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Evolutionary and Radical Approaches to Economic Reform

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Abstract

At the end of 1989, most economists agreed that the optimal approach to socialist economic reform involved immediate destruction of old institutions and rapid conversion to capitalist arrangements. This approach is called the radical one. The evolutionary approach has always offered an alternative program of reform. The paper discusses the recent breakdown in the radical consensus and provides a general overview of the evolutionary approach. Two conceptually distinct sets of evolutionary theories are examined – evolutionary economics and conservative political philosophy. Drawing upon these existing theories, the paper builds the rudiments of a single philosophy of evolutionary reform. The evolutionary and radical schemes are then compared. Their different implications for the speed of reform, the use of the old institutions, the magnitude of single elements of reform, and the use of theory are highlighted.

1. Introduction: The radical reform model begins to break down

During 1989 as the East European revolutions proceeded one after another and the economics profession became increasingly engaged in the reform process, there was almost a consensus amongst economists about the way in which reform should proceed. First, there would have to be liberalization – the freeing of all economic actors from central government controls. That liberalization would necessarily be accompanied by a drastic, market-style stabilization based on tight money and the hardening of budget constraints. The guiding light in the first steps of reform would be that all economic agents, whether state or private, would participate in the market under the same set of conditions. Given the immediate reliance on the market mechanism, the old institutions of traditional control – especially the planners and the supply organizations – would be destroyed. The existing structure of property rights in the state sector would be eradicated in order to give the government complete control over state assets. This measure would occur as preparation for privatization, which would be pursued as soon and as fast as possible.

The 1989 consensus view of economic reform, I will call the radical

approach.[1] It emphasizes speed, the destruction of the old, and the quick conversion of organizations to the arrangements of developed capitalist economies.

The train of events over the last two years in Eastern Europe has not been kind to the radical model. There are now signs that the former consensus is breaking down. One constantly hears pronouncements from officials and academics that reform is more difficult than expected, more costly than expected, and slower than expected. But disappointed expectations are not the prime factor in cracking the academic consensus. Rather, the radical model is coming into question because of the manner in which expectations have been disappointed. In this introduction, I list a few facts that seem pertinent in this respect. As I do so, I hint at the way in which these facts undermine the radical program of reform and serve to justify a different approach. The paper then outlines this alternative approach.

No normative model is ever implemented cleanly, but in East Germany the radical model came as close to complete implementation as one is likely to see. East Germany seemed to have everything – a big brother to hold the currency firm and to ensure credibility of the reform process, a structure of laws and institutions that were accepted immediately, and immediate entry into the world's largest trading bloc. In addition, the whole package could be implemented overnight. That implementation resulted in the largest economic disaster in Europe in the post-war period.[2]

The economic reform that conformed least to the radical pattern was that of China. In that country there were the worst initial conditions, including communist leaders who would not let go, and a large urban, state-owned industrial sector with much influence. From the radical perspective, the reform was implemented in the most chaotic manner, with distortions of immense magnitude, with opaque property rights, and with large barriers to competition. Nevertheless, there can be no doubt that the reforms in China are as successful as have been seen anywhere.[3] The contrast between the Chinese experience and the East German experience should surely give pause to those confident in the radical model.

It is now clear that the radical reform model faces large implementation problems in the East European countries. These problems damage the coherence that is the most important economic property of the model. Consider the following statement by that most radical of all reformers, Vaclav Klaus, the Minister of Finance of Czechoslovakia: "I agree that the opinion claiming that cooperatives will cease to be a significant entity in our agriculture within my lifetime is nonsense and stupid ideological propaganda."[4] Similarly, Polish government officials have in the past made grand statements about radical implementation of a capitalist economy by swift privatization, refusing to countenance the third way of

employee ownership. Nonetheless, the major step toward privatization in Poland so far has been employee buyouts – a method that had been greatly denigrated by the radicals.[5] The inability to implement major aspects of the radical reform program surely argues that there are problems in its conception, particularly the supposed coherence that is at its heart.[6]

The tenacity of the old appears not only in the inability to destroy existing institutions. The organizations that were expected to change their behavior in response to the new conditions have failed to do so. This is particularly the case for the large state enterprises that still dominate the East European economies. The press reports, the observations of politicians, and the performance of enterprises now speak in one voice on this issue.[7] The lack of organizational response calls into question the notion that austerity and liberalization will rapidly change the behavior of existing organizations. It is now clear that the hope for Eastern Europe lies primarily in the new organizations that are created in the private sector and then selected and shaped by market forces.

