

THE COMMUNIST BLOC: TRANSFORMATION IN PROGRESS

by Rafal H. Krawczyk

November 1988 brought the 71st anniversary of the October Revolution and the Russian adoption of the communist system. After World War II the communist system spread around the world, completely changing the life of many nations. Now, there are almost 1.5 billion people living under the *nomenklatura* system and working daily under conditions of centrally planned economies. However, after decades of expansion and economic growth, all communist countries are now approaching, more or less quickly, very serious multilevel crises of which the economic one looks the most disastrous. There is more and more awareness in the West that something very important is developing in the whole communist world. If the West wishes to influence this process, it is very important to understand these developments properly.

One can read frequently in Western newspapers and periodicals the thesis summed up by Jackson Diehl's article in *The Washington Post* of October 16, 1988: "Communist World Can't Jump Price Reform Hurdle." The article is quite typical of Western opinion on the economic troubles that have plagued the communist world since the beginning of the 1980s.

In Poland this year the inflation rate will probably exceed 100 percent. In Yugoslavia, the rate is more than twice that. China faces unexpected obstacles in her economic reform, and the Chinese government, frightened by an inflation rate of 50 percent annually (the highest since the communists took power) is slowing the implementation of new measures.

In the Soviet Union, the future of economic *perestroika* looks gloomy.

Jumping the Price Hurdle. All of the evidence seems to support the title of Diehl's article. Other Western evaluations are very similar to Diehl's. *The New York Times* of October 14 states that "without an end to subsidies and establishment of market prices, which means a painful interim of austerity and inequality, there is no way to economic health." It does not say, however, how to establish market prices if the market simply does not exist in communist countries. It is also worth adding that most reformers in centrally planned economies are eagerly accepting the approach of the international financial community, which dictates that, to revive economic growth, a country must first raise consumer prices in order to diminish state subsidies. Thus, communist governments list "price reform" as the first objective on their agenda. The question arises, however: why can't they succeed in jumping the price reform hurdle despite repeated efforts, if it follows its own beliefs and Western advocates? Could there be some trap hidden behind the hurdle?

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The facts speak for themselves. Yugoslavia introduced her economic reform based on the idea of "self-governing" socialism and free market prices in 1965. Hungary started her effort to reach a "socialist controlled market" ultimately in 1968. China introduced reform in 1978, widely recognized as the world's most dynamic transformation from a Stalinist economic model to a free market. Poland, after the convulsive years of Solidarity and martial law, climbed two "stages" of economic reform. The first one began in 1982 with 300 percent price hikes. The second one started at the end of 1987 and took observers by surprise because it in fact rejected many communist economic dogmas. It seems, however, that all these efforts failed to achieve their objectives, and the communist world has experienced repeated waves of reforms that simply do not work. The question is why?

Using Western Criteria. It is not easy to answer this question in the United States. The American public, bankers, and journalists seem to forget sometimes about the substantial differences between the two economic systems. They try to explain developments in the East usually by painting pictures with Western brushes and Western imagination. Such a method of explanation does not help people in the West to understand the essence of *perestroika* or the sudden delay in Chinese reforms. It makes the picture dimmer instead of clearer.

Understanding the East is not necessarily an American problem until the day when great business and political opportunities open up, which is not as far away as many people think. I insist that there is a great margin of probability that there will not be a single communist state on the Earth by the end of this century. Is the West prepared to benefit from this entirely new situation? Are the reasons behind the inevitable fall of "The Eastern Empire" properly understood in order to exploit the opportunities for world peace? What are and what will be the basic mechanisms of transformation from a Soviet-style economy to a free market one? Is a free market transformation a prerequisite to democracy? These are questions which, if improperly answered, may bring about revolutionary and violent developments, harming not only the one-third of the world population living under the communist system, but the Free World itself.

Communism is a creature walking on four legs: ideology, a "flat social structure," a centrally planned economy, and a political *nomenklatura* system. All of these have a very practical meaning, and they were very useful and even efficient in the past. All of them must work together to make the system energetic. But now, after decades of militancy based on the potent aggregation of most of the national resources under control of the state, all four legs apparently have become more or less consumptive. All four legs are shaking, and walking seems to be more and more painful.

