The Political Economy of the Transition Process in Eastern Europe

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Contents

Tables and Figures

Tables

Figures

5

After the Shock. Some Lessons from Transition Policies in Eastern Europe

László Csaba[*]

Introduction

In the third year following the collapse of state socialism, a market economy and sustainable economic growth are still a long way off in the countries which used to belong to 'Eastern Europe' in the post-Yalta parlance. In other words, the 'jump into the market' has proved to be a rather long jump, which will provide food for thought for a fair number of analysts for quite some time to come.

The intellectual challenge posed by systemic transformation is best described by the following paradoxes. On the one hand, the West has won the Cold War, but traditional Sovietology has lost the battle. Whereas its leftist-radical wing was taken by surprise by the collapse of what it postulated to have been a peculiar case for modernisation, the conservative right wing was equally astonished that its apocalyptic prophecies have suddenly come true. For this latter group, it was rather embarrassing to answer the question: why just in 1989 and not at some earlier point did that system collapse, a system which it considered to be unworkable from the very outset?

Therefore, understandably, area studies have been pushed to the background in policy making. Mainstream economics and theoretical economists of some famous universities, as well as officials with the international organisa-

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tions, have taken over. Similar to many developing countries, but especially to Latin America in the 1980s, the universal panacea was prescribed, but is functioning somewhat differently from the way it is postulated. In both Latin America and Eastern Europe, real world economies react differently to the medicines than in the laboratories of abstract modelling. Stabilisation has not been fully mastered, and economic recovery has not taken place in the time frame originally envisaged. This is hardly a surprise to anyone who considers institutional, motivational, historic, and social factors to be relevant explanatory variables for understanding real world economies and economic development.

To put it differently, what we are experiencing in Eastern Europe is anything but a textbook case, for which solutions are easily available provided decision makers show sufficient diligence in studying advanced courses at better universities. Developments – no matter how controversial they are – have not invalidated economic theory or area studies, even less the experience of international organisations in coping with non-market systems. However, they have presented a new challenge to all three areas of activity. The challenge is there both in the theoretical and policy context, requiring fresh approaches and an interdisciplinary effort to attain a better understanding and a better performance alike.

What is the issue? In a nutshell: a fairly large number of countries, from Albania to Lithuania, have decided to give up tinkering with socialist reforms, and instead have opted to jump into the market by way of what is conventionally termed shock therapy and mass privatisation. In fact, Hungary and the Ukraine seem to be the only exceptions to the general rule. Now, the problem is that in all the countries concerned, including the one-time GDR, economic performance is well below targets, whereas the social and direct economic costs are much higher than envisaged. Moreover, the evolution of the salient features of a market order is substantially more sluggish than the majority of analysts and the general public would have expected. This gloomy picture – documented by a vast database assembled by the *Economic Survey of Europe 1991/92* – is that of a depression comparable to that of 1929–33.

This might not be a problem *per se*, at least in economic terms, since a complete overhaul of the development model, specialisation pattern, economic system, and international finances would hardly have been feasible without major sacrifices. The problem lies in the socio-political acceptance of such a protracted hardship, which seems to be quite narrow in the countries which do not enjoy the capital injections and other transfers making the East German economic miracle work. The Polish election results of 1991, the stalemate in Bulgaria, the very thin power base – and the resultant zig-zags in the economic course – of the Gaidar and the Stolojan teams exemplify how the socio-political feedback of recessionary strains restrict the ability to implement given transition policies.

For the time being, the relevant issue is no longer whether or not a shock treatment could have been avoided, as this issue has been settled by history. The immediate policy is that of recovery, and the tasks the states/governments in the region can undertake to foster it. The answer to this is rooted in our reading and interpretation of the events of the last 3–4 years. Is it really the overemphasis on the quantity theory of money against the theory of effective demand which is at the heart of the great recession, as a recent impressive analysis by Laski (1992) concludes? Should we really go so far as to maintain that shock therapy is a road to de-industrialisation and lasting underdevelopment? (Lösch, 1992, pp. 48–53). Is is really the contraction of output which is the major 'failure indicator' of the shock therapies applied all across the region? (Köves, 1992). The answer depends on our reading of the events. Thus, without attempting to be comprehensive, I try to summarise in a thesis-like manner what in my view we have learned in the last few years from transition policies. Then, I shall offer my answer to the policy question. What follows below is anything but an exhaustive catalogue of possible theoretical conclusions, but these seem to me to be the most policy-relevant lessons from empirical evidence.

