THE TRANSFORMATION FROM COMMUNISM TO CAPITALISM: HOW FAR? HOW FAST?

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"Our interpretation of the existing system suggests that there is no other way of improving it than by an evolutionary approach. We do not pretend to know all of the solutions, [but] we are afraid of the unrestrained reform romanticism of some of our colleagues.... We try to be led by pragmatic flexibility rather than by moralistic or ideological fundamentalism. Sound reform measures should be guided by properly understood and well-articulated national interests, not by abstract ideas...." Václav Klaus and Tomáš Ježek (1991, pp. 37-39).

"[T]he economic transformations envisaged (in Eastern Europe) ironically mirror the communist project. They implement an intellectual blueprint...drawn up within the walls of American academia and shaped by international financial institutions. These transformations are meant to have radical effects, to turn all existing social relations upside down. They offer a panacea, a magic elixir which, once taken, will cure all ills." Adam Przeworski (1992, p. 45).

**Rhetoric and Reality**

In a brief but epochal moment at the end of the past decade and the beginning of the current one, faith in, and support for, the Communist economic and social system collapsed over an area of the globe spanning twelve time zones. Surprisingly, given the totality of Communism’s collapse, its rival economic system, capitalism, has made little progress in filling the void. Indeed capitalism, that is to say, functioning and viable capitalism, has barely crept eastward by a few hundred miles to the eastern borders of Poland, the Czech Republic, Slovakia and Hungary.2

While the successful creation of a viable capitalist system on the ruins of the planned economy is a novel effort, the difficulties encountered even in those countries that have made relatively successful efforts to do so and the seeming failure of transition efforts in most of the countries of the region have stirred a debate between those who favor a rapid and broad effort to introduce markets, private property and other elements of the capitalist system and those who favor a more gradual program of dismantling the old economic system and the evolution of capitalism, possibly of a uniquely indigenous variety, in response to the political and economic forces in the region. Those who support rapid and broad measures for the transition to capitalism point to the success of such measures in combatting open or repressed inflation, in creating functioning markets, in introducing private ownership and capitalist institutions, in laying the foundation for future economic growth, and in the integration into the world economy that such programs have produced in the Central European countries that have pursued them with the requisite resolution. They also point to the chaos and dysfunctional economic behavior that characterize those countries that have failed to eradicate Communist-era economic institutions, enterprises and methods of economic management.

2. Even the commitment to capitalism of the current regime in Slovakia is in some in doubt.
Critics of such rapid changes argue that too-extreme transition measures have caused grave dislocations in economic activity, as evident in the production declines suffered by countries that have adopted policies of rapid system change and orthodox macroeconomic stabilization. They argue that a less radical and sweeping approach to transformation, one that retains many of the institutions of central planning and allows markets, the private sector, and capitalist institutions to emerge gradually would be less costly in terms of foregone production and human dislocation. The gradual reform of the Peoples' Republic of China, which has been characterized by increases in output and relative price stability, is often cited as an exemplar of an evolutionary path of transition from socialism to capitalism.3

Unfortunately, while real choices remain open to the peoples of East Europe and the former USSR, and while real evidence is increasingly available on the effects of various transition strategies, the debate between advocates of rapid change and the evolutionary approach has taken on an increasingly ideological and philosophical tone. This increasingly ideological nature of the debate has led to a number of curious intellectual reversals of terminology and ideology, as is amply illustrated by the quotations that open this essay. The first, written by the Finance, and later Prime, Minister of Czechoslovakia and his advisor, argues strongly against ideologically-based reforms introduced by "unrestrained romantics." Clearly the authors, who engineered the radical Czechoslovak price liberalization of 1991 and the mass voucher privatization of 1993, the most extreme and wide-ranging one-two punch of East European transition programs, were warning against grandiose schemes to "optimally" combine market and plan or post-plan socialist institutions and mechanisms. To them, it was precisely the evolutionary approach of attempting to devise a means for the two systems to coexist while leading to a successful transition that smacked of the academic intellectual blueprint for experiment and social engineering that Preworski attributes to those who advocate the big bang.

Not only has the idea of what constitutes social engineering been stood on its head by proponents of evolutionary transition. They have also sought to capture for their own use the philosophical basis of liberal economics in which rapid transition strategies were rooted. Thus, in 1991, in the article from which I draw the opening quotation, Klaus and Jezek describe themselves with some self-consciousness as liberals of the Friedmanite and Hayekian type respectively. Evolutionists at that time tended to base their analysis on the intellectual legacy of Schumpeter, but now, as is evident from Murrell (1993) and Poznanski (1919), they have sought to capture Hayek for themselves. They are, of course, right to try do so, for at least Hayek got it right regarding the long run viability of capitalism and socialism and Schumpeter got it wrong, but one must bear in mind that disputes based on rival interpretations of the same sacred texts are always the most bitter and least enlightening, particularly to outsiders.

As Slay (1993) points out, much of the controversy stems from a confusion of ends and means. That is, preferences about transition measures are often confused with preferences about, or conceptions of, the end state of the economy. Thus, even if the freeing of all prices and the total disengagement of the state from the

3. Critics of rapid reform policies fall into several groups (Kiss, 1993). One, which includes scholars such as Murrell (1991, 1992, 1993) and Poznanski (1991, 19xx, 1993), bases its analysis on the paradigm of evolutionary economics. Numerous other critics employ different paradigms, including neo-Marxism, Keynesianism, etc. In this essay, even though I focus as much as possible on the writings of the self-described advocates of the evolutionary approach, I at times touch on arguments raised by those who operate in other intellectual frameworks. The justification for this is that both the criticisms of rapid change and the policy alternatives put forward by these critics, such as expansionary monetary and fiscal policies, state intervention and the continued existence of a large state sector, are often, although not always, the same as those raised by the "strict" evolutionists.

economy were the best means of beginning the transition from communism to capitalism, evolutionists seem suspicious that the end product would have to be a Reaganite-Thatcherite economic system. Similarly, even if some measure of price controls and state ownership could be shown to be the optimal transition strategy, advocates of rapid change would view these with suspicion as necessarily leading to a Scandinavian-type welfare state or, worse, some from of "third way." While the end state is to some extent path-dependent, it should be the merits of transition policies within the period of transition and not in some final steady state that should be the basis for their evaluation.

A second source of confusion comes from the failure of proponents of both transition strategies to come to grips with key concepts. One of these concepts is time. At the outset of the debate on transition policies, the sequencing of transition measures received considerable attention, and the focus on sequencing implicitly provided a temporal element. It was understood that drafting and enacting laws, privatizing firms, creating institutions, etc., took time and that, even when put into effect, there would be a time lag until these new elements could benefit the economy. There was, of course, disagreement on the order and pace at which measures ought to be introduced, but even noteworthy advocates of rapid sequencing such as Lipton and Sachs (1990a, b) sought stabilization and the freeing of prices before privatization.

