

**LESZEK**

**SOCIALISM  
CAPITALISM  
TRANSFORMATION**

**BALCEROWICZ**



**Central European University Press**

# *Socialism, Capitalism, Transformation*



LESZEK BALCEROWICZ

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# 1

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## *Introduction: Institutions, Human Nature and Behaviour*

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### **Four Questions**

This book deals with human behaviour and its outcomes under stable and changing institutional conditions. It belongs to a growing body of research which takes institutions as the central variable and tries to explain this change or their impact. Property rights theory, transactions costs economics, agency theory, comparative economic systems, public choice theory, institutional economics, political economy of economic reforms, economic theory of history – these are examples of the relatively recent revival of interest in institutional factors. These theoretical strands take up the development problems which were discussed long ago by great social thinkers, such as Adam Smith, John Stewart Mill, Karl Marx, Max Weber; and, closer to our times, Joseph Schumpeter, Ludwig von Mises and Freidrich A. von Hayek.

These problems were pushed into the background by the expansion of conventional neoclassical economics. This brought to economics a much needed rigour in reasoning from assumed premises, but at the cost of practical relevance. Mainstream economics was built upon assumptions (such as profit maximization by firms) which themselves needed explanation and reflected only certain institutional frameworks. It did not have a consistent set of premises regarding the nature or dispositions of the human beings whose behaviour it attempted to explain or to predict. The behaviour of people as consumers and as producers was assumed to be motivated by self-centred (and usually narrowly pecuniary) reasons, while in explaining or postulating the policies of the state some other motivation was implicitly or explicitly assumed for public officials.

Limits to individuals' capacity to absorb information were not usually considered. Herbert Simon, with his concept of 'bounded rationality', remained a great outsider for many years (Simon 1957).

However, mainstream economics has been changing. Institutionally-based theories, such as I listed above, entered centre-stage. And the most important macroeconomic problems, e.g. persistent unemployment or inflation, were increasingly explained by institutional factors such as the power of insiders within enterprises, staggered contracts, or the role of central banks. The theory of economic growth started to have references to its institutional determinants (for example – market distortions, tax systems, financial systems, political stability) which underline the conventional proximate variables such as the rate of savings and investment and total factor productivity.

However, much more work is needed to integrate the various institutionally-based theories and to elucidate the role of institutions as both dependent and independent variables. I believe that such work should focus on four problems: (1) elaborating a clear and methodologically sound analytical framework to study institutions and human behaviour; (2) a compatibility problem: which institutional arrangements can co-exist, which are necessarily linked to other arrangements, and which are fundamentally incompatible? For example, can democracy be combined with socialism? (3) a performance problem: what are the outcomes of different institutional arrangements and what is the role of these factors as compared to that of the non-institutional determinants? (4) institutional dynamics: what forces govern institutional change at various levels?

There is a definite logical order in approaching these four issues. A clear conceptual framework is obviously required to tackle the other problems. Too many debates in social sciences arise from conceptual confusion, and economics should pay attention not only to mathematics but also to formal logic, i.e. how to deal with concepts and how to reason with words. For example, one cannot begin to distinguish the intra-systemic from inter-systemic changes without clear definitions of various institutional systems.

The performance issue is in a certain sense contingent upon the compatibility question: there is little point in debating the performance of a set of institutional arrangements which cannot co-exist. Also, in analysing the impact of a given arrangement, one should consider the possibility that it is unavoidably linked to another institutional structure. These necessary links may be called 'functional necessities' (see Chapter 5). Therefore, the full impact of the first arrangement would include the consequences of the second one.

Alternative institutional systems, identified by certain institutional invariants, may differ in the scope of these functional necessities; this has a direct implication for the institutional dynamics. To make a transition from a system which is very rigidly built, i.e. contains many functional necessities, a massive change is needed to reach the 'critical mass'. The compatibility problem is related to the issue of institutional dynamics in another way, too. Internal consistencies within some sets of institutional arrangements may lead to their transformation into more lasting institutional systems. For example, an economic system dominated by socialist enterprises into which freedom of private entrepreneurship were introduced would tend to evolve into a capitalist system (see Chapter 7).

However, the problem of institutional change cannot be wholly reduced to the incompatibilities between the institutional arrangements existing in a given country. Socialist politico-economic systems, though very consistently built, collapsed. So there are other forces of change, including poor performance, which breeds social discontent with a given regime – here is the link between the performance and the dynamics issue. But again this link – poor performance leading to social discontent leading to regime change – is far from automatic. We have witnessed enough long-lasting and economically disastrous regimes, based on fear, isolation and indoctrination to refute such a claim. Growing social discontent due to the poor performance of a regime may be perhaps the necessary condition but is far from a sufficient condition for a massive institutional change. Other forces include the mass perception of new opportunities, related to a vision of an alternative regime. This was the role of religious or quasi-religious doctrines, such as Marxism, which had the power to arouse powerful emotions – hatred or hope – and to give a simple, but not necessarily true, interpretation of reality. Mass media, the mass producers of perceptions, should be included in analyses of institutional change, especially in the second half of the twentieth century, in the age of television. Positive examples of changes in other countries, conveyed partly by the media, constitute another factor which influences the perception of policy makers and the public at large. The adoption of such foreign models brings about cultural diffusion. The wave of market-oriented reforms in the 1990s to some extent belongs in this category.

Other external factors include foreign occupations, if the occupier introduces his own country's institutional arrangements. This explains changes in institutional regimes after the Second World War in West Germany and Japan, and – with very different results – in Eastern

Europe. Finally, in explaining massive institutional change, one should not forget the role of chance factors – unintended consequences permeate history.

There is also the role of particular individuals, whose appearance in a position of leadership is at least partly a chance factor. This factor interacts with long-term forces in bringing about institutional breakthroughs. Such individuals may also play a decisive role in the short period of 'extraordinary politics' which then follows (see Chapter 9). During this period, a special mass psychology prevails, and the institutional constraints are still malleable, so there is much more scope than normal for the operation of a personality factor, i.e. for shaping a completely new institutional regime. Massive institutional change results, therefore, from the interplay between long-term forces related to a former regime in a given country, external influences and chance factors.

## **The Analytical Framework**

This section focuses on the analytical framework which I find appropriate for the study of institutions and human behaviour, and which I have used throughout this book. An analytical framework defines the central variables and clarifies the related methodological assumptions. 'Institutions' (institutional factors) are obviously the central concept. I define institutions as all the non-material and at least relatively enduring factors which are external to the respective individuals and are capable of influencing their behaviour. 'Institutions', therefore, cover neither physical objects nor the biological and psychological features (dispositions or human nature) of individuals. The first exclusion is rather obvious, the second is perhaps more controversial but is analytically very important: only by defining institutions and human nature as separate, although interacting factors, can we clearly explain how changes (differences) in institutional factors lead to changes (differences) in human behaviour and its outcomes. And without the clear assumptions on human nature, the structure and change of institutions cannot be explained.

