Introduction
The challenges of the 1980s

The 1980s produced conditions that have tried the Soviet and East European economies severely. The five-year plans for the first half of the decade were prepared in circumstances of unprecedented difficulty and uncertainty. Many plan targets were subsequently revised downwards, but nevertheless remained substantially underfulfilled by mid-decade. Zero and even negative growth was not uncommon. The period witnessed serious external as well as internal imbalances for the Eastern economies, and in several cases payments problems forced the rescheduling of hard currency debts.

It is clear that the Eastern planned economies experienced in the 1980s their poorest performance of the postwar period – as, indeed, did the Western market economies.[1] The coincidence of experience was not fortuitous. Some of the same causal factors were at work. The growth of economic interdependence in the preceding decades had served, to a greater extent than anticipated, to expose the planned economies (especially, the smaller, more open East European economies) to adverse developments in the international economy.[2]

Nevertheless, the difficulties of the 1980s had deep roots in domestic structural problems which were merely exacerbated by more immediate circumstances. The structural problems had manifested themselves in a secular decline in growth – a gradual, but persistent loss of dynamism. Some of the deceleration could be attributed to the maturing of the Eastern economies and to the more complex demands arising from a higher stage of economic development. An associated factor was the increasing exhaustion of some of the original sources of dynamism, such as the ability to tap pools of underproductive agricultural labor and reserves of underdeveloped natural resources. At the same time, the institutions created to promote rapid industrialization at an earlier stage were proving inappropriate to what the Eastern countries term the new, "intensive" phase of their development, in which growth is to rely more heavily on improvements in factor productivity. The failures of the traditional system of centralized planning and management revealed themselves, in three critical areas, to be a major and growing drag on economic performance:

Long misallocation of resources had created inefficient production structures which the system then perpetuated and reinforced. Centralized administration of investment and material supply proved increasingly cumbersome, inefficient and prone to arbitrary decision.

The system proved unable to stimulate a rate of technical progress sufficient to offset the downward pressures on growth from the inefficient use of increasingly scarce resources. This in turn forced greater reliance on external sources of technology.

The poor operation of the system in these first two respects resulted in the inadequate development of economically competitive export sectors in the process of industrialization. This in turn led to chronic balance of payments problems, especially with the West, which became more critical with the increasing reliance on imported technology to maintain growth.

Although these systemic causes of declining economic performance had been extensively discussed and openly identified in the countries themselves, successive attempts at change had for the most part been inadequate, half-hearted or both.[3] The East European countries therefore failed either to perform or to reform.[4] Weak, aging leadership espoused the rhetoric of reform but did not have the will to enforce it. The consequent impasse, allowed to continue for two decades, ultimately not only yielded economic stagnation but bred serious social and psychological problems. The resulting deterioration in the fabric of society manifested itself in increasing corruption, absenteeism, alcoholism and sporadic outbursts of popular unrest as well as in widespread cynicism and apathy.[5]

Political stability was maintained by a social contract between the leaders and the governed. In the 1970s there was a substantial improvement in living conditions throughout Eastern Europe. One sign of this development was the increase of per capita material product in each country, including meat consumption.

This visible improvement in consumption was the critical element of a social contract between governments and citizens throughout Eastern Europe. Never spelled out by rulers or ruled, the social contract was and remains a tacit and ill-defined understanding. In return for increased material benefits and in some countries greater professionalism in planning and management, East Europeans tolerated low participation in economic and political decision-making, rigid and highly centralized political and economic systems, and the denial of many basic civil rights. The cost of consumer improvement in many economies, most notably Poland, was so large that substantial subsidies for consumer goods created a state of monetary disequilibrium that debased the value of the currency.

It was in these circumstances that a series of developments at the turn of the decade could precipitate a situation in the first half of the 1980s that some Western analysts have labeled an economic crisis in the planned economies.[6] These developments significantly worsened some long-standing problems and added new ones to plague harassed Eastern planners.

