

Were there Alternatives to Transition Policies in Eastern Europe? Some Lessons from the Postwar Reconstruction in Austria

Felix Butschek

University of Vienna

The point of departure for these considerations is the comparison of the economic performance of countries which underwent a transformation from a planning system to a market economy. This was notoriously the case with the former Cmea-Countries after 1989. Among them, this paper will concentrate upon the East Central European states; first of all, for historical and geographical reasons (these so-called "successor states" of the Austro-Hungarian Monarchy are more or less Austria's neighbours), but also, because these countries had in the past an institutional structure which is comparable to Central European economies.

On the other hand it must be borne in mind that after 1945 most European countries had to change from a planned war economy - which went further in the regulation of production and distribution than the Cmea-Countries - back to the market system.

The comparison concerns seven years from the start of the transformation: in the former case the years from 1989 to 1996, in the latter the seven years after 1945. A dramatic difference becomes visible. While during this period after World War II most West European Countries recorded considerable growth - some more than doubled their GDP - the East Central European Nations suffered heavy losses in the first years after 1989. Only slowly did their economies begin to expand again; in 1996 they had more or less reached the income level of 1989.

| TABLE - Economic Growth Seven Years after 1945 and 1989 At Constant prices | |
|---|--|
| Western European Countries | |
| | Changes between 1945 and 1952 as per cent |
| Austria | 134.4 |
| Belgium | 37.0 |
| Denmark | 47.1 |
| Finland | 47.5 |
| France | 135.2 |
| Germany | 31.8 |
| Italy | 118.1 |
| Netherlands | 153.9 |
| Norway | 55.2 |
| United Kingdom | 7.0 |
| East Central European Countries | |
| | Changes between 1989 and 1996 as per cent |
| Czech Republic | -3.7 |
| Slovak Republic | -10.2 |
| Hungary | -13.4 |
| Poland | 4.6 |
| A. Maddison, <i>Monitoring the World Economy 1820-1992</i> , (OECD, Paris, 1995). | |

Of course, there are immediately arguments at hand which could explain at least some of the differences between the postwar situation and that after the 'velvet' revolution. It turned out that even severe war damage could be repaired, if the qualified staff of an enterprise remained in action. Minor damage was even easier to repair. And if energy and raw materials could be provided idle capacities were utilized. So the extremely high growth during the years immediately after the war seem intelligible. But reconstruction ended more or less in 1949 and quite considerable growth rates continued.

But there are other arguments which come nearer to the central hypothesis of this paper. Although, as already remarked, wartime

planning was even more all-embracing than the Cmea-System, the whole institutional and organizational structure of the market economy had persisted, including the attitudes of the economic agents. This was true even for Germany, where some sort of planning had started already in the middle of the thirties. It had remained basically an economy with private property and private entrepreneurs.

So the transition to the market system was no doubt far easier after 1945 than after 1989. In the latter case the precedents of a market system went back 40 years. So it certainly could be said that the governance structure of the former Cmea-Countries was ill-suited to the working of a market economy or, as Kornai put it, there was a "disruption of coordination" (quoted from Berend, 1996, p.351).

Economic Policy and Transformation.

How did economic policy react to these circumstances? Regarding the East European Countries one could say that this fact was not recognized! The private American consultants as well as the International Monetary Fund provided programmes under the assumption that these countries were already working market economies. Their proposals concentrated upon immediate liberalization of prices and foreign trade, external and no internal devaluation, but forceful monetary and fiscal stabilization. In many of these countries, with their extremely monopolized markets, these actions led to high inflation, which intensified the restrictive policies and worsened their current accounts. The sudden introduction of convertibility caused additional devaluations, nevertheless the liberalization of foreign trade exposed domestic industry to extremely high pressure. Up to 1989 the Cmea region was a closed economy, where second-rate goods were produced and traded. Now they had to compete with the high-quality products of the west. There was no time allowed for adjustment. In the special case of Eastern Germany, where not even the possibility of devaluation was given, these circumstances led to the virtual extinction of industry.

