

ECONOMIC REFORMS in EASTERN EUROPE and the SOVIET UNION

edited by
Hubert Gabrisch

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Published in cooperation with The Vienna Institute
for Comparative Economic Studies

Economic Reforms in Eastern Europe and the Soviet Union

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Economic Reforms in Eastern Europe and the Soviet Union

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**The Vienna Institute for
Comparative Economic Studies
Yearbook I—1988**

Gerhard Fink, series editor

The Vienna Institute specializes in East-West comparative economic studies and is generally considered Europe's most distinguished research organization in this field. After the first yearbook, the institute plans to issue two volumes per year. This year's selection surveys the most significant studies currently being conducted on reform in Eastern Europe and the Soviet Union.

Dr. Gerhard Fink director of The Vienna Institute.

PREFACE

This is the first yearbook of the Vienna Institute for Comparative Economic Studies, and we are greatly indebted to *Westview Press* for giving us the opportunity to publish it. The Vienna Institute is a non-profit research organization. Established fifteen years ago, it is mainly engaged in the study of the economies of the European members of the Council for Mutual Economic Assistance (CMEA or COMECON) and Yugoslavia and of the major issues of East-West trade.

We intend to edit a series of yearbooks treating of the most burning questions commanding attention at the given junction of time in the developments of the socialist countries and of East-West economic relations. Therefore we start with a volume on the problems of economic reform, probably the most topical subject of present discussions in the West. The individual studies first appeared in the publication series of the Vienna Institute (WIIW Forschungsberichte, Reprint Serie and Mitgliederinformationen) and are now offered to a broader public in a revised and updated form.

I would like to express my special thanks to Hubert Gabrisch for the compilation and revision of the present issue of the yearbook.

Gerhard Fink

ACKNOWLEDGMENTS

I had the great pleasure of completing the first yearbook of the Vienna Institute, but was also assigned the difficult task of making a choice among the many papers published by the Institute in the course of the last few years. The socialist countries are faced today with many problems: structural change, hard currency shortage and indebtedness, lack of innovative progress etc. All these problems increase the pressure for economic reform, therefore I singled out papers dealing with questions of and approaches to such reforms. In my concept of the yearbook, I intend to link more theoretical papers with highly informative country and problem studies.

The manuscripts were prepared for publication by diligent translating and improvement efforts of Fred Prager (Vienna), who shares his name with Fred Praeger (publisher, *Westview Press*) – both born in Vienna many years ago – and Eva Strobl.

Without Renate Garbacz who processed the manuscripts on computer and prepared the camera-ready copy, it would hardly have been possible to publish this yearbook on time and in its present quality.

I would also like to emphasize the invaluable assistance given by Karen Foster and, later, by Carolyn Richards of *Westview Press*, who helped me – over a distance of more than 6000 km – to bring the yearbook into shape.

To all of them my thanks are due. Yet for the yearbook's present form I am solely responsible.

Hubert Gabrisch

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INTRODUCTION

Hubert Gabrisch

Theme and Content of the Book

The following papers deal with the implementing stage of the recent economic reform thrusts in the socialist countries of Europe – the measures and concepts of the years 1981–88. These attempts were undertaken not only by countries with a long history of reform experiences, such as Hungary, or – with reservations – Poland, but also by countries whose policies have traditionally conservative and dogmatic features, such as the Soviet Union and Bulgaria. Even in Czechoslovakia the leadership that hailed the Warsaw Pact armies in 1968 to repress the reforms of the Prague Spring, gives some cautious signals of opening. Only the leaderships of GDR and Romania are unwilling to initiate reforms. What are the problems faced by the latest reform wave, and what are its characteristics – that is the main theme of this book. The authors, many of whom have for long closely followed the reform discussion, analyze the chances and limits of the reform.

The book is divided into three parts. Part I provides a fundamental examination of reform in socialist countries, as reported by Tadeusz Kowalik and Jiří Kosta. Part II contains country studies dealing with reform projects and with national and general problems of transition from centrally planned to reformed systems – Bulgaria (Ilse Grosser), Poland (Cezary Józefiak and Hubert Gabrisch), Hungary (Michael Friedländer), Czechoslovakia (Friedrich Levčík) and the Soviet Union (Peter Havlik). Part III deals with two special areas of reform: foreign trade (Peter Havlik) and the banking system (Michael Friedländer).

Basic Thinking About Reform

Comparing the scope and dynamics of the last reform movements with all previous approaches in the 1960s, 1970s and early 1980s, a basic difference should be stressed: the support given by the Soviet leadership to the very idea of reform in other countries.

