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Public Policy Forum, "Moving to a Market Economy: Economic Reform in Eastern Europe and the Soviet Union"

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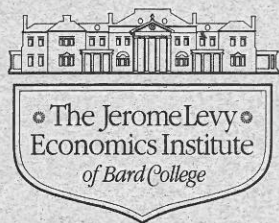


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The Jerome Levy Economics Institute

Public Policy Forum

*Moving to a Market Economy:
Economic Reform in Eastern Europe
and the Soviet Union*

October 26, 1991

PARTICIPANTS


Cezary Jozefiak

James Leitzel

Igor Nit

Dimitri Papadimitriou

Vladimir Shlapentokh



The Jerome Levy Economics Institute of Bard College, founded in 1986, is an autonomous, independently endowed research organization. It is nonpartisan, open to the examination of diverse points of view, and dedicated to public service.

The Institute believes in the potential for the study of economics to improve the human condition. Its purpose is to generate viable, effective public policy responses to important economic problems. It is concerned with issues that profoundly affect the quality of life in the United States, other highly industrialized nations, and countries with developing economies.

The present research agenda includes such issues as financial instability, poverty, unemployment and problems associated with the distribution of income and wealth. Other research interests include the issues of public and private investment and their relationship to productivity, competitiveness, and the prospects for growth and employment. In all its endeavors, the Institute places heavy emphasis on the values of personal freedom and justice.

PREFACE

From October 25-26, 1991, the Levy Institute sponsored a conference on "Moving to a Market Economy: Economic Reform in Eastern Europe and the Soviet Union." The former Soviet Union and the nations of Central Europe have all pledged to move toward market reform. The presentations at the conference examined whether there are different possible means and varying objectives in this regard.

The Public Policy Forum on "How Can/Should the U.S. Help?" transcribed here, included the following list of distinguished public officials and scholars:

Cezary Jozefiak, Senator-Polish Republic

James Leitzel, Duke University and Hoover Institution

Igor Nit, Advisor to Boris Yeltsin, President of the RSFSR

Dimitri B. Papadimitriou, The Jerome Levy Institute of Bard College (Moderator)

Vladimir Shlapentokh, Michigan State University

Copies of papers delivered are available upon request.

The complete conference program is provided at the end of this booklet.

THE JEROME LEVY ECONOMICS INSTITUTE OF BARD COLLEGE

Policy Forum on

How Can/Should the U.S. Help?

at the conclusion of the Institute's conference on

Moving to a Market Economy: Economic Reform in Eastern Europe and the Soviet Union

Cezary Jozefiak, Senator-Polish Republic

James Leitzel, Duke University and Hoover Institution

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Vladimir Shlapentokh, Michigan State University

DIMITRI

PAPADIMITRIOU:

It has become a tradition for all Levy Institute conferences to end with a policy forum. In this session, we seek to discuss the formal presentations of the conference that are relevant to policy in an effort to suggest options for government action. Our central theme is to examine the issue of whether the U.S. and other Western economies should help Eastern Europe and the former Soviet Union—and if so, in what form should we assist?

We have in this panel distinguished members from the U.S., the former Soviet Union, and Poland, the distinguished Senator from the Polish parliament.

I trust all of you are familiar with the current controversy over possible U.S. aid to Central Europe and the former Soviet Union. Jeffrey Sachs, and also Robert Eisner and Kenneth Galbraith—although from a different perspective, have all suggested that the U.S. and the rest of the Western world should help in the restructuring of these economies. On the other hand, a colleague of Jim Leitzel's from the Hoover Institution, Judy Shelton, believes that U.S. aid can actually set back reform. So the opinions are diverse and go from one extreme to the other. Let me open the discussion with Professor Leitzel.

JAMES LEITZEL:

There are two questions that I would like to raise. First, why bother aiding a relatively rich country (relative to developing countries)—for example, why send aid dollars to the Soviet Union as opposed to helping some African countries?

First, to this question there are two possible answers. Assuming that the only goal of an aid provider is humanitarian aid—helping as many poor people as possible—you could still make a case for the Soviet Union. The reason is that, unlike most other situations, the Soviets are undergoing a regime change. The system is up for grabs, and aid at this point doesn't simply raise current levels of consumption, but has the possibility of improving growth rates and raising the future standard of living. The second answer, which is fairly obvious, is that the Soviet Union is very important strategically to the West. Thus, minimizing internal military problems in the Soviet Union will improve chances for stability.

