Major methodological challenges for the economic theory of the firm in the economies of Central and Eastern Europe

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This paper presents the major methodological challenges in microeconomic theory of the firm in the economies of Central and Eastern Europe. The methodological weaknesses of the theory are not only the cause of cognitive limitation but also an important condition for an effective economic policy during the transition period.

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Introduction

The review of subject literature concerning the transition of the firm under the system transition in post-socialist economies confirms the domination of Hockuba’s standpoint according to which: the moment of commencing profound system reforms and the fall of mechanisms of regulations that maintained centralized order constituted a critical point in the evolution of the economic process. The tension and energy of macroeconomic fluctuations, and the energy of imbalanced areas were used during “the great push” that initiated the creation of a new market order. However, this new order could not come into existence immediately. The fall of the collective system did not mean that a market economy had already been established. The initial set of reforms, implemented as a top-down decision, was merely an institutional embryo of the new system (Hockuba, 1995, p. 65). In the initial phase these processes were accompanied by chaos which is a particular state of a system within which one order is disappearing to give a rise to another. The chaos constitutes a process of intense dynamic adjustments of the system elements, a process of changes in the deepest institutional links within the system (Hockuba, 1995; Kornai, 1997). These chaotic structures, which are a mosaic composed of the elements of the old and the new systems, with the passage of time, become structured. The self-organisation of an economy under transition results from an autonomic coordination of numerous economic subjects which, being given a certain freedom of choice, search for an optimal positioning within a new system structure (Ibid., p. 66).

According to Hockuba, Gabher and Stark transition is by necessity an evolutional process in which the state is involved (Hockuba, 1995; Gabher and Stark, 1997). Its essential role is to create an institutional basis of the market order. Therefore, the transition process is carried out to a large degree automatically. The self-organisation is accompanied by a certain inertia of an economy. Such a change has its own logic which should be taken into account while shaping the economic policy.

The main objective of the present paper is to show and analyse major methodological challenges faced by the economic theory of the firm which, in turn, attempts to describe and explain transition processes in post-socialist economies.

Major methodological problems of the theory of the firm in the process of cognition of enterprises’ transition

As was mentioned, the transition of post-socialist economies is connected with a significant scale of constructivism encompassing both the macro and micro economic
space. For this reason, while analyzing behaviours of post-socialist enterprises and changes taking place within their structures, it is difficult to make references only to the economic theory of the firm. Accepting Gutmann’s proposal (quoted by Hockuba) of differentiating the management rules (external framework within which the economic process is being carried out) from the process order (the degree of ordering mutual relations holding between the system elements) it is necessary to remember that the process order arises out of the rules order, though it is characterized by a certain degree of freedom of the application of these rules (Ibid., p.75).

From Hockuba’s standpoint, in the analysis of the transition of post-socialist economies in a micro and macro economic dimension, it is worth using the concept of the economic order.

Based on the concept of the function of an economy’s production as a description process in a system transition proposed by Findlay and Wilson, expressed in the following form:

$$Y = f(L, K)p(G)$$

where: $Y$ - production volume, $K$ - capital, $L$ – labour, $p$ - economic order, $G$ - employees of the state apparatus. The economic order is defined as a structure of economic institutions (Ibid., pp. 74-76). The state is obliged to adjust the economic order under the changing environment and with the assumption that the system is on the edge of the technical border of production capacity.

The change of the economic order is a starting point for solutions concerning changes that characterize the enterprise. On account of the simultaneousness of the processes of the economic order (the rules order) and the process order (behaviours of subjects in the system), the previously formulated view concerning the limiting of the explanatory possibilities of the economic theory of the firm in relation to the concepts of a company under transition appears to be fully justified.

For this reason, the typology of economic systems suggested by Balcerowicz seems to be an interesting methodological proposal of researching change processes in the sector of post-socialist companies (Balcerowicz, 1997). The typology is based on the following three mutually related institutional variables: entrepreneurial regime, ownership structure, and coordination mechanism. The entrepreneurial regime is a part of the legal order. It determines the types of companies that can be established and developed in accordance with the binding regulations. There can be distinguished three basic types of entrepreneurial regime (ER): closed (ERc), open or liberal (ERo), and restrictive (ERr). As Balcerowicz claims: “ERc tends to provide a monopoly to one type of ownership only excluding other types, or limiting considerably their development (e.g., a state-owned company in a socialist economy - author’s comment) (Ibid., p. 125)”

History proves that ERc always favours some type of non-private company and limits or restricts private companies (Ibid.). In turn, the open regime ERo provides a certain choice between various types of companies, both private and non-private (Ibid.). The restrictive entrepreneurial regime ERr provides a monopoly to state-owned companies in certain selected sectors of the economy (referred to as “strategic”), and at the same time it allows the setting up and developing of private companies in other sectors (Ibid.).

