

Lang, Franz Peter

Article — Digitized Version

Short-run effects of economic reforms in Eastern Economies

Intereconomics

Suggested Citation: Lang, Franz Peter (1991) : Short-run effects of economic reforms in Eastern Economies, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 26, Iss. 5, pp. 223-229,
<https://doi.org/10.1007/BF02928994>

This Version is available at:

<https://hdl.handle.net/10419/140313>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

Franz Peter Lang*

Short-run Effects of Economic Reforms in Eastern Economies

The policy of reform in the former Eastern Bloc countries is relying on introducing the mechanisms of the market economy. However, the process of putting such changes into practice with concrete measures has to overcome a number of impediments which have so far hardly been considered by the reformers. The impediments are partly generated by rigidities which are an inevitable aspect of the adjustment process from a planned to a market economy.

The socialist, planned-economy system has left the former COMECON economies in a critical state.¹ A production structure has developed which is neither adequate to the requirements of producers (as regards their inputs, quality standards, etc.) nor capable of responding to the preferences of households (consumer wishes, working conditions, etc.) Furthermore, production is inefficiently organized in large areas of these economies. It now has to be carried out using antiquated plant and equipment (real capital), while there are major deficiencies in qualification levels within the workforce (human capital).

This static inefficiency is a consequence of the dynamic inefficiency of the planned-economy system. The incentives to perform within that system are geared to fulfilling prescribed plan targets. There are no incentives to open up new markets, develop new products, continually modernize plant and equipment, or to provide further training to employees. Encouragement is given to activities which help perfect the bureaucratic monitoring of production, and the administration of existing assets and production capacity, but do not aim at changing any of these. To add to that, employees tend to be hoarded by production enterprises for social policy reasons to such an extent that they would not all be required even if the plants concerned were operating at the limit of their capacity. Compared on an international basis, the productivity of labour is therefore very low.

The plan as a system for controlling the economy coupled with the permanent surveillance of the state and the economy alike, and the use of political means to

compensate for the huge misallocations occurring all combined together to generate a tremendous system of consumptive government spending and subsidies. These were only partly funded out of taxation income and distributed profits from enterprises. The budget deficits were also "dealt with" by printing more money. The result was a monetary purchasing-power excess with no goods available for purchase.²

This purchasing-power excess exists under a politically determined price system providing neither a nationally nor an internationally true reflection of real conditions of scarcity among goods or factors of production. As no organized markets have yet been established which could fulfil the guiding functions of normal market prices, countless black markets have developed which are essentially enclaves of the real market economy, but which only allow access to customers who are well enough off to join in.

Under this system, the domestic currencies of the countries concerned have largely been deprived of their functions as a means of payment and as a store of value. Convertible foreign exchange operates as a parallel currency, or else exchanging parties prefer to barter. The main means of storing value for private individuals consists of hoarding convertible currency.

In the opinion of many experts, the legal foundations of a market economy can be rapidly and readily established once the political will to do so has been formed. However,

¹ Cf., among others, W. Linder: Grundpositionen der Reformpolitik, in: S. Bradke (ed.): Wirtschaftsreformen in Osteuropa, Grösch 1989, pp. 33 ff.

² The problem as it applied to the GDR is dealt with in some detail in: F. P. Lang, R. Ohr: Die währungspolitischen Perspektiven der DDR, in: Wirtschaftsdienst, No. 12, 1989, pp. 610 ff.

*University of Brunswick, Germany. The article is based on a lecture delivered by the author on February 18, 1991, in Sofia.

the current parliamentary, legal and organizational difficulties in introducing the legal framework of the market economy in the former GDR cast doubt upon too high a level of optimism on the course of reforms. Even when it was simply a case of transferring a legal system which had already proved itself in practice (i.e. that of the old Federal Republic of Germany) to apply to a zone sharing much of the same cultural background, events have shown that a great deal of time is necessary, and that the citizenry cannot be expected to grasp the new conditions automatically.

