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The Soviet Experiment in Industrial Management: Status and Prospects

A Research Paper

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The Soviet Experiment in Industrial Management: Status and Prospects

A Research Paper

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SOV 86-10012
March 1986

The Soviet Experiment in Industrial Management: Status and Prospects

Summary

*Information available
as of 1 February 1986
was used in this report.*

The Soviet experiment in industrial management launched under Yuriy Andropov in January 1984 was designed to increase productivity, promote innovation, and improve product quality by increasing the enterprise manager's incentive and ability to pursue these goals. Specifically, the experiment:

- Reduced the number of enterprise performance indicators and made the satisfaction of customers' demands for new and better products—as reflected in delivery contracts—the major measure of enterprise success.
- Increased the rewards for fulfilling plan targets and the penalties for failing to do so.
- Gave the enterprise manager greater control over investment funds and material rewards for his work force.

The experiment's approach to Soviet industry's ills was similar to that of the unsuccessful Kosygin reforms of 1965 and other ill-fated revisions of management and planning made under Brezhnev. It has also encountered similar problems. Although Soviet media have credited the experiment for modestly improving contract discipline and reducing labor costs, they also have reported that managerial inertia at the enterprise level and bureaucratic resistance in the economic ministries have limited its positive impact. For example:

- Enterprise managers reportedly have persisted in playing safe, refusing to accept difficult contracts, hoarding labor and materials, and avoiding modernization of plant and equipment that could result in temporary declines in production.
- The ministries and central planners, resenting the transfer of authority to the enterprises, reportedly have impeded implementation of the experiment and have often failed to provide enterprise managers with the investment goods they ordered with their increased funds.

Konstantin Chernenko paid lipservice to the experiment and extended it to additional branches of industry, but did little to remedy its inherent failings or reduce bureaucratic obstructionism. Mikhail Gorbachev, in contrast, has not only scheduled the experiment to be extended industry-wide, he has also put additional teeth in its provisions for improving

product quality and modernizing capital equipment. Perhaps most important, Gorbachev has made it clear, through personnel and organizational changes, that he expects the experiment to be strictly implemented:

- Enterprise managers henceforth will face a stiffer system of centrally administered quality certification with greater incentives for producing top-quality goods and increased penalties for lower quality production.
- The economic ministries and central planners have been ordered to give priority to investment orders financed from enterprise funds.
- Gorbachev has moved aggressively to replace recalcitrant bureaucrats and has launched a major reorganization of the USSR Council of Ministers in an effort to refocus the central bureaucracy on long-term problems and reduce its petty tutelage of Soviet firms

The changes Gorbachev has made in the experiment and his avowed determination to ensure its success, in our view, could yield positive if modest results. As emended by Gorbachev, the experiment could, if implemented strictly, reduce hoarding of labor and materials, alleviate supply bottlenecks, and improve the enterprise's role in investment decisions. Positive results are dependent, however, on two important prerequisites. First, the authority of the ministries must be reduced so that the nascent decisionmaking powers of the enterprises will not be countermanded or diluted by ministerial micromanagement. Second, steps must be taken to avoid potential inconsistencies between enterprise performance indicators such as the reduction in product cost and the improvement in product quality. If these prerequisites are not met—and Gorbachev is a long way from meeting them—the experiment, like others before it, will do little to improve performance. In fact, the experiment could prove counterproductive; ministerial meddling and perverse behavior by the enterprise caused by an irrational mix of success indicators could actually worsen enterprise performance

In either case, the experiment is not the key to the radical improvement in industrial performance that Gorbachev seeks. As long as enterprises cannot choose their own suppliers, for example, contracts will be poor instruments for satisfying the demand for new and better products. Similarly, attempts to improve contract fulfillment will not increase rationality in planning unless prices reflect true scarcities and consumer preferences. The experiment's attempt to strengthen incentives for innovation also will be frustrated if bonuses and wages continue to be linked to the fulfillment of output

targets; managers will be loath to initiate retooling programs that may bring temporary dips in output. Greater competition among firms and the threat of unemployment may be necessary to motivate Soviet managers and workers toward achievement of higher production standards.

Gorbachev has reportedly established a task force to propose additional measures that go beyond the provisions of the current experiment. A Soviet economist who claims to be a member of this task force has stated, however, that it is a long way from agreeing on specific proposals. For the immediate future, Gorbachev is likely to concentrate on fuller implementation of the experiment and on his campaigns for increased discipline and cadre renewal. Should these efforts prove insufficient to bring sustained improvement in economic performance and successful modernization, Gorbachev may be prepared to take bolder steps to provide competition among Soviet firms and increase consumer input into production decisions. Even so, he may be reluctant to try measures that promise long-run economic benefits at the risk of short-term economic dislocation and political backlash.

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The Soviet Experiment in Industrial Management: Status and Prospects (U)

The Experiment's Beginning

In July 1983 the Soviet party and government leadership approved a decree on "measures to increase the rights of enterprises in planning and economic activity and strengthen their responsibility for the results of their work." Its effect was to mandate a management experiment that began in enterprises of five industrial ministries in January 1984, and is currently scheduled to be extended industrywide by January 1987. Soviet commentators have described the experiment as an effort to encourage and enable industrial firms to increase productivity, promote innovation, and improve product quality—all crucial goals in an economy beset by worsening resource constraints, widespread technological backwardness, and low production standards.

