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Introduction [to From Socialism to Market Economy]

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Introduction

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With stunning speed the socialist experiments of Eastern Europe and the Soviet Union have now apparently come to an end. Despite half a century or more of efforts directed by Communist leaders toward building socialism, the citizens of these countries now find that the structure for which they had endured great sacrifices will not survive. The citizens of these nations are now faced with the prospect of constructing a new economic structure based upon a foundation of markets and private ownership.

The problems produced by the transformation of these economies was the theme of a lecture series held at Western Michigan University during the 1990-91 school year. The lectures presented form the basis of this volume.

Marer points out that the countries of Eastern Europe have several models to emulate in creating their own market economies. These options include a social market economy of the sort typified by West Germany or a consumerist market economy of the U.S. type. The third model is a Japanese-style corporatist economy. Marer's opinion is that the East European nations are most likely to emulate the first of these versions. A social market economy fits more closely the cultural attitudes and social vision of these peoples than with the other models.

Marer argues that all successful market systems of whatever type exhibit a common set of institutional traits that are the source of their success. These include private ownership of the means of production,
the presence of strong competition and freedom of trade, a strong and convertible currency, an efficient system of financial intermediation, avoidance of prohibitive taxation, adequate infrastructure including environmental protection, a pluralist and stable political system, and the freedom to pursue personal goals.

In contrast, Marer observes that the legacy of the socialist experiments of Eastern Europe and the USSR is devoid of almost all of these features that effective market systems require. Marer’s essay, therefore, concentrates discussion upon matters of institutional change and the creation of new institutions as the primary focus of the transition process. His essay surveys the current state of affairs with regard to the above-mentioned institutional structure in the East European nations. In each case he describes the legacy of the previous system and the major obstacles facing institutional change, and he offers suggestions for various “transformation options”—the pros and cons of alternative transition strategies. The essay concludes with discussion of strategic issues such as timing and the speed of reforms and the potential role of western aid in the transition process.

The paper by Abram Bergson shifts the focus to consideration of economic reforms in the Soviet Union. Bergson’s paper provides us with a sort of “report card” or progress report on reforms in the Gorbachev era in that it indicates the nature of the reforms initiated and examines the difficulties produced as a consequence of those efforts. Bergson begins by examining the pre-Gorbachev structure of the economy and its performance. He identifies the impetus to perestroika as stemming from recognition of increasing stagnation of the rate of economic growth relative to earlier periods and to that of the West.

Bergson points out that Gorbachev’s initial response to these difficulties was to propose a restructuring of industrial planning which sought to substitute market forces for bureaucratic control in the area of enterprise operation. He reports that little actual change resulted from this attempt, a result which he attributes to the continued dominance of “state orders” in guiding production, bureaucratic opposition, lack of financial discipline, and the lack of a real price system.
Bergson also surveys the results of other elements of perestroika such as changes in property relations and the legalization of private enterprise. Here again Bergson indicates that the changes have met with rather limited success, though the growth of cooperatives appears to be an encouraging sign. Bergson identifies onerous taxation, ideological hostility, and the distortive effects of the material supply system and Soviet prices as primary obstacles to the growth of private enterprise.

Bergson devotes particular attention to the circumstances of the breakdown of the consumer goods market. He points out that while the consumer market has seldom worked well, its current status is nothing short of disastrous. The culprit Bergson identifies is a burgeoning government budget deficit which has pumped a considerable amount of purchasing power into a market already chronically in a state of excess demand. This has led to unfortunate side effects, including a "falling off of interest in work."

Bergson finds the lack of success of perestroika not too surprising, given the immensity of the task and the short period of time that has elapsed, though there is clearly an undercurrent of criticism by Bergson of the manner in which the reforms were instituted. One gets a sense that he feels "mismanagement" or lack of conceptual vision on the part of Gorbachev contributed to the current situation. He rather diplomatically asks "whether, with more skillful management at the highest level, a more favorable outcome might not have been achievable."

Joseph Berliner offers us a perspective on the origins on Gorbachev's reform efforts. Berliner's key insight is his characterization of perestroika as a "revolution from above." He reports that Soviet economic reforms, unlike those of Eastern Europe, stemmed originally not from a state of crisis or impending collapse, or even from widespread dissatisfaction of the common man. Rather, the impetus for reform arose initially from the "enlightened wing" of Communist leadership which was concerned primarily about the effects of long-term trends of lower growth rates and feeble technical progress.
The fact that *perestroika* was imposed from the top down rather than bubbling up from below explains, Berliner tells us, some of its characteristic features and peculiarities. Among those features, Berliner singles out three as being of particular importance. *Perestroika* has been actively opposed by a number of groups including workers and bureaucrats who felt threatened by the changes. Hence, *perestroika* has never had widespread popular support to invigorate it. A second effect has been a sort of aimless drift of the reform process. Those who initiated the reforms were members of a group that had never seriously questioned the overall effectiveness of the central planning mechanism and had therefore never considered alternatives to that basic framework. Last, Berliner identifies the rationale of *glasnost* and its connection to *perestroika* as arising from the same seed. He asserts that Gorbachev recognized that reforms that would need to be carried out by the party and the economic bureaucracy would be sabotaged; hence, these groups could not be counted upon to promote reform efforts. *Glasnost* thus was something of a propaganda campaign designed to discredit the existing system and its defenders and elicit popular support for reform.

