TITLE: The Culture of Policy Making in the Transition From Socialism: Price Policy in Mongolia

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THE CULTURE OF POLICY
MAKING IN THE TRANSITION
FROM SOCIALISM:
PRICE POLICY IN MONGOLIA

September, 1992

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and Georges Korsun
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Summary

The transformation from socialism gives economists a unique opportunity to observe the effects of culture on policy. Until recently, today's reforming socialist countries were intellectually and economically isolated from the capitalist world, and thus their culture of policy making developed in a very different manner from that in the West. This paper--by examining a small element of the transition in a specific country, price policy in Mongolia--argues that the culture of policy making that arose and took root under socialism has profound implications for the progress of reform.

In the abstract, Mongolian society was ready to move to a market economy and accepted that price controls were inconsistent with such a move. But when choices were made in the real world, where leaders were faced with a disastrous and largely unintelligible economic environment, price controls re-emerged as the preferred policy tool. This occurred despite the avowed commitment of the government to radical reforms and despite intense external pressure to follow those reforms.

The paper first outlines some basic features of Mongolian price policy: dissonance within and among policy measures; a proliferation of price controls, controllers, and arguments in favor of controls; and spontaneity and decentralization of controls. Several possible explanations for these characteristics of price policy--in addition to cultural influences--are then considered: a preference for the old system; second-best policy; a policy game played out among competing economic actors; and rent-seeking behavior on the part of price-policy officials. The influence of the culture of policy making in framing and guiding decisions emerges as the most convincing explanation. The experience of Mongolian price reform might be paradigmatic--if somewhat extreme--of what happens generally when a radical reform is introduced in an unreceptive and rapidly deteriorating economic environment.
The Culture of Policy Making in the Transition from Socialism:
Price Policy in Mongolia

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1. Introduction

The concept of culture is rapidly re-entering the lexicon of mainstream economics, after decades of near banishment. The central aspect of culture important to economists is that it involves a vision or model of the way the world does or should work, shared by the members of a society (or a subset thereof) by virtue of their past participation in that society. This vision is an input into decision-making processes, affecting decisions both directly and indirectly through the interpretation of new information.\(^1\)

The conditions under which culture will be an important determinant of performance seem particularly likely to apply to the construction of economic institutions and the formulation of economic policies in the transition from socialism. Increasing returns in the development of the institutional and policy framework arise from the interdependence among institutions, among elements of policy, and between the two. (North 1990) If these increasing institutional returns are combined with imperfect markets that generate incomplete information, then "...the historically derived perceptions of the actors shape the choices that they make...[and]...the imperfect and fumbling efforts of the actors reflect the difficulties of deciphering a complex environment with the available mental constructs--ideas, theories, and ideologies." (North 1990, p. 96)

The transformation from socialism gives economists a significant opportunity to observe the effects of culture--ideas, theories, and ideologies--on policy making. Many of the reforming socialist countries were intellectually, economically, and culturally isolated from the capitalist world. The ideas learned and used by policy makers were far from those established in market economies. For much of the population of most reforming societies, the black market constituted the sum total of experience with the market.

In this paper, we argue that the culture of policy making inherited from socialism has profound implications for the transition from socialism. We do so by examining a small element of the transition in a specific country. We show that price policy in Mongolia has been greatly influenced by the understanding of the nature of economic processes that arose and took root under socialism. This influence has been paramount despite the avowed commitment of the government to radical reforms and despite intense external pressure to follow those reforms.

Mongolian price policy reveals processes that might be more obscure elsewhere, for two reasons. First, the effects on policy of the economic culture inherited from the central-planning era are likely to be more transparent in Mongolia than in other reforming countries because of its extreme isolation, as discussed in Section 2. Second, as Section 3 argues, given the relative clarity of the nature of the price policy that is

\(^1\) For current examples of the use of the concept of culture, see Milgrom and Roberts (1992) and North (1990), passim. Although these works apply the concept at very different levels--the corporation and the nation, respectively--their separate uses of the term have much in common.
consistent with rapid reforms--fairly complete and immediate decontrol--it is a simple matter to identify elements that are inconsistent with the goal of radical reform.

The basic features of Mongolian price policy are outlined in Section 4. This interpretive description offers insights into the general nature of the reform of socialism. The categories identified to illuminate developments in Mongolia are relevant to many policy areas in the countries undergoing transition. Indeed, the experience of Mongolian price reform might be paradigmatic--if somewhat extreme--of what happens when a radical reform is introduced in an unreceptive and rapidly deteriorating economic environment. (In Section 3, we highlight some of the similarities between the developments analyzed in this paper and those in other reforming countries.)

In Section 5, we consider some hypotheses that might explain the progress of price policy in Mongolia and especially the characteristics described in Section 4. As is necessary, given the material under study, our evidence is tentative and qualitative. For this reason, we acknowledge the plausibility of several hypotheses and examine the arguments in favor of each. We conclude that the weight of evidence is on the side of one--the influence of the culture of policy making in framing and guiding decisions.

2. Mongolia

For nearly 70 years, until 1990, Mongolia was the de facto sixteenth republic of the Soviet Union, especially in economic terms. International trade was carried out almost wholly within the CMEA. Mongolia’s industrial base was put in place by the Soviet Union, and its viability depended on continuing interaction with that country. During the 1980s, international trade and government-budget deficits exceeded 20 percent of national income, but these were financed in large part by grants and soft loans from the Soviet Union. The economic isolation from the West and the support from Moscow were mirrored on the intellectual side. The Mongolian elite was primarily educated in Moscow, with only a few individuals going as far west as Budapest. Mongolian educational institutions and their economics curricula were based wholly on the standard Soviet model. (See Alexeev, Gaddy, and Leitzel, 1992, for a description.)

The reformist government, formed after the country’s first free elections in 1990, was a coalition dominated by the former communist party, the Mongolian People’s Revolutionary Party (MPRP). In these early years of democracy, the political parties have evidenced little of the cohesion and distinctiveness that appears in a settled democracy. Members of the newly formed parties did greatly influence the government’s reform strategy, but personal contacts and established channels of influence were as important in this process as membership in the coalition government. To a large degree,
the reform program in Mongolia represented an aggregation of the views of the country's elite.

In a scenario common elsewhere, domestic economic equilibrium was sorely lacking when real reform began. Half-hearted and piecemeal reforms had slackened monetary and budgetary control, while doing little to establish markets. During the late 1980s, a monetary overhang had accumulated and shortages were pervasive. Moreover, in January 1991, when economic reforms began in earnest, large-scale economic distress was about to befall Mongolia. Soviet aid was precipitately cut off at that time. With the destruction of the CMEA trading arrangements in early 1991 and the collapse of the Soviet economy throughout 1991, Mongolia was faced with non-delivery of critical imports and the demise of its principal export market. (Imports in 1991 were only 40 percent of the levels expected at the year's beginning.) The government lost control of monetary and budgetary policy, rather than tightening policy. As foreign aid and IMF advice began to flow toward the end of 1991, macroeconomic policy improved. But this was not before the economy had deteriorated so badly that years of patient attention to good policy would be needed to restore macroeconomic equilibrium and the previous standard of living.