The experiment is the latest in a long series of largely unsuccessful efforts to address problems in the planning system by devising better performance indicators, increasing material incentives for workers and managers, and improving decisionmaking at the enterprise level. It is yet another effort to provide more specific means of implementing the comprehensive decree of July 1979 calling for steps to improve economic planning and performance.

Provisions of the Experiment

The decree that launched the experiment was expressed in general terms and allowed for specific provisions to be tailored to the particular needs of the participating ministries. All the participants, however, were to conform to the same general guidelines.

First, the number of centrally determined indicators of enterprise performance was to be reduced. Previous efforts to do so had not been successful because planners introduced new targets or reintroduced old ones to deal with continuing problems of enterprise performance. The experiment's authors, however, evidently hoped that a different mix of indicators would achieve better results.

Second, fulfillment of planned targets for output sales as specified in delivery contracts was to be the major indicator, and managerial bonuses were to be made dependent upon fulfillment of contracted deliveries. Here, again, the central planners hoped to overcome previous difficulties in implementing similar measures (see inset).

According to Soviet press reports, 60 percent of all bonuses under the experiment have been tied to contract fulfillment and made independent of other results; if contracts are not met, bonuses for other indicators such as increased labor productivity, improved product quality, or increased profit are to be decreased. The rewards for fulfilling contract commitments also are greater than those previously given for achieving comparable targets, and the penalties for nonfulfillment have been increased. Managers may earn up to three times their salary in bonuses over the year for fulfilling contracts.

Third, managers were to be given expanded rights to retain and distribute profits earned from cutting costs, reducing manpower, and improving product quality and to distribute savings within the wage fund for higher supplementary pay and increments to workers' salaries. Savings in the wage fund can be used for wage supplements of 16 to 24 percent for highly skilled workers and 50 percent for engineering and technical personnel, or wage payments up to 250 rubles for workers. Managers can use incentive funds to reward workers for greater productivity and higher quality production and for taking on additional duties. For example, in enterprises under the Ministry of Heavy and Transport Machine Building, workers can receive up to 10 percent of the piecework wage in bonuses for combining jobs.

Finally, enterprises were to be given greater control over investment funds used for renovation and technological improvement in production. Amounts remaining in the production development fund at year's end

The Search for the Ideal Indicator

The experiment's establishment of fulfillment of delivery contracts as the major measure of enterprise success is the latest attempt to devise an ideal performance indicator. The 1965 Kosygin reforms, while increasing the importance of measures such as profits and profitability, continued to evaluate enterprise performance primarily in terms of gross value of output (GVO). Because this measure includes the value of purchased materials and parts, as well as the value added by the enterprise itself, it encouraged producers to make excessive use of expensive material inputs as a means of achieving plan targets. To remedy this problem, in July 1979 GVO was replaced as the major performance indicator by normative net output (NNO), the sum of normal wage costs, social insurance charges, and profits. Subsequently, however, Soviet economists found fault with NNO for failing to promote efficient use of labor. They also charged that it failed to respond effectively to customers' needs for timely deliveries of new and better products. The use of contract fulfillment as an indicator is designed to address the latter problem by requiring producers to meet the delivery dates and quality standards specified in the contracts negotiated with their customers.

Fulfillment of delivery contracts is not a new measure of enterprise success; it has been used for several years as a secondary indicator. For example, a 1978 decree made the formation of incentive funds and bonuses dependent on fulfillment of contract obligations. This decree had little of the desired effect because too many exceptions were granted to industrial enterprises. Even in cases where nonfulfillment of contracts exceeded 10 percent, managers could still receive bonuses. New instructions went into effect in January 1983 forbidding bonuses in cases where failure to deliver goods reached 2 to 3 percent, and the State Committee for Material and Technical Supply set a list of the most important products requiring 100-percent fulfillment for payment of bonuses. Again, however, so many exceptions were allowed that results still were unsatisfactory.

could be carried over for the next year and were protected from confiscation by the ministries. In addition, part of the depreciation allowance for capital repairs—previously under central ministerial control—was to be placed at enterprise disposal for the retooling of production units. Enterprises may use part of funds specified for scientific and technical development to plan and design new equipment and to compensate startup costs, and they may make broader use of bank credits for retooling.

None of these or the other, more specific provisions of the experiment amounted to more than minor changes in the industrial management system that had existed since the 1965 Kosygin reforms (see table 1). The experiment's authors, however, evidently believed that these reforms had been fundamentally sound and that with minor modifications and stricter implementation they would be better able to achieve their intended goals (see table 2).

Participants and Supply Arrangements

In selecting the first participants in the experiment, Soviet planners chose ministries and enterprises that had relevant experience and that were headed by managers who were not resistant to change. The ministries selected were:

- USSR Ministry of Heavy and Transport Machine Building.
- USSR Ministry of the Electrical Equipment Industry.
- Ukrainian Ministry of the Food Industry.
- Belorussian Ministry of Light Industry.
- Lithuanian Ministry of Local Industry.