In most of the former Eastern Bloc countries, though, the institutional conditions which have been inherited continue to constitute major obstacles to reform. Established power elites within the state system and the economy, for example, tend to behave sceptically towards changes in the system because of the privileges they have enjoyed or the positions they have held in the past. Thus their political opinions, their past activities and their level of ability combine together to act as a conservative impediment to reform (e.g. in the Soviet Union).

The difficulties are added to by a vast number of technical and organizational problems involved in transplanting a whole system, ranging from establishing a monetary and financial system appropriate to the market economy (banks, financial exchanges, etc.) to building up effective management in business enterprises.³ The problems also include deficiencies in the training levels of potential employees in such enterprises, the lack of suitable production facilities, inadequate infrastructure, and so on. In the monetary and banking sector, in particular, the impossibility of assessing the creditworthiness of potential borrowers is proving to be a virtually insurmountable obstacle to smooth business operations. This is a problem which cannot be solved until a rational price system exists. No less formidable are the bureaucratic problems entailed in setting up a state apparatus compatible with the market economy.

Even assuming that the political will exists, the creation of a new legal framework appropriate to a country's own circumstances requires a considerably longer time than does the adoption of existing patterns. When training or retraining their economic officials, the countries concerned have to rely upon their own limited resources or upon obtaining assistance from abroad. If they take the latter course, the advice they receive is not normally adapted to local needs, and the costs can be substantial.

Added to that is the further need to cater simultaneously for contrary political interests and to find steps towards reform that are appropriate to the cultural and traditional circumstances in the country. However, problems of this nature range far beyond the realm of merely technical and organizational difficulties.

Political Credibility

Even when the basic policy principles on the overall guidance of the economic system have been formulated and legally implemented, and even when the organizational and technical hurdles already mentioned have been successfully jumped, that still does not automatically mean to say that a satisfactorily functioning market economy will now operate. A crucial factor in the success of reforms in practice is their credibility and the expectations generated among the participants in economic processes.

In Eastern Europe the unaccustomed debates, often thrashed out in a heated atmosphere, between political groupings which had been largely unknown in the past can very quickly lead to negative expectations among the public at large as far as the stability of the reforms is concerned. The problem applies especially to the multi-ethnic countries of the Soviet Union and Yugoslavia. The present crisis gives evidence of this problem. The negative influences these debates generate upon expectations both at home and abroad tend to be largely ignored by those involved in them. Yet they do have a detrimental effect on the real chances of success for the reform process, even if counter-reformatory tendencies are left out of account.

If, for example, there is a suspicion (or expectation) that the reforms will quite soon be curtailed again, or even reversed, this will lead, under market conditions, to specific reactions by market participants. Entrepreneurial activities will be oriented towards short-term profit maximization in low-risk activities.

There will be a general absence of long-term investment activities aimed at expansion. Entrepreneurial activity will thus remain confined to a relatively small area which will not actually cover those fields where the main supply deficiencies have been occurring.

In this climate of expectations, entrepreneurs use their new-found freedoms, which they also judge will be short-lived, to place an extreme emphasis on their own short-term advantage. The prices they demand will be high, and speculative forms of behaviour will occur. These include such activities as destroying goods in order to make them more scarce and drive up their price, or selling products exclusively to foreign customers or those who are able to

³ On the amount of time required to carry out organizational changes of this type, cf. F.P. Lang: *Finanzmärkte, Währung, Prognosen*, in: R. Ruoss (ed.): *DDR-Informationseminar für die Nahrungs- und Genussmittelwirtschaft*, Frankfurt 1990, pp. 14 ff.

pay in convertible currency. Market participants on the demand side tend to buy goods just to hoard them, which only goes to further heighten market scarcity. Thus the drive to secure personal advantage, which is a desired aspect of the market system, in this case actually exacerbates the scarcity prevailing in the marketplace.