According to Balcerowicz, the entrepreneurial regime (ER) may be treated as a dependent variable or as an independent variable. In the first case, the entrepreneurial regime analysis is conducted to research causes and ways in which the regime was created in its different forms. This is the subject for various historical studies. In the second case, the underlying idea is to explain the impact of the entrepreneurial regime on other variables of the institutional order. As Balcerowicz claims this is a problem for consideration within the theoretical institutional economics. To quote him: “while operating the entrepreneurial regime variable one can formulate clear and falsified statements referring to two other

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1 The author acknowledges three main types of ownership structure: capitalist (with the domination of private companies), socialist (with the domination of state-owned and self-governmental companies) and mixed.
factors of the structure sphere - the ownership structure \((OS)\) and the inter subject deployment of ownership rights \((ISDOR)\). \(OSo\) stands for the initial state of \(OS\), \(OSn\) for the final state after the passage of time from the moment \(t_0\), and \(T\) stands for the time interval between the time moments designated as \(t_0\) and \(t_n\). Balcerowicz has formulated ten statements on the dependencies between \(OS\) and \(ER\). These are as follows (Ibid., pp. 128-131):

Statement 1. The open entrepreneurial regime is a satisfactory condition for maintaining the inherited capitalist property. This means that if \(OS_0 = OS_{co}\) and \(ERT = ER_{oT}\) and there do not occur periodical nationalisations, then \(OS_n = OS_{cn}\), where \(OS_c\) is capitalist ownership structure.

Statement 2. The open entrepreneurial system endeavours to transform the inherited socialist \((OS_s)\) or mixed \((OS_m)\) ownership structure into the capitalist structure \((OS_c)\).

Statement 3. The closed entrepreneurial system constitutes a necessary and satisfactory condition for maintaining the inherited (or introduced) socialist ownership structure.

Statement 4. The restrictive system of entrepreneurship is necessary for maintaining the inherited mixed ownership structure.

Statement 5. Hindering private entrepreneurship will support the transformation process of the inherited capitalist ownership structure into the socialist or mixed structure (such a situation assumes the state’s monopoly in new investments).

Statement 6. If \(ISDOR_o\) is highly dense and \(ER = ER_r\) and comprises the barriers set up to deter private entrepreneurs, then this imbalanced layout tends to last even through many generations (the situation of affluent families can serve as an example here).

Statement 7. Less dense \(ISDOR_o\) in connection with \(ER_o\) will benefit the creation of less dense layouts in the future that will be ascribed to a lesser degree to further generations of owners (however, in the same families).

Statement 8. This is a conclusion drawn from statements 6 and 7 indicating a significant decrease in the inherited high density and \(ISDOR\).

Statement 9. The originally well balanced layout of ownership rights in relation to enterprises, possible to be obtained during post-socialist transformations as a result of coupon privatization, is very unlikely to last for a long time.

Statement 10. The closed entrepreneurship system and the socialist ownership structure resulting from it, the main distinctive socialist features, unavoidably generate a situation in which decision-making rights are concentrated in the hands of the state bureaucracy.

### Table 1. Types of Economic Systems

<table>
<thead>
<tr>
<th>Entrepreneurial regime ((ER))</th>
<th>Ownership structure ((OS))</th>
<th>Coordination mechanism ((CM))</th>
<th>Type of system</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open</td>
<td>Capitalist</td>
<td>Market</td>
<td>Market capitalism</td>
</tr>
<tr>
<td>Closed</td>
<td>Socialist</td>
<td>Command</td>
<td>Scientific socialism</td>
</tr>
<tr>
<td>Closed</td>
<td>Socialist</td>
<td>Limited market</td>
<td>Market socialism</td>
</tr>
<tr>
<td>Restrictive</td>
<td>“Mixed”</td>
<td>Distorted market</td>
<td>Distorted capitalism or quasi-capitalism</td>
</tr>
<tr>
<td>Open</td>
<td>Under transition from socialist to capitalist</td>
<td>Immature market</td>
<td>Interim liberal economy</td>
</tr>
<tr>
<td>Restrictive</td>
<td>Slow changes</td>
<td>No plan, no market</td>
<td>Tightly controlled interim economy</td>
</tr>
</tbody>
</table>


As can be easily inferred, the statements can be tested empirically and they are based on the logic of individual choice and layout of social institutions. The indicated dependencies are a subject of interest among historians. However, taking into account the fact that the system changes in post-socialist economies to a large degree are of a constructivist
character, the set of statements formulated by Balcerowicz may be regarded as a proposal of a transition processes research programme.

