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THE CULTURE OF POLICY MAKING IN THE TRANSITION FROM SOCIALISM: PRICE POLICY IN MONGOLIA

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The Culture of Policy Making in the Transition from Socialism: Price Policy in Mongolia

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Summary

The transformation from socialism gives economists a unique opportunity to observe the effects of culture on policy. Until recently, today's reforming socialist countries were intellectually and economically isolated from the capitalist world, and thus their culture of policy making developed in a very different manner from that in the West. This paper--by examining a small element of the transition in a specific country, price policy in Mongolia--argues that the culture of policy making that arose and took root under socialism has profound implications for the progress of reform.

In the abstract, Mongolian society was ready to move to a market economy and accepted that price controls were inconsistent with such a move. But when choices were made in the real world, where leaders were faced with a disastrous and largely unintelligible economic environment, price controls re-emerged as the preferred policy tool. This occurred despite the avowed commitment of the government to radical reforms and despite intense external pressure to follow those reforms.

The paper first outlines some basic features of Mongolian price policy: dissonance within and among policy measures; a proliferation of price controls, controllers, and arguments in favor of controls; and spontaneity and decentralization of controls. Several possible explanations for these characteristics of price policy--in addition to cultural influences--are then considered: a preference for the old system; second-best policy; a policy game played out among competing economic actors; and rent-seeking behavior on the part of price-policy officials. The influence of the culture of policy making in framing and guiding decisions emerges as the most convincing explanation. The experience of Mongolian price reform might be paradigmatic--if somewhat extreme--of what happens generally when a radical reform is introduced in an unreceptive and rapidly deteriorating economic environment.

1. INTRODUCTION

This paper argues that the history of policy making can deeply influence current economic policy decisions in reforming socialist countries. History's impact lies beyond the rigidity of inherited organizations; it acts separately from the inherited allocation of power and property rights. Notions and practices that are a product of past historical experience are an autonomous force in the development of policy, and they endure even when policy makers deeply desire change.

Many labels could be attached to the phenomena we describe. We have chosen the word *culture* because the most common interpretation of that term captures the essence of what we hope to convey. The central element of culture, a common set of beliefs and practices resulting from a shared historical experience, is exactly the phenomenon on which we focus.

As explained in Section 2, our treatment of culture is consistent with standard methodology applied to a setting in which informational and learning processes are all important.[1] In fact, our conclusions on Mongolian price policy exemplify North's (1990, p. 96) point that: "...the historically derived perceptions of the actors shape the choices that they make...[and]...the imperfect and fumbling efforts of the actors reflect the difficulties of deciphering a complex environment with the available mental constructs--ideas, theories, and ideologies."

The paper's stimulus was provided by observation of the tortuous progress of price reform in Mongolia. With much fanfare, Mongolia's government proclaimed a policy of rapid and complete price liberalization. The commitment to liberalization was both genuine and widespread: there was a general aspiration within society to move to a market economy. However, in the turn from abstraction to action, the details of legislation, the rules embodied in regulations, and policy implementation painted a very different picture. Resultant policy was a curious mélange of the old and the new.

To explain these developments, we argue that price policy was greatly influenced by the policy practices inherited from the socialist era and by understandings of the nature of economic processes that were embedded in these policies. These influences have been important despite the genuine commitment to reforms within society.

We review the overall context of Mongolia's reforms in Section 3, as preface to Section 4's detailed description of the characteristics of price policy. In the transition literature, top-level official pronouncements often become accepted as fact, while the underlying reality of policy is hardly observed. Therefore, a significant component of this paper is simply its demonstration of how far pronouncements can diverge from reality. With appropriate changes in details, the general elements of this description could apply to many policy episodes in diverse reforming countries. Indeed, the experience of Mongolian price reform might be paradigmatic--if perhaps extreme--of what happens when ambitious market reforms confront an unversed and rapidly deteriorating economic environment.[2]

In Section 5, we examine a number of alternative explanations for the developments in Mongolian price policy, including our culture-of-policy-making hypothesis, exploring how each fits the facts. This "test" of our hypothesis uses revealed preference--we examine the real decisions of policy makers confronted with reform's thorny choices. Unfortunately, we see no way to combine this revealed-preference approach with statistical tests, given that the evidence is qualitative. For this reason, the paper's conclusions are more tentative than usual.

2. THE CULTURE OF POLICY MAKING

Academic tomes have been written on the definition of culture, Kroeber and Kluckhorn (1952), for example, finding 164 distinct definitions. Nevertheless, the many uses of the term typically have a common element: an emphasis on behavior, information, and ideas that arise from shared experience within a particular society.

Bikhchandani, Hirshleifer, and Welch (1992) and Hirshleifer and Welch (1993) provide insightful analyses of how culture can arise within a rational-choice framework. Their focus is on the effects of incomplete information, specifically when past decisions are known but the information that spurred these decisions is hidden. In this case, the history of past decisions can come to dominate present information in the calculus of decision makers. Present policy might follow past policy, even though full information could call for change.