Political events in the Middle East at the end of the 1970s set off a wave of economic disturbances in the international sphere from which the Eastern countries found themselves no longer insulated. The disruptions in the supply of oil from Iran and Iraq, and the jump in its international price, had an appreciable, if limited, immediate effect on the oil-importing economies of Eastern Europe. While continuing to import most of their oil from the Soviet Union under special arrangements, they had sufficiently diversified their sources in the 1970s that by 1978 they relied on OPEC sources for some 10 per cent of their crude oil imports.[7] Moreover, Iran and Iraq were their major OPEC suppliers.

A special case was Romania, which had become a net importer of oil only in 1976, but by the end of the decade relied heavily on the Middle East for its rapidly growing imports. The second oil price shock precipitated a balance of payments crisis in Romania which forced it in 1982 to reschedule its external debt.

The other East European countries were only temporarily sheltered from the full force of the international oil crisis, however. Under regional pricing arrangements, the price of their imports of Soviet crude began to rise with a year's lag, and continued to increase even after the international price of oil had stabilized and then declined.[8] Moreover, the gap opened up in 1979–80 between the preferential Soviet price to its East European allies and the price the USSR could command for its oil exports on world markets, together with the prospective leveling off of Soviet oil production, induced it to pressure its allies first to limit and then to reduce the volume of their oil imports in the 1980–85 plan period.

The Soviet Union initially benefited from the sharp rise in the value of its sales of oil on hard currency markets and the more gradual improvement in the terms of its trade with Eastern Europe. Like other oil exporting countries, however, it subsequently had to contend with the balance of payments effects of the oil glut which the price shocks of the 1970s ultimately produced on world markets. In sum, the rapidly changing situation in the international oil market in the course of the 1980s faced

Soviet planners with the challenge of strong and widely varying pressures on their hard currency accounts.

The East European economies suffered further indirect effects from the second oil crisis when it set off a new round of general price inflation, followed by the most severe Western recession of the postwar period.[9] The inflation served to worsen the terms of trade of most of the Eastern countries, with the exception of the energy exporters among them. All were affected by the weakening of Western demand for their exports, and ultimately even weakened demand for energy products.

The high interest rates that accompanied the recession had serious adverse consequences for the Eastern economies. By increasing the costs of financing, they both raised the effective price of Eastern capital goods imports and weakened Western demand for Eastern machinery and equipment exports. Most importantly, they raised the burden of the hard currency debt which the Eastern countries had accumulated over the 1970s, significant portions of which had to be refinanced in the early 1980s.

These circumstances brought an end to the import-led growth strategies which the East European countries had all, to varying degrees, pursued in the 1970s.[10] Hard currency imports were cut drastically as countries sought to restore external balance in the face of worsening terms of trade, deteriorating export markets and a mounting debt service burden.[11] Poland, which had pursued the import-led growth strategy the furthest, was necessarily the most seriously affected by the adverse developments on Western commodity and money markets.

Poland, moreover, was by this time in the throes of major, internal political crisis.[12] It was the disruptive effects of this crisis which brought about the virtual collapse of the Polish economy in 1981, although structural weaknesses and external imbalances contributed, and made recovery more difficult. The crisis affected the other Eastern economies by disrupting Polish exports (notably coal) to them and by requiring a diversion of resources (principally foodstuffs) to Poland which its East European allies could ill afford. In the circumstances, most of the burden of assistance fell on the Soviet Union which provided food, fuels and even hard currency loans. Most seriously, the Polish events damaged the credit worthiness of the other Eastern economies in the eyes of Western lenders, and thereby adversely affected the supply and terms of further Western credits to them.

The Polish crisis, or more precisely the imposition of martial law in Poland, served in yet another way to worsen the situation of its allies. It contributed to the further deterioration of East–West relations. The climate of cooperation that characterized detente had already begun to degenerate in the second half of the 1970s over human rights issues and Third World conflicts. It suffered a major setback at the beginning of the

1980s, when the Soviet intervention in Afghanistan provoked a wave of political and economic sanctions on the part of the West, led by the United States. Many of these were extended or reinforced as a result of the Polish situation. Meanwhile, the accession to power of conservative governments in many Western countries at the turn of the decade had weakened support for the policies of cooperation with the East pursued by their predecessors. Thus, the now more open Eastern economies faced a much less favorable international political, as well as economic, climate as they proceeded into the 1980s.[13]