Another consequence of the uncertainty regarding the political will to carry out reforms is that whatever profits are made tend to be used for consumption, for hoarding foreign exchange or for exporting capital (capital flight). These funds therefore fail to be put to long-term use in the form of investment in the reforming country itself, which means the reform process is unable to gain the necessary momentum of its own.

Pessimistic expectations along these lines also act as a deterrent to foreign investors. They may be worried, for example, that their assets could be expropriated by the state some time in the future, or that their associates in the reforming country could have their economic freedom of movement curtailed or that government bodies could exert an excessive influence on their affairs. However, another effect which arises in that situation is a more important factor as an impediment to investment from abroad. As long as the unfavourable development prospect of counter-reform remains, any economic activities in the reforming country which might serve to attract funds from foreign investors tend simply not to take place. In other words, potential projects in which there might be an interest in injecting foreign capital are not available.

It is particularly in the initial reform phase that it is so important to safeguard the steps towards establishing the market economy by way of credible changes in the political sphere. Only then will the expectations of potential entrepreneurs both at home and abroad gain greater stability, and the right conditions be created for satisfactory market performance. In this regard the failure of the Soviet coup d'état may have improved the Soviet Union's perspectives.

Admittedly, it is also possible for positive reform expectations to be stabilized under an authoritarian political system. Examples of this situation have occurred in China and in certain Western military dictatorships. Conversely, confused political conditions while a system is in a process of metamorphosis towards democracy tend to give rise to uncertainty. On the other hand, the authoritarian political system must not become an impediment to free decision-making and mobility in the economic sphere. Especially under an authoritarian socialist system, it is questionable whether the freedoms necessary for the proper functioning of a market economy can be provided in the longer term.

Norms and Values

Another problem is that certain social norms and values may be detrimental to reforms in favour of a market economy. For example, if it is socially outlawed to seek personal gain by commercial trading, it will not be possible to mobilize profit-seeking and personal initiative to the

PUBLICATIONS OF THE HWWA-INSTITUT FÜR WIRTSCHAFTSFORSCHUNG-HAMBURG

**Karl Fasbender,
Susanne Erbe**

TOWARDS A NEW HOME:

Indonesia's Managed Mass Migration Transmigration between poverty, economics and ecology

Large octavo,
281 pages, 1990,
price paperbound DM 68,-
ISBN 3-87895-396-8

The migration of autonomous settlers and of government-supported transmigrants from the heavily populated inner islands, especially Java, to the thinly populated outer islands has always played an important role in Indonesian development policy. The planning and realization of the transmigration programmes has triggered off a world-wide discussion. This book provides a factual basis for the debate on the conflict of aims between the elimination of poverty, economic growth and the conservation of tropical rainforests. (Only available in English.)

VERLAG WELTARCHIV GMBH – HAMBURG

necessary extent. A similar effect emanates from placing too great a value upon physical labour or closeness to the soil (worker and peasant syndrome). Market economy reforms may also be impeded by habits which favour a wait-and-see attitude or the call for government assistance rather than personal initiative (welfare-state mentality).⁴

Such attitudes or forms of behaviour are, on the one hand, based on the ideology prevailing or the experiences gained under socialism, idealizing physical work whilst at the same time facilitating a certain basic level of consumption without any need for individual effort. On the other hand, exaggerated expectations of the market economy have been aroused by the propaganda put out by Western politicians. This leads to a mentality in which a level of social prosperity is claimed which the majority of reforming countries will hardly be in a position to do justice to, on account of their overall economic weakness. Disappointments resulting from unduly high expectations may even eventually be the reason why reform objectives are abandoned.

