

Varieties of Market Economies and Capitalisms

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With the collapse of communism in all of its varieties, it looks as if there is a place for only one kind of economic system – for capitalism. To be able to give or to try to give answers to the questions whether there is also a place for something like market socialism, whether there may be a place only for capitalism, possibly or even probably in a great variety of forms (Freeman, 2000), or whether there will be a dominant stock market rather than welfare capitalism (Dore, 2000), one may look for help from recent economic and political history. We are not interested in centrally-planned economic systems, however, and we are not going to look into their histories, because these economic systems cannot help us to find an answer to the question whether there is a place for something other than capitalism. It may look strange for us to ignore something that had been analyzed so painstakingly by Western economists until its very end and even beyond that, but the reason why economists were so interested in the Soviet-type economies was not their economic relevance but the political or geopolitical importance of the Soviet Union. What we have in mind when we refer to recent history is the so-called »third economic system,« the economic system with workers' self-management and with socially-owned business enterprises. But again, as will be seen, it is not because of its economic relevance in the usual meaning of »economic relevance.« It is because of its economic relevance in a special way that we will take that economic system as the alternative to capitalism and use its recent history to help us to answer the questions we are interested in.

An economic system with social ownership of business enterprises is indeed a pure utopia. This is not the case with a centrally-planned economic system, an economic system with state-owned business enterprises, which is no utopia at all. It differs from a market economy and capitalism only in matters of degree, in that it is less economically efficient, less democratic, and less humane. It is different with the third economic system that we are taking as the only possible alternative to capitalism. It is a pure utopia in that if such a pure socialist economic system, without capital and without capitalists, wants to approach market economy, it must become a pure utopia. Alternatives to capitalism do not differ only in matters of degree, but are simply not possible.

In the first part of this paper we will describe the basic characteristics of the third economic system, one which is generally not known in the West among its advocates or among those who ignored it completely. We must admit, however, that one can find more or less the same ignorance among economists or political economist in its home country. In the second part of the paper, we will explain how this utopian economic system functioned, what kind of financing it required, and how the system collapsed.

The other recent historical experiences that may be helpful for finding the answers to the questions we are interested in are those of the transitional economies – how they abolished state or social ownership and where these economies have found themselves after doing so. In the third part of the paper we will discuss these experiences and consider whether something new and interesting has appeared during transition. Unfortunately, we believe that not only has nothing new appeared in the transitional economies, one cannot expect that anything new will appear in that part of the world.

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Nonetheless, transitional economies are not all the same. In the fourth part of the paper we will discuss some relevant differences between them. There are primarily the differences between small transitional economies which must be open, and large transitional economies that need not be so open and therefore may retain some peculiarities or idiosyncracies. There are other relevant differences as well, for example within business sectors of individual countries, that are worth noting. We conclude the paper with some thoughts concerning the future of different economic systems.

I. The »Third Economic System« in a World with Two Dominant Economic Systems

The two dominant economic systems in the world were capitalism, or »welfare-corporate capitalism« as Professor Gordon refers to it, and centrally-planned socialism. In the centrally-planned economic system business, enterprises were owned by the state in more or less the same way as they were privately owned in capitalism. But since there was the same single owner behind all business enterprises, a market for goods could not exist. Consumers, who were on the demand side of the economy, could never go to the another supplier of a product, because another one did not exist. It was also necessary for foreign trade to be highly regulated and centralized. Planners or bureaucrats only took care of what kinds of goods were to be provided. With only one owner, than there could be no competition, because there must be more than one owner for competition to exist. With no competition, there was no market, and with no market, economists as we know them had nothing to do.

It is a bit strange and unusual that centrally-planned economies were analyzed with the same tools, methods and sophistication as market economies. Language developed for market economies should not have been used in the case of the Soviet Union, Hungary, Poland, and the other centrally planned economies. By doing so, Janos Kornai (Kornai, 1992), one of the best known and most prominent students of these economics, and others probably did these economies more of a disservice than helping them as they had intended.