To the woes that beset the Eastern economies at the turn, and into, the decade must be added a series of natural disasters: earthquakes, floods, droughts, record-breaking winters, and generally poor crop conditions in many countries of the area. These diverted badly needed investment resources, rendered energy conservation more difficult, produced widely fluctuating harvests and reduced exports. In mid-decade, there occurred a devastating man-made disaster which had widespread economic effects not only in the Soviet Union but throughout Eastern Europe: Chernobyl.[14]

Although the worst years for the Eastern economies by most performance measures were 1981–83, improvement thereafter was slow, halting and uncertain (as it was in the West). In several cases, initial "recoveries" subsequently collapsed. The experience of the early 1980s left East European governments with few illusions; and an atmosphere of somber realism characterized the approach of most countries to the economic challenges of the second half of the decade.

Still, those most adversely affected by external adversities and the lack of reform, restructuring and adoption of an export strategy, for example, Poland, might benefit most if the external climate and domestic policy improved. The GDR, Hungary, Bulgaria and Yugoslavia may also be favorably affected by adopting the new policies advocated by Gorbachev and facilitated by politically improving East–West commercial relations. Romania's prospects seem tied to the personal policies of Ceausescu. Czechoslovakia, insulated from Soviet change and Western influence, seems likely to have less benefit from external factors.

Although a return to the easy credit, cheap oil environment of the 1970s was unlikely, an increase in commercial relations with the West and even in the availability of new Western credits, seemed possible. Commercial benefits from CMEA trade might accrue in several years if the Soviet economy proved dynamic and the terms of trade become more favorable. Comity and cooperation between the superpowers would help create this favorable climate for improved intra-CMEA relations.

A return to the isolation of the East (desired or imposed) seemed less likely than either a continuation of the changeable, divisive super-power policy or a trade normalization policy. If Stalin's autarchic economic policy were reimposed, with its increased centralization in planning and management, growth in both East–West commercial relations and Eastern domestic output would probably be significantly reduced.

Slow growth and stagnating living conditions tend to break the social contract that has provided a modicum of popular support to the East European leadership and their various economic strategies. Although current projections from within and outside Eastern Europe seem to predict slow growth and reasonably stagnant living conditions, the positive economic margin for satisfying consumer demands and for modernizing enough to be more competitive in the world market is thin and any set of unfavorable external or internal economic setbacks may wipe out the margin, leading to political instability and declining competitiveness.

Although an export-induced growth might be the best chance out of slow growth and austerity, it is a risky policy, requiring new investment and the chance that foreign markets would not be available. In this case, the resulting retardation of growth and austerity would be more severe and politically embarrassing than a status quo policy.

So Eastern Europe faced a difficult choice. It could opt for a slow growth policy that could threaten its consumption-based social contract and lead to an increasingly non-competitive future, or for an export-driven growth policy based on a foreign trade strategy that requires expensive restructuring of the economy and promises uncertain results.[15]

In these circumstances, strong leadership was required. Unfortunately for the populations concerned, the economic troubles of the 1980s occurred at a time of leadership crisis in the Soviet Union – Brezhnev's final illness, his death and his succession by two, elderly short-term leaders whose own fatal illnesses made them equally incapable of providing the leadership necessary to lead the socialist camp out of its difficulties. The situation was mirrored in Eastern Europe where, in the majority of countries, aging leaders, long in power, were little prone to more than stop-gap measures. In Yugoslavia, the death of Tito in 1980 removed not only a dominant political figure, but a unifying force, and brought in a period of weak, collegial rule. In Poland, a leadership which had assumed power through martial law lacked the authority to bring about national and international reconciliation. While the leadership situation in the Soviet Union changed dramatically with the advent of Gorbachev in 1985, his vigorous style and the sweeping personnel changes with which he prepared his program for the economy were welcomed by reform minded East European elites but did not find immediate official emulation in Eastern Europe.

It is these weaknesses of leadership that explain why the economic difficulties of the early 1980s failed to stimulate long overdue reforms, despite the considerably increased pressure to take serious action that they generated. Instead, the response was in the form of inadequate measures reminiscent of previous attempts – launched with fanfare but soon forgotten. The exceptions were Hungary, where important steps were taken, beginning in the late 1970s, to reactivate the "New Economic Mechanism" and the Soviet Union, belatedly, under Gorbachev.

