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REFORMING OR PERFECTING THE ECONOMIC MECHANISM IN EASTERN EUROPE

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Contents

1. Introduction

This paper is about changes in the economic mechanisms of East European centrally planned economies. First a few remarks will be made concerning changes in these economic mechanisms in general, including a brief survey of the historical sequence of major changes. Next, a distinction between two major types of changes: perfecting and reforming the economic mechanism will be introduced and explained. Further, the factors decisive for the choice between the two types of changes will be identified, and some observations concerning the impact of the two types of changes on the operation of the economies will be outlined. Some remarks will be made concerning prospects at the end of the paper.

The paper will cover the seven European member countries of the CMEA, i.e. Eastern Europe including the USSR but excluding Yugoslavia. In studies on the economic development or foreign economic relations of East European countries it is more correct to distinguish between the Soviet Union and the East European six. In considerations that concern the economic mechanism the Soviet experience can and should be discussed together with the experience of the East European six (Bulgaria, Czechoslovakia, the GDR, Hungary, Poland and Romania).

The economic system of each particular East European country includes the institutional forms and structures, operational rules and behavioural patterns in the entire economy, relative to all economic agents. In this paper two limitations will be made. First, the important problem of the role and of the way of operation of the private and semi-private sectors (second economy, etc.) will be neglected. Second, the problems of management within enterprises will be neglected to concentrate on the relations between the state authorities and the enterprises.

2. Changes in the Economic Mechanism and their Motive Forces

The history of East European economic mechanisms can be presented as a long march, with periods of advancement and of retreat, constituting a gradual departure from the Stalinist starting point, i.e. from the system of highly centralised mandatory planning and movement toward less centralised, less demonetised, less bureaucratic economy.

2.1 The changes in retrospect - a brief survey

In the course of this long march, some particularly important and spectacular steps or leaps can be identified both internationally and in respect of each particular country. Internationally, the first wave of reform movement in the mid-fifties, the second wave of reforms in the mid-sixties with the Czechoslovak and Hungarian reforms and the third wave of reforms in the early eighties with the Polish reform seem, in retrospect, to be the most important.

In Bulgaria, a first attempt at a comprehensive reform was undertaken in the mid-sixties but was abandoned in the late sixties. A trend toward extreme centralisation was characteristic for the early and mid-seventies, to be followed by another attempt to decentralise in the early eighties.

In Czechoslovakia, the first comprehensive effort to decentralise was initiated as early as 1958 but aborted after a few years (around 1960). A comprehensive economic reform with an explicit market orientation was elaborated in 1965 and introduced in two steps in 1966-1967, further developed in the spirit of self-management in 1968-69 and halted and was withdrawn completely during the early seventies. The re-introduced system of traditional mandatory planning was continuously rationalised and a 'set of measures' allowing a limited role to monetary categories again was introduced, after two years of 'experiment', in 1981.

In the GDR, the comprehensive 'New Economic System' of planning and management, involving a greater role of monetary categories but maintaining mandatory planning was introduced around 1964. Its transformation into the 'Economic System of Socialism' already represented a certain retreat from the original ideas which were openly criticised and the whole undertaking was abandoned in the early seventies. During the seventies systemic changes were confined to some reorganisations in the planning system with the introduction of Kombinate within or instead of the assocations (VVBs).

In Hungary, only a few details of the comprehensive reform blueprint drafted by specialists in 1957 were implemented and some centralising measures were introduced in the field of investment and of industrial organisation during the late fifties and early sixties. In the late sixties, however, a comprehensive and market-oriented economic reform was introduced. Advance in the intended direction was stopped and even some retreat was experienced in the early and mid-seventies, to be followed by a further wave of decentralisation and monetisation of the system.

In Poland, a comprehensive reform programme was elaborated in 1956-57 but only some minor details were implemented and rather formally (associations, self management). The half-hearted initiatives for changes in the mid-sixties aborted at the very outset while the changes in the price and incentive systems introduced in 1969-70 were withdrawn following the workers' riots in December 1970. The so-called 'WOG reform' based on 'big economic organisations' in the early seventies was 'modified' very soon, due to the mounting disequilibria in the economy. The most comprehensive and best conceived effort to reform the economic mechanism started in 1982, under extremely unfavourable conditions.

In Romania, the first noteworthy experiment to introduce changes in the economic mechanism, to enlarge the power of enterprises and particularly of 'centrale industriale' was undertaken in 1968 but withdrawn already during the early seventies. Another attempt at decentralisation applying the term 'new economic mechanism' borrowed from Hungary was started in the late seventies, with the aim to force economic and territorial units to achieve self-sufficiency but without introducing market mechanisms.

