TIGER

TRANSFORMATION, INTEGRATION and GLOBALIZATION ECONOMIC RESEARCH
CENTRUM BADAWCZE TRANSFORMACJI, INTEGRACJI I GLOBALIZACJI

TIGER Working Paper Series

No. 33

Transition and Development

László Csaba

Warsaw, November 2002

Professor of Economics and European Studies at the Central European University, Budapest, Universitas Debrecen and the Budapest University of Economics and Public Administration, Hungary. E-mail: csabal@ceu.hu, web site: www.ceu.hu.

László Csaba

Transition and Development

Summary

In the early stages of transformation an ideological view of reverting command economy has dominated public discourse and academic exchanges alike. Since abolition of distortions was not followed by immediate growth, but a systemic vacuum, transformational recession followed. When understanding of the substance of proper policies and institutions improved, it turned out that many problems, primarily of creating conditions for sustainable growth, are similar or comparable to those in developing countries.

The evolving post-Washington consensus may offer an appropriate single analytical framework to assess both successes and failures, as well as longer term growth potentials of the postcommunist countries.

Thirteen years have elapsed since the conclusion of the round table talks in Poland in April 1989, which marked the onset of systemic transformations in Central and Eastern Europe. The peoples of the region have been given a chance to overcome the blind alley of the Soviet model and return to the mainstream of human development. This span of time is long enough to allow for some theoretical generalizations. In the present study we analyze the present state of "transitology", at a time when the frontrunners of change are likely to join the European Union by 2004, thus establishing their position as fully-fledged market economies of the European brand. This is a decisive factor in the formation of their economic and political order, allowing them to avoid that particular variant of "east European capitalism" which has evolved in the countries that do not stand a chance of EU accession in the near future and thus miss an anchor for their strategic decisions in the spheres of policy and economy.

In answering the question of "what has been left" or alternatively, "what we have learned" we adopt the following approach. First we survey some salient findings of transitology proper. Then we attempt to put these in the context of new development economics (Todaro, 2000; Meier and Stiglitz, eds., 2001), interpreting the ups and downs of poor countries within the context of general economics. Then we compare the remaining institutional reforms in the region with the ongoing structural reforms of the welfare states in Western Europe. Finally, we search for a basis of collective choices that would enable the EU to enlarge eastward in a way that amounts to more than a minimalist alibi exercise. Our focus is thus on the overall landscape and theoretical novelties, while detailed substantiation of some of the points is left to the references.

1. From ideology to sustainable development

According to conventional wisdom in economics, and also in the predominant view in historiography, the collapse of the Soviet Empire was built into the system and inevitable. Still its speed and timing, as well as its very occurrence remained a surprise to the overwhelming majority of analysts. The situation is best reflected in the fact that the G7 meeting of Houston, convening in December 1990, entrusted the tasks of analyzing and assisting the Soviet economy to institutions whose only common denominator was that the Red superpower was no member to any of them. The joint effort of these (IMF, OECD, IBRD, 1991) – and the parallel endeavors of the European Communities (EU, 1990) – produced weighty volumes; however, by the time of their publication, the object of research – the Soviet Union – had ceased to exist.

Even in more academic analyses the confusion was considerable. Sovietologists, on the one hand, tended to be versed in the languages and customs of the region, not so much, however, in standard economics and its applications. Likewise, academic – and especially macroeconomic – departments had little idea, if any, about command economy in general and the societal context of Central and Eastern Europe in particular.

This applied, basically, also to the international agencies, as their – limited – experience with Hungary and Romania was of little assistance in managing the problems of a disintegrating Soviet empire or a collapsing communist economy in Poland. As a contemporary survey (Murrel, 1995) neatly proves, the lack of knowledge of the specific post-communist context tended to be "remedied" by reliance on shallow analogies to the experience of international financial institutions (IFIs) in developing countries, or a direct application of textbook solutions, without much care about the institutional or historic context into which these insights were to be transposed.

At the level of policy advice, reliance of simplistic adaptations of otherwise elaborate policy conceptions proved even more widespread. Ideological leanings, experimenting spirit and mechanistic application of what the current wisdom on poor countries suggested were combined to produce quick fixes.

Uncritical reliance on standard, pre-cooked solutions, coupled with ideological postulates stressing speed over quality, and instrumentalizing the concept of spontaneous institution emergence for trivial political ends, often swept away any attempt at analyzing local conditions on their own right. This led – as Stiglitz (2000, pp. 552–7) retrospectively illustrates – to a neglect of those *contextual circumstances* which decide about the success or failure of the application of a proven theoretical insight to policy-making. Thus the quest for speed and the resultant policy improvisation (lacking a systemic coherence) has often brought about partial reforms yielding paradoxical outcomes, with unintended side-effects dominating over desired and planned objectives.

Correct theories translated into haphazard policy implementation thus produced perverse outcomes in a number of cases. Suffice it to mention some of the better known cases: in Hungary, public utilities were privatized with a stroke of a pen in late 1995, without, however, their prior regulation. Thus public monopolies were simply transformed into private (or, in some cases, foreign public) monopolies. With "real owners" established, the chances of further liberalization and deregulation (called for by the EU process) are slim, and low efficiency has been built into the system for many years. The introduction of voucher privatization in Russia in 1992–4, at the height of hyperinflation, could not stand a chance of testing the Coase theorem, nor could it build a reform constituency. Similarly, introducing a fully funded private pension system in Kazakhstan in 1999 – while the capital market was lacking – can hardly bring about those benefits on which the general arguments for pension privatization are based.

On the other hand, it would be wrong to ignore the fact that local economists – of a great variety of persuasions – have been, as a rule, poorly equipped to deal with the theoretical and policy challenges of transformation. The contemporary vogue – reform economics – functioned within a self-constraining framework of market socialism, which never addressed questions related to a real market order (like capital market regulation, banking crises, credit crunches or the conflicting demands of exchange rate policy). Its positive message – over and above the critical account of the *status quo ante* – has evaporated in the face of the in-between solutions and ersatz-solutions left behind by the political drive toward real markets and real democracy.

Even in Hungary, where by the mid-1980s economics had long overcome any form of socialism and focused on such issues as capital market, private property and opening up the economy (cf. Kornai, 1990; Kornai, 2000; Csaba, 2002b), these insights had only inadequate influence on policy decisions and institutional options. Until late 1989, the state administration held more radical transformation projects to be politically infeasible. Later, the daily struggle for retaining the solvency of the country dominated any broader considerations, at least until 1992. The former opposition (post-transition ruling parties), stepping in the footprint of the 1956 revolution, called for a third road, based on self-management solutions, with private property and competition playing a subordinate role at best (Laki, 1991; Lányi, 1996). As the two analyses quoted above show in detail, the program of democratic parties was populist rather than pro-market, on occasion going back on the radicalism of the projects adopted by the outgoing socialist administration.

These critical and self-critical remarks do not imply that the entire economic profession were unable to interpret and solve real-world puzzles. Already the earliest analyses (Blommestein, Marrese and Zecchini, 1990) highlighted the focal role of *stabilization* and large-scale *privatization*.[1] In calling for trade reform and *outward* looking policies, including currency convertibility, local analysts joined forces with the leading authorities of the time and elaborated common propositions in line with the mainstream of the day (Köves and Marer, eds., 1991). Consulting has been involved, with a fair degree of overzealousness, making these activities a favorite topic of local humor. But jokes apart, international agencies, private actors, governments, and – predominantly – *the EC/EU played a formative role in the transformation process*, through PHARE, the Europe Agreements and the resultant harmonization of legal systems to the acquis communautaire. The EC has never shied away from an independent role; its policy advice represented a special line in providing guidance for new democracies (Portes, ed., 1991). The latter – despite the latter-day legend of colonialism – had been, from the very outset, a *co-operative endeavor*: local experts were involved, their output was published – although policy advice was furnished by the incumbent apparatus.

In hindsight, the early transitological literature can be divided into two major categories. The *policy oriented* category tended to be dominated by issues that later proved irrelevant or misleading. These included the debate over shock therapy versus gradualism, the theories of how to escape stagnation, how to increase the numbers of domestic owners, how to create capitalism without large capitalists, restitution and reprivatization, and, finally, the search for the optimal technology of privatization. In the more *theoretical category*, an attempt was made to apply the western economic theories currently in vogue. These included an early version of the political economy approach, portraying the building of *reform coalitions* and providing compensation for losers as the major feasibility conditions of successful change (Roland, 1991). Others highlighted the relevance of *fiscal federalism* for finding new equilibria in Russia (Schneider, 1993), and also highlighted the role of *corporate governance* as the link between ownership change and efficiency gains (Dallago, 1994).