If the conditions of the 1980s called for reform, they also made it more difficult to carry out. There was little room left for maneuver. Moreover, if it is to get at the structural roots of the problem, reform must inevitably be long-term – in both its implementation and its effects. As the Hungarian experience demonstrates, it is no short-term panacea. Effective reform requires leadership with the vision and conviction to get a comprehensive program adopted and the authority and resolution to carry it through.

The major question at mid-decade was whether Mr Gorbachev possessed these qualities, and if so whether he would be given the time to demonstrate them. The studies that comprise this volume analyze some of the major problems which he and his Eastern European associates face in these circumstances. Written at the time of his accession, they focus for the most part on the Soviet case. They provide the background to the economic policies which Soviet and East European leaders will pursue in the second half of the 1980s.

The studies group themselves into three areas of challenge. The first set addresses problems of planning and management which we saw to be fundamental to the deterioration of economic performance in the 1980s. Vladimir Kontorovich analyzes one of the most critical macro-economic challenges facing Soviet planners: the increasing difficulty of substituting capital for labor and the associated secular decline in the marginal productivity of capital. The ability to cope with this problem is central to the success of Gorbachev's plans to modernize Soviet industry at a time of severe demographic constraints on labor force growth. Another of Gorbachev's early objectives has been to revitalize the central organs of economic management through the replacement of key personnel, the tightening of responsibilities and the institution of new performance criteria. Alice Gorlin's paper focuses on the last, in terms of measures to improve the managerial function of branch ministries through a shift from administrative to economic criteria of managerial performance. Finally, Martin Cave in his paper deals with the ways in which the "information revolution" has been perceived in the Soviet Union, and with the prospects for harnessing its potential to the requirements of improved planning and management of the economy.

Another group of papers addresses trends in the natural resource sector, in which the energy question is central. Prospective limitations on supply and rapidly rising costs of production have made resource conservation one of the dominant themes of the 1980s. In particular, the leveling off and subsequent decline in the regional (largely Soviet) output of petroleum have stimulated efforts to reduce consumption through policies of conservation and substitution. These policies have been pursued against the background of the widely fluctuating conditions on world energy markets noted earlier. Jochen Bethkenhagen, in his contribution, examines energy policy developments in the German Democratic Republic, a major East European claimant on Soviet energy supplies. Itself poorly endowed, except for inefficient, low-grade coal whose extraction and use impose high environmental costs, and faced with rising import prices as well as absolute limits on Soviet oil supplies, the German Democratic Republic has been under particular pressure to reduce its consumption of energy. Its importance, as the most industrially advanced of the planned economies and most successful in raising the efficiency of energy use in industrial production, make it an especially interesting case. Matthew Sagers and Albina Tretyakova, in their paper, examine an important aspect of energy conservation in the Soviet Union: the attempt to modernize oil refining in order to raise the value added per ton of crude oil. They explore not only the economic and technical aspects of the subject, but in so doing shed useful light on problems of contemporary Soviet industrial management. Robert Jensen's paper summarizes the results of a major, interdisciplinary research effort on the Soviet natural resource sector. The emphasis is on Soviet energy and its links to the world economy, and on Siberian resource development more generally.

A final set of papers deals with the challenge of economic integration in the context of increasing national and international interdependence. For Yugoslavia, integration at both levels is particularly problematic. Toussaint Hocevar examines inter-regional integration in Yugoslavia, a long-standing national goal but one which has attained special urgency in the period since Tito's death. Friedrich Levcik and Jan Stankovsky survey the challenges which the small, trade dependent Eastern European CMEA countries face in the pull and tug of relations with the West, on the one hand, and the East, notably the Soviet Union, on the other. Once again, the problems inherent in reconciling diverse economic partners are not new, but have grown more acute in the conditions of the 1980s. Finally, Harriet Matejka addresses a form of regional (CMEA) economic integration which has been given increased priority by the new Soviet leadership. The subject of joint ventures between CMEA enterprises has gained added interest and importance in light of Soviet initiatives to attract selected Western equity participation in the Soviet economy.

