Political Economy of Socialism in Eastern Europe

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JAN ADAM, Ed. *Employment Policies in the Soviet Union and Eastern Europe.* New York, St. Martin's Press, 1982.

JAROSLAV KREJCI. *National Income and Outlay in Czechoslovakia, Poland, and Yugoslavia.* New York, St. Martin's Press, 1982.

JAN DREWNOWSKI, Ed. *Crisis in the East European Economy.* London and Canberra, Croom Helm; New York, St. Martin's Press, 1982.

PAUL HARE, HUGO RADICE, and NIGEL SWAIN, Eds. *Hungary: A Decade of Economic Reform.* London, George Allen and Unwin, 1981.

STEPHEN R. SACKS. *Self-Management and Efficiency: Large Corporations in Yugoslavia.* London, Boston, Sydney, George Allen and Unwin, 1983.

FRED SINGLETON and BERNARD CARTER. *The Economy of Yugoslavia.* London and Canberra, Croom Helm; New York, St. Martin's Press, 1982.

SAUL ESTRIN. *Self-Management: Economic Theory and Yugoslav Practice.* Cambridge, London, New York, Cambridge University Press, 1984.

THERE IS LITTLE disagreement among experts in the West concerning the general nature of the current economic problems of Eastern Europe. The experts seem to have reached a consensus that the Soviet-type model is now *finally* ready to vindicate their earlier predictions: these economies are in a long-term low-growth trajectory. This secular trend both sharpens the internal contradictions and creates new opportunities for interaction with the world at large. The prospect of systemic failure provides hope for renewal to the citizens within and for a revision of political alignments to the nations without. Whether these hopes are justified only time will tell. At the same time, the West is becoming increasingly aware of the diversity among the states of Eastern Europe. As the performance of the Soviet-type model breaks down, so too does the Western perception dominant since the Yalta conference of 1945, in which Eastern Europe is merely a pale carbon copy and an appendage of the Soviet Union.

At this point, two questions need answering: (1) What are the truly *general* features of a Soviet-type economy that are shared by all the historically different states of Eastern Europe? Alternatively stated, is there a political economy of socialism? (2) How can we account for the diversity among these countries—Yugoslavia, Hungary, Romania, Poland, East Germany, Czechoslovakia, and Bulgaria—within the socialist framework, and how can this diversity help to sharpen our understanding of the features common to socialism? The books by Jan Adam, Jaroslav Krejci, and Jan Drewnowski address broad problems found throughout the East European economies; the volume edited by Paul Hare, Hugo Radice, and Nigel Swain explores Hungary's New Economic Mechanism; and the books by Stephen Sacks, Fred Singleton and Bernard Carter, and Saul Estrin examine the Yugoslav economic approach. This review will focus on their contributions of substance and method to our understanding of these two questions.

THE VOLUME edited by Adam, *Employment Policies in the Soviet Union and Eastern Europe,* considers a basic paradox in the Soviet Union and Eastern Europe—namely, the existence simultaneously of a labor shortage and of an underutilization of labor. The reasons for this paradox are to be found in the

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forces of supply and demand, and are common to all the countries. Factors that influence the supply of labor include: the changing demographic variables (the numbers of new entrants to the labor force are expected to be lower in the Soviet Union and all East European countries, especially during the 1980's); the negligible possibilities for increasing the participation rates of the existing manpower; the performance of workers in the face of existing effort/reward relationships and difficulties of life outside the workplace. Factors that determine demand include: the tendency of managers to hoard labor, given strong incentives to meet output targets and uncertainty of input deliveries, while the rewards for cost-cutting are few; the planners' predilection for investing in capital goods for production rather than in equipment that might ease the extremely labor-intensive requirements of packaging, delivery, warehousing, and servicing.

The management of manpower requirements has been similar in all the countries. It consists of a combination of better planning for supplying particular kinds of labor, the use of material incentives for workers to increase output, but the provision of little incentive to the enterprises to conserve labor. These policies have not been particularly successful, because the core of the problem lies in the system itself. The contributions to the Adam volume underscore this point, thereby raising our interest in those features of the system that resist change.

