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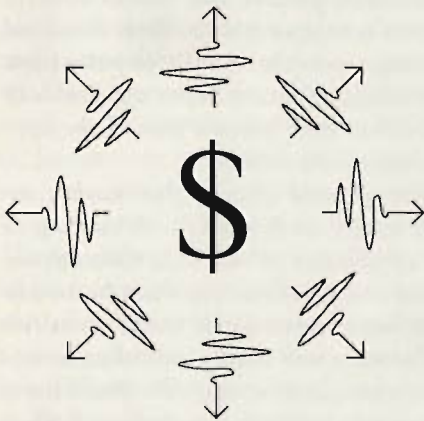
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How Far from Central Planning to a Market Economy?

A View from Albania

New economic structures in Eastern Europe and the former Soviet Union and those countries avowed desire to become market economies are among the most profound economic and institutional changes of the twentieth century. However, there seem to be some glitches along the road from centrally planned to market economies. The journey seems to be longer than most Americans, including American economists, originally thought it would be. For example, Goodwin, Grennes, and Leetmaa (*Choices* Third Quarter 1996) report very pessimistically about the current progress and prospects of agricultural reform in Russia.

In the early days of dramatic change in what was the world behind the Iron Curtain, when we still talked of *perestroika* and *glasnost* in describing the changing events, the evening news would show pictures of McDonald's in Moscow or Budapest as evidence that indeed there were moves toward a "free market" economy. The sponsor of the news program might have been General Electric, whose advertisement showed pictures of a newly privatized light bulb plant in Hungary or Poland where a joint venture with the American firm was evidence that market forces were spontaneously at work. Communism was dead, and America's businesses were carrying the message of free markets throughout the world previously closed behind the Iron Curtain.

There followed a period of considerable debate in the public press and among economists about how fast a country could move away from central planning. Jeffrey D. Sachs of Harvard advocated "cold turkey" change. There were, during

this period, debates about the various nuances of strategy—which would least disrupt social life, cause the least unemployment, etc. There were also discussions about laws and institutions most important to assure permanent transitions to market economies.

The media showed footage of spontaneous fruit and vegetable markets, and more importantly, shots of open-air markets selling all manner of hard and soft goods, rather like flea markets in the United States. Americans of all stations could rest easily, and with some self-satisfaction. Our economic system—our way of doing business—and the values it represents were prevailing in the world, prevailing particularly over the values and way of doing business that characterized the evil world of communism.

Then there is the current period that started about three or four years ago. Development assistance commitments from the U.S. and other western donors were made to various centrally planned countries and the newly emerging states of the former Soviet Union. In addition to foreign aid, large numbers of western entrepreneurs and business people found their way to these places.

Commensurate with the larger number of visitors behind the broken-down and rusted Iron Curtain, news stories started to emerge describing the growth in "western decadence" in the form of bars, discos, and strip joints and the emergence of Mafia types of organizations that now appear to dominate economic life. Business deals by foreign investors have been exceedingly difficult, very risky, and certainly not the opportunity originally expected by many western investors.

Apparently some funny things, and some not-

by
George R.
McDowell

so-funny things, have happened on the way to markets. Things have not turned out as many people in the West had thought or hoped. In some countries, second- or third-round elections have returned former communists to power—the absolute bane of American idealism and belief in the righteousness of what we have, and what we would have them have. How is it possible? What has gone wrong?

The distance to markets

What may be wrong is that we really do not know how far it is to a market economy from a centrally planned one. The distance may be obscured by our misunderstanding of our own market system. Perhaps also we do not fully understand the character



of the classic Soviet-style communist economy and thus we do not have a good measure of the starting place in those centrally planned systems. Therefore, we misjudge the changes that must be made—the distance to be crossed—between our economic system and the transformations necessary in the countries which had Soviet-style economies.

Part of our perceptive difficulties with respect to both the starting place and the desired ending place may arise because we look at trade rather than traders. As Taylor says, “Economists have been content to focus their interest...on the relation of the things exchanged. The relation of the exchangers, though it is everywhere assumed as the social condition of the economic domain, is nowhere attended to” (p. 106). This discussion will only poke at the surface of the dissonance in our understanding of the economic events in the former communist world. It will illustrate some of the distance to be crossed from a perspective gained living and working for

two years in Albania, a country that had one of the most classic Soviet-style economic systems.

One of the difficulties in describing the distance to be crossed on the way to a market economy arises from mistaken phrases and images used to describe our own economic system. Both rhetorical devices and images provided by the popular press and electronic media obfuscate important details of our own system but have become part of the conventional wisdom of our society.