Analysts from transition countries tended to see privatization as an exclusively or predominantly political issue of power redistribution. Their major aim was to break the backbone of the old guard an create stakeholders in the new arrangements (Chubais and Vishnevskaia, 1995). From this angle, classical economic and business considerations and the related success indicators, such as the number of successful corporate *turnarounds*, or the share of companies with improved performance in total output, are by definition *secondary* at best. If the considerations inherent in economic analysis – such as wealth creation, welfare improvement, growing efficiency, better combination of factors – are openly de-emphasized, the resultant absence of these is hardly a surprise (and even less of a proof of the inefficiency of economic theories).

Anybody familiar with the dismal performance of economic reforms of the socialist period, doomed by recurrent recentralization waves, would subscribe, even in hindsight, to the need for radical solutions in order to attain the point of no return. The more we conceive the Soviet empire as a rent-seeking society, with large numbers of conceived or real beneficiaries having no clue about the real cost of their welfare (and not interested in securing its sustainability with their own effort), the more we may condone revolutionary options. However, already early analysts, sympathetic to this point of view (Malle, 1994/2001) have underscored the fact that both the economic efficiency and social acceptance of privatizations are crucially dependent upon the quality of those *institutional and regulatory changes that accompany* (or not, as the case may be) the transfer of property rights. These will decide

[1] Quite a heated debate went on in several transition countries (especially in Russia and in Southeast Europe), centered on the claim that stabilization was nothing more than an IMF straightjacket or a product of ideological overzealousness. Thus many people (publishing e.g. in *Acta Oeconomica* and other Sovietological journals) called for policies that downplayed stabilization, i.e. advocated a “growth first financial discipline later” approach.

whether the transfer of property to private owners is tantamount to the introduction of a *competitive order* and an open society, or public monopolies and the profits accruing to them are merely passed over to private persons. The prosperity of the latter is conditional upon their success in preserving *entry barriers* that preclude any new effort to combine factors in a more efficient manner. If monopolist rent-seeking works, there is no reason to expect privatizations to be efficiency enhancing and welfare improving, not even in the long run.[2]

Seen from this angle, the dismal performance of the Newly Independent States is anything but surprising, and can by no means be attributed to an overdose of "monetarism" or "neoliberalism". Likewise, a privatization based on favors and aimed at nominating a new clientele, while state activism and regulation remain all-pervasive – as is the case under the Putin presidency – will not improve performance; the oil-boom fed upswing can only be short-lived. This does not prove, contrary to what is usually asserted, the uniqueness of Russia, but the *universal relevance* of the economic laws formulated above. A state-led monopolistic economy can *not* be expected, on the basis of available theories, to be *more efficient*, if changes are restricted to property structure, while all other incentives, allocational mechanisms and the overall economic environment remain hostile to any major innovation.

Since the mid-1990s, two new features have dominated transitological literature. One of them is the *transformational recession* (Kornai, 1994), which proved to be a protracted process in all cases except for East Germany and Poland. The second is the *return of successor parties* and the related perception of a threat of societal regression – a point studied mostly in the political science literature (Körössényi, 1995).

With the benefit of hindsight, it is hard to overlook the fact that the fears pertaining to both developments proved exaggerated. Growth did resume, in East Germany already in 1991, in Poland in 1992, and in the rest of the region in 1993–4, but only from 1999 in the NIS. True, growth proved to be sustainable only in those countries which not only preached, but also implemented the agenda of stabilization, liberalization and privatization (SLIP), and, moreover, complemented these steps with *institution building* and solid *macropolicies.* This point has been most forcefully proven by the World Bank (1996) but also by analysts from within the region (Kolodko, 2000b, pp. 57–86).

What institutional/*structural reforms* were needed to get on the path of sustained growth? These included changes in the banking system (i.e. the establishment of financial intermediation proper), and the creation and efficient regulation of capital markets (these are needed to improve allocative efficiency). But further reforms were needed in the inherited welfare systems, immediately related to the focal issue of long-run *fiscal sustainability* (through the problem of intergenerational accounting and the implicit debt of the pension system).

In other words, handling a prime economic problem – the sustainability of the general government position[3] – required interdisciplinary analyses, as is richly documented by one of the pioneering volumes on the subject (Nelson, Tilly and Walker, eds., 1999). The underlying issues here are all related to value judgments and, ultimately, to matters of worldview: the scale and ways of ideal redistribution, the role of state versus civil society in providing public goods and services, the share of centralized versus municipal self-financing in covering the costs of public activities, the new mix of solidarity versus self-care, or the economic value of health.

[2] This insight had been explicitly formulated by the liberals (Böhm, 1982; Eucken, 1948) in Germany and by the theory of collective action (Olson, 1982) in the US, well ahead of the east Asian crisis or the debacle of the NIS in the 1991–9 period.

[3] "General government" becomes little more than a buzzword, if we take it to cover not only the central budget, but also pension funds and other items not figuring in the state's central budget, approved by parliament (but constituting public spending).

In a pluralistic society, based on the coexistence of competing values and life strategies, it is by definition impossible to expect a professional consensus to emerge: *public choices* are needed, and these have to be anchored in constitutional arrangements, i.e. laws that cannot be changed by a new legislation adopted by a simple 50 per cent plus one vote majority. Until a consensus is reached, it might be in vain to expect successor governments to sustain commitments assumed by their predecessors without taking into account their objections. Unless it is *sustained over several election cycles*, no change in the health and pension systems is likely to be successful, and the same goes for the municipalities' role in the economy ("Europe of Regions"). Those reforms are likely to continue long after the EU accession of the frontrunner transition countries (an issue to which we shall come back below). Thus no decision is helpful that is based exclusively on financial or narrow professional considerations, but does not enjoy wide public endorsement.

As far as the return of *successor (post-communist) parties* is concerned, the related fears proved to be unfounded. Global comparisons of the experience of the 1980s and early 1990s (Williamson, 1994) had already proven by that time that leftist parties turned out to be quite efficient promoters of market-oriented reforms (years before New Labor was conceived). This had to do with their high level of organization as well as their social embeddedness. To the examples provided by the volume quoted above, one could add those of France since the mid-1980s or Italy and Greece in the mid-1990s. From among the transition countries, we may list the governments of Hungary in 1994–8, Poland in 1993–7 and the Czech Republic in 1998–2002 (under a minority government). It seems that these have been setting the trend, rather that constituting deviations in need of special (culture- and history-based) explanation.

This outcome is hardly surprising if we take into account the fact that left wing parties in central Europe (not in the NIS) represent mostly the *winners of the transformation*, such as entrepreneurs, civil servants, individuals benefiting from their cultural and social heritage and the like. The more we accept the relevance of inherited skills and starting positions as determinants of privatization outcomes, the less surprised we are to see this. Those in small and micro-business, unsuccessful entrepreneurs (oriented towards local markets only), losers in the transition process, and strata permanently *dependent on transfers* (e.g. pensioners or farmers) tend to group around right-wing parties in protest of the outcomes of the changes. This has lead to the revival of splits according to the interwar lines, with unreconstructed, statist conservative parties becoming a lasting feature of the scene. This may solidify a division of economic platforms which runs contrary to what is observed in most core countries: in Central and Eastern Europe, the left calls for deregulation and privatization, while the right demands more redistribution and state protectionism. In empirical terms, such a division clashes with the models prevailing in political science, still quite widely represented in continental Europe.[4]

At the turn of the millennium, transitology took yet another twist. Primarily in the context of EU accession, external performance measurements have become formal and continuous, while competition for foreign investment has also intensified. In this dimension, the increasing *differentiation* among transition countries has come to the focus of attention among analysts. This growing divergence has been regularly documented using a wide array of indicators by all institutions dealing with the region, from the Transition Reports of EBRD, to the Economic Survey of Europe of the UN Economic Commission for Europe in Geneva, to publications of various regional research institutes, banks and rating agencies. This analytical material, which has been widely presented (most recently e.g. Hare, 2001; Csaba,

[4] The statist economic platform of the CSU in Germany, of Partido Popular in Portugal, of the Danish Republicans, of Alleanza Nazionale or of the Greek Nea Dimokratia is comparable to the stance of the Hungarian or most Polish parties on the right.

2002a), divides transition countries into three different categories, confronted with *three different research programs*.

