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OF THE

Hundredth and Ninth Annual Meeting

OF THE

AMERICAN ECONOMIC ASSOCIATION

New Orleans, LA, January 4-6, 1997

Program Arranged by Arnold C. Harberger

Papers and Proceedings Edited by J. David Baldwin and Ronald L. Oaxaca

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Editors' Introduction

This volume contains the *Papers and Proceedings* of the one-hundred and ninth annual meeting of the American Economic Association. The *Proceedings* record the business activities of the Association in 1996, the annual membership meetings, and the March and January (1997) meetings, of the Association's officers and committees. The *Papers* constitute the greater part of the volume. They comprise contributions that fill roughly the same number of pages as one-and-a-half regular issues of *The American Economic Review*. We will take this opportunity to answer a number of commonly asked questions about the *Papers*.

Who chooses the authors? About a year in advance, the Association's President-elect, acting as program chairman, decides on the theme of the sessions and topics for which sessions will be organized. This is done after consultation and comment, both volunteered and solicited, from a wide range of individuals. (A *Call for Papers* appears in the Summer and Fall issues of *The Journal of Economic Perspectives*.) The theme for this year's sessions is "Applied Economics in Action."

The President-elect invites some sessions and selects additional sessions from the various proposals received. Each session organizer in turn invites several persons (usually three or four) to give papers on the theme of the session and asks others to give comments on the papers. The program chairman decides at the time of organization which sessions will be included in this volume. Space limitations restrict the number of printed sessions. This year we are printing 26 sessions, although a total of 149 sessions were sponsored, either solely by the American Economic Association or jointly with other allied societies.

Are discussants' comments published? Comments and discussions are generally not published. For all sessions, names and affiliations of commentators are printed at the start of each session, permitting readers especially interested in particular comments to write to the commentator for a copy of the discussion.

What standards must the papers meet? The guidelines under which papers are published in the *Papers and Proceedings* differ consid-

erably from those governing regular issues of the *Review*. First, the length of papers is strictly controlled. They must be no more than 12 typescript pages in three-paper sessions, and 10 typescript pages in four-paper sessions. Second, papers are not subjected to a formal refereeing process. However, a paper can be rejected if, after reading it, we conclude that it is utterly without merit. Third, the content and range of subject matter reflect the wishes of the President-elect to investigate and expose the current state of economic research and thinking. In most cases, therefore, the papers are exploratory and discursive, rather than formal presentations of original research.

In order to produce this volume by May, strict deadlines must be met, and there is no time for communication with every author about editing changes made in order to improve content and style and to satisfy space restrictions. Every effort is made to notify an author prior to the deadline if the paper is too long or does not satisfy other specifications.

For the most part, authors were quite cooperative this year, and for this we are grateful. We thank them for making our job easier.

Acknowledgments. The extremely tight production schedule of this issue requires a highly coordinated chain of events; every link in that chain must be a strong one. Especially this year, we are indebted to a group of highly talented individuals for their help in bringing this project to fruition: Kathy Simkanich in the Princeton *AER* office capably handled the voluminous correspondence associated with this issue; Dooley Kiefer and Ruth Mahr provided expertise as copy-editors; and Laurie Burton served as proof-reader extraordinaire. The staff of Tapsco, Inc., our typesetters met the challenge of keeping the issue on schedule, and we are especially grateful to Barbara Stabb for overseeing the typesetting with diligence and good humor. Finally, as in past years, we thank Kathy Holewinski and the Banta Company for their dependable work in printing and distributing this issue.

