

PRIVATIZATION, LIBERALIZATION AND DESTRUCTION

Recreating the Market in
Central and Eastern Europe

Edited by
László Csaba

 **Dartmouth**
Publishing Company

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise without the prior permission of Dartmouth Publishing Company Limited.

Published by
Dartmouth Publishing Company Limited
Gower House
Croft Road
Aldershot
Hants GU11 3HR
England

Dartmouth Publishing Company
Old Post Road
Brookfield
Vermont 05036
USA

British Library Cataloguing in Publication Data

Privatization, Liberalization and
Destruction: Recreating the Market in
Central and Eastern Europe
I. Csaba, László
330.94

Library of Congress Cataloging-in-Publication Data

Privatization, liberalization, and destruction : recreating the market
in Central and Eastern Europe / edited by László Csaba
p. cm.
Includes bibliographical references and index.
ISBN 1-85521-398-2 : \$59.95
1. Privatization--Europe, Eastern. 2. Privatization--Central
Europe. 3. Post-communism--Europe, Eastern. 4. Post-
communism--Central Europe. I. Csaba, László, 1935-
HD4140.7.P758 1993
338.947--dc20

93-32703
CIP

ISBN 1 85521 398 2

Printed and Bound in Great Britain by
Athenaeum Press Ltd, Newcastle upon Tyne.

1	Introduction - by László Csaba	1
Part I Regional Overviews		
2	Economies in transition: problems, patterns and policies - by Béla Kádár	7
	Four challenges	8
	Transformation amidst a crisis	9
	Is there a right way?	10
	Transformation and growth	12
	On the role of growth in transformation policies	13
	Towards a theory of transformation	16
	NOTES	18
	REFERENCES	19
3	The role of the government in postcommunist economies - by Marek Dabrowski	21
	Introduction	21
	The government as a regulator	22
	Some disadvantages of state interventionism in a transition economy	24
	What government functions cannot be eliminated?	25

Governance of transformation	26
The government as an owner	28
The quality of state administration	31
NOTES	32
REFERENCES	33
4 Privatization and foreign direct investment in the East	
European transformation: theory, options and strategies	
- by Paul J. J. Welfens	35
Introduction	35
Privatization	37
Welfare and allocative effects of privatization	41
Privatization cycles?	44
Macroeconomic effects of privatization	46
Interdependencies between privatization and FDI	47
Foreign direct investment in the transforming economies	49
Long term aspects of FDI inflows and welfare effects	54
FDI in the open economy IS-LM model	57
FDI, privatization and the exchange rate	59
International price discrimination	60
Conclusions	61
NOTES	62
REFERENCES	66
Part II Impacts of Post-Soviet Disintegration	
5 Privatization in Russia: a comparative study in institutional change	
- by Silvana Malle	71
Introduction	71
Arguments for and against the uniqueness of Russia	72
Deconstruction, state directors and workers	74
From state ownership to collective ownership and backwards. The institutional path to individual property rights	78
From state property rights to individual property rights through commercialization and closed subscription	81
The role of vouchers	84
The limits of social compromise in institutional changes	87
The privatization agencies and the property funds	89
Small privatization and new private business: developments and preliminary results	92
Conclusions	96
NOTES	98
REFERENCES	100

6 Economic disintegration and privatization in Central and Eastern Europe	
- by Wladimir Andreff	103
On the economics of international disintegration in Eastern Europe	105
Recent shifts in Eastern European foreign trade	109
Testing international disintegration in Eastern Europe	112
Disintegration as an additional obstacle to privatization	113
A bumpy road to a new economic integration	117
NOTES	121
REFERENCES	127
7 Russian foreign trade between liberalization and state control	
- by Pekka Sutela	131
Introduction	131
Pre-reform trade regime	132
The reform platform	135
Was there a new phase in transformation?	138
Controversial outcomes	139
Interrelationships between domestic reform and the foreign sector	142
Turning inwards?	144
Conclusions	145
NOTES	147
REFERENCES	148

Part III Individual Country Experiences

8 Privatization dilemmas in Slovenia	
- by Joze Mencinger	153
Introduction and summary	153
Common features and perplexities of transition and privatization	153
Creating the starting conditions	156
Privatization controversy in Slovenia	158
The Slovene voucher scheme	161
Epilogue	163
NOTES	165
REFERENCES	166

9	Financial intermediation in ex-Czechoslovakia: an assessment - by Miroslav Hrnčir	167
	Controversial results of the first transition phase	167
	The role of factor markets in economic recovery	170
	Conceptual weaknesses in Czechoslovak transition policies	171
	Structural constraints on financial intermediation	172
	Interenterprise debt	174
	Alternative ways of financial consolidation	176
	Costs and implications of delayed financial consolidation	179
	Conclusion	181
	NOTES	182
	REFERENCES	188
10	The changing mix of disequilibria during transition: a Romanian perspective - by Daniel Daianu	189
	On disequilibria	190
	External versus internal disequilibrium - is there an optimal mix?	191
	The pre-transition shock therapy	194
	Stabilization policy and disequilibria in Romania	197
	Interpreting (dis)equilibria in transforming economies	201
	Concluding remarks	205
	NOTES	207
	REFERENCES	214
11	Liberalization and transformation in Bulgaria - by Tatiana Houbenova-Dellisivkova	217
	Liberalization policies in 1991	218
	Adjustment policy	220
	Costs, constraints and alternatives to contraction	222
	For a gradual trade liberalization	225
	NOTES	227
	REFERENCES	230

12	Privatization in Central and Eastern Europe: techniques, policy options and economic consequences - by Morris Bornstein	233
	Concepts	234
	Economic objectives	234
	Social and political objectives	235
	Scope and speed	236
	Methods of divestiture	237
	Free transfer: personal entitlements	242
	Free transfer: institutional endowments	247
	Combinations of methods	250
	Conclusion	253
	NOTES	254
	REFERENCES	256
13	In search of the market: a comparison of post-Soviet reform policies - by Klaus Schrader	259
	Introduction	259
	The legal base	260
	The property question	261
	Competition rules	262
	Liberty of the markets	264
	The assignment of macroeconomic policy tasks	265
	External economic relations	267
	The long road to a market economy	268
	NOTES	270
	Annex	271
	REFERENCES	283
14	Commonalities and differences in transformation - by László Csaba	285
	Commonalities	286
	Conceptual differences	290
	Instead of a summary	294
	REFERENCES	296
	Authors	297
	Subject index	301

1 Introduction

LÁSZLÓ CSABA

In the current flood of books and articles on the transformation of economic Systems it might be just as well to define at the very outset the purpose of the exercise of producing yet another volume on the same subject.