In the USSR, Kruschev tried to improve the operation of the economic mechanism by means of an administrative reorganisation: replacing the branch hierarchy by a territorial one (the sovnarkhozy). The sense of the economic reform of 1965 was genuine decentralisation without abandoning mandatory planning. The reform was, in fact, abandoned from 1969 and was followed by a campaign of centralisation in which emphasis was laid on setting up enterprise associations. A new series of measures aiming at the rationalisation of the planning system and of incentives was proclaimed in 1979, with very limited actual impact on the operation of the system. Soviet economists and officials are now working on a 'radical reform' intended substantially to enlarge the autonomy of enterprises.

2.2 The motive to change: dissatisfaction with the existing mechanism

What explains these continuous changes in the economic mechanism? Obviously, the efforts to change the economic mechanism result from dissatisfaction with its operation. I think, however, that we are dealing with dissatisfaction in two senses.

First, those who participate in economic decision-making in various positions as managers in enterprises or officials in the state administration etc. have experienced in their daily life the irrationalities in the operation of the system. People in various decision-making and managerial posts intend to perform their jobs properly and they feel themselves prevented in doing so. They think they know what should be done and suffer from being limited to do so by rules that seem to be rigid and irrational. To use the term applied in Marxist philosophy, they are alienated from the system. To repeat, it is not only the agents below, i.e. not only enterprise managers who suffer from the irrationalities in the system but also officials in the state economic administration. Let this type of dissatisfaction be called operational dissatisfaction; changes in the economic mechanism have been initiated to remove irrationality and rigidity in the system, to reduce operational dissatisfaction.

Second, politicians, central planners and citizens in general have been increasingly dissatisfied with the performance of the economy. East European economists, analysing the operation of the economic system, attributed the unsatisfactory performance of the economy to specific features of the economic mechanism more and more convincingly. Both professional economists and the public have become more and more aware of the adverse effects of the operation of the economic mechanism upon economic performance. Let this type of dissatisfaction be called performance dissatisfaction.

The two types of dissatisfaction have always co-acted in bringing about changes in the economic mechanism. In retrospect to more than three decades, one can conclude that the weight of the second type of dissatisfaction was continuously increasing, as a result of the deteriorating performance of the East European planned economies and with the increasing degree of understanding the determination of economic performance by the economic mechanism.

2.3 The cause for retreat: conflicts ensuing from the changes

The departure from the Stalinist starting point has not been a monotonic movement. Periods of progress and periods of retreat succeeded each other. So far we have identified dissatisfaction with the traditional system of centralised planning as the main impetus to changes in the direction away from the traditional system. But what about the retreats?

Retreats are usually explained by the resistance to the changes from above (by the conservative central administration), from below (by conservative local bureaucrats), and from outside (by the governments of allied countries), on both ideological and power interest grounds. In addition to that, shortages in the economy, taut plans are often mentioned as bringing about interventions by the authorities. The problem with such explanations is that all these conservative influences are equally present in the periods of advance and in the periods of retreat. The balance between the forces acting in favour of advance (i.e. of departure from the traditional model) and the forces in favour of retreat must shift to bring about the retreat.

The history of the economic mechanisms in East European countries suggests that this shift results from the conflicts that emerge following the departures from the traditional model. Let me give just a few examples. The 'new system of management' introduced in Czechoslovakia in 1958 implied the forming of decentralised investment funds. Under the conditions of a taut plan, the existence of such funds made it more difficult for the central planners to prevent investment from growing beyond the plan, and decentralised investment funds were abolished in 1960.

Under the Soviet economic reform of 1965 enterprises were authorised to make decisions, within limits, on their product-mix, and profitability and revenue from sales were made important success criteria for the enterprises. Under the conditions of fixed prices insufficiently reflecting the interrelation between supply and demand and of the absolute lack of newcomers entering the market this resulted in a falling supply of less profitable commodities which provoked interference in the decisions of the enterprises concerning their product-mix on behalf of the ministries.

In Hungary quotas on employment and on the wages fund were abolished in 1968, and collective farms in agriculture were entitled to establish auxiliary divisions engaged in industrial, building and trade activities. The auxiliary divisions operated more flexibly than the state-owned industrial firms and, partly because they were exempted from the control over average wages, paid higher wages and salaries and were attractive for certain skilled workers and engineers employed by the state firms. The big state firms pressed the government not only to impose extra taxes on such activities of the collective farms but also to introduce limitations on them during the early seventies. Labour legislation was, at the same time, made more restrictive again.

Economic reforms, however comprehensive, necessarily imply numerous compromises. Prices cannot be fully liberalised overnight; thus it is unavoidable that the enterprises be endowed with a higher degree of autonomy in decision-making without prices reflecting scarcities and without profitabilities reflecting market performance perfectly at once. Incentives that are linked to market performance instead of plan fulfilment will necessarily bring differences in incomes inconsistent with the principles of the reform. Part of investment continues to be financed by the state while another part by the enterprises themselves which brings injustice in the formation of enterprise incomes again. These and further contradictions are unavoidable concomitants to any process of change constituting a departure from the traditional system of central planning. The ensuing conflicts, in turn, bring instability into the balance of power that made the changes possible. Then, and only then, will the conservatism of planners in the centre, local officials and observers abroad gather momentum. The result is the beginning of retreat in the development of the economic mechanism.

