to detrimental conflicts between branch interests and the wider interests of the national economy. It is expected that the reorganization will strengthen the authority of the state planning commission, and that the new ministries, which are intended to act as links between the commission and the VVB's, will be in a position to hold the requirements of the latter at a level which can be reconciled with the optimum versions of the national plan.

Hungary

A report on the "comprehensive review of a system of economic management," adopted by the Central Committee on the Hungarian Socialist Workers' Party at its November session,[46] is only a preliminary document. It is to be submitted to party members, social and professional bodies and leading economists for discussion, and on the basis of the resulting revised version final decisions are expected to be taken in the early months of this year. The document, therefore, does not attempt to indicate the exact scope of the changes which the authorities may have in mind at this stage, nor does it refer much to the procedures that might be used when dealing with specific points. Perhaps the most interesting feature of the report is to be found not so much in the originality of the main lines of action proposed—most of which fall within the general framework described in the introduction of this section—but rather the balanced and systematic approach to the various components of economic reform that has been adopted. The emphasis placed on the problems of prices and foreign trade, and more particularly on the need for exposing domestic enterprises to foreign competition in order to obtain more realistic cost-price relationships, resembles the approach adopted in the document originally embodying the Czechoslovak reform. In addition, the report states explicitly that "the market mechanism cannot be regarded as foreign or contrary to socialism."

The report proposes that the number of centrally fixed targets should be gradually reduced in the course of the first 2 years of the reform, but the full development of the new management system will require that the system of providing enterprises with mandatory indicators will be abandoned altogether. Enterprise autonomy will be reflected in the fact that, in the framework of the new management system, economic units will be obliged to formulate their own annual and longer term plans, and that they will have the right to determine independently the programs for the best use of their resources. Eventually, the enterprise will only be obliged to "meet the requirements of the buyer in respect of quality, quantity and timing; and systematically improve profitability." Therefore the existing administrative controls will be replaced by economic instruments of management that will seek to influence the behavior of enterprises in a predetermined way. Such instruments as the income collection of the state, foreign exchange regulations, price, wage and credit policies can be used for making enterprises aware of the plan objectives.

In agriculture, too, the reform strives to develop independent (cooperative) management and to guide it by the use of nonadministrative instruments. Therefore, such categories as enterprise income, production costs, profits, depreciation charges, turnover funds, reserve funds, labor income funds, etc., should also be a feature of cooperatives. The system of material incentives in these enterprises will have to be based more consistently on the principle of independent economic accounting than it has been hitherto. It should be accepted that the more efficient enterprises should be able to confer greater benefits on their staff, in addition to allocating larger sums to the enterprise funds.

As far as prices are concerned, appropriate weight should be given in the costing procedure to the amount of the immobilized fixed and working capital. In

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[46] Népszabadság, Nov. 21, 1965.

spite of the introduction of a capital charge, these elements have not yet been adequately reflected in the price structure. Another major instrument for insuring a closer approximation to real social costs would be a more realistic conversion and accounting of foreign trade prices. In future, the effective export and import prices must be directly reflected in the costs and incomes of the producing units and of foreign trade organizations. Less reliance should be placed on centrally fixed prices, although the prices of basic raw materials, basic foodstuffs and the more important manufactures for current consumption will continue to be determined by the state. It would seem, however, that a significant proportion of other products could be subject to established price maximums or directives, while prices of a third group of products might be left to a process of negotiation between Socialist enterprises.

Considerable attention is also devoted to the investment system and the allocation of financial resources, although the changes envisaged in this particular field do not appear to constitute major departures from the present system. The report points out that centralized decisions and state finance should be necessary only for important projects but, nevertheless, it appears that enterprises are left merely with decisions about maintenance and minor development projects.

As pointed out above, foreign trade questions attract special attention in the report. Foreign trade will continue to be centrally directed, but increasing reliance will be placed on economic instruments. Economic links should be forged between the activities of the producing units and foreign trade enterprises in order to assure that the foreign market will have a more direct impact on domestic production and that domestic enterprises become increasingly interested in foreign markets. It also seems appropriate that the scope of the direct foreign-trade activities of producing enterprises be enlarged in fields where this can be justified by technical, market and/or efficiency considerations. Where it is appropriate, domestic trading organs should also be able to engage in foreign trade. Where export performance is good, enterprises should be allowed to retain part of the foreign trade receipts. However, measures should be taken to prevent domestic enterprises competing in foreign markets.

It is intended that scope should exist for domestic competition between enterprises, whenever this is advantageous to the consumer. In addition, domestic trading organizations should be allowed to import consumer goods (in the framework of the plan), and to use these for influencing the domestic market.

Some of the envisaged changes are expected to be formulated and implemented at a relatively early date, but the main body of the new system will not become operative before 1968, by which time the price reform should have been completed.

