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Symposium on Economic Transition in the Soviet Union and Eastern Europe

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The past and present economic problems of the Soviet Union and Eastern Europe are of enormous significance for the economics profession, roughly comparable to a combination of a manned mission to Mars, a functioning Hubble space telescope, and the passage of Halley's Comet for astronomy. Like astronomers, economists must rely primarily on natural experiments for their data, and the attempt to create centrally planned socialism and the subsequent replacement of central planning by the market are two of the largest economic experiments in history.

For economists participating in or studying the economic transition of the Soviet Union and Eastern Europe, there is no more succinct statement characterizing reform than that of Vaclav Havel (1991) summarizing Czechoslovakia's experiences in the year following its "velvet revolution": "Each day brings new problems, and each day we realize how interrelated they are, and how difficult it is to establish the proper order in which to deal with them." This symposium examines the economic problems facing the reforming countries, the interrelationships between these problems, and current knowledge on how to deal with them.

Of course, economic events from many times and places have the potential to offer important lessons, but the character of the changes proposed and occurring in the Soviet Union and Eastern Europe is unique in at least two respects. First, there is the scale of change. Although each element of reform—price decontrol, privatization, stabilization, and so on—might seem familiar, the confluence of so many elements of such magnitude is

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unprecedented. The word "reform" is surely a misnomer for what is occurring; "revolution" is more fitting.

The second element of uniqueness is that the reforms entail the destruction of an existing economic system in coordination with the construction of a new one. Thus, insight into the current economic problems of the Soviet Union and Eastern Europe must begin by examining the character of the centrally planned system and the economic environment inherited by reforming governments at the end of the 1980s.

In the symposium's opening paper, Richard Ericson describes and analyzes the classical Soviet-type economy, which was created in the USSR in the late 1920s and early 1930s and which became the dominant model in the nations of Eastern Europe after the end of World War II. He argues that this system should be seen as a coherent whole, with its own equilibrating mechanisms and responses to disruption. As Ericson points out, the logic of this system is incompatible with that of a market economy. The essence of the transition to a market is therefore complete replacement of one system by another, leading to profoundly difficult questions about the way in which this can and should be accomplished.

Abram Bergson then assesses and interprets the available information on consumption levels in the Soviet Union, a piece of evidence that is central in understanding why replacement of the old system is necessary. As Bergson shows, meaningful cross-country comparisons entail complex conceptual issues, which have been compounded by the poor statistical information issued by the communist authorities. He concludes that consumption levels in the Soviet Union fall between those of Turkey and Portugal, the two least developed OECD countries.

Tables 1 and 2 offer some additional demographic and economic background information about Eastern Europe and the Soviet Union, using data necessarily much less precise than those of Bergson. Corresponding information on a few western nations is added for purposes of comparison. In reviewing these tables, readers should bear in mind that there are some natural comparisons to be made, based on the position of countries in 1950: West Germany with East Germany, Austria with Hungary, Greece with Bulgaria, and Portugal or Turkey compared with either Romania or Yugoslavia.

Given these low levels of consumption, as shown both by Bergson's article and by the tables, it is hardly surprising that pressure for reform occurred before 1989. However, earlier reforms faced political constraints, as the essay by Thomas Wolf makes clear. Wolf reviews the record of the two Eastern European countries that were most aggressive in attempting to reform a Soviet-style system: Poland and Hungary. The record of these limited reforms provides important lessons that might be used to guide or interpret the policies implemented in the 1990s.

These and other limited reforms focused on steps like the decentralization of decision-making, the scrapping of central planning, and the loosening of

Table 1
Basic Demographic Data on Eastern Europe, the Soviet Union, and Selected Western Countries