First is the *frontrunner group*, where the SLIP agenda has been concluded, the system of financial intermediation and the rule of law are in place, not contingent upon particular political forces remaining in power. These economies are on a *secular growth path*, even though the rate of growth is naturally volatile by the country and period. EU membership has been within reach since the middle of the decade. Here the question is how to *accelerate welfare reforms*, how to build up a social consensus around the major trends of change and how to secure better professional foundations for these processes. The issue is to meet the deadlines and parameters that are vital for a successful integration into the EU. The subject of the debates is thus no longer what needs to be done, but *how and at what speed*. What needs to be done is an issue by and large settled by the prospect and nature of EU accession. This holds for a wide range of issues, from monetary policy to environmental regulations.

In the *second group*, EU membership remains a long-term objective. Still, for the same reason, day-to-day decisions are hard to reach. In this group there is a demand for an answer why transition has remained only a partial success. Social and political forces call for normative approaches that should lead to more successful policymaking and institution-building solutions. A typical case is Romania, where in the elections of 2000, over 70 (!) per cent of the electorate turned their back on various westernizing forces. The returning post-communist party does not enjoy an absolute majority in the legislative, thus is unable to institute any step to change the status quo. There is a serious *gap* here between *economic rationality and social acceptability*, which is also the case with other members of this group. It is a situation for which the greater part of the literature on policy reform offers little or no remedies, since no society can be lead to prosperity against its revealed preferences. On the other hand, a weak government is usually unable to institute major reforms, since such steps involve by their very nature imminent and certain costs, whilst benefits are uncertain and can be reaped only in the future. Thus democratic processes may or may not lead to the selection of a more viable, more efficient institutional setting; the “law” of natural selection may or may not apply in socio-economic processes (Hoff and Stiglitz, 2001, pp. 394–7). In societies which lag behind, there is a tendency to reinterpret the path dependency insight of North (1990) in terms of the inevitability of governance failures in less developed countries and to put the entire blame on those informal institutions which replace the defunct or mismanaged formal ones. While anyone familiar with the original argument would clearly see this as perverting a valid scientific claim, it is hard to overlook the fact that references to path dependency are often used instrumentally to justify interventionism in policy-making and the quest for national models of economic development (which is, in the end, no less than a relapse to the historicism of von Schmoller).

A *third group* of countries consists of the NIS and Southeast European states, where the level of per capita GDP, according to official and internationally comparable data,[5] by and large, still lags at about 70 per cent of the Soviet-era level, and in some cases – like Georgia, Bosnia and Moldova – it is even lower, closer to 40 per cent of the pre-crisis value (UN ECE, 2001/1, p. 254). In these societies, daily *crisis management* is the name of the game and all the *rest*, including wider-ranging structural reform projects, tends to belong to the realm of poetry. Here the major task of research is to find the reasons – over and above incidental factors, like civil wars or corrupted régimes – for the failures and the *inability to correct*. Unilaterally cultural explanations are obviously unsatisfactory for an analytical economist. Good analytical answers are badly needed in such cases as Ukraine, which is a country of

[5] This version is hotly debated in the literature, with Anders Aslund (2001) going as far as to question any real welfare (as opposed to environmental, military or power) loss and call transformational recession a statistical artefact.

France's size, Belarus – comparable in size to Greece or Austria – not to speak of the Caucasian and Balkan countries. These constitute the real puzzles for the western community in general and for the *Ostpolitik* of the EU in particular.

To wrap up what has been said, transitology is becoming an ever *narrower field on its own right*. One part of the countries under discussion "qualifies" for European studies; another one shows a striking affinity to the traditional topics of development economics. While the latter branch of study – as will be shown – has made important advances in understanding the dynamics of less developed and less successful economies, the learning process (of transition countries looking south) is still in its infancy, partly in consequence of the early improvisation. Still, it is hard to overlook the fact that such *traditional topics* in development economics as vicious circle phenomena, or the ways to create an outward-oriented economy or to fight corruption, might have a *direct bearing on countries in transition*.

2. The new political economy of development

Development economics was born right after World War II as an antidote to the neoliberal mainstream, reflecting revolutionary ideas and showing little appreciation for the type of formal approaches that has come to dominate major departments and journals ever since[6] (for an excellent summary, cf. Meier, 2001). This has made it a bestseller among many policy-makers in the Third World, and likewise in the leading departments of major world universities. *Desarrolismo* is a shorthand for anti-American, import-substituting nationalist and populist policies in South America, though literally it means only "supportive of development".

The *original paradigm* of development economics was based on the negation of western market-oriented concepts and policies, and of the laissez-faire of the colonial period. It emerged as a rejection of the materialist West, equated with moral decay, political oppression, racism, and a free market culminating in the Great Depression of 1929–33 and its dire consequences for the periphery. In order to overcome dependency, it advocated state planning (even if no Soviet advisors were around, the current official statistics of the Soviet Union tended to be taken at face value, which resulted in a sincere admiration for the non-capitalist alternative). It also took for granted the idea of import substitution as a means of nation building and state building – an idea that has acquired global appeal ever since the Friedrich List, under the banner of economic nationalism. Furthermore, it took for granted that the state must play a leading role in accelerating economic development (based on various theories of the big push, originating with Rosenstein-Rodan). The central state administration (in the hands of the vanguard) – rather than civil society, municipalities, private capital of domestic or foreign origin – was to become the sole *owner*, *regulator* and *organizer*, constrained only by its own ideological beliefs. The central state was to become the driving force and guarantor of accelerated change.

The more heavily the strategy relied on priorities which deliberately limited the scope of the market – or ones which were just incongruous with, say, the long-time priorities of the market agents, or made recoupment uncertain – the more inevitable it became to *repress the financial sector* by means of highly inventive regulatory measures and justifications (Lal, 1993). It seemed obvious that monetary processes must be (or are by their very nature) instrumental, subordinate to "real processes", which were to be co-ordinated basically by the bureaucracy.

[6] For this reason some of the pioneers in the area, such as Holis Chenery, Evsey Domar or Simon Kuznets qualified as growth theorists (owing to their quantitative orientation that ensured canonic acceptability). The similarly oriented *Journal of Development Economics* is thus more of a forum of the mainstream than of developmental discourse.

It is common knowledge that the more sophisticated an economy and society is, and the higher is its development level, *the greater is the role of prices as the major instrument of co-ordinating* millions and tens of millions of individual decisions, if welfare is to be increased. Therefore, it was inevitable and predictable that the more the financial system is repressed and the longer this repression lasts, the higher are the costs in terms of lost (sacrificed) welfare at any point of time. The longer such an arrangement persists, the greater the lag it leaves behind.

The dominance of bureaucratic co-ordination caused, as it did in the Soviet-type economy, first efficiency losses and later on stagnation. Alternatively, countries tried to borrow in order to bridge the revenue shortfall. But the more money was lent, in the absence of domestic corrective and absorption mechanisms, the less growth could materialize, and adjustment was merely postponed (Easterly, 2001, pp. 101–20). Recurring *payments crises* – and the high visibility of interrupted and never finished grand prestige projects – had a sobering effect. Experience opened up the way to the "monetarist counterrevolution" of the 1970s and 1980s, leading to the gradual change of paradigm in most developing countries.

The *new paradigm* is built upon the appreciation of market-led growth and overcomes the ideological elements derived from the principle of negating everything resembling the western experience. It is generally acknowledged that the same *principles*[7] of solid macro- and micromanagement that work in OECD countries should be valid for less developed countries, and cultural differences can no longer be invoked to justify profligate or simply unprofessional policies. Development is conditioned by public policies ensuring price stability, export-led growth and providing investments for such public goods and externalities that private agents tend to undersupply (more on that in: Behrman and Srinivasan, 1995, pp. 2467–96).

What has been said implies a *Copernican turn* in development economics. On the other hand, the story just means that the discipline of *standard economics has returned into the discourse about poor countries*, and nothing more. Underdevelopment and ways of overcoming it can now be discussed in standard economic terms, following the logic and procedures of standard economic analysis. This return of economics took place in a slow, evolutionary manner, through a substantial amount of trial and error as well as open scientific exchanges – as documented in rich detail by the four volumes of the *Handbook* quoted above. In most of the cases and throughout this process, there was no sign of the oft-alleged dictates of the IMF,[8] wrongdoings of the Chicago boys, tricky stockbrokers and fund-misusers from Harvard, corrupted media multipliers and other folkloristic elements still dominating much of the social science discourse in large parts of the globe. But even if in some individual cases such discourse is substantiated (which is very rarely the case), anecdotal evidence and the related incidental factors can hardly explain the turn of the tide in an entire strand of international intellectual endeavors. As we have seen – and our references prove this *in*

---

[7] Harberger (2001, pp. 549–557) highlights the need to avoid rigidity, especially doctrinaire approaches to policy issues where *discretion* and *common sense* (e.g. in assessing administrative capacities) cannot be substituted with general references to textbook solutions or to abstract theoretical models. Thus this insight by no means implies the mechanistic copying of even "best practices" or an indiscriminate use of benchmarking. The emerging Basle Two agreement is a nice example of how and why decentral assessments – differently tailored within the same logic – may be the only practicable solution.

