Eliminating the shortage economy: a general analysis and examination of the developments in Hungary: Part 2

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Part 2. The end of shortage: an assessment

3. Causal analysis (continued)

3.5. The role of monetary policy

Is it necessary to have a restrictive monetary policy for the shortage economy to be eliminated? Before answering that question, let us clarify the concepts entailed. In monetary policy aimed at controlling the money supply, there is a choice between the following alternatives:

A. The aim is to restrict money supply by comparison with the demand for money. The growth rate in the money supply needs to be smaller than that of the demand for money generated by the expected nominal GDP calculated on the basis of expected inflation and real interest rates. If this is the intention behind the monetary policy, a decision must also be made on the degree to which the restriction is to be applied.

B. The aim is neither to restrict nor to expand money supply by comparison with the demand for money. The policy is designed to ensure that the growth rate of the money supply will be exactly the same as that of the demand for money generated by the expected nominal GDP calculated on the basis of expected inflation and real interest rates. In other words, assuming an unchanged velocity of money, the growth index of the money supply will equal the product of the expected inflation rate and the expected real-growth index.

C. The aim is to expand money supply by comparison with the demand for money. The growth rate of the money supply needs to be greater than that of the demand for money generated by the expected nominal GDP calculated on the basis of expected inflation and real interest rates. If this is the intention behind the monetary policy, a decision must also be made on the degree to which the expansion is to be applied.

The attribute "restrictive" is applied in Hungarian financial jargon not only to an A-type policy, known in Western parlance as a tight, strongly disinflationary monetary
policy, but to Type B, which actually allows for the "planned" rate of inflation. In fact this is only restrictive in so far as it ensures that inflation is kept under control. It will not grow faster than planned in the economic policy, principally on the cost-increase side. 7

Alternatives A, B and C are three possible intentions behind monetary policy. Even if the monetary policy-makers reach a clear decision on their intention, a number of further questions remain open. What means are they able and willing to employ to attain their purposes? And, most importantly of all, are they capable of attaining what they intend coherently and consistently?

Hungarian economic researchers have still not classified the monetary policy of the last six to eight years in these terms. The figures available reflect an inconsistency between the various, perhaps mutually conflicting intentions and the mutually conflicting means. The final result during much of the period has corresponded most closely to the middle case, a B-type, accommodating monetary policy. An A-type, restrictive monetary policy applied in a more, or rather less consistent way at most in various shorter periods. There have been several signs in the last two years of a return to an expansionist, C-type monetary policy, although the signs are not entirely plain and the monetary expansion has not been great. 3

To return to the main subject of the study, the prime condition for eliminating the shortage economy is the implementation of the institutional changes described in Part 1, Sections 3.1 and 3.3, which has been successfully accomplished in Hungary. But this must also be accompanied by an appropriate monetary policy. If the monetary policy is a restrictive one of Type A, it can act as a catalyst, speeding up the elimination of the shortage economy. It erects another barrier before the components of macro demand that are liable to run away. It helps to overcome the investment hunger for the stock of investment credits to be strictly limited. It helps to overcome the hoarding tendency for the stock of credits available for inventory financing to be tighter. If the remnants of bureaucratic price-setting survive, leaving the possibility of inflation being bureaucratically repressed, a policy of curbing and restricting the growth of macro demand will ease the shortage phenomena that accompany the repressed inflation. The restrictive monetary policy will impede pursuit of an income policy that yields to wage pressure, including a permissive wage policy.

All this can also be said to some extent of a B-type monetary policy accommodating to the planned inflation. This will at least not impede the elimination of the shortage economy, even though it may not boost it, so long as the prime condition - completion of the institutional changes listed - is fulfilled.

Based on this train of thought, it can be stated that it is a necessary condition for eliminating the shortage economy that at least a B-type or even stricter monetary policy should apply.

A C-type monetary policy will expressly work against the elimination of the shortage economy if it is applied when the minimum institutional changes required for the elimination have yet to be completed. Elimination of the shortage economy in some of the post-socialist countries has become stuck or been slowed precisely because a C-type monetary policy has been applied. But if the elimination of the shortage economy has basically been accomplished, a C-type, expansionist monetary policy will not cause it to recur, so long as there is no restoration of the earlier institutional system. On the other hand, it helps to speed up inflation and undermine the possible earlier achievements in stabilization. This, however, is no longer a "shortage-economy" phenomenon, but the connection between monetary policy and inflation that normally applies in market economies.
3.6. *A review of a few macro relations*

An illustration of what has been said so far is provided by Figures 1 and 2, which present the basic macro relations in an extremely simplified form, using the method of depiction customary in macroeconomics.

