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# ECONOMIC REFORM IN FORMER COMMUNIST SYSTEMS: THE PROBLEMS OF PRIVATISATION

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## Introduction

The need for market-oriented reforms of the former communist economies has by now been generally accepted by virtually everyone involved in the running of those economies, and no longer only by Western advisers and their local 'economic-rationalist' disciples. Even while Gorbachev was still in power as President of the USSR, the question was not whether to marketise the economy, but rather how fast and deep the marketisation process should be forced to develop. Nevertheless, for Gorbachev and his like-minded survivors in the former 'world of socialism' who still opted for the 'socialist choice'—for example, in Serbia, Bulgaria, Romania and, of course, the Asian communist countries—the issue really amounted to how much of the old socialist economic system could be retained so as to maintain a modicum of communist party control over the 'commanding heights' of the economy and thus keep themselves and their *nomenklatura* supporters in power.

In the European former communist states, at least, that issue has now been resolved, and socialism—with its correlates of communist-party power—has been totally rejected by the newly emergent civil societies of the countries concerned. The August 1991 putsch in the USSR effectively drove the proverbial nail into the coffin of a 'socialist alternative', and the search for some mythical 'third way' has been abandoned.[1]

[1] That is, it has been abandoned in the former socialist world. There are still Western economists and social theorists who continue to plump for some form of 'feasible socialism', which is allegedly more socially effective and economically just than capitalism. The best known of these thinkers is Alec Nove, in his *The Economics of a Feasible Socialism Revisited*, 2nd edition. London: Harper Collins Academic, 1991. See especially his concluding chapter, where his former optimism is replaced by a call for debate, pp. 247-9.

The actual implementation of market reforms, however, has proven much more difficult than the commitment to undertake them. The impediments are more often structural than psychological, but the effects of fifty to seventy years of Marxism-Leninism on the attitudes of peoples from all walks of life in the former communist systems—towards such things as entrepreneurship, income inequality and foreign investments—are undoubtedly also serious obstacles to market-type reforms. In the following sections of the paper I shall attempt to describe briefly the basic structures and processes of the old system and their implications for the reform project. Next I present a catalogue of the most salient elements of the reform programs that have been attempted so far, with special emphasis on the role and problems of privatisation. Finally, I assess the social, political and economic effects of the reforms in those countries with the most experience of reforms to date and try to forecast corrections and course changes dictated by the emergent political realities in individual countries and their likely impact on the transition process from socialism to capitalism and its associated social and political correlates.

**The 'Administrative-Command System' and the Impasse of Socialism**

In some respects the system of centralised planning and administration of the economies of the socialist countries which followed the basic Soviet model was not really an economic system at all. Its primary criterion was not the maximisation of wealth from a given mix of factor endowments but, rather, the maximisation of the perceived utility function of the central political elite, namely, the Political Bureau (Politburo) of the ruling communist party. Apart from ritualistic obeissance to so-called 'laws of socialist development', such as the notorious 'law of the planned, proportional development of the national economy', the central decision makers made their allocative choices more with an eye to maximising the political and military power of their countries and the 'world of socialism headed by the USSR', and to enhancing the responsiveness of their economies to centralised control—and hence increasing their own domestic social and political

power—than to developing the national stock of wealth and popular welfare. Industry and, to a lesser extent, agriculture were run as a single, centrally controlled nationwide enterprise. At least that was the theoretical model of the economy which economic theorists viewed as the ideal. In their pursuit of this ideal there was a marked tendency to opt for the biggest possible enterprises and combinations of enterprises, often with a monopoly position in the economy for a particular product line, in the name of a theoretically super-rational nationwide division of labour. If nothing else, these giant enterprises gave the central decision makers the illusion of greater control over production and the deployment of labour and other resources. In a sense, there was a tacit tradeoff between the central authorities and management of the giant enterprises, similar to the tradeoff between the USSR and the member states of COMECON: that is, the operation of what Hungarian economist Janos Kornai has called 'soft budget constraints'. In return for managerial responsiveness to the basic investment and production decisions of the centre, enterprises knew that they would be protected by budget subsidies or other material and legal privileges to overcome the adverse economic consequences of compliance. State enterprises were simply never compelled to suffer for their poor productive or financial performance.

The same tendencies toward bigness and soft budget constraints were to be found in agriculture. Especially during the 1970s and 1980s there was a conscious policy for the establishment of massive feedlots and agro-industrial combines. In conjunction with Brezhnev's fascination with the possibilities of centralised, computerised management, these were regarded as the next higher stage—beyond large-scale, but non-specialised, collective and state farms –in the perfection of industrial-type organisation, which had always been an ideological imperative of Soviet agricultural development. However, as in industry, these agricultural enterprises proved to be a nightmare to administer and to keep supplied with necessary inputs. There can be little doubt that such integration did enhance the centre's control over managerial behaviour, even if the productive results were not positive.

Central allocative decisions were inevitably voluntaristic and, from the standpoint of economic rationality, almost always wrong. Prices for both producers' goods and consumer goods were arbitrarily set to favour centrally determined priority sectors, such as heavy industry and military production. The result were highly distorted price relativities which were unable to provide appropriate signals for investments and operational decisions.

Money had little intrinsic exchange value, except as a unit of account among enterprises and between enterprises and the State Bank. For consumers, cash holdings were not even domestically convertible, in the sense that a given amount of cash had no predictable value in terms of the quantity of goods and service it could purchase. Increasingly, in the 1980s, although retail prices were fixed, consumers could not find the desired items to buy at these prices and were forced to turn to various alternative, non-official markets (from different shades of 'grey' to black) at much higher prices.[2] By 1990 it was estimated that the population of the Soviet Union held cash savings on the order of 500 billion rubles, or more than one-half of the USSR gross national product at the time.[3] Similar situations prevailed in most of the other Soviet-type economies; that is, before the onset of economic reforms and the transition from repressed inflation to runaway inflation.

There is general agreement among Western students of the Soviet-type economies (STEs) that their basic shortcoming was excess demand, although there is less agreement over the causes of this phenomenon. Some argue that it was mainly due to the

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[2] The process by which the system of non-cash transactions among industrial enterprises came to dominate, or in current jargon, 'colonise', the wage-based cash transactions of the population by tightly linking the money supply to the output of consumer goods, and the breakdown of this linkage in the late 1970s can be found in an article by Mikhail Deliagin, 'Potrebitel'skii rynok v SSSR', *Svobodnaia mysl'*, No. 14 (September 1991), pp. 68-9.

