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THE SOVIET ECONOMY

Gorbachev's efforts to reinvigorate the stagnant economic system he inherited in 1985 have not only failed to achieve their intended result but have plunged the economy into what the Soviets describe as a worsening crisis. By any measure, economic performance last year was the worst since Gorbachev took over, and the economy continued to stumble badly during the first quarter of this year.

- Industry and construction stagnated in 1989, and the Soviets report that first quarter industrial production this year was 1.2 percent below that of a year ago--the first time in decades that Moscow has reported a quarterly decline.
- Although the good harvest last year was a bright spot, the central authorities have had increasing difficulty purchasing, transporting, and distributing foodstuffs, and an increasing number of local officials and farm managers are refusing to ship scarce food supplies beyond their borders.

These problems fall most heavily on the consumer. Although the Soviets report increased supplies of consumer goods and services, a large portion of this increase is attributable to higher sales of alcohol and imported goods. Moreover, the gap between consumer demand and supply has widened as growth in money incomes has soared. As a result:

- Even in state-run stores, where price controls are supposedly in force, prices increased by an estimated 6 percent in 1989--the highest rate since 1950.
- Empty shelves in state stores are forcing consumers to turn increasingly to the black market and to new cooperative enterprises, where prices are often several times higher.
- The shortages, exacerbated by hoarding, have forced widespread rationing: meat and sausage are rationed in one-fifth of the major cities, and soap, detergent and sugar are rationed in most or all of the country.
- By Soviet count, only 50 out of a list of 1200 basic consumer goods are now continuously available.

Consumer dissatisfaction is contributing to rising social tensions and is playing a role in the growing number of strikes and ethnic clashes.

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In response to the country's economic crisis, the leadership last year initiated a series of "emergency" stabilization programs, which included budget cuts, most notably in defense and investment, a shift of resources from heavy industry to consumer-oriented industries, and the sale of bonds and state assets to soak up excess purchasing power. Many of these efforts have proven ineffective: growth in money and incomes continue, and budget revenues are not keeping pace with expenditures. []

In the reform area, Gorbachev is laying the foundation for some potentially far-reaching measures; new laws on land use and property rights break with old Marxist-Leninist tenets. Meanwhile, the economy is neither here nor there--traditional "administrative methods" of directing the economy from the center have been abandoned to a great extent, but radical marketizing reforms have not yet proceeded past the discussion stage. The net effect is that the economy lacks the necessary stimuli, either from the center or the market. []

Recognizing the precariousness of this situation, the leadership is preparing a new stabilization and reform package for the Supreme Soviet. Although it reportedly advances the implementation date for some key reforms and takes bolder charge of the fiscal dilemma, the new strategy is apparently still gradualist and does not approach Poland's shock treatment.

The leadership is wary of public reaction to a radical program and Gorbachev, in a recent swing through industrial cities in the Urals, emphasized that painful measures, such as major price increases, will have to await the enactment of measures to protect the poor. Work is underway to strengthen the social safety net and includes a just enacted pension law, an unemployment compensation bill still in draft, and indexing schemes to compensate for inflation. []

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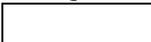
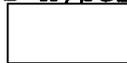
Hard currency woes are adding to Moscow's domestic economic pressures. With imports of consumer goods up and export revenues lagging, especially for oil, the Soviets are experiencing an uncharacteristically high trade deficit, which has pushed up borrowing and prompted high gold sales. A recent development has been unprecedented complaints about Soviet delays in paying for imported goods. Bureaucratic problems, the inexperience of some new traders, and new currency allocation policies appear to be responsible for the bulk of the arrears, but Moscow is also having some liquidity problems as a result of export shortfalls. Western lenders are responding by reducing Moscow's credit rating and raising interest rates on loans--moves reinforced by bankers' concerns about Soviet domestic economic and political instability. []

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Little near-term relief is in sight for the Soviet economy. The same factors retarding recent industrial performance--ethnic disturbances, slack labor discipline, the difficult shift from heavy industry to consumer goods--are continuing this year. Moscow has also recognized that defense conversion--once heralded as a source of quick help for the civilian economy--will be a long and costly process.

For the consumer, inflationary pressures are likely to stay strong, stores shelves to remain empty and the ruble's value to continue falling. The chance of the leadership's new economic program providing even a modest economic recovery this year seems remote. And under certain circumstances, the economy could deteriorate sharply. It is in a fragile state, and a severe shock--prolonged strikes in key economic sectors, ethnic unrest in vital economic regions, or consumer panic that brings hyperinflation--could cause output to drop precipitously.

