Transition to Market Economy

Symposion organized by Albert Hirschman, Michael Keren, Juan J. Linz, Michael Montias November 20, 1990*

Participants from Central and Eastern Europe: A. Dochia (Romania), L. Kolarska-Bobinska (Poland), J. Kovacs (Hungary), I. Rev (Hungary). *Other Participants:* A. Bishara (Jerusalem), C. Bofitto (Milano), A. Hirschman (Princeton — Wissenschaftskolleg), M. Jackson (Louvain), M. Keren (Jerusalem — Wissenschaftskolleg), G. Leptin (Berlin), J. J. Linz (Yale — Wissenschaftskolleg), J. M. Montias (Yale — Wissenschaftskolleg), M. Nuti (Bruxelles), W. Schrettl (München), H.—J. Wagener (Groningen)

Two themes dominated the conference: 1) The importance of historical conditions in setting the initial conditions for reforms. 2) The problem of the optimal sequencing of reforms.

1) Several participants argued that the previous presence or absence of quasi-market institutions would at least in part determine whether transition to market economy would be smooth and rapid or bumpy and liable to retrogressions. In Hungary, twenty years of mini-reforms under communist aegis have created a small entrepreneurial class and made possible the accumulation and concentration of capital that are almost completely absent in Romania (where virtually the only private enterprise and the only domestic capital available are in the hands of fly-by-night entrepreneurs and black-marketeers, for the most part originating in ethnic groups that are regarded with prejudice by the majority of the population). Partial reforms of the state sector in Hungary, Poland, and the GDR have given the managers of firms some acquaintance with market processes, in contrast to Romania, where this experience has been largely absent. Nevertheless, at least one participant noted that the "corporate culture" in state-owned firms was so far removed from profit-maximizing principles and so recalcitrant to change that these firms could not make a smooth transition to market processes, even if they were privatized, as long as the previous management was able to hold on to power. (It was observed in passing that managers of large state enterprises had control over real estate, stores, and warehouses, which they would not willingly relinquish to

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private entrepreneurs. The enterprises they managed were also frequently in a monopolistic position that they would resist giving up). If the dead hand of the past was too heavy, it might be better to establish a private sector *ab ovo* than to create one by transformation of existing enterprises.

2) Various arguments were advanced for and against the simultaneity of reforms (eliminating the monetary overhang, freeing prices of goods and services and allowing them to balance supply and demand, allowing workers to bargain collectively, privatizing state enterprises and licensing new private firms in industry and trade, creating private banks, eliminating quotas on imports and exports, introducing convertibility of the domestic currency). As desirable as simultaneity might be on theoretical grounds, it was generally agreed that some of these measures — especially the return of nationalized assets to previous owners — were so complex and time-consuming that one could not wait for their completion before making a start on those that could be effected more rapidly (such as the abolition of price controls). The disadvantage of a sequence starting with the freeing of prices and moving later to privatization was that monopolies and defects in managerial incentives were sure to drive a wedge between "free prices" so derived and true competitive prices reflecting relative scarcities. If, as some participants believed, convertibility could only be achieved in the fairly remote future, liberated prices might also be distorted and deviate seriously from opportunity costs on an international scale. There were other conundrums as well. The paucity of domestic capital makes it virtually impossible for local entrepreneurs to set up firms with their own savings. On the other hand, state banks are run by risk-averse bureaucrats who are even more reluctant than private bankers would be to lend money to entrepreneurs without guarantees in the form of collateral — which cannot be obtained at present. In the absence of abundant capital, banks cannot effectively be privatized either. The solution of these problems via the attraction of foreign capital runs against nationalistic feelings, particularly in countries such as Romania where a tradition of resistence to foreign encroachment has been cultivated by political parties since the beginning of the century. Schemes to provide ordinary citizens with capital by giving them shares in state enterprises have been written into law in Poland, Czechoslovakia, and Romania. These schemes are popular because they seem to provide a painless solution to the vexing problem of capital insufficiency. It remains to be seen how they will work out in practice.