Where destruction of the old framework of institutions has been accomplished, the results have hardly been fortunate. The single best example of this is the demise of the CMEA in early 1991. The precipitate dropping of the old CMEA arrangements is now widely recognized to have caused enormous problems in East European trade, which in turn caused large domestic economic crises. Many fewer economists now subscribe to the notion that a long-established bureaucratic procedure can be quickly replaced by the market than did one year ago.

While most economists agree that bureaucratic procedure must be replaced by normal monetary transactions in the long run, there is increasing sympathy with the idea that the phasing out of old institutions must be smooth and gradual, in companion with the rise of the new institutions of the private sector. This realization, prompted by the effects of the destruction of the CMEA, is now becoming an important factor in present discussions concerning prospects for the economic composition of the Soviet Union.[8] There are many advocates of the notion that elements of the old system must be protected for a while in order to prevent economic collapse. This is hardly the type of analysis that one would have expected from economists only one or two years ago. It is certainly not consistent with the radical models of reform that were promulgated in those blissful early days of 1990.

Beyond a rise in sympathy for policies that temporarily protect the old system, there is in some instances a movement toward the re-creation of previously destroyed parts of that system. Barter deals are now being forged between countries that suffered greatly from the precipitate destruction of the old CMEA barter system.[9] Consider also the fact that the Polish government is now reactivating its interventionist policies of the past, for example as a credit manager for the state sector. "After so

many years of a state-steered economy, it is impossible to have no intervention at all. In our situation, we cannot assume that the market is going to be the only regulator", according to Henryka Bochniarz, the head of Poland's newly created Ministry of industry and Trade.[10]

In summary, little in the economic record of the past two years suggests that the radical program of reform can be successful. The old cannot be simply destroyed and therefore the radical reform plans have serious problems of coherency. Furthermore, it is now becoming increasingly accepted that sudden destruction of the old can be economically inadvisable. The economic pressures associated with this realization are so great that some of the past institutions are being re-created – a re-creation that is far more costly than keeping the old institutions in grudging acceptance of the fact that they cannot be replaced overnight.

Lurking in the literature there have always been elements of an alternative program of reform. Kornai's (1990) emphasis on organic economic processes and his skepticism about reforming the state sector are inconsistent with the radical approach. Similarly, McKinnon's (1991) analysis concentrates on the details of the existing situation and does not assume that functioning markets can be produced overnight. He therefore advocates temporary non-liberal arrangements in the transition. There are also a series of works of my own (Murrell 1991a, 1991b, 1991c), which have criticized the radical point of view and offered a different approach that one might label evolutionary.[11] Such an approach places little emphasis on reforming old organizations, but instead pins its hopes on the growth of a nascent private sector. An evolutionary policy, therefore, combines a policy of the gradual phasing out of the old institutional framework, an active program to promote new private sector activity and the institutions that this sector requires, and gradual privatization using market processes. In this paper, I summarize some of the strands of thought that provide underpinnings for the evolutionary approach to reform, review the general philosophy underlying that approach, and compare evolutionary and radical schemes.

II. The intellectual underpinnings of an evolutionary approach to reform

There are two conceptually distinct sets of theories that provide underpinnings for an evolutionary approach to economic reform. First, there is the body of theory that falls under the rubric of evolutionary economics. The modern representation of this theory begins with Schumpeter (1950); the most detailed current exposition is that of Nelson and Winter (1982). The informational issues that are at the heart of evolutionary economics are now also a central concern in mainstream theoretical economics. Indeed, the information-theoretic paradigm is challenging the standard neoclassi-

cal view (Stiglitz 1991). That paradigm will eventually provide additional elements for a broader conceptual basis for evolutionary reforms.