IDEOLOGY

The practical meaning of ideology is hope. People's expectations of a better future (maybe not for themselves but surely for their children) had been in the early stages of communism one of the most important incentives for hard work and "mass political activity." However, the future has already arrived, and communist nations and their political activists face empty shops and long lines of tired people hoping to buy merely the most basic goods. Instead of a promising future, communist societies have to cope with deep economic, social, and political crises. The most widespread feeling among communist

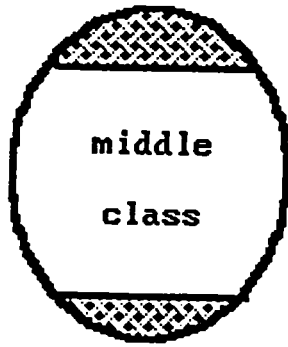
nations today is a lack of hope in a better future. That means the irreversible end of ideology.

Vitali Korotich, who edits the politically lively Soviet magazine *Ogonyok*, when asked what he wants, what he is fighting so hard for, simply says: "I'm tired of labels. I want a normal country." In Budapest, a young journalist says in disgust: "Nothing works here the way it's supposed to in a normal country." In Poland, the Solidarity leader Lech Walesa says the real issue is no longer reforms, "It's how to get out of this abnormal system that can only produce absurdity." In the spring of 1988, Polish Prime Minister Mieczyslaw Rakowski, then a Communist Party Politburo member, distributed a secret memorandum to the communist power elite warning that the future of the Soviet Union and the communist system was in doubt. "Let's do something now before it's too late," said Rakowski. The Kremlin's new ideology chief, Vadim Medvedev, says modestly: "We have to understand better the practice of modern social democracy, and our ideas on economic and social bases of socialism need to be seriously renewed and deepened." There is no need to add to these quotations. This is the real end of the communist ideology. What can replace it?

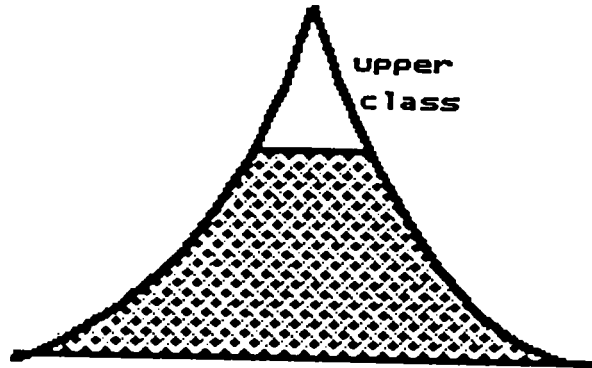
A FLAT SOCIAL STRUCTURE

Social structure was flattened at the very beginning of the communist system. To be wealthy was equal to being an "enemy of the people." The top portion of society was physically or economically eliminated. The social hierarchy was turned upside down. The huge bureaucracy was recruited mainly from the bottom of society. That was one of the most important factors in building up popular support for the system. The state bureaucracy provided a unique historic chance for the poor and uneducated but imprudent individuals and their families. Until recently, a basic commandment was quoted in the communist bloc as important to everybody wishing to make a career in the system: "Remember, never try to be too professional, never try to be too intelligent. That will get you killed." But now there is an obvious necessity to diminish the number of bureaucratic positions in order to save resources and time. There is also a need to promote professionals instead of political activists. The fate of bureaucracy — a spinal cord of the system — seems to be undefined. The differences between social stratification as a foundation of political systems in democratic, underdeveloped, and communist countries are illustrated by Diagram 1.