Consider the oft-used phrase, *free market*, including its use earlier in this article. A viewing of the hundreds of volumes of our U.S. Commercial Code, requiring a room of its own when housed in any of our embassies around the world, does not suggest that *free* somehow means unbridled or unregulated. Our rhetoric is wrong! We don’t have, nor in my opinion do we want, free markets. Rather, what we want and have are *open markets*, with open entry and exit, with rules to the game, sometimes very elaborate rules, but rules that are relatively transparent. Anyone willing to follow those rules may enter and give it their best shot. Those who do best (efficient) grow and prosper. Unfortunately, free markets (unbridled and unregulated) are emerging in much of the formerly communist world, and that is part of the problem.

The open-air fruit and vegetable markets and the clothing and goods markets, whose images flashed across our TV screens as evidence of the demise of communism and the rise of capitalism in the former communist world, are really closer to free markets than to open markets. In those places there is no security of contracts or even surety that the goods for sale are as represented. A Phillips clothes washer may or may not be authentic, and a bottle of cola soft drink with the familiar red and white italic lettering and swirl is called “Joka Cola.” There is only one rule—*caveat emptor*—let the buyer beware. Frequently the performance of even those free markets could be substantially improved by the minimal involvement (intrusion) of government in the form of cement to keep both buyers and sellers out of the mud.

Consider also the deal between General Electric and Poland or Hungary on the privatization of the light bulb plant. By one perspective, both the light-bulb factory and the McDonald’s fast food restaurants were simply deals by large American corporations with the remnant state authorities. Such deals may represent an awareness on the part of corporate America that you had better be big to undertake the risk involved in doing business with those state organizations. Again the operative rule appears to be *caveat emptor*. About the only protection to the western investors against the (former) communist state or its agency renegeing on agreements is the loss of

future investments. When the American corporate investor is large and highly visible, the future possible loss to a Russia or Macedonia from a deal gone sour may be very large indeed.

In the former planned economies, the spontaneous free markets in fields, wide places in the road, and vacant lots in central cities are the implicit acknowledgment of the efficacy of the concepts of supply and demand and consumer sovereignty. Classic Soviet-style economies as represented by Albania were strictly supply-side economies with the sovereign state determining what people needed. The investments by American firms in the economies emerging from the control of communism are virtually without legal protection; there are deals to be made in those places but not a reliable market. It is difficult to see that those deals represent much in the way of change in those societies except for a modest bowing to some consumption demands by citizens and the growing recognition by communist leaders that some capitalist firms had needed investment funds. The images of privatized manufacturing plants used to reassure us about change in the communist world were misleading. The deals of corporate America in former communist states do not mean much of anything in transferring the elements of our society that give rise to and underpin our economic system.

Bromley (*Choices* Fourth Quarter 1993) helps describe the essential elements of our economic system when he argues that privatization and decollectivization of the farming sector in Russia is a minor problem with potential for minimal gains as compared to the gains to be made by establishing conditions whereby there is "a coherent legal system." The legal system required to support a market economy, he argues (p. 7), is one that "indicates (1) clear lines of authority and the division of responsibility among governmental units; (2) clarity and precision in legal rules; (3) mechanisms and processes for the protection of property rights; (4) procedures that offer stability and predictability; (5) a sense of fairness focused on law as a process more than outcome; and (6) accessibility of laws and regulations to the public." But Bromley's focus is primarily on formal institutions of law.

Litwack, from whom many of the ideas for this paper come, goes even further than Bromley in describing, implicitly, attributes of our society that are of economic importance. "Legality," which he says is essential to the functioning of "multilateral impersonal trade" (markets) has two dimensions: "(1) a mutually consistent set of laws, and (2) a belief by the population in the stability and enforcement of these laws" (p. 78). This latter dimension rings of attributes of culture and belief systems. It says that to achieve "legality" in the

economic sphere it is not enough to have laws; they must be enforced and people must willingly follow them. Fallows, in his book *More Like Us*, reinforces the importance of the behavior that is evoked by nonformal institutions of the society when he argues that "a society's strength depends on the way that ordinary people voluntarily behave. Ordinary people are important because there are so many of them. Voluntary behavior matters because it's too hard to supervise everyone all the time" (p. 13).