The institutions of a given country can be divided into three related categories (Balcerowicz 1989):

- (1) The general legal framework and its constituent parts: the Constitution, property law, contract law, company law, electoral law, the penal code, etc. The legal norms on which all these laws are based

are a special type of social norm, i.e., those which are guaranteed by the threat of sanctions from other people. What distinguishes the legal norms is that the sanctions are executed by a special enforcement apparatus which has the monopoly of the use of force and, by definition, constitutes the core part of the state (Weber 1922). The legal framework results from the operation of the political system,<sup>1</sup> and massive changes in this framework mark the institutional breakthroughs we have discussed above.

- (2) Institutional structures, also called formal organizations. Each structure may be understood as an internally connected set of roles. The respective structures may be identified by certain legally prescribed goals and, as in the case of physical persons, by their dates of birth. The types and the shares of existing organizations depend on their legal models, contained in the general legal framework. For example, depending on the ownership law, a country has either a capitalist or a socialist ownership structure (for more on this, see Chapter 7).
- (3) Institutionally determined social mechanisms. They consist, by definition, of the actions or interactions of many people, and their type and properties depend on the general legal framework and on the institutional structures. Examples include democratic elections, which presuppose a wide range of civil and political liberties and – in large societies – the existence of ‘intermediaries’, that is, political parties. In the economic sphere, a centrally important mechanism is the market, which requires a large measure of economic freedom; and, if it is to function well, a developed infrastructure to operate and enforce the law. Markets have two kinds of participants: physical persons and organizations. It is the differences in the latter, especially in ownership types of enterprises, which strongly influence the scope and the properties of a market mechanism (see Chapter 7).

The totality of a country’s institutions make up its institutional system. Based on certain conventional criteria, one can distinguish in it

<sup>1</sup> Different political regimes have different types of legal framework. A socialist state brought a peculiar structure to this framework. The constitutional norms which declared many individual liberties were, in fact, not binding on the state. This was a sort of empty law or facade not to be taken seriously in the analysis of the regime. However, there were regulations issued by the party, which did not formally enter the legal framework, but were in fact laws in the Weberian sense. To reconstruct the really binding legal framework, which mattered for human behaviour, one must, therefore, omit the empty law and add the ‘party law’. In democratic capitalism, in contrast, the formal legal framework overlaps with the Weberian legal framework.

various subsystems, including the political and economic ones. One of the central questions, relating to the problem of institutional compatibility, is what type of political regime can co-exist with what type of economic regime (see Chapter 8).

Turning to the second central factor – human dispositions – I define them in psychological terms (Madsen 1968) as the lasting or relatively lasting features which human beings bring into various decision-making situations, including those which are shaped by institutions, such as the roles of an employee, manager, private owner, or public official. I consider it important to distinguish two different types of human dispositions: ‘invariants’ and ‘variables’. The former is the traditional concept of human nature; the latter, by definition, may differ across countries and time. Both types have motivational and informational dispositions; the informational ones include the capacity to learn.

Before discussing the invariant and potentially variable dispositions, I need to make several comments. First, there is a problem in that ‘dispositions’ belong to individuals, who differ a great deal. In what sense, then, can one speak of ‘invariant dispositions’? Obviously, not in the sense of identical features, but only in terms of what is common to, or dominant among, human beings. For example, people have different capacities for storing information, but each is limited in this respect, and there is a certain upper limit, established by psychology. Each society can be, in principle, described by the statistical distributions of the values of these individual limits and of the other dispositions of its members. The assumption of the invariants conceived in the above terms is crucial in explaining the processes based on mass actions or interactions, such as the operation of market mechanisms or of command planning. Inter-personal variability is, in turn, a necessary premise for explaining the role of the personality factor in social life. For, if people were identical, there would be no scope for this factor. One may try to link the personality factor to more systematic forces, i.e. the rules of selection of individuals to positions or leadership, rules which differ across various institutional systems. This is a worthwhile line of analysis, but one should remember the role of chance factors in the operation of such selection mechanisms and that the related indeterminacy of their results is large. Who, after all, predicted that a personality like Gorbachev would appear as leader of the Soviet party-state?

Also note that institutional systems differ in the type of institutional positions (types of activity) which individuals with some special characteristics may choose, and those differences are important for the use of societies’ motivational and informational potential. For example, in each

society there are some would-be innovators, but the scope they have for displaying their special talents depends on whether their country's ownership law allows private entrepreneurship. Each society contains some individuals who derive special satisfaction from pursuing some non-pecuniary objectives; the scope for the operation of these characteristics depends on the legal possibility of organizing non-profit institutions.

Second, one may question the distinction between the invariant and potentially variable dispositions, by pointing out that societies differ in psychological dimensions. So what, then, are these inter-societal invariants? I am referring here not only to the popular notion of different 'national characteristics', which may be questioned on methodological grounds, but also to the interdisciplinary work using anthropology and population genetics summarized by Claude Levi-Strauss (1983). He described human evolution as a two-stage process. In the first, 'pre-cultural' phase, true biologically determined universals emerged, such as manual dexterity, symbolic thinking, language. In the second stage, different cultures developed in isolated communities and some of their components, such as laws on marriage, hygiene, etc., interacted with the genetic factors in producing populations possibly displaying different distributions of certain types of human nature. However, this possibility does not undermine the case for assuming certain human invariants in the sense of what is common to or dominant among human beings. At least some of these invariants may be linked to the 'pre-cultural' stage. Furthermore, it is an open empirical question as to whether contemporary societies really differ because of the operation of these cultural and genetic forces. First, the past few centuries have brought about a great deal of homogenization of these cultural components which interact with genetic factors. Next, any potential differences may only be a matter of degree, but not of kind. For example, nobody would assume that contemporary societies display qualitatively different types of motivation. Finally, if societies nowadays differ in certain dimensions, then it is more likely to be due to differences in the content and scope of learning in successive generations; and this can be explained by the invariant capacities to learn interacting with the mechanisms of socialization (acquiring values and rules of behaviour) and of education. I will return to this in a while. But now let us turn to the issue of motivational dispositions.

By definition these dispositions shape an individual's preferential ordering of various courses of actions (options) he/she perceives in various decision-making situations, thanks to his informational

disposition.<sup>2</sup> Motivational dispositions may be known, for example, as needs, aspirations, internal norms of behaviour, etc. Of these, needs seem to be the most fundamental in that they determine, for example, the range of behavioural norms an individual may acquire. One can envisage motivational dispositions as consisting of various layers. It is in the most fundamental layer and the dispositions which are its direct products that one has to look for motivational invariants. The other layers may express inter-cultural variability, which is nevertheless constrained by the fundamental motivational layer.