[3] According to a Soviet emigre economist now working at Stanford University's Hoover Institution. Mikhail S, Bernshtam, 'Without shock, in four steps', *New Times*, No. 42, 1990, p. 9.

excess purchasing power in the hands of the population, which was, in itself, a result of the inordinate share of investments going to producers' goods industries, at the expense of consumer goods production. Others argue that it was a product of the voracious taxation system in its various guises, by which some 80 percent of GNP was absorbed by the state. In the words of former Soviet economist Mikhail Bernshtam:

> Today the state takes into the treasury about 80 percent of GNP owing to the small wages fund, the turnover taxes and the remaining direct and indirect taxes. Then the state reimburses to people a part of the taken money in the form of subsidies on retail food prices, on ... rent, pensions, public health and education.
>
> Such a high rate of taxation is the greatest secret of the economy which is under state control.[4]

In the final analysis, it is difficult to disagree with Lipton and Sachs that the basic cause of the chronic shortages which have plagued all of these economies was the 'insatiable *investment demands*, accommodated by state planners and by the central bank'.[5] An even more fundamental problem, however, is what the state did with this control over the lion's share of national resources. Unsound investment decisions by the political authorities led to the current chaos in industrial and financial structures and prices and the costs of routine transactions, all of which are greatly encumbering the processes of economic reform, especially privatisation. This is true even in relatively de-centralised socialist economies with a tradition of attempts at 'market socialism',

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[4] ibid., p. 11. This point is well developed theoretically by Stanford University economist Ronald I. McKinnon in his description of the processes by which the state effectively siphoned off the planned 'surpluses' of enterprises by a system of virtual taxation which gave the State Bank virtually unlimited disposal of national resources for designated investment priorities. Ronald I McKinnon, 'Stabilising the Ruble', *Communist Economies*, Vol. 2, No. 2, 1990, pp. 131-2.

[5] David Lipton and Jeffrey Sachs, 'Creating a Market Economy in Eastern Europe: The Case of Poland', *Brookings Papers on Economic Activity*, No. 1:1990, p. 99.

like Yugoslavia. Ljubo Sirc, an exile Slovenian economist working in the UK, has commented:

> the economic chaos in Yugoslavia can be compared only to the economic chaos in other communist countries: the worst feature of it is the entirely distorted production structure, in other words a total lack of investment criteria. All the rest stems from this shortcoming, which has not been overcome in Yugoslavia any more than in other communist countries, much later recruits to reform.[6]

As already mentioned, one of the consequences of the ideologically distorted criteria for centralised and highly politicised investment was the concentration on large-scale enterprises as the epitome of socialist industrialisation. With typically 90 percent of industrial production in the state sector, the average enterprise has, for example, in Poland, 1,132 employees, usually employed in several plants, where the average labour force is 378 persons—as compared with around 80 workers per plant in Western economies.[7] (For some data on the relative size and shares of public enterprises in the STEs and Western economies, see Table 1 in the Appendix.) The bias towards bigness is one of the main sources of investment hunger in the economy; and because of perennial labour shortages in industry, there is a tendency for management to pay the highest possible wages, consistent with central wage fixation policies, as well as overmanning, in order to maintain the largest possible workforce. In combination, these tendencies have created grave problems for the new post-communist regimes in trying to marketise and privatise their economies. The large enterprises are general uncompetitive on the international market and unattractive to potential foreign investors, yet their closure implies sudden unemployment for large numbers of

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[6] Ljubo Sirc, 'The Yugoslav Economy at the Turn of the Century', *Communist Economies*, Vol. 1, No. 4, 1989, p. 464.

[7] Lipton and Sachs, op. cit., p. 83.

workers, particularly where a given enterprise is the primary source of employment in a particular region.

An analogous situation obtains in the state sector of agriculture as well. Even in Poland, where more than three-quarters of the farm land was in private hands, state-sector farms were important employers of labour and suppliers of the market. A state farm visited by the author in Pultusk, north of Warsaw, in the summer of 1990, employed around 240 workers on its various plant and animal enterprises, comprising in all some 650 hectares. The farm was threatened with closure, and no further investment funds were being allocated by the state. Its commercial sales through the remaining state trade network brought in enough cash to maintain current operations, but the prospects for the following year were bleak. The workers expressed little interest in acquiring shares in the farm as a private corporation, nor were top officials interested in a management buyout. This uncertainty over the economic future was general in the Polish countryside, in the private as well as the state sector.[8]

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[8] These impressions were gained in the course of two visits to the Polish countryside in July and September 1990. In the first tour I was accompanied by a Polish agricultural economist, Mr Tomasz Adamski, who helped to formulate my questions to the personnel on the ground. I alone am, of course, responsible for the conclusions expressed here. In the second tour I was a member of a delegation of specialists on East European agriculture from around the world, attending a conference on East European agriculture in Ciechocinek, Poland. There were individual private farmers who seemed to be attuned to the new opportunities and were organising direct sales of specialty items, such as eggs and horticultural products, to consumers in the major cities in avoidance of the established (monopsonistic) state trade network. A recent report on the transformation of agriculture in the Czecho-Slovak Federal Republic indicates that similar problems of monopsony in procurements and uncertainty among producers exist there as well. In the CSFR the share of the private agricultural sector was minimal, and the transformation process is analogous to that in the former USSR. Nancy J. Cochrane, 'Observations from a Trip to the CSFR: How Enterprises Are Adapting to New Conditions', USDA:*CPE Agriculture Report*, Vol. IV, No. 6 (November/December 1991), pp. 1-5.

In the former Soviet Union there has been increasingly frank condemnation of the long-standing policy of treating agriculture as a non-economic sector, whose resources were to be extracted for the development of the rest of the economy, with little concern for the profitability and economic viability of agricultural enterprises. The problem of 'non-equivalent exchange' between agriculture and industry—in essence, price parities between agriculture and industry—has been a central focus of the attention of agricultural economists, in the search for ways to make agriculture viable. The problem is a massive one. In Ukraine, for example, the state 'agro-industrial complex' accounts for more than 40% of the republic's gross social product and over two-thirds of the 'public consumption fund'. Yet the sector remains non-viable and substantially dependent on the shrinking state budget. Agriculture is thus crucially in need of radical transformation; however, judging from the structural problems of the sector and by the tenor of recommendations by local economists, the opportunities for doing so, at least in the vital short run, are among the most limited in the post-communist economies.[9] Poland, Yugoslavia and, to a lesser extent, Hungary may consider themselves fortunate that they already have considerable experience with a large private sector in agriculture, at least at the production end; but they, too, still have major problems to address in restructuring the relationships between this sector and the monopolistic and monopsonistic industrial and commercial systems.

Summarising the inheritance of economic malaise confronting the post-communist regimes in their efforts to reform the STEs, it would be difficult to improve upon the assessment of Dr Ljubomir Madžar, a prominent Belgrade reform economist. Madžar concludes that

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9 See, for example, the assessment and recommendations for the situation in Ukraine by prominent Ukrainian agricultural economist P.T. Sabluk, 'Nauchnoe obespechenie perekhoda agropromyshlennogo kompleksa Ukrainskoi SSR k rynku', *Ekonomika sel'skokhoziaistvennyk i pererabatyvaiushchikh predpriiatii*, No. 9 (September 1991), pp. 2-6

The harmony and consistency [socialism] was expected to bring into the economy turned into disorder and incoherence. Ironically, it is only the centrally planned (or otherwise bureaucratically co-ordinated) economies which have created so-called 'structural discrepancies' and 'price disparities'. The two could be considered the duals of each other and both epitomise the misallocation and concurrent waste of resources which seem to be inherent in non-market economies.

