Dismantling the Command Economy in Eastern Europe
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FOREWORD

The third yearbook of The Vienna Institute for Comparative Economic Studies, published under the imprint of Westview Press, contains a selection of papers and studies elaborated during 1990 by the Institute's staff researchers and visiting scholars from both East and West. Within the time span of less than one year the political framework in Europe has completely changed, proffering new opportunities, but also confronting Europe and the world at large with new challenges. The collection of papers presented in this yearbook focuses on economic problems related to recent changes in the countries of the former Eastern Bloc and Yugoslavia, thus contributing to better understanding of the difficulties of economic transition which these countries must currently face.

I would like to express my special thanks to Peter Havlik for the compilation and editing of the present issue of the yearbook.

Friedrich Levcik

ACKNOWLEDGMENTS

The revolutionary changes occurring in Eastern Europe since the fall of the Berlin Wall set into motion processes which make it extremely difficult even to keep abreast of, let alone to analyze in depth, ongoing economic developments. The editing of this yearbook was thus a particularly challenging and difficult task. The authors, presented at the end of this volume, deserve my special thanks. The book could not be ready for publication without the editing help of Fred Prager and the text processing of the camera ready copy by Renate Szumilowski. Both have performed their tasks with usual precision and speed. Carolyn Richards of Westview Press has helped to ensure that the publication of the yearbook followed within the shortest time span possible under the circumstances.

While I express my thanks to all who have helped to prepare this yearbook, I take the responsibility for all remaining errors and shortcomings.

Peter Havlik
INTRODUCTION

Peter Havlik

Since the fall of 1989 sweeping changes have occurred in all of the countries of the former Eastern Bloc. Mounting economic difficulties, combined with the effects of perestroika and glasnost' in the Soviet Union, have not only contributed to the collapse of the power monopolies of communist parties in all countries of the region, but have, as a consequence, changed the whole postwar order established in Europe. Contrary to numerous failed attempts at reforms in the past, which focused largely on perfecting the traditional mechanism of central planning under the control of the one-party State, the democratically elected governments in most countries of Central and Eastern Europe now express their wish to dismantle the traditional command systems, and to replace them with fully-fledged market economies based on pluralistic property forms and democratic political institutions. A "return to Europe" – in the economic context understood largely as an opening of the country towards trade and more economic contacts with the West – is high on the agenda in all post-communist countries. These – historically unprecedented – strategic aims are being pursued with varying vigor in each of the countries under review, since both their historic traditions and starting conditions for a successful transition differ widely. Theoretical and practical aspects of current attempts at dismantling the command economy are analyzed in this volume both from generally theoretic, problem-oriented, and country-specific perspectives.

General Issues

There is a broad consensus that a return to communist dictatorship of the old sort is rather unlikely in the countries of Eastern Europe.
Contrary to the disintegrating Soviet Union, where future developments in individual republics may go virtually in any direction, the new democracies in Eastern Europe need not fear the danger of a communist coup d'etat, but rather they must learn how to cope effectively with the difficult legacy of the past and with the adverse consequences of transition. The newly emergent nationalism, combined with a vacuum of functioning political institutions, poses another formidable obstacle, left behind by the communists after they were stripped of power under popular pressure. Though partial setbacks are certainly possible, the way back to the old system seems hardly viable, if only for that system's little disputed inability to respond appropriately to challenges of global technological, economic and social changes in the Western world. Last, not least, the Soviet Union today is no longer capable, either militarily or economically, of supporting its former allied communist clients: instead, it has to concentrate on maintaining its own integrity.

Most of these countries in transition have more or less clearly defined their goal: the establishment of a market economy with pluralistic ownership structures and democratic political institutions. Kazimierz Laski and Hubert Gabrisch convincingly argue in their contribution that there is no feasible "third road" between plan and market economy. However, the question of what particular kind of market economy should be striven for is of decisive importance already at the very beginning of transition, and the authors suggest that their preference is for West European partnership models of market economy instead of the more confrontational models of the Anglo-American variety. Implicitly, their further preferences seem to point in favor of more gradual – though consequent, but nevertheless slower – transitional changes in comparison with other advocates of a more abrupt switch, known under the slogan of "shock therapy". For one, the arguments for a more gradualist approach to transition are based on the sheer complexity of the whole task: on the necessity to start from the very beginning (e.g. with the establishment of institutions and market mechanisms that are often taken for granted in the West, but which either do not exist or were discredited in the East – such as trade unions, diversified ownership structures, market clearing prices, etc.). Second, the social costs (in terms of lower living standards, higher unemployment, etc.) resulting from the abrupt curtailing of domestic demand by the implementation of tight budgetary policies, combined with simultaneous liberalization of prices, might be too high, thus endangering the maintenance of a necessary social consensus in the new and fragile democracies, which
have inherited enormous liabilities from the past. A version of "market socialism" seems unavoidable for a certain period, since the cohabitation of a huge State sector with an emerging, but initially still small private sector, will be inevitable during transition. On the whole, neither a gradualist approach nor the shock therapy can be unequivocally recommended, since both approaches have their pros and cons. Besides, the preference for any particular approach to transition is a matter of ideology as well: unresolved disputes between Keynesian and monetarist theories in the West may serve as an example.

The question of Western support is of decisive importance for the success of transition in the East. Remaining trade barriers should be abolished, the necessary financial aid must also include at least a partial remission of existing debts. Technical assistance – another important part of Western aid – should not cover transfer of embodied technology only, but also of management know-how, marketing, statistics and legal norms, etc. Western governments, international organizations and private companies must pool their efforts, since the required amount of resources is much larger than originally expected. Raimund Dietz, whose contribution to Part One of the yearbook tackles problems of Eastern transition within the theoretical framework of a switch from command to exchange (market) communication, sees little possibility of success without massive participation of Western capital. Otherwise the social net in Eastern Europe might easily collapse and the West would be forced to erect new walls, thus missing the unique opportunity for reintegrating the East into the free world after decades of costly and artificial division.

