edited by

Peter Gey, Jiří Kosta,
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CRISIS AND REFORM IN SOCIALIST ECONOMIES

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Crisis and Reform in Socialist Economies

About the Book and Editors

Providing an important overview of the growing diversity in modern socialist economies, this collection contrasts economic developments in the Soviet Union, Hungary, Poland, Yugoslavia, China, and Cuba. On the basis of empirical country studies, the authors analyze the institutional setting, economic policies, and performance of each country for the first half of the 1980s and assess the prospects for the years ahead. They examine the factors behind the success or failure of each economy and discuss the main conflicts facing today's socialist economies. This thorough evaluation provides a useful comparative view of the pressures and constraints of systemic changes in different types of socialist economies.

Dr. Peter Gey is an assistant professor and a research fellow at the Institute for Market and Planning at the University of Frankfurt, where **Dr. Jiří Kosta** is professor of economics and **Dr. Wolfgang Quaisser** is a research fellow.

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Peter Gey
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Contents

1

Diversity and Transitions in Socialist Economic Systems: A Comparative Introduction

Peter Gey and Jiří Kosta

In contrasting the economic developments in the Soviet Union, in Poland, Cuba, Yugoslavia, Hungary, and China, this collection evaluates the pressures and constraints of systemic changes in different types of socialist economies. On the basis of empirical country studies, the authors analyze the institutional setting, economic policies, and performance of each economy during the first half of the 1980s and assess the prospects for the years ahead.

This introduction begins with an overview of the growing diversity in contemporary socialist economies, showing that today it is more difficult than ever to describe the economic structures and policies characterized as "socialist." Since the facts of, and the internal and external reasons for, the economic crisis in the countries concerned are extensively presented in the individual studies, our introductory remarks then concentrate on a comparative view of the basic issues and problems of economic reforms in the socialist countries under consideration. A comparative analysis of the economic problems, which have emerged in the past during the course of market-oriented reforms such as introduced in Yugoslavia and Hungary, is also presented in the second contribution to this book.

Growing Diversity in Socialist Economic Systems

After World War II, when the Soviet Union expanded its control over a number of Eastern European countries, there was only one model of political and economic organization ideologically considered by communist parties world-wide as authentically "socialist:" the main institutions and major policy instruments which emerged during the great industrialization drive in the Soviet Union in the 1930s. Even communist leaders such as Josip Broz Tito in Yugoslavia and Mao Zedong in China, who rejected the Soviet claim to ideological and political hegemony in world socialism, did not question the so-called Soviet model of central planning and economic guidance.

The introduction of the basic elements of the Soviet economic model showed substantial time-lags due to the fact that the specific conditions varied from country to country. But from the very beginning, the means of production in key branches of the economy were rapidly nationalized and central state agencies under communist control were established, followed by the collectivization of private farmers and small owners in the areas of industry, retail trade, and services. Even the Yugoslav government, which became politically dissident in 1948, was extremely keen to present itself as truly communist in economic terms and started full-scale collectivization in the very same year. However, both the effects of the economic blockade imposed by the cominform member states and the immanent deficiencies of a rigidly centralized planning system, including a Soviet pattern of industrialization, induced the Yugoslav leadership to move away from the Soviet-type economic system, giving up collectivization and gradually introducing workers' self-management and market relations (see below).

In the 1960s, economic reforms in discussion since the mid- 1950s, were finally introduced in several Eastern European countries. But at the beginning, the reform measures adopted were not conceptually well-founded and were not basically directed against the principles of Soviet-type planning and management. Thus, with the exception of the Yugoslav challenge to the Soviet leading power within world communism, the Soviet economic model remained essentially undisputed during the 1950s and 1960s. Although some of its elements could not be established throughout the socialist countries (i.e., in Poland, the agricultural production has persisted as family farming) and despite serious political insurrections against the communist regimes (in the German Democratic Republic in 1953, in Hungary and Poland in 1956) and ultimately the attempt at developing "socialism with a human face" in Czechoslovakia (1968), economic theory and practice in the socialist countries (except Hungary, see below) were still dominated by the Soviet model up to the late 1960s. Leftist, radical approaches, such as the Cultural Revolution induced by Mao Zedong in China and the Guevarist utopia of creating a "New Man" in Cuba existing since the mid-1960s, were not considered suitable to tackle the urgent need to intensify production and, hence, were not accepted as manageable alternatives for the more industrialized socialist economies. Finally, both the Chinese and the Cuban economic models turned out to be a type of "War Communism," causing huge damage not only in terms of economic efficiency but also in human life.