Though Berliner's essay goes to considerable length to describe the disruption of the economy produced by *perestroika* and the political obstacles to solutions, one nonetheless is able to detect an occasional note of optimism in his assessment of the longer term possibilities. He sees the development of the cooperative movement and the emergence of entrepreneurial endeavors as hopeful signs of a "grass roots" movement that may be "the foundation for a subsequent major transformation of the economy."

While Bergson's and Berliner's essays seek to survey the overall impact of *perestroika*, Paul Gregory's paper narrows our focus to consideration of the role of an institution of key importance in this process—the Soviet economic bureaucracy.

Gregory characterizes *perestroika* as having proceeded in a series of stages or steps. The first stage comprising the first three to four years of Gorbachev's leadership was characterized by rather naive thinking on the part of Soviet leaders who thought that their long-term economic
decline could be reversed by relatively minor reforms of the existing economic mechanism. The second stage, beginning about 1988-89, resulted from Gorbachev’s recognition that the beliefs guiding reform in stage one were wrong. During stage two, Gorbachev sought to weaken bureaucratic control over the economy by a series of legislative actions as well as by a campaign designed to discredit bureaucrats. The third stage, which for a long time Gorbachev seemed to wish to hold in abeyance but which in light of recent events can no longer be prevented, includes the more radical reforms leading to a full-fledged market economy.

Gregory’s paper deals primarily with the opposition to reform mounted during stage two by bureaucrats. He points out that bureaucrats, who exhibited a natural antipathy toward the reform movement because of its impact upon their power and prestige, mounted their own propaganda campaign which proposed to demonstrate that delay or avoidance of reforms was in the public interest. Gregory’s discussions with bureaucrats reveal that their opposition stems from concerns not only about their own situation but also about the disruptive impacts of the reforms.

Gregory points out that bureaucratic arguments, while based upon relevant concerns— inflation will result, monopolies may arise, etc.—often fail to consider that the reforms will, in the long run, produce a more efficient system. In particular, Gregory finds fault with Soviet bureaucrats’ reluctance to consider that policies might be instituted to deal with the unfortunate effects of reform. For instance, while the privatization of the economy might well lead to the creation of monopoly power, bureaucratic planners would “plan” for competition through the creation of additional firms by the state rather than developing antitrust law and fostering competition through removing barriers to entry. Many of the difficulties with bureaucratic arguments he traces to widespread misunderstanding of the role of prices and of market forces in general.

Gregory demonstrates that as a result of Gorbachev’s efforts at discrediting the bureaucracy, much of the old command system has been broken down without its replacement by market institutions. The result
has been an even more chaotic environment, and an unfortunate side-effect has been that the resulting chaos has been attributed to marketization reforms rather than to the collapse of the planning system.

Herbert Levine's essay on the transition process points out a unique feature of the socialist reform efforts—the lack of a theory or model of the transition process. Reformers in the socialist nations can observe the features of market economies which serve as something of a blueprint for their efforts, but they have little clear guidance about how to bring such institutional structures into existence in their own countries. The situation is akin to that of a person armed with a blueprint of a "dream home," but without any carpentry skills.

Levine argues that there are two factors of key importance in the transition process: the interrelatedness of the changes that have to be made and the requirement of simultaneity in their imposition. Levine points out that even simple changes in one aspect of the economy will require a mushrooming of changes in other areas to accommodate it. Levine cites the example of the desire to change the responsiveness of Soviet managers as a case in point. In order to change managers' behavior they must be given the power to make a whole range of decisions about the use of labor, materials, and machinery. But giving managers such power requires elimination of the system of central material supply, the creation of the right to hire and fire workers, and the right to select technologies and acquire capital, which in turn requires the creation of a banking system based on a new set of lending principles. The process requires an effective price system and macroeconomic stability as well, in order for these decisions to lead to desirable results.

Levine argues that for these reforms to be effective, they must take place more or less simultaneously. This is of course a result of the interrelatedness factor just discussed. Changes in one part of the economy are dependent on changes having been made elsewhere before they can proceed. Undertaking all of these changes simultaneously raises the probability of significant disequilibria occurring.

The final essay in the series, by Josef Brada, directs our attention toward the transition problems specific to the countries of Eastern Europe. Brada informs us that these countries are currently involved in
three related processes. These include the long-run process of transforming the economy into some form of market system, the short-run process of eliminating the macroeconomic disturbances caused by the transition process, and the process of rejoining the world economy. Brada states that these three processes interact with one another "often in ways that seem unpredictable to policymakers and that are not clearly understood by the population." Brada surveys each of these processes indicating the major conceptual issues and problems arising in each of these areas. He examines the specifics of the cases of Hungary, Czechoslovakia, and Poland.

A major theme of Brada's paper is the limited window of opportunity available to political leaders in dealing with the range of problems that the transition process has thrust upon them. After years of listening to the unfulfilled promises of their Communist leaders, they are now impatient and unlikely to rally to leaders who promise a better future at the cost of still more current sacrifice. Indeed, this may be the toughest problem of all faced by the countries involved in this process.

As noted in the beginning of this introduction, these essays are based on lectures presented over the course of the 1990-91 school year. Obviously, tremendous changes have taken place in the former Soviet Union during the interim between the writing of the papers and their appearance here in print. The essays continue to inform, however, as they illuminate factors at work in the past and identify still unresolved issues. They reflect the opinions of some of the most knowledgeable of analysts of the Soviet economy at a particular point in time, and provide a backdrop for developments as they continue to unfold. I believe they will continue to provide us with valuable insights about the process of economic reform in these nations and add to the historical record of that period in the reform process.