Another inhibitory factor are the élitist habits of privileged persons which did not enjoy their high social status because of their own personal achievement or material wealth, but because of the political position they occupied. Their activities are primarily directed at favouritism within specific leadership groups and towards exploiting economic sinecures. These groups have particular difficulty in making the transition to personal initiative and a willingness to perform in the market economy (e.g. by showing entrepreneurial initiative).⁵

In the short and medium terms, value attitudes and privileges and the economic effects they create have to be considered as given factors. Certainly, they can eventually be overcome if constant efforts to inform the public are kept up, yet their obstructive effects on reforms in the short term ought not to be underestimated.

Problems in Reforming Prices

The existing, irrational price system is another hindrance to successful reforms. Hitherto, prices were determined by political decisions taken as part of the planning process. Thus they do not reflect relative scarcities on the goods or factor markets. In its current state, therefore, the price system does not give any information on the true condition of the various markets involved. This also holds true for the new stock exchanges.

The comparison between the Budapest stock exchange and the new Warsaw stock exchange shows that it takes years to achieve stabilization. A further problem is that the moment flexible pricing is indeed permitted, the monetary purchasing-power overhang and the speculative behaviour of market participants bring a complete upheaval in the price system. The purchasing-power overhang leads to general inflation. That in turn will produce substantial distortions in relative prices for a relatively long period, making it more difficult to properly diagnose conditions in the marketplace.⁶

During the introductory phase, the first price effects in newly reforming markets primarily indicate the current, short-term, macro and microeconomic imbalances in the planned-economy system. They do not therefore provide useful information for individual planning within the market-economy system. These problems can only really be overcome by entrepreneurs with particular abilities which, because of the very nature of the system, are not available in the former planned economies.

What existing managers are much better able to do is to monitor quantitative indicators and to gradually adjust production in their enterprises to suit the changes occurring in prices. Moreover, a step-by-step process of adjustment to a rational price system also allows all other economic agents to gradually accustom themselves to the changes in prices.

Initially, therefore, business planning needs to be geared to economic indicators of a different kind. One such indicator is the existing system of black markets, where the current preferences of market participants and the scarcity of goods become apparent. However, the problem here is that the black markets only cover those areas where the purchasers involved are relatively well off. Other indicators which can be used are the analysis of queues, the analysis of existing inventories, and the evaluation of comparable experiences with price reform in countries with similarly structured economies. Another method which has produced good results is to experiment with special economic zones (e.g. the special economic zone of Kaliningrad). However, this latter instrument is best suited to large economies which, like the Soviet Union, have substantial regional variations in development levels.

The conclusion one must draw from the above is that market guidance by the price system should not be the first

⁴ Cf. H. Klages: Es fehlt an der Bereitschaft zum bedingungslosen Ärmelaufkrempeln, in: Frankfurter Allgemeine Zeitung, No. 40, 16th February 1991, p. 7.

⁵ Cf. M.S. Voslensky: Nomenklatura, Munich 1984.

⁶ Inflation also has the effect of expropriating those who possess financial assets denominated in domestic currency. The bulk of these are the savings deposits of the population. The reforms are thus likely to be associated with negative experiences right at the outset as far as the majority of the population are concerned, as they see a redistribution of wealth occurring to their detriment.

step to be taken in the reform process. It is better to approach a rational price structure on a step-by-step basis, using the indicators just mentioned. For this purpose the existing price-setting institutions can be used.

Nevertheless, such a gradual approach harbours the danger that the initial reform phase will be stretched (or indeed, perpetuated) by institutional factors. This danger can be counteracted if the political control of price adjustment is replaced by private-enterprise control which is oriented to maximizing economic advantage. With this in mind, the majority of reformers propose that state-owned property should promptly be privatized.

Privatization of Means of Production

In the market economy individual initiative is given substantial encouragement by private ownership of means of production. In order to overcome this obstacle, it is therefore particularly important that state-owned means of production should be privatized.⁷

One instrument which is often recommended for achieving this is to hold a national auction of state-owned property. Citizens are then able to exercise their own choices via the size of their bids on the extent to which they wish to participate in the enterprises being put on the market. The hope is that this mechanism will create a situation in which interested and efficient citizens will attain power of control over the means of production. Their efficiency is felt to be manifested in their ability to bid in the auction process. However, it is only correct to link the ability to make bids and economic efficiency if the overall system is one in which material wealth or credit standing really are based upon efficiency. In practice, though, there are major problems in this area.