Both of the all-union ministries participating, for example, had used fulfillment of contracted deliveries as the main indicator for formation of incentive funds, and their ministers appeared to be strong supporters of the experiment. In a *Pravda* article in February 1984, Anatoliiy Mayolets, then Minister of the Electrical Equipment Industry, expressed pride that his ministry had been chosen on the basis of past accomplishments in improving output quality and labor productivity and reducing production costs. Sergey

Table 1
Comparison of Experiment
With 1965 Reform

Kosygin Reform Measures	Related Action Under the Experiment
Reduction in number of centrally determined indicators	Same, but with differences in specific indicators selected
Main indicators of enterprise performance were gross value of output, profit, and profitability	Main indicator is fulfillment of contracted deliveries
Managers' bonuses tied to profits	Bonuses tied to contract fulfillment
Creation of three incentive funds for enterprises' own use in production development, material incentives and bonuses, and social-cultural and housing expenditures	Measures to improve use of these funds, increase their size and tie them more closely to results, end ministerial interference, and ensure availability of equipment and materials
Introduction of 6-percent charge on fixed and working capital	Increased accountability for use of capital and funds; targets for reducing costs of production; five-year planning norms based on operational production capacity
Expanded role for Gosbank and use of bank credits	Easier terms for bank loans; some decentralization from Gosbank USSR to republic offices; loan term extended from three to six years
Creation of State Committee for Material and Technical Supply; call for changes in supply system, including direct ties between enterprises	Temporary special supply arrangements for first participants; experimenting with direct ties in some ministries; some decentralization in supply planned for 1987
Creation of State Committee for Prices; major changes in wholesale prices introduced in 1967	Wholesale-price changes in 1982 prior to experiment; increments and reductions in wholesale prices according to quality
Creation of State Committee for Science and Technology to formulate general proposals	Specific measures to promote innovation and S&T progress at the enterprise level
Abolition of Khrushchev's regional councils and return to branch administration through central ministries in Moscow	Personnel changes at the ministry level and other steps to improve the role of ministries in long-term planning and management and to reduce petty interference in day-to-day operations at the enterprise level

Table 2
Goals of the Experiment

Provisions	Problems Addressed
Reduction in number of centrally determined indicators of enterprise performance	Too many indicators act at cross-purposes, create unnecessary paperwork, and lack effectiveness
Main indicator to be fulfillment of planned targets for sales in product range and quality specified in delivery contracts	Poor fulfillment of delivery contracts, late deliveries, poor quality of goods
Expansion of enterprise rights to use funds for renovation and reequipment, and ban on ministerial confiscation of amounts remaining in enterprise production development fund at year's end	Lack of incentive for plant modernization and technical upgrading, frequent confiscation and redistribution of enterprise funds by the ministries
Improved loan terms to promote use of bank credits for retooling	Enterprise funds insufficient for major renovation
Norms for determining production efficiency and labor productivity to be stable over five-year planning periods and to be based on operational production capacity	Setting targets on the basis of the previous year's achieved level (ratcheting) has a disincentive effect—enterprises hold back reserves as a safety factor
Wage fund to be set according to five-year plan norms, with savings earned by doing more work with fewer workers going into incentive funds	Inefficient use of labor, maintaining a large pool of labor as a reserve
Managerial bonuses tied to contract fulfillment	Poor delivery discipline, disinterest in meeting delivery dates, and poor quality of goods
Social-cultural and housing funds to depend on work results; enterprises can spend these funds as they wish	Poor housing and living conditions for workers contribute to low productivity
Increased material incentives and penalties	Insufficient incentive for meeting plan indicators
Bonuses for producing higher quality goods and new products; stiffer system of centrally administered quality certification with supplements or discounts to wholesale prices, depending on the quality of the product	Lack of innovation, poor quality

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Afanas'yev, the Minister of Heavy and Transport Machine Building, had been an early proponent of efforts in the 1960s to increase enterprise autonomy -- a major element of the current experiment.

Although the five ministries selected to participate in 1984 were operating well according to certain indicators, they clearly needed improvement in other areas. The Ministry of the Electrical Equipment Industry, for example, had experienced major problems with rejected goods in 1982 and early 1983. Half of its enterprises were not meeting output standards and had incurred penalties for delivering defective goods. Neither it nor the Ministry of Heavy and Transport Machine Building was meeting contracted deliveries.

Officials of the State Planning Committee (Gosplan) mentioned additional factors that made the five ministries desirable candidates for the experiment. Gosplan First Deputy Chairman Lev Voronin, for example, noted the importance of the two all-union ministries in promoting technical progress throughout the economy and argued that successful results in these industries would have beneficial secondary effects on other sectors. Republic-level ministries of light, food, and local industries were selected to ensure diversified conditions for testing the experiment in a wide range of enterprises.

Planners also appear to have made a conscious effort to prevent the experiment from disrupting overall industrial performance. Only 700 of a total 43,000 industrial enterprises were transferred to the experiment the first year, and not all the enterprises of the participant ministries were affected. In the Ukraine, for example, only 28 of 1,760 enterprises under the Ministry of Heavy and Transport Machine Building and only 54 of 1,500 industrial units under the Ministry of the Food Industry were included in the experiment in 1984.