Hirshleifer and Welch's (1993) informational structure is consistent with the perspective adopted by Oakeshott (1962), the leading proponent of the view that traditions and habits are functional elements of political processes. This perspective emphasizes personal knowledge (Polanyi 1962), which is acquired through active experience rather than from formal learning. New officials do not automatically inherit the seasoned policy maker's personal knowledge of the character of the times and the nature of economic processes. However, past decisions are usually public knowledge and thus become part of the tradition inherited by the current generation.

With this type of informational structure, past policy can have a powerful effect on new decision makers.[3] The shared history of policies is itself a determinant of present decisions. Paradoxically, new leaders, divorced from the information set that led to past decisions, might be particularly prone to following the old policies. It is exactly at a time of leadership change and turnover of decision-making personnel that policy history can have a particularly important informational role. We label this policy history *the culture of policy making*. The effect of the culture of policy making on policy implementation can provide a counter-weight to the changes in policy preferences that new leaders usually bring. Therefore, there can arise an apparent dissonance between generalized statements of preferences, which are unreflective of the informational constraints imposed on decision-making, and actual choices, which do reflect those constraints.

Shiller, Boycko, and Korobov (1991, 1992) have conducted an influential study that reflects on issues similar to those discussed here. In searching for *homo sovieticus*, they distinguish between attitudinal and situational influences, drawing an analogy with the distinction between preferences and constraints. Attitudinal influences comprise traits, personality, and culture. Situational factors include economic expectations and institutions affecting behavior. Shiller et al. conclude that cross-country attitudinal differences are not significant, a conclusion seemingly inconsistent with those of this paper.[4]

The culture of policy making does not fit neatly into the attitudinal-situational taxonomy. A policy maker can rationally follow a tradition, but the articulated reasons for policy choice will surely sound attitudinal.[5] It is hardly likely that he or she will use Bayesian theory to justify the uses of tradition. Nevertheless, the learning process based on the history of policy making generates a technology of decision making that is a constraint for the policy maker, and this is situational. Similarly, Shiller et al. (1992, p. 180) classify "popular assumptions about reciprocity, implicit contracts, and social conventions" as situational. But it is our sense that all these notions might be included under the general rubric of *culture*, as that term is commonly used. Hence, the division between situational and attitudinal influences (or tastes and constraints) is not a powerful one in examining the way that history affects policy-making in the reforming countries.

3. MONGOLIA

For nearly seventy years, Mongolia was the *de facto* sixteenth republic of the Soviet Union. Its industrial base grew in the context of the CMEA's international division of labor and was wholly dependent on CMEA trade. The Soviet Union financed Mongolia's international-trade and government-budget deficits, which in the 1980s exceeded 20 percent of GDP. Economic isolation from the West and support from Moscow were mirrored on the intellectual side, almost all of the Mongolian elite being educated in the USSR. Educational institutions and their economics curricula followed the standard Soviet model.[6]

After the first free elections in 1990, the Mongolian People's Revolutionary Party (MPRP), the old communist party, established a reformist, coalition government. Of substantial importance in the coalition's economic policy making was a small, new party that had been formed around a group of young economists who were imbued with a knowledge of the latest reform fashions. Their presence and influence in the coalition reflected the broad consensus that the old system was bankrupt and that new measures were urgently needed. The failure of the old economic system resonated with newly won independence to reinforce the desire for a decisive break with the past.

Domestic economic equilibrium was sorely lacking when real reform began. Half-hearted reforms had loosened monetary and budgetary controls, while doing little to establish markets. In January 1991, when reforms began in earnest, large-scale economic distress became inevitable with the precipitate ending of Soviet aid and the demise of the CMEA. The government then lost control of monetary and budgetary policy. As foreign aid and advice began to flow toward the end of 1991, macroeconomic policy gradually improved. But this was not before the economy had deteriorated so much that years of patient attention to good policy would be needed to restore macroeconomic equilibrium and the previous standard of living.

The beginnings of a market economy in Mongolia coincided with economic collapse, providing a singularly inauspicious first data point on the performance of markets. As a result, although Mongolians knew that markets functioned successfully elsewhere and although the broad commitment to move to markets remained firm, many expressed the belief that reforms required non-market measures "in our situation." Given the juxtaposition of such views with comments about speculators and monopolists, which arose repeatedly in the media, in official documents, and in our conversations with policy makers, it is evident that the Mongolians perceived their first market experience through a lens formed in the socialist era. This was a factor in the outcome of the second parliamentary election in June 1992, when 71 of 76 seats went to the MPRP, whose conservative wing was advocating reforms at a slower pace. The data and analysis of our paper reflects on the period before this election.

4. THE CHARACTER OF PRICE POLICY IN MONGOLIA

We demonstrate the essential character of policy in the immediate post-socialist setting by highlighting seven characteristics of Mongolian price policy, which are described in the seven separate sub-sections that immediately follow. The emphasis here is on description not on analysis, which follows in Section 5.[7]

The Proliferation of Price Controllers and Controls

Before reforms, Mongolia had a consistent and integrated set of price controls, echoing the traditional Soviet model. Price controls were administered by a single hierarchical structure, buttressed by the MPRP. There was little uncertainty about who had responsibility for setting and monitoring which prices. Under this system, there was little actual movement in prices--a point of pride to Mongolians, who often boasted of having the most stable prices in the world during the socialist era.