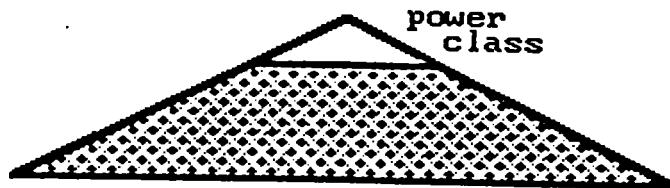
Achieving Internal Equilibrium. Despite the curiosity of social stratification under communist regimes, there are quite logical rules hidden behind this structure, stabilizing the whole system. The system's balance depends on the availability of economic resources. The centrally planned economy and its state-owned companies are a source of state spending for different purposes. A certain balance of spending is essential for achieving an internal socioeconomic equilibrium. At least a half of all resources goes to the state budget. The rest of the gross national product is strictly controlled by central planners. Thus, consumption is not a result of economic development but is dictated by the central plan. The level of consumption and average salary do not reflect the economy's ability to produce consumer goods, but reflects the planner's conviction that salaries offered to employees, combined with expenditures for repressive forces, are sufficient to maintain the social order. The costs of the social order depend mostly on the extent of resistance. That's why the situation in Poland differs from that of Rumania, for example. The cheaper the social order, the more resources that can be diverted from consumption to state projects, which are the main objects of the state's care because they represent a "state power" factor.



democratic
society



underdeveloped
society



communist
society

Diagram 1
Social stratification and
political systems.