**Figure 1. The macro state of the shortage economy**

![Diagram of Figure 1](image)

Figure 1 illustrates the normal state under classical socialism. Actual macro production is equal to the macro supply $S$. The system is supply-constrained. Both the supply curve $S$ and the demand curve $D$ are vertical; they do not react to the price level. The vertical line for macro demand is to the right of that for macro supply; in other words there is macro excess demand. The arrows pointing to the right signify that the curve for macro demand is prone to run away. The precise amount by which $D$ exceeds $S$ is immaterial. The essential point is merely that $D$ is always bigger, because of the propensity of some of its components to run away. Macro demand does not simply consist of the demand covered by money already in the buyers' pockets. To it can also be added the buying intention whose cover is not yet in their pockets, but of which the firm or state institution is aware: if it occurs, the state will cover the expense.4

Figure 2 presents the state after the shortage economy has been eliminated. The most important change in comparison with Figure 1 is that the curve for macro demand has turned. This curve (in the comparative, static realm of the figure, in which it is assumed that all other circumstances are unchanged) slopes downwards. Even if no other factor does so, the so-called real-balance effect will make the owners of money reduce their demand if the purchasing power of their stock of money falls in line with the rise in the price level. The assumption made about the macro supply is that the curve is vertical, in other words independent of the price level.
The turn of the curve for macro demand makes it possible for the two curves to intersect, in other words for the macro supply and macro demand to coincide. The institutional changes then initiate the market mechanism that will actually bring about this coincidence on the macro plane.

**Figure 2. The macro state after the elimination of the shortage economy**

Some economists would interpret the situation illustrated in Figure 2 like this: the basic market equilibrium of the economy on the market for goods has been restored. For my part I would not dismiss this description, since it is valid in a certain sense. But it must not be forgotten that the point of intersection is seen on a two-dimensional, static figure, which presents supply and demand as a function of a single variable, the price level. It may be that at a certain moment, at the momentary price level, the macro demand in the economy equals the macro supply, but meanwhile, looking at the trend, the price level constantly rises, in other words inflation takes place, while the supply falls, supply and demand fail to coincide on the micro level, and so on. So it would not be correct to say the economy shown in Figure 2 was in "market equilibrium" without further careful qualification.

3.7. The self-generation of shortage

As shown already, there are several concurrent causes behind the shortage economy. From the time when this state came into being, people became used to the shortages around them, and this is built into their expectations and behaviour, which further enhances the shortage. Shortage breeds shortage.

Let me cite two examples, both of which have been mentioned before. One is the tendency to hoard: the fact that input shortage can be expected induces the firms to accumulate stocks, which further increases the disproportion between supply and demand. The other example is investment hunger, which was included among the factors causing
shortage. Among the reasons why investors dare to invest in a reckless way is that they need have no fear of being landed with the products. In a chronic shortage economy there is always a buyer.

Expectations of shortage belong to the category of self-fulfilling phenomena in economic psychology. That is among the reasons why the shortage is hard to eliminate. Only when the economic agents sense tangibly over a longer period that the shortage has really ended will they begin to reshape their expectations and learn the new behaviour routines.

3.8. The effect of the political changeover
The institutional changes described in Part 1, Sections 3.1 and 3.3 already began during the period of reforms, in the political framework of the socialist system. It is exactly the example of Hungary that shows that the first important steps towards eliminating the shortage economy can already be made during a protracted process of reform. But acknowledgement of this is compatible with the observation that these changes are ultimately speeded up and consolidated by the change of political system. Before that turning point the situation was ambivalent; no one could be sure that the changes were final. There were historical reasons for this anxiety, above all the suppression of the Prague Spring of 1968, or the partial withdrawal of the Hungarian economic reform in 1972-3. So long as the communist party maintained its political monopoly, the private sector could not become dominant and there were no legal guarantees for the security of private property. State-owned firms still felt that their privileges had been curtailed, but they had fundamentally survived.

In Hungary the political changeover came in 1989-1990. The communist party lost its political monopoly. There were parliamentary elections, after which not only the parties forming the government, but those in opposition could declare in a credible way their adherence to the goal of a market economy based on private ownership. From then on, instead of veiled allusions being made to capitalism, the transformation of the economy from a socialist into a capitalist system became official government policy. This swift, radical change in power structure and officially proclaimed ideology gave impetus to the processes of institutional transformation outlined in Part 1, Sections 3.1-3.3, which led ultimately to the elimination of shortage.