I label the second set of theories 'conservative political philosophy'.[12] The leading works in this genre are Burke (1790), Popper (1971), and Oakeshott (1962).[13] Whereas evolutionary economics concentrates on positive economic analysis, conservative political philosophy is more concerned with normative political issues, particularly the ways in which societies change. As we shall see, the assumptions of these two sets of theories are surprisingly similar, as are their lessons for economic reform.

Murrell (1991a, 1991b, 1991c) examines these two theoretical viewpoints separately but draws similar conclusions for reform from each analysis. This is unlikely to be pure coincidence, given that the two theories concentrate on very distinct aspects of socioeconomic processes. Thus, not surprisingly, one can find many similarities in the assumptions underlying the two sets of theories and the problems that they place at the center of study. Simply put, the world-views of these two basic approaches have much in common.

Since previous papers have discussed each of the individual theories in detail, I concentrate here on establishing a more general overview and on building the rudiments of a single philosophy of evolutionary reform.[14] The following subsection lays out the central vision of socioeconomic processes that underlies evolutionary theory. Subsection II.b examines assumptions of the two sets of theories and uses them to derive some general features of an evolutionary reform process. These features are outlined in Subsection II.c.

II.a. *Commonalities – visions of socioeconomic processes*

Perhaps the central vision underlying conservative political philosophy and evolutionary economics is the notion that socioeconomic mechanisms are information processing devices. Both theories emphasize the limits on individual intellectual capacities and the complexity of social arrangements. They focus on how societies can efficiently use the knowledge available to them and how socioeconomic processes preserve and enhance the knowledge that exists in society. The conception of socioeconomic mechanisms as information processing devices might be profitably contrasted with the view of economics as resource allocating devices.

The second important feature common to conservative political philosophy and evolutionary economics is best illustrated by analogy. Societies can be compared to climbers trying to find the top of a hill enveloped in cloud. With limited information on the local topography, the best they can do is to take the part of steepest ascent and to move forward in small steps, reevaluating their information at each stage. If

they had a map, they could devise a better procedure. But no accurate map is available.

Similarly, societies proceed using only local information. In understanding economic processes, according to evolutionary economics, we must acknowledge the fact that organizations and individuals are engaged in choices that are sharply limited in scope by finite information sets. In making political choices, according to conservative political philosophy, we must confront the fact that it is simply beyond our capacities to map out a process of complete social change. Societies are never in a full-information world; it is a misleading and dangerous abstraction to assume that they are. The view of societies as hill climbers is in direct contrast with the assumption that the choice of laws and policy can be cast in a first-best framework.

II.b. *Commonalities – assumptions and deductions*

Having introduced the two central elements of *weltanschauung*, we now turn to the underlying assumptions. There are two essential assumptions about human knowledge – one concerns its limits and the other concerns its nature. The first assumption is that there are bounds on individual intellectual capacities, and these bounds place severe constraints on the structure and functioning of institutions and organizations. In the economic dimension, this means that one cannot view organizations simply as larger versions of rational economic man, reacting swiftly and accurately to the winds of fortune. Rigidities in economic behavior must be largely understood in terms of the limits on individual knowledge and the effects of these limits on organizational behavior. In particular, old organizations, created in a past environment, will behave very differently from new organizations. In the political dimension, this means that individuals cannot be expected to understand the effects of schemes for large-scale social renovation, especially when this renovation involves a thoroughgoing replacement of all the institutions of society.

The other pivotal assumption about human knowledge is that important insights are gained by distinguishing between two types of knowledge.[15] The first is technical knowledge, the set of explicit rules and procedures that can be conveyed by lecturers and systematized in textbooks. The other is practical, or personal, knowledge – the inarticulable knowledge that is required in the effective performance of any activity and that can be acquired only by direct acquaintance with the activity. Personal knowledge includes information about individuals and organizations in the economic and political systems with which a person interacts.