Madžar goes on to list what he calls the 'undesirable features' of these economies:

(1) unsatisfactory and systematically declining rates of economic growth, approaching protracted stagnation and even economic decline;
(2) an appalling degree of inefficiency and conspicuous waste of economic resources, accompanied by consistent erosion of social capital in some sectors or even in the economy as a whole;
(3) gradual impoverishment of the people and a rising gap in the level (and style) of living compared with the market-based societies, together with all-pervading shortages and growing inability to acquire the necessities of life;
(4) hidden and repressed inflation .... , as well as growing and ever more clearly recognisable signs of open inflation, threatening .... to undermine the very base of the social economy;
(5) surplus employment appearing in the form of disguised unemployment, as well as open unemployment...., destroying efficiency, corroding workers' morale and producing conspicuous social inequality ...;
(6) financial erosion of the economy and growing levels of internal debt and business losses which can only be serviced (and covered) in an inflationary way;
(7) mounting external debts which can only be serviced with great internal sacrifices, intensifying social tensions, and which—because economic policies have to incorporate certain conditions imposed by the creditors, for better or for worse—circumscribe to some degree national sovereignty;
(8) deepening of regional inequalities, to which the egalitarian socialist systems are particularly sensitive and which acquire additional weight in multinational socialist states.
(9) One could add another feature which is not economic in character, but certainly is induced or at least reinforced by economic difficulties, and which

> consists in lowering of moral standards, widespread corruption and abuse of political and bureaucratic power.[10]

This list, as Madzar admits, is not exhaustive, but it contains the essential shortcomings of the STE model in its last stage. The message is clearly that the system was past reforming, or even 'restructuring'—*perestroika*, as Gorbachev evidently still conceived it at the time of his forced retirement. What was needed was a total transformation of the economic systems. There could be no 'third way' or half-way house between socialism and capitalism, if only because there were simply no funds left to pay for further experiments of a 'socialist-market' type. The only issue that remained was how fast and how painful the shift to the market would have to be, and that depended on the specific economic, political and psychological characteristics of the individual countries. Undoubtedly the successor states of the USSR, as collectively comprising the largest economy among the STEs and along most dimensions the closest to the asymptote of the single-corporation economy, would be the most difficult to marketise; but there, too, as of 2 January 1992, under direct pressure from Russian President Boris Yeltsin, the wholesale movement toward the market has already begun.

## Early Conceptions of Economic Transformation

The galloping inflation and rising popular and conservative political unrest associated with Yeltsin's reforms during January 1992 may seem to call in question the strategy of the rush to the market he has adopted. Such an assessment would seem to be premature, however, in the light of the experience of reform programs in other STEs.

The most comprehensive and detailed economic reform program attempted to date is the one designed for Poland by Lipton and Sachs. Sachs has also been a major

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10 Ljubomir Madžar, 'The Price of the Turnaround', *Communist Economies*, Vol. 2, No. 2, 1990, pp. 144-5. Madžar is specifically talking about Yugoslavia, but he attributes these shortcomings to all of the STEs in the twilight of the communist era.

consultant on the formulation of programs for Yugoslavia and the USSR, but the former, after initial successes, later had to be abandoned because of the political disintegration of the country; similar problems have encumbered the implementation of the program in the former USSR, but elements of it have obviously been employed in Yeltsin's crash reforms in Russia from the beginning of 1992.

The essential elements of the Lipton-Sachs strategy for Poland, introduced at the behest of Vice-Premier Leszek Balcerowicz in January 1990, were 1) macro-economic stabilisation, 2) economic liberalisation and 3) privatisation.[11] To combat the effects of immediate crisis and avert the deleterious effects of gradual, piecemeal reform attempted earlier under the old regime, the program placed great emphasis on speed and simultaneity in the implementation of the component elements. The first step, **macro-economic stabilisation**, was designed to eliminate the excess demand which was the predominant shortcoming of the STE model. It involved a combination of fiscal and financial austerity aimed at curbing excessive monetary supply, tightening of credits and the establishment of a stable, internally convertible currency. The zloty was devalued to approximately the black-market rate and pegged to the US$. The government permitted the opening of a multitude of currency-exchange offices (*kantory*) throughout the country, and within a few weeks the currency was effectively stabilised. Indeed, the stand-by currency-stabilisation fund established by international monetary agencies did not have to be used, and the pegged rate of the zloty held up for over a year. (A subsequent further devaluative correction has similarly succeeded in stabilising the exchange rate.)

The second step, **economic liberalisation**, which was to be undertaken concurrently with the first, was designed, by freeing up prices, eliminating subsidies, removing import restrictions and encouraging the establishment of private commercial ventures, to introduce a free market in as many sectors of the economy as possible. The

11 The discussion here is based on the elaboration in Lipton and Sachs, op. cit., pp. 100-101.

initial effect was an immediate jump in retail prices, but also a rapid elimination of consumer goods shortages. The primary objective, according to Lipton and Sachs, was to enable the emergence of effective price signals for the further development of a market economy. Problems with the monopoly position of some producers and buyers inherited from the previous system were acknowledged and were to be combatted by anti-monopoly legislation, which was duly enacted by the Polish Sejm (parliament), but which, for a number of structural reasons, is only gradually having the desired effect.

The combination of tight monetary and credit policies and liberalised prices had an almost magical effect of curbing excess demand—but not only for investments. Indeed, the down side of the Lipton-Sachs 'shock therapy' was a sharp reduction of domestic consumer demand, which soon had a deadening effect on industrial production. While this effect had a positive, stabilising impact on retail consumer goods prices and quickly led to a jump in Polish hard-currency-earning exports (which partly explains the absence of need to draw on the currency stabilisation fund), it also accelerated and aggravated the (anticipated) upsurge in unemployment.

Furthermore, the price liberalisation undoubtedly worked to the advantage of the monopolistic large-scale enterprises which continued to dominate the state sector. This, too, was not unexpected; in fact, a number of the opponents of the 'shock therapy'—or 'big bang' approach to economic transformation in the USSR and other ex-STEs argued precisely for gradualism on the basis of this structural feature of monopoly power in the dominant state sector. For these people, de-monopolisation would have to precede price reform. For Lipton and Sachs, by contrast, **privatisation**, the third step in their program, should proceed in parallel with the other two.[12] Although they acknowledged that the dominance of the state sector and its large-scale enterprises made it unlikely

[12] Lipton and Sachs have devoted a separate paper to the specific issues of privatisation in Poland, on which the above discussion is largely based. David Lipton and Jeffrey Sachs, 'Privatisation in Eastern Europe: The Case of Poland', *Brookings Papers on Economic Activity*, No. 2:1990, pp. 293-341.

that privatisation could be completed speedily, they opposed the selective and piecemeal approach favoured by some of their critics, such as Janos Kornai. They did so on a number of grounds: among others, the entrenched bureaucratic power potential of management in this residual core of the old system and the fear that domestic and foreign private buyers would 'pick the eyes' out of the stock of state enterprises, leaving the state with only the poorest, least saleable performers, which would constitute a continuing heavy burden on the state treasury. In fact, this 'remaindering' phenomenon seems to be occurring in the privatisation process for state enterprises of the former German Democratic Republic being managed by the FRG's specially established conversion institution, the *Treuhandanstalt*.[13]

While conceding that privatisation is virtually impossible to complete in the short run,[14] Lipton and Sachs demand that certain changes be made in the status and *modus operandi* of the pre-privatised state enterprises in order to reduce their potential to sabotage the reforms: above all, that they be immediately transformed into joint stock corporations, with the state treasury as the 100% shareholder and with state-appointed supervisory boards of directors, until suitable divestiture provisions can be made arranged. In the meanwhile, a certain proportion of the shares are to be sold and/or distributed to the public and designated 'financial intermediaries'.