The second question is, what is the role of aid? Why would you give aid to a country during economic transition to do things that it should do anyhow, since they are in its best interest? In fact, a lot of technical aid is being given to the Soviet Union, and significant amounts will be given in the future.

The first point is that any kind of aid that you give frees up internal Soviet resources which they can use for other purposes. So it really doesn't matter much where the aid is because the resources are by and large fungible. In a paper I have written, I talk about food aid, ruble convertibility, and military conversion. I want to just mention the conclusion, which is that the State still seems to supply the bulk of all the private goods, and all the public goods. As you move to a market economy, the goal should be to get the state out of the business of providing private goods. Since the state is generally going to remain in the business of providing public goods, aid can be useful to the extent that it helps promote this function. That is essentially the point, and I think I will stop and reserve most of the time for Professor Nit.

IGOR NIT: We have vast resources, but we have no experience in effectively running an economy. For 73 years we could not run a country: Our economic system was never efficient, as demonstrated by the repeated failures of the five year plans. We were solving some political problems which we disguised as economic issues. Since the 1930s, there has been a history of conflict between economic personalities and the political interests of the leadership.

For example, Stalin's efforts at collectivization of farms was nothing short of "bandit reform." Peasants were not permitted to sell their goods at public markets without permission from the chairmen of the collective farms—in essence, everything produced on the collective farm was confiscated by the state. However, this was not limited to collective farms, but rather transcended all production in Soviet society. The whole product belonged to society-at-large, and the planning committee determined distribution of the product. Thus, no one was the owner of his or her labor.

From 1985-87, this conflict was reflected in the Law of Enterprises. In theory, the law states that enterprises have the freedom to choose types of production and allow them direct access to the consumer their consumers. But, stipulations in the law permit high ranking state officials to distribute the income. This practice has ominous consequences for joint ventures with foreign partners. Although the enterprise is allowed to choose its partner, state regulation of income distribution prevents the enterprise from fulfilling its obligation to the partner. This has led to a reduction of ties between Russian and foreign enterprises.

Since 1987, a struggle has existed as enterprises seek to divorce themselves from the hands of state ministers. Although the enterprises are the producers of goods, the distributive bodies have been the decision makers. This is a conflict not along the traditional lines of leftists vs. rightists or democrats vs. conservatives. This conflict suggests the existence and emergence of another independent force—producers. The second strike by miners in 1991 manifest the demands of producers for freedom to use and distribute their income. In fact, it was this group (producers) which was the decisive force along the barricades during the August coup. There are many young people—new private businessmen, brokers, and others—engaged in private sector activity who were very cognizant of the consequences if the coup had been successful.

After the victory of democratic forces on August 21, the situation appeared to change radically. However, it should be noted that only the top layer of the decision making body was removed from power. The large majority of the hierarchy controlling distribution is still intact.

With regard to my vision for the future of Russia, I echo the sentiment that privatization is important. However, privatization is valuable not primarily as an economic instrument—in fact, economic productivity may even decline in the short run—but rather as a means of removing power from the distributors. We have three principal problems facing us: How to feed the people, how to restore money supply, and how to avoid riots and general social collapse?

The ensuing question is the nature of foreign assistance we need to achieve our objectives. I reiterate the dire need for your help in teaching us how to manage our economy. We need to develop your peers on our soil. I agree with the sentiment that American aid to Russia should be directed at removing the state from the business sector.

Therefore, I think that the aid should be of a commercial nature, and should promote cooperation between American and Russian enterprises. You are experiencing difficulty in determining with whom to deal with in our market, but we are trying to create an organization which will immediately inform foreign parties of potential partners. It seems to me the most auspicious form of aid will be joint ventures between enterprises. We recognize your interests in minimizing risk, and would welcome the idea of major investments being limited to zones of political stability in our country. I wish to ask the Senator from Poland to give us his views on the question of whether the U.S. and other Western economies should provide aid.

CEZARY JOZEFIAK:

I would like to make some general remarks on the kinds of Western assistance, taking into the account the Polish experience. I should start by saying how important Western political support for the opposition was, particularly during martial law. It had great significance for us, and it helped in removing political barriers to economic reform. However, we now have different economic problems associated with economic reform, namely Polish foreign debt. As you know, there was an agreement on reduction of the foreign debt, and it is significant because it focuses on the structure of official debt. These were not easy negotiations on a political level, and I believe the role of U.S. government officials helped greatly since they understood the effects of this situation on the future of the Polish business community.