Very modest price liberalization was initiated as early as 1988, but reform began in earnest in January 1991 with a resolution setting forth the principle that any price was free unless the government specifically announced otherwise.[8] This resolution listed a number of prices that were to remain controlled "at the initial stage of the economic transition," but it freed 60 percent of prices. Even before this measure, the government had announced a commitment to a free-price system, with only temporary controls to protect the poorest segments of society.

As negotiations with the IMF proceeded in 1991, the government reaffirmed its intention to continue rapid liberalization. A measure passed in September 1991 halved the number of prices subject to government control.[9] In early 1992, more steps toward decontrol culminated in a resolution that left only flour products, transportation, utilities, fuels, and medicines formally subject to official controls.[10]

With this progression of measures, and the abolishment of the former price-setting bodies, one might have expected the cessation of intervention into price setting. The old habits were widespread, however. Many organizations and individuals promoted measures to control prices, partially as a result of individual initiative at all levels of government, but also partially fostered by the central government itself, which intervened on an ad hoc basis and condoned the individual initiatives. Government resolutions, individual politicians, the ministries, the new commodity exchanges, local authorities, and the police were all culprits in the continuation of price controls.

Initiatives in conflict with the government's stated preferences for liberalization occurred at even the highest levels. These were of two basic types. First, there were measures that set prices, particularly in the agricultural sector.[11] Second, individual politicians intervened to control specific prices. For example, after social unrest over milk-price increases in the capital city, members of the cabinet pressed the city's price commission to lower prices.

Ministerial units of the central government acquired considerable authority to intervene in price-setting. That the Ministry of Trade and Industry should provide the lead by perpetuating some of the old measures is not surprising given its absorption of the old price-control agencies. The Ministry of Finance set retail mark-ups and assumed responsibility for the confiscation of profits resulting from price increases deemed to be excessive. Jurisdiction over the pricing of urban land was claimed by four ministries and by local authorities. The Ministry of Agriculture and the Ministry of Trade and Industry shared responsibility for setting agricultural procurement prices.

Not only old organizations engaged in controlling prices. New entities, set up to aid the process of transition, often acquired a tinge of price regulation themselves. Commodity exchanges, which were created to facilitate trade as the old distribution system collapsed, provide an example. Whether the true function of the exchanges was to control prices or to encourage market transactions is the subject of considerable disagreement. The former perspective is encouraged by the general perception we found among Mongolians that if an organization's function involves distribution, in practice the organization should force a non-market distribution.

The extent of price decontrol, or more correctly the lack of decontrol, was evidenced in data collected in 1991 for Mongolia's first consumer price index. The period covered by the data--between the collapse of Soviet trade relations and the introduction of large-scale Western aid--was a time of severe macroeconomic disequilibrium. Monetary emission financed a budget deficit of over 20 percent of GDP. Money supply was increasing at an annual rate of 200 percent in mid-1991.

These data show that 70 percent of officially decontrolled prices did not change in the first eight months after decontrol, despite the severe macroeconomic disequilibrium. Moreover, the data evidence a divergence between capital city and rural areas. Prices not subject to central government controls, whose movements would reflect the stringency of ad hoc local controls, rose by 19 percent in the rural areas and 32 percent in the urban areas. Unofficial controls on prices were tighter in the rural areas, where local officials were more removed from the main currents of reform established in the capital.

Spontaneity, Decentralization, and the Role of Local Officials

Policy at odds with central government directives often arose from the spontaneous actions of officials. Price controls proliferated as these officials, especially local administrators, used old policy practices in the new environment.

When the old party-based structure of administration dissolved, local officials began to assert their independence. Local bureaucrats found themselves pressured by local politicians not to implement national policy. New local price commissions filled the gap left by the decline of the old apparatus, keeping the old policies in place and sometimes expanding their scope. The propensity to control prices at the local level extended even to private sector prices, which had never been controlled previously. These developments at the local level provide one explanation for the negligible price movement that occurred in the six months following the initial liberalization measures.

The central government later validated the increased jurisdiction of local authorities, officially recognizing the local price commissions by formalizing their role and composition. They were to be headed by local administrators and to comprise "representatives of producers and consumers of all property sectors and experts, obliged to direct price policy ..., to coordinate price levels, [and] to take measures against price monopoly."[12]

Re-centralization

The divergence between national policy and local measures was troubling to both national and local officials. The reaction, however, was not to coordinate measures in line with the reform polices. Instead, after nine months of decentralization, measures were taken to systematize and coordinate the myriad new price controllers. An October 1991 resolution referred to "the need to centralize the forces of control organizations in order to combat negative phenomena arising during the transition to a market economy" and created a commission to oversee all price-control policies.[13]

In November 1991 the government accepted a proposal developed by the local authorities to set up coordinating councils for economic policy.[14] The objectives of the new councils included "regulating among themselves the prices for goods." This measure was a continuation of the spontaneous local policy development that had characterized the previous months. But paradoxically it also brought about re-centralization, since the councils were now encouraged to coordinate their actions.