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13 For a good short account of the problems of the *Treuhand*, in agricultural as well as industrial privatisation—including what the author calls 'cherry-picking' (what I have called 'remaindering'), see John Hurst, 'East Germany faces new reality', *The Australian Financial Review*, 9 December 1991, p. 14.

14 They expect the process to be completed within four years for the largest 500 Polish state enterprises, which accounted in 1990 for 2/3 of total sales and 40 percent of the total employment in the dominant state industrial sector. Lipton and Sachs, 'Privatisation...', pp. 302 (Table 2), 327.

They propose a formula for the parcelling out of shares in five 'tranches'.[15] In the first, about 10 percent of the shares in the enterprise would be sold at a discount or given *gratis* to its workers, with another five percent being reserved for incentives to management. In the second tranche, 20 percent of the shares would be used to capitalise a new, non-budgetary pension system, comprising several separate pension funds, each of which would hold a portfolio of shares of different enterprises, with corresponding rights of oversight for each. One of the objectives of this plan is gradually to reduce direct state funding of the pension system, as well as to eliminate direct state bureaucratic involvement in industrial management.

The third tranche would involve similar method of capitalisation—to the tune of 10 percent of the shares—of the state-owned commercial banking and insurance systems, with an eye to privatising them, too, and transforming them into active players in the industrial investment and oversight processes. The fourth tranche, consisting of 20 percent of the shares of the target enterprises, is to be distributed free of charge or at discount prices to all the adult citizens of the country. This could be done either in the form of shares in investment trusts (mutual funds) in which shares of a number of enterprise have been deposited, or, alternatively, in the form of vouchers that are exchangeable for shares of particular enterprises or of investment trusts (to spread the risks of the multitude of small investors).

The fifth tranche, comprising the remaining 35 percent, would remain temporarily in the hands of the state treasury, to be disposed of gradually after the first four tranches have been completed. Lipton and Sachs estimate that the latter process will take one year. The government's minority bloc of shares would not confer paramount state rights on the board of directors to be appointed by the various shareholder groups

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15 Details discussed in ibid., pp. 327-332. For another discussion of privatisation, whose author, World Bank economist Branko Milanović, is repeatedly cited by Lipton and Sachs, see Branko Milanović, 'Privatization in Post-Communist Societies', *Communist Economies and Economic Transformation*, Vol. 3, No. 1, 1991, pp. 5-39.

and institutions. They recommend for this purpose the recent French approach to privatisation: namely, that a substantial block of the government's shares be sold to a carefully selected 'stable core' of investors with the necessary operational and financial expertise and a long-term commitment to make a success of the enterprise.

Whatever its subsequent fate in the process of implementation (on which we shall have more to say later) Lipton and Sachs's elaborate scheme was clearly well tailored to address major problems of the STE legacy. It is worth reiterating some of them here to illustrate the generic pitfalls awaiting serious programs of economic reform in these countries. The ubiquitousness of state involvement in the economies has had qualitative, as well as quantitative dimensions; that is, in addition to the **fact** of state interference, one must consider its **nature**—the psychological effects of the system implied by Madzar in the supplementary ninth item in his catalogue of shortcomings. One of the reasons for Lipton and Sachs's emphasis on speed of privatisation is the need to avert the phenomenon of '*nomenklatura* capitalism', or 'spontaneous privatisation', as it is called in Poland—where members of the former communist ruling elite take advantage of their old connections and new opportunities to gain control over state enterprises as their *de facto* personal property. This has occurred on a massive scale in the USSR as well, as managers and (often democratically elected) local officials collude to appropriate the fruits of what is still nominally state property.[16] In Poland, after almost a year of bitter experience, the practices of nomenklatura capitalism became the object of special preventive legislation, which has not been universally effective.

The need to establish clear parameters of ownership is the main reason for Lipton and Sachs's insistence on the immediate conversion of state enterprises to joint-stock corporations wholly owned, at first, by the state treasury, acting in most cases through a special agency, or ministry in charge of privatisation—on the model of the

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[16] For examples of Soviet practices see the case stories by Olga Kryshtanovskaya, Alexei Pavlyukov and Yelena Chekalova, 'Soviet Millionaires', *Moscow News*, No. 29, 1991, pp. 8-9.

German *Treuhandanstalt*.[17] The current chaos of property legislation does indeed evidently provide fertile soil for growth of nomenklatura capitalism, but the sorry state of the majority of enterprises has made it very difficult to develop immediate free-market alternatives, especially where foreign investment is concerned.

Another problem inherited from the past which illustrates the psychological as well as practical legacy of the STE syndrome is the preference on the part of workers and former officials alike for worker ownership and worker self-management of the privatised enterprises. The ideological basis of this preference is clear, as evidenced by Gorbachev's endorsement of this form of 'privatisation' in his half-hearted efforts to retain a socialist element in his market reforms. Arguing from the experience of worker self-management in Yugoslavia over four decades, Sachs correctly pointed out that such enterprises have a bias in favour of distribution of profits as wages, rather than investments for long-term development. He points out that such enterprises tend to isolate themselves from domestic and international market forces and are unlikely to be attractive to private investors. That is why he wished to limit the proportion of shares in privatised enterprises to 10 percent, whereas the limits preferred in the domestically determined Polish and Yugoslav reform plans were of the order of 20-30 percent.

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[17] In Poland there is a Ministry for Privatisation; in Hungary it is called the State Property Agency; in Bulgaria, by contrast, the process has been entrusted to a single individual until a suitable agency can be established by legislation. Marvin Jackson, 'The Progress of Privatization', *Report on Eastern Europe*, Vol. 2, No. 31, 2 August 1991, pp. 40-45. The person then in charge of economic reform in the former Yugoslav republic of Slovenia, Prof. Jože Mencinger, a prominent reform economist, told the author in an interview in July 1990 that he opposed the approach of converting public enterprises to state-owned corporations because this in itself, he feared, would require a bureaucratic apparatus which would be difficult to dislodge at a later stage. He preferred to have public enterprises sold off directly to private investors. Mencinger was replaced in the spring of 1991 by an official prepared to follow the Sachs approach, but the privatisation process in Slovenia does not seem to have been much accelerated by the change.

A further legacy of the STE past was the preference for a 'sheltered-workshop' environment for industrial production. For an Australian, this preference does not seem so strange, since much of Australian industry has been accustomed to operating behind high tariff walls, favouring import substitution over production for export. In the highly inflationary context of industrial behaviour in the STEs in the past decade, enterprises found it more profitable to sell on the domestic market than to try to compete on the world market. Despite low wages by world standards, the output of these economies has not been cost-competitive, to say nothing of quality. Thus, much of what they have been able to sell abroad has brought losses to the economy.[18] Lipton and Sachs considered this phenomenon a significant collateral reason for the immediate elimination of state subsidies and the removal of barriers to competing imports of goods and services.

These were all serious obstacles to transformation, and the Lipton-Sachs approach was certainly a cogent way of dealing with them. However, there has not been universal agreement on the appropriateness of their remedies, namely on the timing of the various steps or stages of reform and on the methods of privatisation. (For an assessment of the advantages and disadvantages of various forms of privatisation see Table 2 in the Appendix.) In Russia, for example, prominent economic reformers, such as Pavel Bunich, Nikolai Petrakov and Larissa Piiasheva (all conspicuously absent from the Yeltsin team), have criticised the abrupt shift to free pricing without first abolishing the state trading agencies, which were sabotaging the reform, and without having previously accomplished the 'swift privatisation of state property'.[19] On the issue of privatisation, even some of Lipton's and Sachs's Western colleagues did not share their optimism that broad-front privatisation, before the establishment of a share

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[18] The Prime Minister of Slovenia told the author in an interview in July 1990 that his government was not enthusiastic about increasing exports at the time, since at the existing exchange rates they were a source of significant losses.

