

# Transition, agriculture and the vanishing market

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## Abstract

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## **Non-technical summary**

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# 1. Introduction

One of the "hot" topics in economics over the last decade was the transition of the former socialist countries in Central and Eastern Europe from centrally planned to market economies. Economic transition represents a major challenge for economists of different backgrounds and beliefs. Its dynamics has been far from smooth and has presented numerous puzzles and surprises. One paradoxical outcome of the economic reforms is the emergence of subsistence agriculture in all countries in transition. The expansion of subsistence was initially treated as a temporary "side" effect of transition and was not paid full attention. Its endurance and its considerable size however, have now forced its recognition as a major problem to agricultural development, and it has been described as an externality and an important barrier to "efficiency" in agriculture (OECD, 1999, Sarris et al., 1999). It is not objective of this paper to present overview of these practices, but some FAO (1999) survey data on Bulgaria present a strikingly clear picture of the problem: 77.2% of individual farms, 68% of small co-operatives and 40% of small private farms do not sell any production.

The view that subsistence is an outcome of the worsened economic situation began to prevail (Tho Seeth et al., 1998; Caskie, 2000). Subsistence farming in transition economies has been defined by some authors (Kostov and Lingard, 2000, Kostov 2001) as rational economic behaviour with respect to individual utility functions, and also at the aggregate economic level.

This paradox is enhanced by recognition that the small scale farming that gave rise to current subsistence agriculture was market oriented in the pre-transition period (Kornai, 1992). Kostov (2001) presents a detailed analysis of one country in transition, Bulgaria, arguing that subsistence farmers are predominantly market oriented nowadays. One could ask how it became possible that the reforms which were designed to create a market failed to do so and thus contributed to the decommercialisation of agriculture.

Even the term *subsistence* or *peasant* agriculture adds to the confusion. It is a familiar problem in developing economies. The comparison between LDCs and transition economies however, is rather arbitrary and may be misleading. In the former, subsistence is a characteristic of underdevelopment, while in transition economies the policy emphasis on industrial development in pre-transition years (Kornai, 1980) gives different dimensions to the subsistence problem. This industrialisation created a radically different rurality in the present transition economies. The collapse of the excessive industrial capacities at the beginning of transition is one reason for subsistence expansion (Kostov, 1995). Hence, the phenomenon of subsistence in transition economies is not directly comparable with that in developing countries.

Views about advantages of the market over central planning are rooted in the Austrian standpoint dating to the famous debate on the socialist calculation of the 1920s and 1930s. Another paradox is that these views are often advanced from neo-classically

inclined economists. Is it necessary to remember that the predominant opinion was that the "socialists", represented by Abba Lerner and Oscar Lange have won the debate. The "models" of Vilfredo Pareto (1966), which prove that the results of centrally planned and market economies can be identical and the, much criticised by Marxists, words of Paul Samuelson that "under perfect competition workers can rent capital goods or capitalists can rent workers" (Samuelson, 1972, p.237) are illustrations of this. The ideas of Hayek (1935) about market co-ordination of dispersed knowledge and the market process view of Mises have been largely neglected by the mainstream, although they are used to "justify" the logic of economic transition. The approach is still dominated by the static timeless neo-classical methodology. This methodology encounters huge problems in dealing with transition. Transition is an essentially dynamic process of dramatic economic changes which can not be satisfactorily handled within the static framework of neo-classicism. The mainstream approach is pretty much a "magic wand" methodology. One postulates the initial and the final state and they are then compared to deduce "dynamic" effects. Little attention is paid to the way the system under analysis passes along the route from initial to final state. It simply moves there. It is, therefore, hardly surprising that such a point of view has immense difficulties in coping with subsistence agriculture. It is conceded that this movement can be regarded as consisting of several stages, which are generally viewed in a similar way. Since the end states of all these stages should look increasingly similar to the point of arrival, subsistence agriculture does not fit into this neat picture.

One of the features that distinguishes Austrian economics from the economic orthodoxy is the view of the economy as a process rather than a collection of end states. This property can be exploited in the case of subsistence agriculture in transition economies. While in developing countries subsistence can be regarded as "given" and static, in CEECs subsistence agriculture has been created by, the transition process. This makes the process view a natural and reliable tool in analysing this phenomenon.