Another example concerns eastern agriculture. Trade was quickly liberalized, but at the same time subsidies were greatly

reduced, so that low-quality production had to compete with the sophisticated products of the West, which were highly subsidized (Berend, 1996, p.344). All these influences contributed to the dramatic reduction of GDP. Of course the dissolution of CMEA and the interruption in trade between these countries accentuated this development in spite of the impressive swing in foreign trade from East to the West.

This recent approach is contrasted sharply to the postwar economic policy in Western Europe. Although during the war the Anglo-American powers had already developed the system of Bretton Woods, which was based fundamentally on the free flow of goods, services, money and labour, nobody intended to introduce the market system at once. Of course, these states had to face similar problems as the former CMEA-countries after 1989. As a consequence of price regulation there existed a disproportionate relation between the volume of money and that of goods as well as an incongruent price structure.

Most countries tried to solve the former problem by an internal devaluation. These were frequently not immediately successful. Several approaches were needed, as for instance in France (Hagelheimer, 1969, p. 218) and in Austria (Butschek, 1985, p. 99), mainly because budgets had not been stabilized.

But in hardly any country was price regulation removed immediately and totally; not even in Germany by the famous *Währungsreform*. Although it was undertaken for political reasons rather late (1948) - initially there existed only separated occupation zones - so that production had already recovered to a considerable extent, the prices of some important foodstuffs and products of basic industries, like coal, steel, electricity as well as housing and the capital market remained under control (Buchheim, 1990, p.26).

No Western European country opened its borders for the free flow of goods and financial transactions immediately. The foundation of the OEEC (Organization for European Economic Cooperation) as well as of EPU (European Payments Union) makes clear that liberalization was a goal of economic policy, which was reached more or less only towards the end of the 1950's.

The Austrian Way of Transformation.

The Austrian model of transformation deserves in this respect special interest, as it may be seen as an example of extreme gradualism (Butschek/Baltzarek, 1994). Additionally it formed the basis of the corporatist structure of Austrian society after World War II. When in 1947, in spite of price regulation, inflation accelerated, it was not government but trade unions and employer organizations - in Austria called 'social partners' - who started an initiative to curb this development. A commission was established, whose members were drawn from social partners and government (*Wirtschaftskommission*). All changes in wages and prices were to be unanimously settled in this commission. Price regulation no longer worked properly, but it was expected that wages and prices would remain stable because members of labour market organizations were disciplined and would therefore accept the solution found by their representatives. This assumption proved to be correct throughout the postwar period.

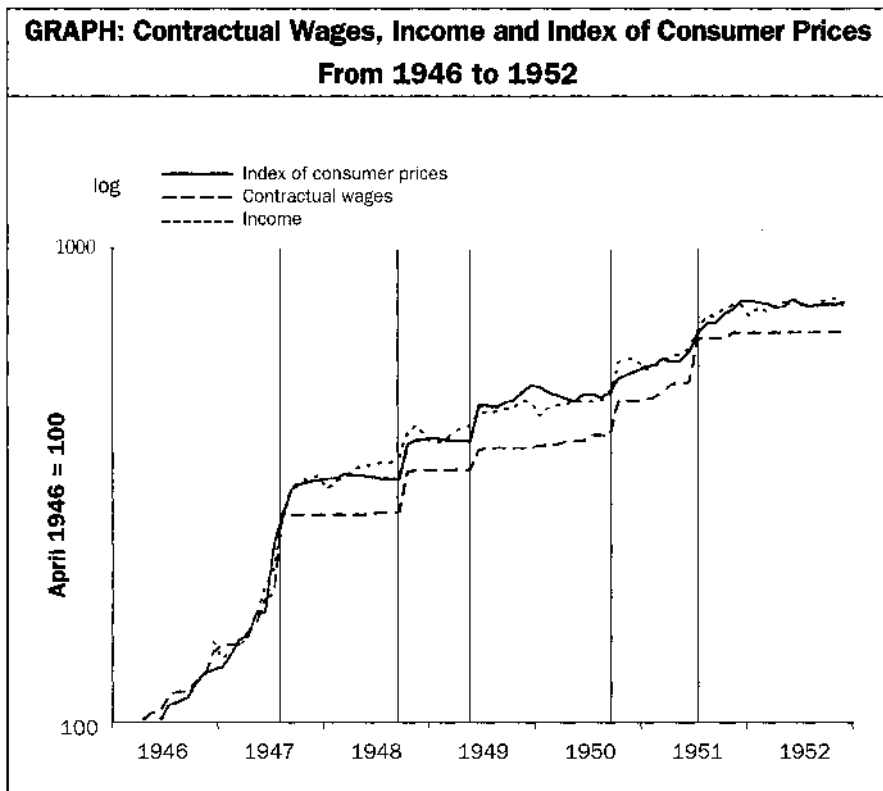
The policy pursued by the commission was to keep nominal wages and at least consumer prices constant at the postwar level and let production grow up to this point. Workers would not participate in the increase in productivity until monetary equilibrium was reached. Politicians, of course, were aware of the necessity to adjust price structures and to modify taxes and social-insurance contributions. Only these corrections were to be viewed as an argument for wage increases. The entire system was put into practice by way of a "general collective treaty".