[8] Even authors sympathetic to the international financial institutions (e.g. Krueger, 1998; Williamson, J., 2000) consider as by and large *unsuccessful* most of the attempts by the IFIs to be involved in institution building in developing and transforming countries. Currently also the IFIs themselves stress the need for domestic "authorship" of reform packages. Moreover the quoted authors consider the mere emergence of a common language, a common intellectual framework for discussing issues, and personal contacts among wide segments of policy-makers – also on the second and third levels – as lasting accomplishments of the IFI-sponsored structural reform projects of various sorts.

extenso – this turn can by no means be attributed to the western triumphalism that followed the collapse of the "evil empire", as it had taken place a *decade earlier*, in the 1980s. The largely pragmatic and policy-level agreement among the various trends of thought came to be known as the Washington Consensus, and later on – with reference to lessons from transition failures, and with a new emphasis on institutions – as the post-Washington Consensus (Williamson, J. 2000; Kolodko, 2000a, pp. 119–40).

Development economics has long been studying phenomena that cropped up as queer novelties for transitology or Sovietology. This applies *a fortiori* to cases when the transformation failure is rooted in the disintegration of formal institutions, regulatory arrangements or even the core state itself. Fuzzy property rights, the lack of independent judiciary and the inability to enforce private contracts by an impartial third agent, rampant corruption, malfunctioning of formal institutions and the resultant informalism, the dominance of traditional networks over imported arrangements, or the impacts of a sizable irregular economy are all among the evergreens of development studies.

The encounter of the "neoliberal" mainstream with "exotic" themes proved to be quite productive. One of the fortresses of formalized approaches, growth theory, and the wide and sophisticated econometric arsenal could now become *applied to real-world issues*; moreover, these instruments facilitated the settlement of debates. In comparative analyses, quantitative methods helped clarify the contribution of various factors to economic success. Applications often allowed the relevance of specific theoretical or methodological propositions to be verified. All in all a variety of contradictory observations, successes and failures could be interpreted within a *single theoretical framework*. Moreover, by reliance on analytical concepts and quantitative methods several long-debated issues could be settled. One of these was the ancient dispute over *import substitution versus export orientation*. Especially following the second oil price hike of 1979, the superiority of export-led policies became evident: the countries adopting this line were disadvantaged in terms of natural endowments, and yet their growth proved *sustainable,* whereas the windfall tended to create "Dutch disease" symptoms and temporary booms in the resource-rich economies in the Middle East. The sustainability of outward orientation went hand in hand with the broad concept of *market orientation* and supportive *institutions*, over and above the narrow prioritizing of external sectors (Balassa, 1993). Long-term analyses have shown that export-led growth is not based on the financial support for sectors selling abroad, but implies a broad liberalization strategy extending beyond the trade sectors. Its intensity, sequencing, timing and overall professionalism explain the cases when this option proved successful and sustainable (Greenaway, Morgan and Wright, 1998).

In order to test the above finding, several analyses have been carried out, probing into the causes of the inefficiency of import substitution policies. These indicated *governance failures* as a major reason, inherent in the original state-centered paradigm (relying heavily on the right choices by the vanguard as opposed to the use of decentrally available social knowledge). This problem has been exacerbated by the frequency of *state capture*.

Third, it proved unjustified to assume that the core *state* would by definition stand for the *public purpose*. State administrations, especially in weak states and under non-democratic arrangements, still predominant in the majority of developing countries, tend to *fall victim to the redistributory tendencies of traditional societies*. State jobs are used to boost employment and serve as rewards for political loyalty rather than to function on meritocratic principles. Cases which do not fit into a typical public choice model, where public policy players maximize their own personal welfare and power rather than any abstract public good, are hard to find, especially in Africa and Central America. This tendency can be reversed if the state becomes *decreasingly involved* in protecting palpable interests (the protective state should only guard unambiguous public goods, such as price stability, competition, rule of law, public security – but not individual producer interests or pre-set redistributory outcomes). On the other hand, the smaller the size of the productive state, i.e. the scope of goods and services provided by the central state, the lower is the propensity (or: the weaker is the motivation) to abuse it.

It can be clearly seen from this angle how *insufficient* is the reliance on such traditional models of growth where development is based primarily on *physical capital accumulation*. These models – which were invoked to justify import substitution – tended to downplay or neglect a key element of endogenous growth, which is the *accumulation and spread of knowledge* in societies (Bruton, 1998). While the accumulation of physical capital may be managed by governmental action – at least in the short and medium run – the accumulation and spread of knowledge can only be *lubricated, but not created* by the authorities.

These insights have lent additional weight to an approach that has always emphasized, albeit sometimes from a minority position, the *social conditioning* of the market as a system. In contrast to the simplistic reading of the Harrod-Domar model, it considers the market as the fundamental coordination mechanism through which the vicious circle of poverty can be overcome (Hayek, 1989; Bauer, 2000). Adherents to this approach interpret as a revolution in development economics the movement from state-led approaches, emphasizing physical capital accumulation, towards a broader, more realistic and socially conceived version of *growth promoting mechanisms*. In this framework, the market rules and institutions – which occasionally emerge spontaneously, but are largely man-made – lead the countries *out* of the low-level steady-state equilibria, relying on the related incentives, allocation and accumulation mechanisms (Dorn et al., eds., 1998).

It is worth emphasizing that a market-based approach to development is by no means equivalent to the revival of the "night watchman state" ideal. Instead of preaching the minimal state, a *strong state* is required: one constrained by constitutional, legal, procedural and other democratic checks and balances (Buchanan, 1977). A civilized market is one constitutionally constrained and protected, where the state is a *regulator* and an arbitrator, but *by no means a day-to-day manager of affairs*, producer or protector of individual concerns. Reliance on self-interest of market actors alone will hardly guarantee the respect for those cultural and civilizational norms that have evolved over centuries, whereas the constitutional rules that secure the latter are setting the rules of the game, but not its pre-determined outcomes (Vanberg, 2001, pp. 2–36).[9]

It is interesting to recall that these "new" insights *were already available by the time systemic changes had started* in Central and Eastern Europe. In a volume published on the occasion of the 25th anniversary of the Harvard Institute of International Development (Perkins and Roemer, eds., 1991), the contributors came out against a unilateral emphasis on trade liberalization as a panacea and called on public authorities to supplement these steps with institution-building measures. True, this call implied something different from what is actually seen in the region, namely, the state replacing (in a Gerschenkronian way) the market. Instead, it advocated a market-supportive state, where interventions build market institutions and overcome co-ordination and information failures, much the same way as it was put forward more recently by Hoff and Stiglitz (2001, pp. 397–412). This requires, in the

[9] A *strong* state thus should not be confused, as is often the case, with an *activist* one, with interventionism and aggressive wielding of power, as the Putin administration seems to interpret this call. It is worth noting that the ordoliberals of the 1930s developed their theory as a reaction to limitless and arbitrary state interventionism in Germany that ended up in totalitarianism. In opposition to it, they call for *cutting back discretion to the minimum* and for a rule-based government (Böhm, 1933/82, Eucken, 1948). In the United States a similar debate over rules versus discretion took place in the 1970s in the context of monetary policy (Kydland and Prescott, 1977). Later on, the victorious position of rule-based management was modified somewhat, with reference to drawbacks of too rigid interpretation of any of the golden rules for policy-making and theories alike (DeLong, 2000).

HIID view, a slim, but well-paid (rather than underpaid) state administration, based on meritocracy and transparency, which refrains from interventionism and day-to-day crisis management. Such an administration may become the *anchor for those reforms* that may lead stagnant societies out of their vicious circles. The timing of sectoral reforms and their pace in this normative view are conditioned by the ability for and speed of social learning, collective choices and interactions in the democratic process of deliberations.

Thus we have come to what a contemporary classic, Robert Bates and Anne Krueger (1993, p. 463) called the *orthodox paradox.* This means that extending the scope of the market requires strengthening the core state, while the policy of grievances and individual rationality (of buying clients) must be *subordinated to collective rationality* (geared towards, e.g., transparency and accountability). In concrete terms this requires financial discipline (such as the balanced budget proviso for the constituent states of the USA), limiting the scope of redistribution (especially if carried out on discretionary basis or in a non-transparent fashion), strengthening the rule of law in the economy, and, last but not least, enhancing the role of *technocratic agencies* (which are not subject to daily political pressures).