Western economists, however, were probably pleased that the language they developed for economic analysis could be used for centrally-planned economies as well as for capitalist ones. They were able to tell themselves that they had discovered and developed something that could be universally applied, which of course is something that must be a science. The application of economic analyses developed in market or capitalist economies to centrally-planned economies should have been stopped when it encountered a system in which there was only one owner, one supplier, and one business enterprise, or at least what was effectively one business enterprise given that the same owner controlled every business enterprise. And of course this peculiarity should have been apparent from the very beginning. But because it was not stopped at that point, it's meaningless findings aroused suspicion that economics was meaningless.

However in addition to capitalism and centrally-planned socialism, there was also »market socialism« – not another dominant economic system but a third rather marginal one. This was an economic system with workers' self-management or social ownership of business enterprises, the system that existed in Yugoslavia from the beginning of the fifties until the break-up of the country or until the social ownership of (nonfinancial) business enterprises was abolished when transition started in Yugoslavia's successor countries at the beginning of the nineties. The reforms which had been undertaken within centrally-planned economic systems under state ownership cannot be taken as genuine reforms. They were just pragmatic changes

intended to make the system run more effectively and not changes moving the system towards either a market economy or »market socialism.« And the same must be said for the numerous reforms within the economic system with social ownership of business enterprises, of which the only genuine one was in 1988, that accepted the idea that social ownership of business enterprises must be abolished. There were definitely three distinct economic systems that were in no way converging upon each other through their reforms.

Although the centrally-planned economic system had its own iron logic, it was not really a utopian system. The third economic system was a truly utopian system, because an economic system with socially-owned business enterprises is self-contradictory, being unable to function at all according to its own rules. It was at the same time the only variety of socialism in which markets for goods and partial markets for labour played quite important roles. The experience of Yugoslavia is worth examining because it proves that market socialism, with social ownership and not even state ownership of enterprises, cannot be anything else but utopian.

Let us start with business enterprises in the third economic system. The first point to emphasize is that they were independent., having had no directives from bureaucrats or planners about what to produce. They sold on both domestic and foreign markets with their products and were concerned with the prices for their products and with their expenses, because the wages they could pay and the surpluses they were able to earn and then reinvest depended on their revenues and costs. In the third economic system the market for goods played quite an important role, although not quite the same role as it played in market economies, since more prices were administratively determined and more domestic markets were protected from foreign competition than was generally the case for market economies at that time. Because wages were not the same everywhere, workers had the incentive to move between business enterprise. Overall, the economic performance of socially-owned business enterprises was much better than that of state-owned business enterprises in centrally-planned economies. Wages were higher and government was less intrusive. All these things were very important for the system to be able to survive -- not indefinitely, of course, but at least until a market economy or capitalism appeared.

The independence of business enterprises from the state was based on their social ownership. Only nonfinancial business enterprises, however, were socially owned -- the banks being owned by the (socially owned) business enterprises and the insurance institutions being mutually owned by their policy-holders. In turn, social ownership was the basis for workers' self-management. Workers' self-management, however, is something of a misnomer. It was not intended to mean that workers were also managers (although professional managers were also workers and members of the trade union). Rather, it meant that workers had and/or exercised some rights of owners. The owner of all business enterprises was society, which of course included the workers. Thus an enterprise had an owner, society, but it was an abstract owner -- that could not be specifically identified by, for instance, an address or telephone number. In the name of the owner, workers were allowed some rights that belonged to the owner.

State ownership and central planning were definitely incompatible with a decentralized economic system with largely independent business enterprises whose performance was to be shaped by the market and which in turn would stimulate workers and managers to produce better economic results. On the other hand, private ownership was rejected as an alternative from the fifties almost until the end of eighties, when in 1988 the law on business enterprises was passed abolishing social ownership. What remained as the right alternative to both was social ownership and workers' self-management, or more accurately, workers' control or self-control if

we define owners are those who are in control. It was the right alternative in the sense that a centrally-planned economic system could be abolished without implementing capitalism.