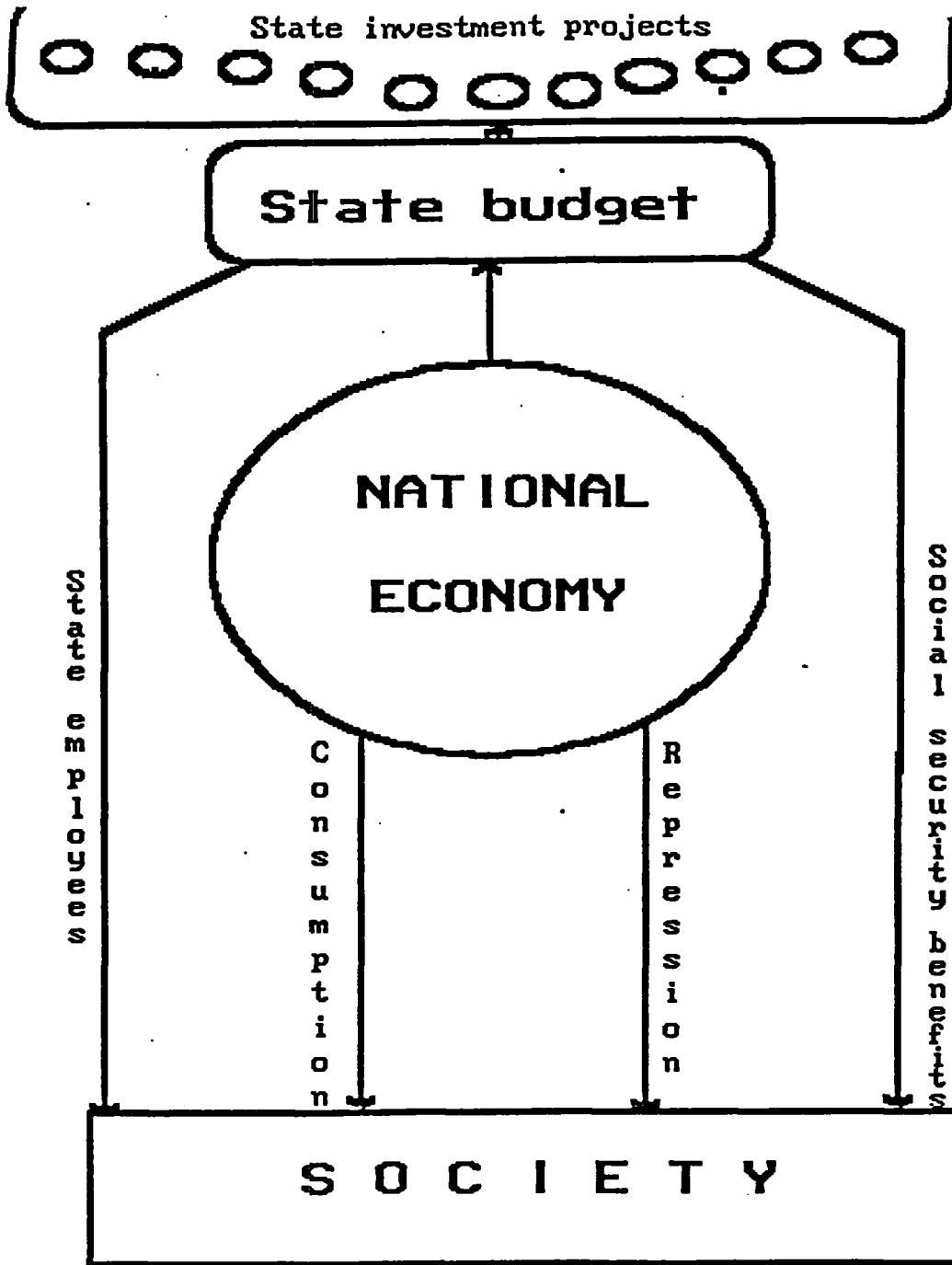


Diagram 2

Socioeconomic equilibrium in communist society.

There are additional factors that influence the socioeconomic equilibrium of a communist country. One of them is state employee benefits that are directly connected with the social prestige of the bureaucracy. The more privileges that are available for the bureaucracy, the stronger is bureaucratic careerism, which solidifies the whole balance of the system. On the other hand, the vast majority of the society depends on some subsidies pouring from the state budget. From our point of view, the most important part of this "social security" factor are subsidies in areas of housing, food prices, health care, and education. Since employees of the socialized sector are beneficiaries of this factor, changes of expenditures for these purposes influence the whole system's equilibrium. Diagram 2 shows the main factors influencing the socioeconomic balance of the communist society and the position of a centrally planned economy as the source of funds for maintaining social order and supporting the state power factor, which is the ultimate goal of the whole system.

CENTRALLY PLANNED ECONOMY

This has been the core of the communist system from its very beginning. Remarks from such prominent economists as Ludwig von Mises and Friedrich Hayek that such a system would ultimately be inefficient were neglected. At the early stage of communism, state central planning seemed to be triumphant and, to some degree, was backed with enthusiasm by many Western economists who warned that the West would be surpassed economically by Soviet-style nations. Early successes of communist economies, however, were only short-term, in that they relied on a concentration of all available resources in order to obtain a high rate of economic growth. This effect could last only as long as the pre-communist market price structure was maintained. But, since communist states intentionally destroyed market forces and granted unto themselves the right of price regulations, their economies became blind.

Price Restructuring. Now the greatest plague of centrally planned economies is a lack of sense of locality. Since state-controlled prices ceased to be controlled, inflation has shot up. Central planning jerks convulsively from one direction to another. Much investment is wasted. Pollution is the most intense in the world, and in the system that touts social justice as the most important issue, there is more inequality than ever. That is why governments of communist nations follow so willingly the World Bank's advice to begin reforms by first implementing price reforms. Rulers think that this way they can revive the market price structure and restore the system's orientation in economic surroundings. But it appears to be not so easy. A free market is not simply an implementation of a price equilibrium. A price equilibrium is not even a beginning of market revival, nor should it be taken seriously as a prerequisite for major reforms. Look at the example of Yugoslavia. Yugoslavs implemented price equilibrium in the late 1960s. So what happened? The economic crisis seems to be as painful as in Poland where the price disequilibrium has been intentionally developed for many years. That is because it is impossible to build up a free market price structure on the surface of fully centrally planned economic and social structure. The resistance to price restructuring does not come merely from those who don't like it. Nobody likes price hikes. The real resistance comes from the communist system's substance, from all elements of the economy and social stratification. People resist price hikes mainly because they doubt that they can bring any positive result, because no link between price changes and productivity exists in a communist system. But this is an element the people have to live with; they are a part of this element, too. Thus, communist countries should not start free market-oriented reforms with price reform but with introducing a new legal

system, a new civil code that will be able to secure property rights and accelerate the emergence of a capital market.

There is a substantial difference between the meaning of the term "market" in the two systems. In a free market system the market is a complex structure regulating the behavior of three market "actors": consumers, entrepreneurs, and government agencies. The government plays a specific moderator's role in a free market system. In the centrally planned economy, the market means something entirely different: it is only a small margin of the economy where consumers can buy some goods with their salaries. Only this part of the economy is called market. Thus, one actor — the consumer — is being kept on a short leash by central planners. Another one — the entrepreneur — simply does not exist. The only independent and really decisive actor remains the state which is an amalgamation of the communist party structure, the government and its agencies, and the socialized sector of the economy. The difference between a free market complex and the market in a centrally planned economy is shown in Diagrams 3 and 4.