As we can see, this broad approach abandons the previous narrow interpretation of reforms embraced by IFIs and most of the literature, restricted to changes in some sectors or policy areas. In the 1990s, reform came to imply deep changes pertaining to the macroeconomic *allocation* mechanism, *decision-making* structures at the macrolevel, and the way *legislation* works (a classical area of political science).

It is in this context that representatives of standard macroeconomics also call for reinterpreting the role of the state as a precondition for stabilization to sustain. In order to attain this, Dornbusch (1993) advocates improving the *administrative capacity* by way of decentralization, by empowering local municipalities with financial competences, with improved transparency and accountability at all levels and in all areas.[10] Reform policies should ensure that support goes indeed to the most needy. They can create mobilizing visions, build a consensus around focal issues, ensure consistency among reforms running in parallel, and thereby contribute to the social acceptance of economic change. In this way, thorough *reform policies may sustain a single electoral cycle and thus deliver.* This is, trivially, a side condition of such undertakings as a successful pension reform, and also brings considerable benefits in terms of improving administrative capacities, strengthening the rule of law, or *changing informal institutions* such as social norms (e.g. the (un)acceptability of taking bribes or applying kinship criteria in making appointments).

Importantly, the institutional focus of the new political economy of development is *by no means a rehash of the state-centrism* of the old paradigm. This is, to a large degree, a generalization of the experiences of three decades of statist developmental strategies. Such an insight follows directly from the experience of non-capitalist development initiatives in sub-Saharan Africa (Paulson, ed., 1999), where the state turned out to be more of a problem than an agent of solution. The volumes quoted above provide ample empirical evidence of how and why governments trapped within various vested interests proved *unable to perform the elementary functions of public policy*, thus *aggravating* the situation that had already been critical anyway. State failure in these cases *lies at the heart of market failure*, which is only aggravated by non-neutral redistributory practices. If foreign investors with a large bargaining power come in, they may further distort the outcomes.

The deeper is the distrust in the abilities of the state as a provider, the stronger is the case for large-scale privatizations; this does not depend on the level of development. The best

[10] Discussing this point, a leading authority of institutional economics, Oliver Williamson (2000, p. 611), notes that the functioning and embeddedness of bureaucracy largely remained a mystery for the social sciences. Neither formalized approaches, nor political science, could come up with an interpretation that could be accepted as a new paradigm. By the same token his own institutional approach remains also open-ended.

empirical overview of comparative country experiences to date (Meggison and Netter, 2001, esp. pp. 380–1) proves that private corporations tend to outperform their publicly-owned competitors and mixed-ownership firms alike. This experience is global and the tendency is overwhelming.

It is true, however, that the *change of ownership,* as seen above, *does not lead on its own*, and in the absence of other conditions, *to improved efficiency*: privatization works in a context. According to the survey quoted above, mass privatization proved to be the least efficient form of ownership change. Its popularity is derived from exigency situations, at least in political terms. A preferential treatment of employees was observed in 91 per cent of cases. Privatization technologies and terms often emerged as an outcome of competing regional, employment, financial, organizational and prime political strategies. As a rule, a privatization proves lastingly efficient if it also contributes to the *broadening of the local capital markets*, by the public quotation of shares. This is the best indicator of whether or not corporate governance has improved, that is, whether a new combination of factors will lead to greater efficiency or just to a changed distribution of rents. Further requirements are the introduction of international accounting standards, the enforcement of disclosure rules and the improvement of the *quality of macroeconomic governance*.

These findings corroborate the conclusions of Stiglitz (2000, p. 577). He blames the reformers in transition countries not only for the neglect of the contextual factors listed above, but also for their tendency to downplay the *feasibility constraints* of any major reform under *democratic conditions*. The further we get beyond the elementary SLIP phase, the more involved we become in administrative and welfare reforms, i.e. in the *modus operandi of the power structures and of millions of people*. Changes in these areas shape the nature of societies. Thus the *public may choose something different from an option derived from comparative institutional or economic studies*. The more willing we are to acknowledge that backtracking is often a result of half-hearted or incoherent reforms, the less likely we become to be taken by surprise. In this context, the literature typically mentions the liberalization of east Asian financial markets: carried out without sound institutions and regulation, but with a fixed rate of exchange. Such conditions invited and triggered the crisis. In turn, liberalizing strategies may well have lost their popular appeal irrespective of their substantive features.

3. Welfare reforms and EU-maturity – a special feature of Central European development

As we have seen above, the success of the frontrunner countries in transition has rested, to a large degree, on the *anchor function of the EU*. As long as EU membership could provide a rallying point for otherwise conflicting forces, it helped to build consensus around major institutional features of the market economy. Likewise, with the implementation of the third stage of the economic and monetary union, and especially with the introduction of the euro as the sole currency in 12 EU states, accession sets qualitative and quantitative tasks for the candidate countries. Given the disparity of economic power (the accession countries account for just about six per cent of the GDP of EU-15) and the expected timing of the enlargement in the middle of the decade, the major features of institution building and policy reforms are pre-set by the Europeanization context. This is true, even though the overlap between the endogenously derived institutional features and the ready-made solutions of EU-15 may not be complete. For instance, the adoption of Pillar Three items (justice and home affairs), or involvement in Pillar Two (common foreign and security policy) may be in conflict with e.g. good neighborly policies, or the need to fight terrorism on a global (rather than regional) scale.

The quality of institutions was shown to be vital for the long-run growth potential of any country. This insight has gathered momentum through the studies of the east Asian crises.

In the latter case, conventional macroeconomic indicators, debt exposure measures and other types of quantitative information failed to perform their early warning function (Lamfalussy, 2000). This may also explain why the early search for quantitative indicators of EU maturity was discontinued and gave way to assessments of a more qualitative nature. The share of the 100,000 pages of the acquis already translated, the number of negotiation chapters closed, or the share of private firms in GDP creation no longer count as factor deciding about the EU-fitness of any candidate. Already by introducing the phase of acquis screening, the EU has indicated its legitimate interest in delivery (as opposed to formal compliance with its criteria).

It would be hard to overlook the fact that a consistent implementation of the acquis is likely to entail yet another systemic change for the transforming countries. The need to qualify for the EMU, the implementation of environmental standards, or the community-level control of state aids, to mention but a few, will surely pose a challenge even to the frontrunners. Likewise, it is hard to deny that the EU is also facing a similar reform of its internal arrangements, owing to the large number and diversity of applicants, but also under the pressure of globalization (Cassel, ed., 1998). Knowing the substance of the Nice Treaty and the schedule of the Convention, it is unlikely that this rearrangement will be concluded by the time of first accessions. Thus a decade-long gradual reform is the most likely outcome. All the more so since democracy does allow for representing sectoral and other vested interests that will lose out in the course of what is a win-win game at the macrolevel.

On the following pages, we adopt a deliberately one-sided view and list only those tasks that are to be mastered by the transition countries. These are viewed from the angle of the new political economy of development, i.e. the extent to which they contribute to a sustainable growth within the EU. High growth in modern economic theory does not eliminate the need to fight inflation, thus the "high growth-moderate inflation" model, which used to perform quite well in several catching-up countries, does not seem to be relevant for our country group.

1. First and foremost, a further disinflation has become an urgent task. This follows not only, and not even primarily, from the relatively close date of EMU membership, but also from the observation that transition countries managed to bring down inflation below the 8–10 per cent level only at times of economic recession. This means that organic disinflation that would not require major sacrifices in terms of growth is yet to come about. As we are confronted with the propensity of representative democracies to overspend, we will realize that this is hardly a trivial a task to accomplish.

Moderate inflation figured prominently in several catching-up stories among the emerging market economies. Broader enquiries into its causes have highlighted the importance of social and psychological factors in bringing about this outcome. Particularly, a lack of credibility and the widespread use of backward-looking indexation formulae are made responsible for sustaining moderate inflation even at times when "fundamentals" would allow for a non-inflationary growth (Cottarelli and Szapáry, eds., 1998). Analysts tend to disagree over how best to overcome this problem. In the volume quoted above, some advocate tripartite agreements, while others call for more monetary and fiscal orthodoxy, applied in a co-ordinated fashion. In both cases the objective is to diminish the share of state expenditures in GDP and to restructure their inherited priorities. Since at the bottom line we talk about rolling back universal entitlements, this is a prime political issue that relates to the basics of the welfare model of each reforming country.