The reasons for this change in the economic system at the beginning of the fifties were probably mostly non-economic. Yugoslavia was a federation of six republics, essentially six or more nations or ethnic groups, each with its own history, culture and level of economic development. What was probably most important was that none of them were dominant. Given this, it became clear that a genuine centrally-planned economic system with state ownership could not function properly. Of course this non-economic impetus had important economic consequences.

In this paper, however, we are not interested in the economic history of the region but in the social ownership of nonfinancial business enterprises as the basic characteristic of a third economic system that is neither capitalism nor centrally-planned socialism. If we are to explain the concept of a socially-owned business enterprise correctly and meaningfully, then we must look at it from the financial point of view. Surprisingly, this perspective had never been taken by any Yugoslav or Western economists (such as Furubotn, 1976 and Vanek, 1969) at least until 1984 (Ribnikar, 1984). The simple reason for this neglect was that those who introduced the system, developed it, and examined it and analyzed it later either did not know anything about finance or ignored it. A financial point of view means that we are concerned with the liabilities/equities side of the balance sheet of the socially owned business enterprise; that is, we are concerned with its funding or its capital structure, to use terms applicable to privately-owned or state-owned business enterprises.

When we do this, we see that socially-owned business enterprises with both borrowed funds, mostly from banks, and unborrowed funds that roughly parallel debt and equity. But the unborrowed funds were not owned by the state, as they would have been in a Soviet type economy, and they were not owned by any private or public person, as in a capitalist economy. They were not owned by anybody in particular. These unborrowed funds were described as belonging to the society as a whole; therefore, they represented social ownership. This left a vacuum concerning ownership rights, some of which were left to be exercised by workers leading to workers' self-management or, more accurately, workers' self-control.

For those who either did not know anything about finance or who ignored it, this was something epochal. It was possible to have a market economy without capitalism and/or socialism without central planning and state ownership. It is of enormous importance that at that time even economists did not know anything about finance or ignored it, because otherwise the preceding centrally-planned economic system would not have been abolished. True social ownership is purely utopian, and if finance had been taken into account at that time, social ownership would not even have been attempted. Within a system of purely socially-owned non-financial business enterprises, there is no way for new business enterprises to start up or for existing ones to increase their nonborrowed funds from external sources. There is no »society« to provide the capital unless enough altruists appear who are prepared to put their money in newly established or existing business enterprises as grants or gifts. Without such altruism, which of course is absolutely utopian, an economic system with socially-owned business enterprises can not function

As we have shown, ignorance of finance was useful, because without it social ownership might never have been tried. But if the ignorance lasts too long, as was the case with social ownership, it will be damaging. Finally at the end of 1988 it was officially acknowledged that social ownership was the cause of the most serious economic ills and that it must be abolished.

II. The Functioning and Collapse of a Market Economy without Capitalism and a Socialist Economy without Central Planning

Although the system with socially-owned business enterprises could not function according to its rules or its blueprint, it nevertheless functioned. In fact, it functioned much better than the centrally-planned economic systems. Surprisingly, the system managed to find a substitute for those »altruists« who were necessary for financing enterprises. These substitutes were banks, who made loans to enterprises at negative real interest rates. As we mentioned, the banks themselves were not socially owned but owned by the business enterprises. And the bank loans made to business enterprises were only partly loans. They were predominantly de facto grants. The redistribution of wealth via banks to business enterprises on the basis of bank loans that were predominantly grants was so effective that at the time social ownership began to be abolished, socially-owned business enterprises had on average more non-borrowed funds than capitalist business enterprises.