Selected Aspects of Transition

Among the bundle of specific problems related to the reform experience in Eastern Europe, a dominant role will undoubtedly fall to money, monetary and exchange rate policies. Katalin Mérő, in her contribution, provides a review of the deformed Hungarian monetary policies, starting with the initial period of traditional central planning during the 1950s and 1960s. At that time, the level of money supply in Hungary was determined by the borrowing requirements of enterprises according to production plans, and the amount of cash and level of wages were kept within strict limits. During the early reform years, restrictive monetary policy had not yielded the desired structural changes, mainly because the capital market was lacking. First attempts at establishing a capital market date from the second half of the 1980s, but a real liberalization program was initiated only in 1989. The
Hungarian experience shows that, for money to become an integrating factor in the economy, the establishment of a real market is necessary. Even in Yugoslavia’s market economy, monetary tools used in various stabilization programs failed to produce the desired results. Ante Čičin-Šain and Neven Mates, in their analysis, identify factors that prevent the effective use of monetary policy in containing inflationary pressures. Apart from general "socialist" features (lack of genuine autonomy of producers, prevalence of the state sector, insufficient market infrastructure, soft budget constraint, etc.), the Yugoslav system developed a number of peculiarities responsible for the monetary policy deficiency. The authors focus in particular on "exchange rate differences" between the banks’ foreign exchange liabilities and their dinar denominated domestic assets, which have contributed to huge central bank losses and to the growth of the public debt. Further, the Yugoslav accounting system and lack of competition among banks fueled inflationary pressures, despite extremely high real interest rates.

One of the most important strategic tasks of transition is the opening of the economy and the introduction of convertibility. Given the fact that the foreign trade monopoly, separating the socialist command economy from abroad, has been one of the key pillars of traditional exchange rate policies, its abolition is a precondition to domestic price liberalization, to improvements in imports allocation, to export stimulation and, finally, to currency convertibility. The review of traditional exchange rate policies in the CMEA countries by Peter Havlik provides an insight into the enormous complexity of tasks which must precede the introduction of at least partial (current account) convertibility. It shows that simple foreign trade decentralization combined with a multiple exchange rate system usually does not bring the desired efficiency gains. Exchange rate policies of countries in transition must aim at the introduction of a realistic, uniform exchange rate, linked to other financial policy instruments. However, governments will be deprived of the possibility of centrally redistributing the bulk of resources, and they must learn how to use more sophisticated tariff and tax levers instead. The analysis of existing experience and market disequilibria in Eastern countries shows that the way to convertibility is a lengthy one; substantial devaluations during this period will be inevitable.

A preliminary assessment of likely impacts of recent political changes in the East on future trade flows is attempted in the contribution by Ivan Angelis. His analysis points out that different bilateral régimes will emerge in individual countries of the former Eastern Bloc, and mutual trade will likely contract when political determinants of trade
are removed. The Central and East European countries' trade in the 1990s will depend, on the one hand, on the outcome of the EC's debate between "widening" and "deepening", and on the other hand on future arrangements in relation to the Soviet Union. The combined effects of all these factors will result in a further decrease of Eastern market shares in world trade, at least till 1995.

The single most important commodity in both East European-Soviet and East-West trade is energy. Todor Balabanov and Raimund Dietz attempt to outline future prospects in this area after the disintegration of traditional intra-CMEA trade. Their basic conclusion is that the East European countries will lose, both in terms of energy availability and of costs – making energy supplies one of the critical factors of transition.

Among the most revolutionary socio-political changes resulting from the transformation of the command economies will be the inevitable abandonment of one of the basic and traditional communist dogmas, namely that of full employment. Though various forms of hidden and disguised unemployment were always present in the command economies, the transition to market economies will lead to the emergence of open unemployment as a completely new phenomenon in these societies. Dealing with this problem will require not only the establishment of appropriate social security nets, but will also impose an additional burden on already strained government budgets and, last but not least, a considerable psychological burden for the population. A skillful mastering of so far little known labor market policies will decisively affect not only the social acceptance of transition, but the very fate of ongoing economic changes as well.

The contribution by Hermine Vidovic shows that a rise in unemployment will result from hardened budget constraints for State enterprises, from privatization measures and also from necessary structural changes in the economy. New employment possibilities may arise in the emerging private sector and in the so far largely underdeveloped services, but they will hardly compensate for job reductions in the traditional industries and in the overstuffed administrative apparatus. Since active labor and social policy measures that might soften the social hardships of emerging unemployment have yet to be developed, and since even then the effects of such policies (e.g. re-training, regional development programs, etc.) will be felt only with a time lag, the immediate prospects are rather discouraging. Unemployment figures at the end of 1990 were still relatively low by Western standards, but the novelty of this phenomenon, combined with the prospect of a future substantial increase in the number of jobless workers, is disturbing. The
West can hardly afford to stand aside without aiding the formerly socialist economies.

Country-specific Transition Policies

Despite many common problems and similarities in envisaged changes, the countries of Central and Eastern Europe (not to mention the Soviet Union) show considerable differences in traditions, economic starting positions, external situations, and approaches to transition. Part Three of the yearbook is therefore devoted to country studies which analyze individual economic situations, approaches and concepts of transition. In Bulgaria and Romania, the process of political changes is probably not yet completed and the situation is highly unstable. Neither country has much of a chance to elaborate clear and socially acceptable transition policies soon. Bulgarian reforms, in particular, will be encumbered by servicing the more than US-$ 10 bn foreign debt and by the country's exceptionally high dependence on the Soviet Union. Ilse Grosser, in her paper, inspects the political and economic uncertainties of the rapidly deteriorating Bulgarian situation. Czechoslovakia, for many years a bulwark of Stalinism and a latecomer to reforms, still enjoys a relatively stable economic situation. Friedrich Levcik and Zdenek Lukas describe how Prague's Velvet Revolution of November 1989 has brought sweeping political changes to that country within less than a couple of weeks, but how the new government, composed largely of former dissidents who make up the core of the Civic Forum, was soon confronted by differences of opinion and nationalist quarrels. Much time has been lost in discussions on whether a market economy should be reintroduced in more gradual or by more radical steps. The latter concept, supported mainly by the adherent of liberal monetarist theories, Finance Minister V. Klaus, seems to be gaining growing support towards the end of 1990. The decision about the start of a radical reform variant from January 1, 1991 (including price liberalization, introduction of internal currency convertibility, substantial devaluation and the start of a privatization program) has been facilitated by the Gulf crisis and by the disruptions resulting from the extreme dependence on trade with the Soviet Union.

