From Planning to Market: Paths in Central and Eastern Europe?

Mauricio Font, *Bildner Center for Western Hemisphere Studies*
&
David Jancsics, *PhD Candidate, CUNY Graduate Center*

Common Features of State Socialist Systems

(Szelenyi 2008; Brezis & Schnytzer 2003)

- One-party states, legitimated by the ideology of Marxism-Leninism
- Little or no individual private ownership of the means of production
- Centrally-planned, command economies: prices & markets play minimal allocative roles

State Socialism, 1950s-60s
Centrally Planned Economy *(Kornai 1992)*

- Emphasis on **heavy industry** as growth engine
- **Agriculture, a neglected** sector
- Large **monopolistic** socialist **firms** *(Fischer & Gelb 1991)*
- Administratively **fixed prices** do not reflect the real costs and hide subsidies *(Szelenyi 1998)*
- **Competition** and **market** mechanisms **neglected**
- **Soft budget constraint**: No particular danger in running loss and no particular advantage in making a profit. The firm survives anyway *(Kornai 1998)*
- Planning did not work: **Distorted information** at the central decision makers' level because of over-centralization.
- **Chronic shortage** *(Kornai 1959)*

Centralized vs. Reform Socialist Countries
(Fischer & Gelb 1991)

Centralized economies: Stable intervention from the central administration
Czechoslovakia, East Germany, Bulgaria, the Soviet Union (though Lieberman reform of 1965).

Reform socialist states from the 1960s: Experiments with decentralization. Greater autonomy of firms & faster response to market incentives
Yugoslavia, Hungary (since 1968), and Poland (since 1981)

Reform and Transition Timeline

- Deng Xiapoing (1978)
- Vietnam (1985)
- USSR: Liberman reform (1965) New methods of planning, 1965; Mikhail Gorbachev (1985): *perestroika & glasnost*
- Hungary (1968): New Economic Mechanism: decentralization
- Poland (1981): Commission for Economic Reform: decentralization

Hungary 1968: New Economic Mechanism (NEM) *(Balassa 1970; Gupta 1980)*

- Official reform program of the communist state
- Main goals: Creating **market** relationships among firms, using prices as allocative functions, responding to *prices to* **maximize profits**, and using profits to budget new investments
- **Decentralized** economic management: Delegate decisions to agents more familiar with markets *(Fischer & Gelb 1991)*
- **Eliminated** compulsory plan **targets**
- **"Byproduct"** of the NEM: Allowed some forms of private business and individual farming and indirectly created a **second economy**

Second Economy: Bottom-up Market Mechanisms

(Cruz & Szeleny 2002; Stark and Nee 1989; Smith and Swain 1998; Gábor 1997)