3.9. Summary of the causal analysis
Figure 3 sums up the relations between the factors affecting the elimination of shortage. For clarity's sake only the main direction of the effects has been shown. In addition, all these factors affect each other, and of course there are reactive effects as well. So moving from left to right, in the main direction of the causal chain, the factors nearer the right-hand side react to the factors to their left.

The fundamental causal connection may seem self-evident to many: once the socialist system comes to an end, the shortage economy ends with it. But there are numerous intervening factors between the ultimate cause (the change of system) and the ultimate effect (elimination of the shortage economy). A particular kind of hierarchy in the chain of cause-and-effect relationships has been expounded so far in the study and appears in schematic form in the figure. According to this, the political structure has a decisive effect on the institutions. These shape the behaviour of the economic actors, and this behaviour generates, eventually, the state of equilibrium typical of the system.

Elimination of the shortage economy requires both the right macro-level governmental policy, above all monetary, fiscal and income policies suitable for the purpose, and a
Figure 3. The causal chain for the elimination of shortage
micro-level transformation that brings into being economic actors whose behaviour is in conformity with the market.

The fundamental idea in this study is the one also suggested by my earlier works: the chronic shortage economy is a system-specific formation characteristic of the classical socialist system. The first moves towards eliminating it could be taken before the political changeover, but these are ambivalent changes that are not yet well rooted or robust. The elimination of the shortage economy becomes final when the transformation of the political and economic system has itself advanced to the requisite extent.7

It is not a necessary condition for the elimination of the chronic shortage economy that the general change of system, including the specific institutional changes emphasized in this study, should take place "one-hundred per cent", with complete consistency. It is sufficient for this purpose, the elimination of the shortage economy, for these to have reached a certain threshold. Let me give a few examples to make this idea clear:

- It is not necessary (or possible) to have perfectly free entry. But there must be enough freedom so that a shortage can induce a relatively swift entry of new firms.
- The privatization of state property need not have been completed. But there is a need for a private sector of a size capable of making up for the shortages left by the state sector relatively quickly. This is a criterion I should like to emphasize particularly. There is no need to wait for the private sector to become predominant before taking the financial measures necessary for eliminating shortage. But not until the private sector has attained a minimum proportion will even the most radical financial stabilization bring lasting results in eliminating shortage.
- It is not necessary for this purpose that imports be entirely liberalized. But there must be sufficient freedom to import to ensure that the shortages left by domestic production can be quickly filled by imports.
- Even if some prices remain fixed, there must be a high enough proportion of free prices to bring about a substantial movement in the price level, so that supply and demand can at least become equal on the macro level.

Hungary began a steady approach to these thresholds in 1968. The first couple of years after the political changeover sufficed to reach the necessary thresholds at all essential points. From about 1992 onwards, the Hungarian economy could no longer be called a chronic shortage economy.

The elimination of the state of a shortage economy took place in Poland over a much shorter period, in a condensed form, as a sudden shock. This was possible because there had begun in the final years of the socialist system a modest, but real process of reform; there already existed a substantial private sector. It was possible also because the act of stabilization was performed after the change of political system in 1988-89. This provided the sense of "irrevocability" in such fundamental questions as abolition of the privileged status of state ownership, free entry, protection and encouragement of private property, and so on.

Several successor states of the Soviet Union, on the other hand, implemented radical stabilization measures before the kind of "minimum package" just outlined had been assembled. The private sector, for instance, was still so rudimentary, and the state sector
so protected, that free entry, competition and adjustment to demand could not develop sufficiently. Understandably, shortage and inflation came to coexist in these countries.

It follows from what has been said that elimination of the shortage economy can take place gradually, extended over a lengthy period, or through a sudden tipping of the proportions between supply and demand, condensed into a short period. But the latter line of development will only lead to the permanent abolition of shortage if the transformation of the political and economic system has previously reached at least a critical minimum degree.

Elimination of the chronic shortage economy is a result of the change of system. This statement can be reversed: observing what distance a country has travelled in eliminating the shortage economy and the extent to which the elimination has proved durable is a concurrent indication of how far it has gone in its change of system.

This is not the only series of milestones for measuring progress in changing the system, but it is one of the most important gauges. The phrase "transition to the market economy" is often used in the language of politics and public life, with a measure of disregard for the transformation in the political sphere. Now an economy can be called a market economy if it is not typified by a chronic, general and all-pervading shortage. So clarification of where a certain country stands with eliminating the shortage economy will yield simple, tangible, easily quantifiable indices for deciding where it stands with establishing a market economy.

By this measure Hungary has already gone quite far. Based on the previous train of thought it can be said that the Hungarian economy has become a market economy. The market mechanism still operates with a great deal of friction - it is not yet "mature" - but it has already become the characteristic mechanism of coordination.

