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CURRENT STATE OF ECONOMIC REFORMS IN EASTERN EUROPE

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The virtually bloodless revolutions of 1989 in Eastern Europe have understandably given rise to a rich complex spectrum of controversy and debate among reformers and specialists in both East and West on the problems and prospects surrounding the ability of these economies to make a successful transition from the distorted legacy of state socialism to an economy that is steered in the main by the market mechanism. A cursory survey of the literature on the subject reveals two related yet distinct approaches. The first consists in the view - popular among the reformers in Central Europe and the CIS as well as those in the West - than an immediate transition to a market economy is an indispensible requirement for the eventual success of the projected transformation. This transition must not be gradual or evolutionary, but must simultaneously be carried out here and now (Leontief, 1990). While the other view - hardly fashionable on either side - consists in emphasising the precarious and unique nature of the enterprise and insists that there are clearly defined limits to what markets can or cannot accomplish (Aage, 1992). An uncritical hasty adoption of policies geared towards drastic systemic change must first of all reckon with the historical specificities of the conjuncture in which the East European countries find themselves in before designing strategies to accomplish the transition.

In this paper, an attempt is made to outline three major issues of the transformation currently underway in Eastern Europe. These include questions of interpretation, reform analysis and the possible lessons of the socialist experience for the developing countries. The paper is therefore divided into three modules. The first module will seek to explore some of the systemic factors underlying the breakdown of the command model. I shall seek to argue that the breakdown of Stalinist regimes in Central Europe was principally though not exclusively the result of economic factors, that the system was incapable of delivering the goods from the very outset and that the seeds of collapse are to be sought in the contradictory nature of centrally planned economies, the forms of rationality and irrationality they inhered and the manner in which the set of behaviours, institutions and motivations that were established in these economies as a result of extensive-growth oriented policies rendered it impossible for these economies to make a transition from extensive methods of accumulation to intensive resource utilisation. The second module discusses current reform initiatives in some of the East European countries. It will advance the suggestion that the widely held hypothesis in current literature on the distinction between a gradualist versus speedy approach to the problem of economic transformation must take into account a differentiation (at the policy level) between macro-economic stabilisation, liberalisation and privatisation. It will also attempt to survey the literature on the reform experiences of the Central European countries since 1989. The third module attempts to briefly point to some of the major lessons contained in the reform experiences of the erstwhile socialist experience for developing countries like India, who are currently involved in the pursuit of objectives not dissimilar to those being pursued in Eastern Europe today.

The Genesis of the Breakdown

The popular conception that few specialists had foreseen the severity of the economic crises that led to the unceremonious collapse of Stalinist regimes in Eastern Europe is, like most popular conceptions, both wrong and misplaced. While it is true that many did not, it is equally true that may did. The truth as is usually the case, lies somewhere in between. The Russian historian, Andrei Amalrik, had evoked the notion of the inevitable end of the former Soviet empire as early as 1970 (Havrylyshyn and Willamson, 1991). Over fifty years ago, the economist Friedrich A. von Hayek, had insisted upon the impossibility of central planning (Hayek, 1944, Persky, 1992). Way back in 1929, the Austrian economist, Ludwig von Mises, had categorically denied the possibility of rational economic calculation - understood in terms of an optimal allocation of resources - under socialism. According to Mises, the absence of a market in the means of production linked to private ownership would cause prices to be arbitrarily fixed as a result of which prices in such a system could not act as a guide in the rational distribution of capital goods (Hayek, Ed., 1935). The literature on the inevitable collapse of socialist central planning and its possible replacement by a market economy is again vast, rich and complex (Campbell, 1974, Drach, 1984, Aslund, 1991, Kornai, 1980, 1990).

However, the notion that the Soviet-type economy has proved to an unmitigated failure and the corresponding notion that the seeds of the collapse were present in these systems from the very outset does not however imply that the economic system of the Soviet-type was historically doomed to perish simply because the logic of the system did not correspond to that of a market economy (1). In other words, the fact that markets were suppressed in these systems provides no cause to assume that the system was intrinsically unviable. On the contrary, it is important to recognise - the collapse of the system notwithstanding - that the centrally planned system had its own economic rationality, coherence and asymmetry (Lavigne, 1974, Winiecki, 1988, Roland, 1989, Hewett, 1988, Ericson, 1992). In this respect, it was no different from economic systems elsewhere possessing as it did its own internal coherence, institutions and corresponding forms of motivations and behaviours among economic agents that simultaneously acted and counteracted the forces that sought to disturb its natural equilibrium from both within and without.

Consequently, the Soviet-type economy was not a historical aberration but a **genuine economic system**, of an extremely specific kind. Indeed, it was these specificities that contributed to insulate the system so effectively from periodic efforts to reform it: those reforms that did not threaten the foundations of the system were allowed to survive over a longer period of time in contrast to those reforms that sought to drastically transform the fundamental nature of the system which were invariably thwarted. An understanding of these specificities is an essential prerequisite to not only understanding the process of systemic transformation currently underway in Central Europe, but also to understanding the need for a comprehensively radical package of measures to transform it.

The typology of the traditional economic system of the Soviet-type is best described as a 'centralised pluralism' (Nove, 1988) or a 'decentralised monolithism' (Bauer, 1982). It was based on state ownership, centralised planning and one party dominance. These were viewed as the 'indestructible' pillars of the system by the notorious 'political economy of socialism' which was nothing but the economic ideology of state socialism (Chavance, 1980). In the industrial sector, the state was the only employer, while agriculture (with the exception of Poland which was characterised by private exploitation), was organised on an essentially cooperative basis with a more or less important role played by state farms (Balawyder, 1980). The private sector in agriculture (including individual exploitation and peasant plots) was extremely varied across all the countries, but it accounted for a fairly substantial portion (eg., 25 percent in the case of the former USSR) of total agricultural production (Wadekin, 1982). The universal condition of shortage periodically led to limited encouragement of private enterprise, but these were fiercely resisted (Aslund, 1985).