The totality of an individual's dispositions constitute his/her motivational potential, which determines what variables she/he perceives as motivators. A variable is a motivator if a change in its intensity is – to the person concerned – a reward or punishment in a psychological sense.<sup>3,4</sup> Expressed formally, motivators are the arguments in an individual's utility function. The expected differences in their values linked to the various options perceived in a given decision-making situation constitute positive or negative incentives.

The problem of motivational invariants includes the question of the relative importance of the self-centred versus the altruistic orientation. An altruistic orientation is present when a positive change in another person's motivator is perceived as a reward by a given individual (Karyłowski 1982). Expressed formally, motivators affecting other people are arguments in the utility function of a given individual in such a way that their improvement increases the value of this function and their decline reduces it (Collard 1978).

The other people could be an individual's relatives and friends or just strangers. One can speak of 'true altruism' when the other people in this definition are strangers, and of 'limited altruism' when they belong to his/her nearest circle. In both cases, altruism can be weak or strong, depending on the magnitude of sacrifices an individual is ready to make.

The issue of the relative strength of the self-centred versus altruistic orientation matters because each person is frequently faced with decision-making situations which involve moral dilemmas: he/she has

<sup>2</sup> Individuals' decisions and, therefore, their behaviour can be interpreted as resulting from their decision-making situations and their informational and motivational dispositions. Some situations are exogenous, i.e., independent of the actor. Other situations result from their previous decisions. For example, the situations a person faces in his/her professional activities largely result from the previous choice of a type of a job.

<sup>3</sup> Some motivators are of a binary nature, for example, preserving or losing a job; others are continuous, for example, pain or income.

<sup>4</sup> One of the central problems of psychology is to explain the internal process of motivation which produces these states (see Madsen 1968; Hebb 1971).

to choose between options which promise higher values of motivators to him/her, but lower values to other people, and options with the reverse motivational configurations. The assumption that people's dispositions are such that they tend to choose the first type of options, except when others belong to their inner emotional circle, has much stronger empirical backing than any alternative assumption on human motivational invariants (see Karyłowski 1982). Such an orientation can be called an enlarged self-interest.

Another issue regarding these invariants is what type of factors motivate the majority in every society: such motivators can be termed 'universal'. This question goes beyond the assumptions of conventional economics and gives the enlarged self-interest much fuller psychological content.

Psychologists agree that invariant motivational dispositions include primary needs, i.e. dispositions to feel pain, hunger, thirst, cold, sexual drive, boredom, and tiredness (Malewski 1975). Beyond that there is no widely accepted and integrated theory of human motivation. However, drawing on a number of theories (see Madsen 1968), one can point to two other types of powerful invariant dispositions: emotional or psychological needs and the tendency to maintain or increase self-esteem (for the latter, see Koziellecki 1987). It is also worth singling out – from among the primary needs – the need for sensory and intellectual stimulation, which, if not fulfilled, results in boredom (see Hebb 1971).

This disposition helps to distinguish two kinds of effort: one is self-rewarding and the other is not. The increases in the first type of effort demand much more pecuniary stimulation than those in the second. This has clear implications for behaviour in various kinds of jobs.

Self-esteem makes such factors as prestige or career prospects powerful motivators. Besides, it is a disposition which is at least partly related to two important theories of motivation. One of them is the theory of cognitive dissonance (see Festinger 1957; Aranson 1972); This dissonance is a perceived contradiction between a person's beliefs (including his self-image) and the incoming information or his behaviour. Since such an internal state is a punishment, the affected person tends to eliminate it by manipulating his/her beliefs, by selective reception of incoming information or by manipulating the content of this information. This theory is obviously relevant to the discussion of the issue of human informational invariants (see later). It can be fruitfully applied to the analysis of many economic problems.<sup>5</sup> Another theory is

<sup>5</sup> Akerlof & Dickens (1982), and Gilad *et al.* (1987) are some of the few economists who have done so.

that of achievement motivation, i.e., a tendency to value options perceived by the decision-maker to be moderately probable of ending in an outcome widely defined as 'successful' (McClelland 1961). This motivational disposition helps to explain the economic superiority of private ownership over alternative ownership forms (see Chapter 7).

The basic needs, the psychological needs, the need for sensory and intellectual stimulation, and self-esteem jointly generate the set of universal motivators which explain most of individuals' choices both in the economic and non-economic spheres. Some of these motivators may stem from more than one type of invariant disposition. For example, income, a motivator cherished by conventional economics, may matter not only because of its capacity to fulfil basic needs but also because it may serve as a measure of success (Röpke 1977). Besides income, other universal motivators include various kinds of expected effort, factors affecting cognitive dissonance, and variables influencing self-esteem.

The informational invariants of human beings are largely captured by Herbert Simon's notion of 'bounded rationality'. This concept was already implicit in the pre-war 'socialist calculation debate' in the writings of Brutzkus, von Mises and Hayek (see Chapter 4). In contrast, the proponents of various schemes of socialism, headed by Lange, were arguing within the framework of mainstream economic orthodoxy; this explains why they were – until recently – declared victors on 'theoretical' grounds. But it was a peculiar notion of a theory, which blinded its adherents to the rather obvious problems of the real world. The importance of realistic assumptions to human informational capabilities in the analysis of the impact of alternative institutional arrangements was demonstrated by the problems this theory encountered.<sup>6</sup>

Realistic assumptions would include limits to human memory, information processing and learning. They explain, among other things, the unavoidable existence of a hierarchical multi-level organizational structure under command socialism (see Chapter 5). Limits to the pace of learning, given differences in the required scope of learning, explain why different processes of institutional change have different maximum possible speeds, which in turn helps the understanding of such features of the post-socialist economic transition as its two-stage nature, or the tendency for tax evasion to increase temporarily (see Chapters 10 and 14).

<sup>6</sup> The proponents of the theoretical superiority of socialism also based their claims on usually implicit unrealistic assumptions about motivational dispositions, i.e., they either assumed complete altruism or total obedience to the socialist state. Oliver Williamson's (1975) 'opportunism' was thus not considered possible under socialism.

Another type of informational invariant, and one which is not captured by the notion of 'bounded rationality', is the tendency of individuals to engage in intra-personal distortion of incoming information, so as to reduce the cognitive dissonance. This tendency for self-manipulation includes attempts to block the sources of information in conflict with deeply held beliefs, or to distort the information. The extent to which individuals are allowed to engage in such intra-personal informational distortion may be linked to the nature of their institutional positions, and these positions to the nature of the whole institutional system. Strictly hierarchical systems devoid of open competition may be expected to be especially susceptible to such distortion. Hierarchies also produce a strong tendency for inter-personal distortion of information in the relationships between subordinates and their superiors.