I would like to stress that the results are not as simple as one would imagine. In the short-term, we must repay higher sums of money under the rescheduling of repayment agreement. Nevertheless, we hope that in the long-term the rescheduling will be effective in allowing our economy to undergo reform. The next problem I would like to mention is related to foreign technical assistance. Yesterday, I mentioned that Polish managers and administrative staff, especially in state owned enterprises, do not adjust their activities to extend to market conditions—the conditions given by the economic policy. They often do this simply because they are seeking shortcuts—for example, they pressure the government to reduce taxes. However, they are usually so passive because they just don't possess the knowledge nor the experience to adjust for market conditions. Thus, training from Western industrialized countries is required, and this will have a significant impact on our economy.

However, there is some criticism connected with the nature of foreign technical assistance. Sometimes the aid, which is designed to help, has conditions which limit the influence of Polish people in decision making and the spending structure. This should not be regarded as the main point, but only a minor concern related to our foreign trade relations. The collapse of the Soviet bloc poses many difficulties for our exports. Our domestic market is troubled since producers are looking for new export markets. Although we are advised to introduce market reform as quickly as possible, we also encounter trade bias—barriers such as quotas for food, textiles, and steel products. Our negotiations with the European Community problem have yielded no positive results, and the approach of the U.S. government is better from our perspective. In sum, many problems have been already addressed as we undergo market reform, but many others require further improvement and development.

**VLADIMIR
SHLAPENTOKH:**

It seems to me that when discussing American aid to the Soviet Union, it is necessary for the American government to get rid of the illusion that Soviet republics can create a so called "common economic space." In my opinion, it is a total illusion, even if agreements between the Soviet republics include some

economic ties. The West should face the bitter truth that it must independently deal with 10 or 15 republics, and plan aid agreements separately.

I agree with Dr. Nit's comment yesterday that the West must be prepared for large-scale technical aid (for military conversion) to the Russians and others. This is simply a matter of stability and survival for the whole world. Of course, this military aid will be very demoralizing for the Soviet people, and will in some way hamper Soviet or Russian efforts for restoration of their economy. Furthermore, there is a deficiency of human factors: Russians, although often believing that they will restore their economy with their own efforts and skills, need professional and technical assistance. The Bolshevik Revolution led Lenin to build factories and institutions. Today, these factories and agencies need Western management.

The managerial elite in Russia is corrupted to the bones due to 73 years of inefficiency and a demoralization of the Soviet people. Thus, most decisions were not made from a rational basis, but rather to satisfy the official purpose of the institution. Russians have been oppressed in all of their human relations, and Russia needs to recreate a new formal bureaucracy under the leadership of the West. The question of human relationships is so vitally important for the Soviet economy that Russia needs Western commissars. In my opinion, it is a serious condition for their success.

JAMES LEITZEL: I want to be a little "Pollyannish" and lend a more optimistic voice. I have been reading for 6 years about the collapse of the Soviet economy. If anything, these claims of collapse have increased during the past 6 months. But if there have been six years of collapse, why hasn't the Soviet economy yet collapsed?

I believe Professor Nit's earlier points are relevant here. Specifically, it looks as if the state sector has largely collapsed. But the Soviet economy as a whole has not collapsed. There appears to be a significant amount of private economic activity which keeps the economy afloat. It isn't captured in the GNP or accounted for in official government statistics. I believe that accurate information on consumption in the Soviet Union would be useful. In my opinion, there is certainly no evidence of large scale economic collapse in the Soviet Union.

**DIMITRI
PAPADIMITRIOU:**

I want to take the privilege of the chair and ask two questions. The first question is directed to Professor Nit and Senator Cezary Jozefiak, and the second question shall be directed to the American contingency here. The first question is: You have all spoken about joint investment—and we all know that investment is always associated with a rate of return, which requires that there ought to be some future income stream. Given the fact that no relevant history of profits has been recorded, how is an investor from the West to make that kind of an investment? Also, what will be the rate of return? In essence, as my colleague Hy Minsky always likes to ask, what will be the pro forma statement?

IGOR NIT: I believe we should begin by admitting that the Soviet Union as a whole doesn't exist anymore. You should, of course, understand that perhaps the reason you were not getting any income from your investments was that you were giving this help directly to the Soviet government. This aid just dissolved in the hands of the unified government. This government was trying to fulfill many obligations and tasks—Castro in Cuba and other regimes relied on Soviet government support. In some respect, you were paying for the export of communism.