Thus lasting and organic disinflation is hardly possible without transparency in public finances, which allows policy agents to find out who pays what for whom, thus making public choices at all feasible. Otherwise, a typical Olsonian case of a well-organized minority misleading and dominating the disorganized majority is the likely outcome of spontaneous interplay of policy processes. In order to ensure sustained improvements, countries with a less than convincing history of fiscal solidity, and those of low credibility, may usefully employ medium-term fiscal targeting. If the major priorities and numbers of such a plan are made public, both the EU Commission and market players can verify its fulfillment; similarly governments can claim their precommitments as binding constraints when faced with improvised and politicized pressures for more spending. This practice has already been efficiently implemented by the EMU countries, while accession countries may well have to conform to additional requirements in terms of code of conduct that would limit discretionary interventions, but help continuous improvements in the field of fiscal solidity (Braga de Macedo, 2001). Such arrangements – as EU countries have recently experienced – may not go hand in hand with political expectations at times of downturns.

2. On the other hand, a continuous decrease of public dues may prove infeasible and even undesirable. At certain times, as in 1998–2002 in the Czech Republic, or in Romania, the government may not enjoy a solid legislative majority, which obviously limits the room for major expenditure rollbacks. A similar outcome may result from the specific social background of center-right parties in central Europe, discussed above. Several structural disproportions have been diagnosed but not solved in the frontrunner reforming countries, such as the redefinition of the role of farming, environment, and health care. Whatever way these structural problems are solved, it is unlikely to be less costly, since many implicit cost and debt items are becoming explicit in the course of reforms. In order to attain this, a strong state as described above – i.e. one that is capable of liberating itself from the dominance of economic vested interests and of regulating in the interest of preserving diversity (Bruszt, 2002) – would be of vital importance. This normative view, however, is not to be mistaken for a forecast, thus the pressure for redistribution is unlikely to diminish.

3. Maybe the most controversial item is our third point, the redefinition of the role of the state in the provision of welfare. As a recent major volume (Kornai, Haggard and Kaufmann, eds., 2001) illustrates, this requires a truly interdisciplinary approach and policy dialogue as a side condition for any measure to become implementable. By studying the experiences of the 1990s, the editors highlight the importance of blocking powers, the role of formative personalities capable of building up reform coalitions, the need to redistribute inherited checks and balances among various branches of power, and the dangers of state capture. While the authors call for introducing conservative financial principles in the welfare-related areas, they also highlight the need for a non-conservative, heterodox analytical approach to these issues and the necessity to integrate sociological, political-science and psychological insights into the reform projects. Only this makes the way for right sequencing and consensual deliberation that allow for sustainable reforms.

Analyzing the failure of reforms in Latin America and the NIS, Rüdiger Dornbusch (2000, p. 85) underscores the fact that governmental activity should not be restrained to correcting market failures and building market infrastructure, plus providing law and order. For a major welfare reform to succeed and market oriented reforms to survive, a certain degree of redistribution needs to be preserved, or else disintegration or regression to authoritarianism may be the unintended, but inevitable, outcome. This leads us back to the need to redefine explicitly new expenditure priorities that allow for a socially acceptable operation of the market mechanism, while not replacing the fundamental co-ordination mechanism with a prearranged selection of outcomes.

4. Fourth, a solid and stable system of financial intermediation remains a key component of any viable market economy. This task should not be declared either trivial or resolved, even though those transition countries which are also members to the OECD have actually liberalized all, including short-term capital-account transactions, in 1999–2001. In the long run, joining the eurozone will provide an answer to the question. In the medium run, however, it is not clear how crisis-resistant the financial sector of the best transition performers actually

is. As a recent analysis of Poland, Czech Republic, Hungary, Slovakia and Slovenia indicates (Schardax and Reininger, 2001), the banking sector in each of these countries has already undergone a major change. The share of foreign ownership has proven predominant, reaching a maximum of 76 per cent in Slovakia. Banking supervision and regulation has substantially improved, disclosure requirements are no longer just promulgated, but also enforced. Thus problems of corporate governance in the banking sector seem to have found a solution. True, as a corollary, corporate restructuring is no longer financed by domestic banks, with parent companies and the international capital market providing most of the funding for big-company restructuring. Local capital markets continue to play an auxiliary role at best, serving to channel some portfolio investment into the corporate sector, but not mediating the bulk of financial flows. The sunny side of this phenomenon is the diminished vulnerability and exposure of Central European financial systems to international speculation.

The major correction in the international capital markets in 2001, together with the marginalization of regional stock exchanges, highlighted the importance of the economies of scale and scope in financial intermediation. Therefore, Central European capital markets also joined their West European counterparts in the search for strategic alliances. In this process, the logic of industrial organization, i.e. searching for a leading center, dominated over politically oriented intra-regional alliances. With the unfolding of this global tendency, it is beyond doubt that local economic activity will require local funding and services, thus ensuring a lasting role for Central European stock exchanges. Meanwhile, the biggest and brightest companies, i.e. the blue chips, will be increasingly oriented towards global capital markets so as to reduce costs and also the leverage that host governments may exert over them.

5. The more we realize the fact that, in structural terms, it is the future role of farming and the environment that will pose the major challenge for the eastward enlargement of the EU, the more it calls for an interdisciplinary endeavor. In the traditional approach based on microeconomic consideration, incumbents and candidates are irreconcilable adversaries. In a nutshell, candidates tend to form their expectations in terms of the common agricultural policies of the EEC in the 1960s and 1970s. The crux of these was income redistribution in favor of farming by way of market protection, guaranteed prices and the resultant increases in land prices that further limited new entry. Meanwhile, the gradual reform started in 1992 and, supplemented with the 1999 Berlin compromise (Schrader, 2000), has put European farming on a different track. The role of market coordination is gradually increasing, while net contributors have set a series of ceilings on agriculture-related outlays. Instead of supporting production, various non-production-related rural development projects have been coming to the fore. Rural living is no longer tantamount to generating income from agriculture at a time tourism is the third largest global industry, and when the Internet allows for the new economy to overcome distances more easily than ever. These changes, in line with the US and developing country claims represented in the Doha Round of the WTO, allow little leeway for the producer interests in accession countries to dominate the talks the way domestic policy considerations would indicate. In short, the EU is unlikely to invest what has not been invested into CEE farming over the last 50 years or so.

It is hard to overlook the fact that the macroeconomic role of farming is typically a case for collective choice, since it will determine the ensuing type of nation and society. Candidate countries have not yet gone through the phases which the incumbent EU members completed in the 1960s to 1980s. Thus territorial, employment, social, transport, human, infrastructural, educational and environmental omissions all add up to what looks like a sectoral problem.

In theory, the best answer to this challenge is what the European Commission proposed in January 2002 by making a trade-off between diminishing direct supports but compensating for this with greater access to and entitlements from structural funds. The only "minor" flaw in this respect is the very limited ability of candidate countries to draw on these, as is indicated by the very low utilization of funds earmarked for them in the PHARE, SAPARD and ISPA programs. Moreover, as intra-EU experience has shown, drawing on these sources and making best use of transfers are two different things.

Seen from this angle, the issue of EU accession and the related controversy over direct income supports (DIS) to farmers appears in a different perspective. These call for a major rethinking of such crucial points as regional development strategy, administrative reform, education, social stratification and the related longer-term visions, not least concerning the rational expectations based thereon. These are mostly unrelated to the most vocally discussed items, such as the distribution of DIS between farmers from the candidate and incumbent countries. Still, these are poorly researched and formulated issues, which goes, among others, for those of public versus private forms of transport (and the related infrastructural developments), industrial or bio-agriculture, Internet-based or industry-based society, a serving or a servicing state (to rephrase Buchanan's productive and protective state), together with the related levels of public dues that millions of taxpayers are willing to accept, and similar strategic options.

Answers to these comprehensive challenges are unlikely to be simple; still, it is the median voter who will finally decide which of the high-flying ideas will be legislated, especially at the constitutional level. Moreover, this will decide the final cost-benefit balance of the actual EU accession, including the type and sustainability of growth in the acceding economies. If societies resist the fundamentals of an EU-compatible policy, as the growth of Euroscepticism may indicate, the real issue is transformed from the traditional questions of convergence and its time span, into a different one: what kind of global economy do we want to integrate with and in what capacity, once the EU option has been practically rejected.