Human dispositions may vary across countries and time. The special states of these variables may be called psycho-social peculiarities. This is a theoretical definition which should be distinguished from the empirical question of whether they exist, and how to establish their existence.<sup>7</sup> Such peculiarities may include internalized norms of behaviour towards other people, one's family or one's own future, due, for example, to certain religions, or to traditions passed down over generations. Such factors are often referred to as 'culture'. Another component is the stock of knowledge (human capital). There are two main questions concerning variable dispositions: (1) their role in explaining differences in performance by countries or regions of the same country; (2) their role in explaining or predicting transition from one institutional system to another.

Both problems are subject to much speculation, often in caricatured forms. For example, the poor economic performance of South Korea was sometimes explained by Confucianism, yet Confucianism is often cited as the main reason for that country's extraordinary economic success since the early 1960s. Also, certain countries are sometimes declared incapable of introducing successful economic reforms because of their special culture. To avoid such pseudo-theorizing one should, I think, follow a clear methodological rule: the existence of psycho-social peculiarities cannot *a priori* be ruled out. But their existence should be established empirically, and independently from specific behaviour. Otherwise one

<sup>7</sup> A given psycho-social peculiarity must be a feature of the relevant distribution of the values of a certain individual disposition in a given society, e.g. an especially high frequency of occurrence of high or low values; this high (low) level is usually understood as a special trait. Psychological investigations of the representative samples of various populations would be needed to test the existence of a given peculiarity. For an example of such research, see Shiller *et al.* (1991).

easily commits the fallacy of explaining specific behaviour by the specific dispositions which are deduced from that behaviour.

With respect to how to explain systematic differences in performance, I believe another rule should be followed. An explanation in terms of the interplay between different institutional factors and human invariants should have priority over the explanation in terms of some psycho-social peculiarities. In other words, only if the first explanation proves to be unsatisfactory (and the reference to other easily identifiable factors fails, too) is one justified in searching for an explanation in terms of some peculiarities. But, again, this is only justified if it is empirically possible to establish their existence.<sup>8</sup> And in analysing the impact of institutional variables, one must go beyond such conventional notions as 'capitalist economies', as they mask many differences in the institutional frameworks of these countries.

Throughout this book I try to explain differences in behaviour and performance in terms of the interplay between various institutional frameworks and invariant human dispositions. There is, however, one psycho-social variable which I included in this analysis of economic performance, especially with respect to an economy's innovativeness (see Chapter 6): the level and structure of human capital. There is a two-fold interaction between the type of the economic system and this capital. First, the type of economic system partly determines – via the expected returns to various lines of education – the structure of human capital, i.e. what sorts of skills are acquired in the educational institutions, and the content of the learning-by-doing acquired by graduates in the practice of their professions. Second, the type of economic system determines how the 'new' human capital, a product of the educational system, is to be used. Both issues have important implications for the transition from one economic regime to another. If the inherited general human capital is large but not adequately used under the previous regime, then an appropriate transition makes a rapid increase in the

<sup>8</sup> One of the few studies which meets this condition is the excellent work of Robert D. Putnam (1993) in which he shows that the differences in 'civic culture' between Southern and Northern Italy, which he links to the differences in their history, affected the operation of the regional governments, established in the early 1970s. However, this study is insufficient to establish a general case that certain psycho-social peculiarities are inescapably long-lasting so that they unavoidably and seriously differentiate behaviour under the same institutional framework. Much more extensive comparative research would be needed to establish such a case. Besides, even with respect to Italy, this study omits the possibility that the post-Second World War policy of massive public investment in Southern Italy might have perpetuated the inherited patron-client culture, which distinguishes it from Northern Italy, where such investments did not take place.

utilization of this potential possible, and also provides incentives to close up the gaps in its structure (for more on this, see Chapter 10).

This brings us to the second problem, i.e. how one should treat the issue of psycho-social variables in explaining or predicting inter-systemic transitions. First, one should realize that the assumption about human invariants prohibits a naive belief that a radical change of institutional regime may produce a completely 'new man', a dream of the early socialists. Human dispositions, therefore, should not be treated as epiphenomena of institutions.

I mentioned that the institutional breakthrough may produce a special state of mass psychology for a short time. However, this is not to say that radical institutional change produces special motivational dispositions; this extraordinary psychological atmosphere results from the interplay of certain invariant dispositions and a country's suddenly changed situation.

Second, what about the psycho-social inheritance of the former regime? One of its components, human capital, was already discussed. With regard to the others, there is a general rule which has already been mentioned: the recourse to psycho-social peculiarities is justified if they can be established empirically and independently from the specific behaviour one seeks to explain. This should prevent an easy use of the *homo sovieticus* hypothesis in explaining the post-socialist transition. This hypothesis is contradicted both by the very different transition paths in each of those countries which was exposed to socialism and by direct psychological research. The latter has shown that Soviet and American respondents were basically similar in their attitudes towards fairness, income equality, incentives, and their understanding of the functioning of markets (see Shiller *et al.* 1992). However, even if socialism had left some psycho-social peculiarities, there would still be a question of how one should consider them in structuring the transition away from socialism. And here psychology can be of help, once again. The theory of cognitive dissonance (Festinger 1957) tells us, among other things, that people are more likely to adapt internally to external changes if they are radical and, therefore, perceived as irreversible, than if they are small and thus regarded as easy to reverse (Balcerowicz 1989). This psychological argument strengthens the conclusions which one might have derived from studying 'the constructional logic' of command socialism (see Chapter 5).

It should be emphasized that the analytical framework presented here does not reduce theoretical institutional economics (or, more generally, the study of institutions) to psychology. It is an attempt to gain a better understanding of the structure, impact and change of

institutional arrangements and systems by using inputs from psychological theories, inputs which go beyond the traditional psychological assumptions adopted in conventional economics. The propositions which one can devise by using this framework are not simple replications of the findings of psychology but result from the interplay between the assumptions about alternative institutional structures (or more generally situational factors) and the explicit psychological premises on the dispositions of individuals. This approach, I believe, can give a fuller sense to methodological individualism, which is a central and rightly cherished principle of analytical social science.<sup>9</sup>

## About the Book

This book, including the present chapter, attempts to summarize the research on institutions, institutional change and human behaviour that I have undertaken since the late 1970s. It contains chapters which are based on my earlier writings, published in Polish but not in English, and chapters which largely replicate some of my earlier English publications. All these chapters, although written at different times, were guided by the analytical framework which I have sketched above.

The first part of the book, 'Socialism versus Capitalism', focuses on the comparative analysis of the performance of the alternative institutional regimes. It also discusses problems of institutional compatibility and the related problems of the necessary scope of institutional change away from socialism and the compatibility of various political and economic regimes.