At this time, however, we are talking about economic health by creating commercial structures. I would divide this aid into two types: One is humanitarian help, and we will be using the term help literally. So it is just help, and not an investment with an expected return. The other kind of help resembles the help

which a teacher gives to his students. Are you asking in what way you could help the new Soviet businessman and new commercial structures? There is one example I wish to offer. Our defense industry is really in a difficult position. In contrast to the American situation, we concentrated our best forces in the defense industry. Thus, the prospect is that much of the knowledge from our defense industry can be used for peaceful purposes by foreign investors—for example, the electronics industry. We have neither the money nor the time to develop this by ourselves, but a joint venture relying on the cheap labor of our experts in the defense industry can be mutually beneficial.

You should understand that with the collapse of the state system, we require an immediate stimulus to boost our economy and become competitive in the international market place. We just need some simple technology and some minor investment.

DIMITRI

PAPADIMITRIOU:

Thank you very much. Let me ask Senator Cezary Jozefiak to respond to my earlier question. In the absence of a record of profits, how could an investor regain his investment in Poland? What would be the incentive?

CEZARY JOZEFIAK:

Frankly, it is a difficult question and not easy for me to answer. As you know there is a contradiction between a policy of stabilization and a policy of development. However, I should mention some possibilities. For instance, the German government decided to give guarantees to German exporters of investment goods. It evaluated the possibilities of making a profit, and because the German exporter is afraid that the return may not be sufficient, the government is offering a guarantee as an investment incentive. The Polish-German Commission, established in order to evaluate this project on both sides, and the German government will soon decide whether or not to guarantee this project. I believe that activity like this shows some ways for solving the problem of investment. The improvement of our economy may go hand in hand with such activity. Perhaps, private investors will eventually be attracted to our market without guarantees. Unfortunately, however, foreign private investors have up to now followed a wait and see strategy.

THE FLOOR:

What, in the opinion of the panel, is the need for increased food aid? Also, is the problem actually one of reduced food supply or distribution of existing supply?

VLADIMIR

SHLAPENTOKH:

The situation is really absurd, and it reminds me of the situation in the Soviet Union in 1928, before the beginning of collectivization. Collectivization started in the Soviet Union because peasants did not want to give grain to the state. Thus, comrade Stalin, as we all know, reacted by pressuring peasants on collective farms and state farms to give bread to the state. So it is a very ironic that the situation is very similar today. The government is again asking the world to send grain, when that grain is being stored in collective and state farms in the Soviet Union. When the Americans make decisions about aid, they should be aware of this situation.

IGOR NIT:

First of all, I don't agree with my friend and colleague Vladimir Shlapentokh. The first question was whether we really need food help this winter, and the second was whether we will be able to distribute it. The first question is very easy to answer: We need it desperately! It is really a catastrophe with regard to bread. Whether or not we will be able to distribute it—we will do our absolute best, and we are very receptive to your suggestions as to how to get the bread to the consumer directly. It is not a secret that a foreigner in our country is regarded as a first-rate person, and using your expertise in allocating this aid would be a major benefit. This would be a humbling experience for many Russians, but the bitter truth is that it is necessary to protect against hunger in Russia. But we must face this reality now. We are

separated from you not only by the Atlantic ocean, but also by the ocean of 70 years of craziness in which we had to live.

Russia is really a very strong destabilizing factor in this world. As a result of years of heavy expenditures on defense, we have atomic stations, bacteriological weapons, chemical weapons, and atomic rockets. Thus, if the state really does collapse, we can't imagine what will happen from the political fallout. We also have a wealth of resources, including oil. If Russia could be integrated with the world market, its resources would serve as stabilizing factors. Stability in the Soviet Union is in the best interest of the world. That is why I believe the world should be interested in helping us—to use these resources for everyone's advantage. I would like to conclude by referring to the proverb, "Not by bread alone." We need your spiritual support, your knowledge, and your competence. Thank you.

DIMITRI

PAPADIMITRIOU:

Let me bring this discussion to a close. It seems to me that the consensus of the panel would agree that the U.S. and the rest of the Western world should assist the Central and Eastern European economies in the process of restructuring.

Thank you all for being here.