Limitations at the National Level

In the egalitarian societies of the Eastern Bloc countries, the private wealth necessary to pay for the privatization of state-owned enterprises, whether they are auctioned or sold by some other means, is not available. The fact that wealth is relatively evenly distributed, and that there is thus a lack of extremely wealthy individuals, renders it impossible to privatize large production units in particular.⁸ Yet such large-scale production units are the predominant type of enterprise.

The few existing large fortunes are in the hands of the former ruling élite, of speculators or of black marketeers. Thus if nationalized assets were privatized by auctioning to domestic citizens only, the greater part of them would fall into the control of these types of people. That is precisely why the public rejects such a solution in the countries concerned. It is in any case open to doubt whether these groups, in view of their interests and their level of business knowledge, are really suited to become the entrepreneurs of the future.

Another problem with a purely national auction is that the sale of assets in return for domestic currency does not provide the state with readily usable revenues, as the currency has largely lost its purchasing power. Indeed, as a supporting measure to back up the reform of the price system, the funds thus received ought to be eradicated in order to reduce the monetary excess demand. Privatization by auction, then, would in reality be tantamount to handing over the stock of real capital of the state to the former ruling élite.

The only way of assuring some kind of justice would be to distribute the title deeds of ownership relatively equally among the population as a whole. This is what the present Polish government has announced it will do after parliamentary elections in autumn. Given that situation, there would appear to be a good case for aiming to achieve such a broad spread by issuing shares ("people's shares") and creating public companies. However, in order to ensure efficiency it is important that capital should be accumulated where it can be put to the best possible use by entrepreneurial talent. The issue of people's shares does not fulfil this requirement, and if anything is more likely to prolong the existing state of inefficient social levelling.

If participation certificates are simply distributed among the public, this entails a tremendous fragmentation of capital ownership right from the outset. In a system of public limited companies with broadly dispersed shareholdings, entrepreneurial motivation would thus need to be mobilized by properly monitored management boards. However, there is a general lack of the necessary entrepreneurial potential, and in the emerging system with broadly dispersed people's shareholdings the controlling influence exerted over the management bodies would tend to be oriented to populist objectives rather than to profit maximization and business efficiency.

A further aspect ignored by a system of equal distribution is that the various enterprises have different levels of competitiveness and different survival capabilities. There are many enterprises inherited from the planned-economy system which are simply

⁷ Aside-effect of such a programme is that the government earns income which it is able to use for creating the infrastructure of the market economy.

⁸ A suggestion on how this might be done is made by L. Zhai: Vom Volkseigentum zur Aktiengesellschaft? Perspektiven der chinesischen Unternehmensreform, in: Die Betriebswirtschaft, Vol. 50 (1990), pp. 103 ff.

uncompetitive under market conditions. Even so, they still number among the state-owned assets now due to be privatized. The individuals receiving shares in privatized enterprises if ownership is broadly spread will not have any influence over the specific competitiveness of the companies whose shares have been allotted to them. If the assets they have acquired are unprofitable, they will soon find they are expropriated again by the sanctioning mechanism of the market. However, that same mechanism can also lead to a situation in which an enterprise which is competitive in its operations falls into the hands of entrepreneurially incompetent individuals who can ruin the business.

The problem of an unequal distribution of wealth, then, is implanted right at the beginning of the transition process. It is also added to by the problem that existing real capital is very inefficiently allocated. Not only is the reform process brought into disrepute as a result, but the starting conditions in the bid to gain dynamic efficiency in the development of the economy are also impaired. The privatization of state-owned assets on a purely national basis is therefore a somewhat risky undertaking in the early stages of reform towards a market economy.