Dissonance

Dissonance within policy was evident in two distinct forms. The most apparent was between the ambitious goals pronounced by the top politicians and the decisions on policy implementation made by those politicians and by lesser officials. Ultimately more striking was the dissonance that appeared in the form of conflicting elements of a single policy statement, even in official policies emanating from the highest levels. We turn first to the dissonance between the general announcements and the implemented decisions.

The progression of official resolutions tells the story of a fourteen-month transformation from almost total price control to almost total decontrol. This timetable is as swift as any in the reforming socialist world. Looking behind the scenes, however, one finds a very different picture. Officials acknowledged that, *pace* the official announcements, no decontrol actually occurred in the six months after the first liberalizing resolution. Moreover, the detailed Order implementing that resolution required all economic entities, public and private, to comply with rigid pricing procedures, whether or not the prices officially remained under government control. These procedures included registering prices with "price-setting bodies" and establishing within enterprises price committees that were to include representatives of buyers and of government agencies.[15]

Despite successive resolutions on price decontrol, concurrent measures introduced new controls. As detailed above, some resolutions gave local governments new authority for price control. In August 1991, minimum prices were set for selected agricultural products.[16] A measure introduced in October ordered the confiscation of all profits resulting from price increases deemed excessive. This measure was interpreted as applying to all prices, whether of public or private firms.[17]

Perhaps more important than the dissonance that occurred *between* measures is the dissonance that occurred *within* them. Measures typically opened with a lofty statement of preferences, and this statement often conflicted with the more specific actions that followed. The government claimed that it was "[a]iming at shifting to the market the logistics of distributing and selling consumer goods," for instance, in a resolution that simultaneously required governmental organizations at both the central and local levels "to control prices for goods set by private shops so that these prices do not exceed the average market level."[18]

Probably the most remarkable example of such dissonance appeared in the Privatization Commission's report issued at the end of 1991. This Commission spearheaded economic reform, and its chairman was widely recognized as the country's leading economic reformer. In a candid report aimed at a domestic audience, the Commission reiterated the general commitment "among our people to make the privatization process irrevocable and intensive." But despite the Commission's dedication to reform, the report also set forth the notion that "[f]rom the very beginning, it is necessary to pay special attention to setting control over [and supervising the implementation of] the contracts of privatized shops ... and other enterprises on issues relating to maintenance of the types and sizes of services, the supply and price regimes, and the number of employees."[19]

The degree of dissonance was perhaps highest in March 1992. The measure that was highlighted as the culmination of liberalization was put into effect, while at the same time, every single pricing decision in Mongolia was subject to the scrutiny of several governmental authorities, as we have detailed above.

The Explanations for Price Controls

Explanations for the use of price controls abounded. They were often conflicting, and many contained elements that were not relevant to a market setting. Their sheer number and their questionable nature argue that they were ad hoc rationalizations, rather than the true underlying reasons for intervention.

The most common arguments focused on the transitional nature of the economy. Members of the Privatization Commission, for example, believed that privatization was a precondition for free prices. There was a perceived need to help the market do its job until the transition was over, one measure mandating that local authorities "ensure balance between societal demand and supply in the market economy environment [and] coordinate price levels."[20] Even resolutions that created new forms of price controls cite "shifting to market relations" as their goal. Thus, "Supplementary Measures to Shift to the Free-Price System" set prices for agricultural products "in order to ensure the stable functioning of agricultural entities during the initial stage of the transition to a market economy."[21]

Sometimes the measures were more specific in their diagnosis of problems, than simple referring to transitional problems. One resolution ordered "measures to combat monopolies and the practice of setting prices too high," and another set prices in response to perceived problems arising from a monopsony in hides.[22] In this case, price controls were used in spite of the fact that the monopsony problem resulted from actions of the state, particularly the ban on exports and the continuation of the central distribution system.

The above suggests that the concern with monopoly emanates as much from views of capitalism arising from the past as from an appreciation of the actual character of monopoly in a market economy. This point applies even more to another problem perceived in the economy. An "invisible economy" of speculators was said to be "destabilizing" the supply of goods in Mongolia.[23] The presence of market manipulation was a constant theme justifying the regulation of prices. The pursuit of any economic rents was labelled speculation, a term with very negative connotations.

This focus on preventing windfall gains was an element of many measures and would sometimes impede decontrol. The last of the highly symbolic measures to announce price liberalization removed price controls from all consumer goods except flour and related products. Decontrol was not deemed necessary for these products because they were produced using last year's harvest, which was conducted when the old prices were valid.[24]

(Mis)Conceptions of Liberalization

The previous paragraph demonstrates a tendency to focus on historic costs, rather than opportunity costs, and a lack of appreciation of the demand side. One official with authority to intervene defined the free price of gasoline as that price equal to the import price converted at the official exchange rate, plus import duties, transportation costs, and a fixed wholesale mark-up. The resultant price was one quarter of the world price for gasoline when using free-market exchange rates. Not surprisingly, when gasoline had this "free" price, there were enormous shortages. The notion of a free price seemed to fit better with the old concept of average-cost pricing than with the concept of a price reached through a market process.