## **2. Institutional framework of transition**

It is well recognised that institutional constraints are important determinants of economic processes. Transition from centrally planned to market economy means a change in the institutions underlying economic activity. Institutional foundations of these two economic systems are clearly incompatible and no market logic could apply until institutional changes have taken place. The latter requires time. The nature of institutions indicates the importance of time. Beginning with the famous dictum of Menger about the role of money and the dominant in Austrian tradition view on the spontaneous and unintended emergence of many important economic institutions, one can understand that institutional development requires time.

Transition can be expressed as a process of changing old institutions and creating new ones. The incompatibility of many of the institutions of the centrally planned economies with the market principles, simply means that changing the old institutions would involve their destruction. Destruction is easy compared to creation, and the gap in the speed of these two processes creates numerous problems.

Institutions are interpreted as a social crystallisation of rule-following behaviour (Hayek, 1973). They represent the "rules" that individuals follow to cope with uncertainty (O' Driscoll and Rizzo, 1996). They have an information role, providing rules and routines that are proved to work in given situations. Faced with uncertainty of the future individuals confine their behaviour within these rules. This helps them to predict individual behaviour and to achieve a "pattern co-ordination", a notion which better reflects economic realities than the more familiar one of equilibrium. We do not "know" the future, but we can "imagine" it, or at least its typical features. The institutions represent at the aggregate level the "means of orientation" (Lachmann, 1971) and their change impacts on the behaviour of economic agents. As Hayek points out, institutions represent a stock of social capital. The radical removal of established institutions in the initial stages of transition therefore represents a waste of social capital, which would have serious consequences for the further development of transition economies. Instability is the logical consequence and visible result of the destruction of the old institutions. Rules of behaviour, prescribed by the institutions destroyed during transition now cease to work. This increases uncertainty. The process of institutional change necessarily brings instability in the observed economic behaviour, thus creating instability at the aggregate level. There are two main sources of this instability. The first is the impossibility to follow the rules of thumb prescribed by the destroyed institutions. This is often described as a "vacuum" created by the destruction of the old structures and the lack of new ones. The second, arguably more important, source of instability is related to the informational role of institutions. Hayek (1973) argues that patterns of routine behaviour transfer information. Except for the restrictions that they impose on individual behaviour, institutions are considered to convey knowledge. Therefore rules of thumb can be regarded as workable adaptations to the environment. The nature of transition changes the environment. This is the essence of transition - to replace the central planning by a new market environment. Therefore even if the old institutions are still in place, the routines of action they prescribe will convey erroneous information which increases the instability. In a normal market economy, any increase in uncertainty would give rise to counteracting process aimed at creating patterns of institutionally sanctioned behaviour that would reduce the uncertainty. In the market process uncertainty can be endogenously created by entrepreneurial discovery and later offset by appropriate changes in institutions. This reflects both the evolving and unintended character of institutions and their role in the knowledge process. We use the word "discovery" to characterise entrepreneurial activity. It emphasises the view of the market as a process of acquiring knowledge (entrepreneurship) and stocking it (institutionalisation). The institutional destruction that

took place in the early stages of transition, precludes the self-sustaining nature of this process. The wasted social knowledge can not be easily replaced. Uncertainty stemming from radical economic changes can not be reduced unless new institutions are promptly installed. It must be acknowledged that the approach to this problem in transition countries has been ad hoc. A type of institutional engineering has been applied. The latter represents exogenously imposed institutional changes. Exogenously imposed institutional changes would ideally be applied to enhance the effect of the basic, fundamental economic institutions. Menger's (1963) distinction between organic and pragmatic institutions is a useful illustration. We have a different type of exogenous change in transition economies. The "foundations" of new legislation and other institutional changes are planted onto the economy. In other words the leading role in institutional development is attributed to pragmatic institutions. Menger (1963) defined such an approach to economic institutions as ahistorical. In introductory textbooks on institutions, it is explicitly stated (usually giving as example Latin American experience in adopting the principles of American constitution) that such practices are deemed to fail. What this "institutional engineering" attempts to do is "save" time needed for the knowledge process to develop and yield results. We would like to stress that the effect of such externally imposed changes may and will conflict with existing and functioning institutions and these frictions would additionally contribute to augmentation of uncertainty.

The rise of uncertainty in transition economies can be seen as a self-enhancing process. The loss of social knowledge creates uncertainty, which can not be reduced by new institutions, because they need time to evolve and develop. The market economy has to be learnt. Many exogenously introduced institutions are "foreign" bodies in the structure of the economy and do not help to reduce uncertainty. The market process in these conditions leads to a high number of errors and acquiring reliable knowledge is difficult. We should stress that this analysis does not apply to the piece-meal changes in China's dual-track route, but to the dramatic experiences of Central and Eastern Europe.