J. DAVID BALDWIN
RONALD L. OAXACA

THE TRANSITION FROM SOCIALISM

The Reform of the Welfare State and Public Opinion

By JÁNOS KORNAI*

There is complete agreement among researchers studying the post-socialist transition that one key task ahead is radical reform of the pension system, health care, provision for children and the aged, social assistance, and the other spheres of the welfare system. There is broad, but by no means complete, agreement about the line the changes should follow. The state monopoly bequeathed by the communist system needs to be broken up, and the absolute sway of bureaucratic control ended. Scope must be provided for private enterprise, business ventures, various forms of voluntary and compulsory insurance, activity by private firms and non-state nonprofit organizations, and competition. However, there is no agreement at all on how far or how fast these changes should go, or what configuration of institutions and organizations would be most fitting. This lack of consensus is hardly surprising. No general agreement on this has been reached in any country in the world. I need hardly labor this point here. The clash between diametrically opposed views has been especially evident in the United States.

What happens to the post-socialist countries' welfare sectors in the future will depend on a range of factors. Here I would like to address just one of these—the sympathy or resistance the public shows towards reform—and confine myself to post-socialist countries where the essential institutions of parliamentary democracy have stabilized. Under these conditions, the changes will not depend on a couple of economists winning active support from some benevolent, reformist dictator. The new rules will have to pass every stage in the

democratic political process. The changes will have to be enacted, which means convincing a majority in the legislature. This will depend on the stance taken by political parties, which is influenced ultimately by the opinions of the electors. To that extent, progress with welfare reform becomes a problem that belongs to the field of political economy.

What does the public in post-socialist countries think of reform of the welfare sector? Very little is known about their views. The results of parliamentary elections so far do not allow a definite conclusion to be reached, because open confrontations of alternative programs of welfare reform have not featured prominently in the party contests. In most countries, the various successor parties of the communist party have put forward social democratic programs. Many observers attribute their electoral successes partly to voter anxieties about losing their universal entitlements under the 'premature welfare state' (Kornai, 1992) that the communist system created. However, even where such parties have a parliamentary majority, they cannot feel the support of an absolute majority of the electorate behind them, and some (such as the socialist parties of Poland and Hungary) are themselves prepared to countenance partial reform of the welfare system.

For the time being, the only way to ascertain the public's opinion seems to be by direct enquiry and economic-psychological experiments. Even this is only beginning. In this contribution, I would like to recount and comment on a few of the observations.

Some researchers say that the public in the post-socialist countries expects the state to continue its paternalistic behavior (see e.g., Zsuzsa Ferge, 1994). This viewpoint is based on comprehensive international comparative studies showing that, despite variation from country to country, at least two-thirds of the

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population (and in some countries a higher proportion) expect the state to see to pensions, provisions for children, jobs, health and so on, as its communist forebear used to do.¹

I took issue with this interpretation of the findings (Kornai, 1996). In my view, the respondents had been affected by two circumstances when they answered in favor of paternalism. First, it had not been clear to them what price, in the form of huge taxes, the public has to pay for its ostensibly free health care, university education, universal pension entitlements, and so on. Consider, for instance, that the payroll taxes and social-insurance contributions paid by employers and employees in the Czech Republic, Hungary, Poland, and Russia are already as high as about 50 percent of gross wages or more, before account is taken of other forms of taxation. Secondly, the respondents were only familiar with the present system. They had little knowledge of other, non-state, decentralized institutional forms and mechanisms. My counterhypothesis is that citizens would respond otherwise if the question were put in a different way; in other words, if the respondents were better informed about the tax "price" of the state's commitment and were given alternatives from which to choose.

To test this hypothesis and counterhypothesis, my colleagues and I conducted a wide survey, with a representative sample of a thousand Hungarians. The first detailed analyses of the results are contained in two studies by László Csontos et al. (1996a, b).²

Our survey confirmed that the Hungarian population possesses sketchy, unreliable information about taxation in general and has even less knowledge of the tax impositions required to finance welfare programs (i.e., of the

TABLE 1—INSTITUTIONAL CHOICES: SUPPORT FOR "STATE," "MARKET," AND "MIXED" SOLUTIONS (PERCENTAGES)

Solutions	Financing	
	Pensions	Hospital care
Centralized state solutions	21.4	35.5
Mixed constructions	56.6	44.1
Market solutions	18.5	17.9
Unable to decide	3.5	2.5
Total	100.0	100.0

Source: Csontos et al. (1996b table 4).

tax price of these programs). Only one-fifth of the respondents managed to guess this tax price within a margin of error of 25 percent. The rest made estimates that were further from the mark or failed to answer at all.