According to Balcerowicz, there exists a tight connection between the entrepreneurial regime and the ownership structure, particularly when: ERo → OSc, ERc → OSs, ERr → OSm. Both variables determine the way of coordination in an economy. Having considered the entrepreneurial regime, ownership structure and the coordination mechanism, Balcerowicz has constructed the specific typology of economic systems (Table 1).

Each type of economic system corresponds to a specified efficiency measured by various indicators. Also, there is a variety of companies’ internal structures, their behaviours and mechanisms of corporate governance.

In the context of the analysis of changes in the sector of post-socialist enterprises, Balcerowicz’s proposal allows not only the consideration of their classification as worked out by Beksiak (2002) but also allows the consideration of relations holding between the state and an enterprise connected with, for instance, political capitalism or capitalism without capital, characterization of functioning mechanisms and structures of control over a post-socialist enterprise, or, lastly, description and determination of the involvement level of informal economy in the process of capital accumulation and allocation (Hellman et al., 2000; Martin, 2002; Staniszkis, 2001).

Assuming additionally that the configuration of ER, OS and CM, understood as basic characteristics of the institutional order that influence the macro and micro efficiency of an economy, is possible to be incorporated into Findlay and Wilson’s aggregate function of an economy’s production (already mentioned by Hockuba), and accepting the view that transition is an evolutionary process of a constructivist character, and partly spontaneous, the result of which may be various types of economic systems, Balcerowicz’s proposal should be treated as coherent with Stark’s (Stark, 1992) thesis.

However, Balcerowicz’s concept depicts certain limitations of the economic theory of the firm understood as a tool for a theoretical explanation of changes in post-socialist enterprises. Taking into account the standpoint of cognitive realism it must be acknowledged that the theory of the firm constitutes a picture of an enterprise functioning under the open entrepreneurial regime, capitalist or possibly mixed ownership structure and market coordination mechanism. This is why the results of the empirical verification of the consistency level of the contemporary theory of the firm with the actual processes of various changes in post-socialist enterprises is not the confirmation of its adequacy, but a certain measure of the progress of transition from the closed to the open entrepreneurial regime and the accompanying system of capitalist ownership. Therefore, it can be inferred that a certain level of inadequacy of the economic theory of the firm, perceived both as a picture of the examined fragment of the reality of post-socialist economies and a descriptive tool, constitutes a distinctive feature referred to while making references to the analysis of the transition process in countries of Eastern and Central Europe. There can be noticed here a methodological discontinuity due to the lack of total compatibility of the respective instruments used in the analysis of socialist enterprises and enterprises functioning under the open entrepreneurial regime.

The aforementioned proposals of Hockuba and Balcerowicz enable us to identify the cause of the explanatory limitations of the economic theory of the firm in the research on the transition of post-socialist enterprises without making any references to the argumentation connected with the evaluation of its validity. The higher the efficiency of the contemporary economic theory of the firm in explaining changes in the sector of CEE economies, the closer to the open entrepreneurial regime and capitalist ownership system this is, and thus to the market economic order. On the one hand, it is necessary to be able to perceive drawbacks of the economic theory of the firm for the purposes of research on transition, especially during the Big Bang period and initial phases, on the other hand, accepting the methodological proposals set out by Hockuba and Balcerowicz, it is possible to analyse changes taking place in post-socialist enterprises, in fact, without referring to the theory of the firm. In this way it is possible to defend the thesis formulated on
the grounds of economic history according to which an enterprise is a subject in the market economic order, though the history of economic systems shows the cases of quasi-enterprises, just to mention as an example, the existence of socialist enterprises.

There is another essential reason for which the aforementioned arguments are worth accepting. It is connected with the view that the transition processes are primarily of constructivist character and only within some limits are they spontaneous. This means that the transformation process of former socialist enterprises and the development of new private entrepreneurship require active involvement on the side of the state. Therefore, it must be emphasized that the market economic order does not emerge spontaneously. This is entailed in the aforementioned Dugger’s principle (Dugger, 2005, pp. 309-324). To some extent it is a generalization of a well-known concept of the Great Transformation created by Polanyi (1944, pp. 139-140).