Experiences of the last four-five years have shown transformation to be a much more lengthy and controversial issue than many analyses and decision-makers would have anticipated. The process is both more protracted and socially less accepted than most participants and observers of the change had expected. Thus both at the policymaking and the analytical levels there is a degree of disorientation. The need to elaborate new strategies is widely accepted. We aim at contributing to this task.

The collapse of the external and internal Soviet empire as well as of Yugoslavia and Czechoslovakia have confronted major decision-making centres of the world with dozens of new countries with a plethora of problems resulting from the erosion of the peace systems of Versailles and Yalta. Among the many uncertainties one thing seems certain: there is no return to the bipolar 'normalcy' of the Brezhnev and Gorbachev years. The European Communities - confronted with their Northern enlargement and internal reforms of the Common Agricultural Policy and of the Budget - are in imminent need of elaborating more efficient strategies than their involvement in Yugoslavia was. The United States seems to turn towards its internal problems - health and tax reform, improvement of education, integration of marginal groups, tackling the fiscal crisis - at a time when that country has remained the only military superpower in a multipolar world. Finally Japan, the NICs and Germany have yet to find their role and place in addressing many global problems, one of them being the protracted transformation and the resultant explosive situation in one half of the old continent.

But also in analytical terms a lot remains to be done in the available analyses of what has gone wrong - if anything - with the postcommunist developments. It is consensus view that costs are significantly higher whereas benefits are smaller and primarily less immediate than had been expected by analysts and the societies involved. The danger of *Welmarization*, with the resultant threats in terms of defence, migration and overall destabilization is well recognized by most decision-making quarters. However, the novelty, the multiplicity of the tasks as well as the ambiguous results of previous applied analytical analyses make their answers often *belated* and *retroactive* both inside and outside of the transformational area.

In order to improve both understanding and action the European Association for Comparative Economic Studies has been organizing a series of conferences and workshops. The idea is to provide a forum for the multiplicity of views, for concurring analyses, for enabling the comparison of available - often controversial - evidence. Thus this book could *not* be conceived as a *monograph*, with a strict structure of analysing issues, which is an option some readers may be less willing to accept than others. This option however allows for a reader to get a flavour of the arguments both in terms of geographical and conceptual diversities which is one of the editor's chief objectives.

Second, this is *not a conference proceedings*. Though most of the contributors were attending the second general conference of EACES, organized by its current President, Prof. Hans-Jürgen Wagener in Groningen, The Netherlands on 27-29 Sept 1992, this is a highly selective choice from over 120 papers presented there. Some of the authors were giving different papers, others revised their texts substantially on the base of discussion, still others contributed separately, without having attended the conference.

By the same token as a third factor I should like to stress: it was not my intention to collect declarations of the faithful, thus those looking for conceptual 'clarity', 'unanimity' will be disenchanted. But from my perspective, *diversity* has a value of its own which seems to have been played down in the first years of the transformation debate, in search of the single optimal trajectory of change.

Fourth, there is hardly any direct *policy recommendation* in this book. With the current pace of changes it seems not very expedient to make such proposals in books. It is the line of analyses which might be of interest for those who will read it not in the immediate aftermath of production.

Finally, it is not the intention of anybody to have passed the final word in the ongoing transformation debate. What all of us expect is that our analyses, at least in part, will remain of lasting relevance for understanding the complexity of transforming entire macrosystems in a diversity of cultural and historical settings. Involving the experience of Southeast European nations is meant to serve this objective.

Let us turn the coin and set out positively what this volume is all about! First of all, this is a *state of art report*, by which readers can have an overview of the level, nature and standing of the transformation debate in and about the region. Second, one may grasp some of the *focal points* which have crystallized in the transformation debate. To note just one: the question whether or not there is a need to stabilize *before* transforming the system or vice versa has been settled by experience. The attempts of the Gaidar team to transform a system without stabilizing first ended with a disaster.

understanding of transformation. Given that economics tended to develop in the direction of formalized models over the last few decades, this is in many ways a *reversal* of the trend. Experience in the countries analysed here have called attention to those cultural, historical, societal factors, which used to be parts of classical political economy but later tended to be relegated to the realm of obscurity, from which standard economic science often abstracted intentionally and conceptually. While openly acknowledging the virtues of the mainstream, the usefulness of our more traditional approach seems to be increasingly accepted by those confronted with the tasks of transforming the economies. Some of the contributors who have themselves been *actively participating in transforming* one or other economy, like Kádár, Dabrowski, Daianu and Mencinger lay special emphasis to this circumstance.

The volume is divided into four major parts: regional or functional overviews, analyses of Soviet disintegration, individual country experiences and comparative perspectives. My intention is to allow both for the systematic and the selective reader to find what he is after. For the first, some new insights to the *theory of transformation* will be offered. In this area, in my view some of the conventional questions may have to be re-stated in the light of the findings presented here. For the second group of readers experiences of such *less known cases* like those of Slovenia, Bulgaria or Romania, or the rather unconventional approaches of Malle or Welfens might be of special interest.