[19] Robert Haupt, 'Russian economy in dramatic decline', *The Age*, 5 February 1992, p. 8.

market or some other form of expert valuation of assets, would generate its own system of valuation.[20] Countries like Hungary, Poland and, for a time Yugoslavia, have sometimes preferred to engage Western accounting firms to assess the value of state enterprises before attempting to sell them off and, in some cases, to handle the transactions, for a substantial contingency fee.[21] In many instances these consultants find it expedient to restructure the large state enterprises into saleable bites before attempting to sell them.

But undoubtedly the greatest obstacles to the full implementation of the Lipton-Sachs scheme have been political. The reforms are not being imposed in a vacuum. In the avalanche of disintegration of the STEs and the political systems behind them recognisable civil societies have developed in most of these countries, and their activities have exerted a tangible corrective influence on the policies of the new democratically elected governments.[22] Unlike their predecessors, the new rulers cannot inflict the pain and sacrifices associated with radical economic change without the consent of the governed, and that can no longer be taken for granted, even in the short run. Sachs fully acknowledged from the outset that the shock of his 'shock therapy' approach wou'd have to be short and demonstrably successful in order to win the support of the electorates. The results have been encouraging in some countries, but not

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[20] See, for example, the comment on the Lipton-Sachs privatisation scheme by Lawrence H. Summers, the chief economist of the World Bank, who recommended that sales should be delayed until after the valuation of the assets subject to sale. Lipton and Sachs, 'Privatisation...', pp. 335-6. The Hungarians are reported as having rejected the Sachs approach in favour of that of Janos Kornai, who advises the dismantling of the socialist sector in gradual stages, while concentrating on the development of new small– and medium–sized enterprises *de novo* in the private sector. Ivo Jakovljević, 'Privatizacija na istoku', *Danas* (Zagreb), 9 October 1990, p. 52.

[21] Jackson, 'The Progress of Privatization', p. 42.

[22] For an analysis of the emergence of the civil societies out of decaying communist systems, in both Europe and Asia see Robert F. Miller (ed.), *The Developments of Civil Society in Communist Systems.* Sydney: Allen & Unwin Australia, 1992.

sufficiently positive and decisive to make it possible to stick to the letter of his prescriptions, even where governments have shown the wili to do so.

## The Results So Far

The shift from socialism to capitalism has proven to be much more difficult than its advocates had foreseen. Even where specific schemes like the Lipton-Sachs program and the German *Treuhand* model have been followed more or less closely, the social and economic fallout has been more toxic than anticipated. Moreover, the massive Western assistance upon which the reformers depended—and which formed an integral part of Sachs's prescriptions for Poland, Yugoslavia and the USSR—has not been forthcoming in the volumes and time frames required. Nor have the EC countries been as receptive as expected to exports from the newly reformed economies, even where a good deal of success had been achieved by them in meeting import standards. This has been especially true of agricultural exports.[23]

Nevertheless, a good deal of progress has been made in transforming the former STEs. There is general recognition that the structures and financial means for a return to the old system simply no longer exist, even if the will to return is certainly alive and well among conservative politicians, bureaucrats and important sections of the population. By the end of 1991 the private sector already accounted for approximately 50 percent of total economic activity in Poland and Hungary.[24] The Polish Main Statistical Administration announced in early February 1992 that, while state sector

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[23] Polish President Lech Walesa complained bitterly about these import restrictions during a speech before the European Parliament in Strasbourg on 4 February 1992, reported in *Donosy* (E-mail from Warsaw in Polish), No. 726, 5 February 1992. One of the speakers at the Ciechocinek conference mentioned above in note 8, the director of a successful private agro-industrial import-export firm, specifically complained of such restrictions, emanating principally from Germany, on his firm's attempts to export strawberries and muchrooms.

[24] Ben Slay, 'Economic Reformers Face High Hurdles', *RFE/RL Research Report*, Vo. 1, No. 1, 3 January 1992, p. 100.

production continued to decline in 1991, in the private sector it was growing; 38% of registered production workers were now employed in the private sector; private savings had grown by 155% over the previous year; the foreign trade balance was positive; the external debt had been reduced by $US 2 billion; and inflation was relatively stable (!) at 70.3 percent for the year.[25](See Figure 1 in the Appendix.) The share of the private sector in industrial production rose to 20 percent, as compared with 16 percent in 1989. By September 1991 there were 1.5 million private businesses in Poland, although 87 percent of them were engaged in trade.[26]

In Hungary the situation was even more favourable. The country had managed to attract almost half the total foreign investment in the region in 1991. With more experience in at least partial economic reforms than any other of the STEs, the institutional, managerial and financial skill base there was more conducive to marketisation than elsewhere; and the pre-reform inflationary situation was considerably milder than, say, in Poland, where it had reached four digits by the end of the communist era. Inflation during the first nine months of 1991 was, thus, the lowest in Eastern Europe at 36 percent. Hard-currency exports were up, in part as a result of the forced closure of access to the Soviet market, and the current account was expected to be in surplus.[27]

Elsewhere in the region progress was slower than in Poland, Hungary and, of course the former GDR, which was now firmly in the Federal Republic's generous embrace. Yugoslavia had basically ceased to exist, and in most areas wartime conditions had put a stop to reform efforts. In the CSFR a reform program did not really get under way until well into 1991, and privatisation and market relations were largely limited to the small-scale commercial and services sectors. The economies of Romania and

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[25] Reported in *Donosy*, No. 724, 3 February 1992.

[26] Jan Bazyl Lipszyc, 'Public sector on the decline—private on the go', *Gazeta Wyborcza*, reported in *The Insider*, 9 December 1991, p. 7.

[27] Slay, 'Economic Reformers...', pp. 101-2.

Bulgaria continued to be plagued by political infighting, with only slight movement in the elimination of former communists from positions of power. The preferences of the latter were clearly for retaining as much as possible of the old system, and substantial sections of the population were receptive to their socio-populist appeals. Thus, even though rather radical reform programs were pushed through the legislatures in both countries—and suitably approved by the IMF and the European Development Bank—real progress toward the market and privatisation was not impressive.

Real reform has only just begun in the successor states of the former USSR. The three Baltic States have gone furthest in transforming their economies, but success has been modest so far, and they are still searching for a niche for themselves on the international market. In the meanwhile, they continue to pursue access to the Russian, Ukrainian and Belorussian and other ex-Soviet markets, but clearly only as a short-term expedient; they remain highly sensitive to linkages which might infringe their newly regained independence. The current chaos in Russia as it pursues radical price reform and marketisation could conceivably place Yeltsin's entire program of social, economic and political transformation in jeopardy. The lesson that there is no way back to the 'administrative-command economy' without the use of naked terror has evidently not been sufficiently learnt by conservative opponents of reform—and by growing numbers of ordinary Russian citizens as well. The reform measures in Ukraine, Belarus and some other successor states in the CIS seem to have been more cautiously dosed, and the prospects for some of them may be better than for Russia, if only because of the magnitude and complexity of its social and economic problems. In any case, the fact that Marxism-Leninism held sway in the CIS region for over 70 years, not 45, as in Eastern Europe and the Baltic States, is certainly one of the important differentiating elements in the transformation equation.