The interview with each respondent lasted about an hour. The kind of enquiries customary on a questionnaire were augmented by a rapid experiment in economic psychology. After the respondent had given a spontaneous answer to a question, the interviewer always divulged the correct answer, and at a later point in the interview, offered a set of choices. The respondent might choose, for instance, between a wholly state-run pension system; a voluntary, commercial, purely "market" system; and an intermediate, mixed system that would combine state and market components. Three similar alternatives were offered for health care. These were very narrow choice sets, of course, which the interviewer had very little time to explain. Nonetheless, they amounted to an effort to offer respondents a choice among alternative welfare systems. The responses obtained are summarized in Table 1.

The table allows some important lessons to be drawn. The Hungarian survey did not vindicate the assertion that most of the public insists rigidly on the nationalized, centralized, bureaucratic systems familiar from the socialist system. Rather, a large majority is inclined to choose institutional forms and mechanisms that give scope to the market mechanism and private enterprise as well.

I would not attach great importance to the numerical distribution of the results. Clearly

¹ The data are summarized in Jiří Večerník (1995 p. 164). Večerník used as his primary data source the SOCO Survey "The Social Consequences of Transition," which was conducted in the Czech Republic, Hungary, Poland, Slovakia, and the former East Germany. The survey was initiated, and the SOCO data were created, under the auspices of the Institute of Human Sciences, Vienna.

² The study, made at the author's initiative, was directed by Csontos and conducted under the auspices of the Hungarian research institute TÁRKI (Social Research Information Center).

the proportions would have been different if the interviewers' explanations had been more detailed. Another factor, of course, was whether the interviewer managed to arouse sympathy or antipathy for one alternative or another. The open debates of the next few years will need to supply as much information and argument as possible to the public. Perhaps still more effective than information will be first-hand experience. The survey showed, for instance, that the strongest propensity to depart from wholly state-run, centralized forms in health service was among individuals with recent bad experiences when they or a family member had been ill. Even more important is positive experience with the new forms. Having appeared in Hungary only a couple of years ago, decentralized, non-state pension funds are now springing up everywhere. If people conclude that these operate reliably and to their advantage, they will have less fear of breaking away from the monopoly of the state pension system. The situation will be similar in other areas of the welfare sector.

Members of post-socialist society have not yet digested the idea that they bear the main responsibility for their lives. After all, it was drummed into them for decades that the state would look after them when they fell sick, became disabled, or grew old. They have not yet accepted that they, primarily, are the ones who have to prepare for these eventualities. The survey included a question about how the respondent was preparing for old age, to which 51 percent replied that they had not thought about it yet.

On the other hand, people in the region are not averse to the institution of voluntary insurance. Respondents who already had some kind of voluntary insurance were more inclined to choose the alternative of non-state insurance, wholly or partly, for their pension or health insurance. This observation was corroborated by another experience. During the survey, respondents were presented first with an exaggerated dilemma. Formerly, the state subsidized medicines to a large extent, so that retail drug prices were very low. It is not surprising that this, beside other causes, led to per capita drug consumption in Hungary being greater than in France, a far more developed country. The first question, without any prior

explanation of the tax consequences, was whether the low drug prices should remain. The overwhelming majority answered yes, they should. Respondents were then told the tax price of having cheap medicines and were presented with a list of hypothetical choices, including private pharmaceutical insurance with alternative magnitudes of the deductible part. The higher the premium, the lower the proportion of medicine costs the insured would have to pay. It immediately became clear that only about one-third of respondents would choose the scheme with the highest premium and the full coverage of costs by the insurance company.