Special arrangements were made to help the experiment get off the ground. Because participants had to rely on supplies from nonparticipating enterprises and thus could fail to achieve satisfactory results because of supply problems over which they had no control, the incentives for contract fulfillment might not have

a chance to work. To reduce the impact of this potentially serious problem, Gosplan's Voronin announced in January 1984 that for the coming year the orders of participating enterprises would be stamped "experiment" so that they would receive priority attention from the supply organizations. In addition, a commission established to oversee the experiment was to work with the appropriate ministries and departments to ensure uninterrupted delivery of materials and fuel, timely shipment of finished goods, and prompt payment by recipients. By granting temporary preferential supply arrangements to the first enterprises in the experiment, Soviet planners also served notice on managers of those enterprises that they could no longer offer problems with suppliers as an excuse for their own shortcomings.

Initial Soviet Assessments

Not surprisingly, official Soviet statements and press comment on the experiment during 1984 were generally favorable. There were, however, frequent complaints that bureaucratic resistance was impeding the experiment's progress and that the experiment did not go far enough in addressing the ills of the planning and management system.

Benefits of the Experiment

Most commentators seemed to agree that using fulfillment of contracted deliveries as the major indicator of enterprise performance was bringing good results, with more enterprises meeting contract commitments than before the experiment. Although improvement in 1984 over 1983 involved only a few percentage points, the complete fulfillment of this indicator by the first three republic ministries in the experiment and the progress achieved in the two all-union ministries were well publicized (see table 3).

There were also Soviet press reports that the experiment had reduced hoarding of equipment and materials—a widely used means of ensuring against delivery delays and shortfalls. In an economic journal in August 1984, for example, the first secretary of the party committee of Sverdlovsk Oblast reported that,

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Table 3
Fulfillment of Contracted Deliveries

	1983	1984*
Electrical Equipment Industry	96.6	99.0
Heavy and Transport Machine Building	97.6	99.6
Ukrainian Food Industry	98.0	100
Belorussian Light Industry	98.8	100
Lithuanian Local Industry	98.4	100

* Data as of the beginning of the fourth quarter of 1984.

Sources: *Ekonomicheskaya Gazeta* No. 42, October 1984; *Izvestiya*, 3 June 1984, p. 2.

to avoid the increased fines for hoarding that the experiment had introduced, 26 machine-building enterprises in his region had turned over about 5 million rubles' worth of surplus items to producers with a current need for them.

Other Soviet officials credited the experiment with achieving increased labor productivity and savings in the work force. Gosplan Deputy Chairman Stefan Sitaryan, for example, stated in a *Pravda* interview in October 1984 that the Ministry of the Electrical Equipment Industry had reduced the number of workers 7,000 below the plan without allowing production to slip and that no ministries participating in the experiment had requested an increase in the number of workers.

Some observers and participants cautioned, however, that too much significance should not be attached to these apparent improvements. In mid-1984, for example, Gosplan's Voronin, the head of the commission in charge of the experiment, noted that at least some of the improvement might be attributable to the general economic upturn that had occurred during the first half of the year. Furthermore, Minister of Heavy and Transport Machine Building Afanas'yev noted in a *Pravda* article in May 1984 that, although the experiment's early results were encouraging, they were

largely due to employment of readily accessible reserves.

Other Soviet commentators subsequently charged that much of the improvement in enterprise performance had resulted from the special supply arrangements that had been made to assist the participating firms. These commentators argued that, when the experiment was extended industrywide, participants could no longer receive such special attention and, as a result, much of the improvement in enterprise performance would prove to be short lived.

Bureaucratic Resistance

Enterprise managers often expressed disappointment with the way the experiment was being implemented. Directors of various Moscow plants, for example, complained in the press that, contrary to provisions of the experiment, plans were frequently changed, planning was still done on the basis of previously achieved levels, little progress had been made in rationalizing the selection and assignment of suppliers, and enterprises were being held responsible for reporting on former indicators as well as on new ones. They also charged that the central bureaucracy in Moscow continually interfered with rights that had supposedly been given to the enterprises. The Ministry of Finance, in particular, was faulted for issuing instructions that effectively changed provisions for increasing economic incentive funds. Managers complained that funds for the development of production, in some cases, were less than before the experiment and that financial agencies deposited above-plan profits intended for incentive funds in the budget.

In turn, representatives of the central bureaucracy claimed that enterprises were not responding to the new system of penalties and incentives and that there had been no radical improvement in strengthening contract discipline in enterprises under the experiment. They complained that enterprises continued to violate shipping deadlines and wrote off fines for delivery failures against fines they received from suppliers or against additional profits.

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In a newspaper interview in February 1985, for example, the Belorussian Minister of Trade stated that, despite incentives under the experiment to produce better quality products, defective goods were still appearing frequently in the stores. Although his ministry had levied fines on suppliers of 1.4 million rubles for defective goods and 5.6 million rubles for violating contract conditions in 1984, enterprises were able to soften such blows by fulfilling production targets that enabled them to cover penalties for nonfulfillment of others.

There appears to have been ample basis for the complaints of enterprise managers and ministers alike. In a speech at a June 1984 conference of party and industry leaders, Moscow city party boss Viktor Grishin discussed the shortcomings and unsolved problems of the experiment and faulted both the central bureaucracy and the managers at the grass-roots level. He admonished the ministries to exercise greater care in implementing the experiment, but he also called upon enterprise managers to study the new regulations, make skillful use of the rights given them, and show more responsibility.