To eliminate the paradox of labor shortage and underutilization, major changes in the system would be necessary. First, the enterprises would need to have a significant financial interest in using labor more economically. The principal way to stimulate such interest is to make enterprises profit-conscious. This can be accomplished if three requirements are met: (1) enterprises must have a large degree of autonomy in their day-to-day operations; (2) meaningful prices must be set for inputs and outputs; (3) enterprises must want to maximize profits, a desire best stimulated in the socialist context by giving to the enterprises control over a significant portion of their profits.

Of these three conditions, autonomy in daily operations has been the easiest one to fulfill. It was instituted in Yugoslavia in the 1950's and in Hungary in the late 1960's.

Meaningful prices—which are useful to planners even without full enterprise autonomy—have been a much greater problem in all these countries. Such prices are necessary to establish a rationale for profits, namely, that the firm is providing goods that society wants and needs but lacks. Introduction of meaningful prices also can help to underscore the arbitrariness of the political (as opposed to economic) redistribution of profits from profit-making enterprises to enterprises and sectors of the economy favored by the political leadership. Therefore a standard is set by which government investment policy can be criticized, thus limiting the government's arbitrary power over the surplus.

Not surprisingly, allowing enterprises to use a portion of their profits for investment is the most difficult step. Ultimately, it is through the control of the surplus of society that system managers direct the system and reproduce it, as Marx had clearly perceived over a hundred years ago in his study of capitalism. If the system managers were to surrender the control over the surplus that they presently have through their control of prices and the existing centralization of profits, this would be a revolution of major proportions.

The second requirement for eliminating the paradox of simultaneous shortage and underutilization of labor is to motivate workers at all levels to do their jobs. This calls for the carrot of material rewards and the availability of desired goods, and possibly the stick of potential unemployment for the lazy. It would certainly also require—although this is not discussed in the Adam volume—a reduction in the antagonism between the workers and the regime. System managers have tried to buy their way out of this dilemma by providing more consumer goods, but the leadership finds it difficult to procure from the system enough goods to pay the annual installments on worker demands.

It appears then that, without significant change, no major improvement in either the demand or the supply side of the labor equation can occur, and yet failure to correct either side poses problems for the regime. The Adam book demonstrates that the policies followed to date will not resolve the paradox.

IN THEIR STUDIES, Krejci and Drewnowski cast innovative nets for a better understanding of the underlying socialist system in Eastern Europe. In his *National Income and Outlay in Czechoslovakia, Poland, and Yugoslavia,* Krejci uses national income accounts to quantify the Marxian notion of surplus. According to this definition, surplus is that portion of current production which is not necessary for the reproduction of the current labor force or for the replacement of current machinery. It can be used for augmenting capital stock, improving standards of consumption, waging wars, building pyramids, or supporting an idle class. A surplus can also be used to expand society's productive capacities and, if it were so used, could stimulate high rates of economic growth. However, if the surplus is squandered on poorly planned investment projects and top-heavy state administration, consumption remains low over time and there is little growth in productive output.

Krejci studies the size of the surplus in three countries with different socialist structures, Czechoslovakia, Poland, and Yugoslavia, in the years 1967 to 1978. (It is a pity that he did not include Hungary in this comparison.) He carefully develops three concepts of surplus. While one is based on East European net material product accounts, the two more useful ones come from the cost and expenditure sides of reconstructed gross national product accounts. Krejci establishes that the surplus—however measured—was higher for Czechoslovakia than for Poland or Yugoslavia but that the rate of growth for Czechoslovakia was lower. Why that was so and how it was that the smaller surplus was used more productively by Poland and Yugoslavia are the questions Krejci's work raises.