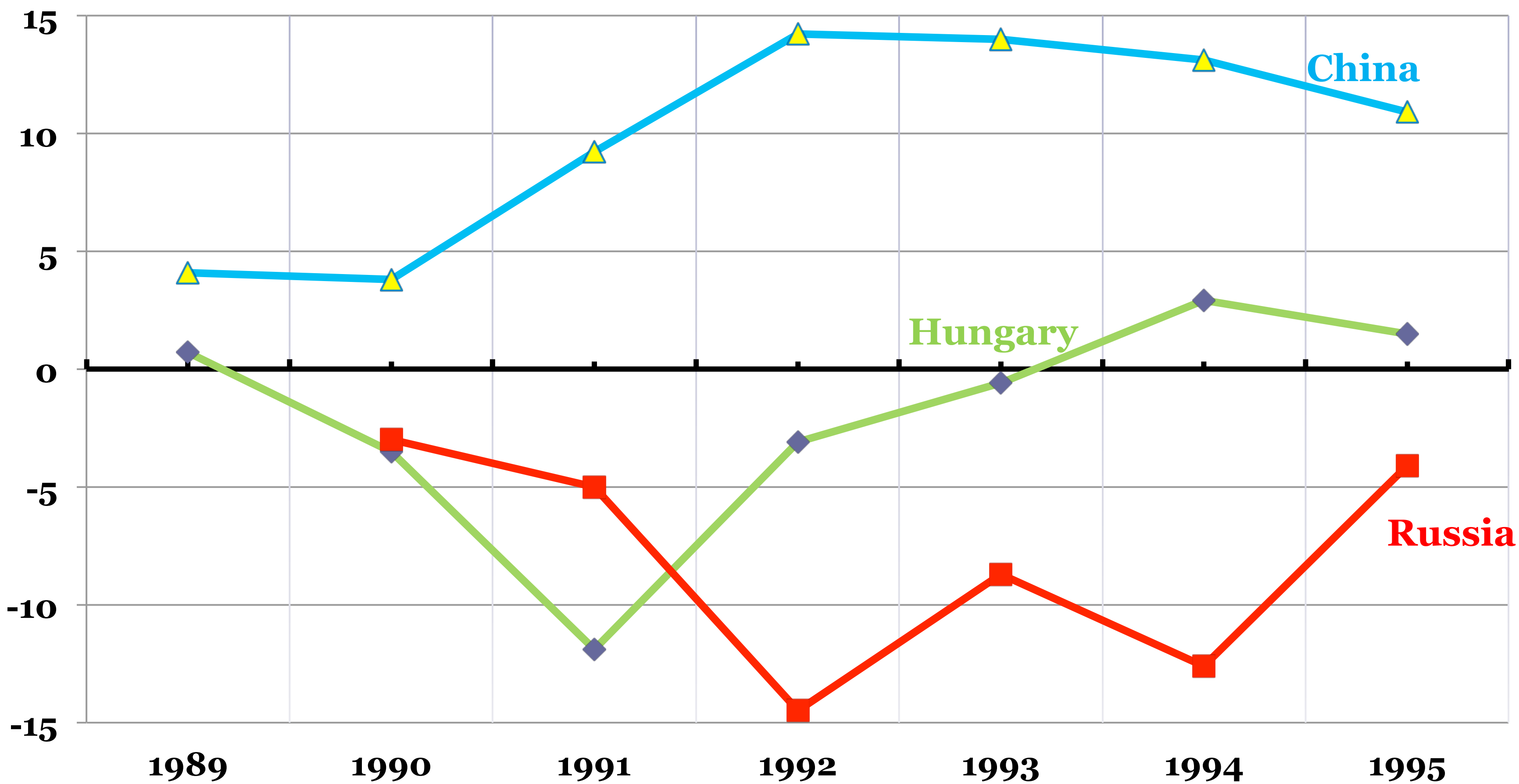
- “Not illegal” neither legalized by the state but tolerated by the authorities
- Economic sphere relatively autonomous from the state. Some power and market opportunities for peasants and workers *(Nee 1989)*
- Dynamic market mechanisms in the agriculture
- By the late 1970s this hybrid model of state-controlled large estate production and small-scale private family farming coexisted peacefully and contributed a relatively advanced agroindustry
- In the 1980s mini-farms produced about 40-50% of Hungary’s vegetables *(Agócs & Agócs 1993)*
- In the 1980s three quarters of all households received some income from the second economy *(Kornai 1989)*
- In the 1980s one third of the total active work time was spent in the second economy *(Kornai 1989)*
- Only little private property allowed: No much private accumulation of capital *(Selenyi 1998)*

From Planning to Market: Three Different Paths

- **China:** gradual transformation guided by a developmental state *(Szelenyi 2008)*
- **Russia**: "Dual" transition: economic and political liberalization. Struggle around new property rights between the political elite and oligarchs; limited institutionalization of markets; no foreign investors *(Szelenyi 2008; Burawoy 1996; Stark & Vedres 2006; Braguinsky & Myerson 2007)*
- **Central Europe** (Poland, Hungary etc.): "Dual" transition but "blurred" property rights *(Stark 1996);* cross-ownership networks in the early 1990s. "Fishing in muddy water". Privatization first and regulations only later *(Bruszt 2006)*. Significant foreign investment after mid-1990s *(Stark & Vedres 2006)*.