Even the most skeptical Westerner could not conclude that the failure of the Mongolian economy in 1991 was a failure of the "market." The collapse of the erstwhile big brother was of paramount importance, with ineptitude on macroeconomic policy an important second factor. Nonetheless, Mongolians view the situation differently. The beginnings of the market coincided with economic collapse, providing a singularly inauspicious first data point on the performance of the market. Although they knew that markets functioned successfully elsewhere, many Mongolians expressed the belief that this was not possible "in our situation." Given the juxtaposition of such statements with comments about speculators, monopolists, and foreign profiteers, which arose repeatedly in the media, in official documents, and in conversations with Mongolian policy officials, one can conclude that the Mongolians' first experience with the market was filtered through a cultural interpretation. This was manifest in the outcome of Mongolia's second parliamentary election in June 1992, when 71 out of 76 seats went to members of the MPRP, whose substantial conservative wing was advocating a slower reform than other elements of the political spectrum.

3. Price Controls in the Transition Process

Among Western economists, discussion of price reforms during transition is almost passé. One finds ready agreement on the proposition that price decontrol must come swiftly at the beginning of reforms. This consensus is reflected in the nature of the reform programs acceptable to the IMF. The emphasis on immediate price decontrol is also consistently an element in formal statements of the reform programs adopted by those governments that have made a firm commitment to undertake comprehensive reforms. Apart from the obvious examples of Poland, Hungary, and Czechoslovakia, this emphasis on a rapid movement to free prices can be found, for example, in the reform
packages announced by Bulgaria, Mongolia, and many of the CIS states, including Russia.³

Nonetheless, a significant degree of state intervention on prices has been a feature of the reforms in many countries.⁴ In some cases, Czechoslovakia and Hungary for example, this feature is a stated, if somewhat surprising, element of the original reform plan.⁵ More often, price controls reappear in a manner inconsistent with the usual reform intentions. Sometimes the reappearance is a plain and a simple retreat. For example, Ukrainian price liberalization occurred in early January 1992, but by the end of that month price controls were established for monopolies, and then in early February the liberalization itself was annulled.⁶ In the more interesting cases, the retreat begins in a less formal manner: the old habits of policy making reappear and dent the consistency and coherency of the established reform program. After Bulgaria’s price liberalization in early 1991, for instance, “projected” prices for major products began to have the quality of controls, which were later formalized in a decree in August 1991.⁷

In Russia, the situation is more complex than in Eastern Europe and perhaps more analogous to the Mongolian one, detailed below. The Russian government has insisted that its price liberalization program has proceeded in essentially linear fashion,⁸ yet price controls remain important. In comments to be echoed in our discussion of Mongolia, Yavlinsky characterizes Russian price policy as decentralization of control over prices, not liberalization.⁹ Even in the initial price liberalization law, Russian local authorities received much leeway in controlling prices. Subsequently, new institutions of price control were set up, for example, the Ministry of Finance, the Russian Federation Government Commission for Operational Control of Resource Supply, and the bodies applying anti-monopoly decrees.¹⁰ The presence of price controls is thus a likely cause of the sporadic goods availability that followed the reforms. During March 1992 a typical food item

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³ The announced moves invariably contain some riders that keep price controls on a few essential commodities. But these exceptions are announced in a manner that establishes their pragmatic and transient nature. It is not these price controls with which the present paper is concerned.

⁴ In referring to state price-control activities throughout this paper, we refer to the actions of high-level administrative bodies, not the inevitable influence that state enterprises have on prices in their capacity as buyer and seller. Since the policy situation is constantly in flux in reforming countries, we make no claims that the information on controls is current at the time of reading.

⁵ In the case of the Czechoslovak Price Law (passed November 27, 1990, effective January 1, 1991), the measure’s strength is rather inconsistent with the rhetoric of the reforming elite.


⁸ See, for example, the report in Izvestia, February 29, 1992, summarized in the RFE/RL daily report of March 3, 1992.


could be found available for sale in only 30 percent of Russia's cities and a typical non-food item in only 60 percent.\textsuperscript{11}

We stray from Mongolia in the above examples to emphasize that the phenomena on which we focus in this paper are general in the process of reform, not specific to a particular country. Mongolia might be an extreme case, but we have found examples in many countries of similar developments.\textsuperscript{12}

4. The Character of Price Policy in Mongolia

The information given below is based on two sets of sources. First, there is the formal record, chronicled in publications, resolutions, laws, speeches, and press interviews. That formal record provides only a small part of the picture, and a somewhat distorted part. Indeed, this must be the case if our argument is correct—that the culture of policy making affects attempts to implement through a top-down process policies that are radically different from those previously in effect. Hence, the formal record is bolstered, amended, and interpreted using information from a large number of interviews with officials making and implementing policy in Mongolia.\textsuperscript{13}

In this section we identify elements of the qualitative character of Mongolian price policy, giving specific examples of the information that leads us to emphasize each element.\textsuperscript{14} As it happens, the discussion focuses on aspects of policy that have negative connotations when viewed from the first-best perspective. But we would like to diminish the extent to which readers attach a normative connotation; it should be remembered that we describe a country wrestling with the enormity of profound economic and intellectual change.\textsuperscript{15}

Dissonance

There were two aspects of dissonance within price policy. The most apparent was that between the reform goals announced by the central government and the decisions of individuals implementing policy. Second, and more striking, was the dissonance that appeared in the form of conflicting statements within single documents, often official documents emanating from top levels of government. We turn first to the dissonance between announcements and implementation.

\textsuperscript{11} Data from Delovy Mir, March 28, 1992, as reported in FBIS-USR-92-074.

\textsuperscript{12} The list of countries in which we have found evidence for these phenomena, to greater and lesser degree, are those mentioned above—Bulgaria, Ukraine, Russia, Czechoslovakia, and Hungary—plus Romania, Moldova, Kazakhstan, Uzbekistan, Belarus, Kyrgyzstan, Latvia, and Turkmenistan.

\textsuperscript{13} For obvious reasons, we do not reference these interviews. If further elucidation is necessary, readers are invited to contact the authors directly.

\textsuperscript{14} For details of the events and policies that have shaped Mongolia's price-reform effort, see Murrell, Korsun, and Dunn (1992).

\textsuperscript{15} Denizer and Gelb (1992) estimate that urban living standards might have fallen by as much as 75 percent over a very short time period.
Until 1990 almost all prices in the economy were set by the central government. Modest steps toward price liberalization were initiated as early as 1988, but price reform began in earnest in January 1991 with the enactment of a resolution that set forth the principle that all prices were free except those for which the government specifically announced otherwise. This resolution listed a number products and services whose prices were to remain controlled “at the initial stage of the economic transition,” but according to government announcements it freed prices covering fully 60 percent of trade. Even before this measure, the government had announced a commitment to move to a free-price system, with only some goods subject to temporary controls aimed at protecting the poorest segments of the population.