Thus, the national economy in a centrally planned system is divided into two areas which are not connected directly: the market area and non-market area. The primary part of the economy is the non-market one. The market area is of secondary importance and represents the consumption factor from Diagram 2. The GNP is distributed in two sequences: the extent of consumption is not decided before the level of investment is stabilized. The level of consumption is what remains after the investment plan is executed. Interrelations between market and non-market areas are shown by Diagram 5.

THE NOMENKLATURA SYSTEM

The system of *nomenklatura* has stopped working. It has been frequently misunderstood in the West. This system is very unusual because it gives more power to informal (non-normative) institutional structures than to formal (normative) ones. That lets power elites implement the most democratic-looking legal systems in the most oppressive regimes in the world. This allowed, for instance, Stalin to celebrate the abandonment of the death penalty in the Soviet penal code while millions of people were dying in the Gulag. The *nomenklatura* system is not reflected by law. The only legal basis for communist party power is its role as a "vanguard" as mentioned in the communist state's constitution. The real basis of its power, however, is the social contract formed and solidified by years of Stalinist repressions. The position of the Communist Party hierarchy in the state's structure is shown by Diagram 6.

No One to Blame. Now the *nomenklatura* system has stopped working. Poland is a forerunner of the *nomenklatura*'s decay, and this can explain the phenomenon of the Polish case. Formally and legally, the Polish Communist Party had no power. It had always relied upon vocal orders, never written decisions, to carry out its wishes. That is why all the documents found by Solidarity activists investigating illegal practices contained only signatures of people from administrative institutions — Communist Party leaders appeared to be free of any charges. Even Mr. Gierek, Polish ruler and the first secretary of the powerful Communist Party Central Committee, pretended he was not in a position to make any important political or economic decisions. He was fired from his post but since there was no legal evidence against him, he was never punished. After martial law was implemented in Poland, the Polish *Sejm* became one of the busiest parliaments of the

1. Market complex in a free-market economy.

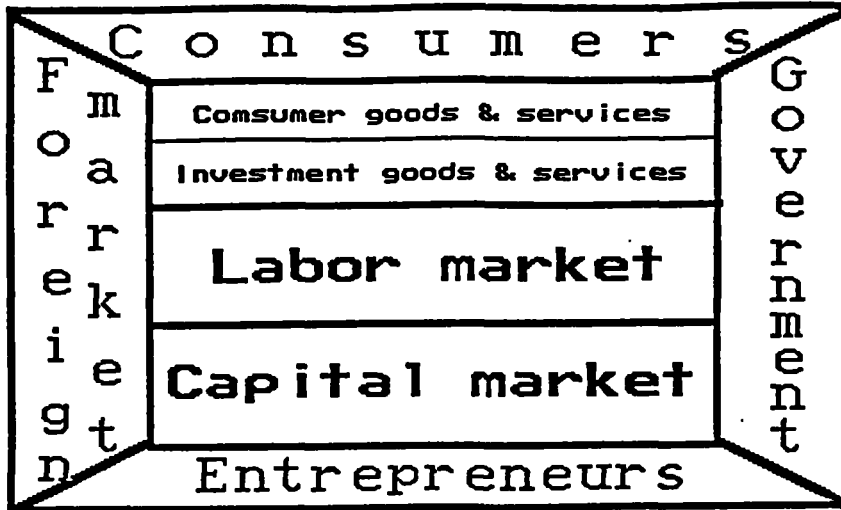


Diagram 3

Market complex in a free-market and Soviet-type economies.

