

# Transition<sup>1</sup>

Miroslav Prokopijevic  
(Belgrade Open School and ICER)

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**Abstract:** The intention in this article is to consider some basic questions of transition after the more than ten years that have elapsed since this process has started, and after the emergence of a huge literature which tries to explain it. The structure of the article is as it follows: Part **I** is about a tentative definition of transition, followed by part **II**, which presents an analysis of the big-bang theory, probably the most popular policy recommendation for post-communist reforms. Part **III** is about privatization, which championed the attention of economists dealing with transition. It is argued that policy recommendations are unlikely to work during transition in the East Europe, if they do not take into account specific conditions in these countries; since conditions are quite different and since they change during reform, a strong commitment to reform is more important than a ready-made program. That indicates why nearly all policy recommendations of western experts (and those experts from East Europe who support them) have missed the point.

*“...the reformer has enemies in all these who profit by the old order, and only lukewarm defenders in all those who would profit by the new”.*

Machiavelli, *The Prince*, ch. VI.

*We simply have no good models of policies in Third World, transition or other economies.*

North, 2000, 8.

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## I

The fact that around 30 states in Euro-Asia<sup>2</sup>, with 380 million people inhabiting ca. 24 million square kilometers is in transition, makes it one of the largest single economic and social happenings in history. The term “transition” is not the result of a happy choice<sup>3</sup>, since it can refer to any change of one state of affairs to another one, but it has become the trade mark for one of the most popular topics in economics and social science, resulting in a huge transitology literature. In order to produce something on transition which makes sense, one needs to go a step back, to see what has produced the need for transition. No doctor cures the consequences of a disease, without asking what has caused the outbreak of the disease. However, it is not easy to establish the analogy with the doctor in the case of transition.

Although transition has made possible by the collapse of communism, the debate about this process goes on, without reaching any consensus about why communism collapsed.<sup>4</sup> It is not difficult to observe that the left wing authors feel uneasy about the collapse of communism. Let us put aside those who say that the collapse of communism has nothing to do with the idea of communism, for their evident essentialism and for their unfounded hope, that something which never passed the test of time, despite numerous attempts, will do so one day. This episode was a strong setback to their convictions, since they perceived communism as related to ideals they themselves have represented, like social or labor democracy. They prefer to be silent on the issue, and to regard their own position with or without warning bells: those who do not hear an alarm proceed on as nothing has happened; those who hear the alarm recognize the need for changes by paying a fee to the spirit of time, by suggesting a reduction of the role of the state in economic life, pointing out the role of markets, and making other adjustments. And some of these authors who in the midst of 1980s, i.e. a few years before the collapse of communism, expressed belief in great achievements

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<sup>2</sup> China for now can not be considered as a post-communist country.

<sup>3</sup> “First, it was not politically suitable to call East-European economies with their real name – developing or underdeveloped countries. That would have been at odds with the political objectives of making the former communist countries feel treated as equals by the Western community ... Second, a new name had to be coined to justify policies that proved rather ineffective in the Third World experience, but were proposed once again – sometimes in different versions – in the East-European context”. Colombatto. 2000, 1.

<sup>4</sup> Colombatto (2001, 5-11) offers a classification of theories related to the causes of the collapse of communism.

and a good future for the Soviet type of socialism, as J. K. Galbraith and P. Samuelson did, would apparently be over-questioned (overburdened), since it would require a profound change for them to abandon their trust in the future of communism by posing questions about the causes for its collapse. That would ask for a deep intellectual and political redefinition, which makes little sense when one is so broadly famous for advocating certain views.

On the right wing side, communism was never liked, but the majority of these authors also never tried to explain it systematically, restricting themselves to more or less elaborated remarks about the strange sides and murky conditions of the communist world. To many among them, the collapse of communism also came as a surprise. But at least one group of scholars enthusiastically sought out the fatal mistake in the communist construction, and that group was the Austrians of different generations. The best known diagnosis from this school stems from Ludwig von Mises, who traced back the constructivist error of communism to the impossibility of economic calculation. This approach is sometimes repeated in our times. A more moderate approach from the same school of thought points out that poor economic performance is caused by inappropriate calculation rather than its impossibility. Mises's approach was valuable at the beginning of the debate over communism, since it singled out one really essential point, at the time when there was a lot of confusion over communism, but just repeating Mises's solution today does not contribute to better understanding of the past. Those who today reduce the troubles of communism to the impossibility of calculation should try to answer the question, how could such a system have lasted for seven decades? They were inefficient systems in the economic sense but lasted for a long time. And by being efficient in economic sense while remaining politically oppressive, communism could probably have developed along some other lines, similar to those of Chile after 1973 or the "tigers" from the Far East from 1960s onwards. But by having delivered next to nothing both in an economic and political sense, communism had little to offer in an increasingly competitive environment of the XX century. Many forget that communist authors and leaders promised more freedom and prosperity to citizens under communist rule, than was to be found in the capitalist world, and by doing so, they actually accepted the premise that the communism was a rival to capitalism in the same race, where only real results matter. In order to deliver their promises, communists surprisingly did not further cultivate the inherited achievements of the societies where they took power, but destroyed and annihilated them under the justification that

