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# ***JPRS Report***

# **Soviet Union**

***Economic Affairs***  
RESTRUCTURING OF FINANCE-  
CREDIT MANAGEMENT MECHANISM  
By V. K. Senchagov

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[Translation of subtitled booklet: "Perestroyka Finansovo-Kreditnogo Mekhanizma Khozyaystvovaniya" ("Restructuring of Finance-Credit Management Mechanism"), by Vyacheslav Konstantinovich Senchagov, doctor of economic sciences, professor, and USSR deputy minister of finance, published in Moscow by Izdatelstvo "Znaniye", 22,256 copies, 64 pp; BBK 65.9(2)]

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### **Restructuring of Finance-Credit Management Mechanism**

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### **Annotation**

The pamphlet examines the fundamental changes in the field of financial and credit policy resulting from the radical reform of the economic mechanism.

It is aimed at managers in various levels of the economy and at readers, lecturers, and students of people's universities and in the system for teaching production economics.

### **Finances—A Most Important Part of the Economy**

The radical restructuring of management of the economy that is taking place in our country is aimed at creating an integral, efficient, and flexible system for guidance of the economy that makes it possible to form the new shape of socialist society, speed up socioeconomic development, and satisfy the needs of the Soviet people more fully. Perestroyka, which is based on the priority of economic methods of management, is called upon to increase the efficiency and quality of work at all enterprises, to speed up scientific-technical progress in a major way, to deepen in every way the interest of the workers in high end results of their work, and to develop initiative and socialist enterprise.

The conversion of the basic production unit to the new conditions for activation of commodity-money relations lays the foundation for application of economic methods

of management. At the same time, a change is taking place in the entire organizational pyramid for management of the economy, unnecessary levels are being eliminated, and ministries are being consolidated and removed from the zone of economic management so that all the principles of cost accounting (khozraschet), self-support, and self-financing will have their full effect and will reach every structural subdivision and every worker. It was to that end that the June (1987) Plenum of the CPSU Central Committee outlined specific directions for the restructuring of planning, finance-and-credit relations, pricing, the organizational structures of management, material and technical supply, and the system and forms of remuneration of labor.

What is fundamentally new here is above all that enterprise plans, thanks to the system of orders, are clearly oriented toward the consumers, toward meeting their requirements, which is becoming the most important criterion in evaluating the quality of the enterprise's entire production performance and commercial activity. Satisfying needs and effective demand is more and more becoming the concern of entities actually carrying on economic activity, rather than of ministries—which were the agents of the command-administrative system of management.

In the economic mechanism of the basic production unit, a larger role is being given to categories related to fuller utilization of commodity-money relations. The finance-and-credit system is being restructured to that end, and money is being given a greater role in the economics of the enterprise. These tasks were set by the June (1987) Plenum of the CPSU Central Committee and by the 19th All-Union Party Conference, and they are being performed in strict accordance with the USSR Law on the State Enterprise (Association).

Here, the restructuring of finance-and-credit relations and pricing is related to intensifying the quality of planning and is helping to increase the effectiveness of all the principles of cost accounting. At the same time, finances and prices are having a stronger impact on the internal consistency of plans and on improvement of the structure of social production.

Profit, thrice damned by the utopian socialists and by the ideologists of war communism and the command-administrative system, possessing as it does a constructive potential (as K. Marx put it) of "teaching" humanity "to expend its effort economically and achieve the production goal with the smallest expenditure of resources,"<sup>1</sup> is beginning to take up the role of a leading category in the system of socialist economic activity. It is being transformed from an accounting category to a real criterion of the effectiveness of economic activity and the principal source from which enterprises develop and finance themselves.

It has to be said that the role of commodity-money relations was underestimated for a long time in our country, and the theory of the financial omnipotence of the state held sway. It is on that basis that the parasitic

approach to finances was shaped. It became deeply ingrained in economic thinking that the financial system can always meet the need for additional money resources; the main thing was to find the physical resources, while the money would always be found.

It has to be emphasized in this connection that even in the first years of Soviet power there were quite a few economists loyal to socialist ideals who understood that without normal commodity-money relations and a stable financial system the new type of state could not be built. It was then that V.I. Lenin remarked: "...it has to be remembered that all our radical reforms are condemned to failure unless we have success in financial policy" ("Poln. sobr. soch." [Collected Works], Vol 36, p 353).

Unfortunately, that Leninist principle was not always adhered to in our country, and since the thirties finances have played a secondary role in the economy. They were used in calculating national economic proportions, which were planned without sufficient appreciation of financial criteria of production efficiency. It seems to have been entirely forgotten that the financial mechanism is a very important and inseparable part of the integral economic system for management of a socialist economy.

Steps are now being taken to strengthen the Soviet financial system. But this is by no means an easy road to travel. Underestimation in the past of the role of finances in a planned economy and the failure to understand the fact that financial resources, just like production resources, are limited in size and every decision in the field of investment and social welfare programs must be checked for its financial backing have brought the economy to a problematical state and have aggravated the country's circulation of money.

It should be emphasized that the financial difficulties the economy is encountering did not arise yesterday. They were the consequence of the adverse trends in the country's economic development over many past years. The shortage of financial resources was felt earlier, but sources for overcoming it were exhausted through the strategy of extensive development.

The strain on finances was not properly evaluated. What is more, real strategies for balancing the budget were concealed. In addition, the entire system of centralized management of finances proved to be excessively rigid in its regulation, since it relied on arbitrary decisions.

It has to be frankly stated that the situation with finances still remains problematical in the current 5-year planning period. The session of the USSR Supreme Soviet held last year approved the state budget for 1989 with a deficit of 35 billion rubles. What is more, a sizable portion of the budget's revenues were made up by borrowing funds from the nationwide loan fund. Thus, the total imbalance of financial resources is about 100 billion rubles.

The difficult financial situation was largely inherited from the period of extensive economic development in the past. For many years, the state's expenditures exceeded revenues. The financial imbalance worsened with particular rapidity at the end of the last 5-year planning period because economic growth rates were slowing down. There was a growth of the burden of unsolved problems in the economy caused by the drop in production efficiency and by disproportions in many sectors of the economy. It was the impact of these factors that reduced the growth of the state's financial resources.

Over the last three 5-year planning periods, profit and the turnover tax have fallen 153 billion rubles short of the calculations incorporated in the plan. The shortage of financial resources resulting from the phenomena of stagnation in the economy was offset in the following ways:

- by augmenting exports of petroleum and other raw materials at a time when conditions were good on the world market. Over the period from 1970 to 1985, prices of petroleum rose almost 13-fold;
- through a growth of the turnover tax resulting from the speeded-up production and sale of wine and spirits;
- by raising retail prices of a number of consumer goods, although on a limited scale. As a consequence, the true situation in finances was disguised behind external prosperity and was not the subject of thorough and comprehensive discussion as it is now. Financial difficulties were presented outside their organic relationship to the overall state of the economy.

It would be incorrect to see the root of all our financial troubles solely in the legacy of the past. It has to be openly admitted that the financial situation has not improved in the current 5-year planning period either. This is related to two groups of factors. A number of factors affecting financial resources have begun to operate in the opposite direction. We are referring above all to the dynamic behavior of prices of petroleum products, which in the current 5-year period are causing a drop in revenues from foreign trade. This factor represents a shortfall of 40 billion rubles.

The second factor cannot be considered altogether objective. It has to do with the failure to think through the immediate and remote socioeconomic consequences of the decisions made. Included here are losses from the larger-than-planned drop in the production of wine and spirits. Quite often, local authorities set the manufacturing and sale of wine and spirits below the volume envisaged by the relevant decisions. Since measures capable of offsetting the declining income were not taken as a rule or proved to be harebrained schemes, the losses of the turnover tax amounted to more than 36 billion rubles. More than 8 billion rubles were needed to repair the damage of the accident at Chernobyl, and 12 billion rubles were unforeseen expenditures to restore Armenia's economic potential following the earthquake. Large expenditures were also required to extend international aid to Afghanistan.

The expenditures of the state in the current 5-year planning period are growing faster than planned because 20 billion rubles have been allocated from the budget for additional capital investments in economic development and 18 billion rubles have been allocated to develop health care, education, and housing construction. The social welfare expenditures are urgent in nature, and it is a feature of them that they will not yield an economic benefit immediately.

In the context of the ever more complicated financial situation, it is becoming clear how sensible the decisions were of the June (1987) Plenum of the CPSU Central Committee to draft a special program for financial recovery. The indispensable need to speed up its drafting, "including restoring order in the budget, the financial-and-credit system, and the activity of banks," was also emphasized at the 19th Party Conference.

If we were to briefly characterize the makeup of the program, we might single out its following sections:

1. Evaluation of the activity of finances and the circulation of money in the country.
2. Restoration to health of the finances of enterprises and branches of the economy.
3. Achievement of a balanced budget, improvement of tax policy.
4. Expansion of regions' own financial base and development of the principles of regional cost accounting.
5. Improved use of the loan fund and the increased role of credit in developing cost accounting.
6. Balance between supply and demand, normalization of the circulation of money.
7. Reform of pricing and its impact toward recovery of the circulation of finances and money.
8. Increasing the results of foreign economic relations in terms of foreign exchange and finances and improvement of the foreign exchange situation.
9. Organization of the program's fulfillment.

The program covers a very broad range of aspects. They are organically bound up with the measures to create the new economic mechanism and essentially represent an inseparable part of it. At the same time, the program contains a set of interrelated measures to improve the functioning of finances and the credit system and its interaction with the planning system, with pricing, and with management of foreign economic relations.

An analysis of the financial condition of the economy has made it possible to reveal the full extent to which the country's finances have been neglected and above all the existence of the immense deficit in the state budget, which has been "accumulating" gradually over the last 16 years. It has become clear that our finances cannot be restored to health all at once, especially since the

"health" or "unhealthiness" of finances are rooted in the economy itself, even though the financial system has made and is continuing to make its own "contribution" to the country's general economic situation.

It is becoming increasingly obvious that the solution of social problems on the one hand and the radical economic reform on the other turn on the instability of the financial situation of the economy. All of this necessitates an integrated step-by-step approach to the recovery of finances. The reference is first of all to urgent measures which need to be performed in the shortest time; without them, it is not possible to guarantee the country's normal economic development. Another group of measures has to be envisaged as the 13th FYP is drafted and carried out over the period 1991-1995.

There were a number of problems for which solutions could not be found at that time, and acceptable answers have not been found even now. They include the problem of the state debt, which has accumulated over decades; its size is not commensurate with the most important financial-and-economic indicators and is distorting the entire economy.

The first question has to do with the indicators with which it is possible to judge the state of the country's circulation of finances and money. They include the size of the budget deficit, the proportions and forms of borrowings from the loan fund, the relation between growth rates and the amount of money in cash and noncash circulation, and the growth rates of overall economic indicators. It is important to decide on the basis of comparison—the national income or the gross national product. It is more correct to make the comparison to the gross national product, because it reflects the movement of depreciation and income in the nonproduction sphere. Beyond that, a very important indicator is the growth of money held by individuals in various forms (account balances in the savings bank, insurance policies, bonds, cash, and so on) relative to retail sales and commodity stocks.

The state debt is an indicator that plays an exceptional role in evaluation of the country's financial situation. It reflects the total amount of personal resources attracted to finance the expenditures of the state. As expenditures have grown, so has the state debt. This is a general pattern for both capitalist and socialist countries. For example, relative to the gross national product in 1987 it was 52.5 percent in the United States, 44.3 percent in West Germany, 38.4 percent in France, 56.7 percent in Great Britain, and 92.3 percent in Italy. In the USSR, according to our calculations, it is approximately 46 percent, and there would not seem to be any basis for anxiety. But it should be taken into account that the size of the state debt in our country is excessive, since profound disproportions are observed between supply and demand. Analysis shows that there are limits on the growth of the state debt, especially since under the conditions of the present state of the economy a growth of personal savings is not only an indicator of the growth

of personal income, but it also characterizes unsatisfied demand. That is why the amount of money that corresponds to the unsatisfied demand of the public for goods and services, when it becomes a source for financing state expenditures, figures as one of the factors for hiking up inflation. That is why it is very important to stabilize the growth of the state debt, to begin to free state financial resources of unwise outlays, and to conduct a purposive policy of using money individuals have accumulated for measures whose immediate impact is to increase the size of the consumer market.

Now about the budget deficit. What are the problems here, and what approach can be taken to solving them? We have already referred to its proportions. The division of the deficit into two parts indicated above is, of course, provisional. It is related to the procedure for the drafting and approval of the budget. At the time of the October session of the Supreme Soviet, it was not clear how the deficit of 35 billion rubles would be covered in view of the fact that a portion of the budget is being covered by borrowing more than 60 billion rubles from the bank. Great efforts were required on the part of the government to define measures to reduce expenditures and increase revenues by the specific amount. But we must not flatter ourselves. First, real specific deeds are necessary to implement these measures. The inertia of the old cost-plus mechanism stands like a thick wall on the road toward financial recovery. Second, the diversion of the loan fund to cover expenditures has grown in recent years and reached the critical point.