The notion of liberalization reflected little appreciation for the spontaneous forces of the market. As indicated in the previous subsections, officials thought that they must intervene to ensure that supply and demand were equated and that prices were equalized in similar markets.

Liberalization had a far weaker connotation in the minds of even the most radical Mongolian reformers than it carries in market economies. To Mongolians, liberalization entailed ridding the system of the old mechanisms for regulating prices, but not necessarily eliminating price regulation itself. The aim was flexible prices that could reflect changes in conditions, rather than free prices determined independently of the government. Thus, the Ministerial Order implementing the first liberalizing resolution delineated "pricing procedures" to be followed by all sellers, including private entities. These procedures dictated that "[p]rices shall be profitable for the economy and reasonable for consumers" and specified a cost-based formula for determining prices.[25]

Justification and Registration as Regulations on Prices

Given the formulaic, rather than process-based, definition of free prices, it was not surprising to encounter the practice of requiring sellers to justify prices. For example, even after liberalization, the Ministry of Trade and Industry required the submittal of "draft prices" along with an extensive array of supporting documents. Similarly, in October 1991, state-owned industries were required to "present the basis for setting the prices of their products to the [local] price commissions for revision and agreement."[26] At the local level, the Ulaanbaatar price commission adopted a special declaration in response to its perception that enterprises were exerting monopoly power. All enterprises in the city had to submit their prices for revision and registration. Enterprises not registering prices were subject to penalties and to the confiscation of any profits deemed excessive.

5. POSSIBLE EXPLANATIONS

We now turn to hypotheses explaining the facts described above, beginning with the one we believe has the strongest explanatory power--the culture of policy making. In evaluating the hypotheses, we rely on qualitative evidence. Our method is to examine the productivity of each hypothesis in explaining the characteristics of policy described in the previous section. The evidence can hardly be conclusive, for two reasons. First, we cannot rest on the relative terra firma of econometrics, given the nature of our data.[27] Second, since there is no prior work laying out well accepted, precise hypotheses and the associated facts to be sought in testing them, we were not able to use hypotheses that were developed before our observations of the evidence.

The Culture of Policy Making

The simplest piece of evidence that the culture of policy making greatly affected price policy is the sheer number of economic and political actors who were in ready agreement that price controls were necessary and productive. It was difficult to identify Mongolians opposed to price controls. This was most clearly seen in the positions of the political parties, all of which argued during the 1992 elections for some form of price controls.[28] The similarity of views across the political spectrum represented a deeper commonality within society on the costs and benefits of price controls--a commonality hardly explicable except in the context of the history of policy making.

Even more surprising than the political consensus was the one among the new private-sector interest groups. These groups were strong advocates of price controls, the leader of the largest referring to auction prices as simply black-market prices. Agricultural interests, with most to gain from total price decontrol, lobbied strongly in favor of price controls. A measure entitled "About the Request of Agricultural Organizations", for example, professed that it was "based on the desire of the agricultural and cooperative organizations that the prices of many of the goods supplied by them for state procurement be set by the state."[29] In fact, this measure resulted in shortages. At this time, agricultural interests were the most powerful lobby and a host of alternative measures could have aided them, for example by lifting the ban on food exports or by deregulating the distribution system, which was starving the rural areas of essential goods. Yet, price controls were favored by both the government and agricultural interests, as would be predicted by the hypothesis that policy is weighted heavily toward the use of familiar tools.

Given a consensus based on the culture of policy making, the proliferation of controls needs little explanation. The consensus not only makes controls a favored and familiar policy tool, but also ensures that technocrats do not fear professional or political opprobrium when implementing controls. Indeed, the reverse is the case: any adverse consequence of free markets draws criticism. Price-policy officials were subject to popular and political criticism for price increases, whether or not the prices were under their purview. The consensus also led to the spontaneous generation of new controls. When Mongolian policy makers were seeking to respond rapidly to vast new economic problems, quick agreement on new price controls was much more likely than on unfamiliar, market-oriented measures.[30]

A ready agreement on policy derived from the culture of policy making was instrumental in the spontaneous coordination that enabled officials to implement measures quickly. In late 1991, local officials from different regions, who surely had diverse interests in the regulation of prices, were able to coordinate efforts on price controls. Without coordination, local price controls would probably have been untenable, given flows of goods between regions. The commonality of expectations concerning policy tools was almost certainly crucial in generating a spontaneous policy equilibrium.

The proliferation of price controls was accompanied by a multitude of justifications, many of which would bear little weight for those familiar with markets. But this apparent contradiction dissolves under one scenario depicted by Hirshleifer and Welch (1993), in which the willingness to apply a measure is determined not by present information, but rather by previous use of the policy. In this scenario, justification cannot be found in present circumstances, since the reason for applying the policy derives from the history of policy making.

The effects of historical experience on policy practices can also explain the curious notion of liberalization discussed above. From the perspective of seven decades of central planning, the removal of rigid unitary price regulation and the beginning of ad hoc flexible controls might be the big perceptual leap, defining the essence of change. Of course, for those familiar with market economies, this seems a small move. Mongolians were genuinely declaring themselves committed to markets in the abstract but making decisions that an observer steeped in the experience of the market economy would judge inconsistent with this objective. Mongolian experience thus offers an example of the framing effect (Tversky and Kahneman 1987), where the history of policy making frames choices.