After the monetary, economic and finally also political union with the FRG, East Germany, has formally abruptly disengaged from its Eastern connection, but will naturally suffer from the resulting economic and psychological shock – despite the advantage of being in a position to rely on massive financial transfers and technical assistance from the West. Raimund Dietz attempts in his contribution not only to estimate
the likely effects of the "DM-shock", but to look deeper into the systemic causes behind the collapse of the GDR's economy after the monetary union with the FRG. He too, would apparently prefer a less radical approach to the German-specific form of "transition" to a market economy. He shows that a strong monetary framework is not a sufficient condition for mastering the legacy of communist mismanagement.

In contrast to Czechoslovakia and the GDR, Hungary can rely on more than two decades of reform experience. The results, however, are mixed: ranging from external disequilibrium due to high foreign debt and domestic budgetary imbalances on the one hand, to the accumulation of considerable experience over the years with market-oriented reforms on the other. In his analysis, Michael Friedländer identifies several factors critical to the success of Hungarian transition, listing most prominently among them the political consensus for tight budgetary policies towards the state sector.

Two contributions deal with the situation in Poland, that had started at the beginning of 1990 to implement a radical program of "transition by shock". Kazimierz Laski and Hubert Gabrisch start with an analysis of the rapidly deteriorating situation, towards the end of 1989, in the Polish economy, and then briefly describe the basics of the Mazowiecki government's stabilization program. Their assessment of the first effects of the "shock therapy" is mixed: the price paid for bringing down inflation has been a recession much deeper than expected. Gian Paolo Caselli and Gabriele Pastrello, in their contribution, question some fundamental premises of the application of strictly monetaristic approaches in the conditions of the Polish economy, namely the belief that new entrepreneurs in sufficient numbers will enter the market, which is in a deep recession. Their analysis comes to the conclusion that a "shortage" gap characteristic of the command economy might easily be replaced by a "demand" gap, and they argue for measures stimulating demand (including debt relief schemes).

The example of the Soviet Union shows that a country can land in a deep recession even without adopting any radical economic measures. The rapidly deteriorating economic situation (still not sufficiently reflected by official figures) is being exacerbated by nationalist quarrels and the political struggle for power. Under such conditions the adoption – let alone the consequent implementation – of any reform concept is virtually impossible. Peter Havlik sees little chance for a sufficient reform consensus in the near future, and on this basis predicts a further economic decline for the Soviet economy. The concluding chapter of the yearbook deals with the situation in Yugoslavia. Hermine Vidovic
analyzes the reform program adopted at the beginning of 1990, which shows many similarities with the Polish approach. A lesson from the Yugoslav experience for the Soviet Union strongly suggests that even the best drafted economic reform measures may not bring the desired effects, unless the political and nationalist conflicts can be solved.

**Conclusion**

The fast pace of recent political developments in the East has caught the attention of the world. In the countries of the region, however, the revolutionary euphoria has been gradually evaporating as economic changes remain far below initial expectations. This yearbook attempts to contribute to a better understanding of the complex problems of transition in all their regional diversity. Without such understanding – and, let us hope, also stimulation of awareness of the need for Western assistance – the dismantling of the command economies can hardly be mastered.
Notes

1. For more details see Dietz (1990).
2. "In a demand-constrained system the quantity of money in the hands of an individual buyer sets an effective upper constraint to his total purchases. In a resource-constrained system money in the hands of the buyer is not an effective constraint." (Kornai 1980, p. 518).
3. Before and after the collapse of communist societies expectations and reality fell far apart. Before the collapse most observers and the general public believed in a long drawn-out survival of communism, and after it they expected a short or relatively smooth transition.
4. The very opposite of what the "Left" has maintained comes true: communism did not fail because of its capitalist environment, but capitalism has always been a factor of stabilization and a system of reference, and could be a safety net coming to the rescue of the collapsing East European economies. In isolation or isolated from the surrounding world (or if communism existed world wide), the former communist countries would probably have no chance to reconstruct a civil world.
5. If the set of opportunities increases, i.e., if competition becomes fiercer, the chance that an existing contract will meet the condition of mutual advantage becomes smaller.

References


expectations of households: they would expect their money income to increase at a rate below that of inflation.

On the whole, liberalization without market pressure led to worsening disequilibria in the economy. Monetary aspects have become important factors in both the enterprises' and central authorities' economic decisions. That is to say, the role of money gained a great deal in importance, yet its functional disturbances show that it has not yet became the integrating instrument of the economy. In order to achieve this, further reforms and the establishment of a real market economy are needed.

Table 3.6
Money Income, Consumption and Savings of the Population, 1979-1987
(in Ft billion and in %)

<table>
<thead>
<tr>
<th>Year</th>
<th>Money income Ft billion</th>
<th>Purchased consumption Ft billion</th>
<th>Current savings</th>
<th>Savings ratio %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979</td>
<td>337.3</td>
<td>314.4</td>
<td>22.9</td>
<td>6.79</td>
</tr>
<tr>
<td>1980</td>
<td>368.4</td>
<td>344.5</td>
<td>23.9</td>
<td>6.49</td>
</tr>
<tr>
<td>1981</td>
<td>398.2</td>
<td>371.1</td>
<td>27.1</td>
<td>6.81</td>
</tr>
<tr>
<td>1982</td>
<td>427.3</td>
<td>399.5</td>
<td>27.8</td>
<td>6.51</td>
</tr>
<tr>
<td>1983</td>
<td>463.7</td>
<td>429.9</td>
<td>33.8</td>
<td>7.29</td>
</tr>
<tr>
<td>1984</td>
<td>506.4</td>
<td>469.0</td>
<td>37.4</td>
<td>7.39</td>
</tr>
<tr>
<td>1985</td>
<td>553.0</td>
<td>509.6</td>
<td>43.4</td>
<td>7.85</td>
</tr>
<tr>
<td>1986</td>
<td>598.0</td>
<td>548.6</td>
<td>49.4</td>
<td>8.20</td>
</tr>
<tr>
<td>1987</td>
<td>648.2</td>
<td>615.2</td>
<td>33.0</td>
<td>5.10</td>
</tr>
</tbody>
</table>

Source: CSO, various volumes.