This constitutes the inner logic in the sequence of periods of advance and of retreat in the development of economic mechanisms.

3. The Distinction between Perfecting and Reforming the Economic Mechanism

3.1 Defining the difference

There have been numerous changes in the economic mechanisms of the seven East European countries in the last thirty years. They have had at least one common feature: none of them was sufficiently successful in the eyes of the reform-minded economists who suggested their implementation to the governments. However, they were obviously different in many respects.

Some observers are inclined to call all changes which bring the economic mechanisms further away from the Stalinist starting point (or, at least, all significant changes) economic reforms and distinguish between 'partial' and 'comprehensive' reforms or between 'administrative decentralisation' and 'economic decentralisation' (Bornstein 1977). Purely semantically, this is absolutely correct: 'reform' means change and, possibly, improvement. Why not call, then, the limited changes introduced by the Kádár government in 1957 in Hungary instead of a far-reaching comprehensive economic reform (the blueprint for which was already drafted by the best economists of the country) also steps in the process of the economic reform as Iván Berend does? Why not call the New Economic System of the GDR an economic reform as well as the Kosygin reform of 1965 in the Soviet Union (particularly since the latter was officially called a reform by its initiators)?

Włodzimierz Brus is of a different view: "I understand under 'reform' a meaningful change in the operating principles of an economic system, and not any modification within the old framework". To make it clear, he adds: "In this sense Poland, along with most other communist countries, but unlike Hungary or, outside the bloc, Yugoslavia, has not succeeded, so far, in carrying out economic reform..." (Brus, 1985a, p. 195). Thus Brus limits the coverage of the term economic reform more or less to the same cases that are called economic decentralisation (distinguished from administrative decentralisation) by Bornstein. The difference seems to be only in words.

If I prefer the terminology applied by Brus and I define economic reform as only one class of changes in the economic mechanism, it is because the distinction between 'economic reform' and 'perfecting the system of economic control' has recently acquired an important role in the disputes on economic systems policy in several East European countries. I happened to watch the Czechoslovak television in my home in Budapest on a day in 1980 when the Czechoslovak Minister of Finance Ladislav Lér declared to journalists that, contrary to certain expectations, the 'set of measures' (soubor opatření) introduced in 1981 does not constitute an economic reform but only a new phase in perfecting (zdokonalování) the system of economic control. In the same sense Hungarian politicians emphasised several times in the early eighties that a new, second reform was out of the question in Hungary and only perfecting the system of economic control (a gazdaságirányitási rendszer továbbfejlesztése) was on the agenda. On the other side, the new Soviet Secretary General of the Party, Mikhail Gorbachev expressed his determination to introduce substantial changes in the economic system by using the term 'radical reform' as opposed to 'partial improvements' at the 27th Party Congress. The seventies were characterised by measures aimed at perfecting the economic mechanism (sovershenstvovaniyë).

But how to define what we mean by reform as against perfecting the economic mechanism?

It has been emphasised above that the economic mechanisms of most East European countries are in continuous transition. These changes differ in their direction, their depth and their frequency. It seems that changes are more frequent, say, in Bulgaria or Hungary and less frequent in the GDR. Let us take the example of Bulgaria. In certain periods the changes constituted movement away from the traditional model of central planning (late sixties, early eighties), in other periods they involved a move towards a peculiar form of hypercentralisation (mid-seventies). The changes in the Bulgarian economic mechanism can be viewed as a certain kind of oscillation around an 'equilibrium point' which is a moderate version of the traditional model of central planning. The same holds for the Soviet Union, for Romania or for the GDR. The traditional model as an 'equilibrium point' appears as one to which the economic mechanism returns after each departure from it, as a consequence of the conflicts and contradictions resulting from the changes in the mechanism. The changes, however, have never meant a move to any other model as war communism on the one side or a system without mandatory planning on the other.

The history of the New Economic Mechanism in Hungary can also be presented as that of 'reform cycles'. (The notion is quite widely used in the literature on economic reforms, see e.g. Brus 1985b). Just to recall: after its introduction and moderate advancement toward 'market socialism' (but still very far from anything like that) a period of retreat followed in the early and mid-seventies. The early eighties constituted another period of movement in the direction of the reform blueprint, but this movement has already lost momentum by now. This is also a certain oscillation, but the 'equilibrium point' is beyond the traditional system of central planning: it is in the 'field' of the hybrid which I described as 'neither plan nor market' (Bauer, 1983). In the Hungarian case the departures from this 'equilibrium point' in the direction of a 'market socialist' system are limited, and the efforts to advance further always ended with retreats to that hybrid state - but not to the traditional system of central planning that Hungary had abandoned in 1968.

