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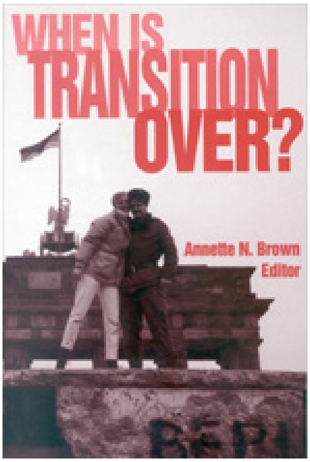
Introduction



Annette N. Brown
Western Michigan University

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Introduction

Annette N. Brown
Western Michigan University

The countries that are changing from communist to postcommunist societies[1] are undergoing a process that has been and continues to be difficult, tumultuous, and often painful for their citizens. In a few short years, people in these countries have lived through more social, political, and economic change than those in more developed, Western economies will see in a lifetime. Both for those living through this process and for those who study and analyze it, there is a recurring question: When is this transition over?

During the 1997–1998 academic year, six distinguished economics scholars—Marie Lavigne, Alan Gelb, Anders Åslund, Nicholas Lardy, Jan Švejnar, and János Kornai—visited Western Michigan University and offered their answers to this question. This book presents their lectures. Their answers are in some ways very different and in others very similar, but always interesting and insightful. In this introduction, I will introduce the speakers, their lectures, and their answers.

THE SPEAKERS

As Marie Lavigne correctly points out in her lecture, the determination of when transition is over will clearly be shaped by the biases of those who are judging, and so it is important to know who those judges are.[2] The participating speakers vary along several meaningful axes. First, they come from different nations: Western and non-Western, transition and nontransition. Lavigne and Åslund are French and Swedish, respectively, giving them a Western European, and possibly even a European Union (EU), perspective. Švejnar and Kornai both grew up under communism in Central Europe, Švejnar in Czechoslovakia and Kornai in Hungary. However, the courses of their adult lives have differed. Švejnar left Czechoslovakia as a young adult and has spent his professional years in the United States as a U.S. citizen, while Kornai struggled for many years as an independent-minded economist in Hungary. In fact, because of his views, Kornai was not allowed to teach in communist Hungary. In a way, their paths have now converged, as both currently split their time between the United States and their home countries, actively contributing to the academy in both. Gelb, as a South African, provides us with a truly outsider's perspective, and Lardy is an American.

Another axis along which the speakers differ is the role they play in the transition process. Lavigne, Lardy, and Kornai are primarily academics, offering their ideas and suggestions principally through the channels of teaching, speaking, and especially writing. Their work then serves as a foundation for policy discussion and initiatives. Gelb, as a World Bank official, has a more direct role. His work requires him not only to study economies but also to recommend specific policies for underpinning the conditions of World Bank loans. He served as the World Bank's Chief Research Economist for transition economies for several years, culminating in his role as Staff Director for the *World Development Report,* devoted exclusively to the issues of transition. Åslund and Švejnar, although both academics, play the most direct roles, as they serve as advisors to transition governments. Åslund was an economic advisor to the Russian government from 1991 to 1994 and currently advises the Ukrainian government. Švejnar was one of the chief architects of the Czech Republic's economic reforms, and he continues to serve as an advisor to Czech President Václav Havel.

A final axis along which the speakers differ is the length of time they have studied communist and postcommunist countries, and thus the breadth of their focus. Lavigne and Kornai have been examining these economies for decades, making them experts not only on economic transition but also on the Soviet-type economies that preceded transition. They have researched and analyzed in detail what we now call "initial conditions." Gelb, Åslund, and Švejnar started their paths to transition economics more recently. In the 1980s, both Gelb and Švejnar wrote about labor management; Åslund wrote his dissertation in the early 1980s about Poland and the former East Germany. Starting in 1989, all three focused sharply on transition. Gelb, during his tenure at the World Bank, has visited, researched, and advised innumerable countries all over the world—in Africa, Asia, Europe, and Central and South America. His points of comparison are not just "East and West," but all points on the globe and many types of economies. Lardy, who concentrates on Chinese reforms, has studied China since the 1970s.

Considered together, these three axes form an "experience space" in which each scholar occupies a distinct point. I leave it to the reader to determine whether and in what ways these experiences affect the views presented in their lectures.