4. The shortage economy and the labour market

The main subject of this study is the market for products (and services). Let us now make a short diversion to include an examination of the labour market in the analysis as well.

Under the classical socialist system, chronic shortage on the market for products coincides for a long time with the presence of excess supply on the labour market. Open unemployment or latent under-unemployment are characteristic primarily of the backward agriculture. But this surplus of labour and other elements of the reserve of labour are sooner or later absorbed by the forced growth characteristic of socialism, assuming that history provides enough time for the process to run its course.

The absorption of the labour surpluses took place in the Soviet Union and the Eastern European socialist countries. The description in the economic jargon of the time was that the extensive stage of growth (the stage based on progressively drawing in new resources) was over, and it was now time for the intensive phase, in which growth would have to be achieved through the more efficient utilization of resources and through rising factor productivity.

From the point at which the socialist economy embarks on the intensive phase, growth slows down, and in fact the economy in several socialist countries begins to stagnate. The economy is not capable of raising the efficiency with which it uses the resources drawn into production, showing a weak performance in raising factor productivity. Every development and growth routine has primarily been tailored to extensive growth. From this it follows that every decision-maker in production, under the effect of the expansion
drive, would like to have access not only to more investment (investment hunger) but to more manpower as well. The shortage of labour becomes chronic in socialist economies past the extensive stage; a sellers' market develops for labour as well.

It is generally known that the utilization of labour within the firm is low: then is "unemployment on the job". With a soft budget constraint, there is not enough incentive to reduce costs, or to economize on labour. This is enhanced still further by the hoarding of labour, an analogous tendency to the hoarding of input stocks. Since the labour shortage has become permanent, it is worth having labour in reserve, lest there be a hold-up in production because some worker or other is unexpectedly absent, or jobs cannot be filled in the future. So surplus labour is not dismissed. Apart from these economic considerations, there are the political and ethical criteria of guaranteeing employment, and job security as well. When the Soviet and Eastern European socialist system collapsed, practically every country showed a chronic shortage of labour. This formed an integral part of the shortage-economy syndrome.

During the post-socialist transition, the elimination of the chronic shortage of products and services is accompanied by the elimination of the labour shortage as well, and in fact the excess demand turns into an excess supply. Unemployment appears and grows. The number of vacancies still exceeded the number of job-seekers in Hungary until May 1990. After that, the number of unemployed rose steadily, reaching a peak unemployment rate of 13.6% in February 1993. Since then it has fallen slightly, the rate in April 1994 being 11.8%. A similar change has taken place in all other post-socialist economies.

The two events accompanied each other and were closely related. Basically, the same causes that end the shortage of products lead to the elimination of the excess demand for labour as well, and then as the process continues, to an excess supply of labour and a sizeable growth in that excess supply. Let me mention a few factors, without aiming at completeness:

The brake on the running away of macro demand, the stagnation and recession of macro demand, and the elimination of investment hunger bring an end to the hunger for labour as well. Far fewer new jobs are created than when the forced growth reached its culmination.

Meanwhile, more and more old jobs are ending. The hardening of the budget constraint on state-owned firms makes production cost-sensitive. Whereas state-owned firms used to turn a blind eye to unemployment on the job before the change of system, they are now less and less able to afford it. Meanwhile, the change in the political environment and the official abandonment of the pledge to ensure full employment and job security enables state-owned firms to carry out dismissals. It can be added that the new private firms will in any case not want to employ more labour than absolutely necessary.

This tipover from labour shortage to unemployment is accelerated by the recession accompanying the transformation. A curious triple connection arises between (i) the changes promoting the elimination of shortage, (ii) the fall in production, and (iii) the emergence and then growth of unemployment. The "curb" on macro demand (among other factors, the income and monetary policy used for this purpose) takes the macro supply with it, as a consequence of the well-known multiplier effect. The demand for labour also falls as a result of the recession. Consumer demand falls further because of the rising unemployment, which reduces the macro demand even more. As a result of the recession there appears not only an excess supply of labour, but excess supply on the product market as well. Or even if there is no tangibly manifest excess supply in the form of rising stocks of outputs, the amount of unused production capacity will grow, and along with it the notional excess supply. The actual production is substantially smaller
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than the potential output. So the previous economy of excess demand has visibly become
the opposite, one of excess supply.