Bank loans were made at positive nominal interest rates, but inflation that not only was, but also had to be, higher than the nominal interest rate turned the loans into grants. It was taken for granted, even in socialist countries, that nominal interest rate had to be non-negative. The only way how to change a large part of loans into grants, if the nominal interest rate had to be non-negative, was for sufficiently high inflation. So »good« inflation was, we can say, somehow a natural habit for socially-owned business enterprises. Through negative real interest rates, an abnormal economic system was normalized. (Ribnikar, 1989) The difference between the nominal and the real interest rate, which actually caused the system to function, was not discovered until rather late in mid-eighties. The indexation, that followed, was a major blow to the system. This wake-up call came a bit too early, because the alternatives to the system were still not considered acceptable.

In a market economy without capitalism and in a socialist economy without central planning, real interest rates must be negative. If nominal interest rates are not explicitly negative, as was the case, then inflation must be high enough to make the real rates negative. It was quite a high price for to pay for a third alternative, and the economic system with social ownership of business enterprises first lost its dynamics, then came to a standstill, and finally collapsed. Its utopian nature could not be overcome any more. Negative real interest rates were not compatible with long-run saving, investment, and economic growth. At the end of 1988, it was clear that a market economy or capitalism was the only alternative. This occurred before the fall of the Berlin Wall and before transition started in centrally-planned economies, at least according to official statistics in the West.

Without a doubt, the people in Yugoslavia benefited from this economic system with social ownership of business enterprises, as an alternative to a centrally-planned economic system with state ownership, although almost all of these benefits have been lost in the major part of the former Yugoslavia during the recent bloody wars. But we are interested in another possible benefit. We want to see if an economic system with socially-owned business enterprises can be a viable alternative to capitalism – as a sort of real or at least nominal market socialism. We have seen, though, that market socialism, if by »socialism« we mean something different from capitalism or private ownership of business enterprises, is a pure utopia. It is, of course, better than state ownership and central planning for three reasons. Its economic

performance is better, it goes hand in hand with a gentler kind of government intrusivness, and its defects appear relatively more quickly. It is evident that it cannot function as prescribed or declared because of its utopian nature.

A third economic system such as that which existed in Yugoslavia can appear only under particular circumstances. We saw that these special circumstances in Yugoslavia were the desire for a socialist system that did not have central planning and state ownership. If a market economy with private ownership of business enterprises is a viable alternative, market socialism will not appear. With central planning and state ownership of business enterprises gone or almost gone, save for China and a few other countries, market socialism is gone as well.

III. The Transition of Centrally Planned Economies and Economies with Social Ownership into What?

When the economies or countries with state and social ownership of business enterprises began their journeys towards market economies and capitalism, they had the almost unanimous support of their populations. This support was without a doubt an expression of people's genuine opinion about economies with central planning and with socially-owned business enterprises. And their opinion was the same as the opinion of most economists. By economists we mean, of course, those who knew economics and not those who knew only quasi-Marxist political economy.

But as these economies or countries proceeded along their paths towards societies with market economies, it was becoming clearer and clearer that they are regressing towards the early years of capitalism. They were moving backwards towards their own early histories of capitalism. (De Soto, 2000) In their experiences, then, we will not be able to find anything concerning the economic organization of society. In fact, transitional economies are much closer to pure than to welfare capitalism in Professor Gordon's taxonomy of six economic systems.

We will not try to explain or to follow the details how it happened that societies concerned with social welfare and equality, albeit more of an equality in scarcity than in abundance, abandoned the notion of »welfare« with the almost unanimous support of their populations. We do not agree with the standard or mainstream explanation of transition (Lavigne, 1995). We can say that it just happened or that it happened because there was nobody powerful enough to be concerned that it should not have happened in so extreme a manner. There were, of course, very clever, very high-level, and very sophisticated debates how transition should be planned, managed, and directed: big bang v. gradualism, macroeconomic stabilization v. structural reforms, free distribution of shares via vouchers v. sale of business enterprises to the highest bidders, etc. These debates are still going on after the fact, although these controversies were not the most important or were not even important at all five to ten years ago when they would have mattered more.