Thus the present wave resembles the first wave of economic reforms in the mid-1950s. But the middle of the 1950s was a period of recovery from Stalinist terror and cold war for East European societies, some

of whom could still remember more urbane times before. It was the era of Khrushchev's destalinization – a first perestroika – and of Gomulka's "Polish way to socialism". Thus T. Kowalik in his contribution remarks that the first wave of economic reforms was "mainly based on moral and political, not on economic principles". It was still believed even by reformers such as Oskar Lange, that the central planning system would be able to ensure high growth rates. It took another thirty years of failures of the old system to convince party leaders that central planning of a mature and complex society ensures only one thing: being outdistanced by the Western societies.

By the end of the 1950s Poland's Gomulka had thrown out the reforms promised in 1956. Khrushchev had been overthrown by Brezhnev. A long lasting period of stagnation followed (except in Hungary). This was a period of sterile debate about the "transition from extensive to intensive development". When reform policies were formulated in Eastern Europe in the 1960s, 1970s and early 1980s, they were viewed by the Soviet leadership more or less mistrustfully. The latter saw their main task in the containment of reforms to the economic sphere, if necessary even by violent suppression, as in the case of the "Prague Spring" in 1968. The tedious phrase was the "Completion and improvement of the planning mechanism", and the outcomes of these policies were disastrous: today the socialist countries are threatened by stagnation, and, even worse, there is no fond hope of either growth or reform (T. Kowalik).

The principle arguments for reform are both economic and political. It is no longer believed that central planning can enable socialist countries to meet the challenges of the modern world by effecting growth led by innovation, competition and the sophisticated demands of the – mainly urban – population. The idea of supplementing or substituting the plan mechanisms by market elements is gaining ever more strength.

Whereas reform thrusts in the middle of the 1950s arose in politics and spread to the economy, and in the 1960s, 1970s and early 1980s were confined to the economy, the path is currently reversed to their spreading from the economy to politics. This is evident in the Soviet Union, in Poland, Hungary and Bulgaria. Modern party and state leaders seem to have learnt from past failures that without political reform, reforms of the economy will not succeed.

Tadeusz Kowalik and Jirí Kosta deal with the problem of whether socialist systems can be reformed. Both affirm this. But they do not offer a blueprint of the system to be aimed at, which, in any case, is probably impossible. For Kowalik, with the experiences of Poland in mind, it is far more important to know the limits to which reform policy must be adjusted. His plea for a crucial reform rejects unrealistic options, such as capitalism, or democratic socialism. In both

cases the conservatives would stage a successful comeback. A crucial reform is the implementation of institutional rules protecting the socialist economy against stagnation and frustration, e.g. principles of self-management and self-financing of the firms, limitation of state control over the economy, introduction of private, municipal, and mixed types of ownership, accepting social pluralism in non-party form. This kind of a reform would, according to Kowalik, be analogous to the Keynesian revolution of the capitalist system, aiming to protect it against unemployment and a chronically under-utilized production apparatus without changing the basic principles of the system.

But where are the social forces supporting reforms when there is no enthusiasm for either growth or for the reform? Previously, the masses believed in new party leaders and the new leaders played their power game. In the 1980s the communist parties look for ways to regain lost influence. People expect improvement of their economic, social and cultural situation. The problem of support and opposition is the main theme of the contributions of J. Kosta, discussing reform experiences in all socialist countries and of C. Józefiak, F. Levčik and H. Gabrisch, who deal with the same matter in their studies of particular countries.

There is a basic contradiction in the reform movement: the new leaders capable of formulating a meaningful reform policy were installed by the conservatives, but the latter are still in control. First, these new men have to change the power structure in society. They must become independent of the orthodox wing. Second, they must quickly improve the unsatisfactory living conditions of important social groups, mainly of the working population in town and country – as J. Kosta stresses. For instance, the Polish leadership is well aware of the necessity of an economic reform yet it is unable to put through the reform concept, because of the population's general mistrust.

Kosta mentions yet another problem: how to start the reform process? There are two approaches: many conservative economists hold that a consistent market reform cannot be entered upon before the structural imbalances and severe bottlenecks are more or less overcome. Those who hold the opposite view do not count on the likelihood of structural adaptation processes within the traditional system. Let us take Poland as an example: here a reform concept following the first approach is being pursued; imbalances and structural weaknesses are to be eliminated by price increases and a price reform. But price reforms are not very popular and therefore most controversial elements of the starting process of economic reform. To begin the reform with the most controversial measure may spark off social unrest and wage increases exceeding the price increases – as the Polish case shows. The failure of such measures hamper the whole

reform process. This lesson should be analyzed by Soviet reformers who envisage a comprehensive price reform up to 1990.