[From Reuters East-West Trade News, Oct. 27, 1966]

Trade with Soviet bloc—January to June

[Millions of U.S. dollars]

	Imports				Exports			
	Soviet Union		Eastern Europe		Soviet Union		Eastern Europe	
	1966	1965	1966	1965	1966	1965	1966	1965
Great Britain	127.4	121.4	162.5	140.5	75.6	59.1	116.8	85.3
West Germany (excluding East Germany)	141.8	131.2	177.5	144.7	62.9	68.3	234.2	210.4
West Germany (including East Germany)	-------	-------	333.2	276.9	-------	-------	431.7	341.5
Japan	124.6	109.1	24.2	18.3	82.1	74.1	34.7	16.3
France	80.3	66.1	85.9	60.9	32.4	36.3	173.1	114.3
Italy	94.0	90.4	171.4	119.7	43.0	47.1	131.4	113.3
Belgium	21.1	17.0	37.2	36.5	13.3	11.4	41.9	33.4
Netherlands	25.5	20.4	47.7	46.6	14.6	7.8	47.1	34.8
Finland	112.2	118.0	27.5	29.4	79.6	93.5	28.4	35.3
Norway	13.4	12.5	17.8	17.5	8.3	8.3	14.5	21.2
Sweden	39.7	34.6	55.7	51.8	19.2	26.5	61.7	52.8
Denmark	17.5	15.0	41.9	39.6	9.9	16.7	38.5	31.4
Austria	21.5	25.9	81.0	74.0	28.0	28.2	92.0	84.8
Switzerland	11.3	3.6	32.2	28.3	8.4	6.7	42.3	28.5

Source: Official trade returns of Western countries.

[From Reuters East-West Trade News, Oct. 27, 1966]

Exports to Sino-Soviet bloc—January to June

[Millions of U.S. dollars]

	Soviet Union		China		Poland		Czechoslovakia		Rumania		Bulgaria		Hungary		East Germany		Total	
	1966	1965	1966	1965	1966	1965	1966	1965	1966	1965	1966	1965	1966	1965	1966	1965	1966	1965
Great Britain	75.6	59.1	42.0	29.6	45.6	29.6	18.8	15.6	10.4	15.6	6.2	6.4	12.3	10.6	23.5	7.5	234.4	174.0
West Germany	62.9	68.3	57.4	28.5	42.5	48.7	48.7	42.9	51.0	60.9	44.8	21.0	47.2	36.9	197.5	131.1	552.0	438.3
Japan	82.1	74.1	164.1	113.2	1.2	3.7	2.2	2.4	11.6	6.8	17.8	2.2	1.2	1.0	.7	.2	280.9	203.6
France	32.4	36.3	45.8	19.2	38.8	10.0	25.3	15.3	20.3	27.3	28.4	10.9	14.3	9.5	46.0	41.3	251.3	169.8
Italy	43.0	47.1	15.5	23.4	28.2	20.9	28.1	20.1	27.0	27.1	17.7	17.0	20.5	20.1	9.9	8.1	189.9	183.8
Belgium	13.3	11.4	7.0	5.9	7.3	7.5	10.8	8.9	3.2	3.6	5.0	1.7	6.0	6.7	9.6	5.0	62.2	50.7
Netherlands	14.6	7.8	8.1	7.0	6.3	4.5	9.1	6.4	3.3	2.5	9.5	7.2	6.9	5.3	12.0	8.9	69.8	49.6
Finland	79.6	93.5	3.4	2.8	10.2	19.8	4.3	3.6	3.0	2.2	.5	.8	4.4	3.6	6.0	5.3	111.4	131.6
Norway	8.3	8.3	3.2	.6	4.6	5.9	4.2	3.6	.2	.8	.3	1.7	1.8	3.6	3.4	5.6	26.0	30.1
Sweden	19.2	26.5	10.1	4.2	14.9	15.1	10.6	7.5	9.2	4.2	2.6	2.8	6.4	5.9	18.0	17.3	91.0	83.5
Denmark	9.9	16.7	1.1	.6	15.9	8.6	5.1	3.6	.9	1.1	3.3	1.9	2.0	5.0	11.3	11.2	49.5	48.7
Austria	28.0	28.2	1.3	.8	16.3	16.2	18.2	15.1	11.7	12.5	10.7	9.8	21.1	19.2	14.0	12.0	121.3	113.8
Switzerland	8.4	6.7	8.5	6.1	8.0	5.6	9.9	8.4	7.1	3.9	5.8	1.9	6.4	5.6	5.1	3.1	59.2	41.3
Total	477.3	484.0	367.5	241.9	239.8	196.1	195.3	153.4	158.9	168.5	152.6	85.3	150.5	133.0	357.0	256.6	2,098.9	1,718.8

[From Reuters East-West Trade News, Oct. 27, 1966]

Imports from Sino-Soviet bloc—January to June

[Millions of U.S. dollars]