communist world needed a new and completely different beginning. So quasi-democracies or authoritarian regimes were replaced by dictatorships, legal systems by party rule, and more or less market economies by planned economies. Having this pre-history of transition in mind, how does one define transition itself?

One way to depict transition would be to say that it is a move from communism to free societies. This is in a sense true, since transition would be impossible without liberalization, but it is not a happy solution simply from the point of view of definitional stringency, since “free” is the opposite of “not-free”, and communism is just one type of non-free regime. To say that it is a move from communism to market democracy is hardly a better solution, besides the internal troubles induced by the term “market democracy”.

To say that transition connotes a fundamental transformation of institutions coordinating and structuring economic, social and political processes in societies (Balcerowicz, 1997), moves in the right direction, although it leaves legal aspects unmentioned, and it is too descriptive, since “process” is a very broad term which can be applied everywhere but which does not say a lot. This definition may be useful, however, if slightly reworked to say: transition consists – basically but not exclusively – in a threefold move: from dictatorship to democracy, from the rule of one party (man) to the rule of law, and from a planned to a market economy. “Basically but not exclusively” means, that changes sweep all segments of life, i.e. they go beyond the three spheres mentioned above, but what happens in these three spheres merely determines the success of the transition.

If one was asked about the applicable evidence for use with this definition, he would refer to the existing evidence from advanced transition countries. In less successful transition countries we would have seen more limited moves along similar lines, provided there was some significant reform effort. Transitional reforms are expected to eliminate communist institutions and to revert to the *status quo ante*, adjusted and improved for changes in international assumptions since communism was introduced into these countries. That means that these countries were not democracies when they became communist, but today nothing other than democracy counts. The rule of law and market economies also look different today, compared with how they looked several decades ago.

One naturally can ask why transition should consist in a move to democracy, market economy and the rule of law, and not in a move in some other

direction. This is not because one relies on a priori knowledge, but rather due to an absence of reasonable alternatives. The demand for market democracy under the rule of law increased greatly during the XIX and XX centuries, since some alternatives like fascism, national-socialism or communism were directly or indirectly defeated, while others, like “third way” or Islamic regime, were not viable and promising competitors. This fact leaves little room for deliberation and spontaneity in what concerns the general direction of reform. Nevertheless, it would be wrong for elites or authorities to impose this type of the regime on people. People in nearly all post-communist countries always lived in non-democratic regimes, with notable exception of Czechoslovakia between the two world wars, and it would be wrong to deprive them of a choice now, when they for the first time in history have the opportunity to choose freely. Such choices are not without inherent risk, since there is no guarantee that people will vote for democracy, market economy and the rule of law. But if the individuals in some country are not mature enough to design and adopt a productive institutional environment that will enable them to take advantage of getting personal responsibility in their own hands, there is no point in imposing of rules upon them as well, since such regimes cannot be sustainable, as the long history of colonialism shows.<sup>5</sup>

As it is already pointed out, transition consists, basically, but not exclusively, in a threefold move: from dictatorship to democracy, from the rule of one party (man) to the rule of law, and from command (planned, dirigiste) to market economies. All three pillars have different roles and requirements during reform.

Democracy should pave the way for individual preferences to count. It is probably easier to see some elementary parts of a workable democracy implemented, than to do the same for the rule of law and market economies. Democracy starts to work as soon as the relevant political parties in a country agree to respect the tenets of free and fair elections, something that can not be said for the other two pillars. Immediate advances in democracy are essential for providing legitimacy for the whole post-communist reform, since the other two pillars need much more time in order to produce results. At the same time, advances in democracy at the beginning of the reform are tests for the other two pillars: if democracy in a country cannot work smoothly, there is no point in expecting that the rule of law and market economy can work there either. It

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<sup>5</sup> The U.S. have intervened on Haiti for several times during XIX and XX century, have even spent decades there before the IIWW, and nevertheless failed to establish a minimally decent regime there. (Even the positive outcome of the last such effort started in 1994 is not sure.) The same would happen in transition countries, if solutions were imposed, and the reform will not work until strong demand for serious improvement emerges from inside the country.

is not necessary to say that democracy will work against market and legal reforms, by providing channels for rent-seeking, because rent-seeking can also exist in poorly functioning democracies. So, democracy is more likely to produce quick results than the rule of law and market economy. Naturally, developing more sophisticated democratic structures, refining democratic procedures like those concerning the protection of minorities and developing a really democratic attitude among people requires much effort and time.

