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INTRODUCTION

Public Choice and the Transformation of Socialism

PETER MURRELL

University of Maryland, College Park, Maryland 20742

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This introductory essay reviews the place of public-choice theory in the study of the socialist economies of Eastern Europe and the Soviet Union and provides an overview of the papers that appear in the present volume. *J. Comp. Econom.*, **15**(2), pp. 203–210. University of Maryland, College Park, Maryland 20742. © 1991 Academic Press, Inc.

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1. PUBLIC CHOICE AND COMPARATIVE ECONOMICS

The articles in the present volume employ public-choice theory in the study of the economies of Eastern Europe and the Soviet Union and especially of the problems of the transition of these economies to market capitalism. Public choice can be defined as the field of study that applies the methodological tools of the economist to nonmarket decision making, particularly within political systems.[1] The purpose of this volume, and of the conference from which it comes, is to stimulate systematic thinking on the way in which the political processes of the socialist economies affect economic outcomes, especially during the transition to the market. Another major aim of the conference was to bring together Western and Eastern scholars to examine

[1] This definition is taken from Mueller (1989, p. 1), which is by far the best summary of the literature that public-choice theory presently enfolds. The field of public choice goes by a variety of names, including collective choice, social choice, or endogenous politics. I use the name that is presently the most popular in the United States.

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these issues collectively, sharing their different perspectives on the study of socialist politicoeconomic processes.[2]

A major impetus for the conference was the surprisingly small extent to which public-choice theory has been used in the study of comparative economic systems.[3] Comparative systems does not focus narrowly on capitalist, market processes. Hence, public-choice theory, which was originally applied to capitalist economies, should be even more useful in comparative systems than in its original domain. Moreover, there is a strong case for viewing centrally planned economies as complex political systems. One might suppose, therefore, that the public-choice framework would play a large role in comparative economics. However, a search of the first 13 volumes (1977–1989) of this *Journal* revealed only four articles that fell within the area of public choice, of which only one (Brus, 1980) provided any positive analysis of the economic behavior of Eastern Europe. Similarly, the journal *Public Choice,* and the scholars who publish therein, have been little concerned with the analysis of centrally planned economies.

Of course, the analysis of decision making within bureaucracies has been at the center of the traditional understanding of centrally planned economies. But this analysis was primarily driven by the economic theory of organizations, rather than by a conceptualization of such economies as political systems.[4] Economic agents were primarily viewed as atomistic, narrowly economic, decision makers reacting to the bureaucratic perversities of the old system. These agents were not viewed as political actors. This approach let to relative neglect of such phenomena as group interests and political coalitions that aim at changing the very structure of the system. Moreover, with economic agents primarily seen as reacting to an exogenous bureaucratic structure, the phenomenon of rent seeking did not become thoroughly integrated into the analysis of system structure. For example, highly protectionist policies were usually viewed either as following from leaders' preferences or as an economic necessity arising from the difficulty of conducting trade between planned and market economies. An application of the rent-seeking literature would cause one to gain a very different view of the structure of protection in centrally planned economies, as Brada shows clearly in this volume.

In the traditional comparative economics literature on centrally planned economies, there were two areas where elements of politics did come to the

[2] A list of conference participants appears at the end of this volume.

[3] The following paragraphs attempt to characterize the tenor of a voluminous literature. Therefore, there are exceptions in that literature to every generality that I state. Thus, one should bear in mind that this is only an attempt to reach broad generalities, not to pay due deference to distinctive contributions, for example, Montias (1982).

[4] In subjecting the existing literature to the following critical characterization, I do not exclude my own work, e.g., Murrell (1990).

fore. First, due attention was given to the important role of the Communist Party. However, for economists, the Communist Party was viewed primarily as a unitary actor, an economic bureaucracy. Where internal politics did become a concern, the focus was primarily on the politics of competition between personalities rather than between competing economic forces.[5] Second, in discussions of reforms, much emphasis was placed on the negative role of bureaucracy in blocking the implementation of decentralizing reforms. This certainly constitutes the beginnings of a public-choice analysis of the determinants of system structure. Carrying such an approach further, one might want to focus on economic agents as initiating policies and structural changes, rather than simply blocking the initiatives of the top leadership. Such is the approach taken in this volume by Szalai, who explains the policies and the structure of the Hungarian reformed economy as outcomes determined by the constellation of political forces within the country.