The concern for the temporal element has largely disappeared from the debate. Many proponents of the "big bang" seem to preach a policy of "the faster the better." Evolutionists, on the other hand, speak of gradual change, but phrases such as "many years" or "when conditions are appropriate" in their writings give less the impression of a well-thought out dynamics and more of a disregard for how long the process may take or when the transition is to reach its end.

A second concept that has fallen victim to the escalation of rhetoric is the clear definition of what is meant by evolutionary and "big bang" policies. Stabilization, market liberalization and privatization are all somehow lumped into the same category even if the means of implementing them, the effects they are intended to have, and the need for them in various countries varies tremendously. Thus, to some observers, any country that has undertaken any decisive action in any area of price liberalization, stabilization or privatization, no matter how uncoordinated to other elements of a coherent economic strategy such measures may be, is seen as an example of a big bang strategy. Thus, van Brabant in his contribution to this volume observes that "there is a wide consensus among ... casual observers ... that countries such as Bulgaria, the former Czechoslovakia, Mongolia, Poland, Russia and the former Yugoslavia adopted shock therapy ...." However common such a view may be, these countries cover such a broad range of actual policy experiences that the notion of shock therapy would have to be so broad to encompass them as to make the term useless as an analytical category. For example, what is the common element in the stabilization policies of the former Czechoslovakia, which were based on successfully achieving a balanced budget for the first three years of the reform program and those of the Russian Republic, whose government's budget deficit for the same period, may well have averaged 15 percent of GDP? Similarly, what is the common element in the foreign trade liberalization program of Poland, where the currency became freely convertible and trade was legalized for all economic agents and Russia or Bulgaria,
where much of the old communist trade practices and apparatus continues in place? If indeed shock therapy is to be defined as any economic policy or combination of policies adopted in this group of countries in the past few years, then shock therapy or the big bang must surely stand discredited on the evidence, but obviously what is discredited is not really a radical approach to stabilization and liberalization of economies, but rather simply bad policy making. Evolutionists face a less daunting problem of definition, since no country has expressly adopted an evolutionary strategy. Hungry perhaps comes the closest, but even there how much of policy is driven by an appreciation of the evolutionist argument and how much is temporization is unclear.

**PRICES AND MARKETS:**

**ECONOMIC EFFICIENCY AND MACROECONOMIC STABILIZATION**

One of the key elements of the big bang approach is the rapid elimination of controls over domestic prices, including the price of foreign exchange and thus of imports and exportables. The arguments for rapid price liberalization rest on two conceptually separate, but often conflated, bases. One of these is that the introduction of market prices will lead to increased economic efficiency and higher levels of consumer welfare. The second reason for freeing prices is to effect a program of macrostabilization by eliminating repressed or open inflation. Critics of the big bang approach have argued that the former goal is unimportant and that the latter goal has imposed costs far beyond the benefits that it offers.

The **Price System and Microeconomic Efficiency**

The liberalization of prices, assuming a relatively stable level of aggregate prices such as would exist if there were no repressed or open inflation, should lead to a more rational allocation of resources. For consumers, queues for rationed goods would be eliminated, (Lipton and Sachs, 1990a) and consumers would no longer be forced to expend their money for unwanted goods through a process of forced substitution (Kornai, 1980). In this way consumer welfare would increase. In fact, in Poland and Czechoslovakia this clearly occurred; queues disappeared, and efforts devoted to providing better service and a wider assortment of goods to consumers were evident even to casual visitors from the West and had a profound impact on the psychology and welfare of domestic consumers (Glikman, 1993, pp. 8-13).

The equilibration of the consumer market, the reassertion of consumer sovereignty, and the better assortment of goods available to the population are gains that are largely ignored or dismissed by critics of the big bang. Such a dismissal of benefits to consumers of any policy measure may be surprising to non-economists, but it comes as no surprise to practitioners of the dismal science. Gains to consumers in the form of more rational prices, better service, and a wider assortment of goods count for little in the policy proscriptions and in the calculations of the evolutionists. This is in part because such gains are thought to be hard to measure, in part because they are seen as subjective and thus somehow less real than changes in firms' profits or in households' income. Thus, against the consumer gains brought about by the rapid liberalization of prices are arrayed charges of monopoly pricing, the emergence of consumerism, conspicuous consumption by
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the wealthy, maldistribution of purchasing power, etc.4 Evidently these critics of rapid market liberalization believe that the paternal Communist state knew best, and providing people with greater choice in their consumption decisions is not a particularly valuable objective.

Although economists are somewhat better at measuring the efficiency with which resources are allocated to production than in measuring gains to consumers, this has not led the critics of rapid price liberalization to produce more coherent critiques of the argument that such price liberalization would lead to a more efficient utilization of resources in the productive sector. In fact, the criticisms raised are self-contradictory. One line of argument, to be found in Whitesell (1990) and Murrell (1991), is that the planned economies in fact allocated productive resources quite efficiently. The obvious implication is that getting market prices "right" will yield few benefits since the static allocation of resources is already quite good.5 The evidence for the efficiency of resource allocation under Communism is based largely on econometric studies, which the authors misinterpret in various ways. For example, evidence that socialist firms tend to be close to the frontier of a stochastic production function is taken as evidence that technical efficiency in socialist economies is as high there as in market economies. Since the "frontier," which represents best observed practice, is based only on observations of firms in one or other of the two types of economic systems, there is no way of judging whether the frontier, or level of technical efficiency, of firms in socialist economies approaches that of firms in market economies. The finding that socialist economies trade according to the dictates of their comparative advantage as dictated by their factor endowments is taken by Whitesell (1990) to mean that such trade is optimal, while in fact it only proves that such trade does not reduce social welfare relative to a situation characterized by autarky.6

A second argument against rapid marketization is that the freeing of prices will lead to large losses among firms, causing widespread bankruptcy and unemployment. Some argue that such losses would occur because large, inefficient state firms need time to make themselves efficient. If this argument is to be accepted, then, of course, the preceding one that productive resources are efficiently allocated must be wrong. On the other hand, if socialist firms have, in fact, misallocated resources in the past, we are then left with the question of whether and how effectively they will respond to strong price signals emanating from the market. On this point I will present some evidence below.

Alternatively, it can be argued that productive resources were efficiently allocated given the pattern of demand that existed in the planned economy, but that this allocation differs radically from that which would obtain in a market economy. Thus even efficient firms in those sectors that experience declines in demand would suffer losses. This, however, suggests a rather limited, if not false, notion of efficiency since it implies that resources are deployed efficiently to produce an inefficient output assortment, such as tanks, vast amounts of steel, etc. The efficient production of unwanted goods hardly makes sense. Moreover, keeping entire sectors afloat despite a lack of demand for their output is a costly exercise.

4. Ironically, "inconspicuous" consumption by the nomenclatura was amply evident under the old system and the state's control over the production of consumer goods and over trade were a form of monopoly that any market-based system of industrial concentration would find virtually impossible to match.