Since personal savings, which represent the impressive figure of more than 300 billion rubles, have a large place in the country's loan fund, the growth of the budget's indebtedness to the bank in essence signifies a growth of the state debt.

The banks, of course, have to regroup the resources of the loan fund and relieve a portion of it of ineffective outlays.

This requires conducting a vigorous credit policy and changing the interest rate as a function of the size of the loan fund and the demand for credit. Relations between the state budget and the banks also need to be put on a paying basis. The general rule in borrowing resources must be that it not worsen the general economic situation in the economy. Healthy relations between the budget and the banks should help to balance financial and physical flows without resorting to a growth of note issue that goes beyond the limits of natural expansion of economic turnover and growth of GNP.

Another issue related to possible forms of borrowing resources from enterprises. Today, the two sides stand this way: the revenues of the budget amount to 494.8 billion rubles, and enterprise income amounts to 250 billion rubles. Earlier, Minfin resorted to various forms of outright confiscation to turn a portion of the economic incentive funds of enterprises and other resources into revenues.

Can enterprises voluntarily lend a portion of their resources to the state in the form of loans on economic terms? Is it possible to float state loans aimed at enterprises? This is a complicated question. Clearly, this can be done with bonds. It would seem to be possible with loans as well. It is important to substantiate its economically acceptable size, the interest rates which must be linked to overall interest rate policy and with dividends on shares of stock and bonds.

One of the main strategies for financial recovery lies in determining the sum total of the cash money supply and noncash turnover. Not much has been done to develop methods of regulating it. Money in noncash circulation and the monitoring of all stages of its movement in keeping with physical flows have not been coordinated with the movement of cash.

A very important question has to do with the causes of the budget deficit, which branches and production groupings survive by violating the unshakable rule of "living within their means." The causes of the deficit are manifold. They lie above all in the disproportionate investments that have not been yielding a standard return. For instance, the volume of unfinished construction amounted to 150 billion rubles in 1988 and had grown by 28 billion since the beginning of the 5-year planning period.

Even though enterprises have made the conversion to full cost accounting and self-financing, 80 billion rubles were allocated from the budget in 1988 for centralized capital investments. These are huge subsidies to support the present level of retail prices (more than 80 billion rubles), differentiated supplements to purchase prices (32.2 billion rubles), major outlays for defense if we take into account all their forms, the disproportionately large scale of production operation at a loss (11 billion rubles), and unproductive expenditures (more than 20 billion rubles). Nor can we omit from the calculation the outlays of the state for housing subsidies (4.4 billion rubles), and so on.

Tens of billions of rubles constitute reserves to guarantee normal operation and fulfillment of planning indicators for profit. In 1988, one out of every three enterprises in the industrial sector and agriculture and one out of every four in construction did not fulfill the planning targets and fell short about 10 billion rubles of profit.

The effective functioning of the economy and its balance depend in large part on how the circulation of money is organized, on how closely the formation of the remuneration of labor depends on the end results of the operation of enterprises and the work of each individual worker. At present, unfortunately, there are a great many channels for obtaining easy money which is not based on the highly productive and creative work of the workers. The conversion of enterprises to full cost accounting and self-financing has so far not solved this fundamental problem.

In 1988, personal income grew more than 8 percent, which is twice the planning projections, so that the

remuneration of labor is growing far faster than its productivity. In the industrial sector as a whole, 1.41 percent of wages is paid for each percentage point of growth of labor productivity, and in USSR Minavtoprom the figure is 1.58 percent. In scientific research organizations, wages grew an average of 20 percent in 1988, and in many institutes they rose 50 percent or more. The growth of wages has been on a still larger scale in project planning organizations. This trend has become stronger this year. In January and February, 2 percent of wages was paid in the industrial sector for every percentage point of growth of labor productivity. In order to halt the unjustified growth of wages, the decision was taken to institute quarterly monitoring of the ratio of the growth of the average wage to the growth of labor productivity. If the assigned ratios are violated, bank branches are given the right not to pay out resources for remuneration of labor over and above the amounts to which enterprises (associations) and organizations are entitled on the basis of the assigned standard ratio.

This is, of course, far from an ideal method of monitoring the remuneration of labor. A search is also being made for other methods related to strengthening the role of taxes as the remuneration fund grows.

The measures outlined to balance the budget and improve the circulation of money can be provisionally divided into the three most important directions: first—reduction of expenditures of the state and growth of its revenues, second—regulation of the effective demand of enterprises and individuals, and third—intensification of the economic reform by giving a more active role to the socialist market. It is basic in this effort that the problems of the financial situation must not thrust us onto the road of holding back the processes of perestroika, that the economic reform must be continued and, what is more, intensified.

At the same time, the plan for carrying out this reform must be detailed so as to take into account the situation as it has taken shape. Emphasis is on the task of carrying out extraordinary measures of recovery, which will take place gradually. In the first stage, during the remaining years of the 5-year planning period, the development of adverse processes in the circulation of money will be halted, and the strictest economy regime will be instituted on expenditures so as to place the budget deficit and the issuing of money and inflation under very strict control. It is in that first stage that the regrouping of financial and physical resources for accelerated development of the consumer sector must begin.

In the second stage, even in drafting the 13th FYP, emphasis must be on the task of guaranteeing that the supply of goods and services corresponds both to the demand of the public and also to the demand formed in enterprises and cooperatives, that is, in the realm of all participants in economic activity. In this stage, the state debt has to be reduced, the purchasing power of the ruble raised, the balance of payments improved, and the prerequisites created for adoption of convertibility of the currency.

In view of the extreme importance of the stability of finances in carrying out the restructuring of the economy, the CPSU Central Committee and USSR Council of Ministers adopted this March a decree entitled "On Measures for Financial Recovery of the Economy and To Strengthen the Circulation of Money in the Country in the Period 1989-1990 and During the 13th FYP."

The principal measures of financial recovery are reduction of the limits of centralized capital investments by 7.5 billion rubles in 1989 and 8 billion in 1980 [sic]. Plans to that end call for halting construction of 390 projects and instituting stricter requirements as to the observance of standard time allowances for construction and as to the quality and technical-and-economic indicators of project plans.

A greater effort is to be made to reduce the subsidies to enterprises and organizations operating at a loss. In 1989, their size is to be decreased by at least 30 percent, and the effort to eliminate operation at a loss will mainly be completed in 1990.

In discussing expenditures, we cannot avoid the question of expenditures related to maintaining the country's defensive capability at the necessary level. This is unquestionably a new channel for financial recovery. As has already been reported in the press, the USSR intends to reduce the military budget by 14.2 percent and the production of arms and military equipment by 19.5 percent. Defense expenditures in the budget represent 20.2 billion rubles. But this amount takes into account only financing the personnel of the USSR Armed Forces and does not take into account outlays to purchase equipment or for scientific projects or design projects. Conversion of military industry does, of course, yield a sizable saving, although at first it will not be possible to do without certain outlays to reconfigure the enterprises in question.

These are just some of the examples of successful solution of the problem of conversion. Instead of missiles, the Votkinsk Machinebuilding Plant will be manufacturing refrigerated tanks for transporting milk and also production lines for bottling nonalcoholic beverages. Instead of military equipment, the "Kirovskiy Zavod" Production Association will be manufacturing automatic production lines for packaging vegetables.

In Minaviaprom, measures are being worked out for the reconfiguration of certain plants manufacturing defense products to the manufacturing of airplanes for civil aviation: AN-72's, TU-154's, and TU-204's.

The measures outlined by the government are only starting points for financial recovery. There is a need in both practice and theory to look for new solutions that are out of the ordinary.

The restructuring of the economy has entered now what is probably its most crucial stage. There is a need for solutions which have been well-thought-out and whose implementation must yield constructive results. That is

why we need to look once again at the entire system of measures proposed and give additional consideration to the following issues.

It would be difficult and naive to believe that a budget deficit that actually amounts to 100 billion rubles can be eliminated in 2 or 3 years. The financial illnesses of our economy are so deep-lying that their treatment will take far more time. These stages in elimination of the budget deficit must be strictly defined.

An ideology of expenditures of the state budget must be worked out most thoroughly. In the first 3 years of the 5-year planning period, budget expenditures have grown by 75 billion rubles and revenues by approximately 2 billion rubles. And this at a time when the transition is being made to full cost accounting (*khozyaystvenny raschet*) and self-financing. It turns out that the transition to full cost accounting and self-financing has not taken the burden off the budget. This means that "in spite of" cost accounting a sizable portion of capital investments are still going to the production sectors of the economy. The financing of capital investments with the resources of the state budget has to be sharply limited. Let existing enterprises take full responsibility for reproduction of productive capital, including new construction, not just reconstruction and retooling, as is now the case.

One of the tasks of financial policy is to put an end to economically unjustified siphoning of resources from the loan fund into the state budget. After all, credit has a number of advantages over budget financing. The resources have to be repaid within a specified period of time. We need to create a mechanism for credit financing through the banks that would be based on the principles of production efficiency and in which the bank would have the right to adjust the interest rate. We are afraid that if we did this today we would do harm to enterprises and violate our own dogmas as to the stability of conditions for economic activity.

As for enterprises, a rigid policy must be conducted whereby money is earned by work. They must feel the shortage of financial resources and carry out measures that make it possible to make up that shortage by increasing their own accumulation.

Realistic measures need to be worked out to halt the adverse trends in remuneration of labor. The point is that remuneration of labor has gotten out of control. The economic standards that have been set do not provide the necessary linkage between remuneration of labor and the end results of the activity of enterprises. What is more, the benefits concerning formation of economic incentive funds in the branches of heavy industry and the additional payments for performance of contractual obligations and the state order are a heavy burden lying on the country's circulation of money.

## Directions in the Restructuring of the Financial Mechanism

Commodity-money relations serve as the basis for the functioning of finances; without their vigorous and harmonious development, the financial system is condemned to performing the secondary functions of cash accounting. It is precisely because of underestimation of the importance of the activity of this sphere of economy that society has developed deep-seated notions of finances as a vessel from which resources can be taken without limit, and the need to constantly replenish it is forgotten. The decisions of the party and government to create an integral system for management of the economy envisage measures to augment the role of finances in the country's economy. This approach is consistent with Lenin's recognition of the importance of finances.

In accordance with standing tradition, our theoretical thought and practice took a very oversimplified approach to cost accounting, in essence castrating it by removing the basic features defined by V.I. Lenin in the NEP period. Cost accounting was divorced from commodity-money relations, which generated a wave of voluntaristic fabrication of an immense number of particular and ineffective "incentives" and "levers," which had nothing at all to do with the main criterion of the efficiency of economic activity. What meaning is given to this term today?

Full cost accounting signifies work for the consumer, doing everything to satisfy the effective demand of enterprises and the public, strict contractual discipline and the inevitability of economic penalties for violation of obligations under contracts, payment for resources of all kinds which the state has granted to the enterprise, the principle that outlays for retooling, reconstruction, and expansion of production must pay for themselves, that production should operate without a loss and achieve the targeted level of profitability, that obligations be unconditionally fulfilled to the state budget, and that remuneration of labor and social development conform in their size to money earned.

What is more, full cost accounting envisages the possibility of terminating the activity of an enterprise operating at a loss that has built up a large debt to the state and its trading partners.

Self-financing is the heart and soul of full cost accounting. It is this that makes the development of production and social development of the work collective directly dependent upon the money they earn.

What has made it necessary to restructure the finance-and-credit mechanism at the present time?

The 27th CPSU Congress, the June (1987) Plenum of the CPSU Central Committee, and the 19th All-Union Party Conference have given a fundamental and complete answer to this question. It was noted at the congress that in recent years there had been a substantial slackening of the pressure of the finance-and-credit mechanism on the economy, the

role of commodity-money relations had diminished, the cost-accounting rights of enterprises had been restricted, and the operation of economic levers and incentives had been hampered. All of this resulted in a growth of the financial strain in the economy and a strengthening of factors holding back its progressive development. The result was a deterioration of the principal economic and financial indicators. Above all, an imbalance occurred between budget revenues and budget expenditures.

The finance-and-credit mechanism is a complicated symbiosis of new elements and of remnants of the old system. Moreover, the new elements include some which were not envisaged by the original conception of the reform. The need for their use arose in the course of the reform. For that reason, in defining the essence of the finance-and-credit reform and its component elements we need to take into account that the new economic mechanism is in constant movement and its conditional elements can be defined only with a certain conditionality and sketchiness. They include radical transformation of planning at all levels of management of the economy by overcoming the approach based on physical quantities and strengthening the role of finances, credit, and money.