The first six chapters replicate my English publications written in 1988–89. I have only deleted a few small parts in order to avoid excessive repetition. Otherwise, I have preserved the original text – not only in the hope that it has withstood the test of time, but also because some readers may be interested in the ideas on economic systems and their change of an author who was later brought into a position enabling him to direct the economic transition from socialism in Poland in 1989–91. The remaining two chapters were written in 1994 and 1995, but draw on my earlier writings in Polish.

Part II, 'From Socialism to Capitalism', discusses institutional

<sup>9</sup> I would like to acknowledge my intellectual debt to Antoni Malewski, a brilliant Polish social scientist who died prematurely in the 1970s. His 1975 book greatly influenced my thinking on how to study human behaviour under various external conditions, including institutional ones.

change, and focuses on the post-Communist transition, started in the late 1980s. It deals with the political and economic developments and the interplay between them. The chapters in this part are based on my publications written in 1993–95. I tried to blend in knowledge gained during my academic studies and insights obtained while holding a position of major responsibility during the period of ‘extraordinary politics’.

Finally, the third part focuses on Poland’s economic transformation and on the related political developments. Chapter 14 describes the reforms prior to the 1990 breakthrough. It was written in 1988 from the position of an academic. The next two chapters analyse the transition in 1989–93. They are based on my publications written in 1993 and 1994. The book ends with my personal recollections on Poland’s reforms, written from the position of an insider.

In my research on which this book is based, I enjoyed the support of many people. Most of them I mention in the footnotes to the respective chapters. Here I cannot help but express my gratitude to my wife, Ewa Balcerowicz, for her patience, understanding and moral and intellectual support in the whole period when I was dealing with institutions and institutional change, both as an academic and as a policy-maker.

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## **Part I**

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### *Socialism versus Capitalism*

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# 2

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## *Problems with the Definition of Socialism in Today's World*

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In discussing concepts, one is on much shakier ground than when analysing issues of causal relationships, for, in the latter case, reality can provide a filter to separate justified propositions from unfounded ones. This is the well-known Popperian falsification procedure. There is no such possibility in the former case. Definitions cannot be falsified. Only the claims made with respect to objects which are denoted by definitions can in some cases (if the propositions are properly formulated) be put to empirical tests, but these belong to the second category. How then can one distinguish 'scientific' definitions of socialism from 'unscientific' ones?

Without even hoping to give a precise answer to this question, I would suggest that any scientific definition should try to meet three rather modest and related conditions:

- It should not be value-loaded.
- It should not be completely arbitrary and changeable over time.
- It should have a certain rigour.

One can easily give examples of the explicit or implicit definitions of socialism which violate at least one of these conditions. With respect to the first requirement, let us note that there has been a widespread tendency in official language in the communist countries to refer to all kinds of negative phenomena as 'deviations from socialism'. In current

The text of this chapter was written in 1988 and first published in 1991 in *Socialism Today? The Changing Meaning of Socialism*, edited by Ota Šik (Basingstoke and London, Macmillan), pp. 65–74.

discussion in the USSR, some authors refuse to acknowledge that there was ever any socialism there, or at least up until 1985. A Polish author asked the rhetorical question: 'Where is there more socialism: in Sweden or in Rumania?' (Malanowski 1989). I think that behind all these pronouncements there is one general value-loaded concept of socialism as a state of universal happiness.<sup>1</sup> So if some events or developments are clearly negative they do not belong to socialism, they are completely independent of it, or happen despite socialism rather than because of it. Some representatives of this approach are all too ready to recognize Hitler's Germany as an extreme form of capitalism but are loath to acknowledge Stalinism as an extreme form of socialism. For 'socialism' is a sacred word for them.

The second condition implies that one should not remain satisfied with passively listing various definitions of socialism, or giving one's own definition, without stating some criteria which would restrict the uncritical expansion or manipulation of the meaning of this term.<sup>2</sup> In other words, socialism should not be an infinitely flexible concept if it is to have any meaning at all. A certain stability of the conceptual network is required if we are to register the changes in reality correctly.

There have, in my view, been two main reasons why a tendency towards an almost unlimited expansion of the concept of socialism has gained ground in the Comecon countries. First, 'socialism' has been the name of the official ideology of the ruling parties. Facing, on the one hand, a grave crisis in their countries but unwilling, on the other hand, to openly admit the failure of this ideology, some of these parties have recently been proposing radical changes, while claiming that they represent modifications of their (fundamentally unchanged) concept of socialism. This is probably meant to convey the impression that there was nothing basically wrong with official doctrine from the very beginning. Hence the ideological claim to keep power does not suffer too much.

As an example of this expansion of the official concept of socialism, let me quote a passage from the 1987 resolution of the Hungarian Workers' Party: 'The second economy and the private sector are integral

<sup>1</sup> The tendency to define socialism in such a way was noted by Sirc (1974, p. 170): 'socialism is often loosely used to mean a system in which everybody has a good life'. He then adds: 'If that is what it does mean, then we are all socialists . . . .'

<sup>2</sup> This should not be confused with the suggestion that there should be some ideological barriers to the systemic changes in the countries of 'real socialism'. The point is that – at least in scientific discussions – there should be a limit to recognizing just any kind of such changes as falling within the scope of 'socialism'.

parts of the *socialist* [author's emphasis] economy'.<sup>3</sup> Similarly, private agriculture has been recognized, by a special clause inserted in the Constitution in 1983, as an element of the *socialist* economy in Poland.

Along with the authorities, there are also some economists who propose radical changes (for example the introduction of a capital market, including a stock exchange) as a means of restructuring within the socialist economy. This probably reflects the desire to neutralize ideological attacks against such changes, and perhaps to provide some face-saving for the authorities, in the hope that they would then be more willing to accept the arrangements proposed. Muddling the concept of socialism seems to be a price worth paying for a (hopefully) increased chance of introducing them. I have some understanding of the motives of this tendency.<sup>4</sup> But I still think that in the interests of conceptual clarity, there should be some limit to arbitrariness in the use of the concept of socialism, at least in theoretical discussions. An additional reason for this restraint is that it appears doubtful whether the strategy of pushing all kinds of changes under the suitably enlarged umbrella of socialism can be effective, as it probably over-estimates the possibility of fooling its opponents.

## The Uses of the Word 'Socialist'

In discussing the concept of socialism, it is worth distinguishing several broad categories with respect to which the word 'socialist' is often used:

- *Socialist ideals* or the desired states of society. There is a whole catalogue of these ideals, the main ones probably being economic justice, fair distribution of income and wealth, removal of poverty.<sup>5</sup>
- *Socialist economic systems*, that is certain types of country-wide arrangements regulating economic life.
- *Socialist doctrines*, that is, sets of propositions which aim at explaining how and why socialist systems are to emerge,<sup>6</sup> or focus

<sup>3</sup> Another interpretation is, however, also possible: that is that the word 'socialist' is meant to imply that although the private sector will be allowed to grow, it will have to remain in a minority (quoted as in Szelenyi 1988, p. 42).