In the case of private entrepreneurs who do not own any significant amount of assets, the sanctioning mechanism of the market economy will not always necessarily operate as it is supposed to in the textbooks. The theory is that profits (an increase in capital) and losses (depletion of capital) act as incentives to behave in accordance with market conditions. However, a basic aversion to risk may produce a tendency to generate rather little entrepreneurial dynamism, operators preferring to maintain modest activities in markets which they believe are secure. An entrepreneur with no assets may well endeavour first of all to earn relatively secure profits in order to build up a certain amount of wealth. With that in mind, he/she will avoid risky ventures if at all possible. In that situation, a lack of assets may therefore impede the dynamism of reform.

On the other hand, an entrepreneur without assets is not in any position to accept liability for any losses he/she generates, i.e. the entrepreneur does not have to suffer the consequences of his/her own business mistakes. If such a person's entrepreneurial ambitions are thwarted, he/she only reverts to the position occupied at the time the reforms began, while the losses incurred have to be borne by the public at large. The Chinese reforms have created many examples of this kind of behaviour.

Hence indifference towards possible losses can lead to a reckless approach to employing real capital which is in short supply right from the start. On the one hand, a high

willingness to take risks may be in the overall economic interest if able entrepreneurs happen to gain the power of control over enterprises and show a particular dynamism. However, if the entrepreneurs concerned do not have that basic ability, an excessive desire to take risks can easily wreck the businesses and thus also diminish the chances of development in the post-reform period.⁹

Privatization Using Foreign Capital

The alternative to a purely domestic privatization is to sell state-owned enterprises to foreign investors. This generates an inflow of fresh capital which government bodies can then use to improve the infrastructure and to encourage and consolidate the reform process. There is also the possibility that entrepreneurial know-how will be imported free of charge into the reforming country. Another plus point about selling to foreign investors is that the enterprises concerned will be assessed on their economic merits. Private purchasers will base their investment decisions primarily on the value of the expected future profits from an enterprise, and by making a purchase they are also demonstrating their interest in keeping the business on as a going concern in the future.¹⁰

A factor counting against privatization by attracting foreign capital is the traditional suspicion with regard to foreign influences. Reasons given for such suspicions include the risk of political outside interference on the back of foreign capital (imperialism complex¹¹), or the perceived growing influence of ethnic minorities.¹² In reality, therefore, the only variant of foreign investment permitted even in the reforming countries is a joint venture with an indigenous majority interest.¹³ The resurgence of nationalism is thus another substantial obstacle to the development of inflows of foreign capital.

Yet even if foreign investors are granted total freedom to acquire assets in a reforming country, it should not

⁹ There are countless examples of the latter problem in the People's Republic of China.

¹⁰ It would appear less likely in the case of Eastern European enterprises that they might be taken over with the prior aim of closing them down (in order to eliminate a competitor), since their product ranges and quality standards have rarely placed them in the position of potential competitors in the world market.

¹¹ Lenin's theory of imperialism is currently enjoying something of a comeback in this respect, in all the countries of Eastern Europe. But in the present it takes the form of a new nationalism.

¹² In Bulgaria in particular, a remarkably pronounced degree of chauvinism is in evidence which leads to an aggressive response, in particular, to the investment of Turkish or American capital. Turks and Americans are widely regarded as having closely-knit, mutual, anti-Bulgarian interests.

¹³ However, this is a device which only has a very limited range of application. Cf. D. Holtbrügge: Joint Ventures in der UdSSR, in: S. Bradke, op. cit., pp. 125 ff.; H. Liesmann: Joint Ventures erfolgreich organisieren und managen, Munich 1990.

necessarily be assumed that the inflow of capital will be great. Private investors always have an eye to the return which the assets they purchase will be required to earn. Where political and other risks are considered to be high, appropriate premiums are applied to the desired rates of return. However, because of the low rates of productivity in most enterprises, there are few potential investment projects offering attractive yields. The rather antiquated condition of many of the existing real capital assets makes it impossible to earn high rates of return at present, and at best these may appear achievable in the longer term. Thus the renewed upsurge of nationalism may lead to a vicious spiral of capital and know-how shortages.