Finances and credit must be the initial basis of the plan and of the system of management to the same degree as the physical form of the product, and they must contain a normative system of connections between the state and enterprise in the creation and distribution of the net product, which is gradually transformed into regulation through taxes, a normative system of relations between the union budget and the budgets of the union republics, oblasts, krays, cities, and rayons, as the basis for development of regional cost accounting; overcoming the cost-plus method of advance-estimate financing of budget-financed organizations so that these organizations become economically motivated to use efficiently the resources allocated by the state for their development; the transformation of money into an active instrument in economic decisionmaking; full linkage of the circulation of money with the circulation of physical quantities; creation of new channels for the use of the money of individuals to solve production problems and social problems on the basis of development of a securities market; returning to credit its true value by reforming the banking system and separating the functions of note issue from the functions of credit financing, and the assignment of these functions to separate units in the new banking system.

Now about changes in the system of financial plans and financial planning. It is important to note at this point that the entire system of long-range, 5-year, and current production plans and also plans for social development will be based on a strict and accurate calculation of financial resources to back them up. Beginning with the very conception of the Basic Directions for Economic and Social Development of the USSR over the 15-year period, then, proposals are being worked out concerning the most important directions for the conduct of financial policy. They make it possible to guarantee vigorous

use of commodity-money relations, to take into account the requirements of the law of value and other economic laws in determining effective proportions in economic development, an economically substantiated rate of accumulation, the growth rates of the national income, and the relationship between the growth of the first and second departments of social production.

A most important direction in enhancement of the role of finances is to guarantee the optimum formation of the most important proportions in reproduction. If the stimulative functions of economic levers are to be fully manifested, the market has to be saturated with goods and services. Here, we cannot do without a radical change in proportions: an increased share of capital investments and financial resources going to development of all production groupings satisfying the needs of the population. After all, it is here that money ends its circulation that has gone through many stages. Since it is in consumption that the balance envisaged in the plan and the extent to which real effective demand has been taken into account are tested.

The limited nature of physical resources is obvious. But for some reason the opinion has become deep-seated that financial resources are unlimited. That is why a good financial person is said to be the one who can always find financial resources in the amount required. But these resources are not just slips of paper. They are related to the production of goods in physical terms. That is why thought should be given to the place and role of the branches of Group B in social production.

At present, the branches of heavy industry are dominant in the structure of production. In historical terms, this has guaranteed us a high independence of our economy from external factors of world development, but this approach to shaping the structure of production also has its negative side. It does not take into account the rate of turnover of fixed capital and working capital, it ignores the time factor, which under present conditions plays an exceptional role in the economy's mobility, in its ability to adapt quickly to new conditions, to be responsive to scientific-technical progress, to changes in the structure of the demand of the public.

In short, the intersector and intrasector structure of the economy are shaped without being connected to effective demand of the public. It has to be said that even the balance of personal money income and expenditures, which is an important instrument for balancing supply and demand, is drawn up without a thorough analysis of the tendency of the socialist market, the effective demand of various groups of the population, and the entire set of factors influencing the dynamic behavior and structure of that demand.

In drawing up the plan for economic and social development, we forget that the so-called Group B, aside from satisfying the demand of the public, is also a stable financial base of the state. Even now when it comprises 25 percent of the total volume of industrial output, it

furnishes more than half of the financial resources created by the industrial sector. The level of return on capital and fixed assets in that branch is threefold greater than the average for industry. That is why the main strategy of structural transformations in the economy, which is to guarantee recovery of finances and the circulation of money—is a radical reassessment of all our theoretical views and the existing planning practice in the direction of creation of conditions for the emphasized development of those branches and types of production that serve to satisfy the effective demand of the public.

Financial planning has to be built on the basis of an essential metamorphosis of the present mechanism of financial centralization. V.I. Lenin felt in his time that without concentration of financial resources it was not possible to achieve major economic transformations. And in the context of the economy's transition to a predominantly intensive pattern of reproduction, this cannot be forgotten. But the stability of the state budget cannot be guaranteed by denuding the finances of enterprises, associations, and branches. At this point, we need different measures and a different mechanism for financial centralization, measures and a mechanism which moreover would not allow the budget deficit to grow.

Something has already been done in this area. At enterprises converted to full cost accounting and self-financing, there has been a substantial increase in the share of profit left at their disposition. In 1989, it reached 51 percent, as against 43 percent before the conversion to the new operating conditions. This is occurring to no small degree because of expansion of the functions of the fund for development of production, science, and technology (FRPNT). It is a source of financing not only for retooling, as was previously the case, but also for R&D projects, reconstruction, and even expansion of the existing production operation. The resources of this fund are being used to finance outlays to prepare and put into production new and modernized products, fabrications and materials, progressive manufacturing processes, to manufacture experimental prototypes, and to build new types of buildings and installations.

It is from this fund that expenditures are covered to maintain children's preschool institutions and other measures for education and health care, outlays to reimburse losses in housing management and utilities, since the level of rent, which was set in the twenties, does not offset the actual costs of managing the housing stock.

The Law on the State Enterprise did not strictly regulate the purposes for which this fund is used. Quite a few enterprises have begun to use this fund on a large scale essentially for an indirect rise of the remuneration of labor.

The resources of this fund are being used to pay rent, to grant additional paid vacation, enterprises are taking upon themselves the payment of personal income taxes, and so on. This is diverting resources away from performance of the main task of social development and is having an adverse effect on the circulation of money.

The revenue base of the state budget is also undergoing change. The share of payments from profit is growing, the share of the turnover tax is decreasing. In the thirties, the turnover tax of enterprises represented 70 percent. In 1987, this indicator dropped to 22 percent, and beginning in 1989 the drop in the share of this payment was halted.

Soviets of people's deputies are also becoming more highly motivated to increase the turnover tax by expanding the production and choice of consumer goods and by improving their quality. To that end, payment of the turnover tax is being transferred from the sphere of distribution to the sphere of production—to the manufacturing enterprises themselves. Turnover tax collections going into local budgets are made directly dependent upon the volume and growth rate of retail sales of state and cooperative trade.

This does not, of course, exhaust the entire set of interrelated stimulative functions of the turnover tax. It is probably necessary to separate from the sum total of that tax the portion which performs only one function—regulating supply and demand. Another part of the turnover tax must possess a broader spectrum of economic functions, including being able to solve the problem of stimulation.

Beginning in 1989, as much as 30 percent of the growth of the turnover tax may be used to stimulate work collectives to increase the production of goods of light industry and also to set up specialized capacities for the production of consumer goods at enterprises in other branches and sectors.

The radical strategy for transformation of the turnover tax is to link this financial instrument more closely to the actual turnover of physical inventories. There is above all a need to expand collection of the turnover tax by the method of rates, which by contrast with the method of difference in prices, meshes better with the cost-accounting interests of the enterprise. Later, taking into account the experience of foreign countries, it is advisable to make the transition to setting the turnover tax in percentages of the added value, which is close in its economic content to net output.

The second pivotal direction of the financial reform is the transition of budget relations with enterprises, associations, and organizations to the normative basis. The success of the restructuring of the entire economic mechanism depends largely on how we solve this problem.

Earlier, the residual mechanism operated in the distribution of profit with the exception of the rate of the charge on assets. Approximately a third of all the enterprise's profit went into the budget in the form of the so-called free remainder, which was defined as the difference between the total sum of profit and all the planned purposes of its use. Now, the normative method has been made the basis of profit distribution. It has substantially altered the character of relations which enterprises and associations have with the budget. As profit grows, that portion which remains with enterprises

and goes to economic incentive funds also increases. Enterprises thus have a direct motivation to increase the size of profit, and it is therefore advantageous for them to reduce the production cost, to apply new technology, and so on. Although, of course, this has not eliminated the inflation of prices as a channel for "earning" profit. But to keep the enterprise off that road, provision has been made to confiscate undeserved profit obtained from hiking up prices; that is, penalties in the amount of that profit are paid into the budget.

The role of charges for resources has been substantially strengthened in the system of relations between enterprises and the budget. The idea behind them is very simple—to motivate work collectives to use public property efficiently. The better the use of resources, the less profit has to be set aside for the budget. The charge on productive assets has been established in the proportions of 2, 4, 6, and 8 percent. At present prices, given the great differentiation of profitability from branch to branch and from enterprise to enterprise, it was not possible at present to establish a uniform rate of the charge on productive assets. This problem will be solved in the next 5-year planning period.

For enterprises which made the transition to full cost accounting and self-financing in 1988, a charge on labor resources has been instituted for the first time in the amount of 300 rubles in regions with a labor surplus and 200 rubles in regions with a shortage of workers. The purpose of this financial instrument is dual: to reimburse the state a portion of outlays to train personnel and to strengthen the interest of enterprises in efficient employment of its personnel.

As is well-known, in accordance with the decisions of the June (1987) Plenum of the CPSU Central Committee, the charge on resources used (for productive assets, labor resources, and natural resources) is to become the principal source of revenues for the budget.

At this point, it was not possible to implement this principle fully in setting the rates of payments into the budget for ministries whose enterprises have converted to full cost accounting and self-financing. Whereas for certain ministries (Mingazprom, MPS, and Minudobreniy), the share of charges on resources in 1988 reached about 75 percent of all payments into the budget, at approximately half of the ministries they amounted to less than 50 percent. For the machinebuilding complex as a whole, payments into the budget representing charges on resources will represent 50 percent of all payments. This is related to large differences in levels of profitability and also in the valuation of capital assets. More than 10 years have passed since the last revaluation of capital assets, and it is natural that they should have experienced the price-related stratifications of that entire period.

More needs to be said about one aspect of relations of enterprises with the budget. Aside from the charges on resources, rates of deductions from profit into the budget

have been adopted. They have to be applied because in most ministries and enterprises profit is growing more rapidly than production resources. If we limit ourselves only to the charges on resources, then the budget will grow more slowly than profit, which is the principal source of budget revenues. However, expenditures of the budget for social development and other outlays of the state are at the present time growing more rapidly than the national income. In short, without that payment it is not possible to balance the state's revenues and expenditures.

The USSR Law on the State Enterprise (Association) envisages the conversion of enterprises, associations, and organizations to full cost accounting and self-financing using one of two models: the first, which is based on normative distribution of profit, and the second, which is based on normative distribution of cost-accounting income. The schemes for distribution of profit and cost-accounting income on a normative basis are given in Figures 1 and 2. The right to choose the model has been left to enterprises and associations making the transition to full cost accounting and self-financing.

Accomplishment of a stage-by-stage transition to formation of the financial base of regions and soviets of people's deputies on the basis of stable economic rates is an integral part of the financial reform. The transition to cost accounting of regions is on the agenda here. The principle of earning resources must be operative in financial relations with union republics and local government authorities. The demand of local bodies of government for financial resources has now increased sharply. We might mention that the budgets of five union republics (Uzbekistan, Kazakhstan, Kirghizia, Tajikistan, and Turkmenia) are subject to deficit financing and are maintained with subsidies from the union budget. But it should not be thought that these republics are making ends meet at the expense of the other 10 because of their poor operation. Differing levels of economic activity cannot, of course, be overlooked. But consideration has to be given to the system of nationwide division of labor that has been shaped. Take Uzbek SSR, for example. It furnishes the country most of its cotton, which, it needs to be said, is a commodity with a high financial return. But because of the present procedure for collecting the turnover tax (and precisely its collection at the point where the end product is processed and produced), the income from cotton grown in Uzbekistan is realized by other republics.

In March 1989, the USSR Council of Ministers presented for consideration of the USSR Supreme Soviet "General Principles for Restructuring Management of the Economy and the Social Sphere in the Union Republics on the Basis of an Expansion of Their Sovereign Rights of Self-Government and Self-Financing."