The remarks above have only touched briefly on the mechanism and motive forces
of the transition, the "tipping over" from shortage to surplus. It would go beyond the
scope of this study to clear up the question of why the unemployment becomes
conserved. There are some well-known partial explanations, including:
- The composition of labour demand and labour supply are not in accord with each
  other, due to the constant restructuring of production. The greater the depth and speed
  of the restructuring (and they will stay very great for a long time in a post-socialist
  economy), the greater the frictional and structured unemployment.
- It may be in the employer's interest to combine a lower staffing level with paying
  higher wages, because the fear of unemployment will then induce workers to perform
  better. (The "efficiency wage" theory.)
- Those actually in employment will tend to work for better wages for themselves, even
  if the higher wage level limits employment. (The "insider-outsider" theory.)
- If employment rises too far, approaching too close to real full employment, it will
  induce wage rises and inflationary pressure, so that the economy adjusts away from
  this high employment rate again. (The "natural-rate" hypothesis.)
- There is a connection between imperfect competition on the one hand and Keynesian-
type underemployment in the economy on the other.¹⁵

I have merely indicated the best-known theories here. A synthesis of the theories
listed (and a few others not mentioned) is emerging.¹⁶ The question is whether these
theories taken together imply that chronic unemployment is an intrinsic characteristic of
capitalism.

Numerous difficult theoretical questions arise at this point. In the case of socialism,
I can state firmly, having gone through a great deal of theoretical examination, practical
experience and debate, that the chronic shortage economy is a system-specific feature.
A concomitant of the chronic shortage of products (at a certain level of economic
development) is a chronic shortage of labour as well.

My judgement is that a similar system-specific feature of capitalism is constituted by
frequent occurrences of real and notional excess supply, the excess capacity
accompanying imperfect competition, and chronic unemployment. If a shortage economy
is typical of the socialist system, the capitalist system can be described as an "economy
of surplus".

The micro markets of market economies are normally much closer to a state of
Walrasian equilibrium (where supply equals demand) than those of socialist economies.
But departures from Walrasian equilibrium can also be observed, of course, in market
economies, the relative frequencies of positive and negative deviations being the reverse
of those in socialist economies. Under the socialist system, cases of excess demand (real
and nominal) were a good deal more frequent, substantial and lasting than those of excess
supply, whereas under the capitalist system, cases of excess supply (real and nominal)
are a good deal more frequent, substantial and lasting than those of excess demand.

It is hard to discern how far these phenomena are cyclical in character, how much can
be ascribed to inevitable frictions of adaptation, and what derives from the system itself.

Whereas the business cycle and unemployment are the subject of a vast literature
marked by divided opinions and sharp debates, there has been very little discussion about
what constitutes the system-specific in the problems of the modern capitalist world. For
most Western economists, the system of the capitalist market economy is simply there,
and the question itself appears odd.¹⁷ An examination of the system-specific nature
requires on the one hand a historical vantage point, and on the other a comparison of
capitalism with differing systems. The post-socialist transformation offers a unique
chance for just such a historical comparative view.

5. Assessment

Finally let us turn to an assessment of the changes. In what ways can elimination of the
shortage economy be rated a favourable or an unfavourable development? Rather than
aiming for a single final result, I will try to break the effects down into their elements.

5.1. Consumer welfare

In a chronic shortage economy, the welfare of a consumer is determined not only by
what is actually consumed, but by the events before and after the purchase.

On a buyers' market, it is mainly the seller who must strive to complete each
transaction, seeking out information and searching, but on a sellers' market the situation
is reversed. Every family must devote hours of spare time to queuing and searching.13

If a purchase eventually takes place, forced substitution is common. In the language
of utility theory, this means the buyer must be content with a smaller utility. The same
happens in a temporal context when the buyer has to postpone a purchase due to a
shortage. A still greater loss of consumer welfare occurs when the buyer abandons a
purchasing intention altogether. Buyers are made to feel worse by their defencelessness.
They experience rudeness from sellers; they must be humble to them, flatter them, or
even try to bribe them. All these various losses to the consumer cease with the
elimination of the shortage economy.

These are changes that cannot be represented by means of synthetic index numbers.
The customary statistics show only the volume and composition of consumption, without
expressing the sense of loss incurred by the effort and disappointment associated with
consumption.

The most misleading practice is to use indices for real wages in the midst of dramatic
changes in the market situation. What does a price increase signify in the case of a good
that was cheap according to the official state price list, but could never be obtained, and
is now expensive, but available on the free market?19 This change, other things being
equal, reduces the index of real wages, while undoubtedly enhancing the welfare of the
individual, the utility enjoyed by the buyer, provided the feelings of loss caused by
shortage are included among the factors determining welfare.