From all three pillars, the rule of law has attracted the least attention in transitology. Special importance of the rule of law during transition consists in the insight that democracy and market economies cannot stabilize and function well until the rule of law prevails. If there is not an unbiased referee in the political arena, this will spoil political life, and lower the entry price for manipulation, corruption, and the threat or use of violence in political life. On the other side, if such a referee is lacking in market operations, it will infuse additional uncertainty into the market, discouraging entrepreneurs, reducing the readiness to engage in transactions, and generally lower the level of market activity. The more instruments of the rule of law are absent, the more depressed will be market operations.

The rule of law remained the least discussed pillar of the transition probably for at least two reasons. First, the main profits from the workable rule of law will be delivered to people indirectly rather than directly that is via democracy and market economies.

Second, post-communist countries do not have a good historical record regarding what the rule of law means. Some elements of the “Rechtsstaat”, a younger and less developed cousin of the rule of law, which existed in some countries where communists took power, were definitively wiped out under communist rule. Communists naturally had some legal system, but it was envisaged to promote the power of the state and bureaucrats over individuals and society, rather than to limit the power of the state and bureaucrats. As such, it was merely a travesty of justice. In such an environment it would be unrealistic to expect that the rule of law can emerge quickly and successfully.

Having in mind that the idea of the rule of law was born out of a very long evolution of Anglo-Saxon common law, one can imagine the difficulty in transferring it into a rather different environment, such as that of post-communist countries. The customs, habits and social capital of the people in post-communist countries are

different from those in the U.S or United Kingdom, so that imports would be unlikely to work if not adjusted, like in Sweden, Spain or Switzerland, where the rule of law is mixed with the law produced by the state and with local customs. Even if the rule of law would be somehow confirmed by parliaments, it is questionable to what degree people would respect such rules. Observed regularities show that people tend to respect those formal rules which are in accordance with their informal rules and habits, and to ignore those formal rules which do not accord. If people violate formal rules only occasionally, it is easy to enforce the law. But if violation becomes the rule, or if people simply ignore the rules, the majority can not be imprisoned. Rules that people ignore or violate routinely must be adjusted, changed, or even replaced. Even enforcement mechanisms must be adjusted to habits and informal rules prevailing in the population. It is important to keep in mind that nowhere are rules completely respected and completely enforced. Significant differences exist even among developed countries. Italy is one of examples where many of formal rules are neither obeyed nor enforced.

Economic issues are champions in getting attention from all three pillars of the transition debate, with privatization as a notorious focal point. One can object at this place by saying, privatization has not justly deserved such a prominent position, since inducing or letting evolve market mechanisms instead of bureaucratic arbitration requires a network of institutions, and those related to privatization are but a small fraction among them. The reason why privatization attracts so much attention among transitologists lies probably in the nature of problem itself. Pillars like democracy or the rule of law, independent of the concrete form they get in some country, require nearly exclusive state action, and are similar to other economic instruments, such as liberalization of foreign exchange or the stabilization of currency. In all these areas quite concrete steps can only be taken by the state. In the realm of privatization, by contrast, there is an opportunity for a different balance in state vs. market actions. And when one declares his views on privatization, it is easy to deduce his views on the whole process of the reform.

The merits of democracy, markets and the rule of law are not just in their positive results, but also in what they prevent. Democracy undermines the power of one person or a small committee to rule over others in a society. The rule of law undermines arbitrary discrimination, and so undermines the power of racists, nationalists and religious fanatics. Finally, market economies undermine the power of collectivists of all types.

From the fact that the general direction of post-communist change leaves little space for originality or improvisation, it does not follow that spontaneity and freedom of choice are excluded during reforms. It is one thing to have a general goal, another to define it precisely, and a third to decide, what is to be fixed and defined, and what left free to be determined by market and social forces. Market democracy is not static, as developments from the XIX century have shown. It is a large family with different degrees of dependency and different types of relationships among its members. Which type to choose, when and how to implement it and at what costs, and which priorities to promote are the questions to be decided. In any case, post-communist societies face a rare situation of being completely free on how to proceed. They were free to choose the rules of the game given their point of departure. And they were able to ignore the advice of scholars, which rarely was appropriate, as we shall see.