The problems to which Grishin referred reflected a combination of the central bureaucracy's unwillingness to surrender authority and the enterprise manager's caution in shifting to new procedures. During 1984, articles in the Soviet press openly criticized the ministries for petty tutelage over enterprises and for foot-dragging in implementing the provisions of the experiment. The ministries reportedly were interfering in small details and other functions given to the enterprises and violating established norms in allocating means for production development and other funds.

According to numerous press reports, ministries also failed to take into proper account the production possibilities of enterprises in formulating plans, disregarded instructions to provide stable norms for five-year plan periods, and arbitrarily changed plan targets. An *Izvestiya* editorial in January 1985, for example, stated that the Ministry of Heavy and Transport Machine Building changed the norms for forming the wage fund at one of its associations four times during 1984. Failure of the ministries to accept

the expanded role of enterprises in drawing up plans, requirements that enterprises continue reporting according to the former range of indicators, and general inertia in moving away from the "old style" of economic management also reportedly impeded implementation of the experiment during its first year.

The press also reported numerous complaints that enterprise managers were not using their new "rights" and were failing to respond to new incentives. For example, although the new performance indicators favor the adoption of more difficult plans by providing for larger additions to incentive funds for fulfillment than for overfulfillment.

Many enterprises did not draw up more intensive plans. Long accustomed to a system of operation that placed a premium on obtaining an easy plan, managers continued to play safe. The promise of material benefit for fulfilling a more demanding plan did not immediately supersede efforts to obtain a plan that could be met without making special arrangements for labor and material resources and taking the risk of running into financial arrears. In fact, the increased responsibility of enterprises for their own work under the experiment, in some cases, led to greater caution. Because managers accepted only those tasks they could be sure to fulfill, the number of delivery contracts declined in 1984 among participants in the experiment. Moreover, they were worried that the old Soviet planning technique of setting targets based on the level achieved would saddle those who adopted and fulfilled more demanding plans with ever higher targets.

Similarly, enterprise managers reportedly continued to maintain and conceal large reserve stocks as a safety factor, although the experiment attempts to discourage such hoarding by providing that existing fines for accumulating uninstalled equipment and above-norm supplies be increased by a surcharge of 3 percent of the value of such stocks. The head of planning for the Kiev bread and confectionary combine, for example, reported in an article in October 1984 that, because there had always been difficulties in obtaining raw materials, the combine insured itself

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for 1984 by placing extra orders for materials. He justified this by claiming that "everyone" understands the need for oversinsuring to meet the plan.

Another shortcoming in adopting new procedures was that local-level organs, in some cases, continued to report results in terms of total volume of sales rather than by the new indicator of contract fulfillment. We do not know whether the practice was prevalent enough to have a substantial effect on results reported for 1984 nor whether it represented deliberate efforts to hide unfavorable results by misreporting on the basis of a more favorable indicator.

Inherent Limitations

In addition to bureaucratic resistance, the experiment encountered other problems that arose from its own inherent limitations. To judge from numerous press reports, the experiment did not go far enough toward improving the supply of materials and equipment to participating firms, increasing their ability to carry out plant renovation and retooling, or enhancing the incentives of their work force. Furthermore, the special temporary supply arrangements provided to enterprises under the experiment reportedly brought minimal improvement in 1984 over previous years.

The chief of a territorial administration of the State Committee for Material and Technical Supply (Gossnab) attributed many of the supply problems to incomplete preparation for the experiment. He charged that delivery contracts and technical specifications of products for 1984 were prepared too late to ensure timely deliveries. Many enterprise managers appeared to agree that inadequate preparation was at fault; there were frequent requests that central planners issue output plans and allocate funds and materials for 1985 earlier so that enterprises would have time to sign contracts before December. Other enterprise managers, however, attributed supply problems to Gosplan itself and called for a reduction in the amount of goods distributed through centralized channels in favor of more direct long-term ties between suppliers and consumer enterprises.

A frequent argument made by both enterprise managers and their superiors in Moscow was that better

results could be achieved only when other sectors—including transport agencies, producers of raw materials, and supply organizations—were included in the experiment and held accountable for results of their work. For example, the Ukrainian Minister of the Food Industry stated in *Izvestiya* in July 1984 that with only one link participating in the experiment it was impossible to respond to consumer demand. The same items would continue to appear on the store counters because the food industry could not tell its suppliers what to grow.

Many participants in the experiment reported that they did not benefit substantially from having their own sources of financing. In particular, they complained that the experiment had not solved the problem of decentralizing some investment financing while maintaining centralized planning of investment supplies—an inconsistency that undermined Kosygin's efforts in the late 1960s to increase enterprise autonomy. Their complaint was a simple but serious one: permitting noncentralized sources of financing for reequipment or renovation can have little incentive effect if the necessary equipment and materials are unavailable. Indeed, the two all-union ministries in the experiment requested a reduction in the share of enterprise production development funds for reequipping and an increase in centralized capital investment because the latter guarantees material resources.

There were also complaints that the size of the enterprises' production development funds remained too small to meet the needs for modernization of production and that reliance on enterprise sources of financing favored larger enterprises over smaller ones. The Ukrainian Minister of the Food Industry, for example, raised both these complaints and noted that, in any event, new machinery needed by the food industry was not produced in sufficient amounts.

