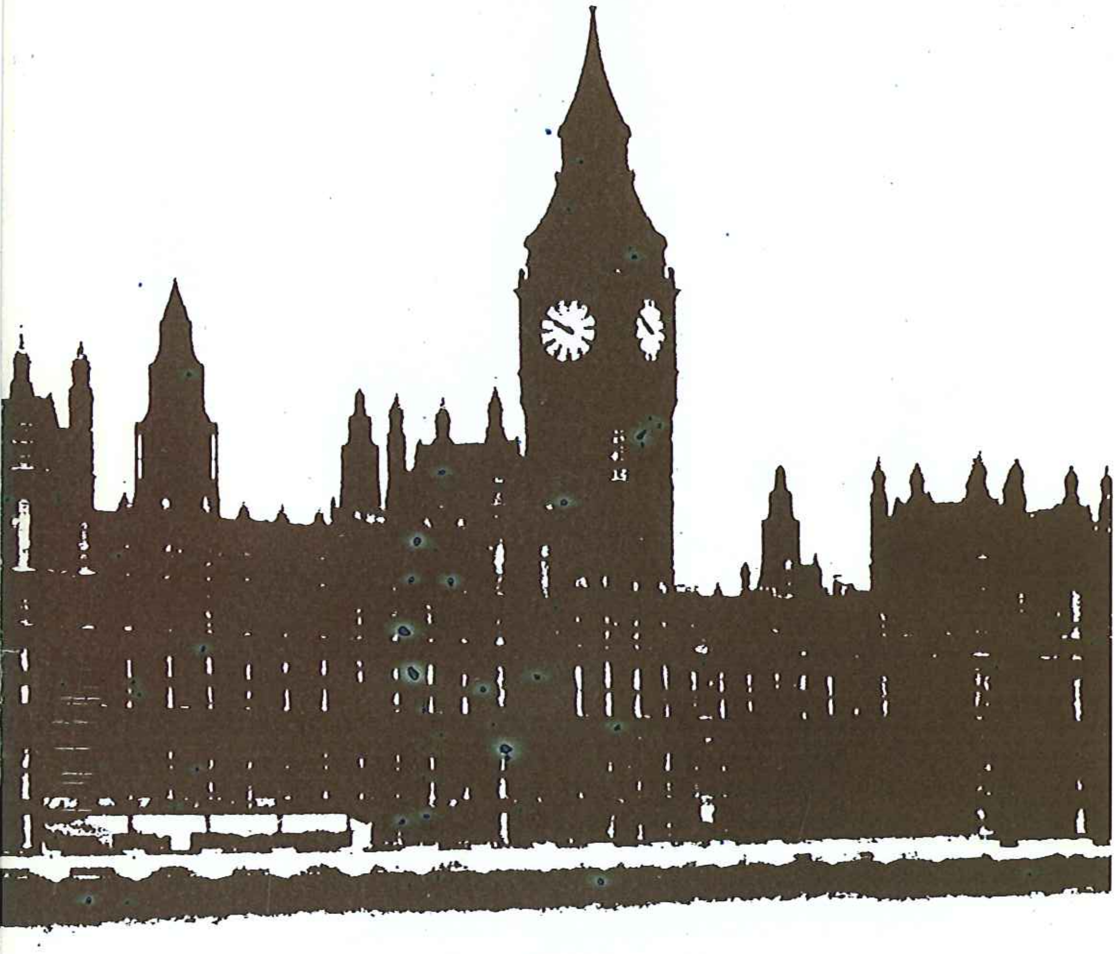
Policy Study No 114

The Democratic Revolutions

Popular capitalism in Eastern Europe

John Redwood MP



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1990

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Introduction

The world is being swept by simultaneous democratic revolutions. A movement which began hesitantly in the 1980s has barnstormed its way into the 1990s. From early beginnings in Portugal, Spain and Greece it gathered momentum in the Philippines, Korea, Chile and Argentina and is now sweeping through the communist countries of Eastern Europe and into Russia herself. It has found its means of expression in people power in the streets, its potent demand in the insistence on free elections, and its emotive rallying points around national flags and local heroes. Its advance was cruelly halted in China in the summer of 1989 with the events of Tianamen Square. The disturbances in Rumania at the end of 1989 demonstrated that not even tanks and fire power can keep a people subject if the army wavers in its loyalties.