2. THE IMPORTANCE OF ANALYZING POLITICAL PROCESSES UNDER SOCIALISM AND DURING THE ECONOMIC TRANSFORMATION

Given the nature of centrally planned systems, one might argue that the structure of the socialist economies of Eastern Europe and the Soviet Union, and the policies implemented by them, must be explained by the interaction of political and economic forces, the essence of the public-choice approach. Interestingly, elements of such a perspective are appearing even in the Soviet Union. The historian Klyamkin argues that the Stalinist system was accepted by some groups of the population because this system benefitted these groups much more than did the New Economic Policy.[6] Following this argument to its logical conclusion, the behavior of the Stalinist system should no longer be viewed as resulting simply from the organizational properties of centralized bureaucracy. Rather, the analysis of that system would examine how the structure of economic organization reflected politicoeconomic forces, particularly those present at the system's inception. Then, inadequacies in the system would be explained as resulting from those same forces, rather than as the adventitious repercussions of an unworkable utopian scheme.

What is true for the determinants of the initial structure of a system is surely even more pertinent to temporal changes in structure. Public-choice

[5] For an example, see Aslund (1989, Chap. 2.) In some of the political science literature, there was more room for the type of phenomena considered central by the public-choice analysis of bureaucracy. See, for example, Hough and Fainsod (1979).

[6] This argument was presented in an article in *Novy Mir* in 1989 and reported in the *Soviet/East European Report* of Radio Free Europe/Radio Liberty of May 1, 1989.

analysis certainly has found a niche in analyzing endogenous government policy in market economies. Obviously, such analysis would be even more pertinent where the whole economy is a political system. For, as Kolodko (1988, p. 65) remarks, ". . . it is well known that the market does not yield to the pressures of group interests like central command planning did." Thus, the types of reforms proposed, the attempted reforms that failed, and the elements of reforms that were implemented were all a result of the complex of political forces within the centrally planned system, rather than simply a matter of choice between abstract economic models.

If, indeed, the very character of implemented reforms is endogenous, then there are profound implications for the lessons that can be derived from the pre-1989 reform experience. The countries with the deepest reforms can no longer be viewed as a random set from the economic perspective. Hence, in order to use comparative analysis to derive conclusions about the economic consequences of reforms, one must build a politicoeconomic theory of the reform decision into one's investigation.[7] An understanding of the effects of reform therefore requires an understanding of the determinants of reform, with public choice being a pertinent tool for the latter.

Turning to the present period of economic transition, the analysis of political processes is perhaps more vital than ever. Even those with only a passing acquaintance with the transition process in Eastern Europe and the Soviet Union must be struck by the primacy of politics in current economic decisions. Normative arguments based on narrowly economic considerations now take a back-seat role.[8] Thus, in privatization debates, distributional considerations command center stage and nationalist struggles and fears of foreign domination exert excessive influence on property laws; and, in discussions of the speed of price decontrol, the stability of governments becomes paramount.[9] Moreover, in reforming countries, democratic politics itself is viewed as a means of solving economic problems.[10] The need for politicoeconomic analysis of the transition is apparent.

The papers in the present volume constitute a brief introduction to the application of public choice in the study of politicoeconomic processes in

[7] This is the problem of sample selection that is common in labor economics, for example.

[8] Of course, a normative argument that the market is better than central planning begins the whole economic transformation.

[9] For an example of this point, see one of the most cited papers in the reform debate, that by Lipton and Sachs (1990). This paper, intended for an audience of Western academics, bases its justification of a draconian stabilization policy on the politics of reform in an emerging democracy.