Because personal knowledge is acquired through activity, it is specific to particular social contexts. A society's stock of personal knowledge is acquired through a long historical process and is shaped by the institu-

tions and organizations of that particular society. It is useful mainly in the context of those organizations and institutions. Since radical schemes of reform advocate measures that destroy much of society's knowledge capital, judgments on the relative merits of radical and evolutionary schemes for reform will hinge to a large extent on the relative importance that one attributes to technical and personal knowledge.

Both conservative political philosophy and evolutionary economics place processes of change at the very center of inquiry. Conservative political philosophers maintain that the great disasters of history have been fostered by utopian schemes of change. This emphasis on change interacts strongly with the assumptions regarding the nature of knowledge. It is exactly when a new world is sought that it is most important to recognize the limits placed by the fact that current knowledge has been produced by the old order.

An evolutionary view of economic processes holds that the relative success of different societies is largely a function of their effectiveness in reacting to exogeneous events and in generating productive social change.[16] For economic systems, innovation and adaptability are the crucial ingredients for success. Again, the assumptions on knowledge are crucial. Those assumptions largely determine the way in which we should understand the nature of organizations and their reactions to change. In particular, successful societies do not rely on existing organizations to undertake fundamentally new activities. Change is accomplished to some great degree by the replacement of the old and by experimentation with, and selection among, new structures: the process of entry and exit. In the reforming countries, this can only be accomplished within the new private sector.

II.c. *Commonalities – general reflections on reform*

Economic and political decisions are circumscribed by limits in social knowledge, especially those limits that result from the fact that this knowledge is inherited from the past. Hence, there will be much persistence in the behavior of the individual organizations and institutions of society. It is quixotic to assume that organizations can escape their past and adopt a thoroughly new mode of behavior. Policy makers cannot design a fixed and flawless blueprint for change to a new order because socioeconomic processes are highly complex and society's information stock is conditioned by the old order. Such limits are stressed by the evolutionary approach to reform. The radical approach focuses on desires for the future.

Reforms must work with what inheres in any given social situation. The behavior of existing organizations and institutions is not likely to change rapidly, at least not in functional ways. Unless destruction is the goal,

many characteristics of existing organizations must be accepted. If one attempts to eradicate all such characteristics immediately, then one invites economic collapse. In the long run, the existing organizations can be replaced by the growing private sector and its associated institutions. But if one ignores the existing character of organizations when designing economic reforms for the short run, then one risks setting in motion a reform that has properties far from those desired.

In their separate ways, both conservative political philosophy and evolutionary economics lead to what might be called the law of the diminishing marginal productivity of change. From the economic perspective, large changes in the legal and policy framework produce highly dysfunctional outcomes, because the capacities of existing organizations are greatly dependent upon their existing environment. Knowledge of how to behave in the new situation is missing, and much effort must be expended initially in developing a new modus operandi. Moreover, as existing economic relationships are disrupted, much knowledge capital is destroyed. Similarly, from the policy perspective, the effectiveness of policy-measures decreases sharply with the magnitude of the break from the past because the knowledge used to design those measures is reflective of initial conditions.

Distinct elements of the two sets of theories combine to produce the final conclusion, which is specific to the transition from socialism. Conservative political philosophy emphasizes the need to identify the most pressing problems within society and to produce change by attacking those problems rather than by attempting to implement a redesign of the whole system. An evolutionary perspective allows us to identify the central problem of socialist economies – these systems had no capacity for change and renewal (Murrell 1990a). This capacity in capitalist societies is provided to some large extent by entry and exit – the process of demise of the old organizations and their replacement by the new.

The first step in an evolutionary reform is therefore to expose existing institutions to challenge by the new. This can only be accomplished by encouraging the nascent private sector. Such encouragement is so vital that it must be an element in all aspects of policy for the transition and it must help to determine policy towards the old state sector. It is in fact an understanding of the processes of change under capitalism that tells us that socialist reform will be a failure unless that new private sector is the main instrument of producing change within the East European economies.

