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Economic Reform and Citizen Entitlements in Eastern Europe: Some Social Implications of Structural Adjustment in Semi-Industrial Economies

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Preface

This paper forms part of the Institute's work on the social and political transformation in Eastern Central Europe and the Soviet Union. When the project was initially formulated nearly three years ago, the intention was to explore the implications for social participation of the emerging economic reforms in centrally planned countries. The focus of the project has changed in line with the rapid pace of political and economic reform over the past two years in these countries. The research programme is now focusing on different dimensions of participation in the light of the changes in property relations currently taking place in communist and post-communist societies.

The author of this paper, E.V.K. FitzGerald, Professor of Development Economics at the Institute of Social Studies, The Hague, has published books and articles on Latin American development problems. He has acted as an advisor to the governments of Mexico, Nicaragua and Peru. At UNRISD, the project is being co-ordinated by Ann Zammit.

In this wide-ranging paper, FitzGerald attempts to relate the processes of economic restructuring currently under way in Eastern European countries to the social aspirations of the people and the political imperatives of a democratic state. The paper highlights a major dilemma facing the countries of Eastern Europe in their attempts to promote structural reform and economic growth. With levels of productivity nearly a quarter of those in Western Europe, the countries of Eastern Europe had attained indices of social achievement not too far below those in the West. At the same time, with the establishment of political and civil liberties have come social aspirations for welfare systems prevailing in Western Europe. These are in direct conflict with the current policies of economic liberalization, stabilization and restructuring. The strategy of the "big bang", promoted by the Bretton Woods institutions and several Western countries and adopted increasingly by countries of Central Europe, implies in the short to medium-term sharp falls in private consumption, curtailment of social services and creation of high levels of unemployment.

The states in Eastern Europe are thus faced with the contradiction between the economic consequences of restructuring and the social aspirations of the people based on the citizenship entitlements of a modern democratic state. These contradictions are the more difficult to resolve as the modernization project itself calls for major investments in education and skills of the labour force. The author concludes that the contradictions can only be resolved within the framework of an explicit social contract between management, labour and the state. This may in turn call for the establishment of clear entitlements as citizenship rights and necessitate the social planning of basic need provision.

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Dharam Ghai
Director

Introduction

The return of markets and elections to Eastern Europe after 50 years of state-centred economy and politics presents the historical prospect of both re-attaining technological modernity and civil society. The economic reforms and democratic pluralism upon which the transition from backward socialism to advanced capitalism is to be based mainly refer to the semi-industrialized countries on the "European periphery" (Czechoslovakia, Hungary, Poland, Romania and Yugoslavia) and follow a broadly similar pattern. Greater Russia presents a quite different problematic, due to its status as both major primary exporter and super-power[1]; while the Asian Soviet Republics, Bulgaria and Albania can best be regarded as agrarian societies on the periphery of the world economy, with a distinct reform agenda[2].

The dismantling of the state enterprise sector is justified by the long-standing diagnosis of the systemic problems of state socialism, but the accompanying economic policies appear to be strongly influenced by a particular reading of the structural adjustment experience of the "newly industrializing countries" (NICs) by the International Monetary Fund and the World Bank[3]. Although there is a general expectation that these reforms will lead to a gradual approximation to Western European social and economic standards over the longer-term, there are clear signs of opposition to the distributive consequences of orthodox structural adjustment. Such opposition is commonly attributed to "conservative" forces (i.e. the bureaucracy) or at best, to "social constraints" which must be overcome in the medium-term in order to achieve the undoubted longer-term benefits. Indeed one of the strongest arguments for "shock treatment" is the essentially political perception of the need to transform economic behaviour before popular enthusiasm for economic reform wanes.

In contrast, this paper argues that although the Eastern European combination of a semi-industrialized production structure with a skilled labour force implies enormous productive potential for the longer-term, this combination also contains a fundamental conflict between efficiency and welfare during a prolonged transition which has perhaps been overlooked in the design of economic reforms along the lines suggested by the Bretton Woods institutions. Above all, the relatively well-educated and socially integrated workforce which provides the basis for future productivity at Western European levels also expects corresponding levels of public and private consumption as "citizen entitlements" which are inconsistent with the radical income redistribution required by orthodox structural adjustment programmes.