Following the first euphoric months after the capitalist revolution of 1989, the shuttle of public mood has moved to the other extreme of gloom and loss of perspective. Scenarios foreseeing decades-long crises, self-propelling depressions proliferated. This book might be already a step towards a third phase of the transformation debate: that of *realistic expectations*. If countries can not be put on a new growth path in weeks, or if the market economy can not be created in seven or even in five hundred days, that might not have to be seen as an evidence for the impossibility of the whole task. Latin America, having earned a bad name over the last 15 years, is back on the growth path and also on the international capital markets - with the notable exception of Brazil and some smaller states. This might support the position of those who believe: setting the time horizon right might be equally important as the elaboration of a detailed master plan for the transition. If for no other reason, than for shaping expectations: the latter and the resultant societal reaction might well be crucial in deciding over the feasibility of the entire transformation exercise.

Finally, I should like to express my sincere gratitude to my colleagues, Ms Katalin Légrádi and Ms Erika Rózsás for their devoted assistance in preparing the camera ready version of this book.

László Csaba
Editor
Budapest, 30 March 1993

4 Commonalities and differences in transformation

LÁSZLÓ CSABA

The purpose of the exercise is to present a summary view of this author by sketching the landscape one may see on the base of analyses collected here.

First and foremost, the inherited bureaucratic systems of Central and Eastern Europe have irreversibly been changed by their ongoing erosion as well as by the policies aimed at transforming the command economy into a free market. Thus, there is *no chance of return to the old ways*. Even if and when a restoration of some form of authoritarian rule seems quite plausible in some countries, even if the public sector will remain heavyweight, even if interventionist policies will be implemented, this will nowhere be equal to the restoration of 'real socialism' of one brand or another. The Soviet empire also belongs to history, even if the present lower ebb of the tide will give way to more expansionist policies of Russia in the longer run.

As a consequence of sweeping changes the concept of shortage economy has also lost its explanatory power for current and future developments. In all the transforming economies money can buy commodities, money has become scarce in relation to commodities and not vice versa. This is a fundamental turn which applies even to the Ukrainian interim currency, the *karbovanets* whose purchasing power is one third of the ailing Russian ruble at the time of writing.

What about Albania and Serbia one may well ask? The answer seems to be straightforward - underlined primarily in the study of Houbenova: as long as the communists are in charge, as long as those striving for a pluralist political and economic order have not legitimated their endeavours by a solid majority won at free elections, it is unjustified to talk about transformation of any sort. This seems to me a relevant point, as previous evidence of decaying socialism has been indicative of the probability of coexistence of shortages with inflation (Gotz-Kozierkiewicz D. et, al. 1992) which has only been supported by Russian experience under Gaidar. In these cases it seems to have been premature to talk about transformation, as the political context has not yet allowed for this term.

experiences (Hermann-Pillath, C. 1993). This interpretation seems to be questionable, as in China and Vietnam the purpose of the exercise is not to abolish and transform, but to maintain the one party rule and the dominance of public property. Thus bold and competent decentralization notwithstanding, *plus ça change, le plus la même chose*, thus the Asian reform-socialist experience is by definition irrelevant for understanding what is *specific* about transforming European macrosystems in their entirety, rather than modifying subsystems of a given economic order.

While the different, even divergent nature of the problems of individual countries is amply demonstrated in this volume, it would be difficult to overlook the large number of commonalities in approaches and issues in transformation, once the hangover caused by depression and by unfulfilled initial hopes is over.

Commonalities

One of the fundamental features of the transformation is its *destructive nature*. Although it could be foreseen (e.g. Csaba, L. 1990) there seems to have been a political consensus at the time of changing the régime that the time horizon of transition is rather short. Besides the ignorance of newcomers to the economics of Eastern Europe, there was a mighty political consensus which moulded the naive beliefs in quick recovery. The outgoing *socialists* had an interest in demonstrating: they have bequeathed an economy which was fundamentally in order. In Poland, Hungary, Bulgaria and in part even in Russia they did launch reforms, thus did what they could: all the blame for the foreseeable depression should lay on their successors. And indeed, personalities like Volskii, Yavlinskii or the Bulgarian socialists have actually managed to build up political capital along these lines, by playing the card of inevitable disenchantment. *Liberal* quarters in their majority seem to have allied themselves either directly - as in Poland and Bohemia - or indirectly - as elsewhere - with the concept of shock therapy. One may and indeed can become a convert to this brand of radical social engineering only if one is firmly convinced of the probability of swift changes, provided persons and policies are right. Conventional abstraction from societal and institutional elements have made a fair portion of the economics profession forthcoming to this seductive approach. Finally, *conservatives* by definition had to be of the opinion, that preserving 'national roots' is possible while radical treatments are superfluous, thus continuity and go-slow policies - pushing economic issues to the background - were feasible only if there was nothing fundamentally wrong with the economy. In this case the right guys in posts of command can actually deliver what is needed to tackle 'more important' - national, historic, cultural - issues.

Well, this consensus proved to be ill-founded. This was illustrated by the dimensions and costs of successful transformation in Eastern Germany (Welfens, P. 1992), which will have medium - to - long - term repercussions for the German federal budget, its debt position and through this on the entire Maastricht process. In the case of Russia, the Ukraine, Serbia and Poland, where the share of defence sector has been disproportionately high in the national economy, a long *adjustment crisis* has been inevitable. As argued forcefully and convincingly in

inevitably implies destroying a lot of capacities and workplaces, since there is nobody who could create effective demand for the kind of services and products in the quantities they used to produce. Moreover, a negative multiplier is bound to be effective for quite some time, spilling over the entire economy (Szamuely, L. 1992, pp. 1792-95). The higher we estimate the share of defence-related industries in ex-Soviet GDP, the more severe this adjustment crisis is bound to be. However it might be controversial to interpret it as a crisis of transition (Köves, A. 1992, p.10), as the crisis of the *perestroika* years was laying precisely in the fact that nothing has happened in these fundamental structural terms. On the contrary, the decomposition of the military, the related erosion and spontaneous privatization are the first signs that the backbone of the monster have finally been touched by the developments. Therefore it is not infrastructure and civilian consumption alone which carry the entire burden of adjustment, as was the case for over sixty years. If a structure is economically fundamentally non-viable there is no other way of getting from secular stagnation to a dynamic equilibrium than via an adjustment crisis started by destroying the old patterns.