2. "Market" in a centrally-planned economy



1. Market complex in a free-market economy.

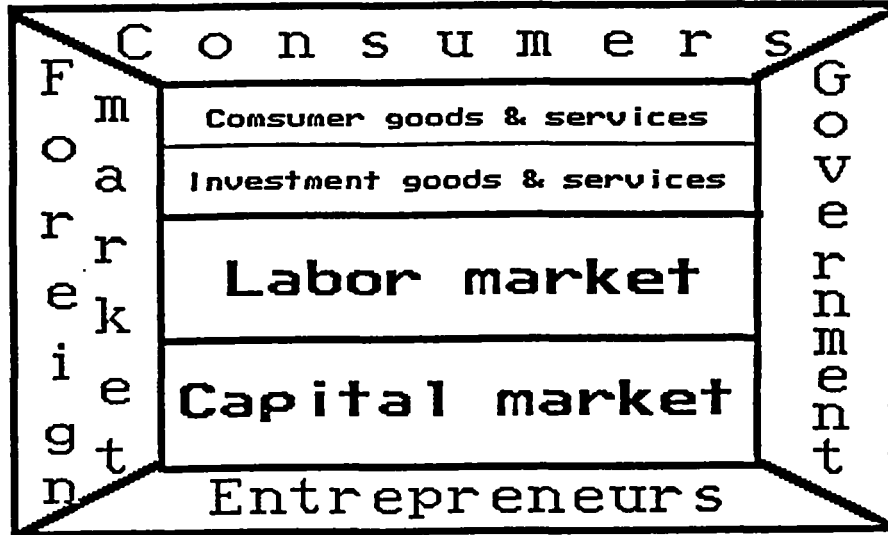


Diagram 4

Market complex in a free-market and Yugoslavian-type economies.

2. Market in Yugoslavian-type economy.



Diagram 5

"Market" and non-market areas in a centrally-planned economy

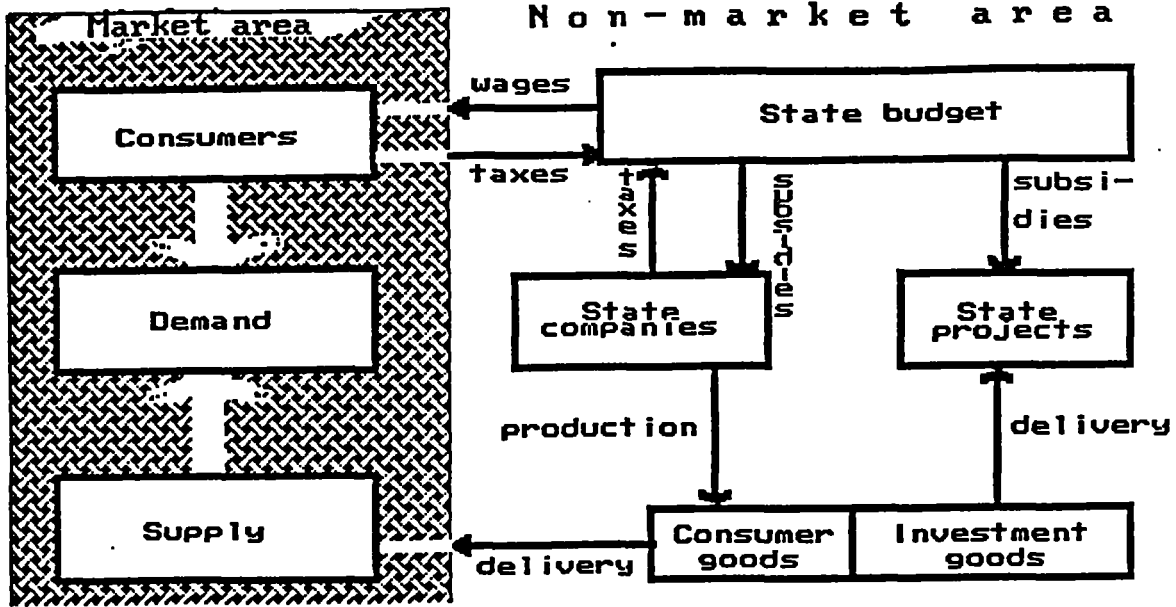
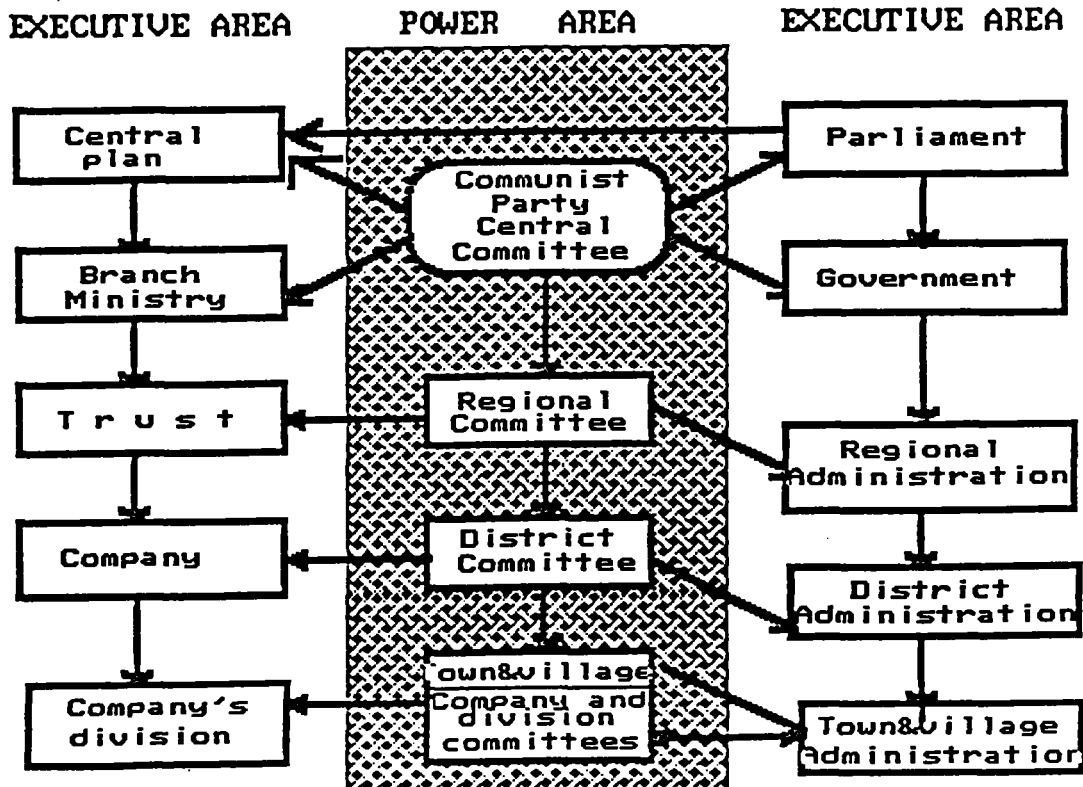