Finally, the culture-of-policy-making hypothesis explains the policy dissonance we observed. Conceptually, society was ready to move to a market economy and policy makers were aware that price controls were inconsistent with such a move. But officials had to make numerous choices in a disastrous and largely unintelligible economic environment. Judgments on the exact form of policy had to depend to no small extent on the experience of policy making that had been accumulated in the previous decades. As the results of Hirshleifer and Welch (1993) show, the use of such experience by new leaders can lead to considerable conservatism in decisions.

The two-fold dissonance identified in Section 4 resulted. When bold statements of goals passed down the hierarchy for implementation, features of the old accreted. For example, the cabinet aimed to replace the old distribution system with market instruments in a resolution entitled "Measures Concerning the Transfer of Commercial Organizations to the Market System," but the ministerial implementing Order, entitled "Regulating the Supply and Marketing of Consumer Goods," set mandatory supply requirements for all types of products.[31] Similarly, it was not uncommon for dissonance to appear within a single policy document. Non-market policy measures prompted by judgments based on the culture of policy making were often introduced with a statement professing a commitment to the market.

Desire for the Old

The culture-of-policy-making hypothesis focuses on information, policy practices, and the technology of decision making. Instead, one might argue that preferences, not constraints, were crucial:

Mongolians used price controls because of a genuine desire for the old system. Presumably, this argument also presumes that maintaining a flow of aid from the West required official statements in favor of markets.

We found little evidence for this hypothesis. At no time, even in very informal interviews, did we sense any hesitation about moving toward markets in principle. Mongolians evidenced their intentions in the exemplars typically cited: Western market economies and the East Asian dragons rather than China, perestroika, or market socialism. The newly won independence from the Soviet Union alongside the failure of the old economic system fueled the enthusiasm for change and the desire to break cleanly with the past. There was general agreement that the old system was bankrupt and that the market was superior. Thus, the initial price liberalization measure was introduced as one that would "leave its traces in the history of Mongolian society."[32]

In stating their aims, later resolutions--which were not for the consumption of aid donors and many of which were not officially translated--did not deviate from the avowed goal of creating a market economy. For example, a typical resolution declared its objectives as "Aiming at transforming economic relations into a unified market system, widening the application of free prices, strengthening the influence of prices on the production and supply of consumer goods...."[33] Reinforcing this, privatization was placed at the top of the agenda and pursued with great urgency. Hence, we conclude that preferences cannot explain the characteristics identified in Section 4.

Second-Best Policy

Mongolia was in the n-th best world of reform. The institutions for monetary and financial control were lacking. Mongolians could certainly have had legitimate fears concerning the effective functioning of markets in this institutional vacuum.[34] Moreover, the collapse of the Soviet economy and the demise of the CMEA necessitated enormous economic adjustments. Perhaps substantial government interventions were an element in the best ensemble of policies available in these circumstances.[35]

While there is some validity to this hypothesis, it does not fully explain the policy characteristics identified in Section 4. Second-best price controls would hardly be generated in a process that modified, and sometimes reversed, central measures. Nor would there be so many overlapping sets of controls. Similarly, this hypothesis cannot explain the absence of alternative anti-inflation policies, such as the freeing of both foreign and internal trade.

There might be one sense, however, in which price controls were the best available policy. The culture of policy making might have so limited the set of anti-inflationary policy tools under consideration that price controls were the best in that small set. In that case, the burden falls on explaining the narrowness of that set. The second-best policy hypothesis then merges with that on the culture of policy making.

A Policy-Formation Game

Central authority breaks down in the reform process, giving the various agencies of government more latitude in constructing their own policies. Hence, differences of opinion on the goals of reform might become reflected in policy. For Mongolia, such differences can be crudely characterized by referring to two groups of players, the "radicals" and the "conservatives."[36] Both groups were represented within the government and each was vying for political and policy influence. This struggle, a policy-formation game, could plausibly lead to some of the features depicted in the previous Section.

The radicals strongly represented the desire for change and were recognized as having the better understanding of markets. Their levers of power were concentrated at the highest levels of the central government. They had the support of aid donors, a critical factor in a country on the verge of total economic collapse. The conservatives tapped the feelings of the ever increasing numbers of people who felt that the economic problems resulted from the nature and speed of the early reforms. The conservatives were dominant in the countryside, where the most viable element of the economy was located. Their levers of power were in the old ministries and in most local administrations.

The policy-game hypothesis can predict some of the characteristics of policy outlined above, but it is not sufficient in itself. It does not explain the relative uniformity of opinion within society, both on the use of controls in practice and on the general desire to move to markets. In fact, the radicals were not opposed to using controls in practice, but rather less open about such use than the conservatives. And the conservatives wanted to implement markets, but were simply more hesitant than the radicals. Hence, outcomes can best be explained by the absence of any group in society willing to ensure that practical policy was consistent with the overall commitment to move to the market.