[10] For example, Kornai (1990) envisages a large economic role for parliament in the Hungarian economic transition, while Sobchak, the Mayor of Leningrad, has advocated parliamentary control of the money supply in the Soviet Union (*Soviet and East European Report*, Nov. 10, 1990.)

socialist economies. Given the limited number of papers, the volume can only skim the surface of this vast topic. But the range of subjects examined in these papers is sufficiently broad to show the variety of insights that can be gained from the public-choice approach. The following section introduces the papers, particularly focusing on the interrelations between them and the overall view of the socialist economies that emerge from this set of papers.

3. AN INTRODUCTION TO THE VOLUME

The papers in this volume fall into two broad groups. The first group, by Brada, Murrell and Olson, Nagy, Szalai, and Popov, primarily examines the politics and economics of the old systems, rather than the economics of transition. But this set of papers does have direct relevance to the transition process, because the politics of transition is an inherited politics. The justification for this point of view rests on several premises. First, and most obviously, the old Communist Parties, or their successors, are still very important in some countries. Second, many of the old political institutions and political connections inherited from the past will not be erased overnight. Lastly, the economic forces that helped to shape the old political alignments are still in place and will be for a long time.

The second set of papers, by Mueller, Estrin, Mandler and Ryterman, and Alexeev, focuses directly on the economic and democratic transition itself. These papers approach both normative and positive aspects of the transition, examining such issues as the choice of property rights, constitutional design, and policies implementing price control.

The contribution by Brada can be viewed as paradigmatic of the way in which the public-choice approach might attempt to explain the structure of the traditional centrally planned economy. He shows that the beneficiaries of rent seeking within the foreign trade system are well-connected individuals from the bureaucratic and Party elite. Moreover, the overall structure of protection benefits the Communist Party, the owner of capital, to the detriment of the weaker factor, labor. Thus, one can argue that the structure of the foreign trade institutions of the centrally planned economy reflects the interests of the Communist Party and the governing bureaucracy. This argument constitutes the seed for an explanation of the institutional structure of the whole centrally planned system itself.

Following such a view of the determinants of system structure, the papers by Murrell and Olson and by Nagy examine the aggregate economic consequences when system design and system behavior are influenced by the changing relative power of different group interests. As these authors show, where power is narrowly concentrated, there is an impetus for growth, which is in the interests of the very top leaders of society. Over time, however, there will be increasing cohesion of lower-level politicoeconomic coalitions that affect the economic efficiency of the system. Murrell and Olson explain the decline in efficiency by decreasing bureaucratic competition, while Nagy highlights the creation of monopolies, increasingly protectionist policies, and the breakdown of central planning into a widespread system of bargaining between industrial, regional, agricultural, and military lobbies. Hence, both papers view economic decline as the breakdown of central planning into a system of politicoeconomic resource allocation. In an empirical examination of this thesis, Murrell and Olson show that the rate of growth of the centrally planned economies vis-à-vis that of the market economies declined significantly from 1950 to 1980.

The papers discussed in the foregoing paragraphs have important implications for understanding the transition to the market economy. The constellation of group interests in the transition and the consonant economic structures are a heritage of earlier times. If the rise of group interests led to a breakdown in the political and economic coherence of the old system, then the collapse of Communist regimes should not be interpreted as leaving a clean slate. The paper by Szalai underscores this point. To Szalai, the history of the Hungarian economy after 1968 is primarily the struggle between the large companies and the Party and state bureaucracy. This struggle, and the influence of economic factors on the relative power of the two groups, explains changes in policies and in the economic system itself. Indeed, the inability of the existing politicoeconomic system to contain and channel this struggle led to the decomposition of that system. Hence, during the transition, the new polity will need to confront the forces that brought about this decomposition, especially the immense power of the large companies. Szalai concludes that unless changes in ownership structure lead to a reduction in the large companies' power, the economic politics of transition might simply be a continuation of the trends of the last 20 years.

A prognosis of continuity of the old politics is, of course, most pessimistic for the Soviet Union, as Popov makes clear in his essay. Popov catalogues the opportunities for reform that were missed in the latter half of the 1980s. He reviews the political and economic forces that led to this stalemate and is not sanguine about the possibility of unblocking the stalemate. Popov is also less hopeful than the other authors in this volume concerning the usefulness of public choice in studying the socialist economies. His skepticism is based on the belief that the rational economic actor model might be inappropriately applied to a system with a very underdeveloped political culture.

