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TITLE: SARTOR RESARTUS? GORBACHEV AND PROSPECTS FOR ECONOMIC REFORM IN CZECHOSLOVAKIA

AUTHOR: Josef C. Brada

CONTRACTOR: Yale University

PRINCIPAL INVESTIGATOR: J. Michael Montias

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Surely the last expectation that the Czechs and Slovaks witnessing the 1968 Soviet-led Warsaw Pact invasion of Czechoslovakia could have had was that twenty years later the visit of a Soviet head of state would give rise to popular expectations of Soviet-induced economic reform and political liberalization in Czechoslovakia. Nevertheless Mikhail Gorbachev's visit to Czechoslovakia, followed by his setting-out of the broad outlines for a radical reform of the Soviet economic system at the June 1987 Plenum of the Central Committee of the Communist Party of the Soviet Union, has fueled speculation not only in Czechoslovakia, but also in the other East European countries and among western observers, that Gorbachev would act decisively and expeditiously to spread perestroika and glasnost to Czechoslovakia if not to all Eastern Europe. This essay explores whether the Soviet Union does indeed wish to promote radical economic reforms in Czechoslovakia and examines some of the economic and political obstacles to such reforms.

My working hypothesis is that if Gorbachev is to pressure the Czechoslovak leadership to undertake radical economic reforms, then he must be convinced that the objective factors, both economic and political, that make economic reform an urgent necessity in the Soviet Union are equally present in Czechoslovakia; that the chances for successful reform in Czechoslovakia are at least as good as they are in the USSR; and that the likely benefits to the Soviet Union of a successful reform in Czechoslovakia outweigh the potential costs of a failed reform. Moreover, if Czechoslovak leaders are to acquiesce to reform, they would need to share these assessments.
The Need for Economic Reform in the USSR and in Czechoslovakia

The economic pressures for reform in the Soviet Union are almost entirely internal; over the past fifteen years the foreign trade sector and external events in general have had a benign influence on Soviet economic performance. The principal manifestations of the failure of the economic system in the Soviet Union is the steady decline in the rate of growth of output since the early 1960s. In part this is attributed to the exhaustion of the so-called extensive factors of growth, meaning increases in productive inputs. Labor growth has slowed sharply, and efforts to substitute capital for labor by devoting an ever increasing share of total output to investment have been unsuccessful. Intensive development, the increase in factor productivity, has not taken up the slack. In large part this is due to systemic barriers to innovation, to ineffective incentives for workers and managers, to poor labor discipline and morale, to excessive centralization of decisionmaking, to an inability to complete investment projects and to corruption. These problems have been exacerbated by the failure to resolve problems in agriculture and in the energy sector as well as by an inability to formulate a policy for regional development that could resolve regional disparities in the availability of labor, capital and natural resources.

Gorbachev has chosen to attempt to break the impasse by increasing investment; if productivity increases as well, then the growth in output should be sufficient to both cover the higher level of investment and provide for the increased consumption needed to sustain labor morale. The urgency of the task comes in part from the deferral of difficult choices by Gorbachev’s predecessor’s, in part
from the fact that delay simply increases the complexity and cost of corrective actions, and in part from the fact that foreign trade gains to the economy will shortly disappear. Between 1970 and 1982 the price of Soviet exports tripled while the price of imports doubled. These terms of trade gains enabled the Soviet Union to import more machinery, equipment and technology from the West and to resolve its agricultural problems through grain imports. As world oil prices decline, Soviet terms of trade will no longer improve, and foreign solutions to domestic problems will become more costly.

The case for economic reform in the Soviet Union is thus compelling in that the mechanism is clearly seen as the cause of the economic crisis. Other cures, including the Kosygin reforms of the 1960s, the formation of associations, the importation of western technology and capital, have proven unsuccessful. Combined with the need to break the vicious cycle of slower growth of output leading to slower growth of capital and the imminent decline of oil prices, these past failures to restore the economy's dynamism provide a powerful impetus for radical economic reform.