Perhaps the only instructive thing about transitional economies is how they have revealed ownership, finance and corporate governance alternatives towards which at least some developed economies themselves are moving. In this way, the experience of transitional economies might have been of some relevance for developed economies. One example of this is the change from state and socially-owned business enterprises into the ownership of enterprises by newly created (at first public) pension funds (Ribnikar, 1990). This solution was in complete accordance with the people's support for the abolishment of the state and social ownership and was at the same

time a kind of a preemptive measure for the inevitable crises of the pay-as-you go pension systems that had to be implemented immediately at the beginning of transition. Of course developed economies are having similar crises with their pension systems.

After this first shock, all other policy measures should have followed: macroeconomic stabilization, liberalization, and institutions building. Once institutions of capital markets and the legal system had been put in place, the pension funds should have begun selling shares of domestic business enterprises to domestic and foreign investors and investing the proceeds from the sales into mostly foreign securities – or even exclusively foreign securities in the case of a small country. This would have been something new and experimental, but only experimental to the extent that all other logical, common sense, expert solutions that were suggested and tried were worse. There would have been no costs to the experiments but only benefits. But it was a missed opportunity.

The transition into a market economy was not something wholly new for which all mistakes should be pardoned, and it was not a transition from the market economy into socialism in reverse which could be achieved very quickly. But unfortunately it was of course taken as both something new and as a transition from the market economy into socialism in reverse at the same time. And that it should be done rather quickly and that mistakes should be pardoned was the motto of the reformers.

Business enterprises in transitional economies are becoming more and more similar to business enterprises in nontransitional economies. Sometimes this is a similarity to earlier forms and sometimes to present day forms. Corporations talk about their (optimal) capital structures, P/E ratios, dividend policies, corporate governance, etc. Many already are or very soon will be foreign-owned. Once this happens, they will dissolve themselves in the larger foreign corporations that acquire them.

This would still have happened in the majority of cases even if business enterprises had first been owned by pension funds. So the point of pension funds is not to prevent this from happening, but to decrease the social and economic costs of transition. Among other things, for instance, it would have created a partially-funded pension system. So far in transitional economies there has been no new capitalism, even during the transitional period, and no new capitalism is to be expected in the future in transitional economies.

IV. What Varieties of Capitalism Will There Be in Transitional Economies?

Although they all had more or less the same foreign advisers and access to the same mainstream thinking, transitional economies will, nevertheless, not have quite the same economic systems. There will be differences among countries; for example, between small and large ones, between countries near the leading economies and countries which are farther away, and even between the corporate and the non-corporate business sectors within the same country.

The numerous countries which are both small and located close to developed countries will be completely opened. This process has already been taking place for some time in Europe, especially in countries approaching EU membership. A great majority of transitional economies are among them, but it is also true for transitional economies that are not yet formally included in the EU accession process. All these countries' corporate sectors will be pretty the same as in the neighbouring large capitalist countries or in the EU. Their corporations are likely to be owned or controlled by foreign corporations, and they will often be home to branches or subsidiaries of foreign corporations. There will be no unique characteristics of their finance, ownership or

corporate governance. Although there may still at present be some differences -- substantial and in some cases even dominant internal or workers' ownership, for example -- it will soon disappear. On the other hand business enterprises in the noncorporate sector will likely be predominantly domestically owned. But they will still be closely tied to the foreign corporate sector -- not only through their suppliers and/or customers but also through their banks at home.