*Moving to a Market Economy:
Economic reform in Eastern Europe
and the Soviet Union*

October 25-26, 1991

FRIDAY, OCTOBER 25TH

**WELCOMING
REMARKS**

9:00 am - 9:15 am

S. JAY LEVY, *The Jerome Levy Economics Institute*

SESSION I

9:15 am - 10:45 am

***Microeconomic Reform: The Creation of Markets, Development Rights,
Constitutional Principles***

CHAIR: KENNETH KOFORD, *The Jerome Levy Economics Institute and University of Delaware*

JOHN LITWACK, *Stanford University*—“*Property Rights and Law as Commitment Devices*”

JEFFREY B. MILLER, *University of Delaware*, **KENNETH J. KOFORD**, *The Jerome Levy Economics
Institute and University of Delaware* and **DAVID C. COLANDER**, *Middlebury College*—“*Application of
Market Anti-Inflation Plans in the Transition to a Market Economy*”

JANET MITCHELL, *Cornell University*—“*Making Firms Financially Responsible: The Bankruptcy
Problem and the Soft Budget Constraint*”

DISCUSSION

DENNIS C. MUELLER, *University of Maryland*

J. M. MONTIAS, *Yale University*

BREAK

10:45 am - 11:00 am

SESSION II

11:00 am - 12:30 pm

Reform in Eastern Europe

CHAIR: RYZARD FRELEK, *The Jerome Levy Economics Institute*

STANISLAW WELLISZ and **MACIEJ IWANEK**, *Columbia University*—“*The Privatization of the
Polish Economy*”

STEPHAN PETRANOV, Institute of Economics, Bulgarian Academy of Sciences—*“Bulgarian Reform and the Opening of the Bulgarian Economy”*

ISTVAN ABEL, Wesleyan University—*“Hungary”*

DISCUSSION **FREDERIC PRYOR**, Swarthmore College
EGON NEUBERGER, SUNY—Stony Brook
CEZARY JOZEFIAK, Senator-Polish Republic

LUNCH 12:30 pm

SPEAKER: MANCUR OLSON, University of Maryland—*“The Key to a Successful Transition to a Market Economy”*

SESSION III 3:00 pm - 5:30 pm
Soviet Union: Economic Policy

CHAIR: VLADIMIR SHLAPENTOKH, Michigan State University

IGOR NIT, Economic Advisor to Boris Yeltsin, President of the RSFSR—*“Prospects for Economic Reform of the Russian Economy”*

DISCUSSION **JAMES LEITZEL**, Duke University and Hoover Institution
MARTIN SPECHLER, Indiana University

RECEPTION 5:30 pm - 6:30 pm

DINNER 6:30 pm - 8:15 pm

**PLENARY
SESSION
WITH OPEN
DISCUSSION** 8:15 pm
Alternative Reform Paths

CHAIR: WILLIAM LUNT, Vassar College

MICHAEL KEREN, Hebrew University—*“On the (Im)Possibility of Market Socialism”*

DAVID COLANDER, Middlebury College—*“Rights and Responsibility in a Market Economy”*

KENNETH KOFORD, The Jerome Levy Economics Institute and University of Delaware—*“Why the Ex-Communist Countries Should Take the ‘Middle-Way’ to the Market Economy”*

SATURDAY, OCTOBER 26TH

SESSION IV 8:30 am - 10:15 am

Macroeconomic Reform: Financial Institutions, International Trade

CHAIR: JEFFREY B. MILLER, University of Delaware

DAVID KEMME, Wichita State University—“*Reform of Banking and Credit in Eastern Europe*”

LINDA GOLDBERG, New York University—“*USSR Foreign Currency Markets: How Much Flexibility in Flexible Exchange Rates?*”

JOHN BONIN, Wesleyan University and **Istvan ABEL**, Wesleyan University—“*Nonperforming Loans and Trade Credit: Implications for Monetary Policy in the Transition*”

DISCUSSION **JAMES LEITZEL**, Duke University and Hoover Institution
JEFFREY B. MILLER, University of Delaware

BREAK 10:15 am - 10:45 am

SESSION V 10:45 am - 12:30 pm

Soviet Union: Social Elements of Reform

CHAIR: RICHARD C. WILES, Bard College

VLADIMIR SHLAPENTOKH, Michigan State University—“*The Mythology of Privatization-A New Phenomenon in Russia*”

ROBERT TOTH, Times Mirror Center for the People and the Press—“*The Times Mirror Survey: Eastern European and Soviet Views of Economic Reform and Social Change*”

DISCUSSION **KENNETH KOFORD**, The Jerome Levy Economics Institute and University of Delaware
SANJIB BARUAH, Bard College

LUNCH 12:30 pm - 1:30 pm

POLICY FORUM 1:30 PM - 3:00 pm

How Can/Should the U.S. Help?

CHAIR: DIMITRI B. PAPADIMITRIOU, The Jerome Levy Economics Institute and Bard College

JAMES LEITZEL, Duke University and Hoover Institution

IGOR NIT, Economic Advisor to Boris Yeltsin, president of the RSFSR

CEZARY JOZEFIAK, Senator-Polish Republic

VLADIMIR SHLAPENTOKH, Michigan State University

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