Press reports also indicated that material incentives under the experiment were not working as intended. Incentive funds, for example, did not always increase when obligations were met, because ministry reserve

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funds and enterprise above-plan profits were, in some cases, insufficient to make the established additions to the funds. Although the experiment provides that required payments from profits into the state budget may be reduced to meet additions to incentive funds, in October 1983 the Ministry of Finance issued instructions that payments to the budget could not fall below a set percentage of total planned and above-plan profit. Part of above-plan profit must also be used to cover shortages in working capital, to pay interest on bank credit, and to pay off long-term debt incurred prior to the experiment.

Both workers and managers argued that bonus payments under the experiment had a poor incentive role. It was easier to draw overtime pay than to wait for bonuses from the material incentive fund. Some managers hesitated to give bonuses because they must account to auditors on why a particular worker received a bonus.

Soviet commentators also noted that the experiment's attempt to link bonuses to fulfillment of contracts often failed. Enterprises that failed to meet quarterly deliveries could still receive all their incentive funds if they made up the arrears by the end of the year. Managers who lost bonuses for nonfulfillment of deliveries continued to receive incentive payments through various exceptions or for meeting other indicators

The penalties imposed upon enterprise incentive funds for producing low-quality goods, moreover, were often much less than costs to the state budget in lost revenue. For example, defective shoes produced by one factory in the first half of 1984 resulted in a reduction of about 34,000 rubles in incentive funds and bonuses to managers and workers, but the reduction in payments to the budget from lost profits was more than 242,000 rubles. As long as the government and not the enterprise incurs the brunt of financial losses due to poor quality, the enterprise manager does not feel full responsibility for the results produced by his enterprise

Extension and Modification

Although expressing concern over these initial problems, the Soviet leadership under both Chernenko and Gorbachev moved forward with the experiment, extending it to 20 additional ministries in 1985 and scheduling further extensions for 1986 and 1987 (see inset). The leadership's approach to dealing with specific shortcomings of the experiment, however, has differed under each of Andropov's successors.

Changes Under Chernenko

The extension of the experiment for 1985 taken under Chernenko's leadership was a preordained course of action, announced long before the results of the first year had been reported or reviewed. In announcing the extension in August 1984, the Politburo gave a favorable assessment of results for the first six months in improving contract fulfillment, productivity, and product quality; reducing production costs; and speeding the introduction of technological innovations. The Politburo noted, however, that all the possibilities offered by the experiment were not yet fully exploited and urged enterprise, government, and party organizations to step up efforts at implementation.

As described by Gosplan Deputy Chairman Sitaryan in a *Pravda* interview in October 1984, the changes introduced in the experiment for 1985 amounted to little more than minor afterthoughts to the original guidelines. They included provisions to expand enterprise opportunities for using the production development fund to modernize plant and equipment, to make social-cultural funds more dependent on enterprise and worker performance, and to link output of consumer goods and services more closely to demand. Managers were also instructed to pay greater attention to improving the quality of output, especially of goods for export. This was to be done both by improving the wage system for technical and engineering workers and by changing the procedures for awarding the official "emblem of quality" to industrial products

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The Extension of the Experiment, 1985-87

Additional participants as of 1 January 1985:

*USSR Ministry of Instrument Making, Automation
Equipment and Control Systems
USSR Ministry of Chemical and Petroleum Machine
Building
USSR Ministry of Machine Tool and Tool Building
Industry
USSR Ministry of Power Machine Building
USSR Ministry of Tractor and Agricultural Machine
Building
USSR Ministry of Ferrous Metallurgy (in part)
Selected republic ministries of food, meat and dairy,
fish, light, and local industries*

Additional participants as of 1 January 1986:

*USSR Ministry of Automotive Industry
USSR Ministry of Communications Equipment
USSR Ministry of Construction, Road and Municip-
al Machine Building
USSR Ministry of Machine Building for Animal
Husbandry and Fodder Production
USSR Ministry of Machine Building for Light and
Food Industry and Household Appliances
USSR Ministry of the Coal Industry
USSR Ministry of the Chemical Industry
USSR Ministry of Ferrous Metallurgy (entire)
USSR Ministry of Nonferrous Metallurgy
USSR Ministry of Mineral Fertilizer
USSR Ministry of the Medical Industry
USSR Ministry of Petroleum Refining and Petro-
chemical Industry
USSR Ministry of Shipbuilding
USSR Ministry of Light Industry
USSR Ministry of Fish Industry
USSR Ministry of Food Industry
USSR Ministry of Meat and Dairy Industry
Republic ministries of food, meat and dairy, fish,
light, and local industries*

Additional participants as of 1 January 1987:

All remaining industrial ministries

Other changes for 1985 were aimed at addressing complaints that the ministries did not allocate means to the enterprises for the production development fund according to established norms and that Gosplan and Gossnab had not yet worked out procedures to guarantee the necessary equipment and material resources for measures financed under the fund. In addition, provision was made to test long-term direct ties between enterprises in the Ministries of Machine Tool and Tool Building and of Tractor and Agricultural Machine Building—two of the ministries included under the experiment in 1985.