5. To be fair, both Whitesell and Murrell have denied this implication in private correspondence. Nevertheless, I believe that the implication flows rather naturally from the purported evidence.

6. For an elaboration of these arguments see Nove (1991) and Brada (1992).
In sum, rapid price liberalization leads to rational relative prices, thus generating benefits to consumers and potentially influencing firms in such a way as to rationalize both the utilization of inputs and the output mix produced. Whether such potential gains can offset the costs of sectoral unemployment and the closing of some firms depends in large part on how firms respond to their environment, a point to which I will return, and on how much new economic activity can be generated.

Price Liberalization and Economic Stabilization

The liberalization of prices in East Europe and former USSR has not, of course, led solely to changes in relative prices. Rather, the liberalization of prices has also led to sharp bursts of inflation, followed in some countries such as Poland and Czechoslovakia by a decline in the rate of inflation and in most others by continuing, if not accelerating, price increases. Moreover, in all these countries, price liberalization was accompanied by sharp declines in output. Critics of rapid price liberalization have made much of these macroeconomic developments. Poznanski (1993, p. 3), for example, writes that "[n]ot only has Poland become the victim of a largely man-made recession, but so have...Czechoslovakia and Hungary..., [and these] output losses were due to policy errors." Among the alleged policy errors were excessive deflation due to too-precipitous a decline in aggregate demand, a credit crunch caused by the destruction of enterprise sector liquidity (Calvo and Coricelli, 1993) and even the possibility that open and repressed inflation in Poland were containable without resort to drastic measures and thus that the reduction of aggregate demand by means of the big bang was unnecessary (Kolodko, 1991).

Unfortunately, while the evolutionists have been quick to criticize alleged policy errors in the implementation of big bang policies, it is noteworthy that none of the criticism has sought to present a gradual or evolutionary program for stabilizing an economy characterized by serious inflationary pressures. Indeed, the policy proscriptions of the gradualists have been either of an ex post character, arguing for expansionary monetary and fiscal policies and for "industrial policies" to help ailing sectors in economies that have adopted big bang policies, or utopian, putting forward the Chinese experience as appropriate for East Europe and the USSR. We will examine the evidence regarding China's macroeconomic experience below.

Absent a viable gradualist stabilization program, one must assume that the gradualists would prefer either high levels of open inflation or price controls and repressed inflation to stable prices accompanied by a temporary decline in output. Such a choice is, of course, problematic, as the gradualists never admit to any economic costs arising from continued high rates of inflation.8

More to the point, economists are beginning to obtain a better understanding of how stabilization through price liberalization works in post-Communist economies, and thus much of the post hoc, propter hoc criticism of big bang stabilizations is being replaced by a clearer appreciation of both their advantages and shortcomings.

7. I confess with some chagrin that Poznanski attributes these conclusions to Brada and King (1992). However, the point of this paper was to show that there was no decline in East European output that could be attributed to microeconomic dislocation caused by liberalization, and that the observed decline was caused only by declines in aggregate demand. Bofinger (1993) comes to a similar conclusion.

8. Thus Preworski (1992, pp. 48-49) discusses the adverse effects of austerity programs on future growth, but is surprisingly silent about the adverse effects of inflation on saving, investment and human capital formation.
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The first point, which evidently needs some emphasis due to the belief that, for example, the Russian Republic has undertaken a big bang approach to stabilization via price liberalization, is that price liberalization is insufficient to stabilize an economy suffering from inflationary pressures. Without a simultaneous hardening of the budget of enterprises and a reduction or elimination of the state's budget deficit, price liberalization will merely lead to further inflation as enterprises expend unlimited funds for real assets and foreign exchange. Of course, fiscal and monetary restraint was always part of the orthodox big bang package, and thus claims that the big bang did not work in countries such as Russia make little sense because neither firms nor the government were able to fulfill their part of the big bang strategy. Indeed, in Europe only Poland in 1990 and Czechoslovakia in 1991 were able to implement what can be viewed as orthodox versions of the big bang strategy. Hungary, while implementing a variety of liberalizing measures, especially in the realm of foreign trade, did not resort to a drastic freeing up of prices due to past price liberalization.

Our understanding is also growing of the effects of exogenous events on the outcome of stabilization efforts. While it was understood that the collapse of East Europe's trade with the USSR in 1991 had a severe impact on output in East Europe, recent work by Rodrik (1992a,b), Berg and Sachs (1992) and Brada and King (1992) and Bofinger (1993) has begun to separate out the effects of this shock from other, domestic, developments. While the estimates vary, they do suggest that changes in the level of output in the region were dominated by the effects of the trade shock in 1991. A telling example of the predominance of the trade shock over any dislocations caused by price liberalization can be seen from a comparison of the dynamics of Czechoslovak and Hungarian industrial production in 1991, a year in which Czechoslovakia carried out its sweeping price liberalization. Industrial production in Czechoslovakia declined by 24.7 percent, in Hungary by 21.5 percent. Given Czechoslovakia's greater trade dependence on the CMEA, the similarity of output responses to the trade shock leaves little scope for lost output from the disruptive effects of price liberalization in Czechoslovakia.

The interaction between macroeconomic developments and policies is also becoming better understood. The essence of shock therapy is to turn the economy from a state of excess demand, where the purchase of whatever is produced is always financed by consumers, enterprises or the state to one where aggregate demand determines the level of output. Shock therapy reduces consumer demand by reducing the real value of consumers' cash holdings and incomes, by reducing enterprise investment and by forcing the state to bring its

9. For an excellent analysis of this point, see McKinnon (forthcoming).

10. Of course, some have argued that the CMEA trade shock was the result of the dismantling of the CMEA, another mistaken measure of big bang iconoclasm (Murrell, 1993, pp. 217-218). Unfortunately this charge does not stand up to close scrutiny. It was the trade policies and subsequently the economic collapse of the USSR that led to trade declines in the region. Finland, also heavily dependent on Soviet trade, tried to balance trade with the Soviet Union in 1991. As a consequence, Finnish exports to the USSR, and along with them the Finnish economy, collapsed, with a fall in output that was not dissimilar from those experienced by Poland and Czechoslovakia (Kajaste, 1992). Of course, the East European countries could have followed the lead of another of the USSR's non-CMEA trading partners, India, which continued to export to the USSR in 1991. When reciprocal Soviet deliveries failed to materialize, India was stuck with Soviet debts of doubtful value, something that the CMEA mechanism also could have produced for East Europe in 1991 (Brada, 1993).

It is also worth noting in this regard that post-1991 trade among ex-CMEA countries held up the best among Poland, Hungary and Czechoslovakia, the countries that had the most liberalized domestic economies and foreign trade regimes, but fell sharply among those countries that continued to rely on state-mediated trade.
budget into balance. Of course, without a precise measure of the degree of excess demand, and with no means of calibrating the effects of monetary and fiscal policy, it is possible that policy makers will reduce demand by more than is necessary to wipe out excess demand and inflation. This problem has been set out elegantly by Gomulka (1991) and analyzed at length by the Vienna Institute for Comparative Economic Studies (1993).