Although it is statistically difficult or even impossible to detect this favourable effect
of the elimination of shortage, the question is what value is put on it by the individuals
considered, experiencing the change. They probably put a far lower value on the
elimination of the shortage than they used to put on the losses caused by shortage.
Hungarian buyers today have grown used to the elimination of shortage, take it for
granted and do not feel overjoyed by it. In the language of utility theory, the utility of
the abolition of an unfavourable circumstance (the shortage-economy conditions as felt
by buyers) does not equal (here is less than) the "disutility" of the existence of the same
circumstance.10 A politician directing the change may be angry about this and brand
people as ungrateful, but that will not change human nature. The housewife who used to
stand bitterly in line at the butcher's and who would be delighted if some piece of meat
or other was thrust at her without any choice being offered now views the great selection
not even with indifference, but with irritation and dismay at the high price of meat. She
will be particularly "ungrateful" about the end of the meat shortage if her means are slim and she cannot afford to buy the meat she would like.

This example sheds light not only on the "forgetfulness" of people when comparing systems, but on the fact that the change of market regime has distributive consequences. Let us say for simplicity's sake that exactly the same quantity and assortment of goods is given to the buyers under each regime, but this set of products fails to fulfil all the potential buyers' needs. Both regimes will make use of specific selection criteria to decide who will get the goods and who is left out. In a shortage economy, there are various different principles mixed up in the selection process: merit, loyalty to the authorities and position in the hierarchy, need, connections and bribery, time of joining the queue, and plain chance. The specific mixture of these criteria varied from country to country, period to period and market to market. Several kinds of criteria apply in a market economy as well, but there is clearly a close positive correlation between income (that is again determined by various factors) and the fulfilment of buying intentions. Here "money talks" first of all.

5.2. The sense of security
The same features of the socialist system that produce the shortage economy generate at the same time a particular stability in prices, wages, employment and welfare provisions. Having already been analysed earlier in the study, these features are considered here purely from the point of view of the effect they have on people's sense of security. The elimination of the shortage economy undermines this sense of security.

The rigidity of prices and wages, which are strictly regulated centrally and laid down for a long time, makes it harder for the economy to adapt and seriously damages its efficiency. At the same time, it increases the household's sense of security in predicting its future financial situation. The fluctuations of prices, wages, exchange rates and interest rates on the market are far less predictable.

Through state redistribution the socialist system provides welfare services according to quite clear rules, although to a low standard. Since these are free or almost free, a chronic shortage of almost all of them develops. To the extent that these services are transferred into the market sphere, the phenomena of shortage come to an end, but as a function of this, the provisions guaranteed by the state are increasingly limited.

As discussed in detail in Section 4, it is the allocation of labour as well as that of goods which tips over from a sellers' market to a buyers' market. Everything that was considered in the last section as a gain for consumers on the market for goods (less search for the supply, greater choice, no need for humility to the seller) constitutes a loss for employees on the labour market. They now have to search for work; they cannot pick and choose between jobs; they may find themselves in demeaning situations. It may be that the same individual is concurrently a winner as a consumer and a loser as an employee. Guaranteed employment and job security come to an end with the shortage economy.

5.3. The dependence of citizens: the relations between the bureaucracy and the economy
No one "planned" beforehand that the socialist system should operate as a shortage economy. But having developed, the shortage economy did good service to the autocracy of the party-state and the power of the bureaucratic hierarchy. The shortage seriously curtailed individual freedom of choice. It was one of the main guarantees that individuals would live in a state of dependence on the state-owned firm and the bureaucracy of the party-state. This was felt in their daily experiences by consumers and by the manager
of a firm as well. The public were also defenceless collectively against the political decisions of the top leadership, which had a sovereign right to decide on matters of supply, demand, prices, wages, and the scale and distribution of shortage.

Elimination of the shortage economy brings defencelessness of this kind to an end. I do not wish to idealize the buyers' market; I do not consider it to be the embodiment of unlimited consumer sovereignty. The tastes of consumers are influenced to a large extent by the producers, not infrequently in a manipulatory way. But they can only do such things within certain bounds. The market is a mechanism that adjusts production to consumer preferences to quite a large extent, even though there are frictions. Or consumers must at least give their consent, through their purchasing choices, if producers try out something new; they cannot use force on buyers for any length of time.