But even in the more successful reform programs, such as in Hungary and Poland, progress has been far from easy; and continued success cannot really be guaranteed. The most serious problem is mass unemployment and associated reductions

in consumer demand. Not only has the latter had a negative influence on production, but it has also reduced governmental tax revenues and the corresponding ability of the state to maintain the necessary social security safety-net or undertake infrastructural investments. The privatisation program in Poland (and elsewhere) has run into a number of legal and political obstacles, which haved undermined the integrity of government programs influenced by the Sachs model. Thus, in October then Prime Minister Bielecki was forced to scale back the scheduled privatisation of 400 state enterprises, which had been intended, as in the Sachs scheme, to be handed over to 20 new investment trusts entrusted with management and public share placement. The program was reduced to only 204 enterprises. Bielecki justified the cut-back with the admission that the remaining companies were in such bad shape as to require restructuring before being put up for sale.[28] Unemployment in Poland continued to rise as inefficient enterprises and agencies were restructured or liquidated, approaching 11.5 percent of the labour force by the end of 1991. This was undoubtedly an important reason for the poor showing of Bielecki's coalition in the October 1991 parliamentary elections. The new Olszewski government is far less committed to the Balcerowicz-Sachs program of economic transformation, and one can expect a slowdown in privatisation, a partial moratorium on further liberalisation of prices and imports and some policies to counter unemployment, which is expected to reach 18 percent by the end of 1992.[29] Indeeed, Olszewski's new Minister for 'Ownership Transformation' (privatisation) announced that the entire privatisation strategy was up for reassessment in January 1992.[30]

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28 Ian Traynor, 'Poland scales down plan to sell off state industries', *The Age*, 17 October 1991, p. 9.

29 Ben Slay, (ed.), 'Economic and Business Notes', *RFE/RL Research Report*, Vol. 1, No. 4, 24 January 1992, p. 44.

30 Ben Slay, 'Poland: The Rise and Fall of the Balcerowicz Plan', *RFE/RL Research Report*, Vol. 1, No. 5, 31 January 1992, p. 45.

In Hungary, too, the impact on the bulk of the population of the largely successful transformation process has been harsh. Industrial production declined by about one-third in 1991, and unemployment reached 8.3 percent of the labour force.[31] Despite considerable stand-by assistance from the IMF, the foreign debt remains the highest per capita in Europe, and increasing income inequalities are a source of rising popular discontent. Public anger has already caused the abandonment of some sell-offs to foreign buyers on the grounds that the national wealth was allegedly being squandered at too low a price. And there are substantial doubts as to the actual rate of transformation from state to private enterprise, with high levels of false reporting of change in both sectors. This atmosphere of fraud and uncertainty is undoubtedly an element in the growth of popular dissatisfaction.[32]

Czechoslovakia, which only began its reforms in 1991, witnessed the same pattern of rapid decline in industrial production and rising unemployment—expected to reach 7.5 percent by the end of 1991.[33] These unemployment figures are not unusual by current Western standards, but against the background of over-full employment, which was a hallmark of the STEs for decades, this level of unemployment is politically difficult for the new democratic regimes to sustain, especially in the absence of an effective safety-net. Even in the former East Germany temporary provisions for job creation by the Federal Government had been exhausted by the end of 1991, and unemployment quickly jumped from 11.8 to 17 percent at the end of January 1992.[34] The situation in Romania, Bulgaria, Albania and most of Yugoslavia can only be described as catastrophic: the old systems have collapsed, and new, market-oriented replacements

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31 ibid., p. 43.

32 Karoly Okolicsanyi, 'Hungary: Modest Growth of Private Companies', *RFE/RL Research Report*, Vol. 1, No. 2, 10 January 1992, pp. 30-2.

33 Slay, 'Economic Reformers...', pp. 101-2.

34 Andrew McCathie, 'Increase in east German jobless', *The Australian Financial Review*, 7 February 1992, p. 12.

have hardly begun to be introduced. The chaotic, and in some cases primitive, state of the industrial and infrastructural networks in these countries offer few attractions for foreign investors, and the available pool of domestic savings, not to mention the structural and psychological preconditions for private investment, are still rudimentary.

Agriculture reflects most of these general problems, as well as a spectrum of special demographic and socio-economic problems unique to that sector. Although the East European former STEs differ widely amongst themselves in the share of the private sector and the share of the population in agriculture, not to mention in the traditions and skill levels of their agricultural population, they have all inherited common problems from their communist past which seriously encumbers the attempt to create an efficient private agriculture. In the words of Timothy N. Ash:

> all these economies share the problems of inadequate and inefficient infrastructures supporting agriculture; the lack of fully functioning credit and banking systems geared to meet the specific needs of small farmers; and the presence of monopolistic input industries that do not provide technology appropriate for the relatively small-scale private farmer.[35]

All of these difficulties apply to the states of the former USSR as well, most of which are similarly trying to shift the basis of their agriculture to a private ownership and free-market basis. Even the Baltic states, which had substantial, and relatively prosperous private agriculture within living memory of many of their inhabitants, have been having serious problems overcoming these common shortcomings, as well as the common psychological inhibitions against taking up the risks associated witjh private farming.

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[35] Timothy N. Ash, 'East European Agriculture at a Crossroads', *RFE/RL Research Report*, Vol. 1, No. 4, 24 January 1992, p. 33-8; quote from p. 33. Much of the following discussion is influenced by the evidence and conclusions presented in this excellent summary.

Nevertheless, given their natural endowments and past trade patterns in Europe, there is every reason to believe that many of these countries will again become major exporters of agricultural products, from horticultural to meat and dairy items—and in some cases, food and feed grains as well. Given the likely persistence of import restrictions on their products by the EC, it is highly possible that they will appear as competitors of traditional exporters like Australia and New Zealand on the world market.

That is certainly not a short-term prospect, however. For the moment—and probably for the next five years—they will have to go through a veritable purgatory of structural, legal and psychological impediments in carrying out the shift to a market-driven agriculture. Given the decisive role of the state sector in most of these countries, this will necessarily involve not only the creation of new private farms, but also the privatisation of more or less intact state farms and producer cooperatives. Even where, as in Hungary, the CSFR, Romania and Bulgaria, there are strong movements to legislate for the restitution of collectivised and nationalised land to their former peasant owners, efforts are being made to retain the most efficient large-scale farming enterprises and to give alternatived parcels of lands to private farmers. Most of the new private farms are relatively small, even by West European standards, and in Romania, which has the most radical land reform legislation, a limit of 100 hectares has been established for private land holdings.[36] There, as well as in Bulgaria and Hungary, encouragement is being given to private farmers to form or (join existing) cooperatives and maintain some form of large-scale joint farming enterprises on a share-holding basis. The scarcity of small implements and other farming inputs mentioned earlier is a good reason for aopting this strategy, at least as a temporary expedient until a fully fledge market in farm inputs and outputs is established.