<sup>4</sup> A similar approach consists of arguing that certain categories (for example, profit, market commercial banking and so on) previously considered to be 'capitalist', emerged long before capitalism. Thus they are not specifically 'capitalist' and are therefore acceptable in 'socialism'.

<sup>5</sup> For various formulations of socialist ideals see: Kolakowski & Hampshire (1974).

<sup>6</sup> Here, Marxian historical materialism is the main case in point.

on describing the properties of these systems and of their (allegedly) superior performance, including their special ability to realize socialist ideals.

- *Political parties and other organizations* which call themselves 'socialist' or profess allegiance to socialism.

An obvious point is that one should be extremely careful in any attempt at deriving the definition of the socialist system from the official programmes and pronouncements of the institutions included in the fourth category, otherwise one may easily fall victim to the political manipulation of concepts. I have already mentioned this danger while speaking about recent pronouncements of some ruling parties in the Comecon countries. But a similar danger exists with respect to organizations in the West which fall under the fourth category. There, the rules of the electoral game seem to be such that it is much easier to change the programme than to own up to it by changing the name of the party or that of its ideology.<sup>7</sup> The Spanish Socialist Party, which carries out a 'Thatcherite' economic policy, may serve as an example.

Another point is that one should avoid *defining* socialist economic systems in terms of the high degree of achievement of socialist ideals (and of other good things). Instead, they should be defined in terms of some institutional characteristics. Failure to respect this requirement leads to value-loaded definitions of socialism,<sup>8</sup> which, as I have already noted, should be rejected on methodological grounds. But there is another methodological reason for conceptually separating the socialist ideals and the socialist systems: only then the link between the two is a matter of theoretical and empirical analysis and not of mere definition. Such analyses may reveal that certain socialist ideals, for example narrowing income differentials, are realised to a large extent under some capitalist systems. Taiwan seems to be a case in point here (see Tsiang 1988). In order to be open to such findings, the believers in socialist ideals should free their minds of socialist doctrines which postulate a rigid link between certain institutional arrangements and a certain type of economic result.

<sup>7</sup> It may well be that changing the name of the party is like changing the name of the firm: in both cases there is a risk that because of the resulting confusion, some 'customers' may be lost.

<sup>8</sup> One example of this approach seems to be Lisichkin's proposal that 'criteria for the existence of socialism should be . . . such . . . as the level of labour productivity, the level of living standards, the level of welfare (for example infant mortality and life expectancy), and the extent of democratic freedoms' (quoted in Ellman 1989, p. 3).

## Socialist Economic Systems

I will now focus on socialist economic systems. I have argued that they should be defined in terms of some institutional characteristics. But in which institutions should we see the distinctive features of these systems? What should be the criterion for choosing such institutional arrangements? I would suggest that in order to avoid arbitrarily stretching the concept of socialist systems, the basic criterion should be the preservation of at least some central elements of its original meaning. On this assumption, most of us probably agree that the distinctive feature of the socialist economy (one which gave rise to the very term 'socialism') is that it is based on the social ownership of the means of production.<sup>9</sup> The concept of this ownership is by no means clear and would require a longer discussion.<sup>10</sup> But whatever it means, it does not encompass private ownership. Indeed, social ownership was meant to be – in some sense – the opposite of private ownership.

There are two main reasons why it was proposed to replace private ownership with social ownership:

- Income derived from private ownership (property income) was considered to be 'unearned'. Only 'labour-income' was recognized as legitimate.<sup>11</sup> An unfortunate effect of this attitude is that instead of being concerned with the overall income differentials, regardless of their source, one may become obsessively pre-occupied with just one type of income, branded as an expression of exploitation.
- Private ownership of the means of production was regarded as the institutional basis for the free competitive market, which in turn

<sup>9</sup> One major exception from this definitional assumption is the definition of the socialist economic system solely in terms of the large extent of redistributive measures as performed by the welfare state. It is in this sense that, for example, the term 'Swedish socialism' is used. Such a usage was criticized by Diehl (1926, p. 580), who argued that it confuses the socialist order with the social reforms carried out under capitalism. *The Economist* seems to be of the same opinion when it says that 'the Social Democrats' model of society' is a 'welfare capitalism' ('New Paths for Socialism', 1985).

<sup>10</sup> I have tried to clarify this and the other concepts of ownership elsewhere (see Chapter 7 and also Balcerowicz 1987).

<sup>11</sup> The assessment of the various sources of income (and of income differentials) is always a value judgement, and this obviously applies to the socialists' appraisal of property income. In Marxism, however, this negative assessment is presented as though it were a scientific finding, when in fact it is simply based on Marx's arbitrary definition of 'surplus value'. For penetrating comments on this, see Sowell (1980, pp. 225–7).

was condemned as a wasteful and extremely inefficient mode of coordination in the economy.<sup>12</sup>

At the same time it was held possible to replace spontaneous market coordination by some superior, conscious harmonization of economic activity, that is, by overall economic planning. In this interpretation, the case for the replacement of private by social ownership is thus derived from the perceived link between the former and the free market, and from the belief that market coordination can be replaced by some superior non-market coordination. In this view, the core of the socialist economy is the overall economic planning, which substitutes for the market, and private property is condemned *because* it makes such planning impossible by giving rise to spontaneous, anarchic interactions in the economy.

This interpretation is typical of the majority of the early socialists, and it is central to Marx's vision of the socialist economic system.<sup>13</sup> What seems to me to be crucial in Marx's perception (or definition?) of private ownership of the means of production, is the 'separateness' of the respective producers, a feature which leads to their interacting in such a way that the 'anarchy of production', that is, the competitive market mechanisms, is the result. Indeed, this separateness appears to be the main reason why private was to be replaced by social ownership.<sup>14</sup> Hence any concept of the latter which would entail this separateness runs against the very core of Marx's vision of socialism. His hope might have been that harmonious non-market coordination could be achieved without centralization; by the free cooperation of the autonomous producers. But we know that this is impossible in any complex economy.<sup>15</sup> For in order to suppress the market, one must restrict the autonomy of enterprises, and this in turn creates a vacuum which must

<sup>12</sup> It is worth stressing that for most of the prominent early socialists (including Marx), it was the free competitive nature of the market, that is economic rivalry, which was viewed as the main evil, as the main source of disturbances in the economy. Market competition is thus incompatible with the socialist tradition. For the presentation of the views of some early socialists, see Kernig (1979). Their view of the free, competitive market was thus the exact opposite of Adam Smith's vision of the 'invisible hand'.

<sup>13</sup> In describing Marx's views on socialism I am largely drawing on Kloc (1980, pp. 1–160). For a similar interpretation to that contained in this work, see Nove (1983, pp. 1–60); Lavoie (1985, pp. 28–38).