The parliament and government of the day, even if operating within a democratic form of state, can influence and restrict the desires of consumers to a certain extent. But it must be added that the more democratic the system is, the less it can dictate to consumers. So in the last resort, the elimination of the shortage economy enhances rights and freedoms as well. Another important phenomenon when discussing the relationship between the bureaucracy and the actors in the economy is corruption. Corruption already existed in the shortage economy; buyers would seek access to the good or service they desired in this way, by bribing the seller or the allocating bureaucrat. With the elimination of the shortage economy and the swift expansion of private enterprise, there is a change of direction, with the seller now wanting to obtain state orders through corruption. In addition, corruption appears wherever the success of private entrepreneurs depends partly on specific actions by state officials charged with deciding who, and on what terms, acquires state-owned assets up for privatization, gains a tenancy of a state-owned building or site, receives a permit to pursue a state-regulated activity, and so on. Many more rich business people can now afford to spend large sums on corruption. With the elimination of the socialist system, the repression also lessens. The great achievement of spreading rights and freedoms has the unfortunate side-effect of loosening the controls. Corruption becomes broader in scale and more conspicuous, particularly in the still insufficiently consolidated period of the transition.

5.4. Growth, qualitative development and technical advance
All that has been said so far about the advantages and drawbacks of the change derives from a static comparison of the two states. To this must be added the effects that exercise an influence on the dynamics of the system's operation.

The change seems initially to have a negative effect on the quantitative growth of the economy, which can be measured, for instance, by the indices for aggregate output. The main driving force behind the initial fast growth under the socialist system was investment hunger, which derived, among other factors, from the expectation that the shortage would persist, so that almost any output could be sold - growth was never impeded by a limited size of demand. This old driving force ceases in the post-socialist transition, while the new forces deriving from the profit motive are initially still weak. Also contributing here are other output-depressing effects accompanying the "tipover".

Meanwhile the change of market regime forces beneficial changes in the efficiency of production. Some of this effect appears quickly, making itself felt in the daily activity of the firm. The previous uncertainty surrounding the acquisition of inputs is reduced, there are fewer problems with obtaining materials, semi-finished products and components. The labour shortage ends, and with it the unemployment on the job. All these changes assist in achieving more effective utilization of the factors of production, which sooner or later contributes to faster growth of the economy.
More important still is the long-term effect. The gravest and most fatal damage the shortage economy does is to join with other factors in retarding technical progress. It deprives economic activity of the driving force generated by rivalry to win and create markets. Socialism lost out in the competition between the two systems above all because it lagged behind in the long term in raising labour productivity.

From comparing political and economic systems, I have come to the conclusion that this will be changed by the switch from the sellers' market to the buyers' market. I believe that sooner or later, the spread of innovations made elsewhere will speed up in the post-socialist region as well, and truly original, pioneering innovations will also appear. Here I can only express my own confidence. We still have to wait for the facts to confirm or deny this forecast.

5.5. Summary of the assessment

The transformation, and within it the elimination of the shortage economy, is a combination of favourable and detrimental, welcome and painful changes. I have tried to present both the favourable and the unfavourable effects in an objective way. The economy switches from one normal path to the other. The attribute normal also conveys that these are not idealized, pure theoretical models with extreme characteristics, but actual historical formations containing a mixture of "good" and "bad". Both paths are marked by a combination of features whose assessment depends on the value system espoused by the individual or group delivering the verdict.

I have no desire to conceal my own verdict: according to my system of values, the advantages outweigh the drawbacks. I see the elimination of the shortage economy as an achievement of the post-socialist transformation, although I am aware that there are enormous costs to be paid for it as well.

It can be assumed that a sizeable proportion of people, on the basis of other systems of values, will form a less favourable value judgement. There are a great many things to explain this. With some people it is the historical forgetfulness mentioned earlier, washing away the memory of the suffering and losses caused by shortage. With others it is the fact that they are on the losing, not the winning side in the redistribution resulting from the switch to a buyers' market. Finally, there is one other circumstance explaining the public attitude. The decisive criterion for a theoretical researcher comparing systems is the long-term effect, above all the way the elimination of the shortage economy will affect the long-term trend in labour productivity. But the majority of people, understandably, pay little attention to this, and wait impatiently for a directly perceptible turn for the better.

All this explains why so many people do not attach particularly great importance to the elimination of the shortage economy, even though this is one of the post-socialist transition's most important, tangible and in the long term significant developments.

Endnotes

1. This paper is being published in two parts, part 1 in Volume 3 (1) and part 2 in Volume 3 (2).

2. Type B policy is commonly referred to in economic literature as an accommodating monetary policy, since it continuously adjusts to the demand for money of the nominal GDP. This is a far apter term than restrictive.

3. In composing these statements I have made use of the studies of Balassa (1993) and Várhegyi (1993).
Attention was drawn to this peculiar "monetary overhang" in Part 1, Section 3.3.