The industrial structure in centrally planned economies was essentially a three tier structure (modelled along the pattern of sectoral ministries in the former USSR), with the 'centre' at the apex of the hierarchy, a complicated ministerial system at the second level (ministries were organised upon a sectoral basis while economic administrations or state committees were organised upon a functional basis) and enterprises and production associations below. The centre consisted of the Politburo of the Communist Party, Gosplan (the State Planning Commission) and the Federal Council of Ministers. We may straightaway note the manner in which the political and the economic found themselves inextricably fused in such a system (Jeffries, 1981). Economic strategy usually consisted of two essential aspects: sectoral distrbution of investments and attaining the maximum level of production possible. The level of production was a result of the application of the maxim by the centre of fulfilling the plan at all costs.

In industry, the state was the only employer and benefitted from a rigid monopoly for the demand in manpower. Labour recruitment was usually direct. High female participation in economic activity was a specific trait of all these economies, most notably in the case of the former USSR. While the right to strike was not allowed, workers were free to not only choose their own jobs but also change it as and when they pleased. This perhaps explains the high degree of labour mobility in these economies. The right to work guarenteed by the constitution also included the obligation to work. It was virtually impossible to fire a worker.

Industrial enterprises were based upon a strong division of labour and were run on the principle of 'one-man management'. The enterprise was headed by a director who in turn was assisted by a chief engineer and assistant directors in the fields of finance,, economic analysis, personnel, supply, sales and transport. Between the worker and the manager lay the foreman who acted as an intermediary between the workers and the management and its services. Piece wages were the dominant mode of remuneration (Harazsti, 1976). Enterprises were often 'over-organised' by a disquieting proliferation in all levels management; while this certainly contributed to destroying initiative at firm level, it often led to the need for more complicated controls and controls over these controls, resulting in limiting quality and flexibility of the enterprise (Lipinski in Kaser, 1969).

The system of employment in most of these economies displayed a completely paradoxical character in that it was characterised by a simultaneous lack and excess of manpower in the production units: shortage in the labour market considered globally coexisted with a chronic excess of manpower in production units. The reasons for 'full employment' in these economies are therefore explicable by the constitutional guarentee of a job in the first instance and the acute shortage in manpower resulting from extensive methods of resource utilisation on the other (Adam, 1987).

Once the centre decided upon a certain strategy for a given period (usually five years), it joined hands with Gosplan to ensure a balance between supply and demand. Communication was essentially iterative. At a global level, this equilibrium was sought to be achieved through the system of 'material balances'. These balances were then translated into operational balances each year and communicated to branch ministries and enterprises in annual programmes. Enterprises consequently received plans which fixed in precise details their tasks in production, investment and innovation. The system was characterised by a predominance of vertical linkages; horizontal linkages were not permitted and were mediated through planning bodies in the higher levels of the hierarchy.

Inter enterprise exchanges were established on the basis of a unique and often bizarre mechanism of vertical centralisation through a network of centralised material and technical supplies. Effectively representing an organised rationing of the means of production, this system can be said to have been at the root of several forms of dysfunctioning within these economies. In all industrialised economies, the output of one enterprise forms the input of one or several other enterprises. In an economy such as the former USSR for example, which was characterised by the production of commodities extending to several million, the enormity, complexity and virtual impossibility of coherently organising and controlling the magnitude of exchanges between enterprises, branches and sectors should be easily evident. Such a system can only function on condition that all the fifty thousand odd enterpises that comprised the former Soviet economy for example, receive their inputs in time. In reality, they seldom did, resulting in cumulative disturbances including supply bottelenecks. Since enterprises are closely connected to their respective branches and since the branches themselves are interconnected, a chain of successive repurcussions is carried forward. As a result, supplies tended to remain permanently disturbed, reinforcing Nove's observation that centralising everything paradoxically frustrates the very objectives of centralised coordination (Nove, 1979, p. 156).

Major economic actors included enterprises, who were charged with the specific task of production and ministries, who were the real executive agents of the central plan. Acting as a vital intermediary between the centre on the one hand and enterprises on the other, the branch ministries were the real centres where economic power was most concentrated. The logic of the system drove ministries to compete with each for greater sectoral allocations from the centre in the same proportion as it led enterprises, to maximise their demands in resources while minimising their output potential. This competition for investment resources predictably led to a periodic dispersion of investments, inducing a cycle beginning with a initial rise in investment and a subsequent process of acceleration followed by an eventual decline resulting in recession (Chavance, 1987, Narayanswamy, 1992). The system worked in such a manner that they were in a position of strength when they sell and in a position of weakness when they buy. As far as the consumer was concerned, he was exclusively dependent on the goodwill of sellers.

The Soviet-type economy was therefore founded upon assumptions which proved to be untenable in the actual functioning of the system. These included notions that the system could register uninterrupted high growth rates and that the resulting abundance would result in the creation of a new 'socialist man' who would be devoid of socially undesirable features (Csaba, 1990). From an economic point of view, the rigid three tier system was based on the assumption that the centre not only knows or can discover what needs to be done, but it also knows or can discover how it should be done (Nove, 1982). This resulted in a system of planning which proved to be nothing more than a process of protracted bargaining between branch ministries to secure increased resource allocations from the centre on the one hand, and between enterprises, to obtain a loose plan from their respective ministries on the other.