An Albanian Perspective

Albania, just north of Greece and across the Adriatic Sea from Bari, Italy, was the most communist of the communist world. Enver Hoxha, a World War II communist partisan, ran Albania from 1945 until his death in 1985. He was followed by Ramiz Alia, who ruled with an only slightly more moderate hand from 1985 until 1991. During his dictatorial rule of Albania, Hoxha broke relations with the Soviet Union because of Khrushchev's public de-



nouncement of Stalin's cruelty. Khrushchev was too liberal—a revisionist—and not true to communist ideology. During much of the 1960s and 1970s, Albania's only friendly economic cum ideological relations were with Maoist China, and even these were severely strained as a result of President Nixon's visit to China.

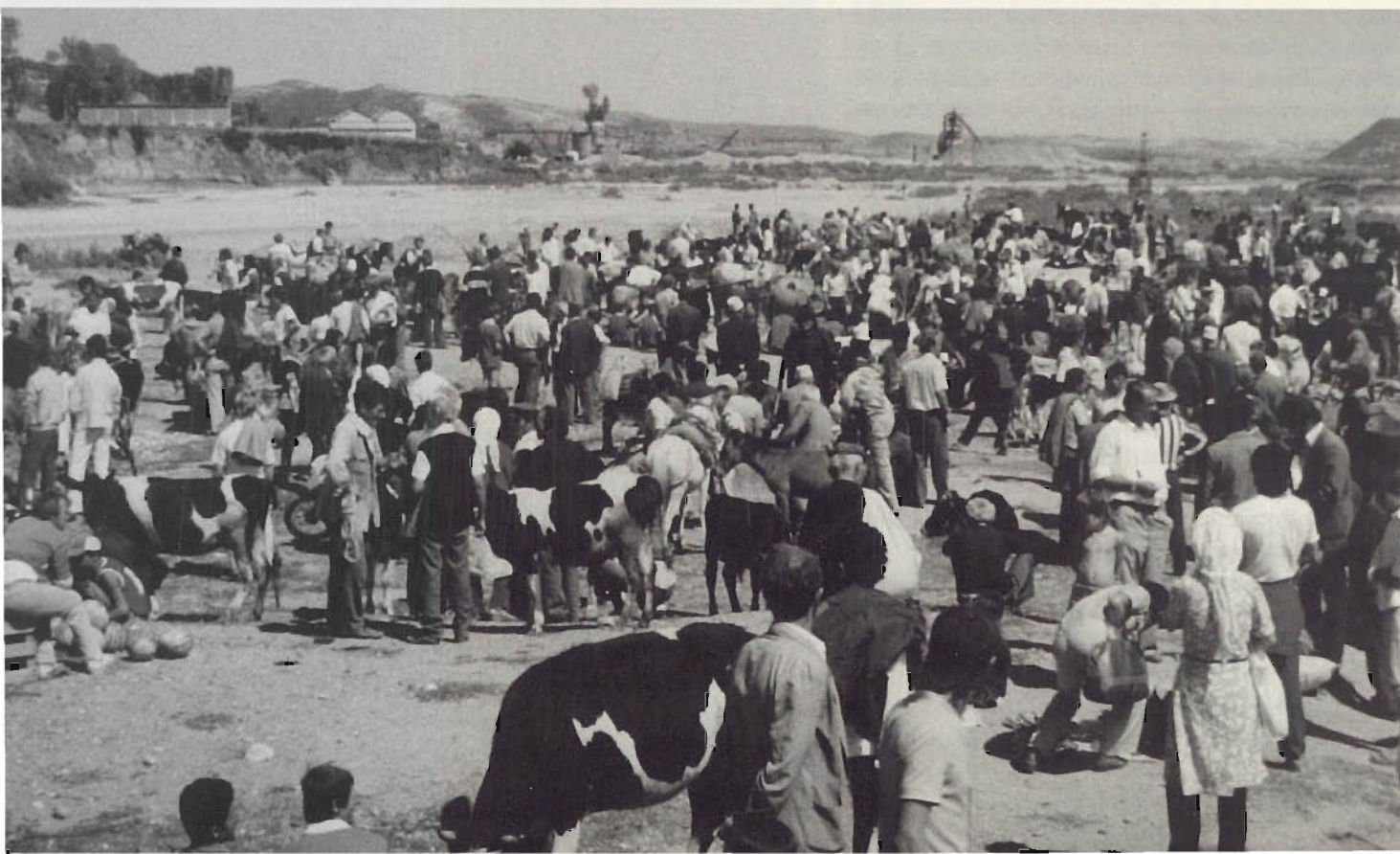
The Albanian people were told by Hoxha that both the West, symbolized by the CIA, and the East, symbolized by the KGB, wanted to destroy Albania because it was such a perfect society that it embarrassed the rest of the great nations of the world. To protect itself from the evil parachutists of the CIA and the KGB, every upright in every vineyard had a spear point affixed to the top to impale attackers. Somewhere between 600,000 and 1,000,000 cement bunkers were built and spread throughout the country to provide a fighting position for every able-bodied person in the event that either the East or the West attacked.