4. Integration, globalization and questions

We have attempted to survey *three interrelated programs of research*: transitology, EU enlargement studies and the new political economy of development. It sounds like a trivial observation that transition countries wish to join the EU not primarily for the transfers, but to enhance their global competitiveness. For the time being, precious little is known for sure about how to reach the point of competitiveness. The conditions are *easy to axiomatize but hard to deliver* – be that credibility, solid finances, good governance or transparent regulations. Our survey has shown that transformation studies and the new political economy of development overlap in highlighting the need for institutions, in the reliance on the major approaches and methods derived from the mainstream, and in acknowledging the need to rely more extensively on the findings and insights of other social science disciplines. The nature of what is called *second generation* reforms is *largely identical* in the two approaches, and so is their aim: sustainable development.

There are at least three groups of reasons why second generation reforms are more difficult to master than first generation (SLIP) reforms were (Krueger, 2000, p. 591).

l. Already in order to launch these, reliance on the political decision mechanism is needed.

2. Given the diversity of issues involved, and in view of the heavy dependence of rationality criteria on culture and on value systems, there is no standard cookbook to go by, of the kind available for trade liberalization or inflation stabilization.

3. In the areas and sectors to reform, the present arrangements have persisted for several decades, and are thus often seen as the only possible/natural way. Likewise, the financial and

equity constraints of reform are less than universally understood. Thus even those who would profit from the changes may well be mobilized against them (e.g. in health care systems).

Let us recall that second generation reforms include clashes among value systems (judgments), thus a professional consensus is hard to achieve even within a single country, not to mention the EU or global dimensions. Thus the travails of continuous social dialogue as well as the dominance of trial-and-error methods cannot be eschewed or bypassed. The more counter-arguments and counter-examples are known, the more analyses are called for. Oftentimes we are simply unaware of those factors that, ultimately, put a severe constraint on the applicability of otherwise elegant theoretical constructs.

Any of the major issues of these reforms involves a series of trade-offs. When we consider the relationship between education and growth, the need to protect investors without suppressing entrepreneurship and innovation,[11] or the interface of trust and control (especially in high-responsibility posts, like those of surgeons or investment bankers, where other people's health or wealth is at risk) it is next to impossible to follow the "if you cannot quantify it, do not talk about it" dictum of the technical economist. The broader approaches found in recent contributions to the literature did manage to endogenize some of the quality factors, but only at the expense of rigor, which used to be the economists' prizest possession in their armory (Saint-Paul, 2000). On the other hand, the general applicability of abstract (formal) methods allowed for the incorporation of some qualitative aspects, including the social conditions of innovation, into analytical models. This has lead to the politicization of the entire growth theory (Hibbs, 2001).

In trying to apply general growth theory to EU accession, we have surveyed five major problem areas. We hope to have demonstrated that any economic theory aspiring to political applicability/feasibility (or simply to social relevance) needs to be open to the interface with other social sciences and their insights. Economists are unable to determine, on their own, the salient features of efficient and workable legal systems, or the complexities of environmental options that may be contingent upon advances in various natural sciences. Some of the more controversial experiences of the last decades, such as the privatization of British railways, or the exorbitant costs of US private health care, caution against making direct policy inferences even from well-established theoretical insights.

There is no single best option outside of the framework of democratically legitimated public choices. This can be easily demonstrated by simply listing the major areas of current intra-EU reform debates: the future of farming, the costs of environmental protection, the need to overcome the democratic deficit while working efficiently in a community of 25 or more countries, the ways of finding efficient forms of regional development, the conditions of transferability of social security claims within the EU, or the modalities of setting up an independent rapid-reaction European force, all require interdisciplinarity and democratic deliberation alike. Therefore, our starting question about the possibility of a purely economic theory of reforms can be answered in the negative, for reasons inherent to the subject matter, although without having to give up the fundamentals of the discipline.[12]

Allowing for interdisciplinarity also paves the way for the insight that taking on board post-communist countries, whose number may be close to the current incumbent membership, will inevitably redraw the EU itself. The enlargement will be "not just another accession" (Eatwell et al., 1995) but will trigger the revision of integration theory paradigms, from intergovernmentalism to the system of entitlements and setup of common institutions. Success

---

[11] On Basle Two, everybody is in agreement – except for the banks concerned; similarly, everybody seems to favor IAS, except the US profession of accountants and consultancies after the Enron case.

[12] In descriptive terms, public choice approaches would flatly exclude the feasibility of reforms. Still, these have occurred and will occur, thus in a descriptive and normative sense we have to leave the door open for a concurring theory, even if it is a heterodox one.

of the related theories in all the three areas will be directly measured by the ensuing development of European states – in a global perspective.

References

Aslund, A. (2001). "The Myth of Output Collapse after Communism", Washington: Carnegie Endowment for International Peace, Russian and Eurasian Programme, *Working Papers*, No. 18 (March).

Balassa, B. (1993). "Outward Orientation", in: Balassa, Béla, *Policy Choices for the 1990s*, Basingstoke: MacMillan, pp. 3–53.

Bates, R. and A. Krueger (1993). "Generalizations Arising from the Country Studies", in: Bates, R., and A. Krueger, eds., *Political and Economic Interactions in Economic Policy Reform*, Oxford: Basil Blackwell, pp. 444–72.

Bauer, P. (2000). "From Subsistence to Exchange", in: Bauer, P.: *From Subsistence to Exchange and Other Essays*, Princeton: Princeton University Press, pp. 3–15.

Behrman, J. and T.S. Srinivasan, eds. (1995). "Introduction to Policy Reform, Stabilization, Structural Adjustment and Growth", in: Behrman, J., and T.S. Srinivasan, eds., *Handbook of Development Economics*, Vol. 3B, Amsterdam: Elsevier, pp. 2467–96.

Blommestein, H., M. Marrese, and S. Zecchini (1990), *Centrally Planned Economies in Transition*, Paris: OECD.

Böhm, F. (1982). "The Non-state ('Natural') Laws Inherent in a Competitive Economy", in: Stozel, W., C. Watrin, H. Willgerodt and K. Hohmann, eds., *Standard Texts on the Social Market Economy*, Stuttgart: G. Fischer Verlag, pp. 107–13 (originally published in German in 1933).

Braga de Macedo, J. (2001). "The Euro in the International Financial Architecture", *Acta Oeconomica*, Vol. 51, No. 3, pp. 287–314.

Bruszt, L. (2002). "Market-making as State-making: Constitutions and Economic Development in Post-communist Eastern Europe", *Constitutional Political Economy*, Vol. 13, No. 1, pp. 53–72.

Bruton, H. (1998). "A Reconsideration of Import Substitution", *The Journal of Economic Literature*, Vol. 36, No. 2, pp. 903–36.

Buchanan, J. (1977). "Law and the Invisible Hand", in: Buchanan, James, *Freedom in Constitutional Contract*, College Station: Texas A&M University Press, pp. 2–39.

Cassel, D., ed. (1998). *Europäische Integration als Ordnungspolitische Gestaltungsaufgabe*, Berlin: Duncker und Humblot, Schriften des Vereins für Socialpolitik, Band 260.

Cottarelli, C. and G. Szapáry, eds. (1998). *Moderate Inflation*, Washington, Budapest: joint publication of the IMF and the National Bank of Hungary.

Csaba, L. (2002a). "Transition and Integration in Central and Eastern Europe", in: Mänicke, K., ed., *Zehn Jahre Wende in Osteuropa*, Frankfurt am Main: Verlag Peter Lang (in print).

_____ (2002b). "Economics: Hungary", in: Kaase, Max, and Vera Sparschuh, eds., *Handbook of Three Social Sciences in Central and Eastern Europe*, Berlin: Wissenschaftzentrum Berlin & Informationszentrum Berlin, Paris: Maison des Sciences de l'Homme, Collegium Budapest, Brussels / Fifth Framework Programme, (in print).

Chubais, A. and M. Vishnievskaia (1995). "Russian Privatization in mid-1994", in: Aslund, Anders, ed., *Russian Economic Reform at Risk*, London: Frances Pinter and New York: St. Martin's Press, pp. 89–99.

Dallago, B. (1994). "Some Reflections on Privatization as a Means to Transform the Economic System: the Western Experience", in: Wagener, Hans-Jürgen, ed., *The Political Economy of Transformation*, Heidelberg and New York: Physica Verlag, pp. 113–44.

DeLong, B. (2000). "The Triumph of Monetarism?" *The Journal of Economic Perspectives*, Vol. 14, No. 1, pp. 83–94.

Dorn, J., S. Hanke and A. Walters, eds. (1998). *The Revolution in Development Economics*, Washington: The Cato Institute.

Dornbusch, R. (1993). *Stabilization, Debt and Reform: Policy Choices for Developing Countries*, New York: Harvester Wheatsheaf.