In a normal market economy the disrupting effect of entrepreneurship and the stabilising role of institutions are complementary. Entrepreneurship under transition is impaired because of the high uncertainty. Whilst in a market economy, entrepreneurship has a constructive effect via its role in the knowledge process, in transition the role of entrepreneurship is likely to be destructive. When there are large blank areas in the institutional structure of the economy, it is much more difficult for knowledge, acquired through entrepreneurial discoveries to be transformed into the social sphere. It is in entrepreneur's own interest to keep this knowledge private as long as possible. In such situation, it is normal to have a large range of rent-seeking activities which are one of the main forms of destructive entrepreneurship.

The errors realised in market process are translated into the transaction balances. Kessel and Alchian (1962) argue that transaction balances and short-lived capital goods are complements, whilst transaction balances and long-lived capital goods are substitutes.

The persistent economic uncertainty of transition is thus expressed in reduction of long-term capital. Taking into consideration that long-term capital is usually associated with the earlier stages of production, leads to a process of transfer of resources from earlier to later stages of production. Kostov (2002) denotes the combination of this process with high uncertainty and institutional instability as *shortening* of production in real time. The term *shortening* can be interpreted in terms of the stages of production effects but also is related to the knowledge process. It reflects that the events that would affect the typical features of economic behaviour are less likely to occur. Learning is impaired and therefore economic behaviour is more conservative. This means that more importance is attributed to rule following behaviour, in response to the lower subjective probability of deviating from the adopted rules, than to creative entrepreneurial activities. The main feature of shortening compared to the normal market process is its destabilising character. In this situation institutional changes are badly needed to realise the missing pattern co-ordination. Shortening makes such changes unlikely because of the difficulties in learning. When learning takes place via entrepreneurship, the acquired knowledge is kept private and thus co-ordination is not improved. It is important to stress that the creative role of entrepreneurship cannot be sustained unless the market process is properly functioning, that is the institutional structure is established. Under conditions of shortening this is increasingly difficult.

The uncertainty associated with the initial reforms increased the relative importance of present consumption relatively to the future. This contributes to enhancing the process of shortening. The shortening process effectively emphasises the later stages of production, the net effect of which is a relative increase in current to future consumption. Therefore this process takes place when there are expectations for a future fall in consumption of the final products.

The influence of inflation is that only short-term finance is available. This further enhances the process of shortening reducing longer term investments. Inflation increases the preference of current to future consumption of consumption goods, such as food, and contributes to the shortening of agricultural production. The process means a need for current food and due to the expected future decline in food production, the danger of future food shortages. Both give rise to a tendency towards self-sufficiency. This may be expected to be relatively temporary subject to the development of the new market institutions. When the new institutions are created the instability is already in place.

### **3. Roundaboutness and its link to the process of shortening**

We can alternatively express the effect of shortening as diminishing the roundaboutness of production. This will be true only if more roundabout production techniques are superior than less roundabout ones. This is generally the case with subsistence and commercial agriculture. The preference of current to future consumption and the



ensuing shortening of production in real time leads to a decrease in both future production and consumption. The decrease in roundaboutness of the production produces the same results. Subsistence behaviour, therefore, can be regarded as insurance against the expected fall in consumption. Let us consider the moment in which this future becomes present. *Ceteris paribus* at this moment the individual would have to face lower consumption. He or she would however have a relatively high propensity to consume (inherited from the previous period). Another consideration is that consumption should be bound below since it is related to the physical survival of the individuals. In many of the poorer countries of Central and Eastern Europe, this is a major determinant of subsistence. Given the unstable macroeconomic situation households face a high risk environment. Their response to instability and uncertainty is to try to secure their basic food supply via subsistence production. Self-sufficiency can be considered a form of risk minimisation. Economic instability changes psychological attitudes and with the possibility of chronic food shortages, market stimuli lose their power. The dramatic macroeconomic changes promoted self-sufficiency as a high order household priority and changed relationships to the market.