In a different vein, the authors in the book edited by Drewnowski, *Crisis in the East European Economy,* put forth their thoughts on the causes of the Polish events of 1980-81 and on the possibility that similar crises might occur in other East European countries. Peter Wiles notes that the defects of the Soviet-type system have long been known, and he asks why they led to serious problems when they did—in the late 1970's and early 1980's—rather than earlier (p. 10). There are a number of answers to this question, in addition to the ones favored by Wiles: (1) the impact of the external shocks caused by two sharp rises in the prices of raw materials in the 1970's, which were quantitatively different from previous price hikes and which fundamentally undermined the raw-materials-intensive and energy-intensive growth strategies of the East European economies; (2) the need to expand foreign trade relations on competitive world markets in order to obtain raw materials and energy resources; (3) the exhaustion of the supply of labor that could be transferred from the agricultural sector—a development that undermined the labor-intensive growth strategy pursued in Eastern Europe; (4) the need to provide more and better consumer goods to maintain the legitimacy of the system and to motivate workers; (5) the insatiable demand for foreign capital goods because the system managers wanted shiny new equipment from abroad, and because foreign capital goods were seen as providing an alternative to systemic change; (6) in light of these five factors, the combination of concessionary prices set by producers of capital goods facing a world market depression and a Western banking system frantically trying to recycle petrodollars proved too tempting: the East European countries overborrowed from the West and found themselves unable to repay.

While these reasons are well known, Wiles underscores the importance of the human element as well. As he puts it, "there is now in all these countries a *fin de siècle* feeling: i.e., a cumulation of disappointments. Not just the economy but the whole theocratic system is no good. . ." (p. 11). Wiles believes that the only way to salvage the human factor is by increasing the use of market mechanisms.

Drewnowski, on the other hand, develops the notion of "economic tissue" (p. 76). Degradation of tissue, or rot, is brought about by the suppression of truth, the eradication of dissent, and the repudiation of fairness. The symptoms of rot are seen in increased reliance by all economic actors on strict procedural regulations as a strategy of self-protection, which results in faulty information, planning without facts, distorted evaluations, incompetence of decision-makers, complexity of procedures, and rigidity of economic targets. As a consequence, common sense is eliminated from both decision-making and human relations. The only remedy is to be found in the restoration of basic human freedoms and democratic rights, according to Drewnowski. His plea is heartfelt, and the notion of rot hits the mark. Most striking, however, is that Wiles and Drewnowski, both economists, reach the conclusion that standard economic variables alone are inadequate to illuminate the real economic issues in Eastern Europe.

OFFSETTING the general bleak picture of the Soviet-type system in Eastern Europe—whether explained by resistance to fundamental systemic change, the size and uses of surplus, or tissue degradation—are the examples of successful reform of the system in Hungary and Yugoslavia. These reforms were successful not so much because they accomplished all their economic goals, but because they showed that reform of the system was possible. Significant changes permitted enterprise autonomy, meaningful prices, some degree of decentralization of investment, a liberalized discussion of real issues, and the provision of more and better consumer goods to the population.

The volume edited by Hare, Radice, and Swain, *Hungary: A Decade of Economic Reform,* focuses on the Hungarian reform. This reform has experienced alternating swings, a broad sweep in 1968 which gave much freedom to enterprises, followed by retrenchment in the mid-1970's. The pendulum swung toward reform again in 1980, and in 1982—with a diminution of the authority of the industrial ministries and their merger into a single ministry, with new mechanisms for relating domestic prices to world-market prices, with a significant easing of regulations on the private and semi-private sectors of the economy, and with the breakup of monopoly enterprises into competing firms. Since this volume was published in 1981, it misses the full sweep of this cyclical pattern.

The contributors to this collection identify the needs for reform and its impact on labor and wages, agriculture, investment, technology transfer, and international trade. The authors of the individual sections provide a good understanding of these various areas and, at the same time, sensibly relate their specific topics to the general picture.

However, an important question is left unanswered: why did Hungary go down the path of reform while the other countries of the bloc did not? The authors seem to argue that the reform—a compromise between the competing demands of different interest groups—did not fundamentally alter the basic power relationships operating within Hungarian society. To support this interpretation, they contend that it was possible to introduce new policy instruments and confer new powers and rights on enterprises, but that measures aimed at challenging real power, for example, the breaking-up of larger enterprises to promote competition or the abolition of industrial ministries, would come to naught. (As we have seen, their predictions were not entirely accurate.) Furthermore, the process of reform was always accompanied by a broad policy of "exceptionalism"—the option for enterprises to avoid the uncomfortable consequences of market-type reform by claiming an exception. Prices would be changed, or subsidies granted, or other methods found to relieve economic pressure. As long as exceptionalism prevails, the beneficial effects of the reforms are muted and the existing power relationships reinforced.