<sup>14</sup> In support of this view, one may recall that Marx considered the growth of capitalist joint-stock companies to be an element of transition between capitalism and socialism because they were increasingly replacing the market mechanism by planned, non-market coordination.

<sup>15</sup> For a penetrating critique of the Utopian nature of the proposals for non-market, and at the same time non-hierarchical, coordination, see Lindbeck (1977).

be filled by centralist planning. Therefore, regardless of what Marx's dreams were, the only real form of social ownership compatible with his vision of socialism as a market-less economic system, is centralized state ownership. 'Real socialism' (and further, 'war communism') is thus in this respect in basic agreement with what Marx's vision of socialism really contains.<sup>16</sup> We may somewhat ironically look at it as an instance of the product becoming alienated from its producer.

### **New Models of Socialism**

The disillusionment with the performance of the traditional Soviet-type economic system has given rise, in the countries burdened with it, to a search for new models of the socialist economy. There is no room here to discuss the evolution of these models. Let me just note that a significant step in this process was the presentation by Brus in 1961 of the 'decentralized model', whereby the decisions regarding current operations would be largely decentralized while the centre would retain direct control over new investment. This kind of model appears to have constituted a basic 'reform paradigm' in the 1960s and 1970s in Poland and Hungary; it was also popular in Yugoslavia (Ellman 1971, p. 20). The model constituted a partial departure from Marxist socialism, since it allowed some elements of the market to slip into the regulation of current production. But it could still be defended on Marxist grounds, as investment decisions were to remain largely the domain of central planning.

Today, however, most of the reform economists are rightly sceptical of the merits of investment centralization (this includes Brus, 1988). The prevailing view now is that efficiency enhancing reform must involve the introduction of genuine market mechanisms, which would include a capital market. However, most of the schemes presented so far still preserve the dominance of the social ownership of the means of production. This is why they are often regarded by their authors or

<sup>16</sup> It is sometimes objected that 'real socialism' offers no clues with respect to the performance of Marx's model of socialism, as Marx predicted that socialism would emerge in the most developed countries, but instead it was introduced into a backward state. But this argument completely misses the point. The problem is not only that the predictions were falsified by historical developments. The point is that if the attempt to introduce Marxian socialism had actually been undertaken in the most developed countries, it would have fared even worse, since the efficiency of hierarchical, non-market coordination declines with the growing complexity of the economy.

commentators as representing the 'socialist market economy'. This, however, provokes comment.

First of all, it should be noted that if such schemes are still to be regarded as socialist,<sup>17</sup> then they certainly belong to the non-Marxist variety.<sup>18</sup> For in a Marxist perspective, 'market socialism' is a contradiction in terms, and ownership is, in my interpretation of Marx, social to the extent that it overcomes the separateness of the producers, that is, their spontaneous market-type interactions.

Consequently, once one abandons the Marxist case against the market, one should also be ready to revise one's ideologically motivated hostility towards private ownership of the means of production.

But my reading of the schemes of market socialism is that for most of their authors and proponents, the adjective 'socialist' and the related insistence on social property do not express any ideological commitment. Rather, they express the perception of what is politically permissible and what is not. However, given the recent changes in the socialist camp, this may be to err on the side of excessive caution.<sup>19</sup> This is why I think that the set of the economic system envisaged should not be constrained by an *-ism*, and that reform discussion – at least among economists – should not be concerned with whether the respective schemes still comply with socialism. Instead, attention should be paid to their potential performance and their capability of solving the grave economic problems of the socialist countries.

<sup>17</sup> The following passage from Ludwig von Mises (1951, p. 141) shows that the schemes discussed, involving the decentralization of investment, represent a radical departure from what was traditionally understood by 'socialism': 'if it is to remain socialist, the socialist state cannot leave to other hands that disposition of capital which permits the enlargement of existing undertakings, the construction of others and the bringing into being of undertakings that are completely new. And it is scarcely to be assumed that socialists of whatever persuasion would seriously propose that this function should be made over to some group of people who would simply have the business of doing what capitalists and speculators do under capitalist conditions'.

<sup>18</sup> Indeed, some of the aforementioned schemes remind us of certain 'Utopian' socialists (for example, Owen or Lassalle), who advocated an economic system based on producer cooperatives.

<sup>19</sup> As an indication, let me cite the recent Polish discussion on the private sector in which many economists demanded that the limit on employment in a single private firm should be raised, and proposed various figures for the new limit. But then, after the change in government in 1988, a law was passed in January 1989, which abolished this limit altogether!

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# 3

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## *On the 'Socialist Market Economy'*

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The search for models of a market economy in the socialist countries with relatively the most reformed economic systems (Hungary, Yugoslavia, Poland) reflects the disillusion with their performance. They are rightly considered to be basically non-market systems, and this is thought to be the main reason for their disappointing results. On the other hand the adjective 'socialist', if it occurs at all in the reform debates, is then usually used to denote that the proposed market system should be different in some respects from capitalism. Thus we get the first approximation of where to locate a 'socialist market economy'. It should depart even further from the traditional Soviet model (i.e. further than the most reformed socialist economies actually did) but not as far as to fall within the scope of capitalism.

The second approximation is obtained after specifying what changes in the relatively most reformed socialist systems are necessary to transform them into 'market economies'. This obviously depends on what is meant by the term 'market economy'. In my view it is an economy where the market mechanism is the dominant mode of coordination in the sphere of private goods, that is, goods which can be distributed among individual users. A market mechanism is, by definition, a horizontal mode of coordination between supply and demand. This rules out any administrative interference in the terms of specific transactions, e.g. administrative prices or administrative rationing. The demand is thus not constrained by any official quotas and its changes can freely express themselves in prices. Furthermore, the

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supply is free to adapt to a changing demand, both in the short and in the longer run. The latter presupposes that the investment decisions are largely decentralized. Assuming that the decentralized investments cannot (and should not) be wholly financed out of the enterprises' retained profits, we conclude that the market mechanism includes some form of capital market, i.e., market for longer-term loanable funds.

There are still many elements of the most reformed socialist economies which are in clear contradiction with this description of the market mechanism, e.g.:

- the remnants or substitutes of the command or rationing mechanism, e.g. predominantly administrative allocation of foreign exchange, open or disguised administrative intervention in the structure of production and foreign trade,
- pervasive price controls,
- bureaucratic restrictions on enterprises' entry into new markets,
- massive inter-enterprise redistribution of financial means via the budget,
- party-state 'nomenklatura' for the appointment of the managers of enterprises, banks etc.

The transformation of socialist systems into market economies must, therefore, involve the elimination of these elements.