A similar *consensus of ignorance* seems to have evolved around the issue of privatization. Here again, as argued by several contributors, public opinion seem to have been misled by the debates over the search of the ideal option, the real single way by which privatization could be speeded up and implemented in an equitable manner. Though the superiority of private over public firms is an established fact both in theory and by statistical evidence, this general consideration has a long way to go before it can be operationalized. As Mencinger shows, in the Slovenian case the adoption of radical mass privatization was intimately related to political insights, and was instrumental in the crusade of political redistributors against management whereas economic considerations were relegated to the background. Similarly as Malle and Hrnčíř explain, there is nothing 'just' about creating a vast number of petty owners who can hardly exert any control over management. Restructuring and modernization of large dinosaurs costs money, jobs, and needs foreign management and organizational skills, as detailed by Welfens. Moreover people are quite right in their resisting the *seizure* of assets by randomly selected new owners who have no record to be trusted as efficient modernizers. Furthermore, Western experience also indicated that popular capitalism is a rather costly exercise which has fairly little to do with improving management and modernizing large firms. Thus the area of experiment does not seem to have been adequately chosen.

While the people's lottery involved millions of citizens and raised hopes for quick recovery, the sobering truth about restructuring seem to have gone under. Thus not only legitimate outcries against misuses prevail, but losses of any output and jobs are also widely taken as palpable evidence of failure. The trivial fact that recovery has not yet started, since the operation is in a rudimentary stage, is often depicted in dramatic tones (see e.g. Kornai, J. 1993). Though experience of developed and developing countries indicate: there is nothing just and immediate welfare-enhancing in privatization, but it is a necessary medicine to be taken by countries with a heavyweight state sector. Further it is an essential ingredient for bringing about a free market economy. Privatization - as Malle notes - is about *taking responsibility*, is about living under uncertainty, taking risks and harvesting the results, be those good or bad. This fundamental truth

to not be served by dispersing ownership, but by well-functioning tax collection and social transfers. Both seem to have been neglected by social engineers.

The size of destruction in transition might be seen as a direct *indicator of distortions of facts and thereby of self-images of societies under state socialism*. The higher the officially reported rates of growth, the more stable controlled prices, the more extended misconceived social welfare services used to be, the more depressing is the hour of truth. It should not have come as a surprise, that *the farther* the state socialist experiment *diverted* the value-, income-, production-, expectational- and price systems of the respective societies from West European normalcy, *the higher is the price* to be paid in terms of depression and unemployment. It has been analysed in detail (e.g. Heitger, B. 1990) that reported growth rates, on which not only five year plans but the level of social services and aspirations in Eastern European societies have been built for decades are fundamentally flawed, as in the last three decades of state socialism no real catchup has taken place. The case of East Germany is rather telling in this point. While at the time of reunification fears of *pangermanismus*, of a socio-economically too strong a Germany proliferated, the direct costs of consolidating what used to be the most advanced Comecon economy will loom over the strongest economy of Europe for over a decade, at least.

This is the context in which the depression in Central and Eastern Europe has to be measured. The forecasts of Houbenova, promising zero growth for 1995 at first, with every fourth citizen lastingly unemployed correspond to the previous Potemkin-village image of Bulgaria as a high growth and quickly modernizing industrial economy. Likewise in the Ukraine, the very idea of discontinuing the 350 years of coexistence with Russia has an inevitably high price, as correctly elaborated by Andreff. He is quite right in underlying: disintegration and transition might cumulatively reinforce depression. Against this background, too little attention seem to have been paid to a new nuclear power in Europe, which has not even ratified START-1, as this is its last remaining card. Under this angle the not-so-benign neglect of the EC and its members against the protracted depression in Russia and in the Ukraine seems to be a hardly affordable luxury from any point of view. Given that popular images have been built on the previous official statistics, whereas expectations entailed quick recovery and generous Western involvement, their confrontation with a soberingly different reality resulted in evident social disenchantment.

Though I think this process is more of a much-needed taking stock of realities rather than as a source of instability, it is fairly clear that no transforming government ever can expect the social backing Helmut Kohl and Tadeusz Mazowiecki used to enjoy when East German and Polish transition to the market was launched. Thus any proposition should be clear whether it is after theoretical glamour or practical implementation. The time of experimentation, of quick fixes is over. As Bornstein demonstrates in detail: everything has a price, there is no single 'correct' option. The interplay of many other factors than the intellectual appeal of a given scheme or the political commitment of a given government which will determine actual outcomes.

And herewith we have come to a further conclusion - underlined especially by Kádár and Welfens - i.e. that transformation is much more than stabilization and liberalization, it also goes beyond a change in the ownership structure.

countries of Central and Eastern Europe aim at their reintegration to the mainstream of human development in cultural, economic, social, technological and historic terms. Therefore in the longer run the issue is far more comprehensive than ensuring a reasonable degree of price stability, positive real rates of interest or the predominance of private ownership in the overall economy. The real strategic task is to lay the foundations of *sustainable economic growth*. This certainly entails developmental tasks, institution building, creating an environment favourable for investments. There can be no doubt that *private capital formation and the enhanced propensity to invest are the clues to solving* this problem. Recognizing this fundamental interrelationship has certainly immediate consequences on legislation in terms of taxation, labour legislation, social spending and the rule of law in general. In particular, the improvement of *financial intermediation* converting available savings to investment use is of fundamental importance.

