Pergamon

Communist and Post-Communist Studies 33 (2000) 475–483

Communist and Post-Communist Studies

www.elsevier.com/locate/postcomstud

Ten years of transition: a review article

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Abstract

Ten years after the launching of the transition process, many books and reports are offering a balance sheet of the transformation that occurred in Central and Eastern Europe and in the former Soviet Union area. The review article looks at some of them, particularly at Grzegorz W. Kolodko's book published in 2000, "From Shock to Therapy. The Political Economy of Postsocialist Transformation". On the basis of this book and of some recent contributions, three major issues are discussed. First, why has there been such a recession in the beginning of the transition process in all countries, and was the recession inevitable? Second, due to the dire criticisms of the standard policy applied in these countries, dubbed the "Washington consensus", has a "post-Washington consensus" emerged? Third, as we are already engaged in the second decade of the transition process, can we state when it is bound to be over, and what role is played by the European Union enlargement in accelerating the end of transition?
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Keywords: Central and Eastern Europe; European Union; Former Soviet Union; Recession; Transition; Transformation; Washington consensus

Introduction

In 1999 and 2000 there has been a large amount of conferences on the topic "Ten years of transition", many special issues in journals, as well as books, reports, and innumerable comments in newspapers. Among institutional contributions, one should mention in particular the very comprehensive surveys by the European Bank for Reconstruction and Development (EBRD, 1999) and the United Nations Economic Commission for Europe (UNECE, 2000). The authors involved in evaluating the

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PII: S0967-067X(00)00017-9

transition are academics, advisers to governments, high-level officials of international institutions, sometimes policy-makers, and may belong to two of the above categories (Kornai, 2000 defines himself as an adviser and an academic; Gomulka, 2000 used to be an adviser to the Polish government; Kolodko, 2000 is an academic and has been a policy-maker in Poland in 1994–7 when he was first deputy prime minister and minister of finance).

The purpose of these assessments is not just to take stock, but also to provide explanations for what went wrong in the transition process, to criticize policies and orientations, and to suggest what remains to be done. Ultimately a question is addressed: is transition over? (Brown, 1999), and if not yet, when? "The post-socialist transition will last at least several more years" according to Kolodko (2000, p. 6). A few years ago Stiglitz stated that "Transition economy is still a well-defined category" (Stiglitz, 1997, p. 1).

There is little divergence among the authors about the outcomes of the transition (or transformation) process. Usually countries are divided into two groups. One group of countries in transition consists of the 10 applicants to the European Union, i.e. the Central and East European countries (hereafter the CEECs, including the Baltic countries). Within this group, macro-economic stabilization has been achieved more or less, structural transformation is still incomplete, and growth has resumed. In the other group, one finds the former Soviet Union (FSU) countries (Russia is to be singled out among the other New Independent States), and the Former Yugoslavia countries (less Slovenia, which belongs to the first group, and plus Albania). In this second group, economic issues of the transition have been overridden by the impact of heavy legacies from the communist system (the FSU countries), of the breaking up of strong political links between the countries (both in the FSU and in the former Yugoslavia), of wars, and of the emergence of political regimes largely dominated by corruption. Here stabilization is not yet completed, the prospects for growth remain uncertain, and market institutions do not function. The comprehensive surveys quoted above (especially EBRD, 1999; UNECE, 2000) provide detailed assessments.

However behind this broad agreement on the outcomes there are strong disputes among experts. This review article is largely based on the book by Grzegorz W. Kolodko (Kolodko, 2000), which covers most of the past and present debates on "the political economy of post-socialist transformation" as its subtitle reads. It is not a comprehensive review of the book itself, which 457 pages discuss the whole process of transition (Departure, Detours, The Journey, Arrival, The Future), with a special elaboration of the Polish case. My purpose is to select a few issues that have dominated the debates on transition over the years, and that are extensively referred to in Kolodko's book, and to look at the various approaches of these issues in recent literature.

The first issue is historical but is still very much discussed. How can one explain the "transformational recession" (Kornai, 1993), or "transitional recession" (Kolodko, 2000) that hit more or less severely all the countries in transition, despite the forecasts of the best experts? A second issue, deriving from the first, deals with the policies applied at the outset of the transition. The magnitude and duration of the slump has led to a questioning of what is usually named the "Washington consen-

sus", i.e. the package of measures meant to ensure liberalization, stabilization, structural reform, and ultimately growth, in the post-socialist countries. This package has been under attack, especially since the mid-nineties. Is a post-Washington consensus emerging and would it lead to a sustainable growth? Finally, a third issue has come to the fore in 1999–2000: what is the end of the journey and when can we say that this long process of change is over?