The symbols of the democratic revolutions have been the Statue of Liberty, the ballot box and the idea of self-determination. People yearn for freedom and some right of self expression. They seek to live in a country where they do not fear the knock at the door at 3 o'clock in the morning, where people no longer keep secret files on them, where their neighbours no longer spy on them and report them to the secret police and where the advancement of their careers no longer depends upon their political views. They seek a land of opportunity in place of a land of *nomenklatura*. Many people in the worst despotisms of Eastern Europe have seen their prospects, even their lives, ruined by a chance remark or the jealous report of a colleague or neighbour. Those who came westwards in the early days after the puncturing of the Berlin Wall, or queued to cross the border through Hungary or Czechoslovakia had on their faces a yearning for liberty which few will forget who saw it. They resented being lumped together as East Europeans, only to be written off as puppets of the USSR. The dignity of the States of Central Europe and the diverse cultures of the Slavic, the Hungarian and German peoples deserved something better.

When I listen to the speeches and statements of former communist ministers, some of them still in office in the run-up to free elections in East and Central Europe, I feel I am listening to the surrender document of communism. Their statements represent an ideological Brest Litovsk. They freely volunteer total surrender, total capitulation of the policies they have pursued for so many years. Where they were used to secrecy and the suppression of information, they are now opening the files and laying proposals before their parliaments. Where before people were chosen *in camera* and appointed for their loyalty or corruption, they are now putting more and more decisions to the ballot. Where before journalists were propagandists for the party machine and had to clear the official line, now an emerging profession of journalism is active in Eastern Europe, and Western news reporters and cameras can go freely where they want. These are startling changes.

The transition to full democracy will not be painless. In each country so much needs to be done to prepare the ground. Parties have to be formed, programmes drawn up, teams of people assembled to contest free elections. The whole machinery of the State needs to be redirected towards the conduct of such free elections and the splitting of the power of the civil service from that of the party, the Security Police and the political mechanisms. In some countries there may be witch hunts as people try to track down the evildoers of the old regime. In other countries, communists who have risen to the top, partly through talent or merit, will try to find ways of redefining their position so that they can re-emerge as businessmen or governors of a democratic State. Some countries may find the opposition shatters, with parties fragmenting, now that its prime task of winning the right to the vote has been achieved. In other countries it may be difficult to find two equally strong rival parties as in Poland where Solidarity swept the board. Some countries may have to endure a period of shifting coalitions as squabbling politicians struggle to get a grip on power. In other countries landslide victories by united opposition forces may create a problem of another sort; how will other parties emerge which can effectively oppose such overwhelmingly successful elctoral machines?

Men like Mr. Nemeth in Hungary and Mr. Havel in Czechoslovakia may draw sympathy and popularity for their brave contribution to the revolution. Yet the formation of dozens of parties – 40 at the last count in Czechoslovakia – could produce a splintering at the polls.

In Russia the quest is for justice more than democracy. Many there feel that the vote will not shorten the bread queue and that capitalism could bring with it injustice.

Some of the constitutional remodelling will look to the United States of America and to Great Britain. It may well take from the United States the separation of powers between the judiciary, the executive and the legislature: separation of powers is crucial in countries seeking to roll back the terrible power of the centralised tyrannies they are replacing. A clear written statement of the relative rights, powers and duties of the different forces within the constitution may be a necessary first step. These same countries may well look to the United Kingdom for its long evolutionary tradition of parliamentary debate and spirited opposition, while also building on the British tradition of the parliamentary question, the need to make ministers directly accountable to an elected chamber and the need for parliamentary approval for any expenditure of money.

The peoples of Eastern and Central Europe have won by their recent exertions the rewards of self-determination, the right to express their feelings and ideas in the cockpit of national debate, the pleasures and pains of a free press. It is not our task to establish with them any form of 'colonial' relationship with the enterprise capitalism of the West; the new democracies will exercise their own will, set their own policies. But the West stands ready to help where wanted. The ideas in this pamphlet are for those who wish to tread the path to private ownership and a freer economy. Each country has to decide for itself how far it wishes to venture, if at all, along this route.

1
Popular capitalism breaks out

The death of communism as a political system is contemporary with its demise as an economic creed. Communism without economic success is nothing. One central purpose of the creed was to give primacy to economics over moral and spiritual values and over every other-worldly consideration. So as a creed Communism spent much of its time trying to demolish churches, religions, nationalities, cultures and old languages. It failed to do much more than suppress them for a while, and drive them underground. We can see the results in the wave of democratic revolutions in Eastern Europe, each one containing its own potent religious, national and cultural symbols. As people take to the streets their first action is to restore their national flag to its former glory and its prominence at the head of their protests. Next, they reassert their right to use the the language of their fathers, to fill the local churches and to bring back symbols of their nation's past. If you stand in the central square in Budapest you see statues of the founding horsemen of the Magyar State, the original Magyars who came onto the Hungarian plain. Not even the Communists had the foolhardiness to strike down these statues. Elsewhere in the capital statues of the heroes of the 1848 revolution serve today as monuments for Hungarian protest and Hungarian identity. Similar symbols abound in Prague, Warsaw and in the Baltic States of Latvia, Lithuania and Estonia. Few can walk over the Charles Bridge in Prague and miss the potency of the past, reflected in the architectural heritage. These are all nations with long histories of ethnic disturbance and border disputes. The Soviet empire managed to suppress such quarrels for more than 40 years; but they are returning now that the political climate has shifted so decisively. In Berlin, Prague, Budapest and Bucharest many are now seeking a way to adopt market economies, hungry for advice on how to transform their economic performance.