At this level of discussion it might be expedient to underline: transformation is thus to be seen as a *package of macropolicies* and systemic changes at least at the normative level. At the descriptive level, as can be seen from the chapters discussing individual country experiences, the above required consistency has become a truly scare commodity. Whereas in the Czech Republic and Bulgaria macroeconomic policies are consistent and go in the right direction, institution building is lagging behind not only the self-set schedule but also behind what would be required by elementary consistency criteria. Likewise, in Hungary, Poland and to some extent in Russia, institution building proceeds, whereas macropolicies follow twists and turns that are more contingent upon contemporary short term political controversies, than on any strategic concept or congruence consideration.

In the above said criticism has been voiced against dogmatic radical marketization concepts, still a strategy was required. Would that mean that until transition is over no new paradigm is needed and pragmatism should be the first commandment of policies, as Köves (1992, p.16) suggests? It seems to me that no strategy can be elaborated without having a clear vision about what are we driving at. Moreover, not even a clear-cut judgement can be passed over concrete reform policies without being clear of our point of reference. This holds *a fortiori* for comparative approaches. Therefore I think the somewhat didactic, still comprehensive and *explicit* set of criteria elaborated by Schrader in this volume may indeed be very useful in orientating both analysts and decision-makers. True, it does not answer the question *how* to get to the ideal point, but lacking the point of reference may only serve for selling policies of muddling through and of shirking radical but necessary reforms.

Should one infer the conclusion from the abovesaid that a general theory or even a *cross-country strategy* of transformation is possible, even commendable? This is a very widely shared suggestion, represented chiefly by Andreff in this volume, but also joined by prestigious international organizations. Both for Central Europe and the CIS the idea is recurrently formulated, that at least a degree of *convergence in transformation strategies* could be helpful for various groups of transition economies, as it could support their reintegration to the existing economic framework.

This conclusion seems to be hasty at best. One of the basic commonalities of the transition economies is their qualitatively different starting position. Different

...with local realities and tasks, as well as the crucial importance of the respective starting points for what is or isn't feasible is strongly emphasized in the analyses of Dăianu, Hrnčíř, and Houbenova. Irrespective of concepts, policies and outcomes were also fairly different in the individual countries, and the only common point in the different stories is that poetry and reality strongly differ. To quote but one example, judging by the statements made by the Gaidar government one could have expected the emergence of massive unemployment. In fact, nothing close to that has happened: actual layoffs are still below a full percentage point of the labour force. Centralization amidst devolution, as described by Sutela, was also a main feature of foreign trade. Thus taking on a suit tailored to someone else's figure might well be blamed for the failure of the Gaidar team (Ellman, M. 1992, p.59). If starting positions, therapies, implementation and popular reaction have been showing professedly dissimilar features, there is very little justification for any analyst to expect any significant degree of convergence either in various transformation strategies or in their outcomes. This finding is fairly congruous with all that can be observed empirically as well as with the recent findings of more abstract system's theory, explaining the set of factors conditioning competition *among* the transforming systems and their performances as well (Schüller, A. and Weber, R. 1993). Thus divergence is one of the lasting factors of the transformation strategies. Their *commonality lays in their uniqueness*, thus individual lessons and peculiar options will be hard to transplant to any other case.

Conceptual differences

If we take national differences for normalcy, we should treat conceptual diversities equally. However, it might be useful to highlight some of those strategic issues, that contributors to this volume - as well - approach in a very dissimilar way.

One of the fundamental fields of disagreement lays in the ways and means that may be conducive to economic recovery. Whereas some of the authors, notably Kádár, Dăianu, Welfens and Houbenova speak up for active *governmental intervention* relying on elaborate means of *industrial and commercial policies*, others, primarily Dabrowski but also Malle and Schrader are much more sceptical about what any governmental action is likely to bring about. These differences are partly philosophic in nature: whether one believes in the growth-promotional role of the state and finds East Asian examples relevant for the region, or conversely, puts his faith in private investors and time, inclined to 'sit out' until the shy deer gets out of the forest and private people see a point in putting their money into investment use. Believers in the latter point to the very depressed price of assets during the adjustment crisis as well as the very high risk premia they earn, provided the rule of law is preserved and taxation is not perverted for political profiteering. This difference must be seen as confessional in nature mirroring similar divisions in the international community of general economists.

In part, however these convictions have to do with the *level of development* the countries in question. Less developed countries normally have less

...is weaker and governmental involvement might be more readily accepted. Further, countries with a relatively large entrepreneurial class and a remonetized economy differ fundamentally from the endowments of the Ukraine and Belarus where the quest for *national independence* is bound to *strengthen statist approaches*.

There is a clear difference of approaches in interpreting the *uses of stabilization policies*, including fiscal and monetary stringency and instant convertibility for *promoting transformation* strategies. It goes without saying that these considerations are frequently in conflict, like the endeavour to privatize more and the need to keep the Budget in a reasonable shape, and many others. Some of the contributors, like Andreff, Houbenova and Kádár underline the contractionary effects of these policies and caution against one-sided obsession with fiscal and monetary targets. Others, like Dabrowski and Schrader, conversely believe that lack of monetary and especially of *fiscal discipline* is an immediate cause for the lengthier than expected depression.

It seems to me that it is difficult to pass judgements on a general base, without considering actual macroeconomic indicators of a given period. Hungary, for that matter, with a general government deficit equalling to 8-10 per cent of the GDP in 1992-93 is certainly not a good case for an overdose of monetarism. Likewise, Russian policies should be judged on their actual accounts rather than on the frequency of statements of intention to make the ruble convertible overnight. In assessing the deficit the causes are of equal importance. If and when the well-known fiscal crisis of the transition is at hand - with the loss of revenues coupled with the explosion of outlays both due to recession - there is very little room for more expansionary policies of any sort.