A substantial change in the methodology for forming the revenue base of the budgets of the union republics is envisaged. Whereas earlier the revenue base of budgets was formed on the basis of expenditures of the union republics outlined in the plan, now their expenditures

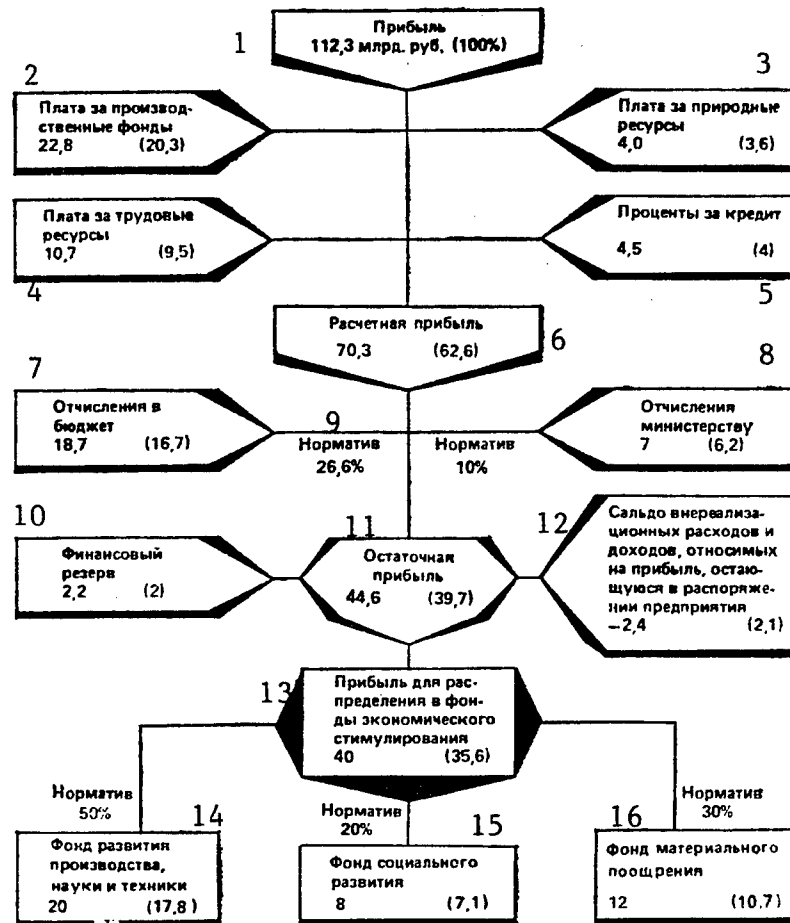


Figure 1. Scheme for distribution of profit at enterprises operating in the context of full cost accounting.

Key: 1. Profit, 112.3 billion rubles 2. Charge on productive assets 3. Charge on natural resources 4. Charge on labor resources 5. Interest rates on credit 6. Calculated profit 7. Deductions into the budget 8. Deductions to the ministry 9. Rate 10. Financial reserve 11. Residual profit 12. Net result of expenditures and income not related to sales and included in the profit remaining at the disposition of the enterprise 13. Profit for distribution into economic incentive funds 14. Fund for development of production, science, and technology 15. Social development fund 16. Material incentive fund

are made closely dependent upon revenues. Up to now when expenditures exceeded revenues, the shortage of resources was covered from the union budget. Now, expenditures must correspond exactly to resources earned. Of course, realization of the principles of self-financing requires demarcation of revenues going into the budgets of the republics and into the union budget and also expenditures made at each level of this system. The system of payments into the budget by all enterprises, whether under union or republic and local jurisdiction, must undergo reconstruction.

The idea of the proposed restructuring of payments into the budget is for all enterprises, independently of their

subordination, to make their contribution to forming the revenues of the union budget. Now, as is well-known, enterprises under republic jurisdiction do not have obligations to the union budget. This gives rise to the desire to have more enterprises under local jurisdiction on one's territory and fewer enterprises under union jurisdiction. At the same time, enterprises under union jurisdiction must pay a portion of their profit and turnover tax into republic and local budgets at the established rates. In order to broaden the revenue base of budgets of the union republics, provision has been made to commit the entire amount of the charge on land, water, and labor resources for all enterprises, regardless of their jurisdiction, into the revenues of the budgets of the union republics.

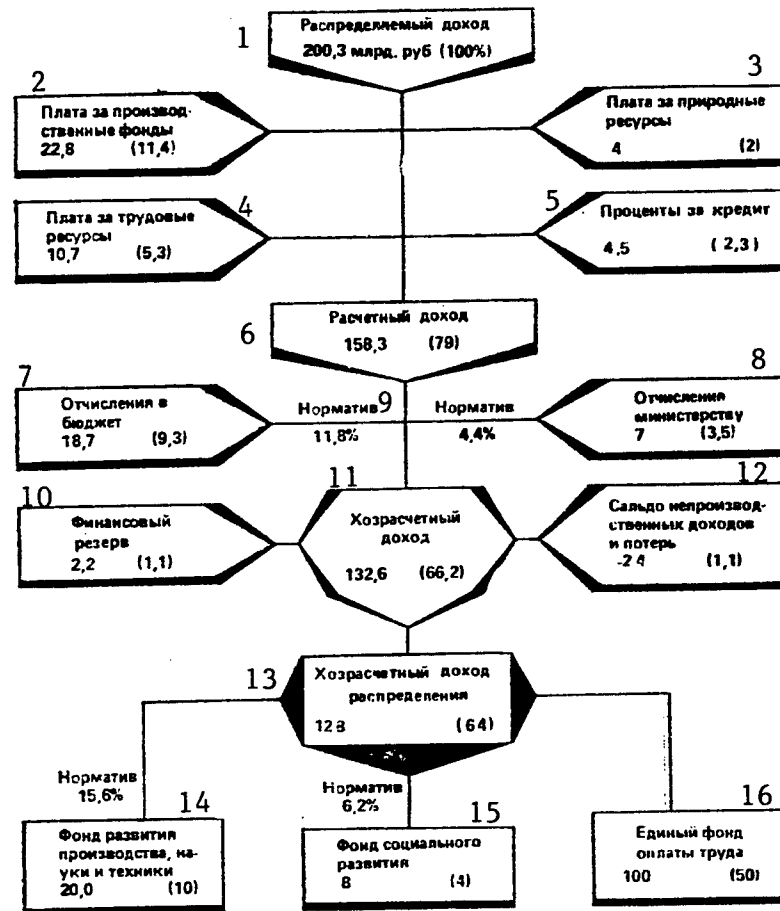


Figure 2. Scheme for distribution of income realized after reimbursement of material costs from proceeds.

Key: 1. Income for distribution, 200.3 billion rubles 2. Charge on productive assets 3. Charge on natural resources 4. Charge on labor resources 5. Interest rates on credit 6. Calculated income 7. Deductions into the budget 8. Deductions to the ministry 9. Rate 10. Financial reserve 11. Cost-accounting income 12. Net result of nonproduction revenues and losses 13. Cost-accounting income for distribution 14. Fund for development of production, science, and technology 15. Social development fund 16. Unified remuneration fund

The budget-financed organizations in the nonproduction sphere were for a long time outside the area of financial and economic transformations. It seemed that there was no place here for either cost accounting or economic incentives. As a matter of fact, many so-called budget-financed subdivisions cannot only absorb resources, they can also take part directly or indirectly in creating them. But these organizations have for all practical purposes been excluded from the sphere of influence of the economic mechanism. Of all the organizational and economic measures, they have been disturbed only by the reduction in the size of their staff and the level of their wages. These possibilities, as is well-known, are very limited, and in the context of the operation of the

residual method of distribution, the needs of these organizations were the last to be met.

Budget-financed organizations are a part of our economy. They must be motivated to improve the end results of their activity: the higher those results, the larger the sources they should have for their own development of production and social development. There is, of course, a complicated methodology here concerning the problem of determining the end result of activity of budget-financed organizations. The forms of activity are highly diverse in the nonproduction sphere. Especially important are the skills of personnel, their ability to perform their official duty, to satisfy more fully people's

need for a wholesome way of life, for broader and deeper knowledge, and for physical and cultural development. That is why the first problem that has to be solved is to find measures of the end results of the activity of institutions in the social and cultural service sector that can be applied in practice.

Medical personnel have interesting experience with the introduction of cost accounting. The scientific-production association for microsurgery of the eye has been operating under the conditions of cost accounting for a few years. Elements of cost accounting are applied in the system of USSR Gosteleradio. Funds for material incentives and social development have been created there. The main directions of the new economic mechanism in branches of the nonproduction sphere have been prepared so as to take into account the experience that has been gained. They have extended to institutions in health care, public education, culture, and the mass media, physical education and athletics, and social security. The new economic mechanism is based in the branches of the nonproduction sphere on combining budget financing of the activity of the institutions with the development of paid services to the public and on performance of jobs under contract with enterprises on a cost-accounting basis.

The system of budget financing of institutions in the nonproduction sphere is undergoing radical change. Whereas previously resources were allocated from the budget for particular expenditure items, now they are allocated on the basis of standard allowances which are stable for a long period of time and which reflect in an integral way the purposes of the activity of the institutions. The standard allowances used in budget financing perform the functions of a price (rate schedule) for services (jobs) which the institutions perform. They are established according to an indicator that characterizes to a greater degree the end result of the activity of institutions in the given branch. For example, for public education—the value of teaching one pupil for 1 year, for health care the value of protecting the health of one inhabitant per year or the treatment of one patient, and for radio and television it is the value of 1 hour of broadcasting, and so on.

### **The Components of the Financial Reform**

Under the new economic conditions, all decisions in the area of improving the structure of production, of capital investments, and of social programs both at the level of the national economy and also at individual enterprises and in regions are being carried out on the basis of strict comparison of costs and results. Financial categories such as profit, profitability, the rate of return and the standard level of efficiency are precisely those standards which compel enterprises to calculate costs and use resources more efficiently.

While emphasizing the importance of finances, at the same time we need to refrain from exaggerating their role. What we mean is that it is in the specific nature of

our economic mechanism, more accurately, of that new model of it which is now being introduced, that finances are only a part of this reform. It is very important to emphasize this because sometimes the idea slips through that all the problems of economic development can be solved with finances and financial reforms alone. This is an oversimplified view.

Enterprises in all branches of material production are now operating on the principles of the new system. A radical transformation of the planning system has begun in order to strengthen the role of finances and the entire cost mechanism for increasing production efficiency: directive planning by means of the system of physical indicators is being sharply reduced, and planned regulation with extensive use of long-term economic standards is expanding. Whereas in 1988, the state order represented 86 percent of output in the machinebuilding complex, in 1989 it represented only 25 percent; the respective figures for USSR Minlegprom are 96 and 30 percent. Even in the fuel and energy complex the processes of reduction of the state order is taking place, and its share has dropped from 95 to 59 percent of the total volume of production.

As the state order is reduced, conditions are being created for expanding direct ties among enterprises, for more active use of financial levers and incentives. The question might arise: What criteria will enterprises take as their points of departure in establishing these ties with one another? In the context of full cost accounting and self-financing, of course, enterprises face conditions in which they themselves must be concerned about their financial condition. As a matter of fact, if they are to have the resources necessary for remuneration of labor and economic incentive funds, to update equipment in good time, enterprises must have financial resources. As we see, concern about the profitability of carrying on economic activity becomes the most important task in the enterprise's activity.

And also about a condition without which the finance-and-credit mechanism cannot display all its constructive attributes. We are referring to development of wholesale trade in machines and equipment. It can be said that for a long time they were not entirely a commodity. They were distributed strictly on the basis of allotment. Given the large demand for machines and equipment, the passive financial policy and the diminished role of the principle of earning resources, the demand for machines and equipment substantially exceeded the supply.

The reform that has been initiated in the system of planning and finances demonstrates that granting enterprises the right to earn resources for their own existence is also creating the conditions for them to commit the money they earned sensibly to retooling, to updating their products, and to solving social problems. And the course of the reform is demonstrating the correctness of this approach. As a matter of fact, enterprises have a considerably greater interest in earning resources.

The volume of wholesale trade last year was 40 billion rubles. Even by 1989 it will increase almost threefold, reaching 115 billion rubles, and in 1990 it will be 150 billion rubles.

And, of course, this is only the first stage. There is much still to be done, and effective cost-accounting forms have to be found for this trade. Enterprises, the system of material and technical supply and its components must acquire the taste and habits of commercial work, must strive to satisfy the demand of consumers through the most economical forms of this trade and at lower distribution costs.

### **The Structure of the Financial Reform and the Directions of Its Intensification**

Now let us examine in more detail the problems of perestroika in the sphere of finances. What are the first steps of the reform?

First, relations between the enterprise and the state budget have been put on a normative basis.

Second, the conversion of enterprises and the branches of material production to the principle of full cost accounting and self-financing has been completed. The heart and soul of it is the departure from distribution of financial resources on the principle of their apportionment, from nonrepayable budget financing of capital investments and other outlays for the development of production to self-financing with resources earned and with bank credit. These principles will spread to the organizations in the so-called nonproduction branches. Although with certain limitations, of course. For instance, the principle will by and large be preserved that certain types of services are rendered to the public gratis. These are health care and education. But even here budget financing will be tightened substantially.

Third, the line has been projected and a set of financial standards has begun to be introduced into relations among the various levels of the budget system.

These transformations are, of course, being harmoniously linked to expansion of the role of regional administrative entities, soviets of people's deputies at all levels of administration from the rural (settlement) soviet, rayon, city, oblast, and kray to the republic. It has to be emphasized in this connection that this is one of the most complicated components of all the financial transformations in our country, since it is here that the interests of the entire union and of each union republic are intertwined.

Fourth, the financial reform embraces the sphere of foreign economic activity both of the individual enterprise and also of regions and branches and of the entire national economy as a whole.

Transformation of the financial mechanism is not taking place in simple fashion, which is also true of the restructuring of the economy as a whole. The main thing is to

set in motion the process of essential changes in the very structure of finances, in the character of relations between the state budget and economic units.