Annual GDP Growth (%)

Source: World Bank



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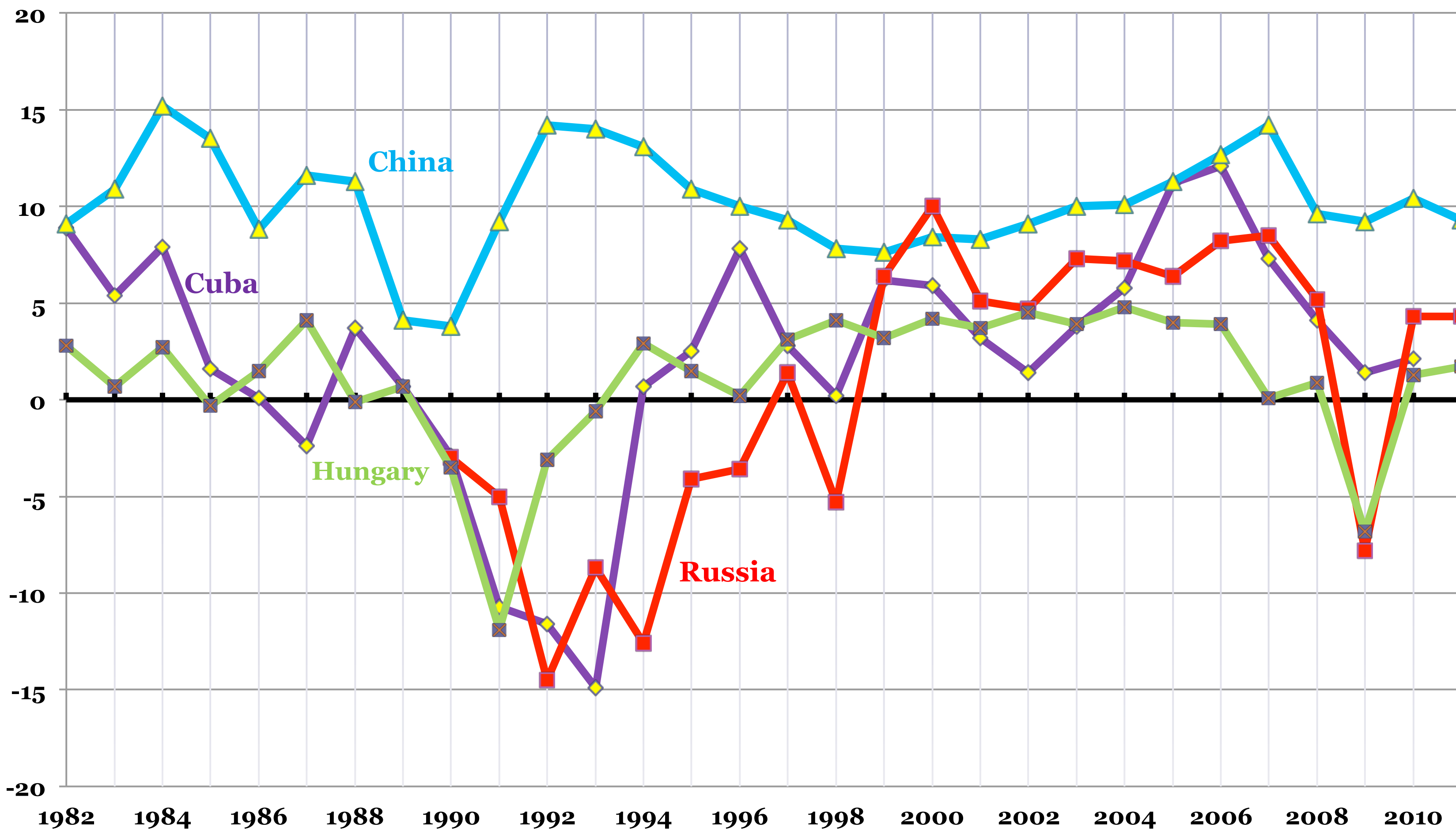

