
DEVELOPMENT EXPERIENCES IN ECONOMIC-TRANSITION COUNTRIES: BACKGROUND AND ISSUES

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Abstract

This symposium examines the development experience and critical issues in several economic-transition countries. The current symposium introduction paper first offers a review of some problems of the centrally-planning economic system that were implemented in many communist countries before the transition period. Next, the paper examines important research topics on economic transition such as reform strategies, institutional arrangements, social and political challenges. Finally, the paper introduces research issues and findings of five papers included in this symposium, which include development experience in Hungary, Mongolia, Ukraine, Cuba, and China.

Introduction

Economic transaction has been one of the major public policies emphasized by policymakers in many post-socialist countries for the last two decades. Governments in more than 30 countries are currently developing policies and programs to transform their economies from a centrally-planned to a market-based economic system. The countries involved in economic transformation consist of industrialized countries such as Russia and countries of Central and Eastern Europe, as well as developing countries such as Angola, Ethiopia and Mozambique in Africa, and Vietnam, Mongolia, and China in Asia.

The development experience in these economic-transforming countries has resulted in many studies of transitional topics from different disciplines and areas. The topics of these studies include, for example, the

examination of the role of government management in the process of transition (e.g., Liou, 1998a, 1998b), the study of bureaucracy and administration development (e.g., Gabrielian and Holzer, 1999; Liou, 1998c), the comparison of transition experience strategies (e.g., Lee and Reisen, 1994), and the analysis of intergovernmental finance (e.g., Bird, Ebel and Wallich, 1995). In general, researchers of these studies not only attempt to test new concepts and ideas in selected individual countries but also try to compare the development experience among many countries.

The purpose of this symposium examines development issues in individual transforming countries and compares the transitional experience among these countries. This introduction paper consists of two sections: (1) an evaluation of general background of economic transaction and (2) a brief summary of research findings of five symposium papers. The background section will examine major problems of the centrally-planned system and address critical issues in the study of economic transition. The summary section introduces major topics and findings of the five symposium papers addressing development experience in five economic-transition countries: Hungary, Mongolia, Ukraine, Cuba, and China.

Background of Economic-Transaction

To examine the development experience in economic-transition countries, this section provides a general overview of two important areas that are related to the background: (1) problems of the centrally-planned economic system in past communist countries, and (2) issues in the study of economic transitions. The first area of concern refers to both general system problems of the planned economy and specific policy mistakes of individual communist countries. Closely related to the first topic, the second area of concern addresses critical reform policy issues such as development strategies and sequence, legal and financial institutional arrangements, as well as social and political challenges.

A. Problems of the Centrally-Planned System

While the sudden demise of Communism was unexpected, the problems associated with the centrally-planned economic system in the former socialist countries have been well recognized by researchers of economic development (Cohen, 1970, Desai, 1983, Treadgold, 1967). In the centrally-planned system, resources allocation decisions are made in response to commands from planners in the administrative hierarchy, rather than in response to prices from the market. The Soviet development

model especially emphasized a high rate of investment, collectivization of agriculture, priority to heavy industry and military, reliance on large-scale and capital-intensive technology in industry, and the relative neglect of investment in agriculture and consumer goods industries (Tsao, 1987, Yeh, 1967)

The problem of the centrally-planned system was that planning did not eliminate the shortcomings of the capitalist system (e.g., anarchy) but generated problems of its own (e.g., the built-in, permanent imbalance between supply and demand) because of the complexity involved in constructing a material plan. It did not abolish waste but generated it on a grand scale. It abolished production for profit, but failed to replace it with production for use. Especially, it produced economic activities in socially undesirable directions and was unable to alter the underlying pattern of economic behavior (Nolan and Ash, 1995: p. 981). The system led to allocation inefficiency because of such problems as (1) the misallocation of both investment goods and inputs and outputs, (2) the restriction on the use of material incentives, and (3) the destruction of the energy and enthusiasm of workers, managers, and farmers (e.g., Perkins, 1988, Prybyla, 1982).

In addition to the systems problems, these socialist countries had also experienced many challenges and difficulties that were unique to their development experience. For example, in China, the leaders had to deal with many factors that were difficult for development and modernization. These factors include subjective conditions as: China's shortage of arable land; its larger rural sector; its educational deficiencies and lack of scientific and technical expertise; and its lower levels of per capita income, industrialization and urbanization. The factors also refer to the mistakes of the radical policies advanced by Mao Zedong, which emphasized the primacy of class struggles, the need for continuous revolution, the promotion of mass participation in decision making and disdain for intellectuals and experts, the use of movements or campaigns instead of normal economic policy measures, and the importance of egalitarianism and normative incentives instead of material rewards and profits (Cheng, 1982). Influenced by Mao's radical policies, the history of the five-year plans in China was a history of violation and disruption, especially related to mass mobilization political movements (the Great Leap Forward and the Cultural Revolution). During the political movements, the economic development programs and goals were not followed, the institutions and factories were closed frequently, and many of the planning bureaucracies were purged because of the power struggles within the Party.