The upshot of this research is that policy makers may have set government spending and revenues at the wrong levels and that monetary targets were not always appropriate. However, economics is not an exact science, and the ability of policy makers in developed market economies to predict with any precision the effects of tax or spending changes, interest rate movements, etc., is notoriously poor despite a long history of policy interventions that should enable them to calibrate their models of the economy. Consequently, it is not surprising that East European policy makers, working with no historical basis by which to calibrate their models, may have erred. Surprisingly, evolutionists, while eager to point to macroeconomic policy errors of authorities in countries that have implemented big bang policies, they seem surprisingly sanguine about the ability of policy makers to carry out the greater requirements for government dirigisme required by evolutionary policies.

Recent work is also beginning to uncover sources of policy surprises. Schaffer (forthcoming) shows that a large part of the surplus in the Polish budget in 1990 was the result of inflated enterprise profits caused by the fact that profits were calculated by valuing the consumption of inventories in production at historical prices. As prices increased in 1990, profits did also because material inputs were valued at unrealistically low, pre-liberalization prices. Since the government's revenue depended heavily on profit taxes, the budget was in surplus in 1990, imparting a deflationary impulse to the economy. In 1991, as inventory prices began to reflect the new price level, profits and tax receipts declined, leading to a budget deficit. Schaffer also demonstrates that cash flow in the enterprise sector was hard hit in 1990, but recovered in 1991, explaining the movement of wages in the Polish economy as well.

Schaffer's work also points out the importance of starting conditions. Poland's fiscal situation was dictated by the effect of the interaction of historical cost accounting and the post-price liberalization surge in prices followed by much lower price increases on enterprise profits. Czechoslovakia, which undertook its price liberalization in the face of much more moderate inflationary pressures, experienced a much smaller post-liberalization price surge and consequently has managed to maintain a balanced budget for the past two years.

Despite inevitable policy errors, the two East European countries that introduced comprehensive stabilization and price liberalization packages have fared much better than the others in the region. In Poland, inflation has only fallen to 40 percent per year, which is nonetheless better than inflation in countries that have not introduced a big bang stabilization, but in 1992 Gross Domestic Product (GDP) increased despite the negative effects of a severe drought on agricultural output, and industrial output and construction activity were both up sharply in the first quarter of 1993. In Czechoslovakia, core inflation in 1991 and 1992 was 10-11 percent per year, and unemployment in the country peaked at 6%. While there is uncertainty regarding the effects of the Czech-Slovak split on GDP in 1993, an increase in aggregate output in the Czech Republic is possible. Indeed, Czechoslovakia's record on output, inflation and unemployment in 1991-93 may well prove

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11. It is important to bear in mind that the measured falls in output doubtless overstated the actual declines (Osband, 1992) and also understated the recent upturn, in part because statistics on output tended to miss the emerging private sector. Moreover, under conditions of transition, the connection between official measures of output and changes in social welfare are likely to be tenuous, Chang (1991), Winiecki (1991).
superior to that of Hungary despite the latter country's more moderate reform policies over this period. In any case, the output declines in Czechoslovakia and Poland are no worse than those to be found in those East European countries and ex-USSR republics that have not introduced coherent stabilization programs, and their prospects for growth are clearly better. Thus, while the implementation of orthodox stabilization and price liberalization policies in Czechoslovakia and Poland may have been attended by inevitable mistakes in policy making, it requires no great effort to demonstrate that in terms of inflation, consumer welfare, and growth potential these economies are much better off than countries that have not attempted, or have attempted only partially, similar orthodox stabilization measures.

One of the glaring weaknesses of the gradualist critiques of orthodox stabilization is that they imagine a rather idealized stable equilibrium as the counterfactual that would exist if orthodox stabilization were not introduced. Thus they are unable to account for the uncontrolled explosion of real wages in pre-1990 Poland or in Gorbachev's USSR; the declines in output that were already taking place in these and other countries under the traditional economic system that they believe would sustain production and living standards if only it could be retained for the indefinite future; and the monetary imbalances that were being generated by the planned economy throughout the region. No doubt orthodox stabilization programs are more painful than some imaginary and idealized scenarios, but the comparison needs to be against real-life alternatives, and the gradualists have yet to explain how the planned economies of East Europe and the USSR were to be reequilibrated to yield acceptable macroeconomic outcomes.

**CHINA: THE DOG THAT DID NOT BARK**

Rather than develop practical alternatives to orthodox stabilization that would apply to the circumstances of East Europe and the former USSR, proponents of evolutionary transition prefer to point to the Peoples' Republic of China as a ready-made model. China has, indeed combined gradual systemic change in industry with rapid economic growth and macroeconomic stability for over a decade (Chen et al., 1992). While Chinese economic performance is indeed impressive, a closer analysis suggests that applying the Chinese lesson to East Europe or Russia may be neither as desirable nor as feasible as it seems.

First of all, contrary to evolutionists' emphasis on gradual changes in ownership and on maintaining a degree of control over prices, the Chinese reform in agriculture involved both a rapid and massive expansion of private property rights, something akin to the "give-always" of productive assets that evolutionists argue should be avoided in East Europe, and an extensive freeing of agricultural prices. Not surprisingly, evolutionists want to have their cake and eat it too, by pointing to China's economic growth, which comes largely form the radically privatized agricultural sector, while at the same time emphasizing the gradual changes in state owned industry, disregarding the fact that the latter's performance continues to be a major drag on the economy.

The Chinese reform also operated under rather unique starting conditions. The extent of macroeconomic disequilibrium was much less than existed in the USSR, for example, and a much larger share of the workforce was employed in agriculture, and in particular in an agricultural sector that was less dependent on machinery and intermediate inputs from industry than are the agricultural sectors of the East European countries. Thus, gains in productivity were quite easy to achieve, helping to improve the living conditions of the majority of the

12. Woo (forthcoming) provides a perceptive analysis of this.
Chinese population. In East Europe such gains were less likely, as agriculture depended on industrial, often imported, inputs, and even if productivity had risen, it would have helped only a small fraction of the population.

Moreover, according to a recent analysis by McKinnon (forthcoming), China can hardly be taken as a useful model of macroeconomic stabilization. Although China has had a relatively good record on inflation over the past decade, McKinnon notes that this record masks the existence of large government deficits. That China has been able to avoid inflation despite these deficits is due to a sharp increase in private saving, from 2 percent of incomes at the start of the reforms to a level of 15 percent, and it is only this increase in the public's demand for money that has prevented the outbreak of serious inflation. McKinnon concludes his analysis by suggesting that this Chinese model of macroeconomic policy may not be sustainable for much longer in China, and that it is not applicable in Russia, where a much more drastic fiscal reform would be necessary. Moreover, saving rates are much higher in East Europe and Russia than they were in China, thus making an increase in private saving much more difficult to achieve.