In fact, the fundamental question in this respect is whether or not the lack of effective demand is at the crux of the problem as Laski (1992) suggests? If not, a less contractionary policy could only be interpreted in a way that has rightly become infamous in Latin America.

One of the fundamental factors of budgetary disequilibria is the loss of trade due to the disruption of Comecon and of the USSR. How should one assess this loss? Many authors - especially Andreff in this volume - would see it as an immediate cost, a loss of welfare borne for basically political reasons. This seems to me a *static approach*. As it is known, much of the current lack of competitiveness of Central European - and indeed, Russian - industries is intimately related to the developmental model which was embodied by Comecon. For one, this meant decades-long seclusion from international competition, for another, an environment where plan-fulfilment under the given output structure was rewarded and innovation of products and technologies penalized, with marketing and product-related services existing on paper only. This state of affairs was only aggravated by the economically inadequate choice of partners, where Russia sacrificed its potential gains from trade with USA, Germany and Japan for trade with Bulgaria for instance. Meanwhile, others were involved in specialization patterns which were incongruous to their factor endowments. In other words, the *nature of the intertwining was harmful* for competitiveness, as there was no way to transform existing patterns into competitive structures. The recent closure of several Hungarian large firms is indicative of this built-in, irreparable deficiency.

mainstream is hardly possible without correcting structural and also trade disparities. In fact, one of the few surviving large industrial companies in Hungary, Dunaferr might demonstrate this point. Conceived by the Germans in the 1930s to utilize Ukrainian iron ore and the transport route of the Danube the firm found by the late seventies that the underlying idea was wrong. In order to restructure its production it bought Japanese technology, switched imports from the Ukraine to India and Brazil, and via a many-years restructuring strategy has fought itself into one of the largest exporting firms of Hungary, causing headaches for the steel lobby of the EC.

In sum, a dynamic perspective is needed. Given that the Visegrád countries have actually regained the markets - in terms of volume - that they lost (as reported in *Frankfurter Allgemeine Zeitung*, 19 Feb. 1993) whereas in terms of value and market shares they even gained (Stankovsky, J. 1992), there is *no justification to be very dramatic about the trade diversion effects* inherent in the transition. True, in countries of the CIS the situation is different. As Andreff shows, their intertwining in 1988 was four times that of current EC levels. Even if allowing for a correction of plan-prices, the interdependence must be seen as substantial and splitting up the empire surely entails losses. But no calculation should be made on the presumption as if the empire could be held together for eternity. Further, it should also be considered, that the starting point was *not steady growth*, not even stagnation, but that of *secular decline*. The Ukraine, for one, could opt either to be an integral part of a fight over redefining the borders of a great power, with the concomitant military conflicts (catchwords: Abkhazia, Tadjikistan, Transnistrian Republic etc) or alternatively try to make use of the better part of Soviet industrial and agricultural potential. It is small wonder that Russian minorities in the Baltic also voted for secession (true, prior to the discriminatory Baltic legislation on citizenship). In sum, indiscriminate application of conventional tools of international trade analysis might lead us to a dead end, though their results must certainly be kept in mind.

One of the classical issues of reform literature is devolution. Decentralization has been one of the basic endeavours for any reform policy. In the transition debate one of the major issues is whether before or after privatization is there a need for chopping up large state monopolies. (e.g. Newbery, D. and Kattuman, P. 1992 p.330). Analyses in this volume indicate, that a fair degree of *caution* is needed in the quest for *decentralization*. Daianu shows convincingly, that delegation of authority to companies with soft budget constraint and with strong trade union control over management has been an important ingredient in the economic implosion following the collapse of dictatorship. If authority is delegated but responsibility is not, the entire decentralization issue may backfire. This issue is being discussed by Schrader and Sutela in terms of Russia from the angle of the rule of law. In fact, the *predominance of local power* over central guidelines (see more on this point in Hanson, Ph. 1993) is one of the worst legacies of Soviet past. This explains to a great extent that the same legislation is not valid the same way in various parts of the same country - this is a tough reality any business executive should learn first. Which we've been witnessing under the reformist disintegration of Russia under Yeltsin was that emergent local powers were far from being partisans of more enlightenment and more entrepreneurship. On the contrary, as evidenced by examples from Uzbekistan to

be attempts at preserving those owned or devised structures which the enlightened central power was just about to abolish. Equally, the lobby of the Civic Unionists in Russia are rightly seen as a group of organised vested interest pursuing completely rational self-interests (Ellman, M. 1993) rather than the personified devil. True, these are the independent managers who tend - with reasonable success - to 'socialize' the risks and costs of their attempts to preserve an antiquated pattern of production and employment. The relative strength of Chernomyrdin seem to have lain in their support. But from the point of view of transformation - as evidenced by the above cited example - decentralization might well become a fairly diverted way to the market, unless it is interpreted within the frame of a traditionally assumed (but not always present) set of systemic preconditions. All in all, the finding is that decentralization is not merely a sequencing issue, but a principal one: the delegation of responsibility, as Malle emphasizes.

A similar interpretative difference might be crucial in terms of privatization as well. Schrader criticizes e.g. the Ukrainians that they plan to devolve only 60 per cent of state-owned assets and even that only in 4-5 years. For me it is more important to clarify, *what privatization in the given context actually means*. In Albania e.g. direct sales meant peasants picking up the railway lines and using the wood lying underneath for heating purposes. Restitution, as East Germany evidenced, may be directly counterproductive for privatization to proceed. In Hungary, one of the fundamental hindrances for large companies - owning chains of restaurants and retail shops - to be sold to actual private buyers is the fact that they have already been corporatized. Analysing the voucher scheme many have come to the conclusion that in fact a more complicated form of state ownership, rather than private property has been created through the investment funds. In sum, although in a real world it might be difficult to draw a strict delineation between private and public property, this demarcation still must be instituted in order to avoid confusion. Thus the question is not so much the speed as the effect and the material substance of privatization policies.