Economic agents were judged solely on the basis of their ability to fulfil plan targets in physical terms ie., number of pairs of shoes, tons of steel, etc. Output targets (which were often accompanied by detailed instructions from the higher echelons of the planning apparatus including ministries and functional units or state committees on how much to produce in what quantity, quality, delivery, material-technical supply, utilisations norms, the wage fund, etc.,) were in principle **compulsory**. This was not value planning as much as planning in physical quantities as a result of which commercial criteria such as the role played by either prices or profits (2) was severely limited (Asselain, 1984, pp. 237-256)

The process of planning in Soviet-type economies is perhaps best described as 'a game of three players' (Drach, 1984) consisting of the centre, economic actors and users. In its barest form, the process eventually reduced itself to a generalised bargaining for investment resources generating the reproduction of 'investment hunger' which was itself a product of systemic imperatives. As Kornai expressed it, this is actually 'a discussion and bargaining process, there is power on both sides. And more. It is a hierarchy. There are many levels, and except at the very bottom or the very top, everybody has two faces. One face is shown upwards and one face is shown downwards. Everybody is bargaining more more inputs upwards and tries to be tight downwards. Everybody has two positions and two faces, it is a Janus-face behaviour. Any description of socialist systems as strict military ones with orders coming from above and everybody having to obey is naive. The boss depends to some extent on his subordinates. If he cannot be on acceptable terms with him, his life will be very unpleasant. I do not want to overstate this point. It is a centralised system. But ultimately, the centre also wants to grow, it wants to expand. There is no power, no goal conflict in the ultimate projections. It is only a bargaining about who gets more and who gets less. And everybody is running for getting more, (Kornai, 1982, p. 106). A considerable portion of investment went into the military sector.

An examination of the real process of planning in socialist economies, (which has very little to do with the formalised process described in the verbose language of the 'political economy of socialism'), lends substance to the view that the centralised economies are better described as 'centrally managed' or 'centrally administered' economies rathar than centrally planned. This is because the degree of adhocism is so pervaive and integral to the actual functioning of the system that it doubtful whether it can be described as 'centrally planned'. Thus, even while the Central European economies were subjected to a form of planning, this did not imply that actual economic development corresponded to what had been planned. On the contrary, it seldom did.

Enterprise plans were subject to a process of negotiation with their respective ministries. Systemic imperatives ('fulfil the plan at all cost), compelled enterprise directors to minimise their output potential and maximise their demands for supplies, investment funds, etc.. It was underestimated in capacities and overestimated in resources. The ministry often found itself unable to either control or process the enormous information it received from the enterprises under its control either with the requisite precision or with the requisite technical knowledge. If the director sought to obtain a 'loose' plan from the ministry, the ministry characteristically responded by imposing a 'taut' plan on the enterprise. The bargaining usually began with the level of physical production achieved during the preceding year (Birman, 1978).

Technological innovation was poor (Amann, Cooper,Davies, 1977, Brus & Laski, 1991). Since investment funds did not carry the costs and risks they would to a Western investor, the criterion of profitability or quality had little meaning. By encouraging enterprise managers to concentrate on the short term, there was no incentive to cut costs or improve quality. Modernisation was therefore slow. Shortages in investment goods led enterprise managers to use their depreciation funds to repair and maintain equipment even when it had become obsolete. On the other hand, shortage in the labour market and the uncertainties connected with the centralised system of material and technical supplies, (the supply system was surely uncertain precisely because it was centralised) led them to hoard excess stocks of manpower, raw materials and semi-finished goods. Shortage in capital goods coexisted with shortage in the consumer goods market as well as the labour market, making shortage a fundamental trait of the **normal** functioning of the system.

The predominance of physical planning caused a severe restriction in the role of either money or prices. Money had no real value to customers (3). Within the state sector, its role was essentially passive representing little more than an accounting entry in the state bank. Monetary and credit policy were thus aimed at ensuring the implementation of plan objectives and preventing or overcoming disruptions resulting from lack of funds. The role played by prices was equally passive; they could remain fixed for unusually long periods. The difference in wholesale and retail prices was the 'turnover tax' which was a kind of sales tax unrelated to either cost or value. Production prices were dissociated from consumption prices with either postive (turnover tax) or negative (subsidies) gaps (Asselain, 1984).

It should not be surprising if such a system should give rise to enormous difficulties in the actual functioning of the economy (4). The system was deeply and fundamentally flawed. In the real world, there is simply no way that the centre can either know or discover what needs to be done. It is one thing to identify the need for something like shoes, but quite another to ensure that the shoes produced actually fit those who are supposed to wear them. But more importantly, the inexorable logic centralisation (typified by the centralised fixation of prices, material-technical supply, the passive character of money, competition for greater resource allocations from the higher planning bodies which led to the generation of an insatiable thirst for investment among both enterprises and ministries, hoarding of manpower and raw materials by enterprises and the vicious circle of shortages in capital goods, consumer goods and the labour market through which the system equilibrated itself and the general aversion to risk-taking generated by the system as a result of which bureaucratic manipulation was the best means of achieving individual advancement), resulted in a situation which rendered centralised arbitration necessary for the normal functioning of the economy. Pressures for reform coexisted with equally profound pressures against reform (Hohmann, Nove, Vogel. 1986).

The major problems inherent in such a system included two sets of problems. The first set of difficulties were related to problems of information or 'informational indigestion'. This was an inevitable result of the inability of the centre to collect, process and act upon microeconomic information. The difficulty was aggravated by the fact that the information was often biased in favour of those who provide it. The second set of difficulties related to problems of coordinating economic activity at various levels of the hierarchy (eg., between the centre and ministries or between ministries and enterprises) which resulted in a variety of inconsistencies, disruptions and other specific forms of dysfunctioning which arose from the very nature of the system (5). As a result, even while the system appeared to be controlled by the centre, the desires of the centre were effectively frustrated by the system (Nove, 1979).

The system of pricing in planned economies may serve as a good illustration: in the absence of competitive markets, the structure of industrial prices renders continuation of centralised management of the economy essential on the one hand, while the latter in its turn reproduces the hetrogenity and irrationality associated with administered pricing. 'If prices cannot provide the necessary information for economic decisions', wrote the Soviet economist, Novozhilov in 1966, 'the missing information must be given under the form of an administrative directive' (Novozhilov cited in Lavigne, 1974, p. 231).