At the same time, the search for ways to intensify the reform, restructuring, as they say, in the course of the reform, is continuing. As a matter of fact, 3 years ago there was no mention of the transition to taxation of profit, of the issuing of shares of stock, no straightforward plans for establishing leasing relations, for organizing commercial banks. Plans in the area of foreign economic activity were rather modest.

But the actual course of the reform, its first constructive results, and also the slipping of the wheels in certain elements made it necessary to intensify both its principles and also the entire arsenal of specific finance-and-credit instruments.

We would like to examine some of them in more detail.

**Leasing** is a progressive new form of socialist production relations and methods of economic activity. It emerged in the bowels of the capitalist economy and represents a rather high level of development of commodity-money relations. It can be regarded as an advanced form of commodity-money relations. The point is that the emergence of such capital-intensive commodities as, say, computers, machine tools with programmed control, and so on, makes their simple sale inefficient. The greatest benefit is obtained from their use in cases when various consumers have access to them.

Under the conditions of leasing, the exchange value of machines and equipment are not paid for immediately, but gradually, as the commodities are consumed. F. Engels noted this peculiar feature of leasing: "The sale of a commodity consists, as is well-known, of the owner giving its use value and obtaining its exchange value. One of the ways in which use values of commodities differ is that their consumption takes place over differing periods of time. A round loaf of bread is eaten in a day, a pair of trousers is worn out in a year, and a house lasts, say, 100 years. The use value of commodities with a lengthy depreciation period, then, can be sold in parts, each for a certain period of time, that is, they can be rented. When the sale is made by parts, the exchange value is realized only gradually...."<sup>2</sup>

As we go deeper into the political-economic content of leasing relations, we should emphasize that no transfer of ownership takes place with leasing. This was a weighty argument on behalf of leasing relations during the period of the NEP. V.I. Lenin emphasized that the lessee is not an owner. "The lease is a contract for a specified term. Both ownership and control remain with us, with the workers' state."<sup>3</sup>

The first variants of leases concluded between work collectives and enterprises are yielding very appreciable results. We might give just one example. One of the building materials combines near Moscow has been leased. The enterprise was suffering chronic losses. But

in just 9 months of operation under the new conditions the collective has realized more than 850,000 rubles of cost-accounting income, whereas in 1985 it received a subsidy from the state amounting to 100,000 rubles. Productivity at the combine over that period rose 1.3-fold. The results are much the same in other leasing collectives.

The ukase of the Presidium of the USSR Supreme Soviet entitled "On Leasing and Leasing Relations in the USSR," adopted this April, is creating broad opportunities for the development of leasing. Without restating its content, we will note a number of important factors which have a direct bearing on improvement of the financial mechanism.

The chief and fundamental question in leasing relations is correct determination of the rent. Experience shows that this is not a simple problem at all. In practice, there has been great diversity in the system of rents. The connection of these payments to the political-economic content of leasing relations has not always appreciated.

Two components must be the general basis of the rent: they are depreciation deductions reflecting the process of consumption of machines and equipment, and the rate of interest on credit or the rate of the charge on productive assets. Stated more precisely, the sum of the rent over the entire operating life of machines and equipment must be equal to the amount of depreciation and the amount of the charge on assets also computed over the entire life of the lease. For better understanding of this process, we should mention that in extending long-term credit the bank follows the rule of ensuring not only repayment of the loan that has been granted, but also realization of a certain rate of income.

When land and minerals are leased, a third component of the rent has to be taken into consideration—the land rent. It would be a mistake to hope to regulate the entire system of relations of leasing collectives with the budget solely through the system of rent.

The rent reflects only one aspect of financial relations, that is, relations concerning use of machines and equipment. It does not touch at all another equally important aspect of financial relations—the realization of profit or income. That is why it is quite legitimate to use in addition to the rent the taxation of the profit (income) of leasing enterprises.

But then the question arises: What is the advantage of leasing relations over the charge on productive assets? It is evident that these advantages lie in the contractual nature of relations between the entities representing state and economic management on the one hand and work collectives on the other. These contracts are concluded for a lengthy period of time and lay down the mutual obligations of the parties.

In essence, the relations between the state and the enterprise become those of trading partners and are fully cost-accounting relations.

Another advantage of leasing relations is the great independence of work collectives in distribution of the profit (income). But it is important that this independence not be reduced solely to the freedom to pay high wages.

The experience of foreign countries in setting up leasing companies needs to be studied most thoroughly. They play an exceptional role in the benefit that can come from operation of the market for machines and equipment. They might conduct an overall policy concerning the setting of rent on machines and equipment, they can take into account the particular conditions under which the consumer uses the machines and equipment, and they can achieve maximum efficiency of expensive and capital-intensive machines and equipment.

**We also need to dwell on the issuing of shares of stock, which is a new form of securities.** It is significant that shares of stock have begun to be issued on the initiative of enterprises, that is, by work collectives without instructions from above have considered it sensible to invest a portion of their savings in development of enterprises, in expansion of the technical base, in the solution of social problems. There are even now more than 20 enterprises issuing stock. The Lvov Production Association "Konveyer" has displayed particularly vigorous activity in this regard.

In October 1988, the government adopted a decree on the issuing of securities in order to place a strong legal foundation under this activity of enterprises.

Now stock is viewed not only as a new financial form for us. Its content is much broader. It is expected to make our forms of economic management more flexible, since it makes it possible to solve three interrelated problems.

**First**, to make the members of the work collective real bosses in the workplace. They will have dividends corresponding to the profit which the enterprise realizes. This essentially increases the motivation of the work collective to use socialist property efficiently.

**Second**, the issuing of stock essentially strengthens the potential for financial activity. Many enterprises, even those performing well, have a shortage of their own resources for retooling and for rapidly putting a new product into production. The issuing of stock, then, provides an additional inflow of the money the enterprise needs to expand production and to increase the competitiveness of its products.

Stock makes the connection between the level of savings and solving the problems of developing the collective's production and its social amenities tangible to members of the work collective. This is the advantage over deposits in a savings bank, where the savings merge in the general flow of credit resources, become impersonal, and can no longer be monitored by depositors.

And **third**, shares of stock make it possible to determine on a cost-accounting basis the redistribution of resources among enterprises, that is, they serve as a form for

siphoning capital among enterprises to the advantage of those which have been achieving higher end results.

The issuing of stock is a first step toward developing a securities market in our country. It is thought that in addition to stock, bonds will also be issued, including special-purpose bonds.

By contrast with international practice, two types are now being issued in our country. Shares of stock of the work collective, which can be acquired only by workers of a given enterprise. This was done deliberately in order to limit the pursuit of dividends in the early going and to create advantages for members of the work collective in taking part in the distribution of the profit. The second type is the stock of an enterprise. This stock is negotiable, that is, one enterprise has the right to sell it to another enterprise regardless of its departmental subordination.

It is important to emphasize that the system for regulating stockholder forms of management has been reduced to the minimum. For example, the government deemed it inadvisable to establish a firm dividend on shares of stock from above, assuming that the collective itself would set its level as a function of the level of production efficiency, nor is the number of shares of stock that can be acquired regulated. All of these rights belong entirely to the stockholders themselves.

The interest of work collectives in issuing stock is raising a number of fundamental questions to which straightforward answers have to be made. What is the character of ownership by stockholders, and is it necessary to speak at all about ownership by stockholders? The whole matter can, of course, be reduced to the mechanism whereby property is operated, but that would be incorrect. It is not simply the mechanism that is changing, but the essence of socialist property is being essentially enriched, its impersonal nature is being overcome, and at the same time this property is not becoming private property because exploitation is completely precluded.

If the stock-holding form of ownership is recognized as an element inherent in a socialist economy, then a mechanism has to be found for using all the powerful aspects of that form of social ownership.

As enterprises become involved in developing the stock-holding form of management, as they acquire the right to independently determine many parameters of stock-holding activity, they must also master skills in the conduct of commercial activity.

What experience there has been shows that many have been sufficiently thoughtful and cautious in approaching determination of the level of the dividend to be paid on shares of stock, have carefully studied the prospects for development of their enterprise, conduct a comparative analysis of the most important economic and financial indicators in a comparison with the analogous indicators of related enterprises, including foreign trading partners, and take into account the general economic and financial

situation in the country and in its individual branches and regions. All of this makes it possible to work out a rather flexible policy in the payment of the dividend and to show moderation in the early period.

There are also other examples in which very high dividends have been paid—at a level of 15-20 percent. Often they have violated elementary requirements of economic management, such requirements as guaranteeing that labor productivity rise faster than the average wage. In these cases, of course, there can be no question of expanding the financial base of capital formation, and the shares of stock cannot perform the functions for which they were issued.

### The Credit System

I would like to say a few words about changes in the credit system. Experience in the conduct of economic activity has shown that the system of self-financing must include the use of credit as an organic element. Credit not only increases the financial opportunities of enterprises, it also makes it possible to monitor more closely the relation between costs and results and the efficiency not only of capital investments, but also of the entire turnover of material values.

In recent decades, credit has lost many of its constructive functions and has essentially been turned into a variety of financing through appropriation. The principles of credit financing have broken down: that the credit should be repaid, that the credit is for a stated period of time, and that there be commodities to back up the credit. And the main thing is that the relations formed between enterprises and banks were far from those of partners. In order to obtain money in the bank, one had to submit an entire pile of various papers. The bank was not interested in the economic and financial prosperity of the enterprise, and the latter had no sense at all of the usefulness of the bank's activity.

That is why a fundamentally different role is being given to the banks in the new model of our economic mechanism. They are to regulate the entire loan fund in strict accordance with the criteria of the efficiency and profitability of production and motivation to expand one's clientele. Indicators of the enterprise's ability to pay, the realistic prospect that the loans obtained would be repaid to the bank, moved into the foreground.

A strategy for setting up the network of banks was selected so as to give the credit system great flexibility. Here, we can also trace definite stages in the intensification of our approach to the use of credit. In 1987, a system of banks was set up to include the USSR State Bank as the bank of banks—the country's note-issuing center, the principal regulator of credit relations, and also the following specialized banks: USSR Promstroybank, USSR Agroprombank, USSR Zhilsotsbank, USSR Sberbank, and USSR Vneshekonombank. These are also institutions of the state, but they operate in an environment of full cost accounting and self-financing.

Development of the bank reform demonstrated the expediency of creating banks of a new type—commercial banks, joint stock banks and cooperative banks. USSR Gosbank has already registered more than 90 banks. As a rule, these are sectoral banks and less frequently regional banks. They are not subordinate to ministries and departments, they are completely independent. Ministries and departments take part in their work on partnership relations, depositing a certain amount of its subscribed capital or acquiring stock.

The founders of banks may be individual enterprises, institutions, cooperatives, or cooperative alliances, and also public organizations. The management of commercial banks is structured on a democratic basis. The supreme governing body is the assembly of shareholders or stockholders. Commercial banks, just like cost-accounting enterprises, are required to fulfill financial obligations to the state budget. Gosbank and Minfin approved in January 1989 "Procedure for Organizing New Banks in the USSR." The activity of commercial banks is regulated entirely by economic methods. In order to guarantee the stable financial condition of banks and to maintain the liquid structure of their balance, they must meet the requirements of standard economic rates and allowances. Above all, the minimum size of the bank's founding capital has been established: 5 million rubles for the commercial bank and 500,000 rubles for the cooperative bank. So that commercial banks will actively seek additional financial resources and not resort to the easiest ways of obtaining them by attracting resources of individuals, it is provided that the sum of personal deposits attracted may not exceed the size of the founding capital and reserve fund. To protect the interests of depositors, it is provided that the total volume of the bank's obligations related to resources attracted may not exceed by more than 20-fold the commercial bank's own resources or 12-fold the cooperative bank's resources.

A maximum level has also been set on the amount of credit granted to one borrower.

Relations of commercial banks with USSR Gosbank are based on the rate of the bank's legal reserves (5 percent of money resources attracted), which are placed in the fund for regulating the credit resources of the banking system, which is in turn at the disposition of USSR Gosbank.

Banks like Avtobank, the Moscow Investment Bank, Sroybank, and the bank of Tsentrosyuz will be performing the most sizable credit operations.

Just to give an idea of the scale of development of the commercial banks, we can mention the size of their founding capital, which exceeds 1.5 billion rubles. In accordance with their charter requirements, these banks can issue credits in the amount of 30 billion rubles. The functioning of commercial banks will help to considerably invigorate the process of mobilizing uncommitted resources in economic activity and commit them to the credit financing of highly effective measures. With the

help of the commercial banks, resources in the economy will be siphoned more actively over to the production of promising new products. Credit problems of regional and local importance will begin to be solved more rapidly. Competition will begin to develop among banks. And, most important, the bank will become a reliable partner of enterprises and cooperatives. Gradually, the banks will be drawn into solving not only purely commercial problems, but also production problems and problems of social welfare. The boundaries that have existed for decades between production activity and commercial activity will be removed.