The first pact proved to be fully successful. After the negotiated increase in prices and wages, inflation came to a halt, especially since the policy was reinforced by an internal devaluation of the currency (*Währungsschutzgesetz*) at the end of 1947. Nevertheless social partners and government initiated a second agreement in September 1948, which again contained some price and tax corrections and the corresponding wage increases. This pact was also successful since prices remained stable after the negotiated rise. In 1949 internal monetary equilibrium seems to have been achieved because GDP had

regained its pre-war level and the black market had disappeared. The director of the Austrian Institute for Economic Research, Nemschak, urged the politicians to return to the market system.

However, the parties continued their activity because it seemed to be very convenient for all of them to settle social and political problems centrally. They negotiated for a third agreement in 1949 and a fourth in 1950, which caused some political turmoil. Nevertheless they concluded a fifth one in 1950, which totally failed and inflation accelerated again.

The permanent use of the instrument of *Sozialpartnerschaft*, which had been established to fight inflation had changed its true nature. It became, in the end, a cause of inflation itself. Inflationary expectations arose as a consequence of the regular succession of wage and price agreements, which led to "political inflation", the more so because



monetary policy was never used to counter it, as the authorities were afraid of dampening investment.

Final stabilization, however, came about also - at least partly - through the activity of 'social partners'. When it became clear after the fifth price-wage agreement that inflation could no longer be stopped in this way, the 'social partners' agreed upon a "price-reduction programme" (*Preissenkungsaktion*). Entrepreneurs agreed to lower their prices and the trade-unions promised not to put forward wage increases for a year and a half. This agreement was now backed by a restrictive monetary and fiscal policy; but inflation was suddenly halted because the change in "regime" seemed trustworthy (Sargent, 1982).

It is important to note, that, during the entire period, the regulation of the economy was gradually loosened. Rationing of wine was ended in 1947, fruit, vegetables and wood followed in 1948, eggs, potatoes and bread in 1949 and at the beginning of 1950 all food rationing was abolished. Similarly, regulation of production, distribution and prices was also gradually removed so that by the end of this period, the market again became the instrument of economic coordination.

How should the Austrian performance be assessed? Austria was one of the most successful states in this period, in spite of rather unfavourable conditions. The country was occupied by the Allied Forces until 1955 and the situation in the Soviet zone was rather difficult. Apart from the conduct of the occupation force, most of the industrial enterprises were expropriated by the Soviet Union as "German property". This meant an aggregate annual loss of approximately 2% of GDP in these years (Seidel, 1957, p.406).