______ (2000). *Keys to Prosperity: Free Markets, Sound Money and a Bit of Luck*, Cambridge (Mass.): The MIT Press.

Easterly, W. (2001). *The Elusive Quest for Growth*, Cambridge (Mass.) and London: The MIT Press.

Eatwell, J., M. Ellman, M. Karlsson, M.D. Nuti, and J. Shapiro (1997). *Not "Just Another Accession". The Political Economy of EU Enlargement to the East*, London: Institute for Public Policy Research.

European Commission (1990). "Stabilization, Liberalization and Devolution. Assessment of the Economic Situation and Reform Process in the Soviet Union", *European Economy*, No. 45. (special issue).

Eucken, W. (1948). "On the Theory of the Centrally Administered Economy. An Analysis of the German Experiment", parts I and II, *Economica,* new Vol. 15, No. 1, pp. 79–100 and No. 2, pp. 173–93.

Greenaway, D., W. Morgan and P. Wright (1998). "Trade Reform Adjustment and Growth: What does the Evidence Tell Us?" *The Economic Journal*, Vol, 108, No. 450, pp. 1547–61.

Harberger, A. (2001). "The View from the Trenches: Development Processes and Policies as Seen by a Working Professional", in: Meier, Gerald, and Joseph Stiglitz, eds., *Frontiers of Development Economics*, Oxford University Press for the World Bank, pp. 541–61.

Hare, P.G. (2001). “Institutional Change and Economic Performance in the Transition Economies”, in: UN Economic Commission for Europe, *Economic Survey of Europe*, No. 2. Geneva and New York: pp. 77–94.

Hayek, F.A. (1989). *The Fatal Conceit*, Chicago: The University of Chicago Press (second edition).

Hibbs, D. (2001). “The Politicization of Growth Theory”, *Kyklos,* Vol. 54, nos. (2–3), pp. 293–316.

Hoff, K. and J. Stiglitz (2001). “Modern Economic Theory and Development”, in: Meier, G., and J. Stiglitz, eds., op. cit., pp. 389–459.

IMF/OECD/IBRD (1991). *A Study of the Soviet Economy*, Vols. I–III, Washington, D.C.: Government Printing Office.

Kolodko, G.W. (2000a). “Ten Years of Post-socialist Transition: The Lessons for Policy Reforms”, in: Kolodko, G.W., *Post Communist Transition: The Thorny Road,* Rochester, N.Y.: University of Rochester Press, and Boydell&Brewer Ltd., Woodbridge, Suffolk (UK), pp. 57–86.

______ (2000b). “The Washington Consensus Revisited”, in: Kolodko, G.W.: *From Shock to Therapy*, Oxford etc: Oxford University Press for the UN University, pp. 119–42.

Kornai, J. (1990). *The Road to a Free Economy*, New York: W.W. Norton.

______ (1994). “Transformational Recession”, *The Journal of Comparative Economics*, Vol. 19, No. 1, pp. 39–63.

______ (2000). “Ten Years After. The Road to a Free Economy: The Author’s Self-evaluation”, in: Stiglitz, J., ed., *The Annual World Bank Conference on Development Economics*, Washington, IBRD, pp. 1–30.

Kornai, J., S. Haggard and R. Kaufmann, eds. (2001). *Reforming the State: Fiscal and Welfare Reforms in Post-Socialist Countries*, Cambridge etc: Cambridge University Press.

Körössényi, A. (1995). “Reasons for the Defeat of the Right”, *East European Politics and Societies,* Vol. 9, No. 3.

Köves, A. and P. Marer, eds. (1991). *Foreign Economic Liberalization: Experiences of Socialist and Market Economies*, Boulder (Col.): The Westview Press.

Krueger, A. (1998). “Wither the IMF and the World Bank?” *The Journal of Economic Literature*, Vol. 36, No. 4, pp. 1983–2002.

______ (2000). “Agenda for Future Research”, in: Krueger, Anne, ed., *Economic Policy Reform: the Second Stage*, Chicago and London: The University of Chicago Press, pp. 585–94.

Kydland, F. and E. Prescott (1977). “Rules Rather than Discretion: The Inconsistency of Optimal Plans”, *The Journal of Political Economy*, Vol. 87. No. 3, pp. 473–92.

Laki, M. (1991). “Economic Programmes of the Ex-opposition Parties in Hungary”, *East European Politics and Societies*, Vol. 5, No. 1, pp. 73–92.

Lal, D. (1993). *The Repressed Economy*, Aldershot (UK) and Brookfield (USA): Edward Elgar.

Lámfalussy, A. (2000). *Financial Crises in Emerging Markets*, New Haven: Yale University Press.

Lányi, K. (1996). “Szociális piacgazdaság – nálunk, most?” [A social market economy for Hungary, now?], in: *2000,* Vol. 8, No. 4, pp. 8–17.

Malle, S. (1994). “Privatization in Russia: A Comparative Study in Institutional Change”, in: Csaba, László, ed., *Privatization, Liberalization and Destruction*, Aldershot (UK) and Brookfield (USA): Dartmouth Publishing Co, pp. 71–101. – reprinted also in: Pejovich, Svetozar, ed., *The Economics of Property Rights*, Vol. I, Cheltenham (UK) and Northampton (Mass., USA): Edward Elgar, 2001, pp. 403–33.

Megisson, W. and J. Netter (2001). “From State to Market: A Survey of Empirical Studies on Privatization”, *The Journal of Economic Literature*, Vol. 39, No. 2, pp. 321–89.

Meier, G. (2001). “The Old Generation of Development Economists and the New”, in: Meier, G., and J. Stiglitz, eds., op. cit., pp. 13–50.

Murrel, P. (1995). “The Transition According to Cambridge, Mass.” *The Journal of Economic Literature*, Vol. 33, No. 1, pp. 164–78.

Nelson, J., Ch. Tilly and L. Walker, eds. (1999). *Transforming Post-Communist Political Economies*, Washington: The National Academy Press.

North, D. (1990). *Institutions, Institutional Change and Economic Performance*, Cambridge etc: Cambridge University Press.

Olson, M. (1982). *The Rise and Decline of Nations: Economic Growth, Stagflation and Social Rigidities*, New Haven: Yale University Press.

Paulson, J., ed. (1999). *African Economies in Transition*, Vols. I and II, New York: St. Martin’s Press.

Perkins, D. and P. Roemer, eds. (1991). *Reforming Economic Systems in Developing Countries*, Cambridge (Mass.): The Harvard University Press.

Portes, R., ed. (1999). “The Path of Reform in Central and Eastern Europe”, *European Economy*, special issue No. 2.

Roland, G. (1991). “Political Economy of Sequencing Tactics in the Transition Period”, in: Csaba, László, ed., *Systemic Change and Stabilization in Eastern Europe*, Aldershot (UK) and Brookfield (USA): Dartmouth Publishing Co, pp. 45–64.

Saint-Paul, G. (2000). “The New Political Economy”. *The Journal of Economic Literature*, Vol. 38, No. 4, pp. 915–25.

Schardax, F. and T. Reininger (2001). "The Financial Sector in Five Central and Eastern European Countries": an overview, Vienna: Oesterreichische Nationalbank, *Focus on Transition*, Vol. 7, No. 1. pp. 30–64.

Schneider, F. (1993). "The Federal and Fiscal Structures of Western Democracies as a Model a Federal Union in Former Communist Countries?" in: Wagener, Hans-Jürgen, ed., *On the Theory and Policy of Systemic Change*, Heidelberg and NewYork.: Physica Verlag, pp. 135–54.

Schrader, J-V. (2000). "CAP Reform, the Berlin Summit and EU Enlargement", *Intereconomics*, Vol. 35, No. 5, pp. 231–42.

Stiglitz, J. (2000). "Reflections on the Theory and Practice of Reform", in: Krueger, Anne, ed., op. cit., pp. 551–81.

Todaro, M. (2000). *The Economics of Development*, 7th edition, Oxford: Oxford University Press.

UN Economic Commission for Europe (2001). *Economic Survey of Europe*, No. 1. Geneva and New York.

Vanberg, V. (2001). *The Constitution of Markets: Essays in Political Economy*, London and N.Y.: Routledge.

Williamson, J. (1994). "In Search for a Manual for Technopols", in: Williamson, John, ed., *The Political Economy of Policy Reform*, Washington, D.C.: Institute of International Economics, pp. 9–47.

______ (2000). "What Should the World Bank Think about the Washington Consensus?" *The World Bank Research Observer*, Vol. 15, No. 2, pp. 251–64.

Williamson, O.E. (2000). "The New Institutional Economics: Taking Stock, Looking Ahead", *The Journal of Economic Literature*, Vol. 38, No. 3, pp. 595–613.