'In the USSR', wrote Nove, 'there are 12 million identifiably different products...(and these corresponded to) 48,000 plan "positions", that is to say, that the average plan "position" is an aggragation of hundreds of product variants which helps to explain why the "wrong" goods are so frequently produced' (Nove, 1983). Clearly, it is humanly impossible to control the supply and demand of twelve million commodities through adminstrative directives. Yet the Soviet-type economy as we knew it attempted to do precisely that and its ultimate failure is explicable through the fallacious assumptions on which the system was founded.

Under the circumstances, it was inevitable that proposals for reform of the system concentrate on either streamlining, improving or perfecting the system of centralised planning by reducing the burden of the centre through the introduction of intermediary cartels or combines (such as that which took place in the erstwhile GDR in the early sixties) or go in the direction of according a greater role to the market mechanism (Jeffries, 1981, Narayanswamy, 1988). The reform experiences of the Central European countries in the sixties indicate a rather negative record in both directions. For example, the alleged success of the GDR (which not too long ago was considered to the most efficient of the centrally planned economies of Eastern Europe), was stemmed from the fact that planners allowed more slack and reserve capacity in plan formulation rather than signifying a substantial improvement of the methods of centralised allocation (Granick, 1975). In most of the other countries, the reforms failed to achieve their objectives. When a market-based reform was attempted in Czechoslovakia, it was put to an unceremonious end by the Soviet invasion of that country in 1968. Hungary was perhaps the sole exception where the reforms have in greater or lesser measure survived since their introduction in 1968. Since that date, Hungary has registered significant advances in moving away from the centralised model which perhaps explains why it is better placed that the other Central European countries in effecting a transition to a market economy.

In retrospect, there appear to be two important lessons thrown up by the reform experiences of centrally planned economies which have a direct bearing on the kind of issues being discussed here. Experience suggests that (a) while it is relatively easy to establish a command economy of the Soviet-type, it is extraordinarily difficult to dismantle it once it has been constituted and (b) that the Soviet-type economy is known for its remarkable resilience to any attempt to substantively transform the status-quo. Partial reforms simply will not do. The characteristics of the system are interrelated and supporting to a degree where attempts to reform some subsets of the system merely succeed in destabilising the economy irrespective of whether the projected reform is directed towards perfecting the mechanism of centralisation or directed towards decentralisation along market lines. Being a closed system, transforming it is tantamount to simultaneously transforming its basic institutions. The extraordinarily difficult nature of the enterprise is heightened by the fact that the world has yet to witness an example of a communist economy which has been able to successfully effect a transition from an economy dominated by central controls to an economy dominated by competition. Even in the case of the Hungarian and Chinese economies, the reforms have been more successful in agriculture than in industry where problems of transformation appear to be more intractable (Richet, 1989, Chavance, 1987). Whether the transition to political democracy in Central Europe following the events of 1989 will be able to make that transition in industry less intractable remains to be seen.

The Transition to Markets in Eastern Europe

The centralised economy of the Soviet-type was therefore intrinsically incapable of coping with the needs of the Soviet and East European economies as the latter began to become more complex and mature (6). As a result, the performance of these economies began to decline sharply over time (Hohmann, Kaser, Thalheim, 1975, Hohmann, Nove & Seidenstecher, 1982). Since I have dealt with this theme elsewhere, it need not be repeated here (Narayanswamy, 1992b). Recent studies not only suggest that the decline in growth was more serious in the East European countries as compared to market economies, but also that there was an important systemic element behind the political changes in Eastern Europe: 'Our comparisons suggest that it is plausible that many people were persuaded in the 1940s and the 1950s that the centrally planned economies would ultimately surpass the market economies, but that in more recent years the observation of these economies naturally generated a sense that they were flawed and decadent' (Murrell and Olson, 1991).

The revolutions of 1989 and the demise of the Soviet Union some two years later, have provided these countries with an opportunity to opt for a Western-type pluralistic political and economic order. In most of these countries, the need to effect a transition to a full-fledged market order, has ceased to be a subject of dispute: the debate is now increasingly concentrated on the ways and means of effecting the transformation rather than questioning either the feasibility or desirability of the projected transition (Narayanswamy, 1992c). This task is essentially centered around three major issues including measures to bring about macro-economic stability, reorganising the role of the state in economic activity by removing regulatory controls and privatisation.

The biggest hurdle which is present in varying degrees across all the countries lies in the absence of a suitable theoretical 'arsenal' which can be relied upon to provide both appropriate and socially acceptable solutions. Many impressive commentaries on the past performance of the socialist planned economy offer little by way of suggesting what needs to be done. It is true that the market economy has indeed outperformed central planning (Bergson, 1991, 1992). It should also be axiomatic that the functioning of real world market economies must contain a number of useful lessons for the reforming economies of Central Europe. However, it is debatable whether the filter of standard neo-classical theory is the best means of extracting those lessons. Most East European reformers themselves believe - and in my view rightly - that it is not (Csaba, 1990). Such a view apprears to be gaining currency among mainstream economists as well (7).

A recent study by a Western economist concludes for example, that economists must look outside the standard models of competition, the focus on Pareto-efficient resource allocation and welfare theorems to build a theory of reform: 'The comparative economic experience of capitalist and socialist economies and modern economic theory offer only a diverse assortment of facts and results. There is unlikely to be a single unifying idea - such as the invisible hand - that captures the essence of this information. Hence, reformers need to be sensitive to the notion that there are many visions of the world, each with its own emphasis and assumptions, clarifying and distorting reality. Of course neoclassical economics is one of these visions; but...it is not a strong candidate to provide the underpinning for reform. Other theories could be much more relevant to the reform process. For example, reformers might want to take into account the lessons of the new informational economics which Stiglitz suggests is producing a paradigm shift in economics. Or, following Kornai, one might focus on the links between ownership systems and the viability of different coordination mechanisms. Or, there might be advantage to viewing reform through the lens of evolutionary economics' (Murrell, 1991, p. 73). Reformers might also take into account the predominantly institutional framework of the regulation school and the manner in which the latter has been applied to the processes of reform and change in the East European economies (Narayanswamy, 1986, 1992c).