The factors that ultimately lie behind the problem of individual provisions for old age or self-payment of drug costs are value judgments about security and individual responsibility. It can be stated generally that these value judgments have far-reaching influence over respondents' preferences, wittingly or unwittingly.

The picture is unclear. A great many people certainly attach great importance to security, which they expect the state to guarantee in the main. There are some observers who go further, arguing that people in the post-socialist world attach more weight to the security guarantees and egalitarian tendencies of the ancien régime than to their newfound freedom. Others, like myself, see this interpretation as exaggerated and one-sided. There is no denying that there are large numbers of losers in the post-socialist transformation: many whose standard of living has fallen and many for whom unemployment has become a permanent threat. Those on whom suffering has fallen call loudly for security and acts of solidarity from society. Nonetheless, the picture is not so simple. The relative weights in people's systems of values vary from country to country. (For instance, preference for security is more characteristic of Hungary than of the Czech Republic.) People's values also differ within countries according to their various attributes. Young people, the more qualified, city-dwellers, the self-employed, and the entrepreneurs are more inclined to accept freedom of choice and individualist values than are the old, the poorly educated, rural inhabitants, and wage- and salary-earners (see

Richard Rose and Christian Haerpfer, 1993; Csontos et al. 1996a, b; Matild Sági, 1996).

Important conclusions can be drawn from the knowledge gained so far about public opinion and the public's information and preferences. The first conclusion researchers should reach is that very little is known. We have a duty to continue the studies and to gain increasingly reliable, comprehensive comparative information, covering more countries. Meanwhile, with due modesty and caution, it is worth formulating a few lessons that might benefit economic policymakers.

The public's tax-awareness in the post-socialist countries must be raised, and its fiscal illusions dispelled. This is a far-reaching assignment in which economists can play an important part, although it extends far beyond their direct activity, of course. The previous system spent decades indoctrinating people with the ideology of paternalism. Contributions to altering people's attitudes must be made by schools, the press and the media, political parties, and many other institutions in civil society.

Still more important than influencing people's thinking orally and in writing is something else to which I have already referred: the new, non-state institutions and organizations should make an appearance and operate successfully. The popularity of the reform could be reduced by the collapse of some poorly planned changes. (There have already been false starts of this kind in Hungary and the Czech Republic.) I do not imagine anyone would advocate shock therapy for reform of the welfare system. This will certainly be an evolutionary change, with natural selection among many mutations, involving alternative schemes, forms, and solutions.

This does not mean that those who have understood the need for reform should stand by, idly observing the evolutionary process. Governments and parliaments have to play an active part as initiators. It may seem like the naive desire of an academic researcher if I add that this preparatory work should be kept apart from the political battles for popularity. If things go that way, the winner will be the one who advocates the most blatant populism, promising to retain the old entitlements and to cut taxes at the same time. The post-socialist

region is full of such cheap demagoguery already. I will express my message as a condition, rather than a desire. The reform of the welfare system will succeed where, and only where, the legislative preparations can be insulated from the arena of political popularity, so that compromise proposals that command overwhelming support can be devised, calmly and proficiently.

As a point of departure, the investigations so far, including those I have mentioned already have confirmed that there is no system of values, and therefore no alternative for welfare reform, that could gain the backing of the overwhelming majority in Eastern Europe. (Incidentally, this proves to be true of other regions as well; see, for instance, the work done by Victor R. Fuchs [1996] on American health reform.) There is no point in thrusting on the public the kind of schemes that might command a majority in one parliament but would possibly be repealed by the next.

It is especially important to produce a situation in which various forms of ownership, various insurance systems, and various types of "provider" can coexist in competition with one another. Citizens should not simply be able to exert their will indirectly, through the abrasive transmission of the political system. They should also be able to choose directly from an available set of alternatives, on as many matters as possible.

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