And another asset for Austria emerged. The "Wage-Price-Agreements" provided high social stability. Trade unions cooperated in the wage-price-system not only because they sought a smooth transformation from post-war planning to the market, but also in order to gain a foothold in the formulation of economic policy. Austrian trade unions extended their traditional area of manoeuvre - wages and social policy - to include general economic policy. The Wage-

Price-Agreements provided the first organizational framework for this. This approach led later to the foundation of the Parity Commission and the Council of Economic and Social Questions as the final organizational installation of 'social partnership' in Austria (Butschek, 1996, p.145).

But, even if one accepts, that gradual change fosters economic growth, the argument is frequently put forward that the communist economic system simply did not work any longer, so that a sudden change to the market economy was unavoidable. This is over-stated: it certainly ran into even more trouble, but it did not break down technically. Furthermore the wartime planning system also became more and more inefficient; black markets expanded, price regulation became patchy, enterprises bargained outside the channels of regulation. But it provided at least the frame for the gradual adaptation to the market system.

Institutions and Economic Growth.

All these considerations are backed by recent economic theory. The New Institutional Economics (NIE) have examined the importance of institutions and organizations for economic performance. According to North the former are "...the humanly devised constraints that structure political, economic, and social interactions. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conducts), and formal rules (constitutions, laws, property rights)" (North, 1991, p.97). Important actors in social and economic coordination are organizations: "It is the interaction between institutions and organizations that shapes the institutional evolution of an economy. If institutions are the rules of the game, organizations and their entrepreneurs are the players" (North, 1994, p.361). This "governance structure" (O.E. Williamson, 1993, p.16) of a country is decisive for its economic development. It determines the level of transaction costs and the attitudes and expectations of entrepreneurs, so it explains the historical time and place of industrialization as well as income differences of regions today.

But one central element of this governance structure is its path dependence. Institutional changes need a comparatively long time - otherwise they could not fulfil their task. And if a whole governance structure is changed, as in the former Cmea-Countries, it is evident that it needs a lot of time to become effective. "While Europe's emerging market economies have made considerable progress in passing the relevant laws and in establishing or adapting organizational structures on paper which may often be done by a stroke of a pen, the adjustment of behavioural patterns, including the accumulation of new institution-specific human capital is necessarily a time-consuming process" (Schmieding, 1993, p. 237). And it is also this fact that leads to the conclusion that the shock treatment of transformation was inadequate.

One example of ill-adapted governance structure may be seen in the rise of corruption and rent-seeking in the former Cmea-Countries especially in Russia. Although certainly one expression of utility maximization, it is inadequate in a working market economy.

Finally some additional empirical aspects should be discussed, because it is not only possible to compare former Cmea-Countries and Western post-war states, but also European and Asian communist countries. Although politically unchanged, the latter have also started a transition process, but obviously far more gradually than in Europe. China introduced special zones where the capitalist system is being tested and is removing regulations step by step. Of course, the game there is not yet finished, because the bulk of state-owned industries have still to be integrated into the market system (Pomfret, 1994, p.192). But until now the model has worked rather successfully because it has produced even higher growth rates than in Europe in the 1950's, and what is said for China may be equally true for the smaller Asian Communist countries as, for instance, Vietnam.

Certainly, additional arguments can be brought to explain the poor economic performance of the former Cmea-Countries, such as the European slump from 1991 to 1993 or limited Western assistance, but in the light of historical experience and theoretical considerations the decisive fact seems to lie in the speed of the transformation process.

The sudden liberalization of foreign trade as well as the dramatic reduction in subsidies removed any protection from underdeveloped industry and agriculture. Even frequent devaluations could not make up for it, so there was no time for enterprises to adapt to the new conditions.

Equally important seems to be the lack of time for adjusting the whole governance structure of these countries. Institutions and organizations, and the attitudes of economic agents were not given time to change calmly and efficiently.

Of course after one decade it seems as if the process of transition has made significant headway, at least in Eastern and Central European countries. But the extremely high costs have already been paid and nowhere is a dramatic acceleration of the catching up process visible, which could be the only justification for the high price which has been paid for the kind of transition adopted by these countries.

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