This differentiation in approach to the problem of systemic transformation has not prevented reality from overtaking deliberations among reformers. While the debate continues, many of the Central European countries have begun to initiate a variety of reform packages which has so far yielded uncertain, complex and contradictory results. While it is admittedly too early to assess the impact of these changes, we may note that the process of transition has predictably begun to display major disruptions caused by (a) the disintegration of the traditional planning system, (b) the painful introduction of both market-oriented legislation and institutions and (c) severe shocks resulting from the collapse of the erstwhile CMEA and the complex bilateral trading arrangements associated with it.

Nearly all the post-socialist economies of Central Europe are in the midst of a depression: industrial production and investment has fallen by about a third since 1989, foreign trade by nearly a quarter, living standards have registered a sharp decline, inflation continues to remain high even after freeing prices and unemployment has risen from approximately zero to about 10 percent in two years in various countries. Problems of inequality and unemployment have surfaced to a degree where they threaten to bring about a further deterioration of economic and social welfare that could well endanger the reforms currently underway in the region (Chavance, 1992).

Apart from economic factors, political stability is an indispensible requirement for the successful implementation of the reforms. This is especially because what we see in Eastern Europe today is more of a transition from authoritrianism rather than a movement toward democracy (Adkins, 1991). This is especially true of Romania where the constituents of the ancien regime have been able to skillfully adapt themselves in the postsocialist order. The transition to a democratic regime based on the rule of law can be expected to be even more protracted in the newly established Commonwealth of Independent States where popular notions of democracy sharply contradict, or are at variance with, how these terms are traditionally understood in the West (8). However, the problem of securing a socially acceptable consensus by reducing popular expectations in the short term is a problem that confronts all the countries in the region. No easy solutions exist.

The unceremonious demise of the USSR has led to a variety of privatisation programmes in the new configurations of the CIS, notably in Russia and the Ukraine. In Russia itself, the unbridled chaos partly inherited from the past characterised by escalating shortages and debt crises, has made the process even more chaotic (Narayanswamy, 1991a). The dubious economic legacy of the Gorbachev era merely aggravated the process (Narayanswamy, 1992a). The Russian privatisation programme appears to a classic illustration of systemic obstacles pulverising good intentions (such as reducing the budget deficit, initiating systemic change and creating a class of proprietors). For one thing, the population is clearly unprepared to bear the costs and risks of reforms across the board. The industrial-military lobby is fighting tooth and nail against the restriction - if not disintegration - of vertical linkages that would result from the commercialisation of state-owned companies. The recent issuing of privatisation vouchers as in Czechoslovakia that can be used for buying property directly or indirectly through investment funds has not had a particularly reassuring impact on the general morale: there is still no firm evidence that it is viewed as either fair or/and transparent.

The liberalisation of prices in January 1992 took place at a time when the budget deficit was estimated to be about 20 percent of GNP and inflation in triple digits. While there is a good case against price liberalisation in the absence of control over the budget deficit and credit growth, that choice unfortunately did not exist. Rather, 'it the choice was between liberalising prices and risking hyperinflation and maintaining price controls with the consequence of growing shortages. In weighing the choice, the government no doubt took into the account the fact that a growing number of transactions were in any case bring conducted in black markets, so that the effective choice was to a considerable extent between hidden and open inflation. It must have also taken into account the unavailability of external resources to help finance the budget and stabilise the currency' (Fischer & Frenkel, 1992, p. 39). While ruble convertibility has since been achieved, it is doubtful whether the Russian government will be able to muster sufficient hard currency reserves to maintain the exchange rate which at the time of writing exceeded 350 rubles to a dollar.

The economic transformation in Eastern Europe on the other hand again presents a mixed picture with Poland, Hungary and Czechoslovakia leading the way, while the other countries (notably Bulgaria and Romania) lagging considerably behind. Yet some common similarities remain: a vibrant growing private sector coexists with a lack of clear incentives for the restructuring of large industrial enterprises in the state sector where 'the collapse of the old system has been followed by a mixture of aimlessness, political rent seeking, asset-stripping and corruption, and not by the clear motivation of wealth maximisation that comes with private ownership' (Sachs, 1992). The lack of a clear policy has led to spontaneous asset-stripping by self-dealing mangers, (popularly known as **nomenklatura** privatisation), which has resulted in raising public distrust, though perhaps to a much lesser degree than that prevailing in Russia.

The Polish experience of privatisation for example illustrates this general trend. Similar to the Yeltsin government, the coalition cabinet in which Solidarity and the communists and their allies (the latter a minority) played a leading role, inherited an economy which was already in deep crisis. The new government affirmed its commitment to a market economy and began a series of measures designed to usher in a market economy based on private ownership in two different ways: 'bottom-up' privatisation as a result of which new firms are encouraged to grow and expand and 'top-down' privatisation as a result of which state assets are transferred to private hands (Sachs, 1992). The changes that have been brought about since 1990 have been both dramatic and tangible. The currency is stable and convertible. The black market has all but disappeared and retail stores are respectably stocked (Wellisz, 1991). However, there is widespread dissatisfaction in proportion to the decline in real incomes.

The impact of the privastisation programme while positive in terms in the creation and development of the new private enterprises, privatising small shops and small industrial establishments through 'liquidation', the step by step (voluntary) process of privatising large industrial enterprises failed to take off the ground (Sachs, 1992). The collapse of the CMEA aggravated the recession, prompting the government to go in for a 'mass privatisation programme' whose results remain to be seen.

In contrast to the Polish experience, Czechoslovakia has been pursuing a dual-track policy on privatisation but here again while the easiest part of creating markets - freeing prices and wages - have been achieved, the more difficult steps of creating markets that allocate goods and factors has yet to be accomplished (Brada, 1991). A singular feature of privatisation in Czechoslovakia is the distribution if vouchers which represents a semi-free distribution of capital to citizens which enables them to bid for shares of firms being privatised. The results of these measures remain to be seen.