As negotiations with aid donors and the IMF proceeded, the government reaffirmed its intention to continue a program of rapid liberalization. The government announced that the farmgate prices of all agricultural products would be freed following fulfillment of the state orders issued in 1991. A measure passed in September 1991 was said to have halved the number of prices subject to government control. The head of the Government’s Price Policy Office reported in November 1991 that the prices of more than 90 percent of Mongolia’s goods and services had been freed, that the prices of fuel, power, and agricultural products had almost reached world-market prices, and that imports were being sold for hard currency at world-market prices. In early 1992 more steps toward decontrol were announced, culminating in a March resolution that left only flour products, transportation, utilities, fuels, and medicines formally subject to controls. The progression of official announcements therefore tells a story of a transformation from almost total price control to almost total decontrol, within fourteen months. From start to finish, this timetable is as swift as any in the reforming socialist world.

Looking behind the scenes, however, one finds a very different picture. Some officials were prepared to state that, pace the official announcements, no decontrol actually occurred in the first half of 1991. Moreover, the implementing order issued in connection with the supposedly price-liberalizing resolution of January required all economic entities, public and private, to comply with rigid procedures in pricing all products and services, whether or not they officially remained under government control. These procedures included registering prices with “price-setting bodies” and establishing price

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committees--to include representatives of buyers and of central or local agencies--within economic units.

Despite the successive resolutions on price decontrol outlined above, concurrent measures introduced new controls. As we detail below, some resolutions gave local governments new authority for price control. In August 1991, minimum prices were set for selected agricultural products. A more insidious measure introduced in October ordered the confiscation of all profits resulting from price increases that were deemed excessive. The government commission responsible for implementing this measure interpreted it as applying to all producing entities, whatever their legal status, and to all prices.

Dissonance occurs not only between measures but, perhaps more importantly, also within measures. The government claimed that it was "[a]iming at shifting to the market the logistics of distributing and selling consumer goods," for instance, in a resolution that simultaneously required governmental organizations at both the central and local levels "to control prices for goods set by private shops so that these prices do not exceed the average market level." 24

Probably the most remarkable example of such dissonance appeared in the Privatization Commission's report issued at the end of 1991. The Commission was the spearhead of economic reform in the country and its chairman was widely recognized as the leading reformer in the government. The report referred to a commitment "among our people to make the privatization process irrevocable and intensive" and announced that 238 cooperative farms (over 75 percent) and 1344 enterprises (50 percent) were already privatized in 1991. In spite of all the indications that the Commission was dedicated to genuine reform, the report also set forth the notion that "[f]rom the very beginning, it is necessary to pay special attention to setting control over [and supervising the implementation of] the contracts of privatized shops ... and other enterprises on issues relating to maintenance of the types and sizes of services, the supply and price regimes, and the number of employees." 25

The degree of dissonance in policy was captured in March 1992 when the measure that was highlighted as the culmination of the liberalization attempts

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21. Ministry of Trade and Industry Order 273. This Order is vague and imprecise, and we have interpreted it in the manner least favorable to our argument. One could also interpret this Order as giving instructions to all economic entities in the country on how they are to decide on price levels.


was put into effect.\(^{26}\) At the same time, every single pricing decision in Mongolia was subject to the scrutiny of several governmental authorities, as we detail in the following section.

**Proliferation of Price Controllers and Controls**

Before the reforms began, Mongolia had a fairly consistent and integrated set of price controls, mirroring the traditional Soviet model. Price controls were administered by a single hierarchical structure that was buttressed by the MPRP at all levels. There was little uncertainty about which individuals had responsibility for setting and monitoring which prices. Under this system, there was little actual movement in prices—a point of pride to Mongolians, who often boasted of having the most stable prices in the world during the socialist era. Nostalgia for this era—and the absence of any appreciation of the costs of the appalling price rigidity—was a significant aspect of the culture of policy-making that the reformist government had inherited.

Since the former price-setting bodies were officially abolished, one might expect that control over prices would have dissipated. The old habits of intervention interfered with this process, however, causing a divergence between policy intent and implementation. A proliferation of organizations and individuals became involved in price policy. This proliferation resulted partially from individual initiative at all levels of government, but it was partially fostered by the central government itself, which intervened on an ad hoc basis in many cases and which often condoned the individual initiatives at both the ministerial and the local level. Government resolutions, individual politicians, the ministries, the new commodity exchanges, local authorities, and the police were collective culprits in the continuation of price controls.

Given the dissonance identified within policy measures, it is not surprising that initiatives in conflict with the government's own stated goals occurred at the very highest levels. These were of two basic types. First, there were governmental measures that set prices, particularly in the agricultural sector. One resolution stated as its first goal "shifting the livestock branch to market relations" and proceeded to fix prices for several commodities.\(^{27}\) Second, individual politicians at the highest levels intervened to control specific prices. After social unrest over milk-price increases in the capital city of Ulaan Baatar, for example, members of the cabinet pressed the city's price commission to change these prices by making new cost calculations and requiring that milk prices be revised accordingly.

Ministerial units of the central government were given considerable authority to intervene in the price-setting process. That the Ministry of Trade and Industry took the lead role is not surprising, given that it had absorbed the old price control agencies. For their own part, officials of this Ministry found their role in controlling prices quite natural, as made


\(^{27}\) Resolution 34, "Farmgate Prices for Some Livestock Products," effective March 1, 1992.
clear in its Order 273, which declared that "[t]he Ministry of Trade and Industry shall be responsible for developing and implementing price policy and for providing organizational and methodological management of pricing and registering prices." The Price Policy Office of this Ministry carries out most of its price-related activities. But a separate department within the Ministry monitors export and import prices and enforces "price discipline" on exporters when it determines this is necessary.

Other ministries also played an active role in the labyrinth of price control. The Ministry of Finance, for example, set retail mark-ups in a disingenuous attempt to avoid the appearance of setting prices outright. In companion with tax collection activities, the Ministry of Finance assumed responsibility for the collection of profits resulting from price rises deemed excessive. Responsibility for the valuation of land has been claimed by the Ministries of Agriculture, National Development, and Finance, the State Committee for Nature and Environment, and local authorities. The Ministry of Agriculture shares with the Ministry of Trade and Industry the responsibility for setting agricultural procurement prices.