The absence of a reliable market for producers is one of the major immediate difficulties. Throughout the region, with the introduction of relatively free prices for

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[36] Ash, p. 35.

farm products, private farmers have experienced serious problems in making ends meet. The decline in real wages has created a shrinkage in demand for food items. This, combined with flood of subsidised imports from the EC has reduced farm incomes and increased discontent in the farming sector, sometimes expressed—for example, in Romain and, for a while, in Poland, as well as parts of the former USSR—in a refusal of the farmers to bring their produce to market. Production is expect to decline in 1992, and this will likely help to equilibrate supply to the declining domestic demand, but in the meantime a number of countries—Hungary, Poland, Czechoslovakia and Bulgaria—have introduced intervention prices to buy up stocks of surplus grain and other items for export. Much of this export will be directed to the Russian and other eastern markets to help pay for imports of needed fuels and raw materials, which were severely cut back by the collapse of Soviet trade in 1991.[37] In short, the initial reliance on a totally free market in agriculture has effectively been abandoned, as the new regimes come to grips with the realities of international farm trade. Whether this will inhibit the development of a rational agricultural development strategy in the context of a private farming system remains to be seen. Much depends on the political situation and the determination of the new governments. In the current climate of rising unemployment and the closure of large-scale enterprises, private farming will undoubtedly represent an attractive alternative to many persons in these countries. However, the absence of traditional peasant expertise and orientation to this type of employment after decades of socialist indoctrination suggests that the number of persons willing and able to make a success of private farming will not be large, and there a major shakeout of the farming sector will have to occur before it can become a viable contributor to the domestic and foreign trade components of the respective economies. It

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[37] Jason M. Lamb, 'Developments in Central and Eastern European Agriculture', *Newsletter for Research on Soviet and East European Agriculture (RSEEA)*, Vol. 13, Issue 4, December 1991, p. 2.

is doubtful whether these countries possess the resources, or their farm population possesses the requisite political clout, to enable agriculture to develop along the comfortable lines as a way of life and a source of income that has become characteristic of the EC countries. That is not impossible, however, and the resulting protected agricultures would then join the EC in pumping their food and fibre surpluses on the world market in competition with countries like Australia.

**Conclusions**

Economic reform is an important element in the re-emergence of civil societies in the former socialist countries and their re-joining the liberal world community. The argument is often made that free-market-oriented economic reform is only possible only in an atmosphere of liberal democratic politics—and there is undoubtedly not much that could be said against such an argument. But it is also obvious that democratic politics can be a serious obstacle to the implementation of consistent economic reform, particularly in a situation, such as exists in the countries we have been speaking about, where the reform involves a transformation of an STE, with all the psychological and social behavioural and structural patterns connoted by that model.

Recent public opinion survey in the region have confirmed this relationship and its potentially negative implications for the completion of the economic reforms that have been undertaken so far. A Eurobarometer poll carried out in Eastern Europe and the former USSR for the European Commission at the end of 1991 found a deep popular disappointment with the democratic institutions that have replaced the communist system.[38] There can be little doubt that the lack of success of the economic reforms promised by the new regimes is a decisive factor in this popular disillusionment. Evidence for this connection has recently emerged in Poland, where because of the

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[38] John Palmer, 'Gloom and doom in ex-Communist states', *The Guardian Weekly*, Vol. 146, No. 6, 3-9 February 1992, p. 8.

difficulties in the economy, opinion polls have shown that President Lech Walesa is currently less popular than his communist predecessor, General Wojciech Jaruzelski, the persecutor of Solidarity, and the present government of Prime Minister Jan Olszewski is even less popoular than those of his two predecessors, both of whom were rejected in popular elections.[39] The problems that Russian President Boris Yeltsin has been having with his reforms indicate a similar slump in popular support, which many expect to lead to a serious reversal of its main objectives and, possibly, the replacement of Yeltsin by anti-reform forces. In Russia, as well as in Poland and Hungary, there is considerable popular ambivalence over substantial involvement of Western capital in the transformation process—particularly foreign buy-outs in the course of privatisation—and this sentiment provides fertile soil for anti-reform demagogues from both ends of the political spectrum.

The political activation of the population and its dissatisfaction with the results of the reform so far are undoubtedly a major complicating factor for the economic reformers, but the theory and practice of the transformation itself have also been found to require serious re-examination. Jeffrey Sachs and his colleagues obviously underestimated the impact of monopoly and monopsony in the state sector in their formulas for price liberalisation, especially in the context of macro-economic stabilisation. The freeing up of retail prices can have a beneficial effect only where supplies are readily forthcoming to exert a restraining effect. In Poland the importation of foreign goods helped to achieve this effect, but it has been less workable elsewhere—Russia, for example. And in general the rise in retail prices has gone so far ahead of expectations as to impose a serious reduction on demand, which has sent such powerful signals to both industry and agriculture as to lead to a general recession and burgeoning unemployment. The legal and bureaucratic obstables to rapid privatisation—and the

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[39] Ian Traynor, 'Poland's dream of cream turns sour', *The Canberra Times*, 8 February 1992, p. 12.

inadequacy of supply channels to satisfy the input needs of the private factories and farms which are able to establish themselves—have meant that there are insufficient domestic competitors to supply the market, restrain prices and absorb labour retrenched by the state sector. The monopoly position of most industries and commodity procurement agencies in the state sector ('nomenklatura-privatised' or still state-owned) has meant that they can cut production and shed labour without seriously damaging their revenues.

Sachs & Co. have also clearly underestimated the valuation problem in their schemes for immediate privatisation. Even where rudimentary stock exchanges have emerged—in Poland and Hungary—the number of firms whose shares are traded (and thus susceptible to a kind of market valuation) is very small. Other state enterprises, on inspection prior to privatisation, has proven to be unsuitable for purchase and woefully unattractive for legitimate foreign investors. The number of scandals over exploitative privatisation by unscrupulous speculators has been one of the reasons for popular disaffection in both Poland and Hungary, and this has forced the governments involved to recast their privatisation strategies. The piecemeal, case-by-case approach specifically rejected by Lipton and Sachs seems to be the one which will dominate the process—and, as they feared, will drag out the process for perhaps decades.

Agriculture has proved to be particularly difficult sector to transform. The liberalised price policies and uncertainties of sales have motivated the farm sector, both privately and state-owned, to demand state intervention by way of price supports and protection against imports. The political clout of the farm population, through strikes and legitimate political pressure, has been sufficient to compel the governments to give in and at least partially satisfy their demands, with the result that in agriculture, too, the original reform program has had to be significantly modified in an interventionist direction.