## II

Among the myriad approaches to transition, the big-bang and evolutionary theories deserve special attention. The big-bang theory, frequently called the “shock therapy”- I will use these terms simultaneously - is based on quickly implemented social engineering, and one of the best known products of this school is labeled “Cambridge, Mass.” Many other programs which emerged later on during transition bear a striking similarity with “Cambridge, Mass.”, so that is not outdated to discuss it now.<sup>6</sup> The evolutionary approach has a technocratic and spontaneous version: the former is represented by K. J. Arrow<sup>7</sup>, among others; the latter advocated by different representatives of the public choice, institutionalist, and Austrian schools. Let us consider the technocratic approaches in some detail.

The “shock therapy” approach assumes that there is no incurable disease, with the communist legacy being no exception. Treatment of the communist heritage envisages a standard prescription consisting of fast liberalization of domestic markets and foreign exchanges, macroeconomic stabilization, privatization, convertibility of currency (current account convertibility), moderate social security networks, and the

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<sup>6</sup> “Shock therapy” has adherents in nearly all transition countries, although they are not necessarily politically influential. Media, experts and general public in transition countries widely share the conviction, that there are just two ways for reforms: shock therapy and gradual, evolutionary changes.

<sup>7</sup> Arrow 2000 is a later version of an article from 1993, which different versions were published for several times.



design and implementation of a legal environment for market activities<sup>8</sup>. This approach assumes that visiting advisers and experts are quickly able to gain insight into the situation of any country, ignoring micro- and macroeconomic issues, social capital questions, customs and history, and that they are able to develop a program of reforms. If politicians and bureaucrats implement these programs, a successful outcome is assured.

After the collapse of communism, this approach was quickly launched, and it raised the hope that the disease of communism was easy curable, that there were time-saving procedures, and that the heritage of this murky system would be easily and nearly painlessly eliminated in a few years. This again raised hopes among peoples of ex-communist countries for an easy transition from poverty to prosperity. It is surprising how much support this approach enjoyed and enjoys, and not only among common people but also among those who are not amateurs in transition issues, although its weaknesses are more than striking. Only scattered authors do not remember that this approach was tried several times in the Third World countries, and that nowhere has it worked well.

In order to develop any program, to start with, one needs to establish some facts about the country in question. This can be done reasonably well, although post-communist countries are not famous for having good historical statistics: even if available for longer periods and all necessary sectors (what is in itself too demanding a claim) the data are not reliable, local analysis, if any, is nearly non-usable, and the real temporary state of affairs is beyond the reach of statistics and the control of authorities, except by brutal physical force. Given this situation, what analysis can be done, how firm can the conclusions be, and what good policy recommendations would be? Probably, a maximum that can be done under such circumstances – and this characterizes almost all post-communist countries<sup>9</sup> – is to get some impression. It is practically impossible to adjust the model and policy prescriptions to the situation, and this is probably one of the reasons why big-bang reforms have taken nearly the same form in every country when they have been tried.

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<sup>8</sup> Shortly before communism collapsed throughout the East Europe, Jeffrey Sachs was selected in 1989 to advise Ante Markovic, the last ex-Yugoslav prime minister before the country broke up, and Sachs has suggested changes along the above lines.

<sup>9</sup> The “Cambridge, Mass.”-program is launched at the beginning of 1990s. Poor statistics have characterized all countries at that time, i.e. in their first post-communist years. Statistical services improved later on in some countries, but still now less than a half of the transition economies has a workable statistics.

Secondly, the “Cambridge, Mass.” approach places too much emphasis on the power of economic knowledge.<sup>10</sup> It promises to deliver abroad what cannot be delivered at home (that is a prediction about the future direction of market forces where valid information on market operation *is* available) i.e. it promises good results despite uncertain data and insufficient knowledge of the actual state of affairs, since such information on market operations is not available. Transition problems would be poorly treated by a fixed program, since transition itself is far from being a routine. The change of real situation requires permanent adjustments in public policies. That is probably the reason why predictions, when made, were either far off of real developments or even contrary to them. The main positive result in the realm of economic knowledge seems to be for people to be more apt to adopt a cautious and skeptical attitude, as advocated by D. North<sup>11</sup>.

Third, the “Cambridge, Mass.” approach completely ignores the problem of social capital. It is one thing to propose a program for a country with a predominantly Muslim population, like Azerbaijan, where there was no real industrialization, where the work ethic is relaxed, and bargaining is the main marketing instrument, and quite another to propose a program for the Czech Republic or Slovenia, which have Christian populations, a long industrial history, work habits similar to Germany, where prices are regularly labeled and where other marketing instruments should be workable. Even East and West Germany need different solutions as we are going to see later on.