Finally, there are political obstacles to the use of the Chinese model in East Europe in that it is not obvious that the sort of control exercised by the Party in China in the functioning of the economy and implementation of the reforms is consistent with the type of pluralistic democracies that the revolutions of 1989 are trying to bring into existence in East Europe and the former USSR. I deal with this connection between the economic and the political transformation of society in a subsequent section of this essay.

**Privatization and Building the Institutions of Capitalism**

While the evolutionary critique of rapid price liberalization and macroeconomic stabilization fails to deliver any useful alternatives, in the area of system change, meaning the replacement of Communist-era institutions, firms and economic mechanisms by privately owned firms and capitalist institutions and policy instruments, the evolutionists have produced a comprehensive and rich set of proposals. This is not surprising because the evolutionary approach is based on a literature that concerns itself with the design and evolution of economic and social institutions. The evolutionary argument, put simply, is that the physical system of production, distribution and economic control that existed in Eastern Europe and the former USSR was supported or sustained by a set of formal and informal institutions. These institutions had evolved during the Communist era in such a way as to sustain the physical system in a reasonably effective way. Thus, to radically change the nature of the physical system, by, say, privatizing and breaking up enterprises or by marketizing relations among them must lead to large declines in output, because the new physical relations cannot be mediated by the

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13. While China’s long-term record on inflation has been fairly good, it has been achieved at the cost of a series of boom-bust cycles that are largely the result of the unwillingness to liberalize capital markets.

14. Those who believe that there is, indeed, some form of gradual reform approach that is applicable to, at least, Asian economies, should read Drabek’s (1990) analysis of the gradual Vietnamese reform for a cautionary lesson.

15. The essence of this literature is that economic relations among agents are subject to a variety of costs stemming from imperfect information, opportunistic behavior, uncertainty, etc. To reduce these costs, institutions appear. These benefit society if their ability to reduce transaction costs exceeds their resource costs. Examples of this literature include Nelson and Winter (1982), Williamson (1975, 1985) and North (1981).
old socialist institutions, and therefore transactions costs will be very high. Likewise, economies that keep in place the physical relations that existed under socialism, say by retaining the existing state ownership of enterprises or by allocating a large proportion of products and inputs by administrative means, but destroy the old institutions of administrative control such as industrial ministries and planning bureaux, will also dissolve into chaos and suffer output declines. As Murrell (1993, p. 217) put it:

"The organizations that were expected to change their behavior in response to the new conditions have failed to do so. This is particularly the case for large state enterprises.... It is now clear that the hope for Eastern Europe lies primarily in the new organizations that are created in the private sector and then selected and shaped by market forces... [T]he phasing out of old institutions must be smooth and gradual, in companion with the rise of the new institutions of the private sector."

Using a formal two-sector model of the economy, Murrell and Wang (1993) set out the policy implications of this line of reasoning. Socialist firms and institutions cannot adapt to new conditions, and attempting to make them adapt through privatization entails large social losses. Thus they should be carried over into the future with their existing modes of operation and supporting institutions. Privatization must take the form of a limited but growing private sector consisting of small entrepreneurial units whose emergence will then lead to the slow evolution of capitalist institutions. Thus only gradually will the economy be privatized, marketized and, finally, capitalist.

Evolutionists also express great pessimism about the ability of individuals in the region to act rationally in a market setting. Thus Poznanski (1992, p. 653) writes that the region "suffers from the lack of a market culture, ie. interest in profit maximization, proper work discipline and self-reliance;" also missing is "respect and attachment for private property" (Poznanski, 19xx, p. 89). While there is no doubt that education about the market system is needed in transitioning economies, that people in the region can not act in their own self interest in accord with existing legal norms belies the upsurge in entrepreneurship that has characterized East Europe in the post-1989 period, and which now accounts for even 50 percent of output in Poland and 20 percent in the Czech Republic. Evolutionists' contempt for this sector takes on a Marxist twist when Poznanski (1991, p.31) criticizes the Polish entrepreneurial sector for being "more involved in the redistribution of national product than in production itself," as if only material products and their creation had any social value and as if only their production could teach business skills.

Unfortunately, this pessimism regarding the ability of people to manage their economic fortunes leaves a gap in evolutionary models, since they are unable to explain when state assets can be turned over to private individuals. Poznanski (1991, p.31) simply proposes that "the pace of which privatization proceeds is determined by the speed at which the supply of market agents is expanded in these economies, or... the pace at which the market ethos will spread out." Murrell and Wang are hardly more precise, leaving the reader to

16. By physical relations, I mean flows of goods, services, capital, factors of production and information.

17. These arguments seem to be little more than the exposition of ethnic stereotypes without a factual foundation.
wonder how, absent a market test where entrepreneurs are free to fail and succeed, one is to determine when the public's ethos is sufficiently advanced to free it from the petty tutelage of the paternalistic state.\textsuperscript{18}

The evolutionary argument finds its analogies in the emergence of capitalism from feudalism, where the institutions of capitalism are alleged to have emerged slowly in response to the needs of the nascent capitalist mode of production through a slow process of evolutionary selection that gradually weeded out the inefficient organizations and nurtured the efficient. Thus,

"[t]he evolutionary approach emphasizes the importance of selection processes, or entry and exit, in accomplishing change. Changes within organizations are de-emphasized in favor of a focus on shifts in economic resources from inefficient (or technologically obsolete) to efficient (technologically progressive) organizations or to new organizations better suited to the new economic environment. \textit{It is a given that these institutions will take many years to create}." (Murrell, 1992, pp. 40, 50, emphasis added).

At some level of generalization, this is a line of argument for which I have some sympathy, but in its particular historical analogies as well as in the way in which it is applied to East Europe it has fatal flaws. The first of these is a definitional one. Although evolutionists posit the critical need for capitalist institutions and the dangers to the economy from their absence or inappropriateness, they never set out precisely what capitalist institutions they consider as vital to the East European economies or explain why these institutions are critical. Thus the reader of their tracts is left with the task of reifying this abstract concept of "institution," and therefore the assertion that certain institutions are indispensable is incapable of falsification because the concept of institution has no conceptual or empirical correlates.\textsuperscript{19}

If, however, one could agree on a minimal set of institutions, such as banks, stock exchanges, laws on corporate governance, contractual obligations and property rights, etc., that the evolutionists might have in mind, then their argument that \textit{these} particular institutions must evolve over time in a slow process of social Darwinism and cannot be created in some reasonably suitable form by conscious human action is demonstrably false. One need only to refer to the work of Alexander Gerschenkron (1962) to see that much of the industrial revolution that swept Western Europe in the 18th and 19th centuries was underpinned by institutions that were consciously designed and put into operation by individuals and governments in rapid spurts of institutional

\textsuperscript{18} These evolutionist recommendations remind me of an discussion with Czechoslovak reformers in early 1989. Someone proposed that small business should be encouraged, and a law be passed that anyone could start a small business so as long as they possessed a certificate that would attest to the fact that the individual had taken and passed a test in entrepreneurship. Presumably the test would be drawn up by a committee of government officials.