Having mentioned the Hungarian reform of 1968, it is time now to say: it was a reform as it constituted a move from one 'equilibrium point' to another one. Before this transition, Hungary also experienced changes in the economic mechanism that could have been qualified as 'perfecting': the new incentives introduced in the late fifties (profit-sharing) or the introduction of a capital charge in 1964. Similarly, the endless modifications in the system since 1968, the numerous revisions in the system of wages control, in the system of taxation, in pricing rules etc. belong to this class of changes.

3.2 The meaning of the difference

What does the Hungarian economic reform, the shift from the traditional 'equilibrium point' in changes in the economic mechanism to another distinct one mean? This shift resulted from a set of simultaneous changes in the economic mechanism. I discussed them at somewhat greater length in another paper (1983), so I will list the changes briefly, comparing them with the changes of the 'perfecting' type. I consider the abolition of the comprehensive control hierarchy, of mandatory planning and of centralised resource allocation to be the three basic components of the reform.

Under perfecting the economic mechanism the all-embracing control hierarchy has always been reshaped but maintained. The shift from the branch principle to territorial principle in the late fifties (USSR, Bulgaria) or the creation of large units with economic accounting (VVBs in the GDR, VHJs in Czechoslovakia in the fifties and sixties, WOGs in Poland in the seventies) or of minor and technologically more closed ones (Kombinate in the GDR and concerns in Czechoslovakia in the seventies and eighties) has never questioned the principle that all economic units constituted parts of one comprehensive hierarchy and continued to be administratively subordinated to the centre. Under the Hungarian NEM, the medium-level control agencies were liquidated, except if transformed into central managements of nation-wide enterprises. The remaining enterprises (nation-wide or not) were formally emancipated from the administrative subordination to the state administration (although their directors continued to be appointed etc. by the ministries up to now) what turned into genuine emancipation in respect of numerous small and medium-sized enterprises.

Under perfecting of the economic mechanism, gross output as a plan target prescribed for enterprises and constituting the main criterion of assessment was replaced by others like sales, profits (USSR, 1965), net output (several countries during the seventies and eighties) etc. In Hungary, plan targets whose non-achievement was sanctioned were eliminated from the economic mechanism and were replaced by the general qualitative requirement to satisfy domestic demand, to meet CMEA obligations and to achieve a satisfactory export performance on western markets. Such requirements nevertheless in many cases prevented Hungarian enterprises from discontinuing unprofitable production but, at the same time, allowed (and encouraged) them to undertake additional production according to profitability considerations (and they have hardly been forced to undertake new activities against their will).

The centralised allocation of resources has been one of the most stable components of the traditional system. The most that could be achieved under the perfectioning of the traditional mechanism has been the delegation of powers to allocate resources to lower levels in the hierarchy, particularly to VVBs in the GDR, to VHJs in Czechoslovakia, etc. In Hungary, in turn, centralised resource allocation was replaced by a satisfactorily operating market for factors of production (though highly monopolised and strongly controlled by the state). Traditional bilateral links between supplies and customers inherited from the old system prevailed on this market but firms undertaking new types of activities often could, though not without difficulties, find a supplier of the necessary intermediate products without any interference on the part of state agencies.

The three elements mentioned above, mutually conditioning each other, constituted the new framework for the operation of the enterprises. The fourth basic component has been the incentive system in a wider sense of the word, constituting the 'charging' for the operation of the enterprises.

Under the traditional system of central planning, 'material incentives' were linked to the fulfilment of plans, particularly those for gross output. Perfecting the traditional mechanism implied the binding of incentives to other plan indices and, in some cases, formally, to actual values of certain success indicators like profits, sales, net output etc. The binding of incentives to such indicators has been realised by means of the so-called 'normatives' indicating the allowed level of incentives corresponding to any value of the chosen success indicators, defined separately for each particular enterprise or association for each particular year. The 'normatives' were necessarily defined separately for each enterprise and for every year due to the lack of a flexible price system under which the values of net output, profits etc. would reliably reflect economic performance. In addition to that, under perfecting the economic mechanism investment continued to be highly centralised and, therefore, the central planners could not tolerate differences in the financial assets of firms which would be entirely reflected in differences in personal incomes.

Under the New Economic Mechanism in Hungary, enterprise incomes and profits were formed under conditions of continuously changing prices of both input and output costs. Prices were only partly liberalised and even the 'free' prices were under political control but the frequent revisions of prices, together with tax increases, created a combined price and tax 'pressure'. The price reforms of 1968 and 1980 eliminated at least the most striking and economically the least justified inter-industry price differentials and made the introduction of a principally uniform system of taxation possible.

While under perfecting the economic mechanism the share of retained profit is defined by means of enterprise-specific normatives (always subject to bargaining between the enterprise and its hierarchical superiors) and the residual of profits is transferred to the state budget, in the Hungarian case the tax (uniform for the majority of enterprises) is deducted from profits and the residual remains with the firms for investment and incentives. Though the system of taxation has always operated with numerous exceptions, it made the enterprises heavily dependent on the levels of their incomes and made inter-enterprise comparisons possible.