Fourth, the ignorance of habits and social capital leaves unclear which rules of the reform program under given conditions are acceptable and which are not; which rules are to be adjusted and how this is to happen; which practices can be changed and which would be costly to change. If the underlying customs, habits and beliefs are at odds with the proposed institutional framework, formal and informal institutions will be in conflict and that will raise transaction costs.<sup>12</sup> The resulting higher degree of incompatibility would delegitimize formal rules and retard the reform program.

Fifth, since this approach ignores the real situation, macroeconomic data, and the limitations of existing social capital, it is likely to be an abstract desideratum of allegedly economic wisdom that cannot be sold directly to voters, but must be imposed by local technocrats and politicians. Even if we put aside whether these politicians have

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<sup>10</sup> Cf. Murrell, 1995, 166-7.

<sup>11</sup> “We are still a long way from having a theory of economic change and the accumulated evidence we have from fragmented stories of different countries does not add up to giving us firm conclusions. A few general observations may be allowed”. North, 2000, 4-5.

<sup>12</sup> The point is rightly made by D. C. North, S. Pejovich, and many others.

democratic legitimacy, these issues pose serious problems for the program's implementation. One is that politicians and bureaucrats have their own interests that could widely diverge from the tenets of "economic wisdom." Real interest of these politicians will direct whether, to which degree, when and how these recommendations will be implemented. And even if politicians do not just pay lip service to the reform proposed by experts, the final outcome of reform implementation can widely diverge from the initial proposal.

Sixth, the other difficulty would be that – even if these prescriptions are applied literally, provided there is something like that – this would be from above (top-bottom reforms), and that does not seem economically wise or politically correct. Economically, people may not freely accept some program, even if it is claimed to be in their interest. If a program can not pass the test of time, there must be either something wrong (mistaken) with it, or people are not mature enough for such a program. Politically, what is the true difference between imposition of allegedly wise economic programs, and the authoritarian and non-democratic implementation of some policy? It seems that the only difference would be in the promise of the program to benefit the huge majority of individuals in the society, while dictatorial imposition of rules does not necessarily take into account the interests of people other than dictator. It is, however, one thing to impose an allegedly optimizing reform program and quite another one to cultivate some social environment for free market enterprise. Later I will add more on this point.

A defendant of the "Cambridge, Mass." approach can hardly refute the above objections, but he can point out that there was no successful reform in the East Europe without having implemented what was prescribed by this approach. This would be true, since there are no serious reforms without liberalization or without privatization. Prescriptions seem to fit, since they contain merely general terms without specific content. To say simply "privatization is necessary" for a successful reform is no different than to say that a sound currency is important for working economy. Statements like this are true because they are tautologies or analytical truths, i.e. to the description of a working economy belongs that a huge majority of resources should be private and that the currency should be relatively stable. To collect several such statements does not require special expertise – it suffices to describe the main elements of some existing market economy. It is much easier to collect some statements about the general direction of reform than to design and implement any sector of the reform. For

example, the types of privatization are very different, the process has not just its static, but also its dynamics, it has a time-table, eventual exceptions, concessions, modifications and adjustments. A number of elements can not be specified in advance, and for this job top economists, who rarely operate outside their office and classrooms, are poor candidates, since they are not trained for that.

Arrow (2000) criticizes both the “shock therapy” approach and slow reforms. Big-bangers are responsible for neglecting local circumstances, due to reform fever, while slow reformers lose pro-reform credibility. His reform proposal borrows from both sides that he criticizes, probably a little bit more from big-bangers. Arrow would like to start “with a rapid entry of private industry into commerce and light industry, followed by gradual privatization of more capital intensive industries, while keeping the government in charge of restructuring legal and financial institutions and the management of declining industries.” (Arrow, 2000, 9) Arrow’s reform proposal has some realistic features, since the experience from nearly all transition countries indicates that retail sale and small services were privatized first, followed by wholesale trade and export-import firms, light industry, and finally by the privatization of heavy industry. Naturally, socialist “giants” were privatized last, if not already closed down as irretrievably bankrupt. This process happens automatically, so that sophisticated state action is not needed to establish an order in the privatization queue. From “Cambridge, Mass.” Arrow differs by being more cautious about quick change, but he shares their confidence in the power of economic knowledge to produce that change. In addition, Arrow is wrongly convinced that reform can start as statist and become progressively liberalized. This is in principle possible, but it has never happened during transition up to now. Reforms that started with a large role for the state, such as in Slovenia, ended with a large role of the state. Nevertheless, Arrow (2000, 13) says: “Gradual transitions require guidance, and the only source of general guidance for the economy is the state. The history of the government as a guide to economic activity is mixed. The activist role of most European states in the immediate post-war period did not hurt their development, but it has proved increasingly useless and even damaging as their economies evolved.” Looking at the European states from 1950s until today, one finds larger, and not the same or smaller roles for the state. It is not easy to see where Arrow feels “mixed” outcomes.