Life Is Not Like in Books

Policy Making

One of the early experiences in policy making was that no matter how serious theoretical controversies prevailed in the economics profession – both domestically and internationally – there was precious little difference in the policy-relevant propositions made by serious academic economists and professionals in the state administration. It is not only that the relative successes with gradualism have produced a near-consensus in favour of continuing this line in Hungary, whereas the absolute failure with gradualism has created a broad consensus behind shock treatment in Russia and Poland. Alternatively, the collapse of the state administration and the entire political context left no alternative to the ex-GDR, Albania, and Bulgaria. Yet, the similarities are even more striking.

On the one hand, continuity in the institutional and organisational structure, in human capital and also in the overall economic environment for companies *grosso modo*, have contributed to a fair degree of continuity in the behaviour of economic agents. This was most palpable in the typical monopolitisic behaviour of large companies trying to produce less and sell their output for a highly inflated price, which in most countries counted as a prime cause of recession. On the other hand, it proved to be premature to call this a

fundamental barrier to transformation (Egger, Kappel and Melzer, 1992, pp. 28–29). The same economic agents have proven to be immensely flexible if the possibility and pressure of economic adjustment forced them to do so. People selling on the streets of cities is but one example; the Russian military-industrial complex deeply involved in privatisation and even in organising the entire economy of the Far East of the country is another; numerous Hungarian firms redirecting their sales from East to West might well be a third.

Thus, if for no other reason than inertia, a combination of continuity and change prevails in all Eastern European economies. On top of this, an element of shock was not missing from any of these countries. For one, the collapse of COMECON delivered a blow, at least on the micro-economic level, to even the most gradualist and non-reforming economies (such as the Serbia or Bulgaria of the day). The collapse of the internal Soviet empire had immediate repercussions for what used to be an integrated economic complex. The logic of history, of the national *renaissance*, superimposed its logic over the meticulous cost-benefit calculation pertaining to secession: Empires rarely disintegrate on the grounds of direct micro-economic calculus. Therefore, it can be taken for granted that the shock implicit in cutting the umbilical cord of imperial division of labour applies to all successor states of the CIS. Moreover, given the unresolved – and probably insoluble – problems of sharing internal and external debt and of sterilising the ever growing rouble overhang, the room for anything other than a version of a shock therapy is extremely restricted indeed.

Since the theory of implicit subsidies failed to explain why Eastern Europe survived the collapse of COMECON, calculations based on historical plan-prices – or their 'recalculation to world prices' – fail to discourage the successor states from seceding from the CIS. However, the micro-economic and also the structural shock remains for them as a given.

No matter how serious these problems are, the heaviest blow in the economic sense was delivered to the economy of the ex-GDR. The economic and monetary union of July 1990 has solved the stabilisation problem in one day. By the same token, the previously highly-protected East German economy was opened up to world market competition at a grossly overvalued rate of exchange. With the five *länder* joining the Federal Republic, the entire legislative infrastructure and institutional infrastructure has been taken over. Despite its shortcomings (see below), this short cut has solved the basic problems of institution-building that other Eastern Europeans will face for quite some time.

German unification is in theory a showcase for what constitutes a jump into the market. However, in policy terms, it is far from being so. On the one hand, East Germany received more in two-and-a-half years in transfers than the Soviet Union would have received under 'the Grand Bargain'. Second, not only institutions, but also human capital have been infused; new rules and institutions have been provided to the 'Eastern brothers'. Third, unification and the concomitant liberties produced an historically unprecedented legitimacy and social acceptance for whatever the Western uncle was about to do. Therefore, if recent analysis (Welfens, 1992) indicates that following the initial euphoria – and subsequent historically unprecedented contraction – East Germany is heading for a 'modest economic miracle' during the rest of the century, the same analysis discloses the inherent barriers to emulation of this laboratory/exercise by any other fellow-traveller. Lacking the five major factors ameliorating the social and, indeed, the economic costs of German shock therapy, anybody following such a route would undertake surgery not only without anaesthesia, but also without medical tools and medicines. To turn the same point around: in policy terms, East Germany has not experienced a classical shock therapy, but rather some much milder version of transition, where the costs were borne to a large extent by others. As large-scale Western involvement in the affairs of the region is rather implausible, the adaptability constraints are equally trivial.

In sum, there was no real 'shock': a combination of radical measures and counteracting factors characterise each and every case. If among the shock therapy adherents a certain delay in institution-building and privatisation is rather conspicuous, gradualists also have some shocks of their own: for the Ukraine, secession from the single Soviet economic space, and for Hungary, the collapse of COMECON coupled with a 25 per cent real appreciation of the national currency (Obláth, 1992). In both countries, these developments constituted a blow to inherited economic structures.