	Population (millions)	*Density (pop./ sq. km.)*	*Life Expectancy (in years)*	*Infant Mortality (per 1000)*	*Literacy Rate (percent)*	*Percent of pop. in urban area*
Bulgaria	8.9	81	72.5	12	95	66.7
Czechoslovakia	15.7	125	72.5	11	99	74.7
East Germany	16.3	154	74	7	99	76.8
Hungary	10.6	114	71	15	99	59.3
Poland	37.8	124	72.5	13	98	61.4
Romania	23.3	101	72	19	98	50.5
USSR	290.9	13	69.5	24	99	65.8
Yugoslavia	23.8	93	73	22	90.5	46.1
Austria	7.6	92	76.5	6	98	55.1
Finland	5.0	16	75.5	6	100	61.8
Greece	10.0	77	75.5	10	95	58
Portugal	10.4	113	74.5	14	83	29.7
Spain	39.3	79	78.5	6	97	91.4
Turkey	56.7	74	65.5	74	70	59.7
West Germany	62.3	255	77	6	99	86
USA	250.4	27	76.5	10	99	73.7

Notes: Population and density figures for 1990. Life expectancy at birth, figures for 1990. Infant mortality per 1000 live births, 1990 data. Literacy rate measured as percent of adult population, 1990 data. Percent of population living in urban areas, 1980s data.
Sources: Central Intelligence Agency (1990a), except for urbanization which is from United Nations (1989).

price controls, but they produced few tangible results. My essay suggests why this might be so. I argue that the superior performance of market economies over centrally planned economies cannot be understood by simply invoking the invisible hand paradigm of neoclassical economics. To provide a theoretical underpinning for economic reform in Eastern Europe, it is necessary to go beyond a characterization of capitalism that emphasizes decentralization within a price system. Simply loosening constraints to create markets is not sufficient for successful reform. Positive efforts at creation of institutions are essential in economic reform, but there is no unified economic theory on how to construct the institutions that are central to the success of capitalist economies.

Beginning with John Litwack's essay, the symposium then takes a turn toward a more normative perspective. Litwack argues that a stable legal framework is a prerequisite for successful economic reform. The experience of capitalist countries shows that the existence of a secure economic legality depends upon a complex web of social traditions and expectations. Countries that have operated for many years without such legality cannot be expected to create it quickly.

Table 2
Basic Economic Data on Eastern Europe, the Soviet Union, and Selected Western Countries

		Per capita GDP as percent of US				
	Current Inflation	*Commercial exchange rates*	*PPP rates*	*Cars per 1000 pop.*	*Telephones per 1000 pop.*	*Meat consumed (annual kgm per capita)*
Bulgaria	50	25	26	127	248	60
Czechoslovakia	9.5	17	35	186	246	76
East Germany	2	36	43	214	233	90
Hungary	29	13	30	156	152	78
Poland	690	9	25	112	122	64
Romania	25	16	19	NA	111	60
USSR	4	25	31	46	124	55
Yugoslavia	1020	14	24	129	146	47
Austria	3.2	85	62	355	525	81
Finland	6.2	107	70	343	617	59
Greece	20.4	27	32	143	413	64
Portugal	13.3	20	30	191	202	44
Spain	7.2	45	42	262	396	66
Turkey	63.6	7	20	20	91	NA
West Germany	2.7	99	74	459	650	83
USA	5.3	100	100	565	789	67

Sources and Notes: Inflation data covers consumer prices in 1990. Data from *PlanEcon Report*, December 21, 1990 and International Monetary Fund (1991). Data for East Germany is for 1989. GDP per capita as a percent of U.S. level using commercial exchange rate is for 1988, from Central Intelligence Agency (1990b); International Monetary Fund (1991); and *PlanEcon Report*, November 3, 1989. GDP per capita as a percent of U.S. level based on purchasing power parity (PPP) exchange rates is for 1988, using author's calculations based upon Central Intelligence Agency (1990b); Summers and Heston (1991); and *PlanEcon Report*, November 3, 1989. The data from the three sources have been adjusted to make all numbers roughly comparable to those in the Summers-Heston paper. The numbers for Bulgaria, Czechoslovakia, East Germany, Romania, and the USSR are much less reliable than those for the remaining countries.

Passenger cars per 1000 population from United Nations (1987). Bulgarian data is from *PlanEcon Report*, November 3, 1989; figure for Turkey is for 1985. Telephones per 1000 population is United Nations (1987). Figures for Bulgaria, Romania, Yugoslavia, USSR are from *PlanEcon Report*, November 3, 1989 and for the U.S.A. from Central Intelligence Agency (1990a). Data are for 1982 for the U.S.A. and for 1985 for Finland. Annual kilograms of meat consumed per person are for the early 1980s, data from Cook (1987) and *Statistical Abstract of the United States, 1990*.