THE LECTURES

The lectures are presented in chronological order, a sequence that also turns out to work well expositionally. Lavigne provides an effective overview of what transition entails, making her analysis an appropriate point of departure, especially for readers less familiar with transition. Gelb goes on to discuss in more detail what has actually occurred during transition and why it occurred that way. Åslund then narrows the focus, emphasizing one of transition's most serious problems, rent-seeking, and its solution. Lardy focuses specifically on China, arguing that the gradualist reforms implemented there are unsustainable. Švejnar picks up the question raised earlier by Lavigne: What is still missing? He presents an extensive list of the transition tasks ahead. Kornai completes the collection by moving beyond transition and discussing what he considers to be post-transition policy.

Lavigne begins by outlining the many legacies of the past and explaining how they negatively affect the transition process. She argues that one significant legacy is the large set of specific social values, which, crediting Kornai, she calls "paternalism"; this legacy means that changes in very basic attitudes are needed before people behave as proper economic "agents." She then describes the basic elements of the transition package, discusses generally how these elements have been implemented, and compares the outcomes. In short, liberalization has been fast (in most cases); stabilization is still fragile; and structural transformation has been slow. Unlike the other authors, she also assesses the outcomes using the Human Development Index, which so far shows improvement only in a few countries. Lavigne lists several barriers to achieving standard market economies and then discusses more specifically the obstacles that the candidate countries face in achieving EU membership. In terms of barriers, she again stresses the problem of attitudes and emphasizes the need to build strong civil societies. For EU membership, the obstacles arise from poorly defined membership conditions that are in some cases stricter than those for current members.

Gelb starts his lecture by elaborating a point that general economic analysis often forgets or ignores, but that the process of economic transition brings to the fore: “Like automobiles, market economies come in many different models.” Gelb goes on to make several interesting and compelling arguments. To be successful, reform policies need to be broad-based, as they are highly interdependent, and they need to be sustained, as the cumulative exposure to reforms is more important than the immediate situation in determining the outcomes. Three different forces drive reforms, which naturally lead to differences in the pace and phasing in of change across countries. There are many, if not too many, explanations for transition outcomes. Gelb asks and answers the fascinating question, “Could an alternative policy have worked in Central and Eastern Europe and the former Soviet Union?” In his conclusion, he raises an even more important question, “What kinds of economies and societies will the transition countries turn out to be?” He identifies, in particular, the increasingly unequal distribution of property and income as a major challenge for the future.

Where Gelb gives many explanations for the differences in outcomes among countries, Åslund focuses on one: rent-seeking. He draws a clear line between rent-seeking (which he defines as the extraction of monetary benefits from the government) and inflation and between inflation and gross domestic product performance. He then identifies the various types of rent-seeking and who has benefited the most from this behavior. In explaining why rent-seeking was so much larger in the former Soviet Union than in East-Central Europe, Åslund explores the political-philosophical legacies of the communist system, including the strength of the old communist elite (Nomenklatura); the weaknesses of the postcommunist state, democracy, and civil society; the quality and independence of the media; and the people’s understanding of and attitudes toward the market. There were also economic legacies influencing rent-seeking: kleptocracy, perverse relative prices, deep financial crises, and natural resource endowments. Åslund then argues that rent-seeking has been significantly reduced in most of these countries of the former Soviet Union and emphasizes that privatization has served to diminish rather than to increase rent-seeking.

Lardy's lecture is distinct from the others in that it focuses on one country and that the country in question, China, has followed a very different—gradualist—reform path, starting in the 1970s. Lardy compares China's reforms to those of Eastern Europe and the former Soviet Union and argues that in spite of China's superior economic performance, its reforms are unsustainable. Three issues raise particular concern: enterprise performance and debt, nonperforming bank loans, and declining tax revenues. In the second part of the lecture, Lardy examines the necessary reform of China's banking sector in more detail. It would be extremely difficult for China to default on household liabilities as Russia did, because the volume of household savings is tremendous. It would also be infeasible for China to gradually recapitalize banks through reinvestment of profits as Hungary did, because the necessary recapitalization is too great. Instead, Lardy recommends that China recapitalize by injecting government bonds into these banks.

Švejnar, in the first half of his lecture, describes the "Central European model" of transition and compares and contrasts it with two other models, the "Asian model" and the "Russian and NIS model."[3] He identifies several key areas where the transition outcomes have been systematic, or similar, across the Central European countries, chief among them being that all of these countries now have functioning market economies. More interesting, perhaps, are the distinctive results that he identifies among these countries, which so often are considered as a group. Privatization has proceeded unevenly; labor force adjustment has differed significantly; and various exchange rate policies have resulted in diverse foreign trade performances. The second half of the lecture focuses on the challenges ahead for Central Europe. Although other speakers visit this theme, Švejnar provides the most detail, giving what Lavigne might call a full prescription for finishing transition in Central Europe. The foremost challenge, Švejnar argues, is to generate and sustain high rates of growth. The building blocks for this growth include such strategies as high rates of efficiently placed investment, human capital development, and establishing effective corporate governance.