The failure of communist economics is at once apparent to any visitor or any student of the relevant statistics. The technology of Eastern factories is decades behind the times. The East has been starved of much of the information technology revolution. Computer control systems are not common in industry or commerce and the Pole on the street is not about to buy his first home computer or to send his child to a computer-using education at the local primary school. What computing and electronic talent there has been in Russia has been almost entirely concentrated on the defence industries. The communist bloc was a series of lesser developed countries with rockets. The levels of income per head, allowing for difficulties in translating exchange rates for non convertible currencies, are one fifth or less of those in the West. The contrast in access to consumer goods, holidays and cars, has been growing ever greater, to the point where it is no longer acceptable to those in Central and Eastern Europe. Energy was diverted to heavy industry to the exclusion of consumer preferences. Czechoslovakia makes a ton of steel for each adult and child in the country every year, but there is not very much that each can do with it. Professor Galbraith's thesis of convergence in the world economies has proved mistaken. *Divergence* has grown as each year has passed. Once the East German border guards were instructed no longer to shoot emigrants from east to west, and the Hungarians pulled down their section of the curtain, the rest was inevitable.

The communist economies have discovered that a rigid system of production planning, of rationing by queue and allocation, of state control over every innovation and the mass nationalisation of every industry has produced an economic Sahara. The strains were less obvious in the 1950s and 1960s when the West was besotted by the economics of large scale production and the organisation of that production in big factory units employing large labour forces. Then Eastern Europe and Russia could argue that they were doing the same thing on a systematic basis through state control, using that control to redress what they thought was the imbalance in rights between employer and employee in the large multi-national company. Now that economic development is so largely centred upon the enterprise of thousands upon thousands of small companies and upon the flourishing of competition in a knowledge-based marketplace, the gap between the two systems has been growing more rapidly. The West's system, based upon enterprise and the entrepreneur is 'customer-friendly', geared to the development of democracy. Britain, with 3.5 million people in self employment and one million companies now registered at Companies House, has generated many thousands of new jobs through the small enterprise sector. Those who have responsibilities for running their own business would not tolerate a complete lack of responsibility or involvement in their political lives. Eastern Europe needs to create a new class of working entrepreneurs capable of developing the new products and the new ideas needed.

This pamphlet sets out the problems in the economic sphere which these emerging democracies are likely to face, and suggests some practical remedies for the problems on the way.

2
Agriculture and the land

The lack of adequate food in some countries like Rumania and the inefficiencies of distribution and packaging in the richer countries like Hungary is one of the most pressing problems to be tackled in any reform programme. In Poland a system of soup kitchens and emergency relief has been established by the new Government to tackle problems of poverty. The collective farms in Comecon countries have demonstrated their incapacity to meet market requirements both in terms of volume and of quality. The main reason is that the agricultural employee lacks incentive.

Land reform is needed to tackle this problem. As most land is, with the exception of Poland, owned directly by the State, the State can transfer land out in parcels to families to farm and to organise, allowing them to keep some of the benefits of their labour, and profit. The neatest and most comprehensive way is to have a parallel process of giving shares in industrial and national concerns to employees in those sectors of the economy, and land to those in the agricultural sector. There could be some kind of reversion if a family wished to change the use of the land, or some kind of deferred payment for the land if those in the industrial and commercial sector felt an injustice in the direct, free grant of land to agricultural families. The exact terms of the transfer are not too important. What matters is that a large amount of land is parcelled out into the hands of those likely to till it productively and for profit. The new owners should not be so encumbered by debt or early capital repayment as to jeopardise the viability of their holding. The Polish experiment in land distribution has raised output compared with the collective farm era, but further progress requires other changes in pricing, distribution and consolidation of holdings.

The main heads of debate in any wholesale scheme of land reform concern the size of the holdings to be distributed and the terms of the transfer, to ensure justice between those who receive and those who do not receive the land. The size of holding is quite important. There is a temptation to minimise it. Certainly, just to give people a few acres each would much increase the output of vegetables, fruit and other market garden produce. There would not be the same beneficial impact on grain and dairy products which require bigger units. There may be a case for a two-tier structure where the smallholdings are given free to everyone who applies, granting only one per family and ensuring that the family lives near enough and is motivated enough to till it. The second tier of grants might be given to much bigger units able to produce viable grain and dairy produce; here, a basis of deferred purchase would be needed whereby the State would participate in the profitability of the enterprise, but allow sufficient incentive for the new owners to prosper.