	Soviet Union		China		Poland		Czechoslovakia		Rumania		Bulgaria		Hungary		East Germany		Total	
	1966	1965	1966	1965	1966	1965	1966	1965	1966	1965	1966	1965	1966	1965	1966	1965	1966	1965
Great Britain	127.4	121.4	51.5	37.4	73.9	66.4	29.6	24.5	17.9	16.7	10.6	7.5	9.2	8.4	21.3	17.0	341.4	299.3
West Germany	141.8	131.2	45.7	36.0	48.9	38.4	40.2	36.4	35.5	29.2	19.5	16.4	33.4	24.3	155.7	132.2	520.7	444.1
Japan	124.6	109.1	156.1	113.9	1.4	1.5	4.0	4.0	9.0	9.1	6.7	2.8	.3	.2	.1	.6	302.2	241.2
France	80.3	66.1	28.8	21.2	20.1	15.6	14.5	14.2	20.3	15.9	8.3	1.9	11.1	7.2	11.6	6.1	195.0	148.2
Italy	94.0	90.4	24.5	17.0	35.4	32.4	21.1	19.0	37.8	29.0	29.0	12.5	27.5	20.9	20.6	5.9	289.9	227.1
Belgium [1]	21.1	17.0	8.2	7.9	6.3	6.2	8.7	10.3	3.3	3.9	1 9	1 4	4.8	3.9	12.2	12.3	66.5	62.9
Netherlands	25.5	20.4	15.7	13.7	8.4	6.7	13.7	13.7	2.2	2.5	2.1	1.7	6.2	6.1	15.1	15.9	88.9	80.7
Finland	112.2	118.0	4.8	3.3	10.8	12.0	5.4	6.1	1.6	1.1	1.0	.8	2.7	2.2	6.0	7.2	144.5	150.7
Norway	13.4	12.5	2.4	2.5	6.5	5.0	6.0	5.8	-------	.3	.3	.3	1.8	2.2	3.2	3.9	33.6	32.5
Sweden	39.7	34.6	7.2	7.8	20.2	17.9	10.1	11.4	4.5	3.9	1.3	1.1	6.6	6.1	13.0	11.4	102.6	94.2
Denmark	17.5	15.0	2.9	2.9	16.6	16.7	8.0	7.0	.6	.3	.5	.3	3.4	3.4	12.8	12.0	62.3	57.6
Austria	21.5	25.9	5.0	2.5	19.9	17.6	18.6	18.1	8.8	11.2	7.2	4.5	15.4	11.2	11.1	11.4	107.5	102.4
Switzerland	11.3	3.6	7.2	5.9	5.4	5.0	11.4	9.8	4.1	1.7	.8	.6	7.2	8.1	3.3	3.1	50.7	37.8
Total	830.3	765.2	360.0	272.0	273.8	241.4	191.3	180.3	145.6	124.8	89.2	51.8	129.6	104.2	286.0	239.0	235.8	1,978.7

[1] 1965 figures revised, 1966 figures provisional.

Total free-world trade and free-world trade with Communist areas, 1948 and 1959–65

[In millions of dollars]

Year	Total free world	Total Communist areas [1]	Communist areas as percent of world	Eastern Europe	Eastern Europe excluding U.S.S.R.	U.S.S.R.	Communist China
Free-world exports: [2]							
1948	54,400	1,968.5	3.6	1,434.2	900.7	533.5	534.3
1959 [3]	101,800	3,669.1	3.6	3,003.2	1,854.0	1,149.2	651.0
1960 [3]	113,700	4.425.1	3.9	3,738.4	2,174.0	1,564.4	669.9
1961 [3]	118,800	4,966.6	4.2	4,198.2	2,372.6	1,825.6	738.9
1962 [3]	124,900	5,172.2	4.1	4,471.8	2,454.0	2,017.8	678.4
1963 [3]	136,100	5,622.1	4.1	4,786.8	2,675.0	2,111.8	804.6
1964 [3]	153,300	6,810.3	4.4	5,729.0	3,147.3	2,581.7	1,045.2
1965 [3 4]	165,300	7,556.6	4.6	6,219.5	3,523.1	2,696.4	1,268.0
Free-world imports: [2]							
1948	60,000	2,008.0	3.3	1,519.7	1,026.0	493.7	488.3
1959	107,100	3,762.8	3.5	3,039.5	1,795.3	1,244.2	698.3
1960	119,600	4,462.1	3.7	3,661.0	2,145.9	1,515.1	776.6
1961	124,800	4,987.1	4.0	4,225.6	2,367.3	1,858.3	732.4
1962	132,800	5,517.8	4.2	4,684.0	2,491.8	2,192.2	796.2
1963	144,000	6,240.6	4.3	5,255.0	2,827.0	2,428.0	939.7
1964	161,000	7,024.8	4.4	5,714.7	3,178.6	2,536.1	1,257.5
1965 [4]	174,900	7,856.4	4.5	6,312.6	3,486.0	2,826.6	1,489.9

[1] Includes trade with Outer Mongolia, North Korea, and North Vietnam.
[2] Including Yugoslavia and Cuba.
[3] Beginning 1959 free-world exports to Communist areas exclude reexports from Hong Kong.
[4] Preliminary.

NOTE.—Eastern European and Communist Asian figures are compilations of unadjusted data, as reported by free-world countries.

Source: International Monetary Fund and U.S. Department of Commerce.