19. I do not agree that capitalism in East Europe would not benefit from the presence of the capitalist institutions that are to be found in modern industrial societies. Nevertheless, one cannot posit that the absence of such institutions in East Europe would preclude the existence of broad-scale capitalist production for two reasons. The first is that institutions reduce costs of certain transactions, they are not, however, indispensable for such transactions. Second, there may well be relatively effective second-best solutions to the absence of certain institutions. Unless proponents of the evolutionary view identify specific institutions and the costs imposed by their absence, debate on this issue is impossible.
innovation. Indeed, Gerschenkron extends this process of institution innovation to the Soviet period, and Spulber (1966) carries the argument over to the case of East Europe.

Gerschenkron viewed industrialization in Continental Europe as an effort of late-comers to catch up with England, which was the first country to pass through the industrial revolution. Late-comers felt a tension between their own economic situation and that of countries that had successfully industrialized. Lacking in the latecomers were precisely the institutional prerequisites or preconditions for the development of a modern industrial society. Gerschenkron demonstrated that the absence of these prerequisites was overcome by the creation of institutional substitutes through private or state initiatives. Thus, in France and then in Germany, the state supported new private institutions, such as large universal banks, that served to overcome the existing lack of more traditional institutions to promote capital formation, financial intermediation, and the application of entrepreneurial activity. Farther to the East, where preconditions for industrialization were ever less favorable, the state itself had to assume the tasks of organizing and maintaining such institutions.

This is not to deny that, once founded, such institutions were subject to both internal evolution and a Darwinian competition with alternative institutions. What is important, however, is that institutional innovation was breathtakingly rapid, surprisingly often successful and, even more surprisingly, frequently the result of government initiative or support for nascent private initiatives. Also important for today's East Europe is Gerschenkron's finding that the focus of these innovations was on institutions oriented toward activity in heavy industry, banking and the other "commanding heights of the economy" and not the small business and service sector that the evolutionists see as the means of introducing capitalism in East Europe.

This historical experience should not be surprising. No doubt good institutions make for better outcomes than bad institutions, but the great difference in institutional arrangements, even among developed market economies, suggests that the Darwinian selection of institutions does not converge to some unique and optimal set of organizations. Indeed, Williamson himself cautions against an interpretation of his work that would claim that "the institutions emerging from the competitive process will be efficient or 'transaction cost minimizing'" (Bowles and Gintis, 1993, p. 95). Williamson (1993, p. 107) warns, "That is too strong. I hold only that the institutions emerging from the competitive process will be comparatively efficient; and I eschew reference to minimizing and maximizing." Consequently, if the institutions observed in market economies after some period of selection are not optimal, but only better than rival alternatives, then the conscious design of institutions in economies that lack them can in fact lead to relatively satisfactory outcomes.

A second problem with the gradualist program is that it rests on several unstated assumptions whose validity is doubtful at best. The first of these is that a capitalist and a state-owned and managed system can co-exist in a way that will enable each to exploit its comparative advantage to the utmost. It has long been understood that "one needs to perceive the Soviet-type economy as a coherent whole—a true system—with its own inherent logic, necessary components, and natural interaction of these components. It, like any other

20. These findings regarding the invention and rapid introduction of socialist institutions are also problematic for the evolutionists' claim that socialist institutions are now valuable because they have evolved to be suitable for a system of state owned enterprises. Indeed, the opposite is true; these institutions were created and put into operation en masse, and it seems clear, given the downward spiral of economic performance in the region, that bureaucratic tinkering with the economic mechanism never increased its capacity for managing an economy consisting of large state-owned firms. That bureaucracies always evolve toward increasingly greater efficiency is an easily disproven hypothesis; see Murrell and Olson (1991) for just such evidence for East Europe.
economic system, is as much an organism as a mechanism, tending to counteract forces impinging from the outside..." (Ericson, 1991, p. 11). Thus, there is no guarantee that the evolutionary approach, which requires the long run co-existence of a large Soviet-type system with a small, nascent and fragile capitalist system in a single economy will eventually result in a triumph of capitalism over socialism.\textsuperscript{21} Indeed, just the opposite is to be expected, as the economically and politically powerful state sector will act to marginalize or wipe out small capitalists.

Perhaps one might be willing to take such a risk if it were, indeed, the case that maintaining a mixed economy, one part state owned and planned, the other private, would yield high levels of output and welfare by preserving the production of the socialist sector. However, recent theoretical work (Zhou, 1993) as well as past experience with partial reform in socialist economies suggests that such arrangements are likely to reduce rather than improve social welfare and the functioning of the economy.

In the end, as with the discussion of price liberalization, the desirability of rapid privatization and institutional change in transitioning economies depends to a large extent on the response of state-owned or formerly state-owned firms to such reform measures, and it is to the evidence on this point that I now turn.\textsuperscript{22}

\textbf{ENTERPRISE BEHAVIOR IN THE TRANSITION}

It has been something of an article of faith that socialist enterprises and managers were too sclerotic and unresponsive to the radical introduction of market forces, hard budget constraints and new, private, owners. This belief owes much to Kornai's (1990, p. 62) influential view that:

"The manager of a state-owned firm ... wants to invest more, obtain an even greater amount of hard currency, import more machinery and equipment from hard currency markets, travel more and let his colleagues do the same; and, of course, he wants to pay more wages, since this can boost his popularity among employees and ease the tensions around him. It is time to abandon hope that the budget constraint can be hardened."

which is echoed by Murrell (1991, p. 41):

"Given that [the Communist] system survived from a number of decades in a number of countries, it is reasonable to suppose that organizational routines were selected according to the needs of the unreformed environment.... Moreover, the allocation of personnel to positions has occurred within that bureaucratic system. Thus, the centrally planned systems will have an

\textsuperscript{21} To carry the evolutionary analogy further, would one have bet on the mammals over the dinosaurs if there had not been a cataclysmic event, (what paleontologists might call a big bang) that made the dinosaurs extinct?

\textsuperscript{22} The reader may be surprised that I have not touched directly on the feasibility or desirability of large scale privatization. In part this is because much of the debate on this topic is not even worth reading, much less writing about, although I must admit (\textit{O culpa felix}) to having done both in the past. Moreover, with the conclusion of the first wave of voucher privatization in Czechoslovakia, it is evident that large scale privatization is feasible; whether it is desirable or not should be left for history to judge as there has been too much \textit{ex ante} pontificating on this topic.
allocation of human capital and of management styles that matches the dictates of a non-market environment."