Sustainable Growth

The shock has been delivered. Still, countries of the region are a long way from a full-fledged market economy, and signs for sustainable growth are mixed at best: recovery does not follow immediately after the treatment, as some seem to have expected. In fact, neither development should have taken us by surprise. First, stabilising an economy and building up market institutions are two different tasks of different quality. Second, as the countries in question have been undergoing not only a cyclical or a balance of payments crisis, but also a fundamental, systemic and structural one, medicines devised for curing short-term imbalances obviously fall short of overcoming more basic difficulties. This, however, is not their fault. Finally, though any conventional econometric exercise is able to pinpoint the very sizeable growth potential of the Eastern European countries, experiences of other regions caution us to avoid accepting such an exercise at face value. In Latin America, achieving sustainable growth took a long time. Most of the delays resulted from slow response of private investment. Stability, clarity in tax and property rights rules, and a low but positive rate of interest are the key elements to recovery, but it takes time for these measures to take effect (Corbo, 1992, p. 414). These

conditions are known to exist in the majority of post-communist economies.

Again, like Latin America, stabilising and reform policies have continuously been criticised by representatives of vested interests, as well as by those segments of the academic community who consider output growth and increases in GDP as appropriate success indicators of positive economic performance, even in times of structural and systemic change. Experience of West European adjustment following both oil price hikes, as well as the theoretical analysis of several observers (Winiecki, 1991a; Gomulka, 1991), have advanced a large number of factors responsible for a protracted fall in output. Nevertheless, political public opinion, and reliance on Keynesian traditions, have prompted many authors to advocate an expansionist, inflationary line. Industrial circles in Hungary, Poland, and Russia began to fight 'fiscal dictatorship' from the very outset. With some delay, agribusiness also has intensified its lobbying for debt forgiveness, fresh money, and market protection. Within just 3–6 months of the initiation of these policies, pressures to correct the line, and to grant exceptional preferences to certain powerful interest groups, have also made gains in the verbally most radical governments (in Poland, the Czech and Slovak Federal Republic (CSFR), and Russia) (Dabrowski, 1992; Charap, et al., 1992; Csaba, 1992). In Serbia, Bulgaria, and Romania, industrial conflict and political power struggles resulted in the same. In Hungary, first in November 1990, and later in May 1992, an alternative, 'supply-side approach' began to gain momentum within the Government. The real surprise in the latter case is how little these much-publicised political controversies actually influenced decision making, which has something to do with the rather strong institutional independence of the National Bank of Hungary, and with the dominant power position of the Ministry of Finance (which, in fact, is a legacy of socialist reforms).

Should we really follow this line and pass an overall negative judgement on transition policies on the grounds that in two or three years it has failed to produce sustainable growth? I would hesitate to subscribe to this theoretical proposition. For one thing, in Latin America, where only one of the many crises of Eastern Europe (fiscal chaos) surfaced, this length of time was not sufficient for mastering that single problem. Stabilisation and reform policies: a) are of a dimension which is difficult to measure against the time horizon of conjecture; and b) by definition cannot be interpreted in a narrow technocratic sense, i.e., as a means of promoting overall economic growth. Transforming the post-communist economic systems into a liberal market order does have a value of its own at least on two levels: it enhances individual liberties, and rolls back the worst-case scenario, the open and irreversible secular crisis. The latter point is rather obvious in the case of the South-East European countries, notably Yugoslavia, but also in terms of what constitutes the CIS at the time of writing. My own country, Hungary, is a prime example that on occasion avoiding the worst things acquires a value of its own. Thus all policies in the region should be seen as exercises in acute and belated crisis-management.

Having delayed the reforms between 1956–89, the *anciens régimes* of the region created a burdensome legacy. The internationally non-competitive economic structures, the grave indebtedness, and the widespread public misconception of the actual level of development of these countries – not to mention the expectational and motivational structures and value systems which hinder rather than support economic adjustment – cannot simply be overcome by way of a miracle. There is a price to be paid, and the story of East Germany is indicative of the actual cost. If financial structures and public priorities in Western countries are anything but conducive to a new Marshall Plan, which can be taken for granted, it seems obvious that the only way open to the region's governments is that of a lower-cost, slower-pace option. There is no one else but the population of these countries who can pay for adjustment, in terms of recession, unemployment, restructuring, and inflation.

This is not to imply that there is no way out or that the policies of the new governments have been irrelevant. On the contrary, avoidance of socialist obsession with state investment and growth rates is one of the major pieces of advice that should be heeded in the longer run. It can be demonstrated in detail that overcoming the allocative inefficiency of the socialist system means by definition more growth with less investment; however, savings, especially private savings, will be more difficult to accumulate in the transition period (Borensztein and Montiel, 1992, p. 153). Therefore, private investment and the propensity to save deserve special treatment during this period, as do incentives encouraging these factors.

