



Market Failure

A Guide to the Eastern European “Economic Miracle”
by Laszlo Andor (contributor), Martin Summers (editor)
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Take-Aways

- The economic experiment in Eastern Europe disenfranchised the region’s lower classes.
- World financial institutions, such as the IMF, have implemented case by case financial solutions in a part of the world that requires regional solutions.
- Lack of traceable ownership of real property is a problem in Eastern European economic reform.
- Structural adjustment programs seek to liberalize, privatize, and deregulate the economies of countries that want western loans.
- Eastern European economic programs want to privatize state-owned industries.
- The cold peace is the economic remains of the cold war.
- Market Maoists’ undeclared goal is to permanently destroy the reform capacity of communist governments.
- Market Maoists care about the means of economic reform, not the ends.

Rating (10 is best)

Overall	Applicability	Innovation	Style
7	3	8	7

Review

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Contributor Laszlo Andor and editor Martin Summers review the implementation of economic reforms in Eastern Europe. They present a strong critical analysis of the effect of economic reforms on the people in the post Soviet bloc countries. In great detail, they cover the fight to implement Western financial investment policies in order to break communist political legacies. The authors express their dissatisfaction with the results of reforms in the last decade. This is an important book for individuals who want another perspective on the rush to implement western financial policies globally. However, the book assumes some strong background knowledge of the region's political history and the financial concept of globalization. *getAbstract.com* recommends this book to anyone who does business in Eastern Europe or who is intrigued by the politics of economic reform.

Abstract

Structural Adjustment Loans and Economic Experiments

An economic experiment is being conducted in virtually all post-communist countries: the transformation of Soviet-style economies into modern, market-based economies. This transformation, called "structural adjustment," is policy-based lending from international financial institutions with the consent of the national governments receiving the loan money. The first structural adjustment program is traceable to Turkey in 1980, when the World Bank agreed to lend the government \$200 million in exchange for specific policy measures. Since then, the number of structural adjustment loans has increased, as have their policy-making invasiveness.

Since 1989, countries in Eastern Europe and the former Soviet Union have been asked to accept aggressive internal policy changes as a condition for receiving structural adjustment loans. Eastern Europe can test this experiment by assessing the success – or failure – of these loans in transforming national economies, and by the impact of these internal policy changes on the people in these countries.

Specific changes to internal economic policies include:

1. Currencies should be fully convertible.
2. Controls on the import or export of capital or foreign exchange should be ended.
3. State price controls should be liberated; government spending should be reduced.
4. Unprofitable public enterprises should be privatized.
5. Exports should be increased and imports decreased through market forces.

The goals for implementation of structural adjustment programs are macroeconomic stabilization, increased productive investment, and a return to economic growth. The general objectives toward those goals are liberalization, deregulation, and privatization of state-controlled functions. Inherent in the implementation of structural adjustment programs is the belief that the wealth generated will trickle down to all social classes, although some critics do not agree. The poor are also asked to make adjustments that the rich do not have to make.

Critics also have environmental concerns. Natural resources are being harvested to pay debt service, instead of being used for productive investment. This non-sustaining cycle depletes national resources. Meanwhile, global production methods are replacing local

"Losses are socialized; profits are privatized."

"The chronic inferiority complex of Eastern European political elites has been a constant feature of modern history."

"In theory, private firms which perform badly will die. In practice, they are often resuscitated with social resources."

"The West has tended to treat the post-communist world as a new frontier opened up for the exploitation of raw materials and cheap labor, and as a playground for economic theorists."

production on agricultural lands. Agrarian lifestyles are disintegrating without adequate alternatives, and farm productivity has dropped. Thus legions of people are without sufficient food and have lost their livelihoods.