The proposal described above of interpretation of the inconsistency of the economic theory of the firm with the conditions of the functioning of enterprises under transition requires a question to be answered on the historical boundaries of a system change in post-socialist economies, particularly on the characteristics that allow identification of the completion of this process. From a theoretical point of view, answering the question formulated in such a way appears to be quite simple. Completion of the transition process is connected with the creation and consolidation of the institutional order being the result of some constructivist and spontaneous activities. This order is typical of a capitalist economy. However, the problem is that the confirmation of completion and consolidation of a new institutional order requires referring to a set of parameters, mainly of an empirical nature, that reflect the aforementioned points on the time axis of the transition process. The issue becomes more complicated when the existence of various alternative models of capitalism is taken into consideration.

In Polish economic literature this issue was raised by Wojtyna. From Wojtyna’s point of view a characteristic feature of the debate on alternative models of capitalism is that it can be applied only to well-developed countries. When commenting on other groups of countries, the term that is used is referred to as models (patterns) of development and what is emphasized is the economic role of the state. In this case the models of capitalism constructed on the basis of the experience of well-developed countries become a kind of benchmark and ultimate developmental patterns. This economist expressed a view according to which in post-socialist countries, and especially in Poland, the debate, no matter if it refers to a normative dimension of the problem (what model of capitalism would be optimal), or to a positive dimension (what variant of capitalism has been realized in the system transition period), as a matter of fact, has not been commenced yet (Wojtyna, 2005, p. 2). For instance, applying the way of understanding consolidation proposed by Matysiak (2004, p. 58) as a process of mutual strengthening of the elements such as rules, awareness and economic policy, it is extremely difficult to evaluate the degree of practical realization of the process in relation to the transition of post-socialist economies. The matter becomes even more complex when the results of the debate on relative advantages of various models of capitalism are taken into account. This debate is dominated by an institutional analysis.

According to Wojtyna, Amable’s proposal is of a great importance for analyses of alternative models of capitalism (Ibid., p. 17). This proposal advocates the rejection of the view that institutions are designed and implemented for efficiency reasons (Amable, 2003). Justification of this proposal is based on the indication of the difficulty of specifying mechanisms that guarantee the efficiency of institutions being created, the source of which is the lack of a precise definition of institutional effectiveness. In practice, institutions arise out of a political compromise. The debate on alternative models of capitalism remains within the scope of the research prospect that is linked to Stark’s thesis. However, practically, the present results of the debate do not form a sufficient basis for designating a set of empirically verifiable characteristics expressing the degree of consolidation of a system, in accordance with Matysiak’s understanding, which, in turn, is a prerequisite for determining the degree of compatibility of the economic theory of the
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firm with the reality of the activity of enterprises in post-socialist economies. Nevertheless, it appears that an important step bringing the researchers of the consolidation closer to the achievement of the purpose could be referring to the concept of institutional complementarity. This would facilitate the understanding of the sources and the essence of the difficulty of changing the institutional order that is characterized by a considerable degree of inertia that is a consequence of the dependence on history.

The issue of the complementarity of a set of institutions and the character of macroeconomic policy in the period of system transition that was raised by A. Wojtyna seems to be vital as far as post-socialist economies are concerned. In subject literature complementarity perceived in this way is analysed according to two different methods. While the first method is connected with building certain “ideal types of capitalism”, the other is based on the construction of the major institutional spheres of a market system with a view to identifying the degree and scope of complementarity of various institutions.

Both methods allow the determination of the scope and effects of constructivist activities in relation to the new social and economic order expressed practically in one of the capitalism models and in the forms and methods of an enterprise’s activity typical of this model. According to B. Amable’s proposal, these enterprises can be characterized by certain drawbacks resulting from the functioning of effective and ineffective institutions. In this respect the assumptions of bounded rationality, opportunism and uncertainty of human activity accepted by the new institutional economy may also be adequate for the description of companies behaviours in a post-socialist economy burdened with the mistakes of constructivism and “the path of dependence on history”. The economic theory of the firm applied for the period of the transition should be treated as an integral part of the transition theory, or in a broader sense, of the social change theory. The relations between the theory of the firm and the policy theory (including the economic policy) are particularly important. Another thing that should be taken into account is the impact of globalization on the local variants of capitalism constructed during the process of capitalism transformation.