Notes
1. For a detailed description see Óváry-Papp (1948).
2. i.e. net material product.
3. Money-related data were first published only when Hungary joined the IMF, in 1982. The data were traced back only to 1971.
4. Deposit money covers primarily the sight and time deposits of enterprises (although deposits of private individuals also belong here, they represent only negligible amounts).
5. Based on Huszti (1968).
6. i.e. gross material product.
7. i.e. net material product.
8. This hypothesis was formulated by Soós (1986). Kornai (1980) represented a different view. According to his theory, money always plays a passive role in the system of plan breakdown. But Kornai does not discuss the periods during which the aim is to restrict investments. Soós holds the view that regulation through the plan can only distribute increments. Another instrument is needed for restriction, i.e. money that is able to express interests which are opposed to the interest in growth.
10. For details see Antal/Várhegyi (1987).
11. This was manifested in a decision by the Central Committee, whereby central authorities paid special attention to the situation of 49 large companies. In practice this meant that these companies enjoyed individual regulation.
12. That is to say, the households as savers behaved in line with the model that can be described with Friedman’s theory of permanent income. There are also some empirical supports for this statement. With respect to the period 1960-1982, Hungarian data were used to test how the various types of savings functions fit the data. It was found that the hypothesis of permanent income gave the best approximation (Riecke (1985)).
14. For details see Bánfi/Sulyok/Papp/Szász (1986).

References


NBH, *Quarterly Review*, various issues.


In a conventional accounting system, banks would cover part of their costs by the difference between very low and zero interest rates on sight deposits and relatively much higher interest rates on credits. This could be interpreted thus, that in this way banks appropriate part of seigniorage to cover the costs they incur as partly public institutions.

Under the Yugoslav accounting system, however, the entire difference between very low interest rates on sight deposits and the revaluation interest rates on credits constitutes a surplus of revaluation revenues and may not be used to cover regular bank costs.

Thus, the accounting system has had an exceptionally strong influence on the behavior of commercial banks. However, this has shown, especially in 1988, some negative aspects of these solutions. Despite a great increase in the net-worth position of the banks, they started to charge extremely high real interest rates on the loans they were granting. Even successful banks have started to charge real interest rates between 15 per cent and 30 per cent. Some banks have started to apply rates even as high as 50-60 per cent on the already revalued principal.

This has, among other things, been made possible through the lack of competition among banks, and through the non-existence of alternative channels of financial intermediation outside the banking system. The situation was subsequently worsened by the fact that banks wrote off considerable amounts of their claims without simultaneously exercising any pressure on their debtors for the settlement of their claims and an increase in their efficiency. In this way high interest rates are paid by those enterprises that were able to do so, whereas for poorly operating enterprises the interest, inclusive of revaluation interest, is frequently written off.

Notes

1. During the preceding period, particularly during the seventies, there were almost no changes in the dinar exchange rate. Very large capital inflows in the 1970s provided abundant financing for balance of payments needs and enabled the maintenance of a virtually fixed exchange rate.

2. It would be more appropriate to give figures for these two currency areas separately, but respective data are not readily available.

3. Unfortunately, it seems that in 1989, federal government expenditures were increasingly financed by loans from the central bank. For more information thereon see data on the liabilities and claims of the

4. Banks have frequently found various ways of avoiding acceptance of such deposits. It should be noted that a securities market exists in Yugoslavia only in rudimentary form. Predominant are bills of exchange with a maturity of maximum 90 days, which are issued in relation to commodity transactions between enterprises. Private individuals do not have any possibility of buying such securities, but enterprises mutually trade in them. This is, in fact, the only form of the capital market existing at present.

5. The negative exchange rate differences in commercial banks we did not netted out by the positive ones, since these appear in different banks. The amount of positive exchange rate differences (i.e. gains) was, after all, negligibly small in comparison to the amount of the negative ones.

6. Positive rate-of-exchange differences realized on account of short-term claims continued to figure in the income statement.

7. This state of affairs represents a kind of curiosity in that banks were compelled by law to increase interest rates on credits they grant.

8. In Yugoslavia interest rates on sight deposits are determined by a cartel agreement concluded by commercial banks. Until 1988, they amounted for households to 7.5 per cent, for economic enterprises to 4 per cent, and to zero per cent for all other clients. Since 1988, this interest rate has amounted for all clients to 25% of the revaluation rate.
economies will approach forms not significantly different from the conditions prevailing in the Western business world.

Notes

1. See also van Brabant, J.M., "Exchange Rates in Eastern Europe. Types, Derivation and Application", World Bank Staff Working Paper No. 778, The World Bank, Washington, D.C., 1985. The problem of intra-CMEA exchange rates is not addressed here: these exchange rates are now mostly negotiated bilaterally, they underlie specific rules and, moreover, will be subject to change during the process of overhauling the existing intra-CMEA trade and cooperation arrangements.


3. An alternative term are foreign trade multipliers, sometimes defined as the ratio between valuta price and domestic price of a specific product. With the given official exchange rate and information about the multiplier, the internal exchange rate can be easily calculated (and vice versa).


5. Izvestiya, 28 October 1989, p. 4. On November 1, 1990, a system of commercial rates for convertible currencies was established.