One can see two patterns for the development of the banking sector in transitional economies, but both are the same in the sense that in both cases banks at home must heavily rely on banks and financial markets abroad. Although there were suggestions, forecasts, and even intentions that transitional economies should be or would be financial-market-based economies, and the advantages of financial-market-based versus bank-based economies were emphasized, business enterprises still rely mostly on bank loans. And the greatest reliance is on short term bank loans. But domestic banks are small, especially in small economies, where even a banking system with a single bank would mean a very small bank by European standards. Another problem is that they cannot collect long-term funds at home, either in the form of deposits or via the issuance of long-term bonds. There is simply not enough trust in domestic financial assets. So in the short term nothing can be done.

The first pattern for the development of the banking system is that domestic banks are simply taken over by foreign banks. That is, the governments allow foreigners to purchase them or even make special efforts to sell them to foreign banks. If they do this, they expect not to have problems with banks any more and in addition they earn some money from the sales. Formerly domestic banks become branches or in some cases wholly owned subsidiaries of foreign banks. The domestic banking sector very quickly becomes an integral part of the much larger European banking sector. While some larger businesses may be financed through financial markets, domestic non-corporate businesses are financed by these domestic facilities of foreign banks, and the banking sector is important.

The second pattern is that banks remain, or at least try to remain, outside the direct control of foreign banks. But if they want to survive, they must use banks and financial markets abroad to assist them with financial intermediation. Because they are small and their funds are short-term, they have a problem making long-term loans to their borrows. To enable them to do this, they must lend short-term to and borrow long-term from banks and financial markets abroad. But to be competitive such a »two-step« process of asset transformation must be as cheap for the bank's customers as the usual simpler »one-step« process. Otherwise, domestic banks will disappear. In order not to disappear and for domestic businesses to be financed by domestic banks, the domestic banks will have to be wholly integrated into the banking system and financial markets abroad. There cannot be a great difference for their borrowers -- largely noncorporate business enterprises -- whether they are financed by domestic or foreign banks.

This is even more important for domestic corporations that are financed via financial markets. They can escape having to depend upon domestic and/or foreign banks, but they cannot escape financial markets and investors entirely, and many of these will be institutional investors abroad. When domestic institutional investors such as investment funds, pension funds, or insurance companies appear, if they appear at all, they will invest predominantly in foreign securities. In a small country there will never be a sufficient variety and volume of domestic securities. This means that foreigners -- foreign institutional investors -- will be the most prominent investors in domestic securities. In a small economy, however, there will be few corporations large enough to effectively market their securities to foreign institutional investors. Without domestic or foreign investors in their securities, banks will be the only source of

financing. So all corporations, the few that are financed via capital markets and the more numerous noncorporate businesses that are financed by banks, will be closely linked to the foreign, international, or world banking system and financial market.

The countries that will be able to isolate themselves from the world economy and the banking and financial systems in whole or in part are in the first place large countries. We can add to them a few small countries close to them or in the remote regions of the globe. They may stay with state-owned business enterprises in some sectors of the economy or even in the majority of them. We suppose that they will decide to do this because it will benefit them, or at least they will think it will benefit them. But they will not have an economic system that can be called market socialism.

V. Some Conclusions

Because an economic system with social ownership of business enterprises is utopian, it is not a viable alternative to capitalism for economic systems with central planning and state ownership to use as the goal of reform. Initially it was considered an alternative, but it had a limited life because it did not have sound money and/or normal finance. As soon as a market economic system or capitalism came to be regarded as a viable alternative as happened rather late at the end of 1988, social ownership lost its *raison d'être*. Market socialism, whether we label it the »third way« (Giddens, 1998), »stakeholding capitalism«, or »welfare capitalism« (Gordon, 2000), does not exist except as a pure utopia.

Transitional economies are not bringing forth anything new, although they might have had certain possibilities for introducing capitalism to the world a second time in a different way that would have been of interest to developed economies as well. Instead, they went back into their economic history, they tried to be good pupils of orthodox mainstream economic thinking, and if they were in Europe, they worked diligently to comply with Brussels. Transitional economies especially the small ones, will be fully integrated in the world economy, because it will be the only way for their financial intermediaries to exist and for their business enterprises to be financed.

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