With TV antennas pointed toward Italy after dark, and radios tuned to VOA, BBC, and Vatican radio, the events of the late 1980s in Eastern Europe could not be kept from the Albanian people. Ramiz Alia, under pressure from student protests, agreed to "free elections" in March 1991. Besides, as many Albanians are prepared to tell, socialism had achieved its equity objectives in Albania—almost everyone had nothing. The year after the elections in 1991 was a year of chaos in Albania. Under the pressure of a general strike protesting stolen elections, and because of a massive flight of young

people to nearby Greece and Italy, the "elected" communist government could not rule. They finally agreed to an interim coalition government with the Democratic Party and to internationally supervised elections that were held in March 1992. The Albanian Democratic Party won those elections with about 67 percent of the vote, and a "democratic" government took power.

Perhaps the most important Albanian word to use in describing the Soviet-style economic system in Albania is *biografi* or biography. Depending on one's *biografi* you could be imprisoned or banished to a remote village for years for even the most trivial offense. Displaying a poster of the Beatles in a university dorm room brought one of these harsh sentences. If instead of a "bad biography" you had a "good biography," then you and your children would have access to the best schools and professions and what few luxuries the society offered. Who you were was all important! Of course who you were was also determined by who your father, mother, aunts, uncles, and friends were, and what their relationship was to the regime.

What was it that made these personal relationships (*biografi*) so important? Is it possibly just traditional village behavior of the people of the Balkans? That Balkan heritage certainly may have contributed to the preoccupation with personal contacts, but it is, Litwack argues, fundamental to the character of Soviet-style economies, and a logical outgrowth of that system, whether in the Balkans or elsewhere. The Litwack argument about Soviet-





style economies and the importance of individual contacts goes something like this: There was the Plan (“yearly material balance plan”) that distributed inputs and proscribed output quotas for all enterprises in the economy. But the Plan was never an adequate basis for operating the economy and there was constant need in virtually all enterprises to make administrative adjustments to the Plan. Indeed, argues Litwack, the continual administrative adjustments to the Plan were a prerequisite to the feasibility of Soviet-type planning and led some writers to describe the system as centrally administered or centrally managed rather than centrally planned. The necessary transactions to make those adjustments required both information and trust, but since these were strictly extra-legal, the trust had to be based on something besides laws.

The system requires each state enterprise to have an expeditor who has an intricate web of long-term personal contacts, many based on familial relationships. The expeditor must be prepared to swap supplies and services so that quotas can more likely be achieved. These transactions were neither legal or illegal—they were extra-legal. Thus this type of personal contact, based almost exclusively on personal knowledge as the basis of trust, became the fundamental horizontal coordinating mechanism in a Soviet-style economy. The system would not work without such contacts! So it was that your sister’s brother-in-law’s father could get you the timber

that was needed in exchange for the iron fittings that were made in your factory from iron supplied by the enterprise where your wife’s second cousin worked. Other bases of friendship/trust beside familial ones that appear to have been systematic in the Albanian system are village of origin, age-group, school classmate relationships, and World War II partisan compatriot friendships—fox-hole buddies.

At the consumer level, the same use of acquaintances and personal contacts prevailed. In Albania there was a saying that was commonly exchanged between the members of the family as they left for work: “Don’t forget to bring something for the family today.” What was meant was, “Don’t forget to use our contacts to take something out of the back door of the factory that we can use to improve our family circumstances either by direct use or by selling it.” In the “People’s Republic” where “they pretend to pay us and we pretend to work,” this was “privilege” granted by *biografi*. It was not theft!

Vertical or hierarchical relationships between superiors and subordinates also tend to be highly personal. Subordinates gave large gifts to superiors which were not bribes for specific goods or services but an investment in a long-term relationship. Further, writes Litwack, special orders for superiors or other important contacts always took priority over all other work. In commenting on a discussion of the emergence of laws in Albania, Besnik Gjongecaj, former rector of the Agricultural University of

Tirana, once told this writer, "We did not have laws; we only had directors." Where highly capricious behavior by the director was the rule, the only protection was a long-standing relationship based on personal connections strengthened by continuous investment.