10. A corresponding agreement was reached at the 45th CMEA Session in Sofia in January 1990. The complete switch, however, will be gradual, although Hungary announced the use of hard currency accounting in trade with the Soviet Union already for 1990.


12. As so-called "incomes from foreign economic activity" (customs fees, export earnings and non-commercial transactions) recently

13. See Ekonomicheskaya gazeta, No. 52, 1989, p. 8. These (average) implicit exchange rates are biased, since they do not distinguish between convertible and non-convertible trade.


15. Poland, which fixed the exchange rate on January 1, 1990, at 9500 Zl/US$, introduced internal convertibility and abolished many foreign exchange restrictions simultaneously, obtained a stabilization fund of US$ 1 bn from Western governments and a stand-by loan of US$ 710 mn from the IMF for supporting the exchange rate – see WIIW-Mitgliederinformation, 1990/1, p. 11.
Notes


2. The GDR is beyond all these considerations, as can be taken for granted. Evidently the GDR will be incorporated into the EC by way of integration with West Germany, regardless of the results of the controversy between EC deepeners and wideners.

3. It must be borne in mind that the reshaping includes two movements exerting counter-effects: one is a narrowing of the geographical contents of the CMEA, the other is an expansion of West-oriented trade of the remaining members countries.
- gain economic advantages by being connected to West European supply systems (especially in the case of gas and electricity), but mainly,
- cooperate more intensively in the field of processing and in oil and gas trade.

Notes

1. Oil equivalents are standardized units, normalizing differences in quality and calorific content of different oil blends.
2. CMEA-6: Bulgaria, Czechoslovakia, Hungary, Poland, GDR and Romania.
3. 20 to 30% Soviet delivery shortfalls were reported in the first half of 1990. In June 1990 the CMEA-6 countries were officially informed of a 10% cut in their oil deliveries from USSR (which may actually be much higher), and about possible, even bigger, further cuts in 1991.
5. During the recent visit to Moscow by Jacques Delors, President of the European Commission, agreement was reached on:
   (i) assistance in the investment program to upgrade Soviet nuclear power stations to Western safety standards;
   (ii) opening up of Siberia to Western oil companies, providing direct Western access to Soviet oil, in exchange for guarantees of Western markets for the products.
6. These measures may be rather costly, e.g increasing the depth of crude oil refining from the present 63% up to 73% will cost up to US$ 10 billion and take several years to realize.
7. According to Mr. Steinberg, the GDR minister dealing with environmental issues, the GDR's brown coal production is to be reduced from approximately 300 mn t/y in 1989 to less than 160 mn t/y by 1998. This will reduce electricity production by 2,100 Gigawatt-hours, i.e. approximately 2% of 1988's production. To compensate for the reduction, natural gas imports are to increase 2-3 fold, from 7 bcm to 17-20 bcm, and net imports of crude oil and products are to increase from the present 17 mn t/y to 23-24 mn t/y, if the market does not offer other opportunities (see interview with Prof. Steinberg in "das blatt", 13/1990, May 17, p. 9).
8. As a result of Chancellor H. Kohl's visit to the USSR in July 1990 a skeleton agreement was signed allowing for a gradual increase of German gas imports by 20 bcm by 1993.

9. The lower figure was estimated by the USSR Academy of Sciences and the higher by County NatWest Securities, quoted in the article "Why there is hope for Soviet economic reform", in: Financial Times, July 23, 1990.

10. Adjustment of the retail prices of different energy forms to world market levels at more or less realistic exchange rates, etc.

11. For 1990 approximately 1 mn toe (out of totally contracted 6.5 mn toe) will not be delivered, and further cuts are to be expected in 1991.

12. For deliveries due in August 1990 the tender for three 82,000 toe cargoes (246,600 toe) of Algerian Saharan Blend or Libyan Sirtica or Breda was awarded to ÖMV and Philbo. Shipment will be coming via the Adria pipeline from Yugoslavia's Adriatic terminal.

13. A recent example is the joint venture between the US trader Philbo and the Hungarian Mineralimpex.

14. While in 1990 CSFR was paying TRbl 97 per ton of crude, this may change for 1991 to US$ 180 per t (US$ 25 per barrel). That would mean a price increase from Kcs 973 per ton (exchange rate 9 Kcs/TRbl) to up to Kcs 4,320 per ton (envisaged exchange rate 24 Kcs/US$), resulting in a 4.44 times higher price in 1991 as compared with 1990.

15. Estimated at 2.5 mn toe for 1990, out of totally contracted 16.7 mn toe.

16. Losses of 0.5 mn toe for 1990, and up to 5 mn toe (1991-1995) if the embargo were extended, have been named, amongst other sources also in the Statement of the President, in Duma, August 20 1990.

17. In 1989 the hydro-electricity share in total electricity production was 15.5%.
- reduction of working time, and subsequently shortening of the working week;
- work restrictions for retired people.

It must be doubted whether the countries of East Europe will overcome emerging social problems caused by unemployment in the near future, since the announced social programs (Poland, Czechoslovakia, Hungary) are in conflict with tight budgetary policy. On the other hand, the newly formed governments need full political support from the bulk of society, since the way to a market economy will be paved with unpopular measures.

It is another question whether the West can afford to stand aside without extending massive help to the discomfited, formerly socialist, economies.

Notes

3. See also the contribution by H. Gabrisch, K. Laski in this volume.
policy-makers. Important external determinants in shaping economic policy lie in the results of debt restructuring negotiations with Western commercial banks and the impacts of Bulgaria's membership in the IMF (and the World Bank). The latter is likely to work towards a more energetic stabilization policy and an acceleration of reforms – and so might recent developments in Soviet transition policy.

Notes

1. *Rabotnichesko delo*, December 5, 1989, p. 2, and January 30, 1990. The 1989 report is still characterized by gaps (the Statistical Office itself having no information on foreign debt, the budget deficit and the private money overhang) and lack of specification, with many data inconsistent with preliminary 1988 figures available to us so far.