Several other features of the New Economic Mechanism like the mixed investment system with the possibility to invest being an important incentive for enterprise management or the direct access of Hungarian producers to foreign markets (true, under strong bureaucratic control) also deserve mentioning. Without going into further details, let a few remarks be made at this point.

First, let it be emphasised that the various changes in the system mentioned so far proved to be mutually strengthening and, as a result, made the entire set of changes irreversible.

Second, after nearly two decades during which the NEM experienced temporary setbacks and heavy trials, it proved to be resistant to efforts to recentralise. After the first oil crisis, central allocation of certain imported raw materials was introduced but their allocation was soon deregulated. The administrative measures introduced since 1982 proved to be much more stable than the ones after 1973 but the 'agreements' between enterprises and the state administration have not developed yet into a comprehensive system. Some enterprises refuse to make agreements and the majority of small and medium-sized enterprises have not even been invited to make them.

Before making the third remark, let it be recalled that several authors like János Kornai or István Gábor consider the non-state sector or the second economy to be the field of genuine reforms and express their doubts concerning the reformability of the state sector or first economy. I think that unlike the GDR whose private sector is restricted to peripheries of the economy (to traditional handicraft and services), lacks dynamism and can easily coexist with a traditional planning system in the state and co-operative sectors, the Hungarian non-state sector is very strong in industrial services, but in some progressive market segments in consumer services could only emerge and survive in close contact with the state sector because of the latter being also different from the traditional model of central planning. The non-state sector can acquire the necessary inputs only because centralised resource allocation has been abolished; it can expand because large state enterprises need their services and they are more or less free to acquire them.

The changes that, in their complexity, constituted an economic reform in the above sense were presented here on the example of the 1968 reform in Hungary. A similar set of changes was introduced in 1967 in Czechoslovakia and in 1982 in Poland. In both cases, however, one of the important components was missing. In Czechoslovakia, the medium-level control agencies called 'general directorates' were preserved and, as a consequence, the organisational hierarchy of the traditional mechanism was not abolished. Provided the reform survived the political events of 1968-69 the general directorates might have been abolished as was proposed by several economists in the discussions on the reform of the time. Actually, however, the power of the general directorates over the enterprises was increased as part of the re-establishment of the traditional mechanism of central planning in that country.

In Poland, the blueprint of the 1982 reform incorporated all the elements listed above. While during the early seventies the changes in the economic mechanism were based on the primary role of the associations called WOG, at present enterprises are formally emancipated and made independent. However, under the conditions of heavy shortages experienced by Poland in the early eighties the authorities considered it indispensible to maintain some temporary forms of centralised resource allocation. This factor undermined the other changes: since the allocation of resources was bound on the satisfaction of central plans of output in the so-called 'operational programmes', bargaining on output plans was also preserved. Since the 'voluntary' associations (zrzeszenia) replacing the obligatory ones (zjednoczenia) obtained some power in resource allocation, the elimination of the medium-level control agencies was not accomplished either.

Thus, while we can assert that in Czechoslovakia an economic reform was in course in the sense defined above, in the Polish case it remains still open whether the set of changes conceived as a genuine reform will be accomplished as such. Polish economists often express their doubts whether the changes have already been irreversible. Agreeing with them, we have to emphasise: there exists, at least, the chance for that. Although we do not intend to analyse here developments in non-CMEA countries, we can state that the changes that took place in Yugoslavia in the mid-sixties represented a genuine reform. Since then oscillations continued but the 'equilibrium point' has clearly been different from the economic system in Yugoslavia before 1965 and from that in the countries of the CMEA.

3.3 The causes for the difference

The question is often raised why has Hungary accomplished more or less successfully an economic reform, why have Czechoslovakia and Poland been less successful in doing the same and why have other countries like the USSR, the GDR or Bulgaria never undertaken the same kind of changes in the economic system.

The first answer that suggests itself is of purely economic character. It has often been assumed that the development level (the complexity of inter-industry relations in the economy and the relative importance of the so-called extensive and intensive growth in economic development) and the size of the country (openness to the external world) were decisive. (Such an explanation fits into the argument according to which the traditional model of planning was adequate to the beginning of industrialisation and changes in the economic mechanism are necessitated by economic development, so widespread in official texts in Eastern Europe). The evidence in Eastern Europe plus Yugoslavia and China does not support such an explanation. A small country with a mature economy such as the GDR has insisted on the course of perfecting the economic mechanism while the less developed Hungary and the less developed and considerably larger Poland undertook the course of reform. Since 1970 the equally small and highly industrialised Czechoslovakia joined the GDR in the course of perfecting its economic mechanism. The Soviet resistance to deep reforms has often been explained by the size of the country and the ensuing limited importance of foreign economic relations in the Soviet economy. The recent developments in China question the appropriateness of such an argument: China is as large as the USSR, and her dependence on the external world is probably not substantially higher than that of the USSR, and still radical reforms comparable only to those in Hungary and Yugoslavia have been initiated there.