The basis of a research programme in the field of the methodology of the economic theory of the firm

The subject literature survey and the considerations carried out allow the formulation of the following conclusions and methodological postulates addressed to the economic theory of the firm:

1. A significant limitation of the research on changes in post-socialist enterprises conducted within the scope of the theory of the firm is the fact that the main subject of research is an enterprise in a capitalist economy and not in a post-socialist economy.

2. Research undertaken in the area of the sociological theory of social change, economic sociology and political science may constitute a certain completion to theoretical and empirical analyses of post-socialist enterprises (Clarke, 1996; Duflo and Senick-Leygonie, 1997; Husain, 1994).

3. Problems of transformation of the post-socialist enterprise require the analysis of the process of liquidation of the institutional loophole and the consolidation of the market economy in the Central and Eastern European countries.

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1 As A. Wojtyna claims, the concept of ‘the complementarity of institutions’ was taken by Amable from Aoki. Two institutions are said to be complementary when the existence of one of them increases the effectiveness of the other. In the case of occurrence of complementarity, some institutions are characterized by an increased efficiency due to their relation with other institutions.

4. Research on the transformational processes of post-socialist enterprises should be conducted in three dimensions: the system dynamics, the institutional and structural dynamics, and the micro and macro levels.

5. Identification of the size of transformation of an enterprise made for the purposes of the theoretical analysis requires acceptance of certain ontological and epistemological assumptions. The starting point for doing research on the post-socialist enterprise can be the known model of “the Illyrian company” (Ward, 1958, pp. 566-589).

6. It can be noticed that literature on transformation of post-socialist enterprises has been influenced by all the trends of the contemporary theory of the firm (Boardman and Vining, 1989; Bos and Peters, 1992; Haskel and Sanchis, 1995; Murrel, 1991; Swan and Lissowska, 1996).

7. “Path dependency” fulfils a considerable role in the description and explanation of the transformation process including the microeconomic scale. The analysis of the “path dependency” depicts an easily noticeable continuity of the system on the macro scale and discontinuity on the micro scale. This means that to explain the course of system changes in post-socialist economies on a macroeconomic scale it is not necessary to apply the theory of the post-socialist enterprise. However, the problem of continuity and discontinuity in the period of transformation is significant since it determines the scope to which the past affects the present (Kleer, 2003).

8. The differentiation of the effectiveness of allocation (concerning the available resources) and the dynamic effectiveness (the ability to promote broadly understood investment) introduced by Grabher and Stark is of a crucial importance in describing and understanding the process of the development of entrepreneurship in post-socialist economies.

9. Methodologically interesting is a proposal to research post-socialist firms within the following triad: people, institutions, organisations. With the assumption of the ability to decompose the triad it is possible to examine the peculiarities of the transformation separately on each of the three levels of the triad.

10. The system transition on the microeconomic level is not only an escape of enterprises from socialism but also an endeavour to build a modern and competitive market economy.

11. Until now no economic theory of the firm in transition has been created. During research on enterprises in transition the already existing microeconomic models of the firm are applied. However, it can be assumed that an increase in the degree of the consistency of the economic theory of the firm with the reality of the world of post-socialist economies in transition is a measure of progress in building the market order.

12. An analysis of the post-socialist enterprise should be carried out in line with an analysis of macroeconomic changes in the transitional economies of Central and Eastern Europe with the consideration of the phenomenon of the variety of models of capitalism.

13. Due to the parallelism of the processes concerning the economic order (the rules order) and the process order (behaviour of subjects in a system) the view of limited explanatory possibilities of the theory of the firm in relation to the description and explanation of behaviours of post-socialist enterprises seems to be fully justified.

14. From a methodological point of view, an interesting proposal of a changes analysis in the sector of post-socialist enterprises was made by Balcerowicz. It is based on the typology of the economic systems relating to three mutually linked institutional variables: type of entrepreneurial regime, ownership structure, and coordination mechanism.

It seems that the aforementioned problems explicitly show an urgent need for the intensification of research in the field of the methodology of the economic theory of the firm, which is an instrument in the analysis of transitional processes in enterprises from the economies of Central and Eastern Europe.
The considerations above prove that the economic theory of the firm is still faced by important challenges. The methodological weaknesses of the theory are the cause of significant cognitive limitations in the field of the transitional processes of enterprises from post-socialist economies. Overcoming these weaknesses is a condition for making progress in research on the system changes considered on a microeconomic scale in the countries of Central and Eastern Europe.

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