In sum, admittance of the limitations of the stabilising shock does not invalidate the reasons for its being delivered. Stabilisation is a precondition for new institutional arrangements to make sense, even if they are slow and piecemeal in their evolution. Thus, the efficiency gains to be expected from these arrangements are also bound to be gradual, though mutually reinforcing. Further, they help to move the process along in a shorter period of time. (Winiecki, 1991b, p. 10). However, this time has to be taken, and not only because tens of thousands of economic actors must become familiar with the new rules and opportunities. Investment is by definition a matter of confidence, which can of course be taken for granted in a model, but cannot be in an economy in transition. As Corbo (1992, p. 414) notes, the major danger here is uncertainty pertaining to the rules of the game and the overall policy line: in Latin America, 'when the risk of policy reversal was reduced, investment and growth started to emerge – but it took a while'.

Allocative Efficiency

It follows from what has been said above that the major technical economic question for transition policies is not the ideologically inspired issue of

privatisation (see below), but rather ways and means of dramatically improving allocative efficiency. Price liberation and formation of a marginal rate of exchange can be expected from stabilisation – or, in the case of Hungary, as a legacy of the past reforms – as given. This encompasses three major elements: a) creation of an independent monetary authority concerned with protecting the purchasing power of the national currency; alternatively, if we are sceptical about this step, joining the national currency to an international currency board (Hanke and Schuler, 1991): b) restucturing and rolling back the budget's almighty role in the economy – discussed in greater detail below: c) evolution of a truly independent, partly foreign and privately-owned commercial banking system.

Seen historically, capitalism has never started to emerge with the stock market and other refined forms of financial intermediation. If one has to start 'from scratch', there appears to be no realistic alternative to starting markets in areas like labour, housing, retail business, small-scale industry, etc. In this case, as Steinherr (1992) notes correctly, there is neither the need nor the possibility of eschewing the step of creating a large number of small but competing commercial banks offering financial services to their clients. The nature of this market is such that it works through trial and error, and neither the capital nor the special knowledge of refined financial markets are really necessary. This argumentation is well substantiated by what one observes across the region. In Hungary, for example, where the stock market already has several years of history, only 0.2–0.3 per cent of capital transactions ever show up. In the case of Russia, simple money transfers may pose a problem for many banks. In the Czech and Slovak Federal Republic, monopolistic structures must rely on a large number of administrative measures in the banking sector, such as dictated rates of interest, credit ceilings, etc. (Charap, et al., 1992, p. 14). In Poland, all through the reform process, large enterprises with considerable bargaining power have remained 'creditworthy' for the banks (Winiecki, 1992). All in all, less significant problems than the evaluation of large companies on competitive capital markets remain to be addressed. This might pose a problem for the concept of mass privatisation, but for the national economies, the immediate problem lies elswhere.

The major problem of the commercial banks is that while in theory they could substitute for capital markets, in practice they are a major source of misallocation and of allocative rigidity. This is because they embody either implicit fiscal subsidisation, or present sectoral priorities of the State, or carry the weight of investment decisions previously made by governmental authorities at different times (Tanzi, 1992, p. 24). As long as they continue to crowd out private ventures from the market and continue to distort the interest rate structure, these banks positively contribute to the structural rigidity of post-communist economies, since they fail to channel scarce savings in the right direction. In this way, they also have a share in watering down the allocative effects of price liberalisation.

How can this deadlock be overcome? First and foremost, credit liberalisation has led in many developing countries to emergence of a parallel private money market where both the incentive to save and the function of channelling funds to efficient use are given. Further, banks should be gradually freed from state tutelage by selling their shares to non-state agents (who should not be their clients). This is privatisation. Further, the inherited sectoral and territorial segmentation should be overcome, thus producing real competition for clients. Last, but not least, a large number of banks is a commendable but hardly sufficient condition for meeting the challenge. Without a major infusion of capital and technology, which can only be imported from abroad, financial intermediation will hardly be able to break out of its present role as 'the underdeveloped nerve structure of a dinosaur, unable to coordinate the body of a large and comprehensive economic structure' (Dietz, 1991). This is not to deny the need for a capital market. Countries of East Asia, where high growth rates could be attained for decades without relying on capital markets, have completely different social, cultural and even economic endowments, including the population's high propensity to save coupled with the low articulation of organised vested interests. This experience can hardly be replicated in the context of emerging pluralism and a European cultural setting. Moreover, these countries have been undergoing reforms reducing the role of government and increasing the role of the market in many areas, including allocative decisions (Jung, 1991; Kim, 1991; Chu and Lin, 1991; Hsiao, 1991; and Pascha, 1990).

