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Defense Conversion — Four Views

On 2 October, a group of Soviet economists, Vladimir Faltsman, Gennadi Kazakevich, Aleksei Makushkin, and Zurab Yakobashvili spoke on the USSR's conversion of large portions of the military to a civilian economy.

Difficulties and Expectations

The first speaker, Vladimir Faltsman, concentrated on the difficulties involved in conversion: what can we expect from the move from a military to a civilian economy? Expectations must not be too high, he cautioned; the economy is not yet able to cope with many aspects of conversion. For example, there is the question of markets and demand for civilian products. Who decides how much of what to produce? No mechanism exists to determine this. How realistic is the plan for conversion? Military factories are a heavy industry, specifically designed for military hardware. Converting them to produce civilian goods will be expensive, and Faltsman calls the idea wishful thinking.

An example of wishful planning gone bad is the telephone service. The government had planned that by 1990 there would be one telephone for every person in the USSR. However, as of now there are only 30 telephones for every 100 families. This is not a good indicator of future success.

Pointing out further difficulties, Faltsman noted that the level of foreign and domestic investment is low. The capital base is too small to support a major conversion of factories. One requirement for heavy investment is a free market economy. The USSR's first major step to a successful open market must be the conversion from a military to a civilian industrial base. This catch-22 will prove difficult to overcome.

Reactions and Possibilities

Gennadi Kazakevich explained the difficulties in predicting the economy's reaction the conversion. Since all macroeconomic models have changed over the last five years, it is impossible to measure things like growth. While Soviet planners understand the benefits of a conversion, many doubt that it will be successful.

The three most important factors in the conversion are: 1) raw materials and capital goods, 2) "final consumption goods," and 3) military production. It is impossible to create accurate econometric models to predict what will happen to these three areas. The problem that begs resolution is resource allocation. Should all resources released by the conversion be turned directly to production of "final consumption goods," or should this so-called peace dividend be used as capital investment in facilities that will eventually produce such goods? If all resources are used for immediate production, there will be few shortages now, but a weak industrial base in the future. On the other hand, if all resources are committed to civilian industrial development, there will be the usual grave shortages now (only 2% growth), but the potential for a strong industrial base in the future.

Both problems must be addressed. The Soviet economy must diversify and be transformed. Individual factories' autarky must end; they must stop making every single part of the final good they produce. Communication among industries must improve. The state must relinquish control of the economy, a question still not decided.

The process, says Kazakevich, has at least begun. Industries in both the military and civilian sectors are trying to establish independent enterprises for purely civilian goods, unattached to military production. One Leningrad arsenal that makes military and civilian goods is now trying to produce a larger proportion of consumer goods. But consumer goods are less profitable, and the arsenal, faced with an economic crisis, asked the ministry if they could sell their civilian goods independent of state price controls, only to be refused. They attempted to become a cooperative, but were again turned down. Since Leningrad is attempting to become a free economic zone (not unlike Hong Kong), the arsenal is supported by the Leningrad soviet. Many enterprises are trying to take advantage of this situation, become private, and keep their profits. But that is a question that will not be answered for a long time.

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Legislation and Structure

According to Aleksei Makushkin, the two main problems with the conversion are defense legislation and institutional inertia. In the first case, the problems involve the passage of new laws to open up the defense sector to technicians and technologies from other countries. This technical and scientific knowledge could lead to a blooming of the economy with respect to the west, or it could go the other way. The Soviet Union has never been wont to reveal sensitive information or technology. The prospect of money and prosperity might not be a tempting enough carrot. Indeed, the idea of western firms and institutions having access to sensitive defense information could lead to passage of new and more restrictive laws.

The problem of institutional structure may be even harder to overcome. Having operated for so long with a slow moving vertical power and economic structure, there is little inclination to move to a more efficient horizontal system. Since the government and the economy have been so closely interwoven from the beginning, any structural economic changes would naturally be followed by structural changes in the government. The difficulty is thus doubled. Makushkin was not optimistic about the prospects for rapid change in either of the hierarchies. The conversion will demand a complete change in the government's attitude toward the economy, and there is presently no bureaucratic movement to do so.

A Different View

The final member of the panel, Zurab Yakobashvili, focused on the internal aspects of the conversion. He prefers to think of the conversion as an integral part of an overall reform package whose ultimate fate remains uncertain. The conversion continues despite the fact that no one is totally sure what is taking place. "Everything is happening 'beyond the fence.'" This is a major weakness of the process. Yakobashvili agrees with his colleagues that the new economy will require scores of new machine factories; most will have to be made by transforming military factories. Here, the difficulty arises; the technical imbalance between military and civilian enterprises is significant.

The program's success will depend in large measure on outside economic relations. In this area the USSR is not necessarily working at a disadvantage. It can use its enormous reserves of natural resources to encourage foreign investment, although these markets are limited and need to be expanded before foreigners can be expected to invest on a large enough scale to make a substantial impact. Foreign investment can be of considerable help to many areas, for example electronics and computers. Soviet industries and businesses also need to pursue and stimulate outside economic relations so that they can earn money themselves. The west must take a serious look at the conversion and, realizing its magnitude and importance, be willing to invest heavily in the future of the Soviet Union.

Each speaker had a slightly different angle on the problem of conversion, and thus each offered different prospects. There was optimism and pessimism, hope and fear. But there was a definite consensus; everyone realizes that the Soviet economy is undergoing cataclysmic changes and that there are no simple solutions and no right or wrong answers. It seems that the only good answers are ones that lead to more complex problems.

— *reported by Joshua Larson*

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