5. 48% of pensioners get even less than 100 leva p.m. See *Rabotnichesko delo*, December 18, 1989, p. 6; December 26, 1989, pp. 1f.; December 27, 1989, p. 2; January 1, 1990, p. 4; Sofiafter Nachrichten 51/1989, p. 5.


8. The medium-term fall in Bulgarian machinery and equipment exports was explained by losses in the oil-producing countries' purchasing power (*Rabotnichesko delo*, December 18, 1989, p. 6).

9. No indication was given of recoverability of credits outstanding. The debt service ratio, other things remaining unchanged, would be more than one half (*Rabotnichesko delo*, December 12, 1989, pp. 1-3; March 7, 1990, p. 1).

10. Hard currency exports are assumed to be exports to the Western industrialized countries plus two thirds of exports to the LDCs (1989: US$ 1.845 bn), net figures depend on whether credits outstanding are taken into account or not.


12. The rather meaningless "official exchange rate" of 0.809 foreign-exchange leva might be further used for foreign trade statistics.

13. As the main legal norm regulating economic activities, among a plethora of others, Decree no. 56 by the State Council is still valid by
mid-March 1990 (see WIIW-Mitgliederinformation 1989/7). The 500 state and 670 municipal firms so far registered (Rabotnichesko delo, February 24, 1990, p. 1) were established mostly from above and curtailed in their independence by the associations (having de facto assumed the role of the former branch ministries), which were dismantled in the meantime.

14. A first BCP draft was subject to scathing criticism (as flavored by a cosmetic tinge of the phraseology inherited from the old regime) in Rabotnichesko delo, December 29, 1989, pp. 1, 4, where the author maintains int. al. that authentic shut-downs would comprise enterprises producing more than one third of national income, and that a price increase equilibrating the market would probably be at more than 1000%. He then pleads for an instant start of radical economic reform, combined with foreign support and postponement of debt service.


16. The main sources of this report are: the report of the parting Lukanov government to the Parliament (early August), Demokracya (daily of the Union of Democratic Forces), August 21, 1990, supplement, and Duma (daily of the Socialist Party, renamed from Rabotnichesko delo), July 10, 1990, pp. 1f.

17. One liter of high-octane gasoline costing now 2.40 leva, the average 1989 wage being 267 leva.


According to the new government's program the following measures for market-oriented reform should be taken by the beginning of 1991.\(^3\) The above-mentioned demonopolization and de-etatization of state enterprises should be practically completed already this year. As for the required institutional framework, industrial and trade supervisory authorities, unemployment offices, fiscal offices, stock exchanges, commercial courts and a new chamber of commerce should be established. The liberalization of prices in wholesale and retail trade should be prepared, all related risks should be analyzed and minimized. Prices for the purchase or lease of ground are to be determined. Employment and social policy up till the end of 1990 is to focus on preparations for the retraining of workers, the creation of new working places, a new law on family allowances, a new wage system, the financing of social insurancem, and the adjustment of old-age pensions to inflation.

Considering the period of time necessary for the evolution of such institutional framework (and its costs) or for the introduction of such measures in the West, this timetable looks very ambitious if not unrealistic.

Notes

1. This differs from the Western concept of GNP, since it excludes a large part of services.

2. Internal convertibility means the opportunity for Czechoslovak firms to buy hard currency at the commercial exchange rate for needed imports. On the other hand, all enterprises and even joint ventures must sell all their hard currency export revenues to the Czechoslovak banks. Private persons can buy US$ 66 annually (at the current non-commercial exchange rate) as well as acquire convertible currency at the newly established valuta auctions, but at a higher price than at the official non-commercial exchange rate.

Notes


6. "The conversion rate of 1:1 for wages and salaries fixed in the State Treaty does not appear to put German Democratic Republic companies at a competitive disadvantage when seen in relation to average labor productivity and the corresponding differentials between the two Germanies". ECE, The ECE economies in mid-1990, Geneva 1990. The ECE referred to the study: Bundesministerium für innerdeutsche Beziehungen, Texte zur Deutschlandpolitik, Series III, Vol 5, 1987, p. 59, where the average productivity gap for the producing sectors was estimated at 50 percent.


8. This success – if one can speak of a success at all – was based on the fact that the SED (Socialist Unity Party) avoided certain mistakes and exaggerations committed by other communist regimes. Thus during the so-called reconstruction period the SED did not inflict real declines in living standards on the GDR population, did not invest (for lack of investment means) in gigantic projects, rejected an extreme levelling of wages and incomes – the GDR’s intelligentsia was relatively better off than in other socialist countries –, and the GDR pursued a less rigorous confiscation policy: by the end of the 1970s there was a considerable number of partly private firms, etc. This "rationality" of SED policy might be traced back to the weak legitimation basis of the Party, forcing it to proceed more circumspectly, economically and politically, than its Eastern brother parties. But it also contributed to the extreme inflexibility and prevents a thorough revision of the economic and social
policy concepts established at the beginning of the 1970s by Honecker and his team.

9. "Socialist countries have a much lower percentage of the services sector in production, in labour force and investments than their capitalist counterparts. ... In the past 40 years Greece and Spain have caught up with the German Democratic Republic and Czechoslovakia, the most developed countries in the Eastern Bloc."

(Ehrlich, Eva, Services: in the Limelight and in the Backward, Paper prepared for the Fourth Annual Seminar on the Service Economy, organized by Progres, Geneva, May 30 to June 1 1988, pp. 22-23). An "index of infrastructure levels" developed by Mrs. Ehrlich shows that in 1978 the GDR still recorded the highest level among the East European countries, but that the level had increased between 1965 and 1978 by only 6%, whereas by 17% in the case of Hungary, and even by 31% and 35% in the case of Spain and Greece respectively.

10. The exchange rates have been differentiated with respect to different categories of claims and assets. While the mass of private savings of GDR citizens were converted 1:1, debt claims of enterprises have been halved from 260 bn Mark to DM 130 bn. But since enterprises will not be able to serve these debt claims, they will have to be written off, so that savings (as money claims of the population against the banking system) have no counterpart in claims of the banking system against the economy. Thus the exchange of savings by the population, most of them at the rate 1:1, boils down to a transfer of purchasing power potential from the FRG to the GDR.


