The Transition from Communism

1989

- By Christmas Poland, East Germany, Hungary, Czechoslovakia, Rumania, Bulgaria, and Albania have eliminated Communist Governments.

1990

- German Unification, October 1990.

1991


The Puzzle

\[ Y_t = A_t K_t^\alpha L_t^{1-\alpha} \]

\[ \text{Marxist Economies} < \text{Market Economies} \]
The Transition from Communism

The Expected Pattern

Y

The Actual Pattern

Y

The People’s Pizzeria

Issues

• Transition Problems
• Legal Systems
• Safety Net

• The Peoples Pizzeria to be privatized.
• Shares are transferred to someone
  – Cannot exercise managerial control
  – Whole organization is incompetent and collapses in the light of privatization
The Transition from Communism

Managing Miller’s Pizzeria

- Limited knowledge of how one works in a market economy
  - Showing up on time
- Limited legal system
  - Cannot enforce contracts
- High level of Corruption

The Stages of Transition

Feudalism → Capitalism → Communism

Communism → Chaos → Capitalism → Communism

The People’s Pizzeria

Transition to new businesses means a temporary decline in productivity.
The Social Welfare System

- Hungary
  - 40% income tax
  - 40% social security tax
  - 24% VAT

Effective Taxes

100 Forints

29 Forints Welfare

42 Forints Income Tax
Effective Taxes

- 100 Forints
- 71 Forints
- 42 Forints

The Transition from Communism

- 29 Forints Welfare
- 29 Forints Income Tax
- 9 Forints VAT

The Transition from Communism

The Response

- Cheat
  - Work for yourself
  - Deduct everything
- Don’t Work Hard
- Corruption

End

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