Not only organizations existing under the old system were involved in controlling prices. When new organizations were set up to aid in the process of transition, their activities often also contained a tinge of price regulation. The exchanges, which were set up to facilitate trade as the old distribution system collapsed, provide an example: in the end, flows of goods were forced through them. The true function of the exchanges is the subject of considerable confusion. Some officials view them as exchanges in the Western sense, some view them as ways to control the prices of goods produced by monopoly industries, and still others view them as ways to control prices in general. The exchanges thus demonstrate the extent to which the perceptions of new market-economy institutions can vary. The general director of one exchange viewed his role as determining prices, while another viewed his exchange as simply facilitating trade through an auction process. Yet other officials were very critical of this latter notion. To many Mongolians, knowing that an organization's function involves distribution implies that the organization should force a non-market distribution.

The most ominous player in the implementation of price policy in Mongolia is the police. Some price-related resolutions specifically call upon the General Board of Police to participate in their implementation. Police officers can confiscate goods being sold at prices deemed excessive, impose fines upon persons responsible for such prices, and make judgments and take actions on the spot.

The extent of price decontrol, or more importantly the lack of decontrol, was evidenced in data collected in 1991 by the State Statistical Service for Mongolia's first rigorous consumer price index. The period covered by the data--between the collapse of Soviet trade relations and the introduction of

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29. See, for example, Resolution 279 of 1991 and Resolution 35 of 1992.
large-scale Western aid--was a time of severe macroeconomic disequilibrium. A budget deficit of over 20 percent of GDP was completely financed by monetary emission. Money supply was increasing at an annual rate of 200 percent in mid-1991. These were exceptionally inflationary times.

These data show that for the prices that were officially decontrolled, more than half (68 percent in Ulaan Baatar and 75 percent in a rural area) evidenced no price changes in the first eight months after official decontrol, despite the severe macroeconomic disequilibrium. Price decontrol was not occurring in a manner consistent with central-government announcements. Moreover, the data evidence a divergence in the extent of price movement in the capital city compared to rural areas. (Prices not subject to official controls, and therefore more subject to divergences in local controls, rose by 19 percent in the rural areas and 32 percent in the urban areas in the same period.) The informal constraints on the movement of prices seem tighter in the rural areas, where local officials have been more isolated from the main currents of reform policy established in the capital.

Spontaneity, Decentralization, and the Role of Local Officials

The dissonance within policy and the proliferation of price controllers partially resulted from the fact that the new policy arose on the spontaneous decisions of individual actors, rather than as a result of coordinated governmental directives. Dissonance arose because individual actors were interpreting official policy in ways inconsistent with the government's overall philosophy. The proliferation occurred as a result of officials using the old habits of policy making under the new conditions. This was especially true of local administrators.

When the old party-based structure of hierarchical administration dissolved, local officials began to assert independence from the central government. This independence was one of the reasons that little price movement occurred in the first six months after the supposed liberalization of early 1991. Apparently on their own initiative, local officials kept the old policies in place and even expanded their scope. Bureaucrats in local administrations found themselves pressured by local politicians not to implement national policy. The propensity to control prices at the local level extended even to those prices that had been designated as decontrolled and those in the private sector that had never been controlled. As central control diminished, the old price policies spontaneously began to reappear, but this time largely through initiative at the local level.

Later, measures taken by the central government validated the increased jurisdiction of local authorities. The most important among these measures was the official recognition of local price commissions and the formalization of their role and composition. They were to be headed by local administrators and to consist of "representatives of producers and consumers of all property
sectors and experts, obliged to direct price policy ..., to coordinate price levels, [and] to take measures against price monopoly." \[30\]

Certainly, an ambivalence in central-government measures contributed to the behavior of local authorities. Even the January 1991 resolution that was advertised as the first serious price-liberalizing measure required state-owned enterprises "to inform their local [administrations] about their grounds for changing their prices and tariffs...." \[31\] The readiness of local officials to implement their own policies was perhaps encouraged also by the tendency of officials at the very highest levels of government to use price controls as ad hoc solutions to economic and political problems. This has been particularly the case with important consumer goods, such as milk. Though more zealous than their central-level counterparts, the local authorities were following a spirit that seemed prevalent also at the national level.

Re-centralization

The lack of policy coherence was certainly troubling to officials. Their reaction, however, was not to coordinate measures in line with the new polices. Instead, re-centralization occurred. After nine months of decentralization, measures were taken to systematize and coordinate the myriad new price controllers. An October 1991 resolution stated "the need to centralize the forces of control organizations in order to combat negative phenomena arising during the transition to a market economy" and created a commission to oversee all price-control policies. \[32\]

In November 1991 the government accepted a proposal developed by the local authorities to set up coordinating councils for economic policy. \[33\] The objectives of the new councils included "regulating among themselves the prices for goods." This measure was a continuation of the trend of decentralized, spontaneous policy development that had characterized the previous months. But paradoxically it also led to some elements of re-centralization. The policies that were being generated from below were now edging closer to those of the centralized era.

Arguments Used for Price Controls

As price controls and controllers became embedded in the policy process at all levels of government, arguments for price controls abounded. In each measure passed, the government saw a need to establish the reasons for its actions. Each official interviewed seemed to offer a new reason for price


\[32\] Resolution 279, "Measures to Restrict Producers' Monopoly Power and to Stop Some Negative Phenomena during the Transition to a Market-Based Economy," October 1, 1991.

control. Some of the arguments were somewhat cogent, others would be implausible in a market setting. What is notable is the sheer number of arguments that were put forward, rather than their particular substance. The presence of so many arguments—some conflicting, many of which do apply in a market setting, but all in favor of the same interventionist policies—argues that these were rationalizations and not in themselves the reasons why the familiar policies were adopted.

The most common arguments focused on the transitional nature of the economy. For example, some members of the privatization commission believed that privatization was a precondition for free prices. But even resolutions that created new forms of price controls cite "shifting to market relations" as their purpose. This was because of a perceived need to help the market do its job. One measure even mandated that local authorities "ensure balance between societal demand and supply in the market economy environment [and] coordinate price levels."

Some measures focused on failures in the economy that were perceived to be problems of the market or of the transitional phase. Inflation was, of course, a principal focus of concern. Moreover, the rapidly changing distribution of income between various social groups was deemed in need of address by price controls. Thus, "Supplementary Measures to Shift to the Free-Price System" set prices for agricultural products "in order to ensure the stable functioning of agricultural entities during the initial stage of the transition to a market economy." Additionally, measures often directly followed urban unrest, to which the Mongolian leaders were particularly sensitive. For example, the government responded to protests over attempts to liberalize milk prices in September 1991 by placing a ceiling on milk prices.

Although general reference to the transition was often invoked as the reason why these problems had occurred, sometimes the measures were more specific. One resolution ordered "measures to combat monopolies and the practice of setting prices too high," for example, and another responded to perceived problems of monopsony in hides and skins by setting the prices of these goods. Price controls were used as an anti-monopsony device in spite of the fact that the monopsony power was in most part due to actions of the state, such as its ban on exports and its continuation of a central distribution system that discouraged entry.