I will give only a few examples of the direction in the activity of the commercial banks. For instance, the Moscow Commercial Bank for Innovations "Inkombankinterznaniiye," whose charter capital is 10 million rubles, has set itself the task of financing the creation of highly effective technologies in the area of processing food scraps, storing fruits and vegetables, separating valuable materials and rare earths from waste- and seawater, and the recycling of concrete and reinforced-concrete rubble.

The Tartu Commercial Bank intends to finance the production of personal computers in Riga jointly with Great Britain.

The Moscow Joint Stock Bank for Innovations has outlined a large program of joint projects with enterprises, organizations, and scientific-technical cooperatives of Moscow in developing, building, and manufacturing photoenergy transformers, permanent magnets made from manganese, and aluminum alloy, and precision equipment. This entire effort will be performed on the basis of authors' certificates and developments which have not been used up to now.

Work is now being completed on the Law on Banks, which will create reliable legal conditions for the further development of the banking system.

### **From Payments Into the Budget to the System of Taxation**

**Taxes on personal income.** Restructuring the system of management is essentially enhancing the role of material work incentives and is increasing the differentiation in wages and other worker income. This necessitates a thorough rethinking of the role of personal income taxation. At present, the maximum level of taxation is 13 percent when wages exceed 100 rubles. The present tax system and level of taxation do not allow for greater differentiation in the remuneration of labor, they preserve leveling from the standpoint of individuals who have low and medium-level wages, and this situation seems completely unfair when they pay from their income the same share of tax as individuals who have high income. That is why it is quite legitimate to institute a new system of personal income taxation.

It is first of all a question of reducing the tax burden on population groups with low income, that is, those who

receive wages of 80 rubles, and also to lower tax rates on wages in the range from 81 to 100 rubles. More than 9 million persons will realize a gain from the tax reduction.

Second, it is a question of increasing the progression of taxation on earnings exceeding 700 rubles per month, that is, to introduce a progressive scale of the income tax. That would seem to be fair. But we understand the delicacy of this problem. That is why the scale must be justified, it must not undermine the incentive for work that is highly productive and well-paid.

At the present time, 1.4 million persons receive wages at that level. A rate of 15 percent will apply to the amount exceeding 700 rubles and not more than 900 rubles. The rate will rise to 50 percent on the amount of income exceeding 1,500 rubles. Increasing the progressive rates of taxation will not affect the main body of workers and employees whose wages, as is well-known, average 217 rubles per month. It is important that the new tax rates be applied not only to the wages of workers and employees, but also to the income of cooperatives, including those who work under contract with them.

A special tax status is envisaged for workers working in the regions of the Far North and other localities with harsh climatic conditions. As is well-known, coefficients applied to wages and also supplements for length of service have been introduced in those regions. That is why in these cases the higher rates of the income tax will be applied only to the base wage of this worker category. They will pay tax at the rate of 13 percent.

Thus, fundamentally new approaches to organizing financial relations in the economy have been laid down as the basis for restructuring the financial system, and the requirements of the USSR Law on the Enterprise are the guide to them. Everything that contradicts the letter and spirit of that law is now being resolutely weeded out. Financial priorities have been given to economic initiative, full cost accounting, and self-financing, but under the absolute condition of increasing at the same time the responsibility for the end results of economic activity. In other words, it is a question of basing financial relations on stable standard economic rates and allowances which are not subject to someone's arbitrary decisions and which make it possible for the enterprise to have a clear idea of its financial possibilities.

Today, all the profit which enterprises realize is distributed according to the standard rates and allowances. Previously, about 30 percent of profit was transferred to the state without any standard rates or allowances at all. Every year, this share changed, which made the enterprises uncertain about whether additional efforts to earn profit would be completely absorbed by the state budget. Innovations were held back, and it was not possible to reveal the entire potential for increasing profit.

The standard economic rates and allowances in effect for the distribution of profit reflect the peculiarities of the transitional period and the performance of economic reforms. They have been drafted on the basis of the

5-year plan that has been approved and the planned volumes of outlays for simple and expanded reproduction of fixed capital.

In view of the fact that these costs are individual from one enterprise to another, the standard rates governing distribution of profit have also been individualized. Some economists felt that the 5-year plan should have been changed on the run, rather than deriving the levels of the standard economic rates from the proportions established. But it seems to us that it would have been very difficult to do that from a technical standpoint, and it would have required revision of direct ties and contracts already established between enterprises.

Two principles have been made the basis of payments from profit (income) into the budget. One consists of taxing the factors in the growth of profit—productive capital and labor resources. The charges for productive assets and labor resources are among payments of that kind. The principle of normative regulation of the size of profit and income operates alongside that principle.

The question arises: To what extent does the present system of payments into the budget from profit motivate work collectives to constantly increase production efficiency; does it not contradict the course that has been plotted toward extensive development of commodity-money relations and the socialist market?

If we are to find an answer to that, serious attention should be paid to the experience with taxation in the socialist and capitalist countries, where the level of development of commodity-money relations is far higher than in our economy. That is why it is quite legitimate to study the experience of those countries with taxation.

In 1988, a group of specialists and scientists visited Hungary, Italy, West Germany, France, and Canada in order to study the methodology of tax regulation of the economy, to discover everything that could prove to be useful to our country. We are, of course, far from thinking that we can transplant directly elements of one economic system to another. But everything that is acceptable to us and promotes the development of socialist principles of economic activity can be used in modified form.

There is at present a lively discussion among specialists: On what foundations should the relations of enterprises with the budget be built in the future 5-year plan? Proposals are being advanced: to give up the charge on productive assets and build taxation on the basis of balance-sheet profit, with the charge for labor resources and natural resources included in the production cost of the product.

It does not seem that the charge on productive assets has outlived its usefulness. In the context of normative distribution of profit, the charge on assets has been given a real channel for having an impact on the motivation of enterprises to make better use of productive capital.

Previously, the enterprise was indifferent to the saving on resources because the benefit achieved thereby was drained off into the budget as additional profit. The picture is changing radically in the context of normative distribution of profit. The saving on the charge for assets is directly reflected in the size of the enterprise's net profit. A number of other arguments can be given to support preservation of the charge on productive assets.

The main thing is that the socialist enterprise, as the possessor of public property, must compensate the state for outlays to reproduce fixed capital and guarantee that the state obtains a minimum rate of benefit from the use of that capital. At the same time, in the new economic mechanism a number of factors have arisen which operate toward gradual displacement of the charge on assets with forms of economic regulation that are more advanced and profound in their content. The reference is first of all to the extensive development of long-term credit, to leasing relations, and also to intensification of the principle of self-financing, to the development of stock-holding forms of management. State property does not, of course, disappear or dissolve in those forms, it becomes richer in its internal structure.

It should also be taken into account that the level of development of market relations is now at a level where the regulatory functions of the market in measuring the efficiency of the various factors of production and development are still extremely inadequate. That is why we have to have a system of economic regulators that would bring the socially necessary requirements up to the level of efficiency of all the factors of production.

While preserving during the 13th FYP the principles of the charge on resources, at the same time we need to radically change the system of standard rates used for drawing profit off into the budget. The transition needs to be made from individual rates to taxation of the enterprise's net profit. Production costs might at the same time be included in the charges for resources. The tax rates must be as uniform as possible, although we cannot do without a certain differentiation at first. Tax scales have to be worked out as a function of the level of profitability of production or as a function of the amount of profit.

### Factors for Augmenting Financial Resources

As is well-known, financial resources are the subject matter of financial relations. The task of restoring finances to health, then, comes down to maximum possible expansion of sources for the growth of financial resources. Moreover, in the context of full cost accounting and self-financing of enterprises and the strengthening of the financial base of the union republics, the recovery of the union budget cannot occur at the price of weakening the finances of enterprises and republics. That is why true restoration of finances to health must include a comprehensive program for the effort to increase financial resources at all levels of management of the economy.

Sources of finances are incorporated in the value and money "membrane" of the social product and the national income. This "membrane" is quite appreciable and is expressed in quantitative terms in the levels and dynamic behavior of financial resources. Their formation and use are closely bound up with the gross social product.

We should mention that the principal sources of financial resources are profit, the turnover tax, depreciation, income from foreign economic relations, proceeds from individuals in the form of insurance premiums, taxes, lotteries, and so on. One portion of financial resources is formed in the process of material production, while the other is formed in the sphere of redistributive relations.

The fact that financial resources are growing faster than indicators reflecting the growth of the physical base of reproduction indicates an increase in the share of money resources accumulated in the process of redistribution.

The correlation of financial resources with the dynamic behavior and structure of social production makes it possible to refine the approach to financial recovery. Its most important indicators are the formation and use of financial resources and of their individual elements.

The purposes, tasks, and pathways of financial recovery must take into account the specific nature of factors for the growth of financial resources at various levels of management. At the national economic, regional, and branch level, the structural factor has exceptional importance; that is, in defining the policy of distribution of capital investments and labor resources we need to consistently take into account differences in the level of the indicators of the output-capital ratio, the rate of turnover of working capital, profitability, and the productivity of labor.

Yet at present the investment program of the national economic plan does not take into account the limited nature of the volume of financial resources and the level of financial return of the various branches and sectors. This is one of the main causes of financial strain in the economy. For example, in light industry 1 ruble of fixed capital produces about 4 rubles of output, or 3-4-fold more than the average for the industrial sector; the turnover period for working capital is about 78 days, or 3.8 days less than the average; and the output per worker (in wholesale prices not including the turnover tax) exceeds average output in the industrial sector by 7 percent, and if the turnover tax is included, it is 1.4-fold greater.

It is also important to take into account here that the products of light industry represent approximately a third of retail sales. While it has this relatively high financial return, this branch at present receives 3.3 percent of all capital investments for its development.

That is why it is a priority task of the 13th FYP to speed up the development of branches that satisfy the effective demand of the public. Guaranteeing the balance between supply and demand by improving physical proportions

opens up the way to normalization of the circulation of money and to increasing the purchasing power of the ruble.

It would, of course, be incorrect to reduce the task of financial recovery solely to improved linkage of the supply and demand for goods and services on the basis of accelerated development of light industry. The structural factor in financial recovery is far broader; it also includes other intersector and intrasector proportions.

Where should the effort at financial recovery of enterprises and branches begin?

First of all, there is a need to set up a comprehensive analysis of the financial condition of enterprises, ministries, and departments. Financial indicators have to be on a par with production indicators. Today, a majority of managers in the economy recognize the principal financial indicator—profit. At the same time, many do not have a good understanding of this indicator's anatomy. Profit, after all, is one of the most multifactor indicators. If the dynamic behavior of profit is to be managed, attention has to be centered not only on production indicators like the volume of production, the structure of output, production cost, and quality, but also the commercial aspect of one's operation, reduce unproductive expenditures and losses, delinquent indebtedness to suppliers and banks, above-allowance inventories, operation at a loss, etc.

Restoring health to the enterprise's balance sheet is among the priority measures of financial recovery. Relying on the rights extended by the Law on the Enterprise, it needs to clear from its fixed capital, its material and technical base, equipment that is unnecessary, superfluous, obsolete, and physically worn-out, and sharply reduce major repairs, which are ineffective. Capital assets become factors working for the stability of the enterprise's economy only when they are periodically renewed on the basis of integrated application of progressive new technology and equipment.

One of the most important directions in the effort for financial recovery is to increase the efficiency of the use of working capital. The state of the use of working capital probably reacts more sensitively than any other indicator to discontinuities in the organization of production, its smooth flow, and also to disruptions in partnership relations among enterprises and their observance of contract discipline. Here are some figures on how sensitively the factor of the rate of turnover affects financial condition. Physical working capital amounts to 470 billion rubles, and a 1-day acceleration of its turnover affords a saving of more than 4 billion rubles. Plans call for obtaining 20 billion rubles in the current 5-year period by speeding up the rate of turnover of working capital.

In the old economic mechanism, there were many obstacles along the road to optimum use of working capital. There were rigid barriers between fixed and working capital that restrained a siphoning of funds between

these two components of productive assets. By contrast with fixed capital, there has been no straightforward system for the financing of working capital, the scale of credit financing of working capital has been expanded artificially, and the credit has been spent to support permanent needs for working capital, that is, for those outlays for which the enterprise's own resources are intended. It has been a widespread practice to replenish working capital that has been spent out of the resources of enterprises performing well.

In the new economic mechanism, both fixed and working capital (and the growth of own capital) are financed out of the fund for development of production, science, and technology. Some economists feel that multipurpose use of the fund for development will result in working capital being "eaten up." But the conversion of enterprises to self-financing does not confirm the soundness of those fears. On the whole, the working capital situation continues to be a bottleneck in the financial operation of enterprises and ministries. For example, in 1988 its shortage was 600 million rubles in the fuel and energy complex and 500 million rubles in machinebuilding.