Diagram 6

The "nomenklatura" and an organization of a communist state.



world, issuing hundreds of new regulations to prevent blaming the administration for further Communist Party apparatus power abuses. The Communist Party has never recovered from this blow, and its informal power weakened as never before. It was also a heavy blow to the *nomenklatura* system, and it explains why Poland under military rule turned out to be one of the most liberal countries in Eastern Europe.

Back to the Future. Life has become uneasy in the East not only for the ordinary people but also for their rulers. There are many questions coming out of the communist Pandora's box which, if not answered properly, may result in hopelessness and violence. That is why the governments and power elites desperately seek for any pragmatic answer to the current crisis, no matter how unpleasant. Now, the ultimate answer exists, which I am going to offer during my second lecture. It is not an easy one to accept, but people facing a firing squad are usually well-prepared to make many concessions, no matter how great. The answer lies in the popular Polish joke, that "socialism is the longest way from capitalism to capitalism." Some communist governments understand the problem better than others. The Parliament in Budapest, Hungary, has just approved a Law on Corporate Association which, from the beginning of next year, is intended to let the private sector blossom, liberate the movement of capital, and allow Western companies to buy Hungarian ones. Hungarians now seem to be taking capitalism out of the closet and on to the statute books.

The communist nations, after decades of economic and social experiments, now find themselves trapped in a time machine, which is taking them back to the reality they had passed. They have to witness history again, but this time in reverse: from a centrally planned economy to a free market, from the flat and equalized society to social and political diversification, from *nomenklatura* to democracy, but also — from hopelessness to newborn hope. It is a long, rocky, and dangerous path, but what the West can do is help them mount the mule.