Protagonists of spontaneous reform barely differ from the “Cambridge, Mass”-type of economists in true acceptance of some well known tenets of the market

economy, and so they would not deny the necessity of privatization or liberalization during transition. Spontaneity does not mean step by step evolution in any direction - for example, an evolution outside the scope of locally colored market democracy. It also does exclude an evolution toward anarchy conceived as chaos, where institutions decay, with or without violence, and where the predictability of future actions tends to zero. One difference between adherents of technocratic vs. spontaneous solutions is in the absence of readiness by the later to impose solutions upon people, even if they might be in the best interest of people. This indicates another, probably crucial difference. Proposals like “Cambridge, Mass.” rely on the more central coordination introduced from the top of the social system, while advocates of spontaneity rely on a decentralized coordination process<sup>13</sup>. This has some consequences which are so important that they actually articulate a pretty different vision of transition reform in two cases. It seems that reformers who recommend spontaneity allow people to experiment, to try to find out solutions for emerging problems, and that the vital impulse goes bottom-to-top rather than the other way around.

This characterization might lead to the objection, that something like this is not possible, since it happens to be rare that rules are self-enforcing. True, people accept rules freely and they became self-enforcing if and only if the gain from obeying the rules exceeds the gain from violating them. Basic traffic rules like “drive right” or “drive left” are an example for free obedience. However, it is difficult to establish the analogy even between traffic rules and criminal or commercial law, since the violation of a commercial law could be profitable for many more individuals than a violation of traffic rules. Everybody expecting to profit from a violation of commercial law would have interest in breaking the rules. And it is even more difficult to establish the analogy between elementary traffic rules and the rules of the economic game, since the incentives flowing from the economic rules are more complex and diversified. But even if one assumes that traffic and economic rules are similar<sup>14</sup> in nature, this changes little the outcome of an eventual imposition of economic reform over some population.

But the same can not be said for some other rules: whether it is more profitable to invest in agriculture or tourism, whether individuals negotiate in this or

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<sup>13</sup> Cf. Boettke, 2001.

<sup>14</sup> Swedish government has organized a referendum in the late 1950s in the effort to persuade people to change “drive left” for “drive right”, to provide compatibility with the rest of continental Europe, and got support of just some 20% voters, while nearly 80% was against the change. The government has tried to diminish this set back by keeping a low profile over the issue, and a decade later imposed the change per decree. This is, naturally, not what an adherent of spontaneity might hope to do.

that currency (provided both accept that freely), whether firms should be small, medium-size or large, whether one move is better than the other one and the like – all these questions are where people should be left alone to find solutions they find best.

### III

Like many other puzzling questions that immediately divide those considering a problem into several camps, so has privatization divided economists and social scientists into gradualists and big-bangers (in other terms, into evolutionists and revolutionists), into free marketers and statistis, into technocrats and advocates of spontaneity, into econocrats, sociocrats and politocrats. There are those who take some moderate position among the extremes, and there are a lot of opportunities to combine the positions.

The division into gradualists and big-bangers (shock therapists) is about the *tempo* of reform. The division into free marketers and statistis is about proper *role of the state* during economic reform. The debate between technocrats and spontaneitists is about the *direction* from which the reform is to be made, top to bottom or reverse. And the debate between econocrats, sociocrats and politocrats is about the  *motive* for economic change. Let us consider them in turn.

If the only  *motive* for privatization was the economic one, i.e. efficiency, one should ignore all other possible motives and put just that into focus. By taking a longer prospective one would be able to see that the arrangement inherited by communists is inefficient because of several distortions and biases. Prices are distorted (the majority are frozen or controlled); producers are favored over consumers, debtors over creditors, exporters over importers; the internal market is covered by a number of decrees; the external market is restricted by barriers; currency is permanently inflated, budget constraints are permanently softened, etc. It seems that it is not so easy to make decisions under these conditions. But holding elements of the economic environment constant, what would be wise to do? To enforce law and contracts, and to let individuals find their own way in utilizing resources, or entering the game into some other way.