The above suggests that the concern about monopoly results as much from previous teachings on capitalism as from the damage to the economy that monopolies were perpetrating at the time. This point applies even more to

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35. Some of this redistribution, for example that to the detriment of the agricultural sector, was undoubtedly due to the inconsistent application of liberalizing measures, rather than to their use per se.


another problem perceived in the economy. An "invisible economy" was said to be "destabilizing" the supply of goods in Mongolia. An "invisible economy" was said to be "destabilizing" the supply of goods in Mongolia. The potential for manipulation of the market was a constant theme in officials' attempts to justify the regulation of prices. Of course, in the rapidly changing economic environment many rents were accruing. The pursuit of these rents, even by state industries, was labelled speculation, a term with large negative connotations in both past and present Mongolian rhetoric.

This focus on preventing windfall gains was an element of every liberalizing measure. Instructions of the following nature were common: "The Mongolian Government . . . (entrusts) the Ministry of Trade and Industry, [the local administrations], and all other relevant organizations to take stock . . . of centrally supplied goods . . . [and] to calculate the price balance [i.e., the capital gain] and turn it over to the State Budget." This focus was another reason given for the continuation of controls. The last of the highly symbolic (but hardly effective) measures to announce price liberalization removed price controls from all consumer goods except flour and related products: decontrol was not deemed necessary for these products since they were produced using last year's harvest, which was conducted under the old prices.

The Weak Definition of Liberalization

The previous paragraph demonstrates the Mongolians' tendency to focus on actual costs, rather than opportunity costs, and their lack of attention to demand. An economist with large authority to intervene in pricing matters offered a definition of the free price of gasoline as the dollar import price converted at the official exchange rate, plus import duties, plus transportation costs, plus a fixed wholesale mark-up. When converted at the free-market currency exchange rate, the resultant price was one quarter of the world price for gasoline. This suggests that the new notion of a free price fits better with the old concept of average-cost pricing than with a price obtained through a market process.

Liberalization was probably a far weaker notion in the minds of even the most radical Mongolian reformers than it is envisioned in the West. The Mongolian notion of liberalization seemed to entail ridding the system of old mechanisms for regulating prices, but not necessarily eliminating price regulation itself. The essence of the Mongolian understanding evidently is that free prices are simply ones that are not subject to the old system of regulations and that therefore can reflect changes in economic conditions. This does not mean that free prices can be freely set by demand and supply. Thus, the Order implementing the first liberalizing resolution delineated "pricing procedures" to be followed by all sellers, including private entities. These procedures dictated that "prices shall be profitable for

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40. Ibid.
the economy and reasonable for consumers" and specified a formula for determining prices. This formula, which takes into account costs and profits, entirely neglects demand conditions.  

Justification and Registration as Regulations on Prices

Given the propensity to hold a formulaic definition of free prices, as opposed to a process-based definition, it is not surprising to encounter the practice of requiring sellers to justify prices. In turn, this practice has become a means of price control in Mongolia. For example, the ministerial order implementing the first broad liberalization requires that "draft prices" be submitted to the Ministry of Trade and Industry along with an extensive array of supporting documents. Similarly, in October 1991 all state-owned industries were required to "present the basis for setting the prices of their products to the [local] price commissions for revision and agreement."

The Ulaan Baatar price commission adopted a special declaration in response to its perception that liberalization had permitted some enterprises to raise their prices unreasonably and exert monopoly power, causing dissatisfaction among the local population. The aim of the declaration was for all enterprises in Ulaan Baatar to submit their prices to the price commission for revision and registration. The enterprises that did not register their prices were subject to penalty and the confiscation of the portion of their incomes deemed excessive. Although it was claimed that the commission never required registration of the prices of goods distributed through private shops, private shops often voluntarily submitted their prices for registration to forestall later difficulties.

5. Possible Explanations

The previous section outlined characteristics of price policy in the first eighteen months of Mongolian reforms but left open the question of determinants. Here we turn to several explanatory hypotheses, giving arguments that suggest the plausibility of each. Our evidence is tentative, not resting on the terra firma of an econometric study. But this is almost intrinsic in both elements under investigation—the qualitative features of policy and their likely determinants, such as the culture of policy making. Moreover, this feature of the paper also results from the fact that, for the subject of study, there is an absence of well established hypotheses in the literature and associated discussion of which facts might refute or support the hypotheses.

We begin with the hypothesis that we believe has the strongest explanatory power—the culture of policy making. Several of the other
hypotheses are plausible alternatives and help to identify important factors that have contributed to the development of price policy. Nevertheless, we argue that these alternatives are not sufficient to explain the characteristics of policy. The culture of policy making inherited from central planning has created a fertile environment for factors that might not have been significant otherwise, and we propose that this complementary role of culture is the crucial element responsible for the particular policy outcomes that have emerged. In the tangled web of transition, there are multiple determinants of policy and our sole purpose here is to suggest the central importance of one that is not presently at the forefront of discussion.

The Culture of Policy Making

This is not the place for an extended discussion of the definition of culture. Academic tomes have been written on precisely this topic: Kroeber and Kluckhorn (1952), for example, were able to find 164 definitions. Nevertheless, one cannot remain content with the notion--to paraphrase Justice Stewart--that although we cannot define culture, we know it when we see it. The following discussion does not provide a precise definition, but does add some background to our use of the term. North (1990) is an important input into the following.44

In the classic definition of Tylor (1871), "[c]ulture...is that complex whole which includes knowledge, belief, art, morals, law, custom, and any other capabilities acquired by man as a member of society."45 Despite its breadth, this definition contains two elements that serve to guide thinking. First, there is the emphasis on activities of the mind. Second, the emphasis on those activities that result from capabilities acquired within a society.

New policies, being a construct of the mental processes of policy makers, will reflect their beliefs, their understandings of socioeconomic processes, and their resultant decision rules. It is possible, however, that these phenomena show little important variation across time and across countries and are therefore not important in explaining policy variation. In this view, it is differences in economic structure and in political institutions, not differences in the mental constructs of policy makers, that cause variations in policy.

Another view of the nature of knowledge leads to emphasis on differences across societies in the understandings of policy makers, differences arising because individuals' formative experiences occur in different societies. This view emphasizes the distinction between technical and personal knowledge. (Oakeshott 1962, Polanyi 1962) Technical knowledge comprises information that can be formulated into rules, which can be deliberately implemented, learned, or conveyed to others. Personal knowledge exists only in use, cannot be

44 We do not suggest that the view of culture presented here is the only one that can underpin the general thesis of this paper. It is intended to be suggestive rather than definitive.

45 As quoted in Singer (1979).
precisely formulated in rules, and is acquired primarily in learning by doing. (Oakeshott 1962, pp. 12-17)

On the assumption that policy making requires personal knowledge—that it is as much a skill as a science—one must stress the fact that this skill is acquired by experience in a particular socio-economic system. Moreover, because the functioning of a socio-economic system depends upon understandings (or perhaps misunderstandings) shared by participants, there will be much idiosyncracy in the stock of knowledge possessed by policy makers in different countries. Hence, with this view of knowledge, it is natural to note the unique aspects of a society's stock of knowledge and the shared nature of this knowledge, as do most definitions of culture.