The first part of this paper outlines the systemic problem of the pre-reform economies, the existing levels of industrial productivity and welfare provision, and the logic of the economic reform project in Eastern Europe. The second part discusses the perceived "constraints" on the structural adjustment – fiscal stabilization, trade liberalization and privatization – which supports the reform process, from the point of view of their distributional implications. The third part of the paper suggests that these issues of employment, wages and access to public services are better seen in terms of "citizen entitlements"; leading to the conclusion that the

[1] An excellent survey of the "roadblocks to reform" in the USSR is provided by Nordhaus (1990).

[2] The United Nations Research Institute for Social Development (UNRISD), in Geneva, is currently co-ordinating a research programme on the social consequences of the changing relationship between markets and the state in the socialist agrarian economies of the Third World. For some antecedents, see Saith (1985), and FitzGerald and Wuyts (1988).

[3] Despite the longer involvement of the Bank in research into the economic problems of socialist economies (Solimano, 1990) – particularly Hungary and Yugoslavia – the Fund (Wolf, 1985) appears to have had greater intellectual influence on the reform debate; which may explain (or possibly be explained by) the emphasis on short-term financial and ownership measures rather than longer-term issues of investment and trade. For critiques of the "Bretton Woods" view of finance and adjustment in LDCs, see Taylor (1988), and FitzGerald and Vos (1989).

reform programme should be redesigned in order to contain the social consensus necessary for a sustainable re-industrialization strategy – and thus political democracy.

Table 1		
Comparative Development Indicators (1988)		
	Income Level (US$ per capita)	**Health Service** (population per physician)
Czechoslovakia	3,300	280
Hungary	2,460	310
Poland	1,860	490
Romania	---	570
Yugoslavia	2,520	550
Middle-income economies	1,930	2,520
EEC	11,363	385
Spain	7,740	320

Source: Tables 2 and 3. **Note:** Spain is the poorest of those OECD members categorized by the World Bank as "industrial economies".

1. The Economic Reform Project

The breakdown of the "socialist" (i.e. soviet-type) economies of Eastern Europe is self-evident[4]. After an initial period of rapid social reform in the post-War period, the main thrust of economic strategy became "catching up" with Western Europe by forced industrialization based on centrally administered state enterprises and extremely high rates of capital formation[5]. By the 1980s three key factors had combined to make economic reform unavoidable: first, an inadequate supply of basic consumer goods (especially food) and quality of public services, particularly in comparison with Western Europe, which undermined régime legitimacy; second, the inefficiency of modern sector industry, which had fallen behind technologically not only Western Europe but also many NICs, and was unable to meet domestic requirements for wage-goods and producer goods; and third, chronic convertible-currency balance of payments difficulties, where the inability to export manufactures (of sufficient quality) restricted the capacity to import the technology needed for modernization.

According to the "shortage" model,[6] the form of institutional organization in planned economies leads to non-price behaviour and "soft budgeting" as a systemic characteristic of the state firm. Unconstrained demand from firms generates excessive investment rates, inefficient resource use, paternalistic relations between firms and ministries, labour hoarding

[4] The analysis presented here of systemic breakdown is based on the work of Kornai (1980) and Brus and Laski (1989). Of course, there had been earlier reform attempts throughout Eastern Europe in the 1960s, while the 1970s saw considerable economic liberalization in Hungary and Yugoslavia; but nothing on the scale of the present changes.

[5] Of course, socialism was originally supposed to **follow** mature capitalism, with all its productive capacity developed (Brus, 1975). In fact indigenous socialism emerged in what would now be called the Third World – particularly Russia and China while in the case of Eastern Europe, socialism was the consequence of World War II.