What have been the factors that made the Czechoslovaks, Hungarians, Poles and now the Chinese draft a programme for far-reaching reforms and prevented Bulgarians, East Germans and Soviets (but also Poles during the sixties and seventies) from doing so? And: what enabled Hungarians to implement their reform more or less successfully and what made it less successful for Czechoslovaks and Poles? I think the answer to these questions can be found beyond economic factors, in the peculiarities of social psychology and politics in the countries concerned.

The first question is that of the emergence of the reform programmes. It seems to me that two conditions were necessary for this. The first condition was the experience of a deep economic and social crisis that forced both the ruling élite and the intellectual community of the given country profoundly to understand the disfunctioning of the traditional economic mechanism. This means a culmination of both types of dissatisfaction with the operation of the economic mechanism discussed in section 2.2 above. The first such case was the collapse of war communism in Soviet Russia and the introduction of NEP. Next, the Stalinist economic policy and system were strongly discredited in some East European countries, particularly in Hungary and Poland in the mid-fifties, following Stalin's death and the 20th Congress of the Soviet Communist Party. A similar crisis and intellectual development was experienced by Czechoslovakia in the mid-sixties and by China and Poland in the late seventies-early eighties. In all these cases professional economists, state and party officials and the wide public shared the conviction that the traditional mechanism of central planning had to be replaced by a different economic mechanism. Such a crisis has not occurred in the GDR or, at least up to very recent times, in the USSR yet.

The second condition was the presence of a more or less free intellectual community of economists formulating proposals and being in contact (and, to a certain degree, in mutual understanding) with the experts in the party and state administration. A certain degree of the emancipation of the economics profession from the official ideology is part of this second condition. This second condition was created by the liberalisation of intellectual life following Stalin's death and the 20th Congress, particularly in Hungary and Poland, during the sixties in Czechoslovakia and during the eighties in China. This is what enabled Czechoslovak, Hungarian and Polish economists to work on and discuss various ideas about changing the economic mechanism, in open discussions including the official press, and what enabled Hungarian and Polish economists to analyse the lessons of retreats in the development of economic mechanisms during the periods of setbacks and to maintain a certain continuity in their ideas. In other countries, even when the government was, for some time, more receptive for some ideas of an economic reform, the community of economists was not in a position to make sound proposals.

The second question is that of successful elaboration and implementation of the reform programme. In that respect, the readiness of both academics and government experts to co-operate and make the necessary compromises proved to be a decisive factor in Hungary and was essentially missing in Czechoslovakia in the mid-sixties and in Poland both in the seventies and in the early eighties. In the Hungarian case, this was achieved, in the narrow sense, as a result of the procedure of work on the reform blueprint in 1963-68 but also, in the wide sense, as a product of the political developments following the 1956 uprising. The first could be copied, to a certain degree, by the Poles in 1980-81 but not the second.

4. The Effects of the Changes on the Economy

4.1 Raising the problem

The question arises whether it makes much difference, after all, in the economic development of the countries if their respective governments took the thorny path of economic reforms or were satisfied with perfecting the economic mechanism. In discussing the problems of economic reforms the partisans of far-reaching reforms often have to face the objection that the countries in which reforms were undertaken like Hungary or Yugoslavia did not perform any better than Bulgaria, the GDR or (since 1971) Czechoslovakia.

The problem of comparing the growth performance of different countries are well known. In East-East comparisons these problems may have been easier in the fifties when the growth patterns of different eastern countries were more similar, the economic mechanisms were almost identical and so were the methods applied by the statistical services of these countries. Since then, however, substantial changes have taken place in all these respects. The growth patterns have diversified to a great extent. In Romania, for instance, the Stalinist priorities (emphasis on heavy industry, neglect of agriculture, autarchy) have been preserved while most other countries have given higher priority to agriculture and consumer industries and, particularly Bulgaria, Hungary and the GDR, have paid more attention to international co-operation. As far as consumption is concerned, in the USSR and the GDR greater emphasis is put on the satisfaction of needs for unpaid services (dwellings, culture, sport) while in Hungary or Yugoslavia more efforts have been made to meet the diversified demand for up-to-date industrial goods. The differences in the economic mechanisms were touched upon earlier. As far as statistics are concerned, it is sufficient to mention that the statistical services of the GDR, Romania or the USSR essentially maintained the practice of restricting public access to data, and of adopting methods of price and national accounts statistics incomparable with those in the West, while Czechoslovakia, Hungary, Poland and Yugoslavia publish more extensive statistical evidence which in many respects is more easily comparable with Western data (and not always comparable with other eastern countries). All this makes any comparative judgement on the growth performance of any two or more East European countries difficult.