Gosplan also announced measures to increase the size and incentive effect of the social-cultural and housing fund. For each 1-percent increase in labor productivity, the fund was to increase 4 percent rather than 2 percent as permitted in 1984.⁴ An additional measure aimed at linking the fund to more efficient use of materials was tested at enterprises of four ministries under the experiment. In the Ministries of Electrical Equipment, Power Machine Building, Instrument Making, and Chemical-Petroleum Machine Building, enterprises could increase social-cultural funds by an additional 10 percent for each 1.5-percent savings in expenditure per ruble of output.

Minor changes of this sort, many of which were themselves "miniexperiments," were typical of the cautious approach that numerous Soviet sources attributed to Chernenko. They may also have reflected the influence of Premier Nikolay Tikhonov, the elderly party chief's longtime political ally and the man whose bureaucratic empire stood the most to lose from far-reaching changes in the economic management system.

Changes Under Gorbachev

General Secretary Gorbachev came to power with the announced intention of taking a bolder approach to economic problems. He made it clear that greater attention to product quality, stricter adherence to contractual obligations, and greater concentration on

⁴ The method of calculation varied somewhat among ministries. For example, in the Ukrainian Ministry of the Food Industry and the Lithuanian Ministry of Local Industry, the fund was based on increases in profit rather than on productivity.

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*General Secretary Gorbachev
on the Experiment*

*In a speech to metallurgists in Dnepropetrovsk on 26
June 1985:*

It is envisaged that the independence and responsibility of associations and enterprises will be expanded considerably, that the system of wholesale prices and direct links will be perfected, and that the provision of material incentives for labor collectives will be improved. We have drawn general conclusions from the results of the economic experiment and have prepared a new document in which the results are tallied: in which everything that has justified itself is supported; and in which corrections are presented with the object of enriching our economic mechanism, particularly with a view to raising the interest of the labor collectives in scientific and technical progress. It is particularly a question of expanding the rights of the enterprises themselves in questions of using the development fund, the depreciation fund, and so on and so forth. What we have in mind is the creation of the kind of conditions in which it is to the advantage of collectives to produce and to introduce new equipment, to turn out production of the highest quality, and to achieve the highest labor productivity.

*At a scientific and technical conference in Moscow on
11 June 1985:*

More and more industries are joining in the large-scale economic experiment. But, as we agreed at the April Central Committee plenum, we must

move on from the experiment to the establishment of an integrated system of management and administration. . . . If we spend a year, two years, three years going on about the experiment that we are carrying out, that we have extended to another two or three industries, and so on, but fail to devise an integrated system making it possible to unite our entire national economy in a single organism based on the application of new principles of economic management, no progress will be made. The drawing up of such a system must be completed in a short space of time so that all branches of the national economy can be converted to new methods of administration and management during the 12th Five-Year Plan. We must start from the top echelons.

The ministries, in their present form, in the way they function, in the way they manage the enterprises and associations subordinate to them, have no interest in the economic experiment, and in particular they have no interest in the introduction of those principles upon which we are carrying out the experiment. . . . The ministry, with the aid of the State Committee for Labor, of the Ministry of Finance, and in some cases the State Planning Committee, has vast experience and the ability to keep a tight rein on everybody and interpret the decisions of the Central Committee and the government in such a way that, after their application and all the recommendations, nothing is left of these principles.

retooling industrial plants—all goals of the experiment—were among his highest economic priorities (see inset).

In July 1985 Gorbachev unveiled a major extension of the experiment and set a deadline for its introduction throughout Soviet industry during 1987. The July

decree also included several changes that were specifically designed to overcome the experiment's shortcomings, especially in promoting scientific-technological progress

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To address complaints that enterprise managers continued to evade contract commitments for timely delivery and specified quality of goods, the penalties for violations of contract discipline were significantly increased. Supplier enterprises must pay a penalty of 5 percent of the cost of the complete production line for failure to deliver complete sets of equipment or materials. Prior to this provision, suppliers paid fines based only on the cost of what they had failed to deliver.

To address complaints of continued enterprise inattention to improving product quality, the July decree provided a stiffer system of centrally administered quality certification with greater incentives for producing top-quality output and increased penalties for lower quality. Wholesale prices on top-quality goods may be increased up to 30 percent, and up to 70 percent of earnings from such price supplements may be used to augment enterprise incentive funds.² Output not meeting top-quality standards, however, will be subject to wholesale-price discounts of 5 to 15 percent to be charged partly to incentive funds. Production of such output must be discontinued after three years. Enterprises producing top-quality machinery and equipment for export will receive an additional 20-percent incentive increase above the wholesale price, and ministries are prohibited from withdrawing enterprises' hard currency earnings. For these changes to prove effective, rigorous standards for quality must be maintained so that enterprises will be unable to introduce "new" products with higher prices that, in fact, contain a large component of hidden inflation. Yet, as firms throughout Soviet industry respond to Gorbachev's call to speed the introduction of new products, the agencies responsible for quality control will find it increasingly difficult to enforce such standards.