III. Dichotomies: features of evolutionary and radical schemes

The evolutionary and radical strategies for reform are not clearly specified lists of procedures to be followed in specific circumstances.

Rather they are philosophies, or world-views, on general approaches to reform. They are paradigms concerning how to identify the issues that should be addressed and how one should address them. In the following comparison, it is therefore not possible to focus on detailed measures. It is possible, however, to review the most general features of the two world-views. This is accomplished by highlighting the chief conceptual differences between the two philosophies of reform and illustrating them with examples. Throughout the following, one should remember the most important distinction between the evolutionary and radical views. This is the contrast between viewing society as an information processing device and viewing society as a resource allocation device.[17]

III.a. *Identifying worst problems or implementing the end state*

The radical reform program is defined in terms of its intended endpoint. It focuses on immediately implementing the features of a mature market economy. The order for implementation of the parts is determined by feasibility as much as by strategy, since the emphasis is on doing as much as possible, as soon as possible. More importantly, no actions are taken unless they relate directly to the attainment of the envisioned endpoint. Existing arrangements are suffered if they cannot be removed, but they are seldom retained by strategic choice. For example, the instruments of macroeconomic control of the old system are eschewed, despite their potentially greater effectiveness than market-based stabilization schemes in the very early stages of reform.

In contrast, the evolutionary approach asks first what features of the old system need to be changed most urgently. The answer is based on a pragmatic assessment of present requirements, rather than a vision of an end-state that lies far in the future. The strengthening of certain types of property rights, for example, might be an appropriate response to organizational inefficiency, even if these particular property rights might not be deemed suitable for the long run. An illustration of this is the case for strengthening workers' management rights in certain enterprises when elements of such rights are deeply embedded from the past. Such a move may allow existing information to be used in its most productive way, given the structure of existing organizations.

Under an evolutionary approach, the policy of not destroying workers' management rights is thoroughly consistent with the expectation that workers' management will not be a feature of the end state of the reform process. So long as the workers' enterprises are exposed to competition from the new private sector, the place of workers' management in the economy can be decided by the market. Meanwhile, in the short run, keeping in place an existing system of workers' management rights avoids the destruction of a large part of society's organizational capital. In

contrast, adopting a radical approach would most likely entail revoking these rights immediately, if they were regarded as inconsistent with the end-state.

III.b. *Destruction versus gradual replacement*

The radical approach emphasizes destruction of old institutions because they are believed to have no value in the end-state and hinder implementation of that end-state. For example, rapid privatization is often advocated as a means of destroying the existing system rather than for any creative purposes. The evolutionary approach, in contrast, would recognize the information that is held in the continuing operations of existing organizations and in the continuing interactions of economic agents in their existing capacities. Rapid change in existing arrangements destroys much of the information that society has built up over time. Even though this information might not be useful in the long run, it could be very productive during the beginning stages of reform, when alternative market arrangements are only beginning to form. As the new private sector institutions grow, hopefully spurred by state encouragement, the old can be gradually replaced.

The destruction of the CMEA illustrates this dichotomy. Those who advocated the CMEA's quick demise are now being forced to acknowledge the short-run costs of replacing it. A policy of gradual replacement would surely have lessened the economic problems of 1991 and would have prevented the need for the Eastern European countries to scramble to construct barter deals to replace the CMEA.

III.c. *Reversibility versus commitment*

No concept has been more prevalent in the reform debates than that of commitment – the notion that unless policy makers are able to back themselves into a corner, their policies will have no credibility. Given that the radical approach aims unstintingly at the end-state, commitment to the implementation of this state is obviously an unalloyed good. When the process of reaching the end-state is considered, the value of commitment diminishes. The evolutionary approach stresses that there will be an immense amount of learning in the process of reform and that the initial policy stance will depend very much on knowledge obtained under the old régime. Therefore, commitment can well be counterproductive. Initially chosen policies will be unsatisfactory and the ability to change them will be important. Reversibility is especially valuable when changing

large socioeconomic systems since the knowledge of such systems is always terribly incomplete and the costs of poor decisions can be immense.