The 1970s and the first half of the 1980s witnessed an overall emphasis on pragmatism in economic policy-making. At the same time, however, the diversity in institutional settings and major policy instruments in the socialist economic systems reviewed in this collection increased considerably:

Both China and Cuba adopted more realistic approaches with regards to their economic activities but the conclusions drawn from the failure of their leftist mobilization regimes were obviously not the same. The Cuban government turned back to the Soviet model of central planning and allocation. However, compared with the orthodox model of the 1961–1965 period in post-revolutionary Cuba, this renewed attempt deals, at least conceptually, with a more decentralized version of planning and management. In contrast to this, China increasingly reduced state and collective ownership and central planning, reestablishing private property rights (mostly in agriculture, small industry and services), market relations, and real monetary terms such as prices, interest, and taxes. In addition, while Cuba started to merge the remaining family farms into producers' cooperatives, the Chinese government dissolved the people's commune and redistributed land and assets to independent family units (see the essays by Peter Gey, Jiří Kosta, and Wolfgang Quaisser in this volume).

In Poland, the severe economic problems existing since the mid-1970s and the political events of 1981 paved the way for the conceptual foundation of a far reaching economic reform, gradually introduced since 1982. Unlike the period 1958–1980 when the Polish authorities showed substantial lack of consequence and patience in the realization of reform projects aimed at the transformation of the traditional Soviet model into a decentralized economic system, the institutional and instrumental changes in the 1980s have been more stable. However, the complexity of the reform and the numerous interdependencies between the basic economic mechanisms on the one hand, and the shortages and bottlenecks resulting from the economic crisis itself on the other, proved to be the main obstacles for the realization of reform laws oriented towards recovering market equilibrium, strengthening the enterprises' position against central agencies, and evoking managers' interest in the growth of exports. In the mid-1980s, direct and indirect centralization in key industrial sectors coexists with market regulation trends in the consumer-related sectors, leading to an increasing separation of economic control forms. Thus, in contrast to the reform legislation which suggested a uniform "regulated market mechanism," the present economic system in Poland can be described as a peculiar "mixed economy" (see the essay by Piotr Pysz).

In Hungary, despite some centralization tendencies in the early 1970s, the economic reforms which began in the mid-1960s have continued over the past one and a half decades, resulting in a specific Hungarian-type socialist economy. On the basis of the leading role of the party, common property of capital goods, indirect planning and market relations, the Hungarian policy-makers developed the "New Economic Mechanism" (introduced in 1968), to a comprehensive conception of a market-oriented reform, reaching beyond the traditional limits of similar reform attempts in other socialist countries. This model not only utilizes the information, incentive and coordination functions of market relations but also redefines the role of the organs of central planning and the banking system. Moreover, the existence of different social groups is ideologically acknowledged, leading to the political consequence that organs for the representation of their interests are increasingly granted (see the contribution by Andreas Wass von Czege).

During the entire post-war period, the Yugoslav economy proved to be the most flexible and changing socialist economic system. When Yugoslavia started to follow its own economic course, the institutional setting and economic rules emerging in the early 1950s, were simply called the "New Economic System." With the abandonment of the Soviet-type centrally planned system it turned out, however, that Yugoslavia, on the basis of social ownership of the means of production and workers' self-management, planned to develop a fundamentally new economic mechanism, usually described as market-socialism. For almost twenty years, the Yugoslav economy relied upon the market mechanism for the allocation of goods and services, applying decentralized planning, financial instruments and functional budgeting. Hence, it seems to be reasonable to term the Yugoslav experience as the prototype of market-oriented reforms in Soviet-type economies, the achievements and shortcomings of which are of general interest to successor countries such as Hungary and China.

On the one hand, the Yugoslav experience of market-socialism in a developing country clearly indicates that even at the beginning of the industrialization process, high rates of economic growth are compatible with considerable improvements in the population's standard of living. In this country, from 1952 to 1971, the gross domestic product (at constant prices) annually increased by 6.3%, and the real income (excluding private agriculture) by no less than 5.8%. In addition, the Yugoslav political system, although not democratic in Western terms, was not characterized by despotism and coercion. Thus, the conclusion drawn by some Western scholars that rapid industrialization requires a high degree of centralization and political coercion as provided by the Soviet-type economic model, was obviously proved incorrect by the post-war development in Yugoslavia.

On the other hand, the Yugoslav political and economic leadership failed to implement efficient macro-economic stabilization policies since it was not willing or able to develop the legal framework ~~and the~~ entire ~~range of economic~~ institutions and policy instruments usually required by market economic systems. Namely the macro-economic control of income distribution, investment allocation and financial discipline of enterprises and governmental agencies remained inefficient. Since the end of the 1960s, the shortcomings of the macro-economic arrangements and policy instruments created strong inflationary pressures, low investment efficiency, employment problems and significant dependence on external capital sources.