The insufficient mobility and shortage of financial resources are largely associated with diversion of funds into above-allowance inventories of merchandise and supplies. In industry alone, they amounted to 27 billion rubles. The growth of stocks of uninstalled imported equipment is a striking fact. And this is occurring when the country's foreign exchange resources are extremely limited and there is an acute need for highly productive equipment. The psychology of wangling limit-allowances and allocations "as a reserve" for any contingency is proving to be more powerful than the economic levers which are supposed to motivate enterprises to use physical resources efficiently.

Large unproductive expenditures and losses are one of the factors in the financial instability of enterprises and of ministries as a whole. Penalties for violation of delivery contracts comprise a sizable portion of the losses. In 1988, 23 percent of enterprises did not fulfill contractual obligations and for that reason paid about 4 billion rubles in fines. Adoption of the new procedure for making up losses, which was envisaged by the Law on the Enterprise, and the payment of fines, forfeits, and other penalties out of cost-accounting income has shown how substantially financial results depend on unproductive expenditures. There are quite a few enterprises which have fulfilled the plan for balance-sheet profit and yet have had a shortage of funds to form economic incentive funds because they paid large penalties for violation of contracts. At the same time, in a number of sectors of the economy—in trade, material and technical supply, the electric power industry, and transportation—enterprises have shown a steady interest in earning cost-accounting income not by improving their principal activity, but on the basis of penalties. This is not a simple phenomenon. The positive thing is that the parties to a contract are watching more closely each other's performance, a taste

for the commercial aspect of economic activity is being acquired, but there is also some exaggeration in the commercial direction, an oversimplified understanding of its essence, the producer's monopoly has not yet been overcome by any means, and the consumer is forced at present to be satisfied with what he can get at the particular time.

How is this problem to be solved?

First of all, new standards have been adopted to serve as the basis for determining the amounts of penalties. They are more reasonable, they do not build up excess profit, but are called upon to reimburse the direct loss. It should be taken into account here that their impact on cost-accounting income is far greater than on balance-sheet profit. In the distribution sphere and also in certain production branches it is probably advisable not to credit the entire difference between fines collected and paid to cost-accounting income, but only a part of it, while the other would go to centralized funds to carry out measures related to financial recovery.

Getting out of the red is an important direction in financial recovery. Many managers in the economy have become accustomed to operating at a loss, a psychology has been formed which takes operation at a loss for granted, this is based on a lack of confidence in the possibility of solving this problem and underestimation of the role of the financial direction of the enterprise's activity and of the importance of profit in a socialist economy. Lenin's principle about the incompatibility of cost accounting and operation at a loss has been forgotten. He wrote: "I think that the trusts and enterprises have been founded on cost accounting precisely so that they will take responsibility themselves and at the same time will be fully responsible for operation of their enterprises without a loss.... If in setting up the trusts and enterprises and cost accounting we are unable to fully safeguard our interests in a businesslike way and the way a merchant would, then we turn out to be utter fools" ("Poln. sobr. soch.," Vol 54, pp 150-151).

The departure from Leninist principles of socialist economic activity is the principal reason for the large-scale losses that have become deep-rooted in our economy. In 1988, about 13 percent of enterprises in the industrial sector alone, or more than 4,000, were operating at a loss, and the aggregate amount of losses was about 4 billion rubles. The share of enterprises operating at a loss is far higher in such branches of industry as timber and lumber, woodworking, building materials, and fertilizer—between 19 and 25 percent of their total number.

In certain union republics, the share of enterprises operating at a loss is not only not decreasing, but is in fact increasing. This is occurring in AzSSR, KiSSR, and GSSR.

We must also mention the constructive experience in the organization of the effort to eliminate operation at a loss. For instance, in UkSSR, BSSR, LiSSR, and LaSSR the

share of enterprises operating at a loss dropped to less than half between 1981 and 1986.

For example, the program for elimination of losses drafted by the Production Association "Atomash" made it possible to reduce losses by 31.5 million rubles in 2 years and by 1990 to start operating altogether without a loss.

The experience of the Krasnodar Worsted Fabric Combine is instructive. The people there correctly understood that there can be no self-financing or financial recovery without a radical change in the attitude toward losses. In a short time, the combine settled delinquent indebtedness to the bank, which at the beginning of the year was 2.4 million rubles. This was achieved by fully taking into account the demand of consumers, by cutting back the output of solid-color fabrics which were not selling, and by increasing the output of multicolored fabrics and updating 25 percent of the product line.

Another example. The Vologda Fittings Plant of Minkhimmash became profitable in less than a year by improving attainment of capacity at new plants.

But it has to be noted that in many ministries and regions of the country the effort to eliminate losses is a formality, an old and tested method is frequently used—merging the profitable enterprises with those operating at a loss in the absence of the necessary scientific-technical and economic justification for that action. And sometimes measures are envisaged for elimination of a losing operation which knowingly cannot be carried out.

For example, the Association "Chimkentshina" of USSR Minneftekhimprom showed a loss for 1981, that is, from the moment it went into operation. More than 200 million rubles have already been spent to cover its losses, or nearly half of the cost of this plant, and the technical level of production and the organization of work remain essentially the same.

Measures aimed at financial recovery must be performed on the basis of the enterprise's own financial base. The question might arise: Where are those funds to be found? An analysis shows that all sectors of the economy possess reserves running into the many billions, which if put into circulation will make it possible to cover the financial gaps. Above all, we must be quite clear on the point that production activity cannot be carried on properly in a bad financial situation.

Under initial starting conditions it is important in the use of one's accumulated funds to give priority to equalizing the financial situation. Elementary order first has to be brought about in settlements and payments, expensive outlays have to be foregone, and measures have to be drafted to increase profit. The new economic mechanism creates the necessary prerequisites for that maneuver. For example, 70 percent of additional profit exceeding the assignments of the 5-year plan may now be left at the disposition of the enterprise. Enterprises whose managers understand the immense importance of

their financial situation are using this additional profit like good stewards—they are committing it to eliminating the causes of financial instability, while others are investing resources in major reconstruction for which the physical resources have not been secured, nor the capacity of construction organizations, and they are thereby detracting from their own financial situation.

Of course, it is not always possible to get out of a financial bind with one's own resources. In these cases, financial aid is possible on commercial terms when enterprises assume obligations to perform specific measures for financial recovery. It is advisable in this connection to create a centralized financial recovery fund. A special mechanism needs to be developed for that fund's operation, and it should not be reduced to the traditional releasing of funds, as is done in budget financing. The disbursers of the fund might make a kind of diagnosis of the enterprise, determine the causes of its difficult financial situation, and draft recommendations for its stabilization.

Another strategy for financial recovery which would be expedient is the attraction of funds from workers on a voluntary basis (in the form of shares of stock and bonds) for fundamental renewal of the enterprise's production plant, facilities for social and employee welfare, and its material and technical base. This is not our customary strategy, but it is quite possible, and some enterprises have already taken this road. This will be advantageous to every worker and for production, since effective application of personal savings yields a certain income, and its use in the context of self-management is under the eye of the work collective.

### **Finances in the New Model of Foreign Economic Relations**

The present-day socialist economy cannot exist out of touch with new trends in the international division of labor, out of touch with the foreign exchange and financial mechanism of the world economy that is developing. And perhaps the most important thing is that today it is not possible to solve the problems of increasing product quality and speeding up renewal of the product mix without our enterprises being involved in the competitive struggle on the world market.

If we look back at the seventies, at that time the very posing of such goals seemed absurd and impossible. The point is that essentially different conditions of trade are taking shape in the eighties, and they demand a reorientation of our entire foreign economic strategy, a restructuring of the entire mechanism of foreign economic relations. It is essentially a question of shaping a new model of both the foreign economic activity of enterprises and also of the foreign economic activity of ministries and departments, which play an important role in shaping the structure of exports and imports.

What do we have in mind when we refer to the new model of foreign economic relations?

Foreign economic activity generates a sizable portion of the revenues of the state budget. This share is approximately 13 percent, or 60 billion rubles per year. Previously, these were mainly revenues from the sale of fuel and energy. But the dynamic behavior and proportions of world prices in the eighties have developed in such a way that a limit has been put on the growth of income from the sale of petroleum, gas, and other products of the fuel and energy complex. And it is quite natural that the task of reorientation of our exports toward the products of the manufacturing branches of industry should now be advanced to the foreground.

We are getting away from the monopolization of foreign trade in stages. In 1986, more than 70 large enterprises acquired the right to carry on foreign economic activity, and many foreign trade associations moved from the Ministry of Foreign Trade to sector ministries.

The number of enterprises with their own foreign trade subdivisions has been gradually expanding. At the end of 1988, a government decree was adopted which essentially removed all restrictions from the conduct of foreign economic activity by enterprises of all kinds. Every competitive enterprise that set itself the goal of delivering products for export can create its own internal subdivision for that purpose or carry on foreign economic activity with cost-accounting foreign trade associations on the basis of contractual commercial relations.

To do this, it has to register with the Ministry of Foreign Economic Relations or the USSR Chamber of Commerce and Industry. But that is insufficient, a license has to be obtained. Licensing is being introduced in order to preclude unscrupulous competition among domestic enterprises and also cooperatives on the foreign market and to prevent possible damage to the interests of the state on that account.

The indifference of our enterprises toward expanding exports of products has been largely related to the fact that their profit did not reflect at all the results of foreign economic activity. This may, of course, seem strange, but that is exactly how it has been.

Today, enterprises which sell products on the foreign market collect for them in foreign trade prices, and then they convert their foreign exchange results by means of foreign exchange coefficients and form their total profit from the sale of products on the domestic and foreign markets. It is very important that enterprises are now creating foreign exchange funds. Deductions to them are made at differentiated rates. For enterprises under republic jurisdiction, the following procedure has been established for the distribution of foreign exchange proceeds: 30 percent goes to the state budget, 70 percent to the disposition of the republic, including 28 percent to the council of ministers of the union republic and 42 percent directly to the enterprise. In the aggregate, the size of foreign exchange funds converted to our currency already amounts to 3 billion rubles. Enterprises now

have the right to purchase independently the products they need on the foreign market out of their own foreign exchange deductions.

Opportunities for the use of resources from foreign exchange funds are expanding essentially at the present time. By decision of work collectives, the resources of these funds in transfer rubles and also in the national currencies of the CEMA member countries may be committed entirely to the acquisition of consumer goods, medical equipment, and to the strengthening of the material and technical base and social and cultural sector, while in the case of convertible currency up to 25 percent of the total amount may be committed to these purposes.

The organization of joint enterprises with foreign countries is a new form of foreign economic activity. It must be said that the creation of these enterprises is proceeding rather rapidly; whereas at the beginning of April 1988 the Ministry of Finance had registered 43, in April 1989 it had registered 404 joint enterprises with almost 1.5 billion rubles of capitalization, 500,000 rubles representing the share of the foreign participants. Sixty-two enterprises were created with partners from the CEMA member countries, 344 with firms of the capitalist and developing countries, and 7 mixed firms. The largest number of joint enterprises was created with firms of West Germany—62, Finland—52, Austria—26, Italy and the United States—30 each, France and Switzerland—18 each, and Japan—9. The financial mechanism of these subdivisions was structured so as to take into account worldwide experience of both the socialist and capitalist countries. To what are we referring? First of all, taxation. By contrast with our practice, in which the average industrial enterprise transfers almost 50 percent of profit into the budget, joint enterprises pay a profit tax at the rate of 30 percent, and at the same time profit which they transfer to the reserve fund and to investment funds intended for development of production, science, and technology is exempted from taxation.

At the same time, the study of international practice is continuing so that the tax mechanism creates a regime that is sufficiently conducive to the attraction of foreign capital.

In discussing the specific features of the new model of foreign economic relations, we cannot overlook the problem of the **convertibility of our currency**. This question is now being taken up at various levels. Financial experts, enterprise directors, and government officials are all taking part in the discussion. Which is understandable. Solving this problem unquestionably makes our economic mechanism more flexible, making it possible to solve more responsively many problems of international economic cooperation and to move more quickly along the road of East-West relations. But the problem of convertibility cannot be solved in a single leap. The currency is a part of the monetary system, and the monetary system is a part of the entire socialist economic mechanism, and, of course, the level of development of commodity-money relations, the character of the relationship between the plan and the market, and

the degree of integration of the processes of planned management and processes shaped as a function of market tendencies, dictate their own logic of an approach to solving the problem of convertibility. It is clear that strengthening the role of commodity-money relations and the socialist market creates the objective conditions for step-by-step movement along the road of achieving convertibility of our currency. Just as it is impossible to make the transition from one economic state to another, from one type of economic mechanism to another, by an instantaneous act, so it is impossible to create the fully developed system of a socialist market and make the currency convertible in an instantaneous act, without purposive preparation. But it is also true that unless we set ourselves the task of moving toward that goal, we cannot pull the monetary-and-financial system out of the slump, and unless it develops, it is difficult to achieve appreciable results in renewing the technical base of our production and in making our products competitive.