12. The GDR has become an open economy after the monetary union with the FRG.


15. The reader will find technical remarks at the end of the tables.

16. Scenarios differ in particular with respect to employment policies: In Scenario B a policy favoring the wage earners would allow more
workers to keep the status of short term workers than in Scenario A. While practically idle, short term workers receive 70-80% of their former wages, formally maintain their status as employees and may be subject to intra-plant retraining programs.

17. GDR pensions, e.g., have been raised from an average of 473 GDR-Mark to 607 DM to compensate for price increases (due to a cut of subsidies for basic necessities and in order to reduce the differences to West German pension levels (Handelsblatt, August 8, 1990, p. 4).


19. "The GDR is likely to take over a social system securing the prosperity level of the FRG, but not the economic development level of the GDR." (Klodt, H., "Statt Investitionen die Qualifizierung fördern", in: Handelsblatt, March 6, 1990, p. 6.).

20. In Scenario A we have assumed that private consumption will fall in 1991, when prices of housing, energy and public transport will rise, but high unemployment may keep wage increases low.


22. Interest payments excluded.


24. \( M \) = \( X \) – balance.


27. It is reported that enterprises meet only a small fractions of their tax obligations (Der Spiegel, 1990/31, pp. 65f).


31. The argument that German unity is manageable economically because the entire social product of the GDR accounts for only one tenth of the social product of a united Germany, does not hold. The GDR's share in total population amounts to one fifth. The smaller the economic volume brought in by the GDR, the bigger – not smaller – are the problems.
- the containment of losses resulting from changes in the mechanism of CMEA trade,
- the willingness of Western lenders to provide Hungary with capital, and
- the volume of capital obtained through direct investments from the West.

Notes

Notes


3. See the project of the budget law in *Rzeczpospolita*, December 12, 1989, supplement "Reforma gospodarcza".


forces could emerge; and this might constitute an alternative to the transition from plan to market through crash.

Notes

1. The "philosophy" underlying the Polish stabilization plan is clearly laid down in J. Sachs (1990).

2. The literature on this point is quite rich. For two outstanding accounts from an historical and a theoretical point of view, see W. Brus (1986), and J. Kornai (1986). The latest developments of the discussion on previous reform failures lead to the problem of ownership, as witness chapter 10 of K. Laski and W. Brus (1989).

3. For an account of the failures in the administrative management of the price reform of the 1980s see Z. Szpringer (1989).


5. The "purifying" role of the depression was a commonsense view in the thirties – shared, inter alia, by J. Schumpeter and D.H. Robertson, but strongly contested by J.M. Keynes. Whichever the assumed causes of the imbalances at the root of the economic crisis – whether "real" or "monetary" – the consequent depression was viewed as the "natural", though "painful" process of getting rid of them.


7. See M.J. Piore and C. Sabel (1984). In their book they present a reappraisal of the Marshallian concept of "industrial district" under the new historical conditions of the double crisis of Keynesian policies and Tayloristic production, showing that "systems" of small firms can achieve the same economies of scale and technological gains previously attributed only to large-scale production.

8. The theoretical reappraisal of the "industrial district" was pioneered in Italy by G. Becattini (1962) (for further developments see also G. Becattini (1989)), while S. Brusco (1980) (see also his collected essays, S. Brusco (1989)) developed an extensive analysis of the productive system of one Italian region – Emilia – based on clusters of very dynamic small firms.


10. Of course this does not mean that all who agree with the price liberalization shock share the view that this implies a real micro-macro adjustment – leaving to monetary policies only the task of price-level adjustment. Our point is that just this was the vision implied by the stabilization plan.
11. Even those economists who are worried by the possible fall in production and employment following the deflationary measures, do not question their stabilizing effect, but raise objections either from the demand side or from the supply side. From the former point of view they stress the danger of an "overshooting" of the measures (see K. Laski (1990)), from the latter one they emphasize the disorganizing effects of a cost "overburden" – due, for instance, to an excessively high interest rate (see W. Herer and W. Sadowski (1990)).

12. Berliner's book (J. Berliner (1957)) is often quoted for stressing the role of "bonuses" in determining Soviet managers' behavior in order to achieve plan fulfilment. This accepted view overlooks the fact that the book gives an impressive account of the pervasive role of uncertainty, not only for what concerns the "safety factor" in determining capacity utilization levels, but in almost all Soviet manager decisions. This uncertainty has a different source than in Western economies, and depends on the general unreliability of "backward" and "forward" linkages of a planned economy. This forces each manager to keep capacity unutilized and to "hide" stocks and labor resources, up to the maximum point tolerated by the central planning authorities. Acting in this way – anticipating others' behavior – managers are reciprocally limiting their production decisions, resulting in unused capacity and shortages at the same time. It's noteworthy that J. Steindl (J. Steindl (1960)), reversing the relation between monopolistic prices and excess capacity (as analyzed in J. Robinson's and N.J. Chamberlin's classical works), traced back the source of excess capacity to that kind of uncertainty prevailing in the market economy.

13. The concept of x-Efficiency (introduced by H. Leibenstein (1966)) has been used in the analysis of Soviet firm behavior by C. De Vincenti (1989a) and (1989b).

14. An impressive statement on such a behavior is quoted in W. Herer and W. Sadowski (1990): "If all firm directors in Poland – said Mr. K. Chmielewski, a Polish manager – had executed the recommendation, issued by a vice minister, of stopping the deliveries to the firms which did not pay in advance, then the whole Polish industry would be completely stuck".