In the early 1970s, far reaching institutional changes indicated that the Yugoslav economic system switched from the socialist market model of the 1950s and 1960s to a basically different model, although the main principles of social ownership and self-management were not abolished. The most characteristic feature of the new economic system, usually described as "contractual," is that the market mechanism was replaced by self-management agreements between enterprises and social interest groups. As Jože Mencinger points out in his essay on the Yugoslav economy in the 1980s, the actual economic system of "social planning" has gradually acquired many characteristics of the administrative or Soviet-type system due to the fact that the abandonment of both the market and a number of "rules of the game" of the "contractual" system made more and more government interventions necessary.

In order to stop the deterioration of the Yugoslav economy indicated by nearly every macro-economic figure, a new systemic reform was introduced in 1982. Despite highly inconsistent approaches to tackling a wide range of economic problems, its main goal is clear: it is aimed at the reintroduction of the market and the reduction of several institutional arrangements of the "contractual" system introduced in the 1970s (see the chapter by Jože Mencinger).

Last but not least, in the Soviet Union itself, changes in the economic organization are under way. It remains to be seen, however, what the real consequences of General Secretary Gorbachev's "radical reform" will be. Recently, in official state and party documents, the envisaged reform measures are summed up in five elements: (1) the effectiveness of centralized economic management is to be improved by a reorganization of the planning and administrative apparatus, (2) the economic administration is to be reduced and made more efficient in order to improve the coordination between the economic management organs at different levels, (3) the autonomy of the production units is to be widened, (4) the utilization of "economic instruments" or "levers" such as financial guide parameters (normatives) and prices is to be expanded, and (5) the collective organization and stimulation of labor is to be improved via the "brigade" working groups.

These measures obviously remain in the scope of administrative reforms introduced in other centrally planned economies in the past, which aimed at "perfecting" and "improving" the traditional administrative planning system as well. However, the pressure for efficient economic reform steps will be enormous if the Soviet Union wants to meet the economic requirements a 20th century super power is confronted with. But it is pure speculation to assume that this might provoke wider margins for reforms which could go beyond the scope of the administrative system (see the essay presented by Hans-Hermann Höhmann).

Finally, let us turn our attention to more general problems concerning the transition from the traditional Soviet-type system to a market-oriented model.

Problems of Systemic Transition

In their essay on "Stagflation Problems in Socialist Economic Systems," Hartmut Bechtold and Andreas Helfer rightly refer to Kornai, showing that he was the one to convincingly expose the Soviet-type planning system as being faced with a soft budget constraint: by striving for plan fulfillment, the decision makers at all levels of the hierarchy will always allot the financial means which are necessary to meet the targets (may it be by subsidies, price increases, tax allowances, etc.).

This practice is not only a phenomenon under the system of central-directive planning. It can become even more serious when a market-oriented reform is envisaged. We know from the Yugoslav and the Hungarian example that in such a situation some elements of the centralized Soviet-type system will come into the foreground because of ideological, political and/or social determinants (see the contributions of Mencinger, Wass von Czege and Kosta). It then turns out that the budget constraint becomes softer since the administrative forms of management were loosened while neither adequate market forces in the microeconomic sphere nor appropriate fiscal and monetary policies had been developed. Let us look at this crux in more detail.

As far as prices are concerned, two points should be considered: the price level and relative prices. The level of prices is to be seen in connection with its economic impact on growth and inflation, both of which will have social implications. One can agree with the concurring opinion of economists that in order to avoid both stagnation and overheating, an inflation rate below 2% is considered to be ideal, and one between 3–7% acceptable for handling both, reform and growth. If relative prices are to correspond to the respective scarcities of different goods, then the level of prices will, no doubt, increase. And this, in turn, again brings about inflationary pressure threatening the social consensus in the country. There is no other solution, however, but to adjust relative prices, if an economical use of resources and their rational allocation is to be achieved.

In the area of work income, the reformers have to cope with a similar conflict between economic rationality and social aspects. To raise productivity, a differentiation of wages is urgently needed. Pleading for wage differences implies, no doubt, grappling with deep-rooted egalitarianism. And yet an increase of wages might bring about inflationary pressures. Again, economic criteria and social aspects come into conflict.

Two other cases of conflicting economic and social goals might appear at the enterprise level: one consists in the contradiction between the need of a rational labor input (which implies the threat of, perhaps temporary, unemployment) and the call for job security (sometimes confused with lifelong tenure in a certain job position); the other case concerns a possible conflict between the requirement of efficient management and the demand for worker's participation in decision making. Both problems are well-known in Poland, Yugoslavia, Hungary and China. Solutions can be found, in our opinion, only in reaching a compromise between economic efficiency and social aspects.