The policy-game hypothesis also cannot explain the dissonance, identified above, within measures that were a product solely of the members of the radical group and were intended purely for a domestic audience. Similarly, it does not explain why price control appeared in new institutions, designed for the market economy by policy makers dedicated to seeing the market economy work.

The differing character of three phases in the development of policy also shows the weaknesses in the policy-game hypothesis. First, many of the features to which we refer in the previous Section are reflective of developments to the middle of 1991, when the split between radicals and conservatives was relatively minor. During this phase, before rapid deterioration of the economy led to the revival of the conservatives, there was a relatively uniform voice underlying policy.

Later in 1991, it became increasingly apparent that reforms were not proceeding as fast as government pronouncements had predicted. Yet since donor aid--critical to survive the winter--was conditioned on swift implementation of reforms, the radicals held the trump card. They could have resigned from the government to protest lack of implementation, thereby threatening the flow of aid, forcing the price-liberalization equilibrium of the policy game. Instead they supported the new price controls, continuing to advocate reforms and not viewing these controls as inherently inconsistent with that objective. In fact, the model of Hirshleifer and Welch (1993) predicts this relative agreement, which is brought about by the common structure of information on policy practices, information that is a product of the history of policy making.

This argument is buttressed by the progression of policy in a third phase, since June 1992, when elections resulted in the complete removal of the radicals from influence. If the dissonance in policy were the result of the policy-formation game, then one would have expected a sharp anti-liberalization turn after these elections. Since that time, however, price controls have diminished. In fact, this is what one would expect if learning in markets gradually eroded the importance of the information, policy practices, and the technology of decision making inherited from the past.

Rent-Seeking

The last hypothesis we consider is that self-interested officials promoted price control. For the case of the socialist economy, Shleifer and Vishny (1991, p. 4) offer the starkest version of this hypothesis: "...underpricing and shortages are the result of the rational choice of the key decision makers, who collect the rents that result from shortages." Ministry bureaucrats and managers of firms have an incentive to keep prices low and to collect the bribes offered because of the resultant shortages.

Corruption certainly existed in Mongolia. Sizeable numbers gained from price controls. But this is not to say that those who reaped the gains from the price controls were the authors of the controls, or were key lobbyists for the controls. Several facts stand counter to the rent-seeking view.

First, consider the proliferation of price-control measures. It is implausible that the supporters of so many varied measures were all in a position to gain financially from them. Second, the rent-seeking hypothesis would presumably lead to a society deeply split on the matter of price controls. Rather, there was the relative homogeneity of views that we identify above. Third, in interviews with Mongolian officials, we established many cases of support, and even authorship, of measures where personal gain was impossible.

Fourth, the open admission by very high level officials of ad hoc personal intervention into the pricing process, which we encountered a number of times, is hardly likely from those profiting illegally from such intervention. Finally, price controls were often placed openly in formal measures. In a country where arbitrary administrative measures were easily possible, the willingness to formalize controls hardly speaks to a process driven by corruption. Put most frankly, intervention is so easy in the post-socialist landscape that there is simply no reason for officials to resort to instruments of law to pursue rent-seeking.

In support of the culture of policy-making hypothesis rather than the rent-seeking hypothesis is the fact that controls usually addressed legitimate public-policy interests, at least when viewed from the perspective of an official convinced that controls could be productive. The justification, timing, and choice of price controls were consistent with such interests. The fear of social unrest was paramount; new measures often coincided with public demonstrations against particular price increases. The effects of distributional concerns on the implementation of price controls was evident. For example, from January to August 1991, the prices of goods consumed by the poor rose 10 percent versus an overall average of 18 percent. For goods officially free from central-government intervention, the average price increase was 32 percent, while it was 21 percent for the subset of those goods consumed by poorer residents.[37] These goods were exactly the ones most affected by the myriad controls of lower-level officials, presumably those controls most likely to be generated by corruption. Yet the effect of controls was still in line with the stated objective of ameliorating the effects of reforms on the poor.

Significantly, the officials who made and implemented price controls themselves perceived these measures as tools for preventing corruption. This was particularly evident in late 1991, the defining moment of the first phase of reform. Faced with accelerating inflation, increasing social unrest, and a burgeoning black market, the government felt itself forced into action. A resolution gave wide powers to a "Government Commission Responsible for Stopping Any Activity Targeted at Creating a Shadow

Economy and for Taking Measures to Prevent Organized Crimes," whose task was to coordinate the fight against corruption. One of the powers given to this Commission was price control: "The profit gained solely as a result of a price increase without using the practical possibility of the economic entity and reducing the volume of production should be completely transferred into the state budget."[38] Also at this time, the government set in motion a study of corruption. In response to this study, a resolution required both central and local governmental organizations "to control prices for goods set by private shops so that these prices do not exceed the average market level."[39] Officials had thus stated their perception of and aversion to corruption. Yet in none of our many interviews did we encounter anybody who suggested that the problem with price controls was that they led to corruption.