An important factor governing investment decisions is the level of costs. When productivity is low, the only way of achieving good returns is to pay relatively low wages. This is indeed possible in the initial situation in the socialist countries, but the public's expectations from economic reforms are such that high wage demands are likely to follow, which may all too easily be met by government bodies exercising leading economic functions.¹⁴ There will also be growing incidental labour costs in future, as the new social welfare system now necessary is built up outside the production sphere, thus quickly eroding the present wage cost advantage.

Yet another impediment to investment in a reforming country is the problem of repatriating earnings to the investor's home country. Whatever profits are made will be in local currency, and these could only be readily repatriated if that currency were convertible. Thus the greater the level of uncertainty over whether it will be possible to repatriate earnings, and/or the less favourable exchange rates are expected to be at the time the repatriation takes place, the more likely it is that an unfavourable currency regime will act as an impediment to investment. Thus an important prerequisite for attracting foreign investment is to establish convertibility, at least on a partial basis, for capital transactions. However, such conditions can only be created by way of international cooperation in foreign exchange and trade policies, which means they cannot be set up overnight.¹⁵

Absorption Effects

Supply shortages on markets are also created whenever a parallel currency is operating in a particular country and the export of goods has been liberalized. The main method then used to obtain a store of value is to hoard either the foreign currency or durable consumer goods. Under these conditions, the only way in which an enterprise can be compensated for its products with a universally exchangeable quid pro quo is for it to sell its products for foreign exchange or to engage in bartering.

The problem is that only a small proportion of the participants in the domestic economy have foreign currency in their possession. Among these are above all entrepreneurs engaging in foreign trade, black marketeers, speculators and members of the old ruling élite. As profitable sales are restricted to this group of purchasers other potential consumers in the economy will not be supplied by profit-oriented enterprises. This explains the major part of the supply problems in the urban regions of the Soviet Union.

The same kind of effect is generated if goods which are in short supply are exported to hard currency countries (export absorption). This allows enterprises to earn foreign exchange which, if the conditions of the reform process are still unclear, they often prefer to invest abroad. Economic activity is thus largely confined to the core area of the domestic economy in which a stable currency (the parallel currency) is used for payment purposes.

Conclusions

The effects described above explain to a substantial extent why many goods are currently so scarce in the reforming Eastern European countries. They emanate from the reform in the dying planned economy and can only actually be avoided in certain specific cases. When political judgements are made as to how successful reforms have been, it is therefore important to be aware of these effects and to make them clear to all concerned. Only then can disappointments be avoided.

Another point which clearly emerges is that reform measures at the microeconomic level cannot be successful unless monetary reforms are also carried out at the macro level. The reform process must also embrace the entire political and social spheres of life. Half-hearted reforms in isolated areas are just as unlikely to be successful as reform measures which are rushed into without proper preparation. It will be clear that carrying out the various reform measures in the right sequence is crucial when it comes to minimizing the economic burdens they entail. Even the present success of the reformers in the Soviet Union cannot solve the real economic problems associated with the process of transition to a market economy. The special burden on the population resulting from the transition process must therefore be reduced by means of active aid from the Western countries.

¹⁴ Given the socialist tradition with which they are familiar, plant managers are rarely able to distinguish between the interests of the enterprise as such (e.g. surviving in a competitive market) and the interests of the workforce (e.g. retaining their jobs and protecting their incomes). They do not realize that avoiding unemployment and maintaining social security benefits represent political problem areas which cannot be solved at the single enterprise level.

¹⁵ Cf. F.P. Lang, R. Ohr, op.cit.