NOTES

1 A number of studies have analyzed the economic downturn in the Soviet Union and Eastern Europe in the early 1980s. For the most detailed treatment, on a country by country basis, see *Soviet Economy in the 1980s: Problems and Prospects* (two volumes), A Compendium of Papers submitted to the Joint Economic Committee, Congress of the United States, 97th Congress, 2nd Session (Washington, DC: US Government Printing Office, 1983); and *East European Economies: Slow Growth in the 1980s* (three volumes), A Compendium of papers submitted to the Joint Economic Committee, Congress of the United States, 99th Congress, 1st Session (Washington, DC: US Government Printing Office, 1985–6).

2 Cf., E. Neuberger and L. Tyson, eds., *The Impact of International Economic Disturbances on the Soviet Union and Eastern Europe: Transmission and Response* (New York: Pergamon Press, 1980).

3 Even Hungary, whose measures to institute broad reforms have attracted widespread attention, is not entirely to be excluded from this generalization. See, for example, Paul Marer, "Economic Reform in Hungary: From Central Planning to Regulated Market" in *East European Economies: Slow Growth*, pp. 223–97.

4 Cf., J. Drewnowski (ed.), *Crisis in the East European Economy: The Spread of the Polish Disease* (London: Croom Helm, 1982).

5 In his analysis of the situation, Drewnowski, *ibid.*, lays stress on what he terms the "degradation of the tissue" of the system.

6 The term is rejected in the East because of its association in the official ideology with the increasing instability of capitalist economies.

7 See J. Hannigan and C. McMillan, "CMEA Trade and Cooperation with the Third World in the Energy Sector," in *CMEA: Energy, 1980–1990*. Newtonville, Mass.: Oriental Research Partners for the Economics Directorate, NATO, 1981, Table 4, p. 224.

8 The modified Bucharest formula (1975) for intra-CMEA pricing established a moving average of the world price over the preceding five years as the base for negotiation of the intra-CMEA price fixed for any given year.

9 The effects of trends in the world economy on East–West economic relations have been explored in two major volumes of papers. See C. T. Saunders, (ed.), *East–West Trade and Finance in the World Economy, A New Look for the 1980s* (London: Macmillan, 1985); and B. Csikos-Nagy and D. Young, (eds.), *East–West Economic Relations in the Changing Global Environment* (London: Macmillan for the International Economic Association, 1986).

10 See Philip Hanson, "The End of Import-Led Growth?", *Journal of Comparative Economics*, vol. VI, no. 2 (June 1982), pp. 130–47.

11 On the process of adjustment, see Jan Vanous, "Convertible Currency Indebtedness of the CMEA Countries, Its Implications, and Outlook for 1983–7", in *External Economic Relations of CMEA Countries: Their Significance and Impact in a Global Perspective* (Brussels: NATO Economics and Information Directorates, 1983), pp. 243–73.

12 On the origins of the crisis, see, for example, M. D. Simon and R. E. Kanet, (eds.), *Background to Crisis: Policy and Politics in Gierek's Poland* (Boulder, Colo.: Westview Press, 1981). The large literature which interest in the Polish situation stimulated is listed in *Poland in Crisis/Pologne en Crise*, Bibliography No. 1, compiled by J. L. Black and H. Fedorowycz, Institute of Soviet and East

European Studies, Carleton University, Ottawa, Canada, 1983 (and three supplements issued annually, 1984–6).

13 A group of French specialists has sought to explore the complex interaction of international politics and international economics in affecting the course of East–West relations in the first half of the 1980s, in C. Beaucourt *et al.* (eds.), *La Drôle de Crise: De Kaboul à Genève 1979–1986* (Paris: Fayard, 1986).

14 The economic effects of Chernobyl are examined in a special issue devoted to the subject by *Soviet Economy*, vol. II, no. 2 (April–June 1986).

15 J. P. Hardt, "Implications and Policy Options. A Discussion Agenda." Presented at the Colloquium on the Economies of Eastern Europe and Their Foreign Economic Relations, NATO Economic Directorate, Brussels, 9–11 April 1986.