Kornai sets out to discuss transformation rather than transition, where transformation comprises the processes following transition that improve the functioning of a capitalist system. An important part of transformation, not just in formerly communist countries but also in some Western countries, is the reform of the welfare state. Kornai begins his discussion of these reforms by stating explicitly the ethical principles underlying his analysis: respect for individual sovereignty, moral obligation to solidarity, and commitment to democracy and the transparency of public decision-making processes. The initial conditions in any transforming economy determine which of these principles might be problematic. Kornai argues that there is a clear need for health care reform in Hungary. Hungarians are currently demanding improvements in the quality of their health care system without understanding who pays for this service. He offers several concrete suggestions as to how the provision of health care can be changed in line with his underlying ethical principles.

The lectures share several threads. All of the speakers, even Kornai implicitly, divide the transition economies into three groups: Central and Eastern Europe (CEE), where Central Europe (Poland, the Czech Republic, Slovakia, and Hungary) receives more attention than Eastern Europe; the former Soviet Union, where Russia and Ukraine are emphasized and the Baltics are often considered to be exceptions; and China and Vietnam, which, if for no other reason, are different because they are still communist. All of the speakers account for the initial conditions, or legacies, in their analysis. In particular, they all mention the need to change people's attitudes towards and understanding of capitalism and market economies. Related to these changes at the individual level, most also mention the necessity to develop strong civil societies, in which institutions support both capitalism and democracy. The speakers generally consider transition in two stages: the first primarily involves liberalization and stabilization, and the second encompasses a myriad of structural reforms. They roughly agree that the first stage is complete in many of the countries, but that progress and success in the second stage have been quite mixed. Finally, most emphasize the concept of transparency as an important goal in a variety of contexts. The lectures also differ in many ways, and perhaps the most interesting divergence lies in the answers that are presented.

THE ANSWERS

When is transition over? Lavigne responds directly, "I think the question is unanswerable." Indirectly, however, she offers another reply: transition is over for the CEE countries when they become members of the EU. This answer is important to consider because it is obvious to many people in Europe, but Lavigne deems it unworkable because the EU conditions are vague and unequally applied. Although she does not offer her own criteria for the end of transition, Lavigne does conclude that it is not over yet. Gelb answers the question straightaway: "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." He further states that no matter how this definition is operationalized, the "transition countries are not there yet."

Åslund measures the end of transition according to the reduction of rent-seeking, which reflects a variety of institutional reforms. According to his standard, Åslund concludes that transition is over in all but a few countries. Lardy argues that transition in China will not be complete until three sectors are aggressively reformed: state-owned enterprises, the financial sector, and government service provision. Švejnar presents two conditions for transition to be over: central planning is abolished, and an efficiently functioning market system takes its place. According to these conditions, he concludes that transition is not over in any of the considered economies. Kornai answers with the most precision. Transition is over when three, and only three, criteria are met: the communist party no longer has monopoly power; the dominant part of the means of production is privately owned; and the market is the dominant coordinator of economic activities. Using these criteria, he concludes that transition in Hungary is over, and probably would conclude that it is over in several other countries as well.

We can group these answers into three categories. Kornai's answer is systemic; that is, he looks at changes in the features of the economic systems to judge when transition is over. He makes clear that the new system, the endpoint of transition, is a market economy as defined by his specific criteria. Gelb's answer also contains a strong systemic component but is more obscure than Kornai's. Gelb defends this obscurity by arguing that models of market economies vary greatly. Each transition economy will have its own terminus of transition, which may or may not resemble a Western market economy. Therefore, the indication seems to be when the economy resembles some kind of market system rather than still being distinguished by its communist legacy. In spite of a similarity in their criteria, Kornai and Gelb reach very different conclusions. Kornai believes that transition is over, at least in some countries, while Gelb says none of the countries has reached this stage.