The Hungarian case is unique in Central Europe because it has been a pioneer is spearheading the move away from the centralised model (Hare et al. 1981, Narayanswamy, 1988, Kornai, 1992). It has had a substantial history of reform as a result of which it has gone the furthest in effecting the transition to a market economy in Central Europe. In contrast to the other economies of Central Europe, most of the measures now being implemented in Hungary were prepared and in many cases implemented before the political transformation that swept across the country in 1989 (Hare, 1991).

Hungary's approach to privatisation also differs from the kind of programmes being implemented in Poland and Czechoslovakia in this specific sense that it can be considered to be a variant of the British approach which is centered around selling shares of the companies being privatised after internal restructuring and reorganisation have been achieved either through the stock exchange or directly to an individual buyer or group of buyers (Hare, 1991). This comes close to what is being practiced in the the former GDR. It has already been attracting foreign capital and next to East Germany is probably better placed than any of the other countries in this respect. While privatisation should perhaps proceed at a faster pace, there is recognition in Hungary that it must go hand in hand with reforms in the financial sector (9).

In contrast to the process of structural transformation in Hungary, Poland and Czechoslovakia, the process of privatisation in Romania and Bulgaria do not present an encouraging picture. The problem is as much a cultural one as it is economic: the legacy of the Ceausescu era pose formidable obstacles to the development of a market economy. While privatisation of land has progressed rapidly, state enterprises in the 'strategic branches of the economy'continue to be subsidised by the state. As a result: 'There is still no clear vision of how the remnants of planning and the creation of free markets should be combined' Ben-Ner and Montias, 1991). The Romanian case also highlights the importance of having a government which enjoys significant legitimacy to bring about systemic transformation: the daunting leagacy of the Ceausescu era has caused the population to be suspicious of the motives of any government policy which suggests that it will be a long time before systemic transformation is accomplished. This is also true of Bulgaria where political reconstruction and economic restructuring has proceeded more slowly than elsewhere in Central Europe: 'Having pushed away its advantage in agriculture and relied instead on subsidised "hot-house' industry, the Bulgarian economy will face a long and hard adjustment until growth can be resumed through viable privatised enterprises' (Jackson, 1991).

This necessarily brief survey of systemic transformation in Central Europe highlights several important 'lessons' (used in the loose sense of the term) that can be isolated from the transition underway in Central Europe. First and foremost is the recognition that what is needed is a 'special dynamic analysis' (Kornai, 1992) which stems from the unique nature of the process of transformation in the region. This implies that privatisaion in Eastern Europe must be clearly separated and qualitatively distinguished from similar processes taking place in either the developing or developed countries. While in the case of the latter, privatisation is about expanding an already dominant private sector and restricting the role of the state in economic activity - as it is in India for example - postsocialist privatisation in Central Europe is about 'breaking the rule of bureaucratic coordination and rendering all of its forms subordinate to spontaneous market processes' (Csaba, 1991). In other words, this is a case of preparing privatisation without private property or where private property exists only in a very rudimentary form. Reformers are therefore caught between choosing macro-economic stability, liberalisation and privatisation; the debate on speed, sequencing and timing refer to which of these tasks need to given priority at what time, when and how.

Secondly, political liberalisation is a necessary but by no means sufficient condition to effect a transition to a market economy. The extent of bureaucratic continuity in Central Europe today, (even in Hungary, over 90 percent of its GDP was produced in the socialist sector in 1990), should be sufficient evidence to disabuse the notion that once the outdated centralised political structure is abandoned, there will be an automatic passage to a market economy. Thirdly, the process of systemic transformation in Central Europe is about creating a market economy and all the complex legal, institutional and informational mechanisms assoiated with it from scratch: the formidable obtacles posed by the disastrous legacy of state socialism is nowhere more evident than here.

Fourthly, the answer to the vexed question of whether gradual therapy or shock therapy is the most appropriate means of bringing about the transition appears to lie in the severity of the disease. Experience suggests that there is a strong case for careful sequencing and speedy implementation of structural transformation; however the monumental obstacles confronting the Central European countries provide equally strong grounds to support the implentation of radical measures gradually. There is therefore a strong case for studying past experience to extract relevant lessons rather than following textbook prescriptions. As Peter Murrell expressed it: 'In matters of economic reform, the skills and knowledge more usually associated with the philosopher and the historian must supplement those of the economic theorist and the econometrician' (Murrell, 1991).

The Hungarian economist, Laszlo Csaba points out in a recent text that in many ways the debate over gradualism versus a cold turkey approach appears to have been overstated and for that reason somewhat misplaced (Csaba, 1992). According to Csaba, this is because well-known shock therapists like Leszek Balcerowicz and Vaclav Klaus who were responsible for initiating radical reforms in Poland and Czechoslovakia were compelled to settle for gradual changes stemming from political exigencies, while the gradualist-oriented Hungarian government has followed an absolute **laissez-faire** policy against companies who suffered heavily in the wake of the collapse of Comecon markets. The question of gradualism or big-bang argues Csaba, is therefore relevant only with respect to bringing about macroeconomic stabilisation, (something which can be accomplished in a relatively short period of time), but is palpably irrelevant with respect to systemic transformation which is now universally acknowledged to be an extremely protracted process.

The experience of transforming the former GDR is a sobering example; the historical and political nature of its success is offset by the apparent failure in effecting the transition from plan to market by the wholesale export of an entire model (Collier, 1991). A report on German reunification published by the IMF argues that the Germans have perhaps been guilty of setting themselves 'idealistically high standards' as a result of which adherence to **Ordnungspolitik** (the institutional framework which guides the free play of market forces) is more easily said than done (Lipschitz & McDonald, 1990). The East German experience therefore highlights the dangers of instituting systemic change based on a model imported from outside through shock therapy and by the same token, it also illustrates the the case for a more differentiated and gradual process of transition.