The Cold Peace and the Great Bourgeois Revolution

The Cold Peace is an outgrowth and economic remnant of the ideological Cold War between the Soviet Union and the United States. Following the collapse of communism, the west invested in eastern national economies only if those nations accepted Western prescriptions for change. The International Monetary Fund (IMF), the European Union (EU), and the European Bank for Reconstruction and Development (EBRD) played significant roles in the transformation. These organizations believe that anything associated with the old system is automatically discredited. This belief has led to largely theoretical diagnoses and therapies for the stabilization and adjustment of Eastern Europe. These theories are based on orthodox neo-liberal economic ideas, which tend to treat the “post-communist world as a new frontier for the exploitation of raw materials and cheap labor.” The impact of implementing these theories is falling short of the hoped for transformation to stability and consolidation. Now, economic policy has created open conflict – the Cold Peace – between the two blocs instead of laying a “foundation for peaceful economic and social development.”

The Great Bourgeois Cultural Revolution is the ideological framework underneath the reforms first instituted in 1989. Leading the ideological charge are the Market Maoists, who believe that political reform is more important than economic results. Since the West wants to make reform irreversible – to prevent communism from ever resurfacing – negative economic consequences resulting from implementation of the reforms are acceptable.

Like Maoists before them, Market Maoists are not above dispossessing substantial portions of a country’s population to achieve their goals. Market Maoists consider this carve-up of social assets and redistribution of power to be a proper function of a market economy. The establishment of private property, regardless of who owns it, is necessary. However, this acknowledgement reinforces the ideological framework of western economic reforms. This problem is painfully apparent in the former Soviet Union, where warring factions compete for privatized or liberalized portions of the economy. These new elites, bargain with “each other and with the residual state bureaucracy for market shares and subsidies.” Market Maoists pursue ideology as more important than mediation of reform measures. This approach encourages fragmentation and disintegration of the eastern economies.

Price Wars, Wealth and Nouveau Nomenclatura

Market Maoists see price liberalization as a primary reform. This involves, “the removal of market regulation of all kinds.” That includes wages and regulations on safety, trade and policing, all of which affect prices. The drive for price liberalization stems from the classical belief that real markets are competitive and that the more “liberalized the economy, the more successful the country can become.” This theory holds that the market — over time – will correct any problems that surface as a result of price liberalization.

Price liberalization and privatization open the door to the accumulation of great individual wealth in post-communist economies. The theoretical core of privatization is that private ownership creates incentives to be efficient that are lacking in public enterprises. In practice, privatization is more directly focused on benefiting speculative investors or expanding monopolistic power than on creating efficiency or building public trust.

“A particularly dangerous fallacy now becoming increasingly popular in some East European societies is the idea that there is some kind of trade-off between democracy and freedom today and prosperity tomorrow.”

“The underlying crisis in the Eastern economies emerged because the centrally planned system, even in a more or less modified form, had consumed its own internal resources and had become incapable of developing new capacities.”

“Dissatisfaction with the quality and quantity of food supply was one of the most potent factors which undermined the social legitimacy of the totalitarian system.”

“We can conclude that the period of the late 1980s and early 1990s has been one of disintegration.”

“The whole Market Maoist model should be rejected and public services should be restructured within a comprehensive strategy for the management of the whole economy.”

“One clear outcome of the globalization of financial markets is that nowhere is far away any more. What happens in Moscow, Mexico, and Algiers will affect everybody, everywhere. This much is absolutely clear.”

The problem with privatization in eastern economies stems from the forces charged with accomplishing the transfer of power. In post communist economies, this has fallen into the hands of those who became rich when they criminally controlled “the supply of goods during those declining years of the old system.” Hence, official statements about privatization are at great variance with its real effects on the population. The Russian people clearly detest privatization, believing that the transfer of power to criminal groups has created a new form of feudalism. Privatization’s proponents dismiss this belief primarily because western creditors agree with it.

Problems have surfaced, but correction has not yet occurred. In the Eastern economies, inflation is the greatest problem associated with price liberalization. Polish and Russian post-liberalization inflation is far greater than analysts anticipated. Poland and Russia have weak fundamentals, and when markets were liberalized, inflation accelerated without control, and beyond predictions. This, in turn, facilitates the collapse of the country’s economy. Instead of looking inward, Market Maoists blame the failed communist economic system.