If the decrease in future consumption has been properly expected, then the choice of subsistence type of economic behaviour would help individuals to increase their consumption relative to the choice of market driven behaviour. That is subsistence has a function to maintain consumption at a higher level and thus offsets some of the consumption effects of the decreased roundaboutness of agricultural production. It further restricts the future consumption for the commercial production and contributes to deepening of the shortening process. In the simple model above the variable that affects the dynamics is the propensity to consume. In the case of a fall in uncertainty the propensity to consume will decline. The latter however may not be sufficient to reverse the process. In order to increase the roundaboutness some current consumption has to be "sacrificed". This has to be accompanied by expectations for a future rise in consumption. Under consumption we understand both domestic and external demand for the final products. This would have been the case the effects on subsistence and commercial agriculture were the same. Then, however, there would have been no need to consider subsistence agriculture separately from commercial one. The immediate response of subsistence farms to changed demand would be more flexible. What they need to do is simply reallocate part of their own consumption to the market. This refers to unexpected changes in demand. In principle such reallocation would represent a shift in the propensity to consume if higher demand is expected. In a world of uncertainty and ignorance, however, such expectations have to be formed. The immediate reaction of subsistence agriculture to changes in production would not necessary involve expectational elements. If the new higher demand stays at this level, the temporary character of the change in the propensity to consume may fade out and the "sacrificed" current consumption may lead to increased roundaboutness.

The key to meeting future expected higher demand is in the increased roundaboutness. This is a process of reallocation of resources mainly capital from later to earlier stages

of production. The capital accumulation in commercial farms, however, largely exceeds that in subsistence farms. Consequently changes in roundaboutness of commercial agriculture would be much easier and greater than those in the subsistence sector. We note the asymmetry in the changes in roundaboutness; while decreasing it may be achieved by dispersing capital resources, augmentation assumes capital accumulation and therefore is a slower process. This differential approach is helpful in understanding the sources of subsistence. The genesis and expansion of current subsistence farming took place in conditions of decreasing consumption demand and roundaboutness of agricultural production. Commercial farmers decrease the roundaboutness of their production slowly in relation to the useful economic life of their assets. The process of disinvestment in agriculture however had begun long before transition took place. (Kornai, 1992, Kostov, 2002) Less roundaboutness and more labour intensive technologies simply means more subsistence.

#### **4. Environmental and behavioural entropy**

The environment to which economic agents have to adapt during transition is highly volatile. This high volatility implies higher environmental entropy. When this is the case behavioural entropy should decrease (Heiner, 1983). This restricts entrepreneurship which is a high entropy type of behaviour. The uncertainty means that even if there is entrepreneurship the chances for reward will be relatively lower.

Institutions are tools to cope with uncertainty. Transition creates persistent instability. Even when the new institutions successfully adapt to the environment, new shocks disturb them and hinder the process of institutionalisation. This volatility does not allow for long-lived capital goods.

When production is shortening in real time, both production and consumption are decreasing in time. If there are expectations for a growth of the market, which include both domestic and external market, then there will be adjustments in the production process to meet this increased demand. The income driven domestic market increase (or expectations for such) will have a similar effect of reversing the tendency towards shortening.

The informational role of institutions aimed at reducing uncertainty can be alternatively expressed as reducing the environmental entropy. Routinised behaviour therefore reduces the behavioural entropy. Heiner (1983) showed that although behavioural and environmental entropy are positively correlated, increasing the latter beyond a certain limit leads to a decline in behavioural entropy. To put it simply, the market process cannot properly work unless the degree of uncertainty is sufficiently low. Low environmental entropy, that is relatively low uncertainty, allows for low entropy type of behaviour. Entrepreneurship not only increases behavioural entropy, it is "creative

destruction" which alters the environment. Thus entrepreneurship increases environmental entropy and via the positive feedback to economic behaviour creates conditions for more innovative activities. Note that this positive feedback is also a form of entrepreneurship. While the disturbing role of entrepreneurship may be related to the Shumpeterian entrepreneur, the constructive entrepreneurship is more compatible with entrepreneurship a la Kirzner. Both are needed for the market process to operate. In a lower entropy environment, the creative entrepreneurship prevails. The lower uncertainty creates a relative stability that allows the entrepreneurs to see and seize the opportunities. Their alertness is an automatic build-in constraint to the disruptive effects of entrepreneurship. These disruptive effects create new opportunities, which are seized by other entrepreneurs. The relative stability of the environment ensures that the overall effect of entrepreneurship is stabilising. When environmental uncertainty increases above the above mentioned limit this forces the system to switch from positive to negative feedback. Higher entropy in this case requires a lower entropy economic behaviour and this restricts creative entrepreneurship. The meaning of the negative feedback is that due to the high uncertainty the constructive entrepreneurship is less likely. The high uncertainty would prevent many entrepreneurs from clearly seeing existing opportunities. The uncertainty would lead to a greater number of entrepreneurs acting on non-existing opportunities and thus further increasing uncertainty. The incomplete market structure in transition economies hinders efficient information flows and makes corrections of erroneous action more difficult. Therefore in transition the economy may get "locked" in higher entropy environment. The negative feedbacks are prevailing and low entropy economic behaviour is dominant. Therefore in these conditions, knowledge process cannot be guaranteed to operate as smoothly as above and entrepreneurship can be destructive. Subsistence economic behaviour, due to its short in real time production cycle, is more predictable than commercial, which means that high volatility in the economic and social environment would lead to augmentation of the relative importance of subsistence agriculture.