The features of culture are often stated in more emotive terms, habits or customs, for example, which fit awkwardly in the standard economics lexicon. By invoking two very familiar assumptions, however, the use of these terms becomes innocuous. These assumptions are the enormous complexity of the information germane to policy making and the bounded rationality of individuals.46 Individuals need pragmatic tools to process and use information. Thus, a policy maker's custom might otherwise be viewed as a pragmatic decision-making rule-of-thumb for a complex environment. In turn, it is exactly these rules-of-thumb and the knowledge of rules used by others that is an important part of the personal knowledge of the policy maker. In this light, one can refer to the habits and customs of policy making and still remain within the bounds of well accepted assumptions.

In presenting this view, we emphasize that culture and rationality should not be viewed as opposites. Rather, they are ways of viewing the informational and decision-making processes of policy makers relevant to different domains. For example, the domain of strong rationality assumptions is a world in which individuals either know the underlying structure of the economy or have accumulated sufficient observations to learn that structure. (Lucas 1987, p. 218) In this situation, it is reasonable to emphasize congruity between understanding and structure. In contrast, an emphasis on a lag between changes in knowledge and changes in structure is not out of place when one examines the beginnings of reform from socialism, a time when markets have hardly been observed, when personal experience is of an economy without private property, and when formal education only encountered capitalism as it was portrayed by Marx and Lenin.

In the view offered, the culture of policy making includes such factors as techniques of decision making, subjective probabilities attached to the effects of policy measures, knowledge of particular institutions, concepts of fairness widely shared within society, and perceptions of what are the legitimate goals of governmental policy. Our hypothesis that the culture of policy making is important implies that the past system's influence on such factors has an enormous effect on present policy. Moreover, this effect is

46. It is of course no coincidence that these are central assumptions in Williamson's (1975) analysis of organization, that personal knowledge is important in that analysis, and that the concept of organizational culture is increasingly well recognized.
not one that can be thought of simply as ignorance of the market leading to poor policy making. Rather, we propose that a systematic view of economic processes resulting from the past leads to policy outcomes and that this view is unlikely to have arisen except under the particular socio-economic system that the policy makers have experienced to date.\(^\text{47}\)

We now move on to argue that the inherited culture of policy making was a prime determinant of price policy in Mongolia. Obviously one cannot prove this point; we must rely on qualitative evidence.\(^\text{48}\) The identification of the characteristics of policy described in the previous section is crucial to our argument: our hypothesis—the central importance of the post-socialist culture of policy making—is productive in explaining these characteristics, and no other hypothesis is productive in this way. Hence, the existence of these characteristics is strong evidence in support of our hypothesis.

The simplest piece of evidence that culture—a shared conception within a society—was an important ingredient in price policy is the observation of the sheer number of economic actors who were in ready agreement that price controls were necessary and productive. In fact, it was difficult to identify economic agents in Mongolia opposed to price controls. This was most clearly seen in the positions of political parties. During the elections in June 1992, all major political parties advocated the use of either temporary or permanent economy-wide price controls. Perhaps most indicative of the homogeneity of views was the position of a party at the extremes, the Free Labor Party. This party, holding an almost Proudhonist position and representing entrepreneurs, advocated the absence of any state after the transition but price controls during the transition. This similarity of views across the political spectrum represented a deeper commonality within society on the costs and benefits of price controls and alternative policies—a commonality hardly explicable independent from the economic history of Mongolia.

Even more surprising than the political consensus was the one among the new private-sector interest groups. These groups were also advocates of price controls: the leader of the largest once referred to auction prices as simply black-market prices. In the economic sector that had most to gain from total price decontrol—agriculture—a focus of lobbying was on price controls to assist farmers. Thus, for example, one governmental measure professed that it was increasing and setting agricultural procurement prices to reflect the

\(^{47}\) At the risk of conveying the wrong impression, we might say that the policy-makers have a biased estimate of economic structure. However, this is not to say that they have not used all the information available to them in a productive way. The problem is that they have not been able to observe many of the variables that are relevant to the estimation of the new structure of the economy.

\(^{48}\) At one stage, given the direct observations we had made about the formation of policy, we thought that we could provide more concrete empirical evidence by asking Mongolians for answers to formal policy questions. To provide a basis for comparison, we used a subset of those questions used in Frey et al. (1984). We found no significant differences in the attitudes of Mongolian policy-makers (primarily economists) and the Western economists whose answers were reported by Frey et al. But when such questions were asked less directly, and phrased in a deep contextual way, the answers were radically different from the ones given in response to formal, non-situation-specific questions. Such differences would arise naturally on the hypothesis that there is an important difference between technical and personal knowledge.
wishes of agricultural organizations. At this time, agricultural interests were the most powerful lobby, and a host of alternative measures could have aided them. (When the measure was passed, food exports were banned, foreign trade was controlled by the center to the detriment of the countryside, and the distribution system for raw materials was starving the rural areas of essential inputs.) For example, total price and distribution decontrol would certainly have changed the terms of trade in favor of the agricultural sector. Yet it was price controls that were favored, as would be predicted by a hypothesis that policy in the transition is weighted heavily toward the use of familiar, even if counterproductive, tools.

Given the consensus on controlling prices, the proliferation of controls identified in Section 4 needs little explanation. The consensus implies not only that controls are a favored and familiar policy tool, but also that technocrats do not have to fear professional or political opprobrium when implementing such policies. Indeed, it is the opposite policies—implementation and protection of the free market—that can be expected to draw criticism. This was certainly the case in Mongolia, where price-policy officials were subject to popular and political criticism for price increases, whether or not the increases were under their purview.

The spontaneity of new controls follows on similar grounds. The creation of new measures requires the promise that political opposition will not arise quickly. This is most likely to be the case when there is already a prevailing consensus that the measure is an appropriate instrument of economic policy. Hence, when policy makers at all levels were seeking to respond rapidly to the vast economic problems that were arising, quick agreement on price controls would be much more likely than for other measures that were unfamiliar but likely to be more productive, such as de-monopolizing the distribution system, removing the trade-licensing system, and devaluing the currency, none of which were pursued in Mongolia. This familiarity with the policy tool of price control no doubt goes a long way to explain the spontaneous regeneration of price controls at the local level.

As we have already seen, the proliferation of price controls was accompanied by a multitude of arguments for price control, many of which would be considered to bear dubious logic and lucidity by those familiar with markets. This characteristic of price control becomes fully explicable if one assumes that the willingness to apply the measure is not primarily determined by its functionality in the new system, but rather its place in the old. Under this assumption, an evaluation of the veracity of such arguments for the market system is not an element of the policy process; instead, the arguments are evaluated in a context that derives from the old system. Hence, injunctions "to work toward enabling the state-owned, cooperative, and private industries and private entrepreneurs to sell their products themselves by giving them shops in administrative centers and dwelling places, and to

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50. This lobby precipitated the biggest single defeat in parliament for the government: the cooperative farm organizations wrested control of the agricultural privatization process from the central government.
control prices for goods set by private shops..." are common even in the most formal measures of the central government.