What can, nevertheless, be said? Let a distinction analogous to that in section 2.2 be introduced. We can speak about the effects of changes in the economic mechanism in two senses. The changes in the economic mechanism may involve changes in the operation of economic units, in the functioning of contacts between them, in the behaviour of agents etc. To give an example: the replacement of hourly wages by piece wages will change the attitude of workers concerning quantity and quality of production: they will strive for higher output and care less for anything else including quality. Let this be called <u>operational effect</u> of the changes. The changes in the economic mechanism may also result in changes in the development trends of macroeconomic variables as the growth rate of national product, balance of trade, but also of such qualitative features of the economy as innovativeness, balance of the market, etc. In respect of the above example: provided that raw materials are in continuous supply, the introduction of piece wages probably results in higher output. Let this be called performance effect of the changes in the economic mechanism.

4.2 Operational effects

What effects then, have the various changes in the economic mechanisms of the East European countries had on the economy?

The new conditions created by the 1968 reform and consolidated since then enabled and forced the agents in the economy to change their behaviour and, thus, the way in which the economy operates to a considerable extent. New behavioural patterns appeared and propogated in the economy without becoming, however, exclusive or even dominant here but, at the same time, not remaining mere exceptions that support the old rule.

Let me give just a few but important examples of such new behavioural patterns here. My first point is that though profitability considerations have not become dominant in managerial decisions, they acquired a substantial role in many enterprises, and as long as they were not suppressed by other considerations as, for instance, the requirement of supplying the domestic market with an important commodity for which the firm was considered responsible or the necessity of increasing exports, they were given priority. Managers made efforts to eliminate unprofitable activities, to replace unfavourable purchases by ones at better conditions. Numerous firms drafted and implemented restructuring programmes that changed substantially the composition of their output. Several cases of discontinued purchases and deliveries and of rejected offers with unfavourable price conditions have been recorded even in trade with CMEA countries.

While 'responsibility for supply' often prevented enterprise managers from discontinuing traditional deliveries or raising the prices of goods delivered for some time, the striving for higher profits resulted in more intensive product innovation and in efforts to diversify the activity of existing firms. In some market segments, this led to the appearance of some elements of competition among domestic suppliers.

One of the important new features has been the opening up of Hungarian enterprises towards the external world. Due to the changes in the mechanism of foreign trade, Hungarian managers became much more informed about and aware of the fate of the products of their firms abroad, of the market conditions and possibilities. It was not by chance that Hungary became the pioneer of joint ventures with western companies in the CMEA.

The enlarged autonomy of enterprises and the partial deregulation of the markets brought about numerous cases of rapid expansion of firms while others were growing much more slowly or not at all. This was made possible by the fact that the 'rachet principle' has lost much of its importance though has not disappeared completely.

The more or less uniform system of taxation and the system of profit incentives, together with the greater role of bank credits in financing enterprises, turned solid financial position into an important success criterion for enterprises. Despite the frequent exemptions from all rules etc. the appearance of the distinction between good and bad enterprises on the basis of their financial positions is an important new feature of the Hungarian economic climate.

Very little was recorded about the operational effects of the short-lived Czechoslovak reform of 1967-69. In Poland, the new elements similar to those in Hungary certainly have appeared but under the very strong constraints of heavy shortages and strong intervention of government agencies into all kinds and details of business activity. The operational effects of the Yugoslav reform would, in turn, deserve special attention.

4.3 Performance effects

It is practically impossible to identify the contribution of all the new elements mentioned above to the Hungarian economic performance of the last decades. In other words, performance effects of the reform are difficult to assess. The only thing one can be sure of is that the improved supply of commodities on both the consumer and producer markets and also the more rapid flow of foreign innovations to Hungary have much to do with the reform. (Just the same seems to hold for Yugoslavia). Not much more can be said: one can only share the belief of many colleagues that without the reform the performance of the Hungarian economy in terms of real growth rates would be considerably worse.

The real importance of the reform for the economic performance of Hungary (and Yugoslavia and even Poland) is in something different. At present the contribution of the reform (or rather of its operational effects) is, though obviously positive, very limited. Still, the operational effects of the reform represent new developments in these economies, whose viability on this soil has already been demonstrated and whose further propagation may increase their performance effect.

But can they propagate further? This question leads us to the prospects of the economic mechanisms in Eastern Europe.

5. A Few Remarks on Prospects

The poor economic results of the last decade in all East European countries increased 'performance dissatisfaction' and put changes in the economic mechanism on the agenda again. With the exception of Poland, however, the changes introduced so far represented only perfectioning of the economic mechanism. The argument presented above enables me to make a few remarks concerning the prospects.

Dissatisfaction with the operation of the economic system is widespread but the conviction of the necessity to replace the existing mechanism with something distinct has hardly reached the ruling circles in Czechoslovakia, the GDR and Romania. The economic performance of Czechoslovakia and particularly of the GDR is presented as fairly satisfactory. Although these countries share the troubles caused by enlarging technological gap and falling international competitiveness with other CMEA countries, the fact that the GDR has reported the highest and most stable growth rates in the CMEA while Czechoslovakia has the lowest level of indebtedness in hard currency provides a certain basis for official selfconfidence. In Romania, in turn, the shortcomings which are openly admitted are treated rather as results of improper human behaviour than being of systemic character. In these three countries, the changes in the economic mechanism adopted by the governments obviously represent only 'perfecting'.