In fact, the credibility of a reform process (as opposed to particular reform policies) might be enhanced by advocating policies that are more easily reversible. Policy that commits itself to particular features at a time when there is much learning to be accomplished and when large mistakes are inevitable is not likely to be considered sustainable. For example, the commitment to a particular exchange rate early in reform actually lessens policy credibility; it is obvious that policy makers cannot identify an appropriate rate before gaining knowledge of the new system.

III.d. *Fast versus slow*

All of the above points to some degree reflect differences of opinion on the optimal speed of reform for the existing institutions and organizations within society. The law of the diminishing marginal productivity of change captures this issue in a general way. Radical reforms pursue speed as a means of destroying the old, on the assumption that the old has no value. The evolutionary approach emphasizes that rapid reforms that disrupt existing relationships also destroy the existing information stock. Such is one interpretation of the collapse of enterprise performance in Eastern Europe after the implementation of shock tactics in several countries. Additionally, fast reforms do not have the potential for reversibility possessed by more gradual reform processes. Since there is a lag between implementation and effect, fast reforms offer no mechanism for stopping a measure during implementation, in the event that its effect be found less benign than was anticipated at the beginning of reform.

It must be emphasized here that the issue of speed only reflects upon the changes in the operating conditions of existing organizations. No similar argument applies to encouragement of the new private sector. Thus, reform should certainly aim at creating, as soon as possible, conditions conducive to the rapid growth of a new private sector.

III.e. *Small versus large experiments*

Many experiments will be tried as countries attempt the transition from socialism to capitalism. Such schemes will rely primarily on theoretical design rather than on simple extrapolation of present experience or on the importing of lessons from other nations. The issue of the size of an experiment during reform and the issue of the speed of reform are

somewhat similar. A fast reform exposes the society to great risks that cannot be hedged by reversibility; so does a reform that contains a single element that is of very large scope.

Because of the incompleteness of our knowledge of how socioeconomic processes work, the evolutionary perspective holds that society must restrict the scope of any single experiment. For example, the grand voucher schemes of privatization can be viewed as a way of exposing a large segment of society to what is essentially the implementation of a theoretical idea. Implementation of the voucher scheme is anticipated in Poland, Czechoslovakia, and Mongolia. From the evolutionary perspective, these schemes are better to the extent that they rely on existing experience drawn from elsewhere, to the extent that the changes that they render are transparent and simple, and to the extent that they are reversible. In these senses then, the Polish scheme is preferred to the Czechoslovak scheme, with the Mongolian scheme least preferred.

The second reason to minimize the scope of experiments is that when things go wrong, as they inevitably will, there will be spillovers across sectors. A unique characteristic of the East European transition is the large number of companies that will simultaneously be subject to the stress of change. Declines in performance in one area will be reinforced by the pressures of adversity elsewhere. Whereas moderate amounts of adversity might be salutary, inducing productive reactions, extreme adversity appears to produce highly dysfunctional response, enhancing crisis rather than diminishing it. It is thus important to ensure that a crisis produced by a failed experiment does not affect too many areas of the economy simultaneously. This is one of the lessons from the effects of the decline of the CMEA that should be brought to bear on the present debates over privatization.

III.f. *Experience versus design*

The radical reforms are the crystallization of the faith in reason over experience and experiment. An evolutionary approach values the accumulated experimental wisdom of society – the stock of its personal knowledge. That approach therefore views with skepticism reforms that use wholly new schemes derived purely from theory, particularly those that exhibit speed, irreversibility, and large scale. Here the Chinese reform experience is extremely instructive. That reform was initiated with successful experiments in the Chinese countryside, out of the purview of the national leaders. The national leaders put in place at the national level a policy that had already been seen to be successful. Theory had nought to do with the choice; the driving force was the replication of experience.