The following five essays together provide a broad overview of economic policies for the transition.[1] Stanley Fischer and Alan Gelb consider the interactions between the various reform measures and their timing and sequencing. They argue that the appropriate way to view transition is as the sequential introduction of packages of complementary reforms. They show how the content of each of these packages depends critically on the initial conditions

[1] In the Spring 1991 issue of this journal, Vickers and Yarrow considered the issue of privatization.

faced by each country, with the element of strategy arising from the interplay between politics and economics.

A crucial element in sequencing is coordination between the loosening of the administrative controls of central planning and the creation of macroeconomic controls suitable for a market environment. As Ronald McKinnon makes clear, macroeconomic imbalances, such as large budget deficits, often arise in reforming socialist countries due to the lack of such coordination. He suggests a set of domestic monetary and tax arrangements, together with a sequencing of enterprise reforms, that might minimize such imbalances.

Jan Svejnar examines the other side of the coin—the microeconomic arrangements needed to improve efficiency and dynamism. He reviews many changes that have been made since the end of 1989 and considers how the policy agenda in the future might be structured in the light of these early developments. Guillermo Calvo and Jacob Frenkel argue that the success of transition depends upon the presence of well-functioning capital markets, and describe ways to help create such markets in the reforming socialist countries.

Karen Brooks, J. Luis Guasch, Avishay Braverman, and Csaba Csaki consider the microeconomic issues in a concrete context—the crucially important sector of agriculture. Their essay exposes the relationships between the various aspects of reform, showing that one cannot divorce agricultural reforms from the effects of stabilization programs, the creation of adequate credit markets, the struggles over the forms and scope of privatization, and the restructuring of related sectors such as food processing and fertilizers. When one also takes into account the crucial political significance of farmers and of food, the agricultural sector perfectly illustrates Havel's observation on the interrelatedness of all the problems of reform and the difficulty of establishing the proper order of dealing with them.

For natural reasons, the case of the Soviet Union often tends to dominate when discussing the lessons of reform of the socialist economies. But of course, each of the nations of Eastern Europe has its own economic, historical, and political circumstances. The symposium closes with a set of short essays on the particular circumstances of each of seven East European countries: Avner Ben-Ner and J. Michael Montias write on Romania; Josef Brada writes on Czechoslovakia; Irwin Collier on Easter Germany; Saul Estrin on Yugoslavia; Paul Hare on Hungary; Marvin Jackson on Bulgaria; and Stanislaw Wellisz on Poland. These glimpses of each country reveal the complexity of the reforms that are being undertaken and the diversity of approaches across countries, even at this early stage. Paths of reform are already diverging, and they will part further in the future.

The papers in this issue were completed in June and July of this year, but in the express train of recent events in the Soviet Union and Eastern Europe, even a few months can make a huge difference. By the time this issue reaches the mailbox, the daily newspapers may be focused on economic reform in Russia and the Ukraine and Serbia, rather than the Soviet Union and

Eastern Europe at the Beginning of 1989

Map adapted from *Communism in Eastern Europe*, edited by Teresa Rakowska-Harmstone, Second Edition, (c) 1979, 1984 by Indiana University Press. Reprinted by permission of Indiana University Press and Manchester University Press.

Yugoslavia. (In fact, we did not even try to solicit a paper specifically about the current state of the Soviet Union, given the unsettled situation of that country throughout this year.) But although the political turmoil creates new issues and difficulties, many of the underlying economic problems will remain much the same.

Economists and economic ideas are being put to the test in the economic transitions of Eastern Europe and the Soviet Union. This is evidenced by the high profile of economists in current East European governments, especially Leszek Balcerowicz and Vaclav Klaus, the finance ministers of Poland and Czechoslovakia; by the crucial role played by outside economic advisers and multilateral economic organizations; and by the eagerness of western economists to jump into the fray. Profound lessons about the nature of economic processes are sure to emerge from analyses of the centrally planned systems, the causes of their demise, and the progress of economic reforms. Moreover, the path of economic reforms will provide insights into both the potential and the limits of the discipline of economics itself, especially economics as a policy science.

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