An additional problem apparent to the Western observer in the Mongolian conceptualization of policy is the definition of liberalization, discussed in Section 4. Viewed from the perspective of seven decades of central planning, however, the removal of rigid price regulation by a single state body and the beginning of ad hoc controls of a more flexible nature might be the really big perceptual leap, that which defines the essence of change to the market. In contrast, viewed from a Western perspective, this might be cast as a small move. There is a close analogy here with the framing effect, used to explain certain apparent anomalies in individual choice behavior. These anomalies occur because choice problems are framed in terms of the norms and habits of decision makers, the more so the less transparent is the problem. Thus, it is not surprising that the Mongolians could declare themselves committed to the market economy in the abstract, but make decisions inconsistent with this when difficult choices have to be made in a very cloudy context.

An explanation for the dissonance within policy immediately follows from the foregoing. One might characterize the Mongolian situation as one where technical knowledge—an abstract solution to the problems of the economy, largely imported—diverges from the accumulated personal knowledge of policy makers, which is the knowledge used to frame concrete choices. In the abstract, society was ready to move to a market economy and knew that price controls were inconsistent with such a move. But in order to implement the market economy, officials had to make numerous choices in a disastrous and unintelligible economic environment. As the situation retreated from abstraction and judgments had to be made, shibboleths were numerous.

The two-fold dissonance identified in Section 4 resulted. As measures passed down the hierarchy, the features of the old accreted. Thus, a cabinet resolution entitled "Measures Concerning the Transfer of Commercial Organizations to the Market System," which purportedly aimed at replacing the old distribution system with market instruments, was implemented under a ministerial order entitled "Regulating the Supply and Marketing of Consumer Goods," which set mandatory supply requirements for all types of products. And, as described above, within single measures one often found both an abstract commitment to the market and measures wholly inconsistent with this commitment.

Desire for the Old

The culture argument, loosely speaking, is a hypothesis on the technology of decision making. Instead, one might argue that preferences per se

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52. If anything they underestimated the amount of price control in market economies.

constituted the important determinant, not knowledge. This hypothesis is that price controls were used because the Mongolians wanted an economic system that employed them—it was a desire for the old.

There is little evidence for this hypothesis. There was general agreement that the old system was bankrupt and that the market was preferable. The exemplars the Mongolians typically used evidenced their intentions: China, perestroika, or the reformed versions of Yugoslavia or Hungary never arose as alternatives; Western market economies or the East Asian dragons were the models to be followed. The close of 70 years of Soviet hegemony meant that the failure of the old economic system reverberated with a newly won independence to reinforce the desire for quick-break change. Thus, for example, the initial price liberalization measure was introduced as one that would "leave its traces in the history of Mongolian society." Later resolutions on prices did not deviate from the avowed goal of the market economy in stating their aims: "Aiming at transforming economic relations into a unified market system, widening the application of free prices, strengthening the influence of prices on the production and supply of consumer goods..." Reinforcing this, privatization was placed at the forefront of the government's agenda and pursued with great urgency. Hence, we conclude that: market economy was preferred and therefore that pure preferences cannot explain the characteristics identified in Section 4.

Second-Best Policy

Mongolia was in the n-th best world of reform. The institutions for monetary and financial control were lacking. Enormous economic adjustment was required by the collapse of the Soviet economy and the demise of the CMEA. Perhaps substantial non-market interventions were an element of the best ensemble of policies that could be constructed in these circumstances. For example, in the less desperate context of the last years of the Soviet Union, McKinnon (1990, p.10) suggests that the government used price controls as a second-best method of controlling inflation. One might hypothesize that the Mongolian price policies were the optimal constrained policies.

While there might be an element of truth to this hypothesis, it can hardly make the characteristics of Section 4 explicable. For example, second-best price controls would hardly be generated in a process that modified, and sometimes reversed, central measures. Nor does there be so many overlapping sets of control. Nor would the hypothesis explain the dearth of alternative anti-inflationary policies, such as the freeing up of foreign trade.

There might be one sense, however, in which the price controls were optimal. The culture of policy making might have so limited the set of anti-inflationary policy tools under consideration that price controls were the best in that set. In that case, one has an almost tautological definition of optimal policies and the burden of explanation falls on explaining the limits

on the set of policy tools under consideration. The second-best policy hypothesis then merges with the one on culture.

A Policy-Formation Game

The previous three hypotheses were roughly consistent with a model of policy formation in which there were no significant divergent interests among actors. But the observation of policy dissonance alerts us to the need to consider the effects of different actors competing over policy. We focus first on divergent images of what policy should be like. In the ensuing subsection we examine the effects on policy of the struggle for individual gain.

Governmental authority tends to break down in the reform process. As a result, various levels and agencies of government have much more flexibility than usual to construct their own policies. This allows differences of opinion on the speed and goals of reform to be reflected in policy. Such differences in Mongolia can be simply characterized with reference to two groups of players, the "radicals" and the "conservatives." Both groups were represented within the government and each was vying for political and policy influence, with its own base of support and levers of power.

The radicals were in touch with the broad sentiment for change and were recognized as better understanding the workings of the market economy. They also had the very visible support of important aid donors, a critical factor in the winter of 1991-92 when the capital city faced the possibility of both starvation and the ruin of its heating system. The levers of power of this group were concentrated at the highest levels of the central government.

The conservatives tapped the feelings of the ever increasing numbers of people who felt that the economic problems resulted from the reforms themselves. They had the support of the countryside, where the most viable element of the economy was located. The levers of power of the conservatives were in the old mainline ministries at the center and also in the overwhelming majority of local administrations.

Given the existence of these two groups and the inability of the central administration to ensure consistency in policy, it is easy to see that the resultant policy game could lead to elements of the outcome depicted in Section 4. In particular, a liberalizing policy from above might occur in conjunction with less-liberal implementation and pressures for control at the local level.

While this hypothesis does capture elements of the policy process, it is not sufficient in itself to explain policy outcomes. It certainly cannot explain the dissonance within measures, especially those written by members of the radical group. It does not explain why there were elements of price control in the new institutions (such as the commodity exchanges) that were

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56. As argued above, we do not believe that either of these groups wanted to retain the old system. The issues were ones of strategy and speed, not whether far-reaching changes were needed.
designed for the market economy by policy makers who were sincerely interested in seeing the market economy work. Moreover, many of the features to which we refer in Section 4 occurred in early 1991, when the split between radicals and conservatives was relatively minor and before the rapid deterioration of the economy had created significant pressure to retreat from reforms.