Thereby we have come to a point when *similar words* may carry completely *different meaning* under different arrangements. Few believers in the market would doubt the usefulness of antitrust policies. In Russia however, as Schrader points out, it was just a covert way of reintroducing price controls way before the toppling of Gaidar as Prime Minister. In Hungary, on the other hand, the Competition Office has proved to be a toothless lion as it is not formally involved in the process of privatization. Therefore neither the State Property Agency, entrusted with divesting state property, nor the State Holding Company, entrusted with preserving state property has to consult, let alone follow the decisions, of the Competition Office. In sum, the open trade *régime* proved to be the essential ingredient in enhancing the market character of the Hungarian economy. On the other hand, Russian experience with the slogan 'let us liberalize domestically first and then open up' proved to be a disaster. Once domestic transition is less than a complete success, there are more than a hundred arguments supporting a need for a 'temporary' seclusion/protection, which will last for another decade.

Comparing Russian and Bulgarian experiences clearly evidences that an economy can, in fact, be fairly successfully stabilized without major transformations, as Houbenova describes. On the other hand a transformation

policy without stabilization, as under Gaidar is bound to failure. Whereas all or most Bulgarian economic agents are getting the right signals and are pushed to adjust to them, among others by foreign competitors, the disintegration of the Russian market has already prompted Russian authorities to have recourse to bureaucratic controls. This covert centralization could well be observed - as done by Sutela - in the entire reform period, when there were no official deliberations as yet to reintroduce the officially fixed ruble rate or the *de facto* monopoly position of old foreign trade corporations on all major exported items (as reported in *Világgazdaság*, 26 Feb., 1993). Thus, owing to the spontaneous restoration of controls, Russian private and public agents tend to get the wrong signals, and maladjust, just unlike their Bulgarian counterparts. In sum, a destabilized economy can not be efficiently transformed, whereas stabilization may be the entrance fee for transformation policies to make sense.

In sum, liberal policies in terms of transformation may hardly be equalled to the politics of state desertion (Ábel, I. and Bonin, P. 1993). This is not only because of developmental and social tasks, but as Dabrowski pinpoints, in order to roll the state back active state policies need to be pursued. Welfens draws attention to several facts why abolishing controls is a *necessary but clearly insufficient condition* for being reintegrated in the world economy. In the stiff competition for international capital, locational advantages have to be created and risk premia reduced by instituting the rule of law and by joining in organized international cooperation. The latter has serious ramifications, e.g. the size of the budget deficit can't be chosen at will, or the line of legislative experimentation can surely not go counter to the tide. In sum, with due regard to national specificities, open, cooperative and civilized adjustment policies may bring about results. This proposition might be at odds with some simplistic concepts of 'zero protection', 'zero state' and 'instant convertibility', but might be congruous with the complex realities of transformation in the other half of Europe.

Instead of a summary

Transformation of economic systems does *not* take place *in a vacuum*. Its pre-history as well as its societal environment and international context are important factors influencing the outcomes of the individual strategies to a considerable extent. The relevance of stabilization policies - be those orthodox or heterodox - differ case by case. Whereas in Czechoslovakia there was nothing to be stabilized, in Romania an inverted stabilization took place mostly spontaneously, heavily influencing the meaning and outcomes of transformation policies. East Germany will never share the fate of Albania, and the Ukraine has a separate road to enter. Therefore grand designs of how to transform 'a' socialist economy into 'a' market economy might be of academic interest at best, while remaining hardly instrumental in shaping the actual course of events. Prospects of the individual stories may crucially depend on factors usually outside the scope of economic analysis, like historical, cultural, and political factors, societal perceptions of purely economic propositions, the standing of the government, and last but not least on the reaction of the outside world. Reactions of abandoned children are rarely very rational and foreseeable. Therefore it might be misleading to believe that by neglecting the problems of 350 million people

the repercussions of economic depression will not spin over to the rest of the old continent.

Two questions are left to be contemplated. First, is it true that the *price* transforming societies have paid is *too heavy*? Second, is it really true that *standard economics does not hold* for this peculiar postsocialist region?

My tentative answer to both would be negative. First, if most of the disruption is inevitable, the concomitant price is inherent in the process thus is not really a subject of the debate proper. All economists familiar with countries with a high share of second economy know how little official GDP and living standards estimates are reliable. Though the drop in consumption is hardly to be disputed away, an indiscriminate acceptance of statistics not measuring the healthy part of the economy and self-sufficient ways of consumption are equally misleading. All in all, *GDP* should be *forgotten* as the major or basic *success indicator* in a period of transition. The same applies to most physical indicators. E.g. total Hungarian exports, the same in volume in 1989 and 1992 were about 6 bn dollar worth in the late eighties and were 10.7 bn dollar worth in 1992. This was the point of the entire reorientation exercise, the feasibility of precisely this was doubted by its opponents from the very beginning. Thus only a more sophisticated set of indicators may reflect actual outcomes of the change.

The 'too high a price' proposition fails to take account of the fundamental circumstance, that *not neatly growing, balanced economies were started to be transformed*. As seen above, a grossly distorted official statistics, insensitive to most disequilibria has given a false picture to the public. Moreover, as the cataclysm was not to be unmade anyway, there has not been an option of doing nothing. Those who did nothing are actually faring the worst, as Belarus or Albania might indicate. Thus the actual price of transformation can only be measured against the opportunity costs of a policy which nobody really managed to operationalize. In fact, Romanian, Serbian, Albanian, Ukrainian and current Russian policies are demonstrably inferior - measured by any indicator - to the 'monetarist' policies of the Central European countries. Thus only very strong and mostly hardly operational assumptions may lay at the foundation of presumed alternative policies, against which opportunity costs of the actual line may be measured. Even then, most of the output and employment losses could hardly have been avoided. Only *the differential*, not the entire loss is thus *the subject of the controversy*.