All of this is not to say that personal relationships and interpersonal trust are not important in our American economy in reducing the transactions cost of doing business. The Rolodex file of personal contacts is very valuable. It is simply a matter of degree. In Albania under the communists it was *everything* since there was no legal basis for any other kind of behavior! Thus the Soviet-style economy and the larger society in Albania was a system of privileges based on who you were and who you knew, not on what you knew. It was codified in Albania as *biografi*.

On the way to markets in Albania

There are incredible changes taking place in the Albanian economy as a result of the removal of the repressive restrictions of the communist period. At one point during the communist period the government prohibited the private ownership of livestock in the countryside on the grounds that it was antisocial behavior. Presently virtually all of the collectivized land has been subdivided and is being farmed individually, though the final titling of land

has yet to be completed. Now that the wheat crop is privately grown and marketed, about 80 percent of the crop has been retained for home processing and consumption by the 60 percent of the population that is rural. Previously, virtually all of the crop passed through the government system, thence to state milling and baking facilities, and then first to urban consumers. Now, with rural producer/consumers taking their wheat "off the top," there is an urban bread crisis. Had not western countries provided substantial commodity aid in the form of wheat, urban bread riots would have ensued and could have brought the fledgling government down.

In 1992 Albanians were using hammers to break out holes in first floor apartment walls so that cigarettes and soft drinks could be sold. Today, Colors of Beneton has a shop in downtown Tirana. In 1992 there were virtually no private automobiles. Today there is traffic gridlock with as many as 10,000 used vehicles (mostly stolen) per week coming into the country from the rest of Europe, and with thousands of Albanians learning to drive, en masse. Indeed, it is traffic behavior and control in Tirana that provides one of the best parables of the distance yet to be traveled in the transition to a market economy and the persistence of the culture of privilege in Albania.

There are, indeed, traffic lights in downtown Tirana that were installed in late 1993. Thus, there



is a physical representation of law in the form of the traffic light turning red. But do drivers obey the law? Well, it really comes down to whether you are privileged or not, and it is quite independent of the volume of traffic, the size of the intersection, the risk involved, or much else. If you are in a police car (blue police plates), you do not stop; if you are in a car associated with the office of a minister of the government (green plates), you do not stop; if you are in an official government car (yellow plates), you probably will not stop unless you are a very junior official. If you are in a car with ordinary plates, you will likely stop unless you are otherwise privileged, in which case you will likely not stop. Privilege not represented by your license tag may only be that you went to school with the police officer on duty at that particular intersection at that particular time. Privileged behavior does not just occur at the front of the line of traffic. It also means leaving the line ten or more cars back, moving down the wrong side of the street around the line of waiting cars, into the intersection, and onward. The extreme case of the assertion of this form of privilege is in the use of crowded one-way streets, traveling against the traffic.

This assertion of the old system of privilege in dealing with traffic is trivial in its consequences by comparison to settings of greater importance in the nation's move to a market economy. It is, however, a daily reminder to all of the prevailing social norm at work. It is important to make clear that the issue is not the absence of laws but the ignoring of laws that exist and a culture that simply does not account for any rule that privilege cannot overcome.

In June 1996, my Albanian driver visited America on a tourist visa with his family. The tourist visas were issued based on my assurance that they would return home. Financing of the trip was, I believed, from the proceeds from recovered pre-communist period property. American friends in Blacksburg who had been befriended in Albania were hosting the family in their home. The tourist visas issued were valid for a full year. The original plan as presented in Albania was for a two-week visit. On his arrival, the driver announced he now planned to stay in America the full year, get a job, save the return fare, and have enough money to replace the money spent to get to the U.S.

"We're sorry but work is not permitted on a tourist visa," we told him, "and it is very difficult to get an illegal job, particularly when you speak almost no English." He was distraught and angry. His American friends and former boss had abandoned him and he went back to Albania after a three-week visit leaving very strained relationships all around.

There were three things not understood. First, he could not comprehend that even though his



former boss and other American friends were prominent people in a major American university, they could not get him a work permit despite the law. Second, he could not believe that there were few or no people willing to hire him without a work permit. Third, and most difficult, he could not understand that his American friends did not wish to present themselves to others in their own community as people willing to represent someone in finding illegal work.

Goods and services required or desired were previously the privileges given to those with good biografi and were rewards for services rendered. Today those perks, still under the control of government, have been monetized and most are sold to the highest bidder. For example, entrance to medical school is rumored to be worth something like \$2,000–\$2,500 in side payments to a dean or other school official. Expedient handling of an auto registration costs something like \$20–\$30. It's called a free market: If you control it, you are supposed to exchange it for income! Right?