## **5. What Determines Subsistence Agriculture in Transition Economies?**

Simon (1981) notes that individual plans and perceptions are hierarchical and so are the institutions, which are intentionally and unintentionally "designed" to facilitate the implementation of individual plans. Economic transition is about the change in higher ranked institutions. This change brings about greater instability, because it affects the most typical features of economic events. It disturbs the established pattern co-ordination. Subsistence agriculture is situated at lower levels in the hierarchy of the institutions. Following Langlois (1986) who suggests that when actions are co-ordinated at the higher level in the hierarchy, agents use the freed energy to examine possible

behavioural changes at the lower levels in the same hierarchy, we can now explain subsistence endurance. First the macroeconomic parameters reflect the volatility due to changes in the fundamental institutions, that is those, which are high in the hierarchy. That is the apparent stability does not imply that all the needed institutional arrangements are in place and working. Institutional change is a much wider process. Many of the new institutions were created during economic turmoil. When the environmental entropy decreases, these institutions have to further adapt to this new environment. Whilst establishing stability high in the institutional hierarchy frees energy to be implemented at the lower levels, does this mean that the subsistence structure will be changed? The answer is yes. Self-sufficiency is evidently ranked lower than general consumption behaviour. This means that changes in subsistence have to be conditioned upon obtaining a stable and co-ordinated consumption pattern. A common measure for consumption volatility is the demand price elasticity. Referring to subsistence, we are interested in price elasticity of food consumption. When incomes are low, these elasticities and food consumption volatility are higher and there is little energy to be applied to changing self-sufficiency. The income situation therefore is an important determinant of subsistence agriculture, because it describes its institutional environment.

Subsistence type behaviour, however is not only "consume what you have produced", but also "produce what you want to consume". That is we have to also situate it within the overall food production institutional environment. It consists of agricultural production and food-processing. It is well known that agricultural production is in general relatively price inelastic. Food processing however depends on both domestic and external demand for its products and is much more volatile. Consequently producing for food processing is a different kind of production compared to production which is aimed at immediate consumption. It assumes different plans. The existence of subsistence restricts the domestic market for the products of food processing. Therefore external markets are crucial in changing subsistence farming when regarded from its production side.

Another difference between incomes situation and external markets is that while the former acts directly, the latter has a much more subtle and indirect influence. An increase in the external market for raw agricultural products would also contribute to commercialisation of agriculture. This means that the relatively inelastic production cannot meet the higher demand and some of the production aimed at self-sufficiency might have to be reallocated to the market. If this growth is expected to be irreversible, then some resources would be moved from later to earlier stages of production. This would lead to "expanding" production in real time. This would increase future production and consumption. In relation to the subsistence consumption, this process may restore the original level of consumption, part of which may be "sacrificed" to launch the process of resources' reallocation.