There is something very exciting about starting with a clean slate, where the State now owns everything. In mixed Western societies privatisation schemes have always had a problem because of the complicated inter-relationships of existing interests and the overlap between public and private sectors. In the State dominated economies of the East the problems are greatly simplified and any transfer has to be huge in order to have a reasonably large effect, reasonably soon. This could be important for the very salvation of democracy. This assumes that there will be no jobbing back to the patterns of ownership prior to the communist confiscation. Trying to sort out a host of fifty year old claims, complicated by the fortunes of war and the changes forced by invasion, would make the task of land reform both factious and delay ridden.

3
Markets for agricultural products

A second important element of agricultural reform must be the emergence of reasonable markets in agricultural produce. There will be no incentive if the State continues with quantitative controls, rationing and managed prices. At the same time transitional problems in moving from the heavily subsidised prices currently prevailing to a system of free market prices will be painful. In the early days the prices will shoot up if the market is comprehensively deregulated, because the shortage of foodstuffs will not abate whilst the supply of money in circulation to purchase what food there is remains plentiful, driving prices much higher. During the period of transition it might be possible to run parallel systems where a basic ration is allocated at the state subsidised price from the remaining state subsidised farms during the period of phasing them out, whilst the private marketplace grows as quickly as it can, offering food at higher, deregulated prices. Alternatively, deregulation could take place immediately and in one go; but, if so, the State would have to replace its expenditure on food subsidies and farm subsidies with some benefit system to protect the incomes of those under most pressure. It will also be important, as a later chapter illustrates, to have in place a clear method of controlling inflation by tackling monetary disorder.

The markets themselves will not need too much organising if proper deregulatory measures are taken. The Government will have to set out a basic law of contract and may wish to impose standards for quality, weights, measures and the like. It should not, however, interfere in pricing or in details of market organisation: much better to let these emerge as a matter of local and national practice. Transport does require major improvement, as one great problem now is the amount of food which perishes through delays between the time when it is harvested and the time when it reaches the table. Roads need resurfacing and widening, the management of rail deliveries needs tightening up, new investment is needed in refrigerated containers and trucks. The East needs new rail, road and air links to the West.

4
Privatisation of industry and commerce

Hungary, Poland, Czechoslovakia and other Eastern and Central European countries have already stated that they are planning large privatisation programmes. The size and complexity of the task is daunting. Where maybe 90% of all industry and commerce is directed through state controlled companies, often monopolies, the changes required are on a gargantuan scale.

A government should appoint a privatisation minister at a senior level, to work closely with the prime minister and the finance minister. The aim of the privatisation programme should be to return as much as possible of industry and commerce to the private sector whilst at the same time breaking monopolies. New private enterprise can be introduced in one of four ways. First, as the monopolies, are broken new businesses may spontaneously emerge in competition with the state enterprise. Second, Western capital and technology may be attracted into joint ventures formed between the state enterprise and the Western partner establishing centres of new production and of excellence. Third, existing state assets can be restructured into two or more companies and these sold in whole or part to the private sector. Fourth, state procurement contracts could be used to create effective demand for competing private sector companies, taking some of the links out of the state production chain and deliberately awarding the contracts to private competitors.

All these techniques will be necessary to tackle the immense problem. Granting employees shares in state enterprises being privatised would be one of the ways of building a constituency for change. Creating a stock market will also be necessary in order to provide the means of bringing together buyers and sellers of shares and channelling savings from the domestic economy into the purchase of securities in former state enterprises. The stock markets will grow as and when the privatisation programme commences. What a good stock exchange needs above all is transactions: those reformers who believe that the most important thing to do is to set out a stock exchange law on matters like insider trading will find they are disappointed. The law and the regulation should in the first instance be quite light and should evolve as stock exchange practices develop, driven by the growth in the number of transactions and bargains.

The privatisation minister should set about his task by compiling as quickly as possible a list of all state enterprises and setting accountants to work immediately to compile asset registers, construct balance sheets and begin to work out financial information that is usable. Many of these state enterprises have totally inadequate accounts and their trading records have been grossly distorted by subsidy, by wrong transfer pricing and by a number of state interventions. Some of the early deals in a privatisation programme will be haphazard. It is no good searching for the perfect valuation: no good waiting for the enterprise to be in a shape suitable to be run profitably, as a successful private enterprise company with a good trading history. What is necessary is to get on with it and this will require rough justice in the early deals and valuations which have to be realistic enough to encourage new domestic entrepreneurs and Western technology partners.

Businesses can be restructured for privatisation in many ways. They can be given sensible balance sheets with a reasonable amount of debt which they are capable of servicing with the other debts being written off. They can be given the necessary management capable of taking them forward in the private sector. Where the State is so dominant they can be given the right range and style of contracts to get them started.