A market-type economic reform causes the investment process to become the locus of tensions between the strengthened forces of the periphery (enterprise managers and financial managers), which have the logic of profits on their side, and the various vested interests and the general interests represented by the center, which have the logic of market failure on their side. Thus, the tension between center and periphery takes the form of a debate about the attributes of plan and market, reminiscent of the Yugoslav experience of the late 1950's and early 1960's, when exceptionalism developed to such an extent that the whole thrust of the Yugoslav economic reform was jeopardized. (A comparison of these processes in the Hare collection would have been enlightening.) Nevertheless, despite the failure of the Hungarian reform to win all at once, the resurgence of the pro-reform forces after 1980 attests to the fact that the struggle to continue reform is still going on. Thus, arguments presented in the Hare volume that the Hungarian reform changed little of fundamental significance seem to me to miss an important part of the story.

WHAT OF Yugoslavia's experience? Its unique system of self-management has fascinated observers since its establishment in the early 1950's. It demonstrates that there is a socialist alternative to both the hierarchically-organized, party-dominated, alienating work experience that characterizes the rest of Eastern Europe and to the capitalist experience described in both neoclassical and Marxist textbooks. In the 1950's, decisions about current operations were decentralized to the enterprise level, and the role of planning in the economy was significantly diminished. As is currently the case in Hungary, this reform brought about a struggle between the center and the periphery over the use of profits, a struggle that in Yugoslavia was exacerbated by the regional dimensions of uneven development and national diversity. Eventually, a reform was adopted in 1965 that allowed enterprises to retain their profits for reinvestment. This implied having a means for transferring capital to firms with the most profitable opportunities, and banks were reorganized to serve as such financial intermediaries.

The 1965 reforms resolved the disagreements over allocation of investment but generated new tensions, both over the role of the banks in allocating funds and, within enterprises, over the new and powerful position of the managers. Enterprise management and bank management were both gaining considerable power, independent of the party. The 1974 Constitution was adopted precisely to curb this power, although its popular appeal was based on the promise to improve the unemployment situation, reduce income differentials, and replace selfish "group-capitalist" thinking with corporate-type bargaining and decision-making processes.

The constitution provided a new organizational form for enterprises. Each enterprise was broken down into its constituent parts, each of which had its own separate profit-and-loss statement. Only direct producers were to be able to earn profits and to dispose of them. Profits were to be invested by the unit that earned them, and were not to revert to the central enterprise management for allocation. Banks were also reorganized to make them conform with this new logic of control of investment by the direct producers and to reduce bank power over the flow of investment resources.

In his *Self-Management and Efficiency: Large Corporations in Yugoslavia,* Sacks describes this new form of self-management as it developed in Yugoslavia in the 1970's. Using contemporary Western theory of divisionalized management of large corporations, Sacks assesses whether this form of reorganization is efficient in the Yugoslav context. He gives a critical appraisal of the process of forming prices for transfers between units operating under one roof, and the investment process of inter-unit lending. This fine theoretical work is supplemented with seven case studies drawn from 24 firms that Sacks visited in the late 1970's, and is placed in the context of the organizational forms and divisionalization prevailing elsewhere in Eastern Europe. In addition, he provides significant details about the industrial structure and giant corporations in Yugoslavia, which complements the findings of Saul Estrin (see below).