In other words, given the European and pluralist context, the role of capital markets is fundamental in enhancing allocative efficiency. However, this is a step whose place in the sequence will hardly precede the introduction of the low but positive rate of interest, of competition among banks, and even their privatisation. With the emergence and expansion of private property for buildings, land, small shops and workshops, the valuation of various items of capital assets evolves organically. Thus, if financial reform creates the appropriate institutions, these will be continuously filled with substance. The important point is to have regulation based on the norms and experience of advanced countries, i.e., one protecting the interest of the small investor, prohibiting and sanctioning insider deals, securing the personal responsibility of agents, and precluding financial adventurism. These are the arrangements which seem to have received the least attention by from the playful architects of the CSFR's voucher scheme. Promises of unrealistic returns may end up in major financial scandals, and the need for the State to step in to compensate cheated small investors. This might become both very costly and harmful to the credibility of all financial institutions, especially outside the banking sphere, (i.e., it may backfire).

As we have seen above, the major issue in improving allocative efficiency is removing the sectoral ministries from investment decisions. In the CSFR, the

role of sectoral organs is anything but nominal: they have to approve the privatisation project of the company (in addition to the privatisation agency, Kupka, 1992, p. 308). Thus, two governmental bodies have discretionary rights. This is bound to enforce a structure conserving influence, and opens the door wide for bureaucratic interference. The newly proliferating investment funds also may be underinformed about firms and future returns, which might be costly (*NZZ*, 4 February 1992). All in all, at the end of the day, the appropriate legal and institutional arrangements needed for business practices accepted in civilised nations might be more important for the speed, not to speak of the sustainability, of the entire exercise than the actual time required for capital markets to develop in an orderly, organic manner. In this way, merger controls and other antitrust activities can avoid dangerous and random concentration of power in the hands of a few interests of dubious responsibility and legitimacy. These considerations usually play a role in governmental decisions in major industrial powers, including the USA, Japan, and the EC countries, in addition to the previously cited NICs. However, they might not be included in all textbooks devoted to game theory.

Social Security

A further fundamental element in deciding the success of transition is the *reform of the social security system*. The relevance of this particular issue has been revealed by Hungarian development, where many institutional arrangements already have a relatively long history of existence. For one, direct subsidies to production fell from 19 to 5 per cent of the GDP between 1989 and 1992. VAT and PIT, as well as an effective system of customs duties and a realistic exchange rate, have been around for years. State investments have contracted so much that many consider them to be below minimum, e.g., no flats are being built by the State for social purposes.

It has been a sobering lesson for Hungarian authorities to find that the rolling back of the direct economic involvement of the State has not resulted in a fundamental improvement in the budget's balance. In fact, the structural imbalance has become more obvious than before. Since two-thirds of the outlays are related to the social security system and welfare payments, Hungary has found itself to be an early-born welfare state. This implies that more services are being provided to fulfill citizens' rights than the actual level of economic development of the country can support.

The fundamental paradox in this area is that the need to act is most urgent, whereas the possibilities for a sizeable change are the least feasible, especially in political terms. On the one hand, there are no resources in a contracting economy to maintain social services. These have been granted as if the level of development actually corresponded to the figures disclosed by official statistics and as if the economy were already on the path of 'uninterrupted growth'.

Furthermore, the practice of West European welfare states and their demonstration effect make it nearly impossible for the Hungarian Government to adopt a 'wild West' type of early capitalist approach since it had already formally joined the EC Social Charter in December 1991.

It is not only the misconceived approach of those responsible (i.e., the desire to emulate practices of much more advanced economies without having attained their economic performance) which poses a problem. Development policies of the previous decades partly wasted and partly failed to accumulate the wealth which could serve these purposes. Meanwhile, a contraction in economic activity implies a growth in the number of people who are in need of the support of a social safety net. It is difficut to roll back involvement by the State in times of a protracted depression.

In other words, practices of previous decades have extended rights to many people, especially between the second and sixth decile of the income layer. The actions are not economically well-founded, but they constitute a pillar of the socio-political equilibrium. The affected people constitute the social strata most likely to lose in the newly emerging market redistribution of previous income positions and wealth: civil servants, pensioners, manual workers, the rural unskilled population, and state-employed intelligentsia. Thus, it is politically difficult to follow technocratic advice extended by international organisations to introduce more free market measures – through the insurance principle – than is customary in most West European countries (even though this would be justified on economic grounds).

There is no easy solution or trivial outcome. The ideal policies would entail a gradual, though resolute, reform of the social security system through the introduction of pay-as-you-go schemes and private insurance, beginning with incremental levels of service supply. Various mixed-up functions of the same system, i.e., health care, care for the elderly, support for the poor, etc., should be separated. In a transitory period, the introduction of non-prohibitive fees seems to be inevitable for many of the formerly free services, thus in fact institutionalising existing practice, while securing funds being reinvested in the given services. This does not, however, lead to 'self-financing' in any of the areas. Still, it could limit the exploding outlays of the State.