"Because the...organizational structure ... is suited to the existing environment, it is unlikely to be suitable for a new market environment."

Early evidence seemed to confirm these views. State-owned enterprises in Poland reacted to the liberalization of January 1990 with paralysis; production continued at levels well in excess of sales, and firms passively accumulated losses that they financed by dissipating their assets, borrowing from banks and finally by simply failing to pay their bills. This behavior, however, was largely the result of the failure of the Polish government to introduce an effective privatization program and by the resulting lack of clear property rights in the state enterprise sector. This ambiguity regarding property rights was exacerbated by the fact that workers' councils and a form of worker ownership had been introduced prior to the 1990 price liberalization. Bienkowski (1992) has shown that much of the dysfunctional behavior of Polish firms was due to this lack of clear property rights, with both managers and workers making operating decisions that served their own interests at the expense of rational responses to market signals. Bienkowski (p. 750) concludes that "ways must be found to stop the current actors, who represent the old power structures and interests of the state enterprises, from destroying these enterprises before privatization can be realized." Of course, the recognition that a lack of clear property rights was at the root of the poor market-responsiveness of Polish many state-owned enterprises could argue either for rapid privatization or a "re-nationalization" by the state in order to restore clear property rights. Whether to reestablish state ownership rights or to privatize thus depends on whether or not privatization, or even the prospects of privatization, can induce managers to respond to market signals in a rational and socially desirable way.

Evidence on the effects of privatization, or, at this early stage of the transition process, the credible prospect of systematic privatization, on the behavior of state-owned enterprises is beginning to accumulate. Given the short time since the beginning of the transitions and the delays in collecting data, much of the evidence so far on enterprise behavior comes from case studies. While cases always have something of the nature of anecdotes, if the anecdotes tell a consistent story then it may be possible to draw generalizations from them. In this essay, I will rely primarily on Estrin's (1993) summary of, and conclusions drawn from, a set of 43 enterprise studies carried out in Czechoslovakia, Hungary and Poland in 1992. I will supplement these with Torok's (1993) summary of twelve case studies of Hungarian firms and with six case studies of Hungarian firms carried out by Brada et al., (forthcoming).

The conclusions that can be drawn from these cases are best summed up by Estrin (p. 5) who writes that "in all three countries, but especially in CSFR, most state owned enterprises are making major adjustments in

23. Behind such neutral economic terms as "human capital" and "management styles" lurks a fantastic human reality. What Murrell really proposes is not only retaining socialist economic institutions, but also keeping existing communist planners, party secretaries, ministers, union leaders and industrial officials in their positions of power for the indefinite future. What the political feasibility and economic consequences of such a strategy would be I leave to the reader's imagination.

24. By systematic privatization I mean a process with clearly established rules and procedures, not casual "nomenclature privatizations" and the extra-legal appropriation of state assets by individuals or groups.

25. The reader should recall Peter Wiles' dictum that economic data are nothing more than aggregated anecdotes.
the light of their new circumstances, and these responses...appear to represent the bulk of industry-level adjustment." Estrin and the authors of the cases from which he drew his conclusions examined the short and long term adjustments of the firms to external shocks and the viability of these firms, and they related these to the behavior of managers and workers. In the case of short term responses, the behavior of enterprises with respect to output, employment, product assortment, pricing and market orientation were evaluated. Unresponsive firms failed to make adjustments in these areas, continuing to produce a relatively unchanged volume of output at past levels of employment, accumulating debts and losses along the way. Estrin concluded that three-fourths of all firms had made significant adjustments. There were few systematic differences between sectors, but significant inter-country differences. Despite the fact that both Poland and Czechoslovakia had adopted big bang stabilization policies, one-third of Polish firms had made no effective production response in the more than two and one-half years since January 1990. In contrast, all Czechoslovak firms were judged as having made significant responses, and almost one half of them were categorized as "very active" in their responses. The Hungarian sample fell between these two extremes, as is confirmed by Török (1993) and Brada et al. (forthcoming) who also reported cases of firms that were acting responsively and others that were, in Török's words, "drifting," again in a way that reflected their prospects for privatization.

Similar results emerged in the case of long-run responsiveness, which judged firms on the basis of their ability to develop and implement a long-term strategic plan for dealing with the new market environment. The majority of firms had engaged in a long-term response to the rapidly-changing environment, but significant cross-country differences emerged. In Hungary, many firms had been engaged in strategic planning for some time, while others continued a hand-to-mouth existence.\(^{26}\) In Czechoslovakia, "[t]here were major changes in enterprises' attitude towards their long run strategy...during the period of study due to the impact of the first wave of mass privatization on managerial thinking... [A] majority of firms had developed a long run strategy...[and] management thinking was intimately [tied] to their proposals to restructure and privatize..." (Estrin, 1993, p. 23). Estrin's findings regarding Polish firms confirm those of Bienkowski; most Polish firms are rudderless.

In terms of enterprise viability, Czechoslovak firms also fared best and Polish firms worst, despite the fact that both countries had undergone a big bang privatization. Estrin attributes these differences between the three countries to managerial autonomy, motivation and responsiveness. In Czechoslovakia and Hungary all firms were rated in the highest category for managerial motivation, and the majority received high ratings for managerial autonomy. In contrast, only one-fifth of Polish firms received the highest rating for managerial motivation and in one-third of them managers were either poorly motivated or lacked authority. Correspondingly, in Poland workers dominated enterprise decision-making at one-third of the enterprises in the sample. In Hungary and Czechoslovakia, worker power was minor. These differences in managerial autonomy and motivation are directly connected to actual or prospective privatization and the consequent establishment of clear property rights. Thus, Estrin concludes, the "emphasis on privatization...seems to explain much of the considerable progress towards enterprise adjustment observed in the CSFR and [Hungary]...This confirms the view that progress in privatization is pivotal...to the process of restructuring and reorienting to the market environment" (pp. 38, 39).

The weight of available evidence suggests that rapid marketization and progress with privatization can in fact change attitudes in, and the behavior of, formerly state-owned firms. This means that big bang policies, if

\(^{26}\) For more on this, see the Taurus and Budaprint cases in Brada et al. (forthcoming).
implemented systematically, can in fact yield benefits in terms of improved utilization of resources and greater managerial effort, and East European societies do not need to bear the costs of a slow dismantling of old socialist structures and the dysfunctional economic behavior such structures imply.

**Politics, Big and Little**

The decision to pursue a course of rapid change from a socialist to a capitalist economic system does not depend on economic considerations alone; indeed, economic considerations may be secondary. Even if the case for a big bang privatization and price liberalization were not as compelling as the foregoing discussion suggests it is, people may opt for a faster pace if it is likely to promote their political objectives. This possibility, of course, stands on its head the conventional wisdom that the populations of East Europe would turn from democracy and capitalism if the economic costs of transition were too high or of too long a duration. That this loss of support for democracy, if not always for individual leaders, has not occurred in those countries where big bang transitions took place, but may be happening in countries where the economic transformation has been much less rapid, suggests that the revolutions of 1989 were not about economics alone or perhaps even not about economics primarily.