Singleton and Carter, in *The Economy of Yugoslavia,* convey accurately and concisely the facts and implications of the ethnic, historic, and geographic differences present in Yugoslavia, and their strong centrifugal impact on the economy. They argue that the institutional form of self-management by workers emerged as a means for resolving these differences. They go on to ask whether worker self-management resolves Yugoslavia's current economic problems. They see clearly that wide inter-industry pay differentials encourage all industries to try to attain the pay level of the highest-paid one, and thus have an inflationary impact. They rightly argue that Yugoslav unemployment rates must not be seen solely as the result of self-management. Instead, they ought to be viewed in the context of the large number of newly created industrial jobs and the demographic characteristics of the population, which vary among regions (p. 216). The authors deal less well with integrating the microeconomic details—for instance, their analysis of excess demand for investment, which fuels Yugoslav inflation, neglects the role of interest rates that in real terms are negative.

But their most important contribution is the perspective they give on the Yugoslav system of self-management as a response to the problems of ethnic, historical, geographic, and economic diversity. This raises two further questions: Has self-management succeeded in its task of resolving Yugoslavia's problems of diversity, or has it deepened them instead? Can self-management develop in other contexts? One of the alternatives always floating through the minds of democrats and reformers in Eastern Europe is a vision of a worker-managed system somehow purified of the elements attributed to Yugoslav mismanagement, which, in their own countries, would work "well." How would such a pure worker-managed system function in the broader context of Eastern Europe? Neoclassical theory is a means of providing an answer to this question.

In his *Self-Management: Economic Theory and Yugoslav Practice,* Estrin formally models the worker-managed enterprise in an environment of considerable market concentration, clearly the relevant context for Yugoslavia and all of Eastern Europe. He notes that dynamic models which trace outcomes over time are still too primitive, and he therefore restricts himself to static efficiency (p. 6). The worker-managed enterprise rents its capital resources and makes decisions on output and employment so as to maximize income per worker. One consequence of this practice is that profitable enterprises have high incomes per worker but no incentive to take on additional workers, while workers in less profitable enterprises have lower earnings and few chances of being hired by more profitable firms. What Estrin shows, for the period 1965-74 (when market forces were most strongly in operation), is that Yugoslav data are consistent with the predictions of this theory. In Yugoslavia, income dispersion across firms and industrial sectors is considerable, even when it is adjusted for education, occupation, skill level, or region. Estrin's careful econometric work compels facing up to some of the difficulties in the otherwise appealing system of worker self-management.

WHERE DO these books take us in our understanding of Eastern Europe? The task that lies before us is to reconcile our growing confidence that we understand the operation of the political economy of socialism with our increasing awareness that there is much diversity in Eastern Europe. What are the contributions in substance and in method of the books under review? The three multi-country studies expand our understanding of the substance of socialism somewhat, but on the whole they neither weave a new interpretation of the political economy of socialism nor point to the factors that account for differences among these countries. Their main contribution lies in methodological innovation. This is conscious in the study by Krejci, who develops and quantifies the concept of surplus as a means of identifying differences among the countries of Eastern Europe; and probably less conscious in the cases of Adam and Drewnowski, who insist on the importance of factors usually ignored in conventional economic analysis—resistance to change (Adam) and tissue degradation (Drewnowksi).

The strength of the individual country studies is substantive. Sacks and Estrin use standard neoclassical methodology to explain the theory of self-management and to measure the Yugoslav experience against theoretical results. Hare provides an able summary of the Hungarian reforms up to 1980. The major limitations of the four single-country studies lie in their failure to relate the individual national experiences to the experiences of other socialist countries and to the broad issues of the economy of socialism.

Where do we go from here? Marx, I believe, pointed the way over one hundred years ago in his study of capitalism. Eastern Europe today offers an unparalleled opportunity to observe states with similar ideologies, property rights, and political structures, and strikingly different national identities. Only through a careful study of individual cases in which we search for the common elements, and through the development of general theories which integrate our knowledge of the particular cases, can we come to a sharper understanding of the political economy of socialism.