[6] See Davis and Charemza (1989) for an excellent survey.

and chronic shortages of consumer goods. In contrast, the “disequilibrium mode”[7] suggests that the origins of economic system failure, particularly after the enterprise reforms of the 1970s and 1980s when central planning was virtually eliminated, are to be found in planners’ errors in attempting to achieve high rates of growth through over-accumulation; excessive defence expenditure; slow response to external shocks transmitted from the world market[8] and price distortions – particularly the difference between domestic and international relative price ratios. These two models are not mutually exclusive, of course; but the relative importance attributed to each logically affects the way in which reform policies are designed and the effect they can be expected to have.[9]

Reliable comparative data on the Eastern European economies (EEEs) is hard to come by, but that which is available indicates that levels of output per head lie well within what the **World Tables** (World Bank, 1990) define as “middle income countries” (MICs)[10] and around a quarter of those in Western Europe (EEC) – as Table 2 indicates. Real standards of living (ICP) do appear to be somewhat higher than those in MICs due to different price structures, but are still only a third of those in the EEC. Compared to Spain (the first on the **World Tables** list of “industrialized countries”), the gap is similarly large – output per head one-third and living standards one-half. It appears that while Eastern Europe had been comparable with (say) Greece or Spain in the 1960s, by the late 1980s the progress of Western Europe and of many Third World economies (particularly the so-called “newly industrializing countries”, or NICs) was such that it could even be argued that EEE had achieved “permanent developing country status”.[11]

[7] This had been discussed for some time, of course: see Portes (1979), Nuti (1979) for instance. For an excellent survey of the debate, including a useful comparison between the “shortage” and “disequilibrium” approaches, see Davis and Charemza (1989).
[8] Particularly the oil shocks of the 1970s (Neuberger and Tyson, 1980), but also the subsequent debt shock as repayment of borrowing, designed to permit industrial accumulation to accelerate, became due.
[9] This is not to suggest that the roots of reform are to be found in the discourse of economists, but there is no space here to discuss the social forces generated by the post-War experience of communism – although they will be referred to indirectly below.
[10] These sources should be consulted for definitions, methodology and coverage. The 40-odd “middle-income economies” as defined by the World Bank range from Bolivia (US$ 570 per capita GNP) to Greece ($4,800); with the median case being Chile ($1,510). Good points of reference are Mexico ($1,760), Brazil ($2,160) and South Korea ($3,600).
[11] Winiecki (1989).

Table 2						
Economic Structure (1988)						
	Income Level GNP/capita	ICP*	**Energy Use** TOE#/capita	**Industrial Share** GDP	emp.	exp.
Czechoslovakia	3,300	---	4.4	49	37	80
Hungary	2,460	31	3.1	37	33	69
Poland	1,860	25	3.5	48	28	67
Romania	---	---	3.5	50	36	---
Yugoslavia	2,520	29	2.2	49	41	79
Middle-income economies	1,930	20	1.1	40	25	59
EEC	11,363	65	3.1	41	34	81
Spain	7,740	46	1.9	37	24	73

Source: World Bank (1990), IMF (1990a, b). **Notes:** * ICP is United Nations estimate of per capita income (USA = 100) in 1985 adjusted for the purchasing power parity of currencies; # "TOE" is tons of oil equivalent.

The industrial figures in Table 2 are instructive. The share of industry in output is quite high in comparison with both MICs and EEC, although this also reflects the relatively small tertiary sector.[12] In contrast, the share of industry in employment is similar to that of the EEC, but much higher than that of the MICs, which reflects the relatively low level of labour productivity. The proportion of manufactured exports in EEE is much higher than in MICs and approaches that of the EEC, but of course these products were primarily oriented toward captive CMEA (Council for Mutual Economic Assistance) markets. Finally, energy use in EEE is extremely high, which not only reflects problems of industrial efficiency but also has serious implications for both the balance of payments and the environment.

In sharp contrast, as Table 3 indicates, the levels of welfare in EEE are far superior to those of MICs and comparable with those of EEC. Levels of literacy and secondary enrolment have a clear impact on the quality of the workforce, and thus the potential (if not the realized) level of labour productivity, technological absorption and export competitiveness in the longer run. Similarly, health standards are clearly far superior to those of MICs and approximate those of the EEC. Measures such as per capita calorie intake and population-per-physician indicate levels similar to those of the EEC, although life expectancy and infant mortality are somewhat worse.[13] In any case, all these measures indicate a situation far superior to that in MICs and, more importantly, these levels of health and education (housing is far more problematic) have