Country Studies

The present reform wave started in 1981 with hesitant reform attempts in the smaller socialist countries – mainly in Poland. It gathered speed in 1987, two years after Gorbachev had entered upon his new office as secretary general in March 1985. For two years Gorbachev followed Andropov's course (continuing the Sumy and Togliatty experiments, the temperance campaign, and encouraging the mass media in criticizing abuses), interrupted after the latter's death in 1984. The January 1987 Plenum of the Central Committee and the June Plenum, where the "Basic principles for a radical reconstruction of economic management" were adopted, were the beginnings of Gorbachev's own renewal policy (see P. Havlik's contribution). The present Soviet reform is typically one started from above, and supported from below.

The Polish reform attempt is the outcome of pressures from below, supported, more or less halfheartedly, from above. The economic disaster and the emergence of independent trade unions in 1980 forced the party to try to regain the initiative by the promise of radical reform. The scope and character of the proposed changes were without precedent – on paper. But in 1981 Poland was still under the shadow of a Soviet Union under Brezhnev's sway, and the imposition of martial law under Soviet pressure caused a major slow-down in reform policy up to 1986. What was left of the reform was merely a change of instruments of central control from direct to indirect instruments – as C. Józefiak maintains in his paper. The personal support given to Jaruzelski by Gorbachev found its response in Jaruzelski's full support for Gorbachev's reform course, first among all Eastern party and state leaders. While the idea of a "second stage of economic reform", brought up by the Polish Government in 1986, was a vague publicity stunt, the program presented in October 1987 went, in terms of the economic model envisaged, way beyond any previous concepts of reform (H. Gabrisch).

Reform efforts in Bulgaria starting in the first half of the 1980s were rather hesitant and fragmentary even on paper, characterized by elements of administrative (rather than economic) decentralization, and an inclination towards purely institutional reforms. After the new Soviet leadership had criticized the state of the Bulgarian economy in 1985, official criticism became more poignant. The practical failure of earlier reform attempts was officially admitted and calls for radical change became clamorous. The 1987 reform analyzed by I. Grosser is conceived – as in the Soviet Union – from above

and indicated a timely change in the direction of more clearly pronounced features of market-orientation.

In Hungary mandatory planning was abandoned in 1968. The reform came from above and was supported from below. But measured by expectations, the results are disappointing. In view of the deteriorating hard currency position the Central Committee Plenum of July 1987 called for a period of stabilization, in other words for a rigid austerity policy and for a new set of reforms in order – as M. Friedländer says – "to help sell this unpopular strategy". The reformers prevailed in the Politburo in May 1988; Kádár and other conservatives were replaced. The blueprints for reform in the Soviet Union, Bulgaria and Czechoslovakia go no further than what Hungary intended to introduce in 1968, and it may be anticipated that the same snags and failures will soon be encountered. The opinion, that one must go further along the same path is most clearly held among Hungarian reformers. To them the concepts of genuine markets – e.g. a capital market – are no longer just half-hearted games.

In Czechoslovakia, as F. Levčík shows in his paper, we have the peculiar situation that the most violent opponents of the 1968 reform are now obliged to introduce a comprehensive reform of the economic mechanism. The worsening economic situation and Gorbachev's plea for support for his reform measures at the Working Summit meeting of the CMEA Party leaders in the fall of 1986 has more or less forced these leaders to agree to a reform program. The approach to the reform is characterized by utmost caution so as to keep constant control over the development of the reform.

Special Areas of Reform

There are some new features in present economic reform concepts, compared with all past reform approaches. Not only is a transition from direct to indirect control to be observed, but, going even further, from indirect control to real market regulation, at least in countries such as Hungary and Poland. The strengthening of market forces means monetarization of the economy. It is hoped that some problems of monetary control – e.g. the interaction between saving and investments, or the threat of open inflation – will be solved by a banking reform, described in Friedländer's paper. Another example is the foreign trade sector whose reform aims at eliminating existing difficulties of the balance of payments, exports of manufactured goods, technological development etc. A characteristic catchword is "joint ventures" (P. Havlik).

* * *

The reform process in the socialist countries is only at its very beginning. The transition from a "Stalinist" to a "democratic" order,

and, along with that, to a more efficient economy is extremely risky. The book is intended to make a contribution to the assessment of the general and national factors that facilitate, or impede, this transition.