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PROSPECTS FOR THE PHILIPPINES

TO THE EDITORS: The prospects of Philippine communism is a topic recently addressed by Professor David Rosenberg in this journal (September-October 1984). Rosenberg accurately distinguishes between the pro-Soviet Philippine Communist Party (PKP) and its offshoot, the Maoist Communist Party of the Philippines (CPP). In 1968, when the CPP was formed, the military threat posed by communism to the regime in Manila was nonexistent. However, since 1972, the year President Marcos declared martial law, the ranks of the New People's Army—the armed wing of the CPP—have grown. A recent estimate of armed guerrilla strength is 15,000 (*The Christian Science Monitor* [Boston], Mar. 26, 1985). The NPA has also succeeded in spreading its forces throughout the vast Philippine Archipelago. According to Fidel Ramos, acting Chief of Staff of the Armed Forces of the Philippines, the guerrillas have been able to position themselves in practically all of the 73 provinces.

The successful dispersion of the NPA prevents the Armed Forces of the Philippines (AFP) from concentrating their power in a limited geographic area. At present and in the foreseeable future, the guerrillas are a fact of Philippine life.

There is little doubt that the communist threat is real and, given the current economic and political malaise in the Philippines, threatens to grow. Yet, a sense of perspective is necessary. It is unlikely that the NPA will capture Manila readily. The Philippines is too large and diverse for this. Moreover, the establishment of rural bases is several steps removed from a cohesive national revolution capable of toppling the "US-Marcos dictatorship." It is one thing to convince a peasant in an isolated village of the need to resist local military abuses. It is an entirely different matter to persuade him that the defeat of Western imperialism, the removal of US bases, and the institution of a communist regime are answers to his plight.

The local orientation of the peasantry was the bane of the earlier rural-based Marxist threat, the Huk rebellion of 1946-54. In order to assess the dangers posed by the NPA, it is useful to understand the strengths and weaknesses of the Hukbong Mapagpalaya ng Bayan (People's Liberation Army).

Rosenberg contends that the failure of the Huks was primarily internal, i.e., that "the PKP failed because of its own basic errors of political analysis, strategy, and tactics" (p. 46). While it is clear that the bold 1950 Huk policy of attempting an early seizure of power was both unwise and premature, it is not clear that greater Huk patience would have brought a different result.

In his classic work, *The Huk Rebellion,* Benjamin Kerkvliet contends that the Huk movement was largely conservative in nature. Despite the ideological overlay of Marxism, many Huks fought for a return to the traditional landlord-tenant relationship prevalent during the Spanish era.

Although that relationship was far from perfect, the bond of paternalism guaranteed a peasant's survival. The arrival of the Americans had changed this basic relationship. In administering its new possession, the United States established a free-trade relationship with the Philippines. For the new colony, this meant sudden access for the products of Philippine agriculture to a vast new market. This access, in turn, stimulated agricultural production, and the prospect of large profits changed the relationship between landlord and tenant. With access to the US market, the personal bond disappeared. Landowners left their farms for the glamor of Manila. In their place, overseers managed the daily operation of the estates with the goal of increasing production and efficiency. The old paternalistic rules were replaced by the profit motive.

Under these conditions, the peasants organized. Indeed, the postwar Huks traced their roots to the peasant organizational efforts of the prewar Philippines. During World War II, those early efforts provided the foundation for their evolution into the highly effective anti-Japanese guerrilla army. After the war, the Manila government feared the political and military strength of the Huks and sought on different occasions to suppress them militarily. As tension grew in 1945-46, there were attempts at negotiation. However, as before World War II, the government remained dominated by the rich. Thus, even nominal reforms favoring peasants were impossible.

At the start of the rebellion, the Huks numbered 10,000 battle-tested veterans. Their peasant roots and loyalties made them appear almost invincible within their home territory, the provinces of Central Luzon. Yet, by 1952 their organization was shattered. Two years later, Luis Taruc, the Huk "Supremo," surrendered, while many Huks returned to their villages never to fight again.

What had happened? Certainly, the unwise and premature optimism of 1950 contributed greatly to the Huk demise. Yet, to state as Professor Rosenberg does that the cause of failure was primarily "internal" is too narrow an answer to a complex situation. Other factors, military and political, led to the Huk demise. The army, long feared by the peasants, was reformed. Abusive officers were replaced, and soldiers were commanded to respect the rights of the peasants. The armed forces were reorganized into smaller, better trained units skilled in guerrilla warfare. Their increased mobility and restraint in dealing with villagers paid both