Moreover, the policy-game hypothesis does not explain the relative uniformity of opinion within society on the necessity of price controls. Indeed, one should not characterize the radicals as being opposed to controls, but rather less willing to use them than the conservatives were. This then means that outcomes can be explained by the absence of any group in society willing to push for rapid price decontrol. This is best exhibited by the elements of policy that were implemented in the fall of 1991.

At that time, it became increasingly apparent that reforms were not proceeding as fast as the first pronouncements had predicted. Yet much of the donor aid—necessary to survive the winter—was implicitly conditioned on swift implementation of the reforms. In this situation, the radicals held the trump card: they could have resigned from the government in order to protest the lack of implementation, thereby threatening the all-important aid. But instead they supported the more restrictive policies that the government was implementing. The price liberalization solution to the policy game could have been forced at this time by the radicals, but it was not. Moreover, in parliament the radicals and those representing the agricultural sector—the sector that stood to gain most from liberalization—could have joined together to override the government, but this was never on the agenda.

There were sharp differences on some issues in Mongolian society. But on the matter of price controls, these were small in comparison to the gulf between Mongolian attitudes and those prevailing in market economies. Thus, the game between radicals and conservatives can only explain a small element of the characteristics identified in section 4. Further, this hypothesis relies partially on the cultural assumption, for the conservatives ultimately were not interested in the abstract in retaining the old system. Given this, the culture-of-policy-making hypothesis is still needed to explain why the Mongolians were so willing to chose price controls as an important economic tool.

Rent-Seeking

The last hypothesis that we consider is that policy measures are created by officials out of a concern for their own pecuniary interest. In the context of price controls in the socialist economy, Shleifer and Vishny (1991) have offered the strongest version. They hypothesize that "...underpricing and shortages are the result of the rational choice of the key decision makers, who collect the rents that result from shortages." (p. 4) Since the state treasury keeps the profits of socialist firms, bureaucrats in the

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57. A point verified in interviews by the authors.

58. Their paper examines a wider set of measures than price control.
relevant ministry or managers of firms will have an incentive to keep prices low and collect the bribes that follow from the resultant shortages.

We have no doubt that corruption existed in Mongolia. Sizeable numbers gained from price controls. But this is not to say that the majority of price controls were authored by, or resulted from the lobbying of, those who reaped the gains from the price controls. Our reaction to this rent-seeking hypothesis is similar to the answer that might typically arise to the following question: Do vehicle inspection requirements exist in U.S. states primarily because some repair stations can collect bribes on fake certifications? We would guess that a perceived societal need, rather than corruption, would be the identified cause of such requirements. But even in this case, definitive evidence is difficult to obtain, and this is even more so in the case of price controls in Mongolia.

Several facts stand in contrast to the rent-seeking view. First, consider the proliferation of price-control measures. Although some of these would certainly have been promoted by rent-seekers, it is unlikely that the supporters of so many varied measures were all in a position to gain from them. Second, in the process of interviewing Mongolian officials we established many cases of support, and even authorship, of measures where no personal gain appeared possible. The open admission of ad hoc personal intervention, which we encountered a number of times, is hardly likely from those who profit illegally from such intervention. Similarly, price controls were often placed in formal measures in an open manner. In a country where arbitrary administrative measures were possible, the willingness to formalize measures does not speak to a process driven by corruption.

In many cases, the justification, the timing, and the choice of price controls were consistent with a legitimate public-policy interest, at least in the eyes of policy makers already convinced that controls were productive. The fear of social unrest was tremendous. Hence, the introduction of new measures often coincided with public demonstrations against particular price increases, and price controls tended to center on goods that were bought by the poor. In Ulaan Baatar in 1991, for example, goods whose prices were officially controlled in central government measures were 46 percent of the budget of the average resident and 54 percent of the budget of the poor. From January to August 1991, poor residents saw price rises of 10 percent versus an average 18-percent price rise. Moreover, for goods officially free from central government intervention, the price rise on average was 32 percent, while it was 21 percent for the goods consumed by poorer residents. These goods were exactly the ones affected by the myriad controls of lower-level officials—those price controls most likely to be generated by corruption—yet the effect of the controls was still in line with the stated objective of ameliorating the effects of reforms on the poor.

59. We interviewed a large number of officials and politicians who argued for, and sometimes personally set, price controls. Of course, important information could easily have been held from us and ultimately this is a matter of subjective impression based on these interviews.

60. From data provided by the State Statistical Service of Mongolia, December 1991.
Significantly, the officials who made and implemented price-control measures themselves perceived of these measures as anti-corruption devices. This was particularly evident in the fall of 1991, the defining moment of this first phase of transition, when the government, faced with accelerating inflation, increasing social unrest, and a burgeoning black market, was forced into action. A resolution passed at this time gave wide powers to a "Government Commission Responsible for Stopping Any Activity Targeted at Creating a Shadow Economy and for Taking Measures to Prevent Organized Crimes," aimed at coordinating the fight against corruption. One of the powers given by this resolution was price control: "The profit gained solely as a result of a price increase without using the practical possibility of the economic entity and reducing the volume of production should be completely transferred into the state budget."61 Also at this time, a government study of corruption was set in motion. The government responded to the "very serious shortcomings and violations" exposed in the study by issuing a resolution that required various governmental organizations at both the central and local level "to control prices for goods set by private shops so that these prices do not exceed the average market level."62 Even though officials had thus stated their awareness of and aversion to corruption, in none of our interviews did we encounter anybody who suggested the problem with price controls was that they led to corruption.

The culture-of-policy-making hypothesis goes farther in explaining the characteristics outlined in Section 4 than does the rent-seeking hypothesis. For example, the latter hypothesis would presumably lead to a society deeply split on the matter of price controls rather than the relative homogeneity that we have identified above. Ultimately, however, we do not dismiss the possibility that rent-seeking was an important cause of price controls. Information is naturally hard to obtain on this score. And it was certainly true that some officials made huge gains from these measures. Nevertheless, the sheer proliferation of price controls, the ease with which they were placed on the policy agenda and accepted, and the apparent consensus on their use all speak to the importance of the culture of policy making. This culture was a necessary condition for the work of the rent-seekers; they reap what culture sows.

Postscript

Price policy is relatively transparent. The meaning of a free price and the notion of the liberalization of prices are two of the most conceptually clear elements of the informational set that must be used by reforming governments. There is a remarkable degree of consensus in the West about the need for rapid price decontrol. That price decontrol is a pillar of the policies advocated by the officials of multilateral financial institutions is not in doubt. Yet even in this area of relatively transparent policy, we

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have argued that Mongolian decisions were largely determined by a culture of policy making inherited from the past. The problems we have identified are likely to be much more significant in less transparent areas of transition such as the creation of mechanisms for the protection of property rights, the enforcement of competition laws, and the implementation of regulatory mechanisms for financial institutions.
References