To the extent that a relationship does exist between democracy and capitalism, the costs of transition from socialism to capitalism cannot be measured in economic terms alone. Political objectives, however difficult to quantify, must also play a role in our evaluation of the outcomes. The most telling example of the need for this sort of broader calculus is evident in the case of China. Those who argue for a slow transition to capitalism, if that is where the Chinese leadership is headed, point to that country’s successful economic performance over the past decade under a program of limited and gradual economic reform. Thus, they argue, such an evolutionary transition entails much lower economic costs than were borne by Poles in the course of the big bang. Even if one accepts the economic causality implicit in the above argument, the welfare calculus ignores the fact that the process of slow reform adopted by the Chinese Communist Party not only allowed the Party to remain in power but, indeed, by its very politico-economic logic, required it to do so. Thus the superior economic outcomes enjoyed by the Chinese population must be weighed against the costs of the Tiananmen Square tragedy and the subsequent political repression. Given a similar choice, East Europeans would not have been willing to accept

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27. Critics of big bang policies often claim this. For example Przeworski (1992, pp. 45-46) writes that East European leaders are "exhorted to plunge into reforms about which only one thing can be known with certainty: they will make most people worse off for some time to come. They are urged to short-circuit the democratic process by introducing reforms so swiftly that citizens will have no time to mobilize effectively against them."

Unfortunately such a view of East European politics is at a loss to explain the fact that Václav Klaus, the architect of the Czechoslovak big bang, was the largest vote-getter in the 1992 elections. Nor can it explain why the Antall regime in Hungary is so unpopular despite its gradualist transition strategy.

28. Public opinion polls carried out in East Europe show that the preference for democracy is, in fact, even stronger than the preference for capitalism, although both are greatly preferred by more than 50 percent of all respondents.

29. Thus, Li (1993) writes:

"... economic reform should be carried out according to a general plan and step by step under the leadership of the Communist Party and through the organizations of the Communist Party and the existing organs of state power."
the bargain forced on the Chinese people because democracy and political self-determination were as much, if
not more, the real goals of the 1989 revolutions as was improved economic performance.

The prevailing view of pre-transition politics in East Europe was based on the concept of the social
contract, whereby the Party guaranteed workers a tolerable economic existence and equality. In return, workers
conceded to the Party a monopoly over political power. When the centrally planned economy could no longer
deliver the goods to enable the Party to keep its side of the bargain, this theory argues, the workers overthrew
the Party. This social contract view of East European politics was at best a bad generalization. People knew
that the regimes under which they lived were corrupt and cruel. It was the moral failings and vacuity of
Communism, the terrible double-speak of its propaganda and cultural apparatuses, not to mention the murders,
incarcerations and disruption of careers in the name of socialist legality that offended society so much more than
the drab and underpowered Trabants and Škodas that Communism stingily doled out to the workers. Nor was it
a system characterized by equity; rather rent-seeking, at the level of the individual as well as at more aggregate
levels, and opportunism distributed income in ways that reflected political power and not economic justice. It is
striking, for example, that in the works of dissident writers such as Havel or Kundera there is very little, if any,
description of economic conditions under Communism but a great emphasis on the spiritual and moral vacuum
that Communism created. That dissidence in the GDR and Poland centered on churches and other social
movements is also no accident; indeed even Solidarity's program was at first more a call for the dignity of the
working class than a unionist call for higher wages and shorter hours.

There are, as well, more historically deterministic explanations for the East European demand for
democracy. These largely involve turning on its head Schumpeter's (1950) prediction that capitalism's
economic successes would lead to its replacement by socialism with the argument that it is socialism's successes
that have led to its demise in favor of capitalism and, by extension, to democracy. That socialism was a system
of mobilizing resources of rapid industrialization in the USSR and East Europe was a generally accepted fact.
However effective socialism may have been in mobilizing resources for creating a 19th century industrial
economy, it was an utter failure in the post-industrial period, in large part because of its organizational
shortcomings. 30

If, then, the peoples of the ex-Soviet empire desire democracy rather than bread, are there implications in
this for the choice between evolutionary and rapid transition strategies? The answer is yes on two counts. The
first rests on the empirical observation that "there has been no case of political democracy that has not been a
market economy" Berger (1992, p. 9). There are, of course, arguments why this empirical regularity should
hold, but this is not the place to develop them. The second reason for opting for a rapid transformation if a
functioning democracy is the desired end state rests on public choice arguments. These arguments suggest that
leaving the entrenched bureaucrats and Party members in power to run the state-owned sector will provide them
with both the incentives and the economic wherewithal to form powerful lobbies and interest groups that will
undermine the creation of a true democratic system. Developments in those ex-Soviet republics where neither
privatization nor price liberalization has taken place, and where the old guard continues to cling to its economic
powers, make these dangers amply clear. 31

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30. The most popular exponent of this revision of Schumpeter's prophecy is Fukuyama (1992). A related argument
based on factor proportions is that of Rogowski (1989).

31. For an overview, see Hillman (1992).
In this essay I have tried to demonstrate that evolutionary criticisms of rapid transformation of socialist economies toward capitalism are based on premises that do not withstand the scrutiny of reason and experience, limited as the latter is. Moreover, even if costly, rapid economic transformation may nevertheless be justified if democracy is also a goal of those undertaking the transition.

In the end, I suspect that the above arguments are utterly irrelevant to developments in Eastern Europe and the ex-Soviet Union. We, evolutionists and big bangers alike, have been reading the right texts, but getting the wrong message. Murrell is wont, in his writings, to quote at length from Edmund Burke's, Reflections on the Revolution in France, but mainly for its philosophical ruminations. Consequently, he, I and everyone else involved in this debate have proceeded as if we had all been reading Gibbon's Decline and Fall of the Roman Empire, arguing about the costs and benefits of rapid versus slow transition as if some rational calculus, working its way through a process of historical inevitability, would, or could, guide events in East Europe and the ex-USSR and as if such a rational calculus could really dictate the pace of events.

Preworski (1992) points in the right direction when he writes, in criticism of big bang programs in East Europe: "Perhaps revolutions are shaped by the very systems against which they are directed." Perhaps, but the most important insight in this quotation is that what we are observing is a revolution, and to understand what is going on in East Europe we need to turn not to Burke's ruminations on philosophy, but rather to his narrative of the course of the French Revolution. It is the nature of revolutions to be heedless of costs, to pursue their ends with a self-justification that mocks any effort at the rational calculation of costs and benefits. This was the case with the French Revolution, which too, destroyed human and physical capital in prodigious quantities, and with the Communist revolutions in Russia and East Europe, and so it will be with the current revolutions. Whether enduring benefit can emerge from these events is beyond our ability for calculation, but not beyond our capacity for hope.
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