A successful privatisation programme goes to the core of economic reform in Eastern European countries. Many of them know this and are making important first steps. In Hungary investors from home and abroad can negotiate with the enterprises and see if they can develop a joint venture or purchase agreement. There are safeguards in new draft laws to see that the Hungarian State is not short changed through lack of competition in bidding. In Poland progress is rapid.

5
Money and inflation

Each of the emerging democracies will face, or is already facing, an inflationary crisis. For years, large quantities of local currency have been amassed by individuals in savings accounts. Insufficiency of goods has meant they have had no choice but to salt their money away. Now that they see the opportunities of freedom they wish to spend it, and so too much money is chasing too few goods. The natural result is mammoth inflation.

Currency and monetary reform is a priority with which each country has to grapple. Many Eastern countries have inadequate banking systems and no system for monetary control that would be recognised as such in the West. They are now all examining how they can introduce some monetary discipline. Two basic schemes could be tried for tackling the problem of surplus balances and over valued currencies. The first depends upon encouraging a voluntary transfer of the money from deposit accounts to the Government. This could be done by a major privatisation programme, selling to individuals land and commercial and industrial shareholdings in return for local currency. If done on a large enough scale this could bring a major reduction in the active balances and thereby abate the inflationary pressures. It could also include long term bond issues to finance new investment and the funding of old debt.

The alternative mechanism is currency reform, either destroying all the existing currency and issuing a new currency in the correct proportions for the level of economic activity and output or an internal devaluation of the existing currency, a type of hyperinflation for a day in order to re-establish sensible values and to equate the amount of money with the amount of goods. Yugoslavia is now trying this with the dinar devalued by a factor of 10,000, followed by the introduction of a much tougher monetary policy. The dinar is being linked to the Dm for foreign trade purposes. East Germany may have rectitude forced upon it by a currency union with the Dm. If too high a value is chosen for the Ostmark it will be inflationary, if too low a value it will facilitate major asset stripping by the West whilst leaving incomes very low in East Germany.

It is possible to combine these two techniques. Funding the monetary problem by sale of assets and by the creation of long term government bonds to lengthen the term of government debt will offset the amount of money that has to be eliminated by internal devaluation through currency reform. The new currency reform will not be popular when it is announced and executed, since it will wipe out large amounts of currency which people think has more value at the time that the new values are struck. Thereafter people should be happier as proper monetary control could then ensure that the new currency had some reasonably steady value. Examples of the latter technique include the creation of the new German mark to call an end to the hyperinflation of the 1920s and the switch from the Reichsmark to the Deutschmark after the Second World War. These ushered in long periods of price stability in Germany and strong monetary controls which are the envy of many other countries.

In order to create the techniques for medium and long term monetary control it will be necessary to improve the banking system in each of the countries. The first requirement is competitive clearing banking. State banking systems have to be split up into competing banks, with new banks licensed to come into the marketplace. The second requirement is for Western capital and technology to improve the computing base and the product range of the banks. Complementary to the development of new Western style banking must be the development of central bank controls over the banking system and the establishment of clear monetary targets. Maintaining these monetary targets will require a range of government debt and currency instruments and the management of the marketplace in these instruments. Liquidity can then be injected in or withdrawn from the system when the need arises. Every zloty or forint taken out of bank accounts as payment for State assets sold, or for government long-term bonds issued, is one less zloty or forint that has to cut in value to avoid inflation.

6
External convertibility

Few of the Eastern European currencies are convertible into hard currencies. Each country should take the plunge and move to full convertibility as soon as possible. It supplies an external measure of the value of the currency and would be complementary to internal currency reform and new funding instruments. The main objects of a fully convertible currency are to stem the flight of capital out of the country by illicit means and to encourage inward investment. In Hungary there is now some limited convertibility for the forint for hard currency inward investors seeking to repatriate dividends. Czechoslovakia is working on plans for a freer regime for the crown for inward investors. The dollar is replacing the zloty for many transactions in Poland. Even the USSR is in the early stages of debate on rouble convertibility and changes in Comecon trade settlements.

Strong exchange controls breed their own destruction. Rich people and successful companies find a variety of ways of sending money out of the country illegally or obtaining foreign exchange by trading abroad and not booking it through the state controlled system. A large overhang of convertible currencies in offshore centres is held to the value of individuals and companies in the country concerned but not deployed to the country's benefit. The introduction of full convertibility gives people in the country greater confidence to bring in foreign currency they have earned, knowing that they can convert back again from domestic currency to foreign currency should the need arise. Many lesser developed countries have consistently been sold short by their own citizens and by companies who have taken billions of dollars out of their economies and kept them abroad for safe keeping.