In the second category, the answers are based on outcomes. Lavigne considers and then discards the criterion that countries gain EU membership. While such a result is certainly dependent on systemic changes, the suggested criterion itself examines just the outcomes. Švejnar also proposes a results-based answer: the end of transition is the state of an advanced market economy. Again, a systemic component is involved, especially in the first condition of eliminating central planning, but the ultimate condition is based on outcomes. Švejnar defines efficient functioning to include achieving rapid and sustainable rates of growth and becoming compatible with advanced market economies. In short, these answers suggest that transition is over not just when economies operate differently, but also when they operate successfully. As a result, although Švejnar and Kornai clearly agree that the countries of Central Europe are market economies, Švejnar says they have at least 10 years to go, while Kornai says transition is over.

Åslund's and Lardy's answers, which I will call "institutional," fall somewhere in the middle. Although the rent-seeking that Åslund examines arises from the systemic changes, clearly the new market system is considered to be part of his endpoint. For example, the liberalizations of domestic prices and trade represent two measures toward eliminating rent-seeking that are also part of the systemic change. However, Åslund's endpoint encompasses more. Policies to abolish rent-seeking include the liberalization of foreign trade, the unification of the exchange rate, and the elimination of interest subsidies. He also indicates that a strong central bank is important. With these latter conditions, Åslund includes elements of institutional, or structural, change in his criteria for the end of transition.

Like Åslund, Lardy identifies specific institutional reforms, beyond the systemic changes, that are required for the completion of transition in China. State-owned enterprises need to be restructured so that they are forced to be profitable and desist from accumulating large bank debts. The financial sector, the emphasis of the lecture, needs to be recapitalized and reformed so that banks operate as effective financial intermediaries. The government needs to change its operation as well. It needs to collect more tax revenues and increase its role as a provider of social services so that the enterprises can focus on their primary production. These criteria are clearly institutional, especially since Lardy avoids calling for the privatization of state-owned enterprises, which would be a more systemic change.

Gelb also highlights institutional determinants. For example, he suggests that, even with private ownership (a systemic feature), the Czech voucher funds (an institutional element) will make the Czech economy distinctive, and thus in transition, for some time to come. He concludes that, in practice, the core systemic changes and the combination of institutional changes go hand-in-hand in moving an economy toward its transition endpoint. Compared with Åslund's and Lardy's approaches, however, Gelb's is again more obscure. Where for Åslund rent-seeking identifies a fairly specific set of necessary institutions, Gelb allows that the combinations will vary according to different levels of development.

In sum, the answers are very different, and the old maxim that economists never agree seems to hold true. The question is academic, however, and more important than the proclamation about whether or not transition is over is the analysis of the problems these countries still face and the recommendations for what can and should be done to address them. Along these lines, the speakers tend to agree.

POSTSCRIPT

In more than a year of organizing and implementing this lecture series, and during many discussions with the participating scholars, with my students in the accompanying courses, and with my colleagues in the field, I have often pondered the end-of-transition question. As Kornai says, each of us who works on transition has his or her own criteria, and I offer mine as an additional point of comparison.

Transition is over when the organization of production reaches a long-run, market equilibrium. Gelb actually provides examples for this criterion when he argues that transition will not be over in countries such as Romania and Armenia, which privatized agricultural land into very small parcels, until market forces bring about the consolidation of land into commercial farms; similarly, transition will not be over in Russia until landholding shifts away from large joint-stock company farms. In general, there are many features of these countries' productive structures that are inherited from the communist period, such as too much military production and not enough consumer goods production, or that are created by the transition process, as in the small privatized landholdings in Romania and Armenia, that are not in long-run equilibrium in the market economy. While these features continue to exist, the economies are, by definition really, still in transition.

Clearly, the productive structure of any market economy is constantly evolving, and these changes on the margin are vital for the continued success of the system. I do not mean to say that transition is over when the organization of production stops changing. But rather, transition is over when productive structure has been transformed from its inherited organization to a structure that continues to change only slowly with the evolution of the economy. For example, when the processes of entry, exit, expansion, and contraction act to completely reshape industries, the economy is still in transition. When these processes settle such that they only change overall industry structure during a long period of time, then transition is over. Like Gelb's, my endpoints are obscure, because we do not know *a priori* what the long-run equilibria will resemble. We do not even know whether for any given country there is one, or more than one, possible equilibrium. Thus, this answer, like many answers to academic questions, leads to more questions.

NOTES

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1. In a few cases, such as China, these may be countries that are simply moving to more market-oriented economies.
2. Short biographies are presented at the end of this book.
3. NIS = Newly Independent States (of the former Soviet Union).

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Annette N. Brown
Editor

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W.E. Upjohn Institute for Employment Research
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