Figure 2 shows the so-called "classical" case, with the curve for macro supply vertical. Also known is the "Keynesian" case in which macro supply is an increasing function of the price level. Although the distinction between the two cases is extremely important both theoretically and in economic policy, it is immaterial at this point in the present analysis which case is presented. The essential fact here is that the two curves intersect because of the turn in the demand curve. Explanations of the difference between the two cases can be found in general works on macroeconomics - e.g. Sachs and Larrain (1993, pp.55-76). The distinction is also made in the works of the "disequilibrium" school - e.g. Malinvaud (1977, pp.27-32). The difference between the two cases depends ultimately on two different explanations of the behaviour of wages and the labour market.

The following riddle was widespread in the period of the shortage economy: What would happen if the communist party came to power in the Sahara Desert? Answer: Sand would become an article in short supply.

One question that arises is whether China can eliminate its shortage economy before the political monopoly of the communist party ends. China has certainly progressed a long way through the processes of transformation described in the earlier sections of this study. It must be added that the Chinese Communist Party itself is undergoing transformation to some extent, having departed in many respects in its principles and practice from the behaviour typical of communist parties. How far must the transformation of the political structure go in order to eliminate the shortage economy fully? China's experience will be very important in the process of arriving at a full, scientifically convincing answer to this question, but such an answer will have to wait until the course of China's political and economic reform has been closely observed over a long period.

This was felt by Hungarian state-owned firms after the collapse of the CMEA markets, inducing them to make a swift transfer in their exports and imports. This occurred before the passage of the bankruptcy act and the wave of bankruptcies, i.e. before a more drastic hardening of the budget constraint. The Polish experience after the introduction of the January 1990 measures was similar.

This phenomenon was aptly named "shortageflation" (by analogy with "stagflation") by Kolodko and McMahon (1987) on the basis of experience in Poland before 1990.

On the measurement and trend of the labour shortage in Hungary, see Fazekas and Köllő (1985).

In certain post-socialist countries, such as Russia, unemployment rises very slowly. There are several signs that this is precisely because the transformation does not take place in a consistent way. The budget constraint remains soft, numerous firms that are doomed to fail remain alive and capable of retaining labour that in fact has become superfluous.

To avoid any misunderstanding, let me add that I am not saying the end of the shortage of goods is the cause of the end of the labour shortage and then the development of unemployment. In my view the end of the shortage of goods and the end of the shortage of labour can largely be attributed to common causes.

There are several reasons behind the fall in production; the process outlined in this study is only one element in this complex relation of cause and effect. See Kornai (1993b).

For the concept of notional excess supply, see note 25 in Part 1.
15. This connection has been demonstrated for a special model of imperfect competition by Hart (1982).

16. The most significant advance in the field of synthesis has been Phelps's book *Structural Slumps* (1994). Disregarding some essential differences of expression and terminology, the messages of that book and this study are compatible with each other. Phelps's argument supports the comparison of the labour markets of socialist and capitalist economies put forward here.

17. Putting questions of this kind is largely the preserve of the opponents of the capitalist system, the Marxists and extreme left-wingers. Yet this is a clearly comprehensible question to those who believe in the system as well. I will return to this point in the final section of the study.

18. Competition among sellers does not wholly exempt buyers from the effort of searching and acquiring information, of course. Particularly under conditions of imperfect competition, choosing between substitutes by weighing a large number of qualitative parameters and relative prices can be a complex task. The more developed the economy and the wider the choice is, the harder selection becomes.

19. This problem is convincingly presented in Berg and Sachs (1992).

20. This asymmetry is not expressed in the customary utility functions describing consumer behaviour. The modelling of the asymmetry would entail great technical difficulties and require a profound theoretical revision. Like classical physics, economics builds into its theories an implicit assumption of reversibility. Significant strides were made in certain branches of physics when account was taken of irreversibility in time. A revision of economic theory in this direction has hardly begun. Outside the "mainstream" of economics, some noteworthy works have appeared that already build the idea of irreversibility into the theory. See the works of representatives of the evolutionist school: Arthur (1994), Marshall [1890] (1961), and Nelson and Winter (1982).

21. Of the causes for the emergence of shortage, this one is emphasized in Shleifer and Vishny (1992).

22. As the book by Fehér, Heller and Márkus (1983) puts it graphically, there was a dictatorship over needs.

23. More precisely, it enhances what are known in ethics as "negative" freedoms, where we are free from something (e.g. state repression or interference in our lives). The spread of positive freedom (when we are free to do something) depends in this context on what resources and goods we have at our disposal, *i.e.* on the general wellbeing and the distribution of incomes.

24. In a 1991 survey, 59% of the respondents considered that the prices should be kept low even if that meant there would be a shortage of certain products. See Lázár (1993, p.43).

References


Robinson, Joan (1933), *The Economics of Imperfect Competition*, London: Macmillan.
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