For these reasons, we believe that the culture-of-policy-making hypothesis goes farther in explaining the characteristics outlined in the previous Section than does the rent-seeking hypothesis. We do not completely dismiss the possibility that rent-seeking spurred price controls. Information is naturally hard to obtain on this score and it is certainly true that many stood to profit from controls. Nevertheless, the proliferation of controls, the ease with which they were placed on the policy agenda and accepted, and the apparent consensus on the use of price controls, all speak to the importance of the culture of policy making. Culture was a necessary condition for the work of the rent-seekers. The rent-seekers reap what culture sows.

NOTES

1. The use of culture does not entail rejection of a rational-choice perspective, nor is it inconsistent with the methodological pronouncements of Becker and Stigler (1977).

2. Justifying this point could occupy a whole paper in itself. In an unsystematic search, we have found evidence of developments similar to those in Mongolia, though usually not in degree, in Bulgaria, Belarus, Czechoslovakia, Hungary, Kazakhstan, Kyrgyzstan, Latvia, Moldova, Romania, Russia, Turkmenistan, Ukraine, and Uzbekistan.

3. This paragraph recasts Hirshleifer and Welch's (1993) results in the present perspective.

4. Shlapentokh (1993) examines Russian privatization debates, reaching conclusions similar to ours.

5. In interviews with officials, we found this impression easy to form.

6. See Alexeev, Gaddy, and Leitzel, 1992, for a description.

7. Our most enlightening information source was a large number of interviews with Mongolian officials. With the official record providing only a small and distorted part of the picture, interviews were essential to assess the nature of policy. For further details of events and policies shaping price-reforms, see Murrell, Korsun, and Dunn (1992).

8. Resolution 20, "Some Measures on Shifting the Economy to Market Relations," January 15, 1991. Resolutions had the force of law.

9. Resolution 240, "Additional Measures toward the Transition to a Free-Price System" September 1991.

10. Resolution 35, "Some Measures Regarding Prices," March 1, 1992.

11. For example, Resolution 34, "Farmgate Prices for Some Livestock Products," effective March 1, 1992.

12. Resolution 224, "About Setting Up Price Commissions," July 15, 1991.

13. Resolution 279, "Measures to Restrict Producers' Monopoly Power and to Stop Some Negative Phenomena during the Transition to a Market-Based Economy," October 1, 1991.

14. Resolution 316, "Measures in Connection with Foreign-Trade Activity," November 22, 1991.

15. Ministry of Trade and Industry Order 273.

16. Resolution 252, "Supplementary Measures to Shift to the Free-Price System," August 23, 1991.

17. Resolution 279, "Measures to Restrict Producers' Monopoly Power and to Stop Some Negative Phenomena during the Transition to a Market-Based Economy," October 1, 1991.

18. Resolution 317, "Measures Concerning the Transfer of Commercial Organizations to the Market System," November 22, 1991.

19. Privatization Commission (1991).

20. Resolution 224, "About Setting Up Price Commissions," July 15, 1991.

21. Resolution 252, August 23, 1991.

22. Resolution 2, Measures Regarding the Prices of Services and Products of Certain Branches," January 3, 1992; Resolution 77, "About the Request of Agricultural Organizations," March 9, 1991.

23. Prime Minister's speech to Parliament, May 1991.

24. *ibid.*

25. Ministry of Trade and Industry Order 273, May 14, 1991.

26. Resolution 279, "Measures to Restrict Producers' Monopoly Power and to Stop Some Negative Phenomena during the Transition to a Market-Based Economy," October 1, 1991.

27. At one stage, we sought concrete empirical evidence by asking Mongolian policy-makers to respond to a formal questionnaire. To provide comparisons, we used a subset of the questions of Frey et al. (1984). We found no significant differences in the attitudes of Mongolian policy-makers (primarily economists) and the Western economists questioned by Frey et al. But when questions were asked less directly, and phrased in a deep contextual way, the answers were radically different from the ones given in response to the questionnaire. This outcome is consistent with the framework of this paper. The context-free answers reflect general preferences for the market, while answers to situation-specific questions reflect informational and technology-of-decision-making constraints.

28. Evidence most indicative of the homogeneity of views came from a party at the extreme, the Free Labor Party, which represented entrepreneurs, advocating a stateless society after transition, but price controls in the meantime.

29. Resolution 77, March 9, 1991.

30. There were many productive alternatives available, such as de-monopolizing the distribution system or removing trade-licensing.

31. Resolution 317, November 22, 1991; Ministry of Trade and Industry Order 105, February 13, 1992.

32. Press conference of Deputy Prime Minister Ganbold, Ulaanbaatar, January 16, 1991.

33. Resolution 35, "Some Measures Regarding Prices," March 1, 1992.

34. We thank Fred Pryor for raising this point.

35. For example, McKinnon (1990, p.10) suggests that the last Soviet government used price controls as a second-best anti-inflation policy.

36. As argued above, neither of these groups wanted to retain the old system. The issues were strategic, rather than of the necessity of far reaching changes.

37. From data provided by the State Statistical Service of Mongolia, December 1991.

38. Resolution 279, "Measures to Restrict Producers' Monopoly Power and to Stop Some Negative Phenomena during the Transition to a Market-Based Economy," October 1, 1991.

39. Resolution 317, "Measures Concerning the Transfer of Commercial Organizations to the Market System," November 22, 1991.

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