III.g. *Market process versus market product*

Even a slow reform will eventually destroy many of the existing economic ties. Much personal information will be lost. The process of reform should therefore generate replacement information as it proceeds. Reformers of all shades believe that the market itself is the most successful means of creating such information. Market processes can destroy and rebuild the ties between organizations and between individuals as reform proceeds. This focus on market process contrasts with the view that reform should strive for a desired end-product, without analyzing the process by which that product would be most effectively reached.

An example of employing market processes is the search for the 'natural owners' of firms during the privatization process by using market-type methods to identify buyers (Stark 1990). Natural owners are those who have the appropriate characteristics to run the newly private concerns. Given that such capacities involve personal knowledge, a process is needed to match owners with enterprises. As one can very quickly learn from the von Mises critique of socialism, this matching process is one of the prominent elements of a market economy that synthetic schemes cannot replace, because they do not use the information that already exists in society concerning who has the characteristics of a natural owner. The call for the use of market process, conserving and enhancing society's information stock, is directly counter to the use of the synthetic voucher schemes of privatization that are presently the vogue in Eastern Europe and further afield.

The emphasis on another element of market process follows from asking how market systems accomplish the task of renewal. Such systems do not accomplish change by asking existing organizations to perform completely new functions. Existing entities are often replaced, gradually and haltingly. New entities arise to accomplish the new tasks. If this is a fair characterization of market process, then it is clear that privatization of existing government enterprises can answer few hopes in reforming socialist countries. Rather, policy should encourage a new private sector that is uncommitted to the past and in which a viable process of selection of the best organizations can take place. This policy resonates most strongly with another aspect of the evolutionary approach, the need for policies to address directly the largest problems of the existing system. The renewal process of entry and exit is at the heart of the superiority of market over socialist systems.

III.h. *A dual economy versus the unified, liberalized market place*

The radical reform approach advocates economy-wide liberalization as an absolute priority for a first step. This priority stems from a focus on the

distortions that arise in market economies when distinct parts of the economy face separate rules, a focus reflective of theory centering on resource allocation. In contrast, evolutionary theory, which is information based, focuses on a crucial feature of an economy at the beginning of the reform – the information held by existing organizations is germane to the old economy, while there is the vital need to create entities that are much more attuned to the new. This presents two contradictory needs. First, some of the existing institutions must be preserved; change must be slow enough to avoid the collapse of productive organizations. Second, a spurring of the entry-and-exit process is needed in the private sector. It is possible that a dual economy will be required to meet these contradictory needs during the transition. For example, administrative control of the state sector might be required to forestall the draconian stabilizations that will inhibit the growth of the nascent private sector.

By acting upon these information-based concerns, evolutionary reforms violate one of the basic tenets of existing economic policy doctrine and especially of the radical schemes of reform. There will be a large asymmetry in the way that the various organizations in society are handled. This is simply a product of the fact that reform itself bifurcates history, which has determined the characteristics of society's organizations. One can ignore this fact and pursue economy-wide liberalization, as the radical schemes dictate. But the result will be the destruction of much of the informational basis of economic performance.

IV. Predictions

This paper itself summarizes analyses contained in a number of other works. Therefore, in place of a summary in this section, I use evolutionary theory to offer some predictions concerning the future of the countries undergoing reforms and the likely course of reforms themselves.

First, the evolutionary approach suggests that the most successful reforms will occur in those countries that effect change consistently over an extended time period, rather than in those that attempt to use economic strategies to create a sudden divide between the past and the future. For example, Hungary, which was much criticized in 1990 for not implementing the radical model, now appears likely to outpace Poland and Czechoslovakia in economic performance over the next few years.

Second, the voucher schemes of privatization, because they are large-scale, speculative programs that have never been tested, will encounter severe problems at the implementation stage. These problems have the potential to stall the progress of reform in those countries that have set great store by these schemes.