The basic principles of the radical restructuring of management of the economy, approved by the June (1987) Plenum of the CPSU Central Committee, pointed out concerning the finance-and-credit mechanism that particular attention must be paid to increasing the purchasing power of the ruble and to step-by-step achievement of its convertibility, first of all within the framework of CEMA.

At the same time, we have to purposefully bring about the prerequisites that make it possible to achieve ruble convertibility. What are they? The most important is **strengthening the purchasing power of the ruble on the basis of greater balance between the supply of and demand for goods and services**.

Today, in many cases, money is moving ahead of the commodity as it were. The unearned ruble is flourishing on a considerable scale. A regime has to be created in which money is difficult to earn, which in and of itself is no simple matter at all. It seems above all to require observing the simple rule: increase the remuneration of labor to the extent of the rise of labor productivity and the quality of work. Social welfare payments, just like the remuneration of labor, must have real commodity content. This requires quite significant structural changes in the economy, an essential rise in the share of goods and services satisfying the effective demand of the public in the total volume of production of industrial products. Today, the share of consumer goods and services in our country is 25-26 percent of the volume of production, while in such countries as the United States, West Germany, and Japan that share ranges between 30 and 35 percent or higher.

The level of effective demand of the public, which relies on the stable dynamic behavior of personal money income, has risen, thereby raising major problems for our entire economic policy, forcing us to look in a new way at the approach we have taken in the past to forming so-called progressive proportions of social production. It

is clear today that the proportions in reproduction may not be progressive in and of themselves when they are not related to the state of the domestic market. It is, of course, necessary to speed up the development of machinebuilding. And that course is correct. But it is not possible to examine the problem of accelerating the development of machinebuilding apart from the extent to which that acceleration promotes an increase in the production of consumer goods and creation of an up-to-date sphere of consumer services.

Why is the task of strengthening the circulation of money being put first as the most important prerequisite for achieving ruble convertibility? First of all, as we have already said, the foreign exchange system is a part of the economy's monetary system. The domestic monetary system cannot be strong unless the currency is stable. And it is equally true that world recognition of the strength of our currency requires stabilization and improvement of the internal circulation of money.

Second, the convertibility of the currency, that is, its exchangeability for other currencies, depends on the ruble's rate of exchange. The exchange rate of the ruble itself experiences the influence of the competitiveness of the economy to an essential degree. In order to maintain the high purchasing power of the ruble, the economy must be competitive over a sufficiently broad range of consumer goods. If our competitiveness is judged not only by blue jeans and sound consumer goods, but includes a broader range of goods, then, of course, the unjustifiability of many assessments of the exchange rate of the ruble will be clear. Of course, the present exchange rate of the ruble needs an essential change, and its review has been scheduled for the beginning of 1991.

At the present time, we have a sufficiently high competitiveness for goods in the fuel and energy group and a lower competitiveness for the products of machinebuilding and a still lower competitiveness in the production of consumer goods.

There have been quite a few proposals in the press on adoption of convertibility on the basis of a monetary reform or creation of a regime in which two currencies would function. What is meant here by a monetary reform is essentially a system of exchanging and withdrawing excess money. This approach is justified from the positions of the "people's" economy and social justice, with the argument that unearned money constitutes a large portion of personal money resources. The sources of this approach are deep-rooted in the ideas of leveling communism—in the desire to solve in a single sweep the complicated problems of the circulation of money.

In discussing the question of the advisability or inadvisability of carrying out a monetary reform, we need to take into account our own experience in conducting them at the end of the nineties of the last century and also in the twenties of this one. An analysis has shown that they were carried out in an extraordinary economic

situation, but they had been thought through and constituted a portion of measures to restore health to the economy, to finances, and to the circulation of money. For example, the monetary reform in the period 1895-1897 in Russia (carried out under the guidance of S.Yu. Vitte) was preceded by more than a decade of purposive effort to achieve balance in the state budget, to completely overcome its deficit (the raising of taxes, institution of the state wine monopoly, and so on), to build up gold reserves, to invigorate foreign exchange policy so as to halt speculation with the ruble on the external market, to attract large foreign loans, to establish protectionist tariffs, and to achieve equilibrium in the balance of payments. Over a period of 16 years (1881-1897), the total surplus of exports over imports was 2.6 billion rubles, which was achieved on the basis of a deliberate effort to boost exports. Thus, the prerequisites were created for a moderate devaluation of the ruble. The ruble's gold content was dropped by one-third. A sufficiently inflexible connection was established between the issuance of bank notes and their gold backing, and a ban was introduced on the use of bank notes to "bail out the treasury," that is, to cover the budget deficit.

The profound economic purport of this reform was that it served as the basis for an essential expansion of resource capabilities for development of heavy industry by attracting foreign capital (on the basis of joint stock ownership).

The monetary reform in the period 1922-1924, to which the greatest contribution was made by G.Ya. Sokolnikov, who headed Narkomfin, was in many respects similar in its basic elements to the monetary reform of S.Yu. Vitte. To be sure, we should note the very pronounced extraordinary character of the economic situation. For instance, from November 1917 to 1921 the quantity of money grew 76-fold, and commodity prices rose 93.6-fold. The reform was based on a firm policy of reducing state expenditures, expansion of trade between city and country, conversion of enterprises to commercial accounting, the multidirectedness of the economic structure, establishment of a limit on note issue, conduct of a flexible state income policy, and creation of a foreign exchange market. In both reforms, the emphasis was put on strengthening the gold content of the ruble. A peculiarity of the monetary reform in the twenties lay in the parallel circulation of two currencies during the year—the old sovznak and the gold chervonets. Here, the gold chervonets was issued within the rigid limits of the needs of economic turnover.

The internal dialectics of the circulation of money in the twenties is sometimes essentially oversimplified. However, the objectives of economic policy, which were to develop large-scale industry, required a search for sources of accumulation, and, it must be said, the rigid monetary policy did not stand up to the pressure of industrialization, the desire to speed up the process of capital formation. Soon, they began to resort once again to note-issuing methods of financing capital investments out of the budget on a rather broad scale.

A most important prerequisite of convertibility is expansion of the **economy's export potential**. It is probably difficult to create an economy that would have a high exporting capability for all commodity groups. With all due respect for the justified criticism of the raw materials orientation of exports, it must be taken into account that it has not only guaranteed that the state would realize a sizable portion of its revenues, but for a long time it served as the basis of strength of the country's balance of payments.

Now we need a new and better devised system of measures to invigorate exports in machinebuilding and in the production of other science-intensive products. We cannot rely solely on the ability of individual enterprises and on the creation of joint production operations. We need national priorities in the building of plants for the production of products for export. Likewise, we cannot lose sight of the solution of that problem which is the most realistic for us—freeing ourselves of the outlays of foreign exchange to purchase grain and also metal. In the immediate future, this is the shortest road toward stabilization of the country's balance of payments and reduction of foreign exchange indebtedness. Both the agroindustrial and metallurgical complexes possess sufficient potential to increase the production of high-quality products needed for the external market.

To improve the balance of payments, we need to activate an entire system of factors influencing both the inflow of foreign exchange through expansion of exports and also limitation of outlays of foreign exchange which are ineffective or not very effective.

**Development of equivalent commodity exchange** is an indispensable condition of convertibility. This requires that internal proportions among wholesale, purchase, and retail prices correspond to the proportions of those prices on the world market. We cannot have an objective exchange rate of the currency that would reflect on the external market both the interests of the seller and also his purchaser without taking world price relations into account.

In the context of the growth of the country's external debt and the greater complexity of achieving equilibrium in the balance of payments, it is very important to guarantee maximum effectiveness in the use of the credits obtained from foreign banks. National priorities must be clearly viewed in terms of improved coordination of credit policy. And probably the most important thing is that credits have to be used with maximum return within the country until we manage to solve the problem of efficient use of imported equipment. It is sufficient to say that uninstalled imported equipment is continuing to pile up and amounts to about 5 billion rubles.

Tariff policy must promote equilibrium in the balance of payments. The tariffs that now exist are outdated. They are not performing the functions of regulating the USSR's foreign economic relations. Duties do not influence the choice of economically more effective imported goods, and for that reason they are not having any impact on import policy. The new tariffs would be

expected to promote optimalization of the structure of imports and more optimum expenditure of foreign exchange. They must protect domestic production against foreign competition wherever this is absolutely necessary or create the conditions for greater rivalry among domestic producers in order to make our products more competitive.

Purposive movement along the road of creating a convertible currency requires a radical change in the present tradition with respect to international monetary and financial organizations.

Creation of the prerequisites for convertibility of the currency does not preclude the possibilities of **achieving partial convertibility at the present time**. We are referring to partial convertibility as a most important condition for intensifying development of the process of economic integration with the CEMA member countries. The 43d session deemed it advisable to use the national currencies of the CEMA countries for mutual settlement, above all within the framework of direct relations, joint enterprises, and other new forms of economic cooperation. Currency auctions serve as a most important form of this convertibility. We are referring to the creation of a foreign exchange market. The point is that foreign economic activity of enterprises contributes to the earning of foreign exchange by virtue of effective exports. The creation of foreign exchange funds by definition makes it possible for enterprises to buy and sell foreign exchange from one another. It is advisable that this trade take place both directly between enterprises on mutually beneficial terms and also through the holding of foreign exchange auctions.

## Conclusion

If we try to summarize the basic changes in the finance-and-credit mechanism, then our attention would turn above all to the fact that its restructuring, beginning with purely external forms of its functioning, is more and more growing to become the building of substantial new foundations of that mechanism. At present, these changes are still not systematic or comprehensive enough. The finance-and-credit transformations are still not such as to constitute a reform. That reform, just like the reform of the entire economic mechanism, is in the formative stage.

Further steps along the road of invigoration of this reform must be based on a sound analysis of the results achieved, on a study of the influence of the effectiveness of its particular elements on the interests of enterprises, and on the end results of their activity. There is a need for a critical analysis of the methods and forms of operation of central economic departments, on whom activation of the entire economic mechanism largely depends. It is a question of how competently administrative management has been organized, whether specialists of these departments have managed to master economic methods of management, and whether the scientific foundations are sufficient for working out the normative parameters of economic regulation. There is a

real need for theoretical simulation of strategies for carrying out the economic reform and of its nucleus—finances and credit.

The conversion of enterprises to full cost accounting and self-financing has had a favorable effect on the dynamic behavior of profit, the rise of labor productivity, and the reduction of production costs. For industrial enterprises operating since 1988 under the new economic conditions, labor productivity has risen 5.7 percent as against 3.6 percent at those not converted, production cost has dropped 0.96 and 0.46 percent, respectively, and the growth of profit has been 10.8 and 7.8 percent, respectively.

The process of getting rid of surplus manpower has intensified at those enterprises. At the same time, a qualitative change of direction has not occurred in the activity of enterprises. Scientific-technical progress has not become the basic factor in the development of enterprises.

There is a very great aspiration to realize profit by hiking up prices, by rinsing out the inexpensive elements in the product mix, and for that reason there is a need for a fundamental analysis of the foundations of the functioning of the socialist economy.

If 4 years ago we had thought about where the transformation of the economic mechanism should begin and had correctly determined that perestroika as a whole should begin with strengthening the role of the primary unit, with expanding its independence, then now the question would be different: In what direction should perestroika of the economy develop further?

The course of the reform has shown that the intensification of economic methods in the context of the imbalance of the economy in physical and value terms leads toward higher inflation. The key problem of socioeconomic development as a whole is the problem of balance

in all its aspects; moreover, achievement of financial balance is impossible without physical balance. At the same time, it is not possible to harbor illusions that it is possible to achieve physical balance without the restructuring of pricing and invigoration of commodity-money relations and a socialist market.

Smooth adjustment of the country's overall circulation of money plays an exceptional role in guaranteeing balance between the physical and value proportions of economic development. The movement of money flows must accurately reflect the movement of physical values in the economy.

In concluding, we need to emphasize once again that traveling along the road of carrying out a really radical economic reform on the basis of intensification of market methods of regulation and restructuring of the finance-and-credit system, we need to work on the specific aspects of structuring that system, giving due consideration to every aspect. That task is not within the power of individual scientists and specialists. It is not even within the power of economists or legal experts, philosophers or political scientists and sociologists. Only by joining efforts is it possible, by creating the respective working groups consisting of specialists and scientists, to eliminate the discrepancy that has come about in the economic mechanism and to move forward more effectively along the road of carrying out the economic reform.

**Footnotes:**

1. K. Marx and F. Engels, "Soch." [Works], Vol 26, Part II, p 608.
2. K. Marx and F. Engels, "Soch.," Vol 18, p 266.
3. V.I. Lenin, "Poln. sobr. soch.," Vol 52, p 193.

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