To meet complaints that the experiment did little to enhance the enterprises' role in investment decisions, the decree introduced additional provisions to increase the use of enterprise funds and improve the supply of investment goods. Beginning in 1986, managers in

² Previously, deductions from profits were the only source of financing enterprise incentive funds, and only 17.5 percent of profits were paid into such funds.

heavy industry can use the production development fund for retooling in amounts up to 4 million rubles without ministry approval. (For light industry the limit is 2.5 million rubles.) Moreover, Gosplan, Gosstab, and the ministries are instructed to give priority to providing material and technical resources for such retooling and for projects financed from the enterprises' social-cultural and housing funds. In 1987 the supply of resources for this construction is also to be decentralized to allow direct enterprise orders to territorial organs of Gosstab. The track record of past changes in the availability of investment funds and materials has not been impressive in terms of implementation and effectiveness.

Along with these specific changes in the experiment's provisions, Gorbachev has embarked on a major reorganization of the USSR Council of Ministers that Soviet media have described as an effort to improve interdepartmental coordination, focus the ministries on broad economic problems and long-term planning, and reduce the central bureaucracy's size. Achieving these last two goals would enhance the experiment's prospects by reducing the likelihood of ministerial interference in the day-to-day affairs of industrial firms. However, the Soviet bureaucracy's staying power and the political leadership's reluctance to run the risk of disrupting the economy are formidable obstacles to a major change in the role and power of the ministries.

In addition to the organizational changes he has made or promised, Gorbachev has criticized his predecessors for failure to persist in implementing change, called for greater efforts to carry out the provisions of the experiment, and—perhaps most important from a bureaucratic perspective—threatened to replace obstructionist officials. In April 1985, in his first post-election economic address, he pledged to overcome bureaucratic resistance on the part of ministries and planning agencies. Since that speech, he has moved to replace older, more conservative officials with younger, more innovative managers. The changes have included the heads of many industrial ministries, the chairman and many deputy chairmen of the Council of Ministers, and the chairman of Gosplan. The

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formulation of a new set of managerial success indicators—needed to prevent the new managers from settling into the mold of their predecessors—has yet to be promulgated.

Continuing Problems and Prospects

The experiment has the potential for making modest improvements at the enterprise level in tighter delivery discipline, reduced waste, and greater attention to output quality. Small improvements in these areas, if implemented nationwide, could break some bottlenecks and provide a temporary boost to industrial performance. The preconditions for even this modest success, however, are:

- A reduction in the power of the ministries so that they will be unable to countermand and dilute the expanded autonomy of the enterprises.
- The avoidance of potential inconsistencies between such enterprise performance indicators as the improvement in product quality and the reduction of product cost.

If these conditions are not met—and to date, there has been limited movement in this direction—the result could be no improvement or even poorer performance as enterprises follow a perverse set of success criteria and suffer from ministerial meddling.

Even with these changes the experiment is too limited to be the source of the radical improvement in industrial performance that Gorbachev has said he seeks. Under current conditions, for example, enterprise contracts are seriously flawed as instruments for the satisfaction of customers' requirements. In August 1983, just before the experiment was launched, Gosplan's Voronin predicted that the contract system would improve output quality and promote innovation because customers would simply refuse to accept delivery of defective or obsolete products. Today, Soviet press reports make it clear that this optimistic prediction failed to reflect the realities of a system in which enterprises are assigned suppliers by the central authorities and rejection of deliveries means inevitable failure to achieve their own plan targets. Until enterprises can choose their own suppliers, they cannot effectively influence the quality of goods and equipment they receive.

Furthermore, the new incentives and penalties of the experiment may not provide sufficient motivation for increased innovation. Historically, Soviet managers have been reluctant to reequip their plants because of the disruptive effect such actions might have on their ability to meet planned production targets. By increasing the importance of fulfilling delivery contracts, the experiment may have magnified such concerns. Moreover, granting the enterprise manager a larger role in deciding when to retool increases his responsibility for the resulting temporary decreases in production. Under such conditions, managers may conclude that the risks of using their new powers are greater than the likely benefits.

The experiment also does little to improve the rationality of centralized planning. Providing for greater use of price supplements and reductions according to quality represents only a minimal effort to link production more closely to consumer preference. Soviet economists, moreover, have pointed out that the lack of interenterprise competition continues to have adverse effects on output standards.

Gorbachev, himself, has called for additional measures to improve consumer influence on quality, including contests between enterprises and greater reliance on economic contracts and direct links between producers and consumers. He has reportedly established a special task force to devise some "business mechanism" to promote interenterprise competition.

The task force is a long way from agreeing on specific proposals but is discussing such options as tolerating a low level of unemployment and closing down noncompetitive firms. Closing down firms would be a powerful tool for inducing enterprise managers to make greater use of their powers to modernize their plants.

Clearly, Gorbachev is considering additional changes in the system of planning and management. He has not, however, initiated major systemic changes that might result in economic dislocations, arouse the concern of party ideologists, and threaten bureaucratic interests in the ministries and planning agencies. At

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present, therefore, Gorbachev may be content to continue implementing the current experiment and to focus on personnel changes, reorganization within the economic bureaucracy, and the campaigns against corruption, waste, and alcohol abuse as the least disruptive and politically safest way to boost output in the short term. Should this package of measures prove insufficient to achieve a sustained improvement in economic performance and impart momentum to his drive for industrial modernization, he may be prepared to try additional measures now under consideration.

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