To be sure, Sachs and other reform consultants had based much of their optimism about the success of the reforms on substantial Western financial and commercial

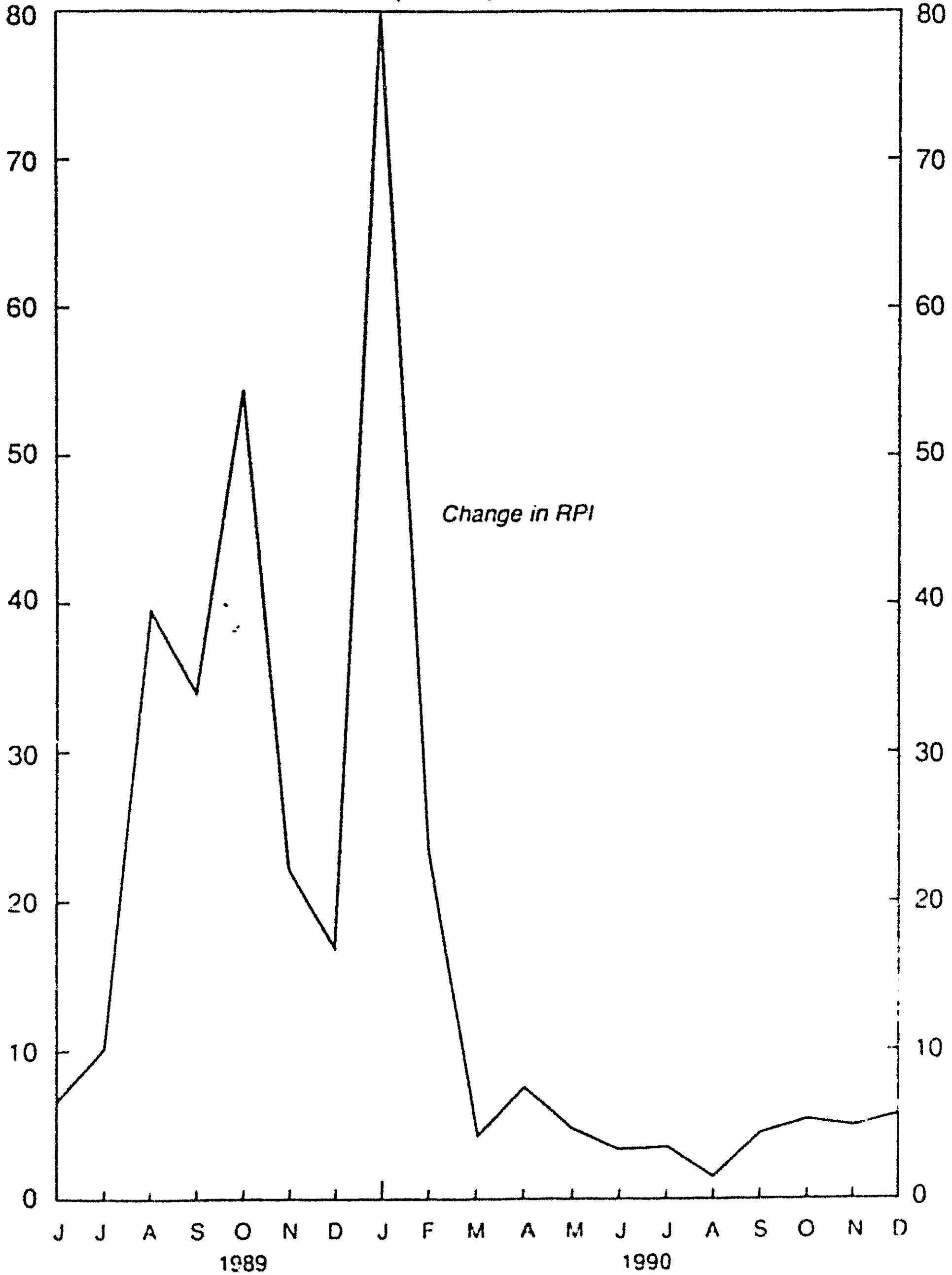
assistance to tide the vatrious programs over the rough patch they they all expected in the intitial stages. This assistance has been insufficient and not always disinterested, although that is not always for want of the will to help. The magnitude of the demand for assistance and the straitened clurcumstances of the Western economies have meant that not as much aid has been forthcoming as the reformers had expected. The West, and especially the EC countries, are well aware of the political costs that could be incurred in the case of the failure of the economic reforms: mass exodus of the unemployed, ethnic and international conflicts that could involve the West militarily and the failure of democratic politics which could lead to prolonged instability in the region. Most Western leaders, consequently, recognise the need for greater economic assistance and for the most rapid possible integration of the East European countries into the EC.

The most likely scenario of developments in Eastern Europe and the states of the former USSR without such assistance (and perhaps even with such assistance if it is delayed or inadequate) will include the emergence of a mixed type of market economy, with the state sector continuing to play an important role. State intervention will become a habit, and the state sector in production and distribution will remain a heavy burden on the respective national economies. Politically, after a period of domestic anarchy and rising popular discontent, some of the countries will turn to mildly authoritarian forms of government such as existed throughout much of the region in the 1930s. These regimes would favour a certain level of domestic and foreign private investment, with strong state corporatist support for the working class and the farmers—in short, a kind of Peronism.

It seems inevitable that, short of rapid integration of all these countries into the EC, some countries will tolerate more democratic pressure on these authoritarian interventionist processes than others and will be correspondingly more or less favoured by othe West. The differences will be determined partly by their inherited pre-communist political cultures, but also by the level of success of their respective systems of guided capitalism. The Singaporean model might in the end serve as a more

useful source of inspiration for their further development than West European, North American or Japanese models that have been promoted up to now, with only limited success, by Western consultants.

APPENDIX

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Source: Timothy D. Lane, 'Inflation Stabilization and Economic Transformation in Poland: The First Year', International Monetary Fund, Research Department, July 1991, p.10a.

APPENDIX

**Table 1. Size of the State Sector, Measured by Output and Employment, Selected Countries**

Percent

| *Country* | *Output* | *Employment* |
|---|---|---|
| *Command economies* | | |
| Czechoslovakia (1986) | 97.0 | ... |
| East Germany (1982) | 96.5 | 94.2 |
| Soviet Union (1985) | 96.0 | ... |
| Poland (1985) | 81.7 | 71.5 |
| China (1984) | 73.6 | ... |
| Hungary (1984) | 65.2 | 69.9 |
| *Market economies*[a] | | |
| France (1982) | 16.5 | 14.6 |
| Austria (1978–79) | 14.5 | 13.0 |
| Italy (1982) | 14.0 | 15.0 |
| Turkey (1985) | 11.2 | 20.0 |
| Sweden | ... | 10.6 |
| Finland | ... | 10.0 |
| United Kingdom (1978) | 11.1 | 8.2 |
| West Germany (1982) | 10.7 | 7.8 |
| Portugal (1976) | 9.7 | |
| Denmark (1974) | 6.3 | 5.0 |
| Greece (1979) | 6.1 | |
| Norway | | 6.0 |
| Spain (1979) | 4.1 | |
| Netherlands (1971–73) | 3.6 | 8.0 |
| United States (1983) | 1.3 | 1.8 |

Source: David Lipton and Jeffrey Sachs, 'Privatization in Eastern Europe: The Case of Poland', Brookings Papers on Economic Activity, No.2, 1990, p.300.

Table 2 Advantages and disadvantages of different privatisation schemes

| Type | Advantages | Disadvantages (problems) |
|---|---|---|
| *Internal* | Popular in successful enterprises<br>Spontaneous process<br>Easy to implement | Possibility of manipulation by the management<br>Privilege for workers in successful firms<br>Does not generate revenue for the state |
| *External* | High revenue for the state<br>Optimal allocation of shares | Difficult to determine reserve price<br>Capital gains for the wealthy<br>Slow process |
| *Free distribution* | Egalitarianism<br>Fast privatisation | Does not generate revenue<br>Ownership dilution |
| *Holding company* | Fast privatisation<br>Experienced management teams | Potential failure of privatisation |

Source: Branko Milanovic, 'Privatisation in Post-Communist Societies', Communist Economies and Economic Transformation, Vol.3, No.1, 1991, p.32.