A lot naturally depends on the concrete situation. But by taking this constant (neutral), it seems that the first point must be to take a longer time horizon and to stimulate the emergence of a system of rules that will facilitate future, newly born firms, rather than existing ones. The justification for this is that existing firms are not

competitive and productive, and if they were of first concern in making rules, those rules would distort markets. In other words, current distortions will be probably reduced to some degree but made permanent. And if one takes a longer time horizon, the creation of new institutional framework to be used by newly created firms becomes more important than the privatization of existing ones. The new institutional framework should include easy entrance and exit options, resistance to changing the rules and equal market access to anybody in business (including foreigners); it should free resources and prices and allow a free disposition over profits<sup>15</sup>. The idea behind all these proposals is to lower transaction costs as much as possible, i.e. the costs of doing business. However, reform and privatization do not take place in an institutional vacuum and are not exclusively driven by principles described by Coase. In an environment where privatization is not over, property rights are not necessarily marketable, and transaction costs could be significant. The reformer who gives priority to new institutional design over privatization of the existing economy will soon lose political ground, since the interests of existing firms heavily outweigh the interests of future firms, like the interests of existing generations strongly dominate the interests of future generations. By eventually being left alone, existing state owned firms can collude in order to strengthen their bargaining position, to get rents, and postpone privatization as long as possible. That would be a minimal objective, while a more ambitious one would include removing reformers. Since the above strategy does not provide a reformer with quiet sleep, he increasingly needs to devote attention to privatization.

Before privatization can start, a government needs to allow a brief period of time to collect evidence on how firms operate. Both the past record and current performance matter. The least questionable issue concerns firms that are long-term losers, i.e. those who cannot become profitable for a long time. They will be liquidated, and this can be done in two forms. First, by stopping subsidies to them, which would indirectly close them down. Second, they can be closed per decree. In both cases their physical assets should be sold once firms are closed.

Remaining firms should be sold, if possible. The question is how and how quickly to do this. With only efficiency in mind, quick sales seem to be the best. However, those running the state may have another interest – to maximize the revenues and funds over which they dispose. They can decide to sell just some firms, to use a part

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<sup>15</sup> Prokopijevic 1998, offers more about this.

of that money to consolidate other firms in order to sell them at a higher price, and to continue this process until state owned firms are exhausted. This approach would allow politicians to maximize revenues and to use a part of money for social transfers such as the re-education of employees and compensation for lost jobs. It would enlarge the degree of political manipulation over privatization and reform, which leads to the assumption that privatization is unlikely to take part without “bribing” the main actors of the game. Workers will be “bribed” by getting transfers and time to adjust to changes, politicians by getting funds to manipulate, managers by getting opportunities to buy firms or shares under favorable terms, and voters by the political manipulation of the national economy, in which some of them profit from transfers.

Let us briefly consider what would happen in the alternative case of the instant sale of all firms. Since domestic capital is rather small in any post-communist country, and larger FDI (Foreign Direct Investment) are unlikely to be attracted in the early phases of reform (with eventual exception of breweries, tobacco factories and similar rare firms), firms will be sold relatively cheaply. New owners will profit largely, and to some lesser degree also those employed by them, but all others will lose. Politicians will lose by getting rather smaller funds for manipulation, large numbers of employees will lose their jobs, some groups will lose social transfers, voters will object to politicians for the easy sale of the national treasury.<sup>16</sup> It would be difficult under such circumstances to preserve a pro-reform majority and continue reforms. And since the free market solution in its pure form is impossible to implement during privatization, this is an obvious opportunity for regulators and technocrats to restate their role. Because the clear, instant and cut-off solutions are unlikely to produce quick results, the opportunity gets lost.

From an economic point of view the best solution would be to sell firms to those who pay the highest price. And if there is an obstacle to the sale of all firms, some other approach is to be considered, for example, that firms are first to be divided into two parts. One part should be sold on publicly announced auctions, and revenues might be deposited in banks and transferred to investment funds with the interest paid back to the state for pension, re-education, health-care and other funds; the other part should be privatized via vouchers or coupons. Which partition should be privatized in one or another way, depends on local habits and social capital. Vouchers worked relatively well in Czech republic, and badly in Russia. Direct sale worked better in Poland and



Hungary. What is to be avoided, is so-called insider privatization, where workers and managers employed in a firm get shares of the same firm. This type of privatization became the worst off of all tried, and it is easy to see why. Since employees are at the same time owners of the firm, there is no a mechanism to connect salaries to productivity and profit. Employees have an overwhelming short-term interest in giving priority to salaries over investment, innovation and all other productive purposes. Predictably, the firms' shares will decline, but this again will not worry employees. Having salaries and shares, individuals have two source of income: since they get salaries every month, they will prefer to have higher salaries than higher shares, and this explains why they do not care about declining share prices. Declining share prices just reflect the fact that expectations for future profits are declining, and this means that that firm has no future. Insiders privatization can be considered as a radicalization of the self-management system, once tried in Yugoslavia.<sup>17</sup>

There are many other concerns during privatization, we now know, that reformers have to consider if they want to enhance reform. Well-organized interest groups or broad skepticism expressed through media can stop and even reverse both privatization and reform, as the experience from the East Europe shows.<sup>18</sup> The situation from country to country is so different that at this point there is no general advice for reformers, except that they need to give as less concessions as possible. The less they are able to pay social demagogy, the better.