The parallel improvement comes in attitudes of inward investors. People are not going to wish to invest in a country if they feel they cannot take their capital back when they want, or if they feel they cannot even repatriate dividends and profits because they are unable to convert local currency into international currency.

Those reluctant to move to full convertibility immediately must develop intermediate stages. An important first step that some countries adopt is to license a foreign company to come in and set up a business and to keep all the foreign exchange it earns from export for reinvestment or for repatriation. Another intermediate step is to allow a certain proportion of a company's resources or profits to be remitted each year thereby enabling the company to earn some hard currency dividends from its investment. The countries which will do best will be the ones which go furthest towards convertibility -- people will take heart from progress made, and will invest where the rules are least onerous.

Convertibility may be accelerated for several Comecon bloc countries by changes in intra-Comecon trade. The USSR may well want to convert its barter trade switching oil for goods with its European satellites, into a hard currency or a convertible rouble trade where it earns dollars for its oil. This will force a series of alterations in currency and trade on the East European countries. If Russian oil is no longer available at subsidised prices in soft currencies, or supplied in return for variable quality Comecon-produced goods, the countries of Central and East Europe may look elsewhere for trade partners A similar change is being speeded by bringing more of East Germany's trade into inner German trade transactions, removing some East German goods from Comecon's planned system.

7
Trade policy

Eastern countries are keen to reorient trade towards the West. They know that the West has technology and a quality of product that they wish to emulate. They talk of turning their backs on the Eastern European trading bloc, with its prevailing barter trade and the strong Russian influence over trading and currency patterns.

What, however, the Eastern countries need is not less trade with each other but more trade with the West. One of the strengths which an Eastern company can offer a Western partner is a sales and marketing system throughout the Comecon bloc and access to other Eastern European markets. They should think hard before discarding this advantage in any precipitate reorientation of trading patterns.

In the early days Eastern bloc trade with the West is going to be in substantial imbalance with the West,which will sell far more products into the East than vice versa. The trade will be matched by a major inward movement of Western capital, a movement which will grow rapidly if there is wider access to Eastern European markets through substantial intra-Comecon trade.

As trade develops the Eastern bloc will first show its skill at producing relatively low value added items with a high labour content. It will be several years before wages in Eastern Europe match those in the West and for those years of transition this will be the Eastern European economic advantage. The West may come to specialise more and more upon services and upon high technology and high knowledge-oriented products. The East will be a workshop for Europe producing textiles, assembled engineered products and the like, as Eastern European countries develop their export capacities.

The European Economic Community has to develop its trade with the East, dismantling the remaining non tariff-barriers to trade on a reciprocal basis and encouraging a two way movement of goods across the borders. Some progress has been made with the removal of the special impediments in the way of Hungarian, Rumanian and Polish trade and these reforms now need to be extended to cover Czechoslovakia and the other Eastern European countries.

The question of access to the Cocom list products is a most difficult one. Eastern Europe is very keen to see the Cocom list revised to enable it to buy more high technology and computer based products from the West than is at present permitted. The West does have to remain vigilant. It would not be right to make available electronic defence secrets to the Russian military, or even to those Eastern European countries which remain fairly close partners of the Russian military machine through the Warsaw Pact or similar links. On the other hand, it is right to review the list more frequently and to take a more generous attitude towards civilian products on the list, since these are the ones crucial to the modernisation of the Eastern European economies (and also the ones which the West can most successfully sell).

8
The legal framework

All these measures entail a reform of the law. Each country needs to frame a law allowing limited liability companies to operate. There needs to be a simple framework of competition, perhaps based upon Treaty Articles 85 and 86 of the Treaty of Rome, and a gradual transition from state monopoly to competitive marketplaces. There needs to be a firm law of contract and a law of private property enabling people to own freehold as well as long leasehold land. The rights of shareholders and industrial and commercial companies need to be defined. These reforms have to proceed at the same time as basic freedoms are being written into the constitution: such as the law to give every man the right to elect a government by secret ballot at periodic intervals, the law to give every citizen basic human freedoms like rights to a free trial, a right to privacy and rights for a free press. In the USSR draft laws of property, joint ventures, companies and limited liability associations are before the Parliament. Several other States already have joint venture laws in operation, including Poland and Hungary.

9
What can Eastern Europe learn from Thatcher's Britain?

The Poles, the Hungarians, the Czechs and others are fascinated by the British experience. Their interest centres around four main areas. First, there is the privatisation programme, and the impact it has had upon several badly organised state enterprises and monopolies. Second, there is urban renewal and the policies adopted to tackle unemployment. Third, there is the success Britain has had in improving the inflation and productivity performance of the economy. Fourth, there is a realisation that they can learn from our accountancy, legal and financial expertise how to create the infrastructure of a free market.