The third approximation is obtained after determining in what respects the socialist economy is different from the capitalist one. There is no unanimity on this issue. The differences largely stem from the varying propensities of different authors to stretch the concept of socialism in such a way as to be able to – seemingly – invalidate the criticism of it, or its earlier versions; at the same time, they often propose some radically new arrangements while claiming that they are still within the – suitably enlarged – framework of 'socialism'. The former tendency is usually motivated by unwillingness to concede defeat in the debates over the possible performances of socialism and capitalism. The latter often reflects the desire to neutralize the ideological attacks against the proposed changes. Muddling the concept of socialism is probably thought to be a price worth paying for the – hopefully – increased chance of introducing new arrangements. I have some understanding for the motives behind this tendency. However, I still think that in the interest of conceptual clarity there should be some limit to the arbitrariness in using the concept of socialism, at least in theoretical discussions. (This should not be confused with the limit on proposing changes with respect to socialist systems.) An additional reason for this

restraint is that it appears doubtful whether the strategy of pushing all kinds of changes under the suitably enlarged shield of 'socialism' can be effective, as it probably overestimates the possibility of fooling opponents.

In order not to be arbitrary in the attempt to limit the arbitrariness in defining a socialist economy, I propose the following mental experiment: one should stop widening this concept at the point where its further expansion would provoke the greatest surprise among the most prominent early theoreticians of socialism, if they were alive. On this principle most of us will probably agree that socialism is *not* based on the classical private ownership of the means of production, i.e. an ownership whereby an enterprise is solely or largely owned by private persons other than the people working in it.

There are a number of models which appear to respect the above formulated restriction and which, at the same time, could be market systems. I can mention only the main ones here.

1. *Illyrian socialism*, or in other words genuine labour self-management of the Yugoslav type. 'Yugoslav' means that workers' rights to control an enterprise are not based on their shares in that enterprise, while 'genuine' emphasizes that – as distinct from Yugoslav practice – there is no hidden party–state control over the enterprises' managers (especially no nomenklatura).
2. *Workers' property*. Enterprises in this model are not only controlled by their employees but are also wholly owned by them, i.e. there are shares which belong entirely to the people working in a given firm.<sup>1</sup> Hence this is *property-based* labour self-management. One of its variants is cooperative socialism: the workers' enterprises take the form of classical producer cooperatives, where each member has equal formal rights in running the enterprise regardless of his share in its assets. Cooperative socialism is an old idea advocated by some prominent socialists (especially Ferdinand Lassalle) in the nineteenth century. It was, however, sharply criticized then by self-proclaimed 'scientific socialists' (Marx, Engels and their followers). Another variant of workers' property would allow the voting rights to rise with a worker's share in the enterprise's capital. However, this 'intra-enterprise capitalism' may be found to overstep the boundary of socialism.

<sup>1</sup> The shares, however, cannot be freely traded, as this would turn the workers' property into classical private ownership. The stock market with its various motivating and information functions has, therefore, no place in this model.

3. *Leasing the 'social' capital.* In this model natural resources and fixed assets are formally national property but are placed against the payment of rent at the disposal of private individuals or groups of people;<sup>2</sup> these people are then supposed to act as independent entrepreneurs. Such a concept of market socialism was proposed as early as 1922 by Boris Brutzkus, an outspoken critic of Marxism. Tibor Liska's 'entrepreneurial socialism' is another example (1982).
4. *Capitalist institutions without private capitalists.* This refers to the conception of an economic system in which enterprises would have the legal form of joint-stock companies owned by some non-private institutions. There would also exist a stock exchange on which the latter could buy and sell shares. Depending on what institutions are to be shareholders we get some more specific models. One of them heavily emphasizes the role of state holdings.<sup>3</sup> Another proposal additionally admits non-administrative institutions like banks, municipalities, universities etc. (Świącicki 1988).

One can envisage still another variant, where each enterprise is predominantly owned by some other enterprises, a minority share belonging to its own personnel as represented by the workers' council. Each enterprise would have a board of directors which, among other things, would nominate the professional management and which would represent the enterprise's shareholders, i.e. its own personnel and other enterprises. Each enterprise would derive some income from the dividends paid out by other firms, and thus would hopefully pressurize them for increased profits. In this way profit-orientation could perhaps be instilled in non-private firms.

5. *Mixed systems.* The above are pure models. However, one can also combine them in many different ways, e.g. by having workers' property and leasing in different sectors of the economy. Another type of mixed system is obtained when one allows the private sector to enter the scene. Yet the assumed concept of socialism condemns this sector to a marginal role, although it is impossible to say precisely at which point a further growth of this sector is already incompatible with that concept. In any case, if we accept it, then we are justified in being surprised when the economic successes due to the enlargement of this sector in the still predominantly socialist economies are attributed to socialism.

<sup>2</sup> These groups, however, do not have to be identical with the enterprise's personnel. Otherwise the leasing solution would fall within the scope of Illyrian socialism.

<sup>3</sup> This solution has been advocated by Márton Tardos.

Space permits me only a few general remarks on the above-mentioned models. Let me first suggest that three questions be posed.

First, is it possible to pass from socialist systems to these models, and what should the transition path be like? This question includes such important issues as how to overcome the resistance of those vested interests which are against a radical economic reform, or how to get rid of shortages without relapsing into high open inflation.

Second, if it were possible to introduce the envisaged systems, could they last? To put the question another way, do they not have some in-built tendency to transform themselves into some other system? I would venture a guess that these systems could last if their conceptions were suitably completed. This means, for example, that they would have to include a ban or at least severe restrictions on the foundation and development of enterprises with different legal forms than the ones on which a definition of a given system is based. The envisaged systems are thus characterized by what may be called a *closed* or *monopolizing* domestic property law.<sup>4</sup>

Finally, if these systems could be introduced and if they could last, how would they perform? Here one should first of all point out that it is difficult to make firm predictions, because the envisaged systems do not have any real counterparts so far. The propositions one can formulate are based, therefore, on very imperfect analogies with some parts of capitalist economies (e.g., the state holdings in Italy's public sector), on theoretical models which cannot be falsified for lack of empirical data (see the vast literature on Illyrian socialism), or finally on simple intuition and common sense. Interestingly enough, one can make much firmer predictions on how the socialist economies, with their relatively high human capital, would perform under capitalism. There are enough comparative studies (e.g. Czechoslovakia–Austria, Hungary–Austria, GDR–FRG) to warrant the conclusion that the overall efficiency of these economies, and consequently the average standard of living of their population, could be much higher than under their present system – albeit at some social cost, especially the danger of open unemployment.

However, one can still offer some conjectures on the performance of the envisaged schemes, assuming they could be introduced and that they would last. Each of them requires a separate treatment. Here I can make only a few points. It seems possible that at least some of these schemes could raise the overall efficiency of even the most reformed socialist economies. Such schemes would increase the autonomy of

<sup>4</sup> For more on this, see Balcerowicz 1987.