Strangely enough, the same holds for Hungary. True, the dissatisfaction with the economic mechanism is quite strong in this country. The inability of the existing economic mechanism characterized as 'indirectly centralized' by Laszlo Antal and as a 'neither plan nor market' system by the present author to enable and force a more efficient and rational operation of the economy is understood by a large number of economists. For me, the last decade provided sufficient evidence of the impossibility to move from the present state to the desired one through a series of partial changes, and something like a second reform (a move from one 'equilibrium point' to another distinct one) seems necessary.

This is so partly because such measures have to be undertaken simultaneously as the demonopolization of the economy (the breaking up of many large enterprises and the creation of thousands of small and medium-sized ones), a genuine liberalization of prices, import liberalization, elimination of the majority of subsidies and extra taxes, separation of business banking from the central bank and the creation of competition between business banks, consolidation of the independence of enterprise management of the party and state administration. If only certain components of this set of changes are introduced separately (as is the case at present) they can hardly be successful.

Let me try to make the difference between perfecting and reforming the economic mechanism clear in respect of present-day Hungary through a few examples. The breaking up of large nation-wide enterprises into small ones with different product lines does not eliminate monopolies. A superfluous administrative unit is removed but competition continues to be absent. A reform would require the creation of the conditions for the appearing of hundreds of new medium-sized enterprises on the basis of the growth of small ones.

The deregulation of prices by means of lifting the constraints on price setting through agreements between each particular enterprise and the state administration cannot be more than exception and cannot set the interaction between demand, price and supply into motion; to achieve that, price constraints need to be lifted as a rule and administrative price controls be exceptional.

Under perfecting the mechanism the authorities provide tax exemptions for those firms which increase their exports in correspondence with the expectations of the government; a reform would imply the operation of an equilibrium exchange rate.

Hundreds of new medium-sized firms, deregulation of prices, equilibrium exchange rates - these are changes which can only be accomplished simultaneously with each other and with several other changes in the economic mechanism and in economic policy.

Since the idea of a second reform was put forward some years ago it has been rejected by experts in the state and party administration on two grounds. Most officials reject the idea of the further move away from the traditional mechanism and principles itself. They insist on the active role of the state administration in managing (and not only controlling) the economy and distrust the market. Government success in overcoming the liquidity crisis of 1982 and improving substantially the trade balance between 1978 and 1984 created illusions about the possibility of solving the problems of the Hungarian economy by means of government interventions, and the policy concerning the economic mechanism was decided in early 1984 when these illusions culminated. Others in the state administration who realize the necessity of further advancement toward a much less regulated economy continue to believe that this can be accomplished through a series of partial changes. Thus also in Hungary the ruling élite does not share the conviction that the existing mechanism is now unsuitable for the country and has to be replaced by a different one.

The other conditions for reform are not provided to a sufficient extent either. It is true that Hungarian economists enjoy an intellectual freedom without parallel in Eastern Europe (except Poland), but professional discussions have been somewhat weakened several times by warnings of the authorities. The Hungarians, who during the sixties could rely on the achievements of Czechs, Poles and Yugoslavs, are now, being far ahead in many respects, alone. Thus they are much less capable of providing an appropriate solution for current problems than they had been twenty years ago.

Still, both conditions can shortly be created in which case Hungary may advance further and implement a new reform.

The Polish case is, from the long perspective, similar. Due to the deep crisis of the late seventies and early eighties, the core of the Polish establishment accepted the conviction of reform-minded economists about the necessity of an economic reform on Hungarian lines. The Polish economists had sufficient ideas and knowledge "in stock" to be able to draft a solid reform program in a few months. The problem is (and here I share Paul Marer's view) that an adequate economic reform in Poland should incorporate both Hungarian reforms: the one implemented in 1968 and the one that still needs to be implemented. And the necessity of the second is very far from being accepted by government experts in Poland. It is, in turn, unclear whether the consolidation of a 'neither plan - nor market' state is possible in Poland now, under conditions so much different from those of Hungary.

In Bulgaria, the necessity of breaking with the existing mechanism has repeatedly been formulated and the recent troubles in the economy may support that conviction. My impression is that the lack of public professional discussions on the operation of the economic mechanism and the insufficient understanding of the economists' argument by non-economists in the establishment that makes the emergence of a sound reform blueprint unlikely, not to speak about successful implementation.

Essentially the same holds for the Soviet Union. Mandatory planning counted as taboo in Soviet discussions on the economic mechanism for a very long time and the active operation of the market was out of the question. For a long time, economic troubles were explained mostly either by the burden of defence and external aid or by improper behaviour of officials and managers. The dependence of unsatisfactory economic performance from the operation of the economic mechanism remained obscure for the majority of officials and of the public. Under such conditions it remains unclear whether the 'radical reform' declared by Gorbachev means a reform of the economic mechanism in the sense discussed in this paper. The Soviet society as a whole is hardly prepared for such changes.

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