Simultaneously, the political factors are favorable to reform, which can be viewed as a "revolution from above" that not only changes the economic system but also alters social relations and causes personnel changes in the middle levels of the government and Party. The new leadership is free to criticize the policies of the past, and, indeed, such criticism, accompanied by personnel changes in the bureaucracy, strengthens Gorbachev's position by creating a class of supporters whose welfare and success is tied to his and whose ideals and aspirations in any case may closely reflect his own.
In Czechoslovakia neither the economic nor the political forces favor reform so strongly. While it is true that many of the defects that characterize Soviet economic performance, low efficiency, poor quality and lagging technological standards among them, can also be seen in Czechoslovakia, it is more difficult to ascribe them to the shortcomings of the system, or, at least, it is easier to defend the system by pointing to mitigating circumstances. A large part of Czechoslovakia's economic problems can be ascribed to the foreign trade sector and to the policies adopted to maintain external equilibrium. The upsurge in raw materials and energy prices that benefited the Soviet economy imposed severe losses on Czechoslovakia. Between 1970 and 1982 Czechoslovak terms of trade declined by nearly 25 percent. At the same time, recessions in West Europe and financial difficulties among a number of Czechoslovakia's Third World trading partners reduced possibilities for increasing exports. These external shocks were exacerbated by errors in macroeconomic policy; in 1976-80 the investment to Net Material Product (NMP) ratio reached historic highs. As a result of this investment binge the failure to complete investment projects became a major drag on economic performance. The 1981-85 period thus was a consolidation phase in which deflationary policies were employed to restore internal and external equilibrium. The volume investment was slashed and imports, particularly from the West, were restrained, thus enabling the authorities to reduce the backlog of incomplete investment projects and to reduce foreign indebtedness. NMP grew at only 9 percent over the five-year period, starting with a decline in 1981 but increasing in the later years.
As a result of this consolidation the growth of NMP has been in the 2.5-3.5 percent per year range since 1983, suggesting that the quantitative, if not qualitative, ills that plagued the economy at the turn of the decade have been, and may continue to be, held at bay without a radical economic reform.

In addition to a less compelling economic rationale for economic reform in Czechoslovakia, there is also greater political resistance to the idea, particularly among the higher echelons of the Party. In the Soviet Union, Gorbachev and the reformers surrounding him first assumed power and then introduced reform, in part because reform measures are a way for them to strengthen their political position and weaken that of their opponents. In Czechoslovakia, the top leadership has been in power for many years and a reform could do nothing but weaken their position. The raison d'être for the existing Czechoslovak leadership is the purification of the economy and of society of the effects of the 1968 reform. Thus the leadership need not debate the philosophical question whether the only difference between Dubček and Gorbachev is, as the popular saying has it, "only twenty years." They can already see in Gorbachev's reform proposals that there really is no more than twenty years separating Ota Sik, the father of the 1968 reform, and Tatyana Zaslavskaya. That is, there is very little difference between the 1968 Czechoslovak reform and the measures outlined by Gorbachev at the June 1987 Plenum. Table 1 shows these similarities between the two reforms; they are striking and could not be ignored by the Czechoslovak people or by the leadership. Not only would such a reform fly counter to twenty years of the
leadership's rhetoric, but it would also stimulate the highly dangerous connection between economic reform and the types of social and political ferment that accompanied the 1968 period.

Any effort at reform in Czechoslovakia would require the participation of reform-minded members of the Party and of society. Since these individuals are not currently in positions of power, an economic reform would represent not a revolution "from above" as in the Soviet case, but rather one "from below" which would at best reduce the power of the ruling elite. In Czechoslovakia such tensions have a unique aspect since, due to the federal nature of the state, the existence of a Czech and a Slovak Communist Party imbues changes in power within the Party at the national level with many of the characteristics of a two-party political system. Thus a change in power between pro- and anti-reformers carries with it the potential for much greater and thus potentially more destabilizing changes in the political power of the Czech and Slovak parties.

The Possibility for a Successful Economic Reform in Czechoslovakia

Even if the existing leadership were to succumb to Soviet pressure and attempt to implement a meaningful reform of the economy, there are serious doubts whether such a reform could succeed. The first set of obstacles can be gleaned from the experiences of Hungary and of the Soviet Union. These experiences show that reform is a difficult process. The conception of reform measures is by no means simple, and the admonitions of Soviet politicians and economists that the reforms of one socialist country cannot be grafted on to the mechanism of another is as true for Czechoslovakia as it is for the
Soviet Union. Consequently Czechoslovak economists and politicians must develop an understanding of the shortcomings of the present economic mechanism, reach agreement on which aspects are amenable to improvement through reform, and form a consensus on the broad outlines of a reform. Whether this conception would be a correct one is, of course, by no means clear. Moreover, the broad outlines of a reform must be given life through the drafting and enactment of legislation, decrees, and regulations needed to create the appropriate organizations and to guide their day-to-day activities. The Hungarian experience with both the 1968 reform as well as with the current wave of reforms indicates that this is a terribly difficult and time-consuming task.