The privatisation experience is of especial relevance to them because of the way in which Britain has tackled the endemic problems of low productivity, high losses, high state subsidies and lack of incentive inherent in the steel and shipbuilding industries. The case of steel shows how a very large enterprise can be transformed from loss to profit by the spur (as well as the actuality) of privatisation, and by the appointment of new management and the creation of a new financial regime. It is a potent model for Eastern Europe as they have many enterprises in the state that British Steel found itself in in the middle 1970s. They find it impossible to break out of the vicious cycle of overmanning, heavy state involvement and subsidy. The British Steel experience shows that new purposeful management can effect the transition, within less than a decade, from such an enterprise to a high wage, high productivity, high output, high quality business which is very profitable and requires no subsidy. The main steps required include proper accounting, the appointment of strong management, the analysis of the market opportunities and the design and creation of product to meet the marketplace requirements. Raising quality was one of the most important steps taken by the British Steel management; for in the 1970s many British consumers of steel in the construction and engineering businesses had begun to give up buying British steel because it did not meet the specifications they required. The promise of privatisation was important. It gave to the employees a stake in the business, and gave to the management an incentive to meet the targets – they became major stockholders in a successful enterprise.

The case of shipbuilding shows how more extreme remedies are needed in the case of a business whose marketplace has collapsed. Privatisation was carried out piecemeal, salvaging those parts of the business where there was an underlying market demand and where there were skills and assets that could be saved. The warship builders was a case in point; here, there was a clearly defined market and a concentration of skill and design capability which could continue to service the market's requirement. Many of the other yards had to be closed because they produced basic commodity shipping no longer in demand during a worldwide shipping glut.

Eastern European economies are bracing themselves for the need to create unemployment on a major scale as they shake surplus labour from their inefficient nationalised industries. The experience of the British Steel Corporation and Corby Town in rebuilding a settlement devastated by the closure of its principal employer, the steel works, is an important one for Eastern Europe. It is a problem which they will certainly encounter since many of their towns and villages depend on a single company and a single product – and so endangered by devastating plant closures as they set about lifting their standards to nearer Western levels.

In Corby a number of initiatives were taken. First, an enterprise zone was created with a favourable tax regime, and cheap land made available to attract new investment. Second, British Steel itself set up British Steel Enterprises to tackle the problems of some redundant steel workers, through new job creation within British Steel itself. Third, Corby Council played an important part in marketing Corby's image as a new town capable of offering a home to new science, leisure and service based industries. Fourth, the Government assisted by making Corby an area eligible for government grants.

Combined, all these methods reduced unemployment in Corby from crisis levels to the national average within five years: a great success story with lessons for many in Eastern Europe.

The second issue that will be of great interest is urban renewal and regeneration. Eastern European economists, planners and ministers would do well to visit Docklands. An area of 5,500 acres was devastated when the principal employer, the docks, closed down. All that remained was a few tower blocks, council flats and an expanse of maltreated wasteland.

The Government tackled this problem by setting up an urban development corporation, to act as a kind of land laundromat, buying in the dirty land, cleaning it up and selling it off to the private sector for enterprise development. Some ten years into the programme the changes are breathtaking. Large scale redevelopment includes hi-tec factories, the complete relocation of Fleet Street to Docklands, the development of a financial centre, new low rise private housing, new roads, telecommunications infrastructure and a light railway reutilising old train tracks. Docklands will become the third major city of the nation's capital alongside London and Westminster. 5,500 acres will have been comprehensively and completely redeveloped within a 20 year period. Many thousands of new jobs and many thousands of new homes will have been created. Millions on millions of square feet of industrial and commercial space will have been made available.

Something similar will need to be attempted in many Eastern European cities. There the Government generally has the advantage of owning all the land already. Its challenge will be to galvanise the private sector into purchasing that land and filing plans for comprehensive redevelopment for all the office and hi-tec space which is required to power the new economies.

Regeneration will also need to encompass environmental improvement. A poll conducted in Czechoslovakia in February 1990 showed that pollution was the greatest worry of the electorate. Hungarians and Poles, too, have become acutely aware of the dangers of hazardous emissions from factories and power stations. A huge programme of restoration and renewal of buildings needs to be complemented by massive investment in clean-up equipment for plant and in new 'environmentally friendly' machinery.

Third, many in Eastern Europe will wish to restudy the way in which productivity in Britain was brought up and inflation brought down. A strong financial discipline through a medium term financial strategy was an important element. Productivity was raised in the first instance by shaking out a large number of inefficient businesses in both the public and the private sectors, by means of a high interest rate squeeze – at a time of world recession. Productivity then grew rapidly from the low point, fuelled by a major investment boom: a boom which both reflected the increase in profitability of British industry, and resulted from inward investment as the confidence of investors abroad grew in the style and successes of the Government. Major Japanese investment is going to be crucial in rebuilding the British motor car industry – which it could expand in a five year period from an output of about 1.3 million cars per annum to one of nearly 2 million, able to satisfy almost the entire British market, following years of very high import penetration.