Early retirement is one of the ways of fighting unemployment, though it has proved to be a very costly one. Increases in the retirement age seem to be inevitable. Many other unpopular measures may become necessary even in the knowledge that they are safeguards against a budgetary explosion, not solutions to the problems faced by the respective services.

Combining high social security contributions with the concomitant low level of services is known to be the best incentive to evade taxes and depress legal economic activity in many developing countries. In Hungary, the 45 per cent contribution paid by the employer, and the additional 10 per cent paid by the employee, is a good indicator of the size of the problem. This contribution

can hardly be lowered without some withdrawal of the State from financing other activities, whose limits we have seen above.

An alternative element is broadening the tax base and drastic tightening of its collection rules along Italian and American lines. Hungarian experience, but also Polish (Dabrowski, 1992; Winiecki, 1992), Russian, and developing country experience (Tanzi, 1992, pp. 33–35), is indicative of the crucial role played by tax collection in overcoming budgetary crises, and securing social acceptance of growing income differentials. To put it briefly, the only economically sensible way of reducing the crippling size of social security contributions is the extension of taxation to areas where previously no excises existed, primarily in the sphere of the private economy. As the limits to cutting fiscal spending are more or less given, revenues have to be collected in an acceptable manner. It is hardly a sustainable situation in which governmental revenues derive primarily from the ailing and contracting public sector, whilst the booming private sector does not pay taxes to any significant degree. In addition to collection, *lower rates, simple tax rules and heavier reliance on indirect taxes* are necessary to change this situation.

Representatives of the business community would probably protest against these measures, but one should not be very serious about their outcry. All international evidence shows that reliance on indirect taxes, and low rates of corporate tax and social security contribution can, and actually in many cases do, coexist with collection rules without paralysing the propensity to invest. The latter is more inhibited by unclear property rights; proliferating, nontransparent, and inconsequent regulation, and the insecurity of wealth and income. Security of wealth and income – together with the freedom of contract and of economic activity – should be constitutionally guaranteed. Under these conditions, the above-sketched measures would certainly filter out some of the 'mafia economy' currently flourishing on the ruins of socialism all across the region. However, this would contribute to more civilised economic relations, and to improvement of the social balance of capitalist development.

Privatisation

It is hardly by chance that the ideologically dominated, fashionable issue of *privatisation* comes at the end of our policy-relevant list of problems. The experience of 1989–92 from Russia to Hungary, from Romania to the CSFR and Poland, are indicative of the following: though private activities are not slow in gaining a share in the total economy, this has more to do with the 'contraction of the cake' than with their (unquestionable) expansion. Moreover, the choice fruits already have been picked. Consequently, for what is left – loss-making large state-owned enterprises; mismanaged agricultural co-operatives: and worn-down large state-owned hotels and department stores –

there is only lukewarm interest by foreign and domestic investors alike. In other words, the exponential growth of private activities is not really the most probable scenario for the coming years. This situation might change somewhat if 'we get the prices right', i.e., ridiculously low, which might be perfectly right micro-economics, but hardly sustainable as a governmental strategy. We might dislike the nationalist wave in the region, and might be justified in our judgement, but we are certainly wrong to remove it from sight just because we talk economics.

Most economic theories – except for Marxism and its inverted variant, the property-rights school – consider ownership relations important, but not of overwhelming importance. This holds *a fortiori* for the policy perspective, since in real world economies – unlike in textbooks – we more often than not find mixed rather than other economies, especially at the lower and middle levels of development.

As we have seen above, in order to get the State out of business, there are several inter-related tasks to be mastered, and privatisation is only one of them. Given the appropriate mix of policies and institutions, public companies perform pretty well in many countries of the world (Newbery, 1992). At the same time, privatisation has brought about mixed results in different areas and countries. For instance, in Korea, one-third of companies privatised in the second half of the 1980s and early 1990s improved their performance substantially, and one-third of them maintained their efficiency level. However, some of them have gone bankrupt (Kang, 1992). In France, in most cases, major efficiency gains have been achieved *before* rather than after privatisation (Andreff, 1992). This is also in line with Hungarian experience, where a change in ownership has not always resulted in improved performance. On the other hand, in 1991, the pressure of the market forced many state enterprises to behave like private firms, i.e., to care about liquidity, sack superfluous personnel, and change the market for their product. Meanwhile, foreign investors have tended to create monopoly positions in areas where they did not exist previously, as in the sugar industry or in the production of portable gas-fillers. Reference to the shortcomings of Hungarian competition policy hardly invalidates our point, since this is what we are driving at: many things other than ownership shape the behaviour and performance of firms in the real world economy.