Even when laws exist in emerging or reforming states like Albania, it is not surprising that under a more or less free market, the old methods of establishing trust in business transactions prevail. Thus, Mafia types of organizations emerge in many of the former communist countries and use muscle and violence to enforce transactions when there is no other basis for trust and when failure to fulfill commitments seems imminent. The techniques used by the Mafia engaged in money lending in Albania are really quite understandable. If you are in arrears on your payment, they simply take over the assets for which you borrowed the money in the first place.

It's a long way to markets

It's a long way to markets in former Soviet-style economies like Albania. Some of the underestimation of the distance to be covered is because many

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of us in America take much of the cultural dimensions of the performance of our own economy for granted; we do not see our basic lawfulness and our shared views of lawful behavior as economic variables. Indeed, that insight may only be visible to us in contrast—when we can observe its absence, and when we look at the relations among traders as much as at what is traded. It is not here argued that America does not have crime or thieves, or that personal contacts are not used to economic advantage. The issue is in the degree to which such things determine the performance of our economy.

The evidence of casual observation in Albania, one of the most classic Soviet-style economies, is that the legality necessary to the successful functioning of a market economy is almost completely absent. This is observed to be true even with ever-increasing numbers of laws on the books in Albania. The issue is the almost complete persistence of the culture of privilege based on biografi: the im-

portance of who one is, rather than on laws that establish some kind of “due process” to reflect what one knows or can do. The alternative to biografi emerging in the private sector is the enforcement of deals by Mafia-type organizations. Of course the new biografi is based on who is more “democratic,” meaning supportive of the existing leadership of the Democratic Party, with all manner of revisionist variants, including who “really wasn’t a communist” under the old system.

This social/cultural impediment to market economics is substantially the legacy of the former Soviet-style economy. Given the persistence of that culture and the difficulty in changing culture, it is likely to be a very long journey to market economies in many parts of the former communist world. Indeed, it may require several generations to accomplish the cultural change necessary to achieve the legality required.

Whether this analysis is applicable to other countries that had Soviet-style economies must be left to others with experiences in such places to decide. If the analysis and its insights are at all generalizable, they suggest greater foreign aid investments for legal studies, development of democratic institutions, and police training and enforcement of such laws as exist, even traffic laws. Such investments, in this light, look more promising than assistance in traditional economic analysis, management, and business development.

“You will know that your country is making progress toward the necessary conditions for a market economy when everyone stops when the traffic light turns red,” I told my Albanian friends on leaving the Agricultural Economics Department at the Agricultural University of Tirana. ☐

Author's Postscript

Since writing this article, Albania has come apart. It is especially important to recognize in the news reports that what has happened is not a civil war but anarchy. A civil war pits two or more coherent groups with internal identities and belief systems against each other while anarchy and its associated chaos is the dissolution of any fabric in the society. The major leadership failure in Albania was the inability to realize that there was little social fabric in the society after communism and what was there was exceedingly fragile—too fragile to withstand the pyramid scheme losses.

Some measure of that fragility was observable in the stairwells serving the hundreds of apartment complexes that are the dominant housing in both rural and urban Albania. By 1995 virtually all of the apartments were privately owned, making the apartment complexes essentially coop or condo types of entities with multiple owners within the single large structure. Normally, there would be somewhere from eight to sixteen apartments serviced by a single stairwell. Aside from the lack of paint, and broken stairs and railings, none of which had been attended to since the communist era, the most treacherous and disconcerting thing about the stairwells was that there were no light bulbs in the available fixtures. At night they were pitch dark, and you took your life in your hands to negotiate them—people memorized the stair counts. There was insufficient relationship among the apartment owners sharing the stairwells to collectively finance light bulbs, secure that bulbs didn't get stolen, take turns supplying them, or take leadership to try to organize such efforts.

Taylor (p. 104) makes clear that the market is a traffic in claims, not in things. Those claims (rights) have their origin in community. The bond of community is never measured by the size of the task accomplished together. “It is measured by the mutuality of their acknowledgments, by the respect for claims they acknowledge in each other, as parties to a common covenant.” Today in Albania there is no mutuality or forbearance—no covenant; there are mostly guns. Unfortunately, prior to the guns, and after “democracy” in March 1992, there was still biografi, no lights in stairwells, and only some folks stopping at traffic lights.

■ For more information

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