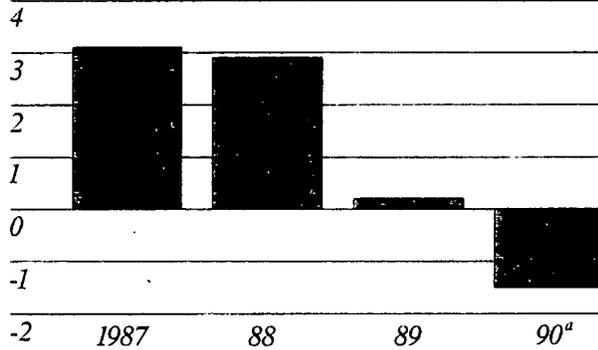


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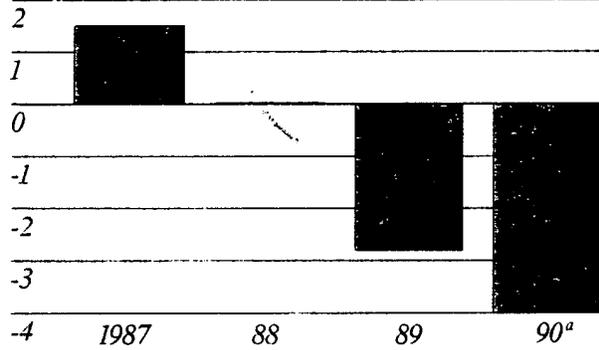
Soviet Performance in Industrial Production and Transportation, 1987-90

Percent

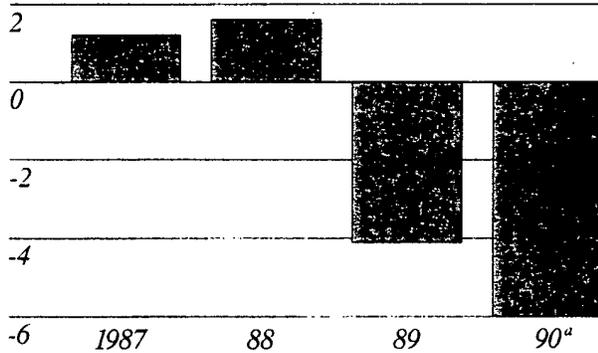
Industry



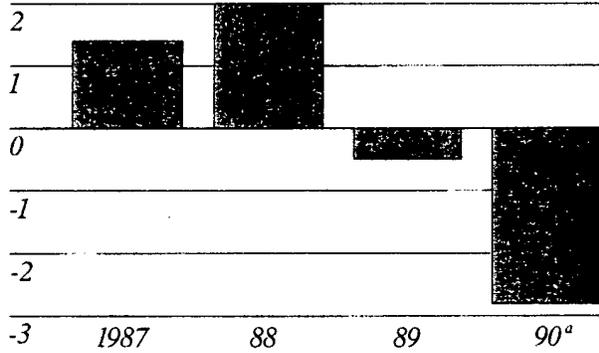
Oil



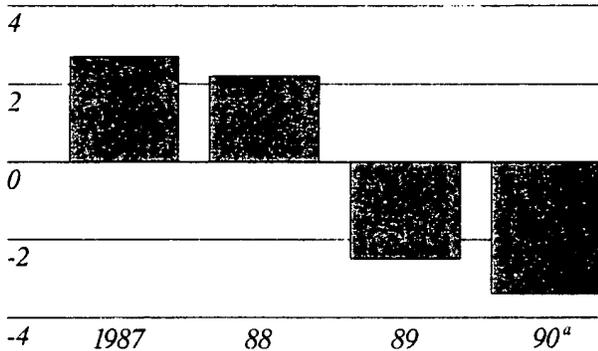
Coal



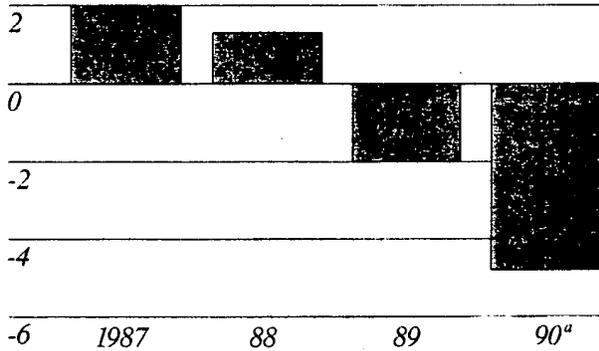
Ferrous Metals



Chemicals



Freight Transportation



^a First quarter 1990 is compared with first quarter 1989.