B. Issues in the Study of Economic Transitions

As emphasized previously, the study of economic transitions has been very popular among public policy and management researchers for the last two decades (e.g., Karatnycky, 1995, Murrel, 1996, Sachs and Woo, 1994). Many policy and theoretical issues have been formulated, implemented, and empirically tested. The author believes that these issues can be categorized into the following areas: (1) reform strategies, (2) institutional arrangements, and (3) social and political challenges.

Reform Strategy and Sequence

The reform strategy issues examined consist of different arguments about reform policy measures and sequence of these policies. For example, one of the major arguments on reform strategies is the difference between gradual reforms and rapid reforms. The dual-track strategy of gradual reform, as emphasized by post-Mao Chinese reformers, attempts to avoid any decline in output by (1) continuing to subsidize the existing state sector (based on the planned system) on the one hand, and (2) encouraging the non-state sector (based on the market system) growth on the other hand. The issue of concern is whether this type of growing out of the plan is a strategy only for countries, such as China, with small industrial sectors and a large underemployed agriculture labor base (Murrel, 1996, Sachs and Woo, 1994).

The sequencing issue refers to different arguments between microeconomic liberalization and macroeconomic stabilization. The issue of concern is the balance between the maintenance of full employment, emphasized in the stabilization policy, and the avoidance of high inflation, related to the liberalization policy. The sequencing issue emphasizes the establishment of a leading sector in the reform process. For example, should agricultural reforms precede industrial reforms, as implemented in the Chinese economic transition? Is privatization really necessary, at least in the beginning of reforms?

Institutional Arrangement

In addition to strategic issues, institutional arrangements have been one of the major supporting factors in the success of economic transition. Institutional arrangements refer to changes in financial, administration, and legal institutions. The changes in financial institutions include both the reform of central banks, the hardening of budget constraints, and the

establishment of private financial institutions. As supported by the IMF, the formal status and operating modes of central banks have been emphasized in all economic-transition countries. The budgeting reforms consist of such changes as the reduction of the past budgetary subsidies and the implementation of new tax systems. The changes in private financial institutions include, for example, the establishment of private banks and stock markets. Despite many changes in financial institutions, the regulation of these institutions is still in its earliest stage of development and requires continuous supervision.

The changes in administration or bureaucratic systems have also been addressed in the processes of economic transition. The changes introduced include, for example, the establishment of a modern civil service system, the rearrangement of the central-local relations, the restructuring of governmental agencies, and the correction of bureaucratic unethical and corrupt behavior. The institutional changes on the bureaucratic system are considered as one of the major factors in contributing to the success of implementing economic reform policies and programs. The institutional changes, however, have not been successful in terms of both the scope and speed as many old departments are still overstaffed and without new functions, while many new agencies lack resources and have limited new functions.

Changes in legal institutions call for the development of a legal and regulatory framework in the economic-transition countries. Legal institutions are critical to a market-oriented economic system because, unlike administrative decrees in the centrally-planned system, they set the rules for enterprises and individuals to compete fairly and freely. Legal reforms consist of the legislative efforts to draft major substantive laws - criminal, civil, economic, and administrative (e.g., constitutional protections for private property, antitrust statutes, commercial codes, bankruptcy laws, foreign investment guarantees); the establishment or restoration of law-related institutions such as the hierarchy of courts, arbitral tribunals, and mediation committees; the emphasis on education and training for the legal profession, as well as the general propaganda work on legal knowledge for the population at large.

Social and Political Challenges

The abolishment of the centrally-planned system and the establishment of a market-oriented system have resulted in many social and political changes and challenges. On the social issues, one of the

important challenges is the issue of social protection or social security. Under the old centrally-planned system, social protection relied on an overfull-employment labor market combined with distribution of benefits by state enterprises (Milanovic, 1995). While it was inefficient because of lacking of incentives to keep down cost, the social protection system worked better than many other aspects of the centrally-planned economics. Under the privatization and liberalization policies, enterprises are unwilling to play the role of social benefactors because of the rising cost of social protections and the declines in revenue gathering capacity. With the increasing numbers of the unemployed and the poor, social welfare expenditures will become a huge burden for the government and social insecurity and inequity may negatively affect the stability of society and the progress of development.

Finally, with regard to political challenges, the issue of concern is the relationship between economic reforms and political liberalization. While politics and economics are inevitably intertwined, three important questions have been raised based on the different development experience in China, Russia, and Eastern European countries. Do sustainable economic reforms require that political liberalization be postponed? Are gradual reforms more politically acceptable than rapid reforms? What is the appropriate relationship (i.e., division of power) among newly elected leaders, the legislature, and the bureaucracy? Despite lacking of the consensus on many answers to these questions, the stability of political environment has been considered as one of the important factors in implementing the policies of transitions and assuring the success of reforms.