The collapse of output in the beginning of the transition was not expected to such an extent

The issue emerged very soon, in 1992–3 (see Lavigne, 1999, for references and a comment of the discussion). Three answers emerged. According to the first one, the collapse was just an illusion, because the figures for the level reached in the communist times were inflated, and because the post-transition figures did not take the performance of the informal sector enough into account. The second answer was that the collapse in output was the logical outcome of deflationary policies that were required for a successful stabilization. The quicker and the more radical the stabilization, the swifter would be the movement out of recession. The third answer was that the transformation (or transition) process itself created imbalances and lags in adjustment that impaired growth. This third answer is sometimes described as a supply-side approach and "regarded as a neo-classical one, though it may be more accurately described as a lower common denominator among all transition economists" (Popov, 2000, p. 11). Popov points to the systemic disproportions inherited from the centrally planned system, such as high militarization, over-industrialization, under-openness of the economies, and a distorted structure of trade among socialist countries and among the former Soviet Republics. Some authors especially focus on the impact of the dissolution of the CMEA and of the Soviet Union. Others (see Blanchard, 1997) insist on the role of domestic distorsions: the disruption of former planned links among state-owned units, that were not immediately replaced by market-type links, entail a process of "disorganization" leading to the collapse of the production in the state sector. In his "transformational recession" approach, Kornai (1993) combines the impact of demand-induced slump and of supply-side and systemic factors.

Kolodko (2000) gives a very comprehensive answer. The lack of experience of the experts led to implementing standard restrictive fiscal and monetary policies, which in turn triggered an overshooting — in the case of Poland, even an overkilling — of stabilization targets, and hence too much contraction in demand (pp. 86–8). Of course "the healthiest response would have been even stronger export-led growth and additional inflows of foreign direct investment" (p. 91; the stance is repeated p. 94), but as we know such inflows occurred only later when the growth path was resumed, and export-led policies reminded of state interventionism which was precisely to be fought off in the early stages of transition. Kolodko is also very critical of policy mistakes, combining poor diagnoses and wrong economics, as far as structural transformation was concerned, largely due to the fact that the communist

legacies were not understood and not taken in consideration. Because of such a neglect, policies applied were simply borrowed from other experiences (post-war reconstruction in Europe, structural adjustment in developing countries). Kolodko particularly insists on the bad sequencing of policy measures: privatization should have occurred only after de-monopolization and "corporatization" of the state sector, and also after an overhaul of the state sector, some regulation of the capital markets should have been introduced prior to the early liberalization of the capital flows, and sound fiscal reform should have been applied before macroeconomic measures aiming at curbing the budget deficit (p. 99). More significantly, the transitional contraction occurred in a situation when the market was still lacking while the planned system had been overturned, especially in Russia and other post-Soviet republics.

Towards a post-Washington consensus: institutions matter, and they have to be built

Many of the explanations provided for the post-transition slump thus point to the lack of proper market institutions at the outset. The second much debated issue in transitional economics hence refers to this missing element in the "Washington consensus", a term coined by John Williamson to describe the set of policy proposals used by the international financial organizations (IFIs), and especially the IMF, to address structural crises in underdeveloped regions (Kolodko, 2000, p. 119–20, provides a very clear summary of the first Washington consensus and of its subsequent alterations).

The Washington consensus may be seen as the expression of the neo-classical mainstream school, or as the orthodox approach to transition. The challenging of the Washington consensus first came from an "insider" as far as IFIs are concerned: Joseph Stiglitz, the chief economist at the World Bank, who subsequently, in November 1999, left the World Bank and voiced still fiercer critics against the IMF (Stiglitz, 2000). Kolodko opposed the "Consensus" in his practice as a policy-maker in 1994–7, and later in more theoretical terms. "The negligence of institutional arrangements has been a grave miscalculation of the orthodox approach." (Kolodko, 1998, p. 2).

The Washington consensus indeed highlights the importance of stabilization-cum-liberalization measures. Institutions are supposed to emerge spontaneously once central planning is abolished. So as to rebuke the objections from the "unorthodox" camp, the "mainstream" school however attempted to show that it had never neglected institutions-building: "The need for legal reform, the creation of a central bank and effective fiscal system, and other aspects of modern government, were widely recognized from the start of the transition process[...] The outcomes have, nonetheless, differed a great deal, with corruption and governance problems apparently endemic in some countries, and far less prevalent in others" (Fisher and Sahay, 2000, p. 20). The assessment of the reform is currently conducted by the EBRD, which annually publishes a battery of "transition indicators" in its annual Transition Report and is growing concerned with institutions-building: "The evidence now shows

clearly that the central lesson in transition is that markets will not function well without supporting institutions, a state that carries through its basic responsibilities and a healthy civil society" (EBRD, 1999, p. 5).