Scissors, Polarities, and a Left Turn

The deteriorating quantity and quality of the food supply in eastern countries is the most potent factor in dissatisfaction with the totalitarian system. Food production and consumption have declined since 1989. These declines in production, consumption, and health are attributable to changes in property relations, market forces, and technology.

Price scissors prevent farmers from making a profit by producing food. A price scissors occurs when increasing capital outlays intersect falling real prices in a saturated market. Western economies address price scissors through intervention in free markets. Market Maoists, however, still say they support the idea of a “global free market in agricultural products.” This rhetoric helps Western economies protect their own agricultural markets by dumping surplus food products in eastern countries. Market Maoists however, still supply ample rhetoric supporting the idea of a “global free market in agricultural products.” The United States for instance controls “forty percent of the world wheat market, sixty per cent of the market in corn, seventy percent in soybeans.” Western economies use intervention and Market Maoist rhetoric to dump surplus food products in eastern countries to protect their own markets from price scissors.

The primary changes in property relations are the disbanding of collective agriculture and the nearly futile attempt to identify private property rights. Many instances exist where people who are not farmers have reclaimed land that their ancestors farmed, thereby displacing people who were actively farming.

Decreases in food production and food consumption are not the only signs of economic failure. High unemployment is also rampant in eastern economies. Measuring unemployment against the concrete standard of poverty makes it clear that the standard of living in the former Soviet Union countries has decreased since the implementation of economic reforms. Blue-collar workers are making the greatest sacrifices during the transition to a free market system. The statistics also show a gender bias: women with children, working women, and young women have fewer options in the market economy. This is due to a loss of state sponsored childcare, ideological emphasis on females working in the home, and the growth of “conference tourism.” Market Maoists dismiss consideration of these problematic results of reform, holding to the belief that economic growth helps everyone eventually.

“Of course, the idea that abandoning democratic values will lead to prosperity is not only morally but also empirically wrong.”

“Social democracy is not dead; it is merely suffering from a mid-life crisis.”

The overriding problem of the transition to a market economy is integrating eastern economies into the west. Initially, this integration hit several bumps including the recession in the 1990s and the absorption of East Germany into West Germany. Integration of remaining eastern economies into the EU is not proceeding as rapidly, due in part to the differing performance levels of post-reform eastern economies.

Integration could follow any of several scenarios.

- New regional blocs may form in East Central Europe (Poland, the Czech Republic, Slovakia, Hungary and post-war Croatia and Slovenia), Southeast Europe (Romania, Bulgaria, Albania, Rump Yugoslavia, Macedonia and Bosnia-Herzegovina) and European CIS (Russia, Belarus, Moldova and the Ukraine). Formation of any one, or all three, of these blocs is possible based on historical cooperation. The first block is the most likely to form because of East Central Europe’s existing close cooperation with the EU.
- A smaller, less integrated, bloc of newly industrialized countries (NICs) may form. This is a less stable option.
- Complete integration into the EU is the most optimistic and stable outcome.
- Further balkanization may occur, in the event of a return to the vast social and ethnic hostilities and unstable political institutions of earlier decades.

The Future

The short-term future calls for incremental shifts from dogmatic to pragmatic approaches. The long-term future calls for complete rejection of the Market Maoist model. In its place, a comprehensive strategy for management of the whole economy needs to be developed.

Immediate investment in people is critical. Privatization of health and education should be resisted, and all other attempts to privatize industries should be assessed upon specific merits and not reform rhetoric. The “informal” economy needs to be rethought, and the tolerance for organized crime rejected. Public investment in improving rural infrastructure is crucial. Politically, clear means of integrating east and west economies should be articulated. Finally, the problem of East European international debt needs creative solutions.

About The Authors

Laszlo Andor is a lecturer at the Budapest University of Economic Sciences. Martin Summers is a former East European Desk Officer for the Catholic Fund, and an Overseas Development and East European Project Worker at the New Economics Foundation.

Buzz-Words

Applied economics / Cold peace / Cold war / European Bank for Reconstruction and Development / International Monetary Fund / Invisible hand / Market Maoists / Market socialist / Nomenklatura / Policy based lending / Price scissors / Socialist market economy / Structural adjustment program