The issue of capital accumulation and amortisation is important to the future development of agriculture. Traditionally capital production models include production of capital goods as separate phase of production process. We can regard monetary funds as a liquid form of capital. This means that when capital is exogenised from the production process, money can be interpreted as capital. Accumulating money is simply another form of capital accumulation. New capital can be brought into the production process against money, which is similar to the substitution of specific capital. Loans can be used to introduce new capital. The latter have to be ensured by collateral. In this relation loans can be regarded as intertemporal substitution of specific capital. At the beginning of transition, agriculture is characterised by declining in economic terms capital goods. This restricted the financial abilities of production units. Subsistence agriculture is particularly deprived of accumulated capital. This suggests that the process of commercialisation would require bringing in agriculture capital resources from outside. An example may be to use of houses as a collateral. The latter needs some pre-requisites. The first is that there has to be stability in the prime use of these assets. The uncertainty, general and specific to the domains of prime use (e.g. housing) and transfer (that is agriculture) of the asset, must be sufficiently low. Expectations about increase in consumption of the final produced good have to be present. Understanding economic development as a process of cumulative causation contributes to our interpretation of the role of subsistence agriculture in transition economies, which Kostov and Lingard (2000) define as a "market clearing mechanism". Agricultural production in general is characterised by a low price responsiveness. The demand for food products, however depends on the income situation. In developed market economies, it is less responsive to price changes. In lower income countries one should normally expect considerable price responsiveness of food demand. In this situation the significant price changes that took place during transition would have destabilising effects on the total agricultural economy, because changes in production would lag far behind the changes in consumption. Furthermore such changes have to recognise the budget constraints, which in some countries will be clearly binding. Subsistence agriculture is the solution to this problem. It supplies major part of the population with food, that is withdraws some demand from the market. Employing backward and labour intensive technologies, it restricts potential agricultural production growth. In terms of expanding subsistence this implies that people are driven out of the market and simultaneously market supplies (that is agricultural production) are decreased. The above process stabilises the food market in conditions of declining domestic purchasing power. For the net agricultural exporters (Bulgaria, Hungary, Romania) the restrictions on export opportunities contribute to subsistence expansion. Most CEECs are however net agricultural importers. Small scale production in these countries therefore has to be compared to an enlarged market dependent on both domestic demand and imports. In this case subsistence production should be regarded as a basis for import replacement. Agricultural decommercialisation in these countries is a consequence of their increased import exposure.

## 6. Conclusions

The process of economic reforms has peculiarities in every country in transition. These specifics have influenced the character and the relative size of subsistence in these countries. The main reason for its existence and endurance is however the process of transition. Drastic institutional changes caused subsistence agriculture. It can not be regarded as temporary and "inefficient" phenomenon (Sarris et al., 1999, OECD, 1999). Subsistence is the reaction of the agricultural economy to the abrupt institutional changes.

The expansion of subsistence took place as a result of economic developments of commercial agriculture and therefore does not contradict market process logic. The view that subsistence agriculture is a perverse result of market reforms is a reflection of lack of understanding of how markets operate. It is however desirable to achieve agricultural commercialisation. Nevertheless agricultural commercialisation can not be regarded as a separate policy aim, because its extent and effectiveness will depend on the institutional characteristics of the market, which would allow for full development of the market process. We have outlined the most important factors likely to influence this process. The first is the income situation. Income impacts not only on domestic demand for agricultural products, but also the institutional development.

The other factor for agricultural commercialisation are the external markets for agricultural and food products. Kostov and Lingard (2000) define the "market clearing" role of subsistence with regard to foreign markets in the case of export oriented economy. Except for Bulgaria, Hungary and Romania, the CEECs are net agricultural importers. Thus it might be useful to generalise analysis to include foreign trade. The stabilising role of subsistence would be valid if there are stagnating exports and there are insufficient constraints on imports. These restrict the size of market which inhibits the process of agricultural commercialisation similarly to Adam Smith's famous dictum about the division of labour. Therefore foreign trade developments may contribute to reversing the process by creating additional market opportunities.

The third factor that would influence agricultural commercialisation is the process of capital accumulation. Capital accumulation as a basis for the production process is often neglected in orthodox economic analysis. The role of money as a universal form of capital relates the commercialisation to the income situation. That is the role of income for capital accumulation and for production growth is related to general economic development. One can view the substitution between different kinds of specific capital that contributes to agricultural capital accumulation as another facet of the same process.

Finally, it is worth remembering that transition economies are often included in the group of "emerging economies". This suggests that they are still not fully pledged

market economies. The market, as Hayek (1935) in the discussions on socialist planning saw it, is a process of co-ordinating dispersed social knowledge. In this sense market does not exist in most countries in transition. The market would need a sufficient stability and developed institutions to exercise its co-ordination role. The assumed in neo-classical economics perfect competition, is an image of absolute stability and determinedness, that is the end of any market, because in such conditions, there is no need for market. Centrally planned economy was almost diametrically opposite to the market one (Kornai, 1980, 1992). The process of transition therefore presents a major challenge to economic analysis. The tools of analysis has to be expanded to situations which diverge from the adopted understanding of market. The object of analysis are not any longer the familiar markets. Transition economies combine elements of the old central planning and the new market system. This a totally new world, where surprises are everyday business. We can overcome these surprises only by obtaining better and fuller understanding of underlying processes.

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