Kolodko (2000, p. 127 ff.) argues that a "new consensus" has indeed emerged, before being widely acknowledged in "high-level international circles", in Poland in the mid-1990s, through the "multitrack" policy then implemented (when he was in charge of economic policy in 1994–7). One might certainly add that other failures of the Washington consensus, namely the tackling of the East Asian crisis in 1997, and of the Russian crisis in 1998 (cruelly attacked by Stiglitz, 2000) perhaps played a greater role than the outcomes in the transition countries, especially after the growth had resumed in Central Europe.

But then, what is the new role of the state? Once the need for institutions-building is recognized, the role of the state has to be emphasized. But what exactly should the state do? Here we have yet to learn the right lessons. Should the state just establish the right institutions and then let them operate while enforcing the rule of law (introducing commercial, banking, tax, and pension codes)? Or should the state conduct a more active policy? If so, which one? Should it engage in industrial policy? The issue has been much debated in the beginning of the transition, in particular because the very quick liberalization of foreign trade led to an overall lowering of tariffs that left the countries unprotected against the initial shocks from opening up (McKinnon strongly argued for the protection of industry in the first years of transition). Beyond that, how should the governments conduct industrial restructuring? While past over-industrialization has been widely criticized, few solutions have been offered to transition countries apart from closing the "dinosaurs" in iron and steel industries, as if all the lessons from the restructuring of these industries in post-war Europe through a very active involvement of the state have been forgotten.

More recently, when the Asian and Russian financial crises triggered a downturn in economic activity throughout Eastern Europe, new thoughts about the desirability of a counter-cyclical policy emerged. The UNECE, in its last survey, emphasizes this point. "One important policy lesson of this episode is that, being rather susceptible to disturbances and vulnerable to external shocks, the transition economies need a more carefully designed set of counter-cyclical policy measures than seem to exist at present." (UNECE, 2000, p. 47). Should neo-keynesian policies be applied? Such recommendations would certainly still more increase the gap between the neo-classical school and their opponents.

Kolodko (2000) is advocating an industrial policy so as to shift back "the economy to the path of growth" (p. 114) in particular in the countries where growth has failed to resume. He also quotes the Polish experience 1994–7 as a "redefined role of the state" (p. 152) which was not easily accepted initially. He again insists on the role of the state in steering the growth process, through a new type of partnership between government and private sector (p. 257), implying not just de-regulation but, using Stiglitz's wording, "re-regulation". Ultimately, "the only really "good" government is a capable government which can ensure robust economic growth and a fair distribution of the result" (p. 267). But Kolodko admits that such a goal has not been attained in postsocialist economies, because governments were eager to cut state

expenditures, on the basis of "the half-baked advice according to which the sooner government becomes small, the sooner the market economy can begin to rise and expand" (p. 268).

Where do we stand now as far as the "Washington consensus" is concerned? It seems that the "mainstream" school has again the cards in hand. Joseph Stiglitz has had to leave the World Bank and is the target of strong critics (Dabrowski et al., 2000), largely based on the fact that he entered the transitology field without knowing much about the relevant countries (but then, this is a feature shared by many advisers, as Kolodko aptly points in his book). Also, his "Comprehensive Development Framework" outlined in his proposal (Stiglitz, 1999) remains fuzzy and seems more inspired by the post-Soviet experience than by the Central European context. The main card in the hands of the orthodox school is indeed the fact that growth has resumed in Central and Eastern Europe (except in Romania, but it is easy to point out that this is a special case of Balkan-type bad politics and foul economic management). Thus the major tenets of the "classical" Washington consensus re-emerge unchallenged:

"Shock therapy" was the right policy

Wherever it has been consistently applied (be it late like in Hungary) outcomes were positive. Broadly speaking, the CEECs exemplify the success of shock therapy, and the FSU countries, especially Russia, the consequences of inconsistent policies. "It has paid to start early and to move fast" (Wyplosz, 1999, p. 28). "The success of transition depends above all on the rapid creation of conditions — institutional, legal, microeconomic and macroeconomic — which are conducive to the development and growth of a new private sector, domestic and/or foreign." (Gomulka, 2000, p. 22). Thus initial "shock therapy" looks justified not only because the countries where it was applied did better than others (in this light the Czech crisis of 1997 might have looked as an embarrassment, but for the mainstream school it did not challenge the rightness of the stabilization-cum-liberalization strategies but was due to wrong structural transformation policies). Not only has shock therapy proved efficient, but looking back at the 90s, the mainstream economists defuse the debate on Big Bang and gradualism. "Rapid policy action was possible in some areas of reform — price and trade liberalization, and inflation stabilization, and perhaps small-scale privatization — but in others it was clear that reform would take a long time." (Fisher and Sahay, 2000, p. 11). Actually "gradualism" has almost dropped out of the vocabulary of transition. The mainstream school speaks of "sequencing", while their opponents talk about "incrementalism" (Stiglitz, 1999, p. 21). And even the tenants of "incrementalism" agree that quick action proved right in some areas of transition: "I have no great quarrel with "shock therapy" as a measure to quickly reset expectations say in an anti-inflation program." (Stiglitz, 2000, p. 21).