This is not to say that privatisation is irrelevant, but from our perspective it is by definition a longer-term process, which gains its rationale in the context of overall *Ordnungspolitik.*

What have we learned from the last few years' experience? First of all, ownership change does not seem to accompany the radical political statements of whatever colour. On the one hand, there is the CSFR's privatisation programme. However, Polish and Russian practice is much behind the self-set schedule at the time of this writing. In analysing the Polish experience, an

adherent of mass privatisation notes (Bandyk, 1992, pp. 435–436) that the implementation of the law of July 1991 proved to be a showcase for all the contradictions inherent in the scheme, primarily the conflict among its objectives. The idea of wide dispersion of ownership conflicts with the need for efficient and strong management at the stage of restructuring. The objective of obtaining a fair price is in conflict with the idea of accelerating the process. Finally, the large number of technical and political considerations that can be abstracted away while explaining a scheme on paper have risen to the surface as actual companies are prepared for sale in the form of foreign and employee ownership issues, valuation of assets, control over management, guarantees for invested money, etc. Therefore, the speed of the process is about half of that envisaged.

In Russia, as well as Hungary, spontaneous privatisation, i.e., sales on the initiative of management, continues on its way. Although a substantial number of politicians and the public have been showing animosity towards what they perceive as a conversion of political into economic power, this – and only this – process is well under way. Both in Poland and in Hungary, and to an even greater extent in Russia, governmental projects of privatisation and 'corporatisation' of firms have not yielded any result. Meanwhile, persecuted, criticised, and condemned managerial privatisations proceed. This is understandable and probably unavoidable, given the subtantial edge provided by information, and the strong motivation of managers. Most of the social apprehension comes from the knowledge that neither the last socialist governments, nor the first 'new' authorities, seem to have learned the lesson from socialist reforms. Namely, it is not sufficient for the State to withdraw, since lacking the appropriate market infrastructure and rules, egoistic special interests may prevail and create chaotic situations (Frydman and Rapaczynski, 1992, p. 267).

This implies – besides the earlier mentioned situation of an inadequate competition policy – a very shortsighted handling of labour issues; and disregard for the budget, municipalities, environmental norms, varied public concerns (insider deals sometimes in plain view), and outright theft. Given that the taxation of private activities is unresolved, and that recession implies worsening living conditions for the vast majority, it is next to impossible to find social acceptance of this kind of enrichment, which has little to do with efficiency considerations. This condition is exacerbated by cases in which it was hard to find sound economics in the privatisation and a long-term acquaintance or 'the first foreigner', etc. was the buyer.

These paradoxes underline the need for transparency, supervision, and provision of legal and institutional frameworks for what is commonly seen as fair trade. Anything which goes beyond, i.e., a sectoral policy on privatisation or the attempt to select 'appropriate' owners, is doomed to failure. Numerous articles producing one or two cases have been the result in both countries.

Turning to Russia, the situation is different inasmuch as no legal framework for privatisation was at hand until January 1992. Since then, there is a new project every month. Thus, something that the Germans would include in *Wirtschaftsverfassung* has hardly come about. Still, the army especially, but other power institutions as well, have proved to be quite successful in turning public property into private hands. This is hardly by chance, since the security of private property is not at all secured at the constitutional level. Further private property for land continues to be prohibited by the April 1992 decisions by the Russian supra-Parliament. Meanwhile, old laws persecuting speculation and profiteering are still in force, with thousands of people still being imprisoned on those charges. The Russian Parliament adopted new anti-speculation laws in March 1992. All in all, security of property is anything but certain.

It is no coincidence that with such a legal and political framework, and under the collapse of state authority and public security, the only type of private business which survives is the mafia business, in addition to various companies of the armed forces. Various mafias wage armed fights in broad daylight in major cities, and their domination of private business is one of the public secrets in Moscow. One wonders what kind of development this might lead to. Some analysts (Szilágyi, 1991) are of the opinion that this kind of intertwining is the major obstacle to the evolution of a normal market economy. Others, including this author, believe that a conceivable – though by no means forecasted – consolidation of state authority, coupled with a liberalisation of domestic and foreign competition, may well undermine the monopoly situation of present suppliers, while making the reliance on the services of informal armed groups superfluous, as we have seen in the USA and in Singapore. But only time will tell what constellation of the many 'ifs' will come true: the game is definitely open-ended.