Driving Forces of Change

- **Bottom-up** mechanisms played substantial role during communism to trigger changes and reform processes in the 1970s-80s (e.g. Chinese peasants & second economy in CEE). These "socialist entrepreneurs" were regarded as the crucial driving forces of economic change
- But key changes came **top-down in 1989-90.** Main actors: developmental state (China), directors of agricultural cooperatives, socialist managers, technocratic and new political elites and foreign investors

Rapid Economic Liberalization in CEE - Suggested by the West

- 1989-1990 – Sudden and unanticipated collapse of the socialist systems in soviet bloc
- Radical economic reforms: One dose and fast treatment
- Immediate market economic turn in Central Europe
- Price and trade liberalization
- Large scale privatization (including land)
- End of state subsidies
- Elimination of import tariffs
- In some countries radical economic stabilization: reduction of inflation rates, budget deficits, and monetary expansions
- COMECON collapsed: Constraint to reorient foreign trade from East to West

Some Consequences of the Rapid Economic Liberalization

- Between 1988 & 1995 the agricultural output fell by 40% in Hungary and 30% in Russia *(Szelenyi 1998)*
- Agriculture output prices immediately driven down by unrestrained competition from West European farmers *(Baukó and Gurzó 2001; Lerman, Csaki, & Feder 2004)*
- Input prices skyrocketed due to deregulation of the prices of fuel and fertilizers (*Borzutzky & Kranidis 2005)*
- “Socialist entrepreneurs“ significantly weakened or disappeared after the collapse of the socialist systems *(Szelenyi 2008)*

Reasons for the Very Limited Role of Socialist Entrepreneurs

- Too **many** and too **small** *(Gabor 1997)*
- **Lack of capital** and access to **bank credits**
- **Lack of abilities** to analyze foreign markets and negotiate foreign contracts (e.g. language barriers)
- **Lack of protection** (e.g. tariffs) against the more experienced, well managed, and capitalized Western competition *(Szelenyi 2008)*

Role of the State in the early 1990s: Not So Much

- Economic activity was liberated from the state (Washington consensus) **but** the state was not liberated from the hold of powerful economic groups *(Bruszt 2002)*
- In the early 1990s CEE **states did not have capacity to:**
- Preserve market order
- Enforce competition
- Regulate relations among economic actors
- Reduce the dangers of regulative capturing by powerful economic groups
- **Extensive regulation** of the economy and regulatory state building began **only in the middle 1990s**, long after the introduction of liberalizing measures *(Bruszt 2002)*. **The rules were defined only after large-scale privatization and reallocation of wealth!** *(Bruszt 2006)*

Social Engineering vs. Path Dependency Approach

- **Social engineering**: Apply the blueprint (e.g. radical reforms) offered by the Western advisors to transit from socialism to market: “Planned capitalism” *(Stark & Bruszt 1998 ; Offe 1992).*
- **Path dependency:** Not a real *transition* from one order to another but a *transformation*, rearrangement and recombination of former structures *(Stark & Bruszt 1998).* **Top-down driving forces** of the past. Elite members are key players: directors of agricultural cooperatives, socialist managers, technocratic and new political elites and foreign investor

Main Problems with Strategies Adopted from the West

- **Significantly weakened** the most promising forces of social change and innovation the **socialist entrepreneurs**

- Western advisors expected that ‘radical treatment’ such as rapid economic liberalization would depoliticize the transformation. But such reforms did not touch the deep structures of CEE societies. **Communist political elites’ social networks survived** and became the winners of the transformation

Conclusion

- Decentralization and market mechanisms under socialism: The second economy complemented the state-controlled first economy and raised the standard of living of millions

- Lack of incubation program/policy to make socialist entrepreneurs less vulnerable to sudden market liberalization

- Weak states in the region: The dominant forces of socialism were able to rearrange themselves into a new capitalist class

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