Summary of Research Issues in Symposium Articles

Focusing on the development experiences in economic-transition countries, this symposium consists of five papers that examine various policy and theoretical issues in Hungary, Mongolia, Ukraine, Cuba, and China. While the first two papers address development process and issues in general, the last three papers emphasize specific topics that are related to theoretical and policy topics in the study of economic transition.

First, Terry F. Buss, in the paper "Economic Development in Hungary," reviews Hungary's progress in transitioning from a centrally-planned, Communist state to a market economy in a democratic society during a decade of 1989 to 1998. Buss first provides the background information on Hungary's central planning system and context of economic

development. He then reviews different stages during the transition process and key economic indicators during the 1990s. Buss further discusses several critical issues related to the successes and shortcomings in Hungary's transition: privatization, enterprise governance and restructuring, markets and trade, legal systems, finance, black market, foreign investment, fiscal policy, foreign debt, donor assistance, compensation coupons, and corruption. Finally, Buss argues that Hungary may be the most successful of former Soviet Bloc countries in transitioning from Communism to a market economy and that there are threats to Hungary's future development such as the impact of budget deficits and foreign debt.

In the paper "The Transition to A Market Economy: Mongolia 1990-1998," Frederick I. Nixon and Bernard Walters examine Mongolia's experience of transition from a centrally planned to a market economy. Nixon and Walters first provide an overview of Mongolia's historical conditions and describe the chief features of the immediate transition. Next, they discuss the liberalization and privatization programs, and identify problems that occurred during the transition process. Lastly, they argue that the Mongolian authorities have placed too great an emphasis on conventional stabilization and restructuring packages and too little attention has been paid to the legal, institutional, and historical constraints of the transition movement.

Hugh Hinton, in his paper "Explaining Policy Choices in Transition Economies," emphasizes the policy implications of transitional policy choices by examining the post-independence economic policy in Ukraine. Hinton first describes the background of Ukraine's development in terms of its potential, actual performance, and structural and policy weaknesses. Based on Dye's policy models, he then identifies four interrelated models to explain Ukraine's economic disintegration: (1) the volunteeristic/executive leadership model, (2) the incremental/pluralist model, (3) the structural/institutional model, and (4) the power elite explanation. Hinton argues that each of the four models emphasizes a key factor in explaining Ukrainian economic reforms, but cannot entirely exclude factors emphasized in the three other models. While the volunteeristic/executive leadership and the incremental/pluralist models have been used to explain both successful and failed economic reforms, the institutional/structural and the power elite models are used exclusive to explain failures to pursue economic reforms. Hinton concludes his study by indicating that the model explanations permit empirical tests of the developmental policy strategies and the explanations, however, raise serious concerns for the reform potential of Ukraine.

Mario A. Rivera, in the paper “A Preliminary Network Analysis of Economic Liberalization in Cuba,” analyzes Cuba’s economic liberalization experience and issues. Rivera explains changes in Cuba’s distribution systems and mechanisms in terms of a state-run “first economy,” a market-oriented “second” economy, and a partially legalized informal “third” economy. Emphasizing the importance of institution building in the economy, Rivera indicates that while the Cuban government has been unwilling to institute legal and institutional reforms of property relations and contracts, there are many indicators of potential development of capable institutions (both public and private). Finally, Rivera calls for a research agenda focused on network-based transition theory, which stresses social and cultural concerns and explores the linkage between existing and emerging institutions and between present and future sociopolitical and economic reforms.

Finally, in the paper “State-Society Relations in Post-Mao Chinese Economic Reforms,” K. Tom Liou examines the impact of China’s reforms on its state-society relations. Liou briefly reviews China’s state-society relations before the post-Mao reforms. He then offers detailed analyses regarding changes in state-society relations that stem from the economic reforms. The changes analyzed are in five major areas: rural, urban, social mobility, individual and social ideology, as well as social control and stability. Liou discusses several critical issues that may affect China’s future development: social inequality, urban-rural conflict, social unrest and crime, a lack of modern legal system, and the role of the Chinese Communist Party.

In sum, the findings of these five articles revealed the importance and difficulties of economic transition in many post-socialist countries. On the one hand, policymakers recognized the important need of introducing new development policy and programs to address many problems of the previous centrally-planned system in order to improve economic and social conditions in their countries. On the other hand, these countries experienced many historical political, social, and economic problems that either have delayed the reform movement or have imposed further costs on their people. While debates on many theoretical and policy issues continued, the symposium articles offered additional information to researchers regarding the literature development through the case study of five economic-transition countries.

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Biographical Sketch

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