The remaining papers in the volume are directly forward looking, in using public-choice theory itself to examine the institutions and policies that should, or will, be implemented in the reform process. Mueller argues that the Eastern European countries are placed in a uniquely hopeful situation, because there is almost unanimity on the need to rewrite constitutions. Hence, there is an opportunity for structuring the new political institutions

in such a way that the most deleterious effects of politics on economic performance can be removed. Lessons derived from observing the problems of Western political institutions can be used to inform the constitution-writing process, and Mueller argues that public choice is the best lens through which these lessons can be perceived. From this perspective, Mueller explores such issues as voting rules, federalism, rights, and redistribution policy.

Estrin examines the types of ownership of firms that should be considered in the new market economies. He concludes that democracy in the workplace, or self-management, should have a role. This conclusion derives from the use of public-choice theory to analyze the economic behavior of a group of self-managed firms functioning in a market economy, Italy. The effects of group decision making can be found in the economic behavior of these firms. However, these effects are not deleterious to overall economic performance.

Finally, the papers by Ryterman and Mandler and by Alexeev consider a central decision of the early stages of reform, the speed and the scope of the decontrol of prices. Ryterman and Mandler show that, because of economies of scale in the creation of markets, the ability of the state to decontrol prices gradually might be severely limited. Under such circumstances, it could be in the interests of the government to favor its constituency, workers in state enterprises, by keeping prices low in the transition, which would mean the lingering presence of queues.

Alexeev considers the fact that the decontrol of prices can lead to Pareto improvements if monetary compensation accompanies the establishment of market-clearing prices. He argues, however, that it is impossible to clearly identify the losers and gainers from price decontrol. Hence, the administration of the appropriate monetary compensation is simply impossible. Thus, the papers by Alexeev and of Ryterman and Mandler show that the economically rational policy might be blocked because of political considerations. These papers are early entrants in what is now a burgeoning area of economic literature inspired by the socialist economic transition—politicoeconomic models of the speed of transition, from both a normative and a positive point-of-view.

ACKNOWLEDGMENTS

This volume is dedicated to the Chinese economist who, before the June 1989 events in Beijing, had agreed to participate in the conference and to prepare a paper for this volume. After those events, the attendance of this scholar at the conference was foreclosed due to his compulsory daily appointments for political reeducation. His fate serves as a pertinent reminder that the individual costs of the vicissitudes of economic and political transition can be very high indeed.

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The Political Economy of Communist Foreign Trade Institutions and Policies[1]

JOSEF C. BRADA

Arizona State University, Tempe, Arizona 85287-3806

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Brada, Josef C.—The Political Economy of Communist Foreign Trade Institutions and Policies

This paper examines the design of the foreign trade institutions of centrally planned economies and the foreign trade policies followed by the Soviet Union and East Europe. At the microlevel, the design of the trade system is seen as fostering considerable opportunities for corruption and rent seeking. At a mesolevel, the objective of the trade system is seen as the protection of capital at the expense of land and labor, to the benefit of the Communist Party. At the macrolevel the political economy of CMEA trade is examined. The paper closes by examining the impact of trade flows on the distribution of political power in these economies. *J. Comp. Econom.*, June 1991, **15**(2), pp. 211–238. Arizona State University, Tempe, Arizona 85287-3806. © 1991 Academic Press, Inc.

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I. INTRODUCTION

Under reasonably general assumptions, free trade maximizes social welfare. Nevertheless, in both market and planned economies politicians have designed institutions and implemented policies that interfere with free trade by actively favoring some trade flows and restricting others. This conflict or paradox between theory and practice in market economies has led to an extensive literature on the political determinants of trade policy.[2] This literature is based on the realization that changes in trade flows influence not only

[1] I am indebted to Christopher Clague, Saul Estrin, Marie Lavigne, and Peter Murrell and conference participants for helpful comments and suggestions on an earlier draft of this paper. All shortcomings are, of course, entirely my responsibility.

[2] For an excellent survey of this literature, see Hillman (1989).

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