The problem of conflicting economic and social goals, however, does not only appear at the microeconomic level, it emerges in connection with policies at the macro-level as well. Under mandatory planning, the enterprises have become accustomed to bargaining for low output targets and high input assignments. Now, with the coexistence of both command planning and market-oriented policies, the former elements causing inefficiencies did not vanish, and the implementation of indirect regulation by fiscal and monetary levers was not simultaneously developed. No wonder that in Yugoslavia a galloping price inflation took place (Mencinger), in Hungary (true, for other reasons shown by Bechtold/Helfer) a type of "stagflation" occurred, and in China the state budget fell into the red. The transition to a market-oriented system must be accompanied by tight financial and monetary policies as Chinese and foreign economists emphasized during the debates in this country.

A special problem of economic equilibrium, similar in nature to the budget deficit, is that of the deterioration of the balance of payments. Hunger for investments, for consumption, and for imports—all phenomena typical for supply constrained economies—endanger macroeconomic balances, if no effective counteracting power exists. In loosening the monopoly of foreign trade, deficits in the balance of payments occur with the consequence of a decrease in the foreign exchange reserves. True, in the Hungarian case the deterioration of the terms of trade in the 1970s was a non-systemic factor, which in addition aggravated this situation. If an improvement in the external equilibrium is to be achieved, an export-oriented strategy must be initiated instead of a strategy of import substitution. This applies not only to China where the orientation is explicit; in this context, an open-door policy means that under the given conditions of overall shortages, imports of technology and the acceptance of foreign loans must be directed at promising export industries and not at domestic consumption. Here again, a conflict between long-term requirements of economic development on the one hand and short-term consumer interests, i.e. social aspects emerges.

In tackling the difficult task of hardening the budget constraint, the interdependence of different policies is to be stressed. To name one example: In neglecting rational pricing, the production and export enterprises, using their extended discretionary power, are more inclined to sell their products to domestic buyers than to foreign importers since the prices at home would be higher than the prices on world markets. To put the problem in more general terms: Only a coordinated reform approach, comprising the various areas and processes, can bring about the desired results. Solving the conflict between economic requirements and social aspects, however, will always be a balancing act.

Three Basic Issues of Systemic Transition

There are three more questions which are crucial for a transition of an economic system:

- Is a dual system bedded in a coexistence of contrary elements (plan/market, public/private ownership, etc.) at all viable, and if so, to what extent?
- Is a reform feasible, or to what degree could it be feasible, if extra-systemic factors such as inherited structures, shortages, growth patterns, etc. are unfavorable?
- Is a market-oriented reform promising if the change-over is realized gradually, or should the transition be carried out in one step ("package deal")?

Within the scope of this introduction, we can only give brief answers to these three questions.

In answer to the first question. Systems which are of a singular, non-mixed nature do not exist in the real world today. Certainly, this does not mean that any mixture of system elements such as different ownerships, different mechanisms of operation, different principles of work motivations and development strategies can be chosen arbitrarily.

In the case of economic reforms under "real socialism," one issue seems to be, in this regard, of particular importance: the compatibility of market forces being used at the enterprise level and the central allocation of primary goods and investments. If the enterprise has to react to market signals, then it should be provided with discretionary competence on the combination of all factors of production. This implies a replacement of mandatory planning by market-conform, indirect regulation of resource allocation. Speaking of investments, the introduction of a capital market would then be appropriate to cope with different problems such as rational allocation of capital and balancing of macroeconomic aggregates. And finally, further reaching decentralization of property rights should be envisaged to bring motivations and initiatives better into play than up to now (see the contribution of Bechtold and Helfer).

To the second question. We could argue in two directions: (1) one cannot start before inherited structures, imbalances and shortages have been overcome, (2) one cannot wait with the reform because within the old system the extra-systemic burden will never be removed.

Argument (2) is, in our view, more convincing. Yet, one must concede that in the Chinese case the strategy of readjustment, consisting in the shift of macroeconomic structures, essentially began under the conditions of central-directive planning, and still enjoyed some success. It was not long, however, before tendencies, well known in China from earlier times, appeared anew: a propensity to accumulate ("investment hunger") and, since the quantity drive in Chinese enterprises in connection with the extended rise strengthened, an extreme acceleration of economic growth took place (the annual growth rate of national income produced rocketed from 4.9% in 1981 to 8.3% in 1982, 9.8% in 1983, 13.9% in 1984, and finally reached its peak with 16.2% in 1985). Looking at the country studies for Yugoslavia and Hungary, the investment hunger could never be stopped. It seems to us, therefore, that a desirable growth pattern ("intensification") can only be achieved in the long run if a reform of the economic mechanism has occurred.

To the third question. Reform-minded economists in Eastern Europe argue that a gradual transformation of the old system to the new one will bring about all difficulties connected with the dual system (as pointed out under question one). And, moreover, the orthodox members of the political leadership would then try to push the reform drive back. Thus a "package deal" is recommended. This argument can be backed by the