Any economist working on less developed countries can advance a thousand of arguments why standard economics should not apply for the region. However, Polish and Czech but even Romanian and Bulgarian experience runs contrary to this proposition. The exchange rate in all the three countries proved to be able to influence elasticities of supply and demand. And conversely, expansive monetary policies in Russia did bring about the demand-pull inflation that was only to be expected. In sum, not repeating many analyses, the standard framework does have a lot to offer in analytical terms. True, when it comes to policy advice, the customary process of *interpretation* an *application for the specific institutional setting* can probably not be saved. Thus, the time of the 'flying Dutchmen' might be over, but it should not be that wrong for established economics either. There might well be a return to normalcy: to the encounter of new subjects with established methods, interacting and producing relevant new findings for the benefit of both, as has already happened so many times in history.

- Ábel, I. and Bonin, P. (1993), 'State Desertion and Convertibility: the Case of Hungary', in Székely, I. and Newbery, D. eds, *Hungary - an Economy in Transition*, Cambridge University Press, Cambridge and New York, pp. 329-40.
- Csaba, L. (1990), 'The Bumpy Road to the Free Market in Eastern Europe', *Acta Oeconomica*, vol. 42, no. (3-4).
- Ellman, M. (1992), 'Shock Therapy in Russia: Failure or Partial Success?', *RFE/RL Research Report*, vol. 1, no. 34.
- Ellman, M. (1993), 'The Civic Union', *RFE/RL Research Report*, vol. 2, no. 11.
- Gotz-Kozierkiewicz, D., Kolodko, G. and Skrzyszewska-Paczek, E. (1992), *Hyperinflation and Stabilization in Postsocialist Economies*, Kluwer Academic Publishers, Dordrecht, Boston and London, 185 p.
- Hanson, Ph. (1993), 'Local Power in Russia', *Communist Economies and Economic Transformation*, vol. 5, no. 1.
- Hermann-Pillath, C. (1994), 'China - a Paradox of Transformation?' in Wagener, H.-J. ed., *The Political Economic of Transformation*, Springer Verlag, Heidelberg and New York.
- Heitger, B. (1990), 'Wirtschaftliches Wachstum in Ost und West (1950-90)', *Die Weltwirtschaft*, no. 1.
- Kornai, J. (1993), 'Anti-Depression Cure for Ailing Postcommunist Economies' (an interview to Hirschler, R.), *Transition*, vol. 4, no. 1, pp 1-4.
- Köves, A. (1992), 'Economic Prospects in Eastern Europe: Is the End of the Crisis in Sight?', *Kopint-Datorg Discussion Papers*, no. 7, - Budapest, Sept.
- Laski, K. (1992), 'Der aktuelle Stand der Diskussion über die Transformationsprobleme', *Europäische Rundschau*, vol. 19, no. 3.
- Newbery, D. and Kattuman, P. (1992), 'Market Concentration and Competition in Eastern Europe', *The World Economy*, vol. 15, no. 3.
- Schüller, A. and Weber, R. (1993), 'Von der Transformation zur Integration: Eine Ordnungs- Handels- und Währungspotlitische Aufgabenstellung', in Schüller, A. and Gröner, H. eds, *Die Europäische Integration als Ordnungspotlitische Aufgabe*, G. Fischer Verlag, Stuttgart, Jena and New York.
- Stankovsky, J. (1992), 'Ost-West. Handel 1991/92: Unerwartet günstige Entwicklung', *WIFO Monatsberichte*, Vienna, no. 11.
- Szamuely, L. (1992), 'Összeomlás után: mi lesz a szovjet utódállamokkal?' (After the Collapse: What is the Future of Soviet Successor States?), *Holmi* (Budapest), vol. 4, no. 12, pp. 1792-1800.
- Welfens, P. (1992), 'German Unification and Systemic Transition: Towards a New German Economic Miracle?' *Acta Oeconomica*, vol. 44, no. (1-2).

Andreff, Wladimir is Professor of Economics at the University of Paris 1 (Panthéon-Sorbonne) and former director of the research team ROSES. His main areas of research are: economies in transition, comparative economic systems, multinational corporations, and economics of sports. In these fields he has published numerous articles and books, the two last being *Privatisation et secteur public dans les pays de l'Est* (Paris, Editions du Centre Français du Commerce Extérieur, 1992) and *Convergence and System Change: The Convergence Hypothesis in the Light of Transition in Eastern Europe* (co-edited with B. Dallago and H. Brezinski, Dartmouth, 1992). He is Deputy President of the Social and Human Sciences Committee of the French UNESCO delegation, expert of the Committee for Development of Sports at the Council of Europe and member of the Executive Committee of European Association for Comparative Economic Studies.

Bornstein, Morris (1927) is Professor of Economics at the University of Michigan (USA), and a former director of its Center for Russian and East European Studies. He has served on the editorial boards of the *Journal of Comparative Economics*, *Soviet Economy*, and *Problems of Economic Transition*. His books include *The Transfer of Western Technology to the USSR* (English and French editions, 1985), and *Comparative Economic Systems* (Irwin, sixth edition, 1989). His articles on the economies of Eastern Europe and the former Soviet Union have appeared in the *American Economic Review*, *Review of Economics and Statistics*, *Quarterly Journal of Economics*, *Soviet Studies*, *Soviet Economy*, *Communist Economies and Economic Transformation*, *Revue d'Etudes Comparatives Est-Ouest*, and other journals.