15. One of Poland's main difficulties (which is usually missed out in the discussion) is the gap between a relatively modern industrial sector, though with all the known efficiency problems, and a backward agricultural sector: first of all from the point of view of the agricultural labor share, which amounts to a – for industrialized countries unusual – degree of 30%, and also with regard to technological level, property
structure, labor productivity. The share of agricultural labor force which ought to be associated even with the actual technological level of the Polish industry is around 15-20%. This means that hidden agricultural unemployment may account for about 10-15% of the total labor force. Italy, whose agricultural labor share was more than 40% after World War II, succeeded in thoroughly transforming its agriculture within twenty years, thanks to two conditions: the enormous emigration and the strong industrial growth. At the end of the 1960s the agricultural labor share had arrived at the level of 14%, which may be a reasonable target – although ambitious – for today’s Poland.

16. The EEC authorities welcomed the entry into the Common Market of countries such as Spain, Greece, Portugal, competitive to Italy with regard to mediterranean products, but Poland would have to enter meat, dairy products and corn markets, on whose protection depend the fortunes of the rich countrysides of Northern Europe. France and Germany have always relentlessly defended their farmers’ interests. It is very unlikely that they will be inclined to face economic, social and political problems in order to permit Poland to solve its own less painfully.

17. Polish exports to the OECD countries account for approximately 45% of total exports, and about 75% thereof consists of manufactures and raw materials, while the remaining part is represented by agricultural products (see COMECOM DATA 1988 (1989)).


19. The removal of these controls is of course needed, and is likely to occur in the near future. But this and the intended achievement of price competitiveness – though necessary – are insufficient conditions to expand exports. If the Polish firms want to gain relevant market shares in order to match the adjustment requirements, numerous other non-price conditions are to be met.

20. The case of Mrs. Johnson-Piasecka and the Gdansk shipyards – and many others just occurring in Poland as well as in other Eastern countries – shows that export benefits are going to be more than balanced by drastic employment cuts, notwithstanding the possibility of crowding out the production of domestic enterprises.

21. The production lines transfer, furthermore, might raise employment problems for the European economies, or at least tensions on the labor market due to indirect competition by the Polish workers’ low wages, worsening the favorable climate of support for the East European economic transformations. This point was for the first time openly raised in the Italian newspaper "La Repubblica" on April 26 1990.
23. For an analysis embracing all the aspects of the developing crisis following Gierek's "great jump" strategy, see W. Kuczynski (1981). The link between the developing of the economic crisis and the divisions in political leadership is stressed in K. Poznanski (1986).
24. B. Grabowski (B. Grabowski (1989)) points out that, in order to pay only for the interest service of the debt, Polish exports would have to be raised by 2 to 4 times over the 1988 level. As he was writing before the recent measures, his figures must be corrected, considering the exchange rate devaluation and internal inflation: hence the needed export increase ranges roughly from 3 to 6 times over the 1988 level.
27. For similar, and more detailed, conclusions see Laski (1990).

References
Becattini, G., Il concetto di industria e la teoria del valore, Boringhieri, Torino 1962.
De Vincenti, C., "L'impresa di tipo sovietico tra tensione del piano e scambi informali", in: Economia e politica industriale, no. 62, 1989 (b).


Herer, W., Sadowski, W., "Dlawic hiperinflacje a nie produkcje", in: *Zycie Gospodarcze*, no. 8, 1990.


Western credits, to sell government bonds to foreign investors, and to attract foreign capital on a massive scale for joint ventures and direct investments. The estimated available resources for imports – net inflow of foreign capital plus export earnings – could amount to US$ 50 bn (or Rbl 200 bn at domestic prices) in 1992. Gradually, an internal convertibility of the ruble (abolition of the current differentiated internal conversion coefficients, devaluation, and introduction of uniform exchange rate and customs tariffs) should be introduced around 1992-1993.\textsuperscript{15} Foreign trade should be decentralized, but the center shall work out tariffs, export and import quotas, and licenses in close cooperation with the individual republics. However, the state monopoly (either at the central or republican level) on exports of key products (oil, gas, gold, diamonds, etc.) shall be maintained.

The adoption (not to speak of the successful implementation) of any reform program will crucially depend on the consensus between individual regions and republics of the Soviet Union, which is yet, unfortunately, not in sight. In view of the numerous and extremely complex (not only economic) problems, the elaboration of a new contract about the Soviet Union now enjoys the highest priority. But whether sufficient consensus about such a contract will be found before the current economic and social crisis of the Soviet state will escalate and lead to a break-up of the Soviet Union, remains to be seen. The 1990 Fall Session of the Congress of Peoples' Deputies will certainly not be the final stop in reform discussions. Besides, any finally adopted reform blueprint which aims at the loosening of central powers and the introduction of more market elements is likely to be met with considerable bureaucratic resistance.

Notes

1. See Izvestiya, January 28, 1990, pp. 1-3, and Table 15.1. In the first half of 1990 national income produced dropped by 2%.

2. The latest issue of the Soviet statistical yearbook openly admitted that previously reported growth rates of national income, industrial production, real incomes, and retail sales for 1985-1987 were "corrected in order to eliminate the effects of reduced production and sales of alcoholic beverages" – see Narkhoz 1988, Goskomstat, Moscow 1989, p. 7.

4. Such a measure is being discussed officially. However, the government’s economic commission recently rejected the idea of a currency reform - see *Ekonomika i zhizn*, No. 8, 1990, p. 7.

5. At the beginning of 1989, joint venture regulations were liberalized (foreign majority share has been allowed and tax regulations were eased), but in April 1989 some additional restrictions (e.g. export and import licenses) have been added - see *Ekonomicheskaya gazeta*, No. 51, 1988, p. 18, and No. 13, 1989, p. 21.


15. The recent introduction by the central government of hard currencies as a parallel means of payment is being criticized as detrimental to future convertibility plans.
- Lifting of the six-month wage freeze imposed in December 1989, but payment for part of the wage increases in the form of internal shares.

In the coming months no substantial recovery of the economy can be expected. Apart from decreasing production and a deterioration in the balance of trade, a new surge of inflation might occur if wage expansion does continue as started in June. On the other hand, the success or failure of the economic reform is highly dependent on the political development of the country; it is generally assumed that the process of disintegration cannot be brought to a halt.

Notes

1. The Yugoslav normative system allows only six months' validity of administrative acts; they can be renewed for a further period.