Fourth, the resurrected democracies will need new professional services. Each State enterprise will require proper accounts, with a valuation of its assets and cost and profit analysis. Each country will require a legal structure to permit the birth and death of enterprises and to underwrite contracts, debts, loans and transactions. Ways will have to be found to reschedule and repay old debts, draw up new financing techniques for trade and investment and to create methods of trading obligations and raising new money. All this necessitates a major transfer of financial technology from the West.

Conclusion

The challenges in Central and Eastern Europe are gigantic. Politicians setting out on the task have to create a democracy and an enterprise economy at one and the same time. They need to remodel land law, contract law, company law, the banking system, currencies, markets, the whole of the ownership and structure of industry and commerce and the organisation of agriculture. Most of them have taken the first and most important leap: they have pledged themselves to free elections and they have torn up all the old ideology of communism. Market forces are in, communism is out. The retreat from Stalinism and statism is now a rout. Some are making a gentle right wheel towards currency convertibility. Others are already tackling the problem of privatising state industries. Central and Eastern Europe can become a development opportunity for the West. It is Western capital and technology that is needed above all else to advance the living standards.

Righting the Central and East European economies may be no easy task. They may have to endure the pain of high inflation, high unemployment, major dislocation and adjustment to Western styles and pace of work. Those Governments that wish to survive against this turbulent background will need to take bold action to stem hyperinflation, to introduce new controlled currencies with firm monetary policies. They will need to press on with privatising state industries as rapidly as possible. It is only when some private enterprises are established, and when enough land is in private hands and enough food is being produced that people will see the advantages of their new style of life. The East will naturally be envious of the West for a long time to come. Now that they can travel to Fifth Avenue, Bond Street and the Champs Elysées, these contrasts will become obvious to all. They can already see some of the Western lifestyle beamed into their living rooms daily on television, and tell that they are missing out on the modern world. This envy will provide some incentive, but it will also require diplomacy and statesmanship of a high order, willingness to take bold action to tackle the problems of inflation and unemployment, skill to persuade people that the cure is better than the disease.

There is no natural right to democracy or enterprise capitalism in any country. It has to be hard fought and hard won, and it is not for the fainthearted. It is a challenge to the West to do all in its power to display what is best in our society to the East, to offer sensible advice, to sell the right technology. It is up to the Eastern countries in turn to create the markets, to create the opportunities, to be prepared to swallow the medicine in order to obtain the cure. Anyone who thinks that the simple casting of a vote in free elections will automatically give them Western living standards, will be cruelly disappointed. Those who seek the prosperity of the Japanese will have to embrace their disciplines of work. Those who aspire to German living standards will have to accept structural changes in their industries. Those who want British or American style democracy will have to accept the delays, compromises and agonising choice that all true democrats accept as the price of freedom. Those questions are for the new democracies to answer, perhaps with a little help from their friends.

Appendix.

Stages to Reform

Country	*Foreign Participation*	*Tax/Currency*	*Law Reform*	*Election*	*Gdp per head*	*Debt*
Bulgaria	Foreign companies may set up separately or in partnership. State permission for majority foreign ownership.	Joint ventures 30% tax. Foreign companies 40% tax.		May. Opposition organised as Union of Democratic forces.	$3,800	$7.2bn
Czechoslovakia	Joint ventures require at least a national Czech participation. Planning a new more liberal law.	40% tax. Tax holiday for 2 years for new ventures (subject to approval). Plans to allow retention of foreign currency in companies.	Rapid progress on drafting new company and foreign participation laws. Applying to IMF.	Civic Forum Opposition now important to interim government. July. c.40 parties.	$2,853	$5.3bn
Hungary	Government approval for majority foreign owned companies. State guarantee of safeguarding foreign investments.	Repatriation of profits in hard currency allowed 20% reduction in tax for foreign ventures. More tax breaks for certain sectors.	Rapid progress. Applying to IMF. Introduced austerity budget.	25 March. Free market parties do well.	$1,473	$20bn
Poland	Foreign investors need permit.	40% 1st 3 years exempt. 30% for UK companies. Zloty devalued and partially convertible.		June 1989 Solidarity landslide.	$1,595	$40bn
Romania	Romanian investors have to be majority holders. J-V must be mainly for export. Need government approval. Now considering more liberal regime.	30%. 10% extra on profits transferred overseas.	Limited progress.	April.	$843	Low

Note: Laws and Economic statutes are changing very rapidly. Individual data needs checking before conducting any business deal.