It would therefore appear that the major lesson thrown up by the transition to markets in Eastern Europe considered both from the point of view of the rich debates that have been generated by the events of 1989 as well as from the reform experiences of the Central European countries since that date and earlier lies in the acknowledgement that systemic transformation will prove to be a much more clumsier and infinitely more complex process than imagined earlier (10). In other words, the role of the state as a manager in this transition is likely to be more rather than less. This is because just as markets cannot be created by decree, it is also true that new institutions seldom arise if they are not legislated. Viewed in these terms, the state has a propensity to be both a facilitator and a destroyer. In so far as this is true, it would be unrealistic to wish away its role in the process. Thus, while systemic transformation (of which expanding private property is an essential ingredient) is an important task, its focus will have to be on the long-term. This is because there appear to be elements other than just the property structure which also play a vital role in determining the competitive nature of a market (Csaba, 1992, p. 15).

The key elements of the transition will therefore have to be increasingly anchored upon creating and maintaining the quality and competitive nature of markets, coping with the organised vested interests of the state apparatus and keeping the economy open to international competition: 'Expanding private property is an important long-term task, but it is not a sufficient condition for creating competitive markets, efficient adjustment and high quality management. Cutting back the budgetary redistribution of GDP, following a policy of stable money supply and keeping markets contestable, is at least as important in the course of the transition as is the change in the property-rights structure...) Csaba, 1991). At a policy level, this will imply a greater importance to maintaing macroeconomic stability, toning public expectations down to realistic levels and strengthening democratic institutions.

Lessons of the Socialist Experience

Since I have dwelt on some of these questions in an earlier text (Narayanswamy, 1991a), I shall be brief. The Soviet model of economic development had for long been presented to the outside world as a model worthy of emulation by the developing countries. And the model did succeed in attracting or inspiring several developing countries to adopt economic institutions or policies characteristic of the economy of the Soviet-type (Wilbur, 1972, Valkenier, 1986). India was no exception.

What are the major implications of the current transformation in Eastern Europe for the developing countries, especially such countries as India, who are involved in embarking on similar though markedly more modest historic journies? It seems to me essential when speaking of the 'lessons' of the socialist developmental experience to effect a distinction between the lessons of the Soviet experience for the erstwhile socialist countries themselves and its lessons for the developing countries especially since they cannot be clearly treated on the same footing. As far as the developing countries are concerned, the lessons of the Soviet experience appear to me to be extremely instructive in a negative way, that is to say, the socialist experience is instructive to a country like India from the point of view of what the latter should **not** do rather than in a prescription of what the country **ought** to do. Schematically, these lessons include:

(a) The Soviet and East European experience of industrialisation is an eloquent testimony of the limits of extensive growth-oriented policies. Being based on a quantitative increase in the factors of production, an indiscriminte pursuit of extensive methods of resource utilisation would result in depleting the very sources that such growth policies depend upon. They are therefore limits to achieving growth through high savings and capital deepening.

(b) The socialist experience also suggests that while extensive growth-oriented policies can be useful to a country interested in expanding its infrastructure, the corresponding objective of effecting a transition to an intensive utilisation of resources can prove to be extraordinarily difficult once the basic objective of creating or establishing an infrastructure is accomplished: 'It stood to reason' wrote Dyker, '...that Soviet planning had to be planning for development - in the first instance - planning to **create** industry rather than planning to **run** industry...' (Dyker, 1985, p.3). The point is merely this: extensive growth appears to be more compatible with the task of **creating** industry rather than the more difficult task of **managing** industry **efficiently**.

As far as India is concerned, there is little doubt about the profound influence exercised by the Soviet model on Indian developmental thinking (Datar, 1972). In its formative years, this influence was mainly centered around the system of planning that was eventually adopted in India (which though very different from the imperative centralised planning of the Soviet-type was certainly inspired by the Soviet experience of industrialisation) and in the establishment of an extensive-growth oriented public sector which has grown phenomenally in the past four decades. This was followed by a growing relationship in bilateral trade and the military sector to the extent that prior to the ascension of Mikhail Gorbachev to the corridors of power in the Kremlin in March 1985, it would not have been an exaggeration to state that India's relationship with the erstwhile socialist bloc could not have been better.

A survey of the Indian economic development in the post-independence period would reveal that like most Soviet-type economies, the Indian developmental experience has also displayed a tendency to lean excessively towards distributional equality at the expense of practically neglecting efficiency (Narayanswamy, 1992d). Now that India too has decided to dismantle the legacy of state sponsored industrialisation inherited from the influence exercised by the Soviet model from the thirties to the fifties. the times are perhaps propitious for a balanced appraisal of the benefits that India had foregone in its excessive preoccupation with equality at the expense of neglecting output growth. The transition to markets in Eastern Europe - notwithstanding the qualitatively different historical settings within which the two processes are located - should not only offer rich insights by helping to avoid mistakes committed by others, but should also help in illuminating the strengths and weaknesses inherent in the path that is eventually chosen. The scope for investigation, comparison and experimentation is profound. The fact that there has been little or no work done in this area merely heightens the tension.

1. In this text, the terms 'centrally planned economy', 'Soviet-type economy', 'socialist planned economy' have been used interchangeably; unless specified otherwise, they refer to an extensive-growth oriented economy dominated by state ownership, centralised planning and one-party dominance which was characteristic of Bulgaria, Hungary, East Germany, Poland, Romania, Czechoslovakia and the former USSR.

2. Was there a fundamental incompatibility between socialism and an economy dominated by profit? Evidence suggests that there was: 'Profits', wrote Marie Lavigne, 'cannot be a real incentive in a socialist economy...profits are the best means by which they (enterprise managers) might be encouraged to act in the general interest...Socialist societies are not money oriented and that is where their strength lies. Any attempt to develop the role of profits is an attempt to change this strength into a weakness' (Lavigne in Fallenbuchl, 1975, pp. 60,61).