In summation, there seems to be a modicum of truth in the somewhat cynical statement seeing an inverse relationship between privatisation projects and reality in the actual changes in ownership structures (Mizsei, 1992, p. 296). It is certainly true that illiquid and rudimentary capital markets suffering from undermanning and overregulation, with limited skills and experiences of the participants, are not very useful tools for mass privatisation projects. This would imply an equally slow pace for transformation with radical shock therapy and gradualist approaches. Moreover, the changes in governmental policies might only exert a minor influence over the actual course of events. It seems from the commonalities of the the CSFR, Polish, Hungarian and Russian developments that there may be something of a *natural rate of ownership change* which is fairly difficult not only to bypass, but also to prevent from happening. This might not be such a great problem if recognised and taken into account properly in the framework of a longer-term transformation strategy.

Concluding Remarks

What has been stated here does not support the optimism of the early years of transition, but also qualifies the present gloom stemming from the socially unpleasant repercussions of the inevitably protracted recession. In other words, the short-term perspective is basically to blame both for the unfounded euphoria following the revolutions, and for the spread of gloom and loss of perspective after only the second year of transformation.

Experience of many countries at various times has proven the possibility of stabilising an economy in just a year or two. However, if we try to list the more important measures contributing to a policy line which deserves the name 'transformation strategy', we tend to find tasks which are medium to long term in nature. Banking reform, evolution of capital markets, tax and budgetary reform, overhaul of the social security system, reform of the financing and management of public companies, and general institution-building is a time-consuming job. It is not only about an optimal blueprint and legislation; it also is about tens of thousands, indeed millions of economic agents learning, practising, and internalising the rules and their outcomes. It is a societal, self-corrective 'learning by doing' process. Even if we concede that not each and every society has to rediscover hot water in the modern world, East German experiences are clearly indicative of the limits to what can be absorbed and adopted in a short period of time, even under ideal conditions (like capital affluence, injection of human capital, and cultural/linguistic commonality).

Experiences of the reforming countries are also promising, inasmuch as the time required for transformation to be completed is certainly not measured in terms of 50–200 years. In our understanding, most countries in the world do not need a 95 per cent share of private property to have a functioning market economy, provided it is sufficiently open. If the exchange rate is right and FDI is not persecuted, realistic evaluation of capital on the one hand, and the growth of domestic savings on the other, close the gap between supply and demand for assets. Banking, taxation and social security reforms, and the evolving capital markets, ensure a sizeable increase in allocative efficiency. Thus, the organic strategy does seem to work.

What are the policy implications of all this? First and foremost, stability of the transition strategy, and avoidance of policy zig-zags and messianistic projects of whatever sort. Vacic (1992, p. 5) might be right in underscoring one of the reasons for the historical success of Western nations. This meant avoidance of major discontinuities in their socio-economic fabric, as any radical push in any direction *per se* increases the probability of counter-reaction, thus of a stop-go policy of the worst sort. Therefore, the inflationary strategy for recovery, advocated by some of the authors quoted at the beginning of this paper, seems to pose the most serious policy mistakes in terms of *conjonture*, as it would undermine fiscal stabilisation and profit perspectives.

As seen before, the present recession has roots other than insufficient domestic demand, thus a Keynesian recipe seems to be unfit for the given set of conditions.

As seen above, following the organic line requires far-sighted strategies, patience, and considerable self-restraint on the side of policy-makers. This needs to be supplemented by conceptually well-founded and technically elaborate major reforms and institution-building. For this, a broad consensus regarding the aims and means of transition is needed, otherwise excellent economic schemes will either not be translated to legislation, or worse, they will suffer from serious flaws in this course. More advanced countries with a more developed civil society and more emancipated economy might be better suited for these types of transition policies, since the reform constituency cuts across the political spectrum. Less-advanced countries with more uncertainty, less knowledge, and less information-processing ability, aggravated by a weak reform consituency, will probably experience wider movements of the political shuttle, as Daianu (1992) correctly observes. Conversely, in the latter group, the transition strategy is more contingent on the competent policy options of the ruling elite, thus the probability of a successful transition strategy under a sort of enlightened absolutism seems to be higher. This finding seems to receive indirect support from the dynamics of change in Russia as well as from the Newly Industrialised Countries. The above-sketched alternative is, of course, not policy advice or a forecast, but one of the rather plausible options one can speculate about. The problem, as we all know, is that there is no guarantee of enlightenment. Yet our policy preferences should not necessarily overshadow the lessons of development economics.

In sum, there are a growing number of signs that transition to the market will be a long journey full of trials and errors. Societies may or may not want to follow a given route, and the end result is not given by historic necessity or political wisdom. The stakes are great, international competition is stiff. The consequences for those lagging behind are evidenced by a large number of underdeveloped nations. But the chances for reintegration into the historic mainstream of economic and human development have not yet been completely missed: several candidates may well qualify.

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