Against this background it is important to bear in mind that Czechoslovakia has a poor record of implementing reform and that current reform thinking and experimentation may not be adequate to support a rapid implementation of reform measures. The first Czechoslovak effort at reform occurred in 1958, when investment decisions were decentralized to the enterprise level and enterprises were encouraged to maximize profits. The reform resulted in excessive investment and in confusion that culminated in the Czechoslovak recession of 1961-62. The 1968 reform, many of whose features were gradually introduced in 1966 and 1967, clearly did not have a fair test in terms of its economic effects but its political consequences were catastrophic. Thus current thinking about economic reform in Czechoslovakia has a good deal of cautionary experience on which to rely, but very little in a positive vein. Similarly current reform
experimentation is characterized by ambiguity of intentions, slow implementation and signs of resistance at lower levels and uncertainty among the leadership. The essence of these experiments is a decentralization which would leave the center concentrating on medium-term and structural strategy and enterprises on day-to-day operations. Plans to try these experiments in selected enterprises were announced for this five year plan period, but so far there is little evidence of implementation. Only if, and the if has been strongly stressed by the leadership, these experiments prove successful would they be extended to the entire economy in the next decade. It seems reasonable to conclude that, as yet, there is no meaningful reform that has the support of a sufficiently broad group of economists and politicians. The current efforts are intended more to show that the Czechoslovak leadership understands the direction in which the winds from the Kremlin are blowing and to have something to put on the table for Gorbachev's visit than as a serious inquiry into the feasibility of a well defined reform model.

Even if a well conceived reform model existed in Czechoslovakia and even if it could be translated into the requisite laws and regulations in a short period of time there are additional obstacles to its success. One is Czechoslovakia's extensive trade dependence on CMEA. In a small economy a major objective of reform must be to align domestic and world prices in order to foster the rational allocation of resources and to foster greater specialization. Czechoslovakia, however, is so oriented to the Soviet market, both as an outlet for its exports and as the source of its imports that reliance on world market signals is infeasible due to the low volume of Czechoslovak
trade with non-socialist countries. Reliance on world prices would also be counter-productive since it would interfere with Czechoslovak efforts to align the economy to the needs of the Soviet Union. More important, reform requires a serious commitment from the leadership. If the leadership does not have a stake in the success of the reform then, as was the case in Bulgaria and Poland, we have only the form but not the substance of a new economic mechanism. As yet such an interest in reform is not evident in Czechoslovakia.

Is Economic Reform Worth the Risk? The View from the Kremlin

In view of the resistance and delays that Gorbachev’s reform efforts are facing in the Soviet Union, there is no one better aware than he that implementing a reform is a time-consuming, difficult and possibly ultimately unsuccessful effort. Consequently, before he chooses to pressure the existing leadership in Prague to follow the Soviet reform efforts, he is likely to weigh the potential costs and benefits carefully. To understand these it is necessary to first recognize that reform of the economic mechanism is but one of the strategies being used to reverse the long term decline in the growth rate of the Soviet economy. The other strategy involves an increase in investment directed primarily toward "leading edge" sectors such as machine tools, production automation, electronics, chemicals and energy. Technological progress is to be spurred by retooling existing plants with more sophisticated machinery and by introducing new production technologies. Since these ambitious demands for new machinery and technology cannot be met by the domestic machine-tool sector, the Soviets have also chosen to strengthen CMEA integration.
Gorbachev has called for the closer coordination of five year plans of the member countries, for joint efforts in research and development and for long-term bilateral specialization agreements between the Soviet Union and the East European countries.

These developments have been viewed with satisfaction in Prague, since Czechoslovakia has been a long-standing and staunch supporter of CMEA integration. Indeed, the Czechoslovak leadership views CMEA integration and Gorbachev's economic strategy as an opportunity to modernize Czechoslovak industry and to place Czechoslovakia at the technological apex of CMEA. This is because Czechoslovakia has long followed an industrial policy aimed at developing nuclear energy, electronics and cybernetics, instrumentation, machine building and chemicals with a view to serving the needs of the Soviet market or in cooperation with Soviet ministries, research institutes and enterprises. With the possible exception of Bulgaria, Czechoslovakia's economy is more closely integrated into the Soviet economy than that of any other East European nation. Gorbachev's economic strategy focuses precisely on those areas where Czechoslovak industrial policy has been seeking to create productive capacities, and thus it represents an important opportunity for Czechoslovakia to develop exports in these sectors. Conversely, of course, despite the size difference between the two economies, Czechoslovakia's exports of machinery and equipment are a significant component of Soviet investment plans.