Quick and extensive liberalization helped recovery in growth

The relation between liberalization and growth has been strongly emphasized in the Word Bank World Development Report (1996) which may be considered as the

reference book on the first five years of transition. At that time, this claim looked as an article of faith, as few countries were beginning to recover. At the turn of the century, it is difficult to challenge the fact that liberalization was necessary and useful. The opponents are left with the argument that in some (many) cases liberalization occurred too soon, and was carried with too little protection. True, but isn't is history now?

Curbing inflation has facilitated recovery

The link between disinflation and growth has been forcefully stressed. "Real GDP rebounds following inflation stabilization" (Fisher et al., 1997, p. 89). "stabilize first, grow next" (Wyplosz, 1999, p. 28). But then the question arises: is there a threshold of inflation beyond which growth would be affected? According to Gomulka (2000, p. 22), "the inflation rate need not, and initially should not, be very low, but it must not be high (not more than 40 percent), and it should be converging to the EU level". In fact the CEECs that have applied to the EU indeed seek inflation rates closest to the EU convergence level (presently three percent), and 1999 data show that in most of these countries, one-digit rates have been achieved along with recovery.

Thus the Washington consensus is alive and well, with some cosmetic changes. And the discussion itself seems largely irrelevant, as one issue is now dominating the scene: the end of transition is increasingly associated with the accession of transition countries to the European Union (EU).

EU accession as the end of the transition process

When is transition over? This was a question asked from several economists during a cycle of lectures organized at the Western Michigan University (Brown, 1999). A variety of answers were given. Andras Aslund, starting from the Russian case, argued that transition will be over there when rent-seeking behavior will come to an end, which was already almost the case in this country (Aslund in Brown, p. 66). Examining the Hungarian case, Kornai stated that while transformation was not yet over, transition certainly was: "the system is now a capitalist one" (p. 100). What was missing for transformation to be complete was a set of institutions, among which he singled out a modern welfare system. In a similar way and dealing with Central European countries, Svejnar considered that these countries now had functioning marker economies (p. 90) while still having much to do to improve market efficiency and to ensure growth. Alan Gelb, who edited the World Bank Development Report 1996 on transition from plan to market, gives the same answer: "transition is over when the problems and the policy issues confronted by today's "transition countries" resemble those faced by other countries at similar levels of development" (p. 39).

The question seems thus quite ambiguous. Starting from the same data, one may or may not conclude to the end of transition, and include different countries in the list of countries having successfully achieved it. The set of indicators devised by the EBRD to assess the progress in transition and published each year in its Transition

Report does not allow one to state that transition is over in a given country, as none of the transition countries reach the highest mark (+4) for all the indicators, and probably will never do; it just allows one to say that some countries or groups of countries are closer to the end than others.

Kolodko (2000 p. 353; also see p. 346) remarks that "the transition is a generation-long process of change". He rightly states that there is a great fuzziness of concepts: are we talking of systemic transition, transformation, market reform? According to him the most important issue is the relation between transition and development, the latter relying on market forces and guided by a wise government policy. He quite aptly compares the emerging markets (which are considered as market economies but have many features in common with transition economies) and asks "how long does it take to "emerge""? (p. 346). Formally, he says, "from a formal viewpoint membership in the OECD and in the EU should be considered a seal of approval that the transition process has been completed" (ibid.), but he immediately adds that in practice new EU (or OECD) members will still have much to do to complete their transformation.

Personally I would take issue with this statement. Not that I disagree with the assumption that once Central and Eastern European countries are admitted into the EU they certainly will have to work on their institutions and policies during a new "transition period", such as Portugal and Spain experienced for example after 1986. But should not we be able to put an end to the process, albeit formally? The applicants to the EU are currently incorporating the so-called acquis communautaire into their laws and regulations. This procedure conforms neither to the "Washington consensus" pattern (as here market institutions and rules are enforced by an authority upon the applicants, and are not left to emerge by themselves), nor to any "post-Washington consensus" scheme (national governments are not free to build market institutions according to the specifics of each country). But then what about the countries that are not yet engaged in this process, or are not considered as possible applicants? For the time being, these countries (in the Balkan area or in the Commonwealth of Independent States) are indeed largely lagging behind both in the transformation process, and on the path to sustainable growth. And for those among them which will sooner or later associated with the EU (the Balkan countries, perhaps one day the most Western CIS republics) the "EU effect" will no doubt accelerate systemic change.

We shall leave the last word to Kolodko: there is no happy ending "because there is no end in challenges" as far as sustained growth, integration into the global economy, and the construction of a civil society are concerned (p. 355). One cannot but agree, with the reservation that these challenges affect most of the developing and even the developed world; it is not just a question of transition.

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