3. 'In this system, wages and prices have very little relation to relative use values or scarcities and reflect planners' priorities and onjectives only in the most aggregate terms. This is hardly surprising in view of the overwhelming task of keeping prices for over 24 million goods and all the varieties of labour aligned with their true and constantly changing economic values. Further, the inflexibility of prices is advantageous for purposes for measurement and physical control; financial flows than reveal physical proportions, rather than reflecting ptice changes. Since prices provide irrelevant or incorrect information about relative values and scarcities, microeconomic efficiency ie neither possible nor indeed desirable given the logic and needs of the system' (Ericson, 1991).

4. 'Management is in fact placed in an anomalous position. On the one hand, its task is to fulfil plan instructions, supposedly embodying the needs of society. On the other, these plans are frequently inconsistent and ambiguous, and in any event, the management's own proposals influence the instructions which it receives. "Many orders are written by their recipients", a Hungarian economist once remarked. So management is in fact in a position to make a whole number of choices, but its performance is evaluated in terms of plan fulfilment, and so it is constrained to use its powers to demonstrate that it has succeeded in terms of the success indicators of the plan. This frequently is to the deteriment of quality and of satisfying consumer needs" (Nove, 1983, p. 77)

5. 'The logic of a command economy', writes Ericson, 'is thus closed. Massive human and capital resources are tied up in wasteful, frequently wealth-destroying activity and must be retooled or transferred into as yet unknown configurations. Only the wholesale, complete replacement of its defining characteristics opens room for an alternative, market-based system to begin to function. Thus, the primary implication for reform arising out of the nature of the traditional economic system is that any reform must be disruptive on a historically unprecedented scale. An entire world must be discarded, including all of its economic and most of its social and political institutions and concluding with its physical structure of production, capital and technology' (Ericson, 1991).

6. 'The economic performance of the East European economies since World War II', writes Mueller, 'is a vivid illustration of the economic costs that arise in a system that is preoccupied by distributional questions. Allocative efficiency in the production of private goods and services was sacrificed to obtain distributional goals and economic security. Whatever the success of the communist systems in achieving their distributional goals is deemed to have been, they exacted a heavy cost on their citizens in reduced living standards and lost freedom of choice. Ironically, the communist systems did not even perform well in achieving public sector allocative efficiency. Environmental degradation is greater in the heretofore communist European nations than in their capitalist counterparts' (Mueller, 1991, p. 345).

7. The recognition that the neoclassical vision is but one of the many visions of the contemporary world should also be supplemented with the recognition that the Marxian vision too is but one of the many visions which simiultaneously clarify and distort reality. In the Marxian case, the excessively deterministic nature of Marx's theory of history has surely contributed to excluding the contemplation of options other than those specified by the theory. All 'visions' therefore appear to suffer from a potential danger of reducing themselves to the deterministic, teleological or absolute undercurrents that invariably accompany them. What is needed under the circumstances is a perspective which views systemic transformation as an open ended process which is pregnant with several conflicting alternatives. The eventual outcome may be positive or negative: there is no guarentee that the option which is eventually adopted will be necessarily better than the order that preceded it. As far reform dynamics is concerned, what this essentially boils down to is the fact that the vision underlying the reform must be conscious of its relativity. The reforms certainly suggest a movement from 'here' to 'there' (even while the latter is less clearer than the former), but not only is there no

guarentee that the reforms will succeed in taking these economies to their projected destination, there is also no guarentee that the new order which emerges in the wake of the old will be necessarily progressive to the one that preceded it. One merely hopes that it will.

8. Acting upon a request from **Moscow News**, the Service for the Study of Public Opinion carried out an all-Russia opinion poll to find out how democracy is understood in Russia and whether the present regime is viewed as democratic by its citizens. The results of the survey present a rather grim picture: a total of 47 respondents were unable to answer the quesion or refused to reply. In other words, more than half the population has no real conception of what democracy means. Further, the key element of democracy in the popular imagination lies in rigid control, order and the absence of conflict. Finally, the view that democracy had triumphed in the hearts of the Soviet people is held by about 3 percent of the total population. See Alexander Rubtsov, Democracy as Understood in Russia, **Moscow News**, Number 4, 1992.

9. 'Bitter conclusions can be drawn from this discourse. Even where the elemental tasks of macro stabilisation have been more or less accomplished, grave problems are constantly reproduced. Even where there has been success in approaching budgetary stability, serious pressure on public finances persists...The danger of budgetary deficit is here to stay...Any kind of quick-fix solutions can only be proposed by economic dilettantes or political tricksters...Strong and persistent efforts must be made to repress the former hyperactivity of the state and concurrently to reduce state spending, while combatting the bureaucratic, centralising tendencies that constantly revive. The change is likely to occur slowly; it will be a good while before today's big government has been reduced to government on a desirable scale...A wise and efficient government can accelerate this development and governmental errors and omissions can impede it, but the final outcome of the transition is not in the government's hands. Under the new postsocialist system, the state can at most influence the economy, which propelled by the interests of those participating in it. This is one of the main advantages a market economy has over centrally managed socialism' (Kornai, 1992),

10. 'It seems to be difficult to come to meaningful propositions about how to transform the state socialist legacy unless factors conventionally dismissed as "extraeconomic" are taken into account. The heritage of the new democracies is not confined to the need to discount the value of all stock indicators reported in official statistics. It also survives in the monopolist-minded behaviour of economic actors as well as in the nature of social expectations. On top of it, national characteristics

and historic and cultural endowments, all show marked forms of continuity. All these added together are bound to soften up any radical government project to change society, whatever its inspiration. This might also explain why the wide and various forms of interplay of specific factors have had one thing in common in all less developed countries: they have thwarted the projects based on a radical marketeer interpretation of mainstream economics' (Csaba, 1991).

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