An economic reform that could dynamize Czechoslovak industry and raise its technological level would obviously be a boost to the Soviet Union. Such benefits, however, are long term, since a reform is
unlikely to make rapid improvements in technology, and, given the Hungarian experience, uncertain to occur in heavy industry, the sector that is of greatest interest to the Soviet Union. The Soviets need better machinery during the current five year plan if Gorbachev's strategy is to prove successful. Thus their economic strategy imposes on their policy toward Czechoslovakia greater considerations for the short run. Here the policy that Gorbachev has generally urged upon his CMEA allies, to promote greater discipline, to speed modernization and to show greater vigor in pursuing CMEA integration, is much more easily and surely achieved in the short run than is a radical economic reform; it is also much more palatable to the Czechoslovak leadership.

A failed reform that created chaos in the Czechoslovak economy would be very costly to the Soviet Union. It would obviously strengthen anti-reform elements within the Soviet Union. To the extent that Czechoslovakia became less able to meet its export commitments to the Soviet Union, the strategy of modernizing and retooling Soviet industry would be imperilled; by how much is uncertain, but, given the general tightness of the current Soviet five year plan, any setback could be a decisive one. If the Czechoslovak reform were to lead to political chaos, Czechoslovakia would become a liability to the Soviet Union politically as well. Gorbachev has followed an aggressive policy of detente, in part to increase Soviet-Western trade prospects and in part to reduce the defense burden on the Soviet economy. Should the Soviet Union be forced to intervene in Czechoslovakia again, these overtures to the West would come to naught.
The Long Term View

I have argued here that, so long as the existing leadership remains in power in Czechoslovakia, there is neither a powerful incentive for the Soviet Union to press reform upon the country, nor is there any likelihood that the leadership will take up the issue of reform with any great vigor. Once the current leadership begins to leave the scene, possibilities for reform may come to the fore with new leaders. It is in this succession that the prospects for economic reform in Czechoslovakia will be determined. Since such a succession process may begin by the end of this decade, we, and the Czechs and Slovaks, will know much more about the pace and success of reform in the Soviet Union, and it is this knowledge that will shape developments in Czechoslovakia.
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<th>Czechoslovak Reform</th>
<th>Gorbachev's Proposal</th>
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<tr>
<td><strong>Central Planning</strong></td>
<td></td>
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<tr>
<td>Detailed physical plans replaced by broad monetary aggregates:</td>
<td>Detailed physical plans replaced by “stable normatives.” Enterprises draw up own plans based on contracts, quotas, government purchases.</td>
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<tr>
<td>Macroeconomic policy implemented through credits and government purchases.</td>
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<td><strong>Enterprise Management</strong></td>
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<td>Enterprises run by management boards made up of workers' and customers' representatives. Boards select managers.</td>
<td>Workers' councils to be elected; managers and foremen to be elected by workers.</td>
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<td><strong>Enterprise Finance</strong></td>
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<td>Enterprises to maximize profits which may be used to boost pay or finance investment. Subsidies eliminated. Unprofitable enterprises will be closed. Bank credits finance operations and investments.</td>
<td>Enterprises maximize profits, which finance investment, and modernization (except for major projects). Workers' incomes influenced by profit. Enterprises on full self-accounting and self-financing. Bankruptcy possible for unprofitable firms.</td>
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<td><strong>Enterprise Operations</strong></td>
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<td>Enterprises free to determine input and output mix. Enterprises given greater freedom to contract with suppliers and customers.</td>
<td>Enterprises draw up own detailed plans for inputs and output on basis of contracts. Greater scope for choice in purchase of inputs. Direct trade between enterprises envisioned.</td>
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<td><strong>Prices</strong></td>
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<td>Wholesale prices adjusted to reflect capital and labor inputs. Some flexibility envisioned. Retail prices adjust much more slowly.</td>
<td>Wholesale prices revised to better reflect production costs. Flexibility for above-plan contract prices; price ceilings. Retail price changes unclear.</td>
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<td>Private and cooperative enterprise permitted in service sector.</td>
<td>Small scale private activity in catering and services permitted.</td>
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