Third, economic performance will not be positively related to the speed of privatization of the large-scale enterprises. In fact, there might even be

an inverse correlation. The basic variable that will most determine the speed of change is the extent to which resources are freed for the new private sector. Undertaking the formal process of creating free markets is not enough. Resources must be prised free from the large enterprises of the old state sector. Moreover, liberalization with stabilization will not accomplish the freeing of resources, because such measures will require continuing policy-induced recessions that restrain the private sector as much as the state sector.

Fourth, significant recentralization of the state sector in the reforming countries will eventually reverse the liberalization that was carried out in the first flush of reforms. This will be necessitated by the continuing lack of attention to market forces by the old enterprises, which were created in the non-market environment. Governments will come to the realization that the small gains in improved resource allocation created by liberalization will be outweighed by the dysfunctional behavior of the old state enterprises in the new market environment. The dual system advocated by the evolutionary approach will thus be created by economic necessity.

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Notes

1. There is no pejorative intention in this choice. There are alternative labels, such as utopian or revolutionary. Each of these would serve as well, so long as the literal meaning was implied, rather than the sometimes pejorative connotations that these words have in typical English discourse.
2. There are those who might defend the East German radical reform by explaining that the exchange rate was wrong or that workers' expectations were too high. In fact, the radical approach is supposed to deal with such problems, which are after all inherent in the change from one régime to another.
3. Instead of the Chinese-versus-German comparison I could have used a Polish-versus-Hungarian comparison with many more nuances but effectively the same conclusion.
4. FBIS-EEU91-112 June 11, 1991.
5. Jacek Bukowski of the Ministry of Ownership Transformation reported in Seattle on June 8, 1991 that six state companies had been privatized by favored methods, whereas 100 enterprises were privatized by employee buyouts.
6. One particularly challenging way to state this point is that if liberalization is implemented and privatization is slowed, then the radicals are in the position of advocating a market socialist economy. But this is just what the radicals have argued against (Lipton and Sachs, 1991).

7. For a sampling see a report on Prime Minister Bielicki's visit to some of his factories (New York Times, June 3, 1991) and the comments of Finance Minister Balcerowicz reported in FBIS-EEU-90-093, May 14, 1991. Similar statements from elsewhere could fill a further paper.
8. This paragraph is solely meant to convey a state of thinking at a particular point in time (September 1991). At this point, it is simply impossible to predict how events will unfold in the coming months.
9. See for example the details of a Soviet–Hungarian deal swapping $100 million of food and buses for raw materials (FBIS EEU-91-107, June 4, 1991). Similar types of arrangements are being reconstructed across the countries of the old CMEA.
10. Washington Post, August 5, 1991, p. A11.
11. Murrell (1990b) implicitly uses the world-view of evolutionary economics rather than making any explicit theoretical connections. The impetus for using evolutionary theories to examine the East European transition is the finding in Murrell (1990a) that the evolutionary paradigm identifies those systemic features most responsible for the differences in the economic performance of capitalist and centrally planned economies. These are the features of centrally planned economies that must be most urgently changed in the process of reform. The concluding chapter of that work contains some preliminary suggestions on the evolutionary approach to reform.
12. An alternative label, quite pertinent in the present context, is the one chosen by Popper (1971 p. 1) – 'principles of democratic social reconstruction'.
13. In classifying these three authors together, there is no implication of profound agreement between them. Rather, the similarities stand out most clearly when the general world-view of each of these works is contrasted to that in the radical approach.
14. Unfortunately, since this paper attempts to summarize and synthesize several other papers, much detail must be omitted. Readers are referred to the other cited works to fill in the gaps in the chain of logic that are inevitable in such a condensation.
15. The distinction between the two types of knowledge has been offered by many authors, most notably by Oakeshott (1962, pp. 7–8) and Polanyi (1962).
16. For a discussion of these points, see Nelson (1990).
17. Unfortunately, much of the analysis below depends on arguments that do not appear above for lack of space, but rather are contained in the papers cited previously.

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