If not solved in theory, the question of the *direction* of reforms (top to bottom or reverse) is solved into practice. "Cambridge, Mass" and similar labeled remedies for post-communist diseases have been used just in some places to a minimum degree, like ex-Yugoslavia, Slovenia, Poland and Russia. Nowhere among all these places have they shown results. Shock-therapists can defend themselves by saying that their programs have not shown results, because they never were implemented to a large degree. In that light, probably an even better example of how disastrous imposed reform projects can be would be the ex-GDR, what is now called East Germany or "Neue Länder". Let us remind ourselves that all six largest West German economic institutes, which advise the German government, have agreed, that the program of reform for ex-

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<sup>16</sup> Voters would think that politicians are literally bribed in order to promote an instant sale, and they will punish them at next elections.

<sup>17</sup> In the Yugoslav case, workers have had some minor rights and they were just nominal owners, while the communist party directed firms via managers. This system was slightly better than common planned system, but inferior to market economy. See, Pejovich, 1998.

<sup>18</sup> Failed reforms are to be found in Ukraine (1994 and 1998), Bulgaria (1992) and Romania (1998).

GDR was good, and that the West German government, backed by this economic wisdom, implemented it throughout 1990s. It was not at all bad that East German equipment has been scrapped, since the fate of equipment is determined by market forces. What was really unfortunate was that the reform-program was imposed from the above, ignoring the fact that persons in the ex-GDR, although also Germans, had a different past and different social capital. The influence of unions in ex-GDR is so strong that the eastern part of the Carl-Zeiss Jena plant, for example, needed nearly ten years to reduce the number of workers from 14,000 to some 2,200, and to become profitable. It also reflects a high degree of regulation, common to the West German understanding of economic affairs since the mid-1960s. The result was naturally a disaster, and it is indicated by massive exodus of labor force and businesses from ex-GDR to the west, by a huge fall of real-estate prices, and in yearly transfers from West Germany to the “Neue Länder”, worth 200-250 billion DM per year, to mention just some “results”. In non-democratic regimes like China today or Chile in the 1980s imposed reforms could work, but democracy in conjunction with broad individual rights offer better instruments to resist the undesirable reforms than such regimes do.

One may dwell on whether the question of what rules should produce the state, which will be borne out of practice and which will emerge in the interaction between the state and the market can be answered as such? It is easy to say that the state is entitled just to minimal rules of the game, and these would be the rules, where there is no a reasonable alternative. All situations where there are choices should be left to the market, and the state should afterwards only eventually refine, monitor and enforce these rules. All rules that are self-enforcing should be left to the market. These criteria draw demarcation lines between jobs which are to be done in a top-to-bottom direction, and these that should will come from bellow, but it is not clear whether such an answer will be satisfactory. Transition is not like moving of water through a pipeline, where one can count quantities transported, provided he knows the pressure, volume, distance, resistance, etc. All new rules during reforms do not come at once to replace those of the centrally planned economy. There are a number of sets of rules which are produced to create a new environment without perfect coordination in doing so, and what is even more important, without exact knowledge of what would fit best. This “veil of ignorance” accompanies reformers throughout reform, and this is why Hayek’s (1973) depiction of institutions as fallible hypothesis (conjecture) reflects well what is at stake. Any rule incorporates some knowledge and some objective, and it may happen that it

works well from its initial implementation. But one can not be sure that this will be so, for we frequently do not know which kind of rule better solves the problem. In addition, rules are not just a matter of knowledge, but a matter of interest, too. The process of rule creation is an experiment where expertise, innovation and success are mixed with ignorance, routine, disorientation and failure. The emergence of a new institutional environment is a process of learning by doing, where new devices are perceived, discussed, designed, legislated and tried, and where some survive, with or without adjustment, while others die. The process can not be copied from western or any other countries, and it can not be merely transferred from one transition country to another. A lot of legislation in developed countries is counterproductive in an economic sense, and emerges due to rent-seeking or due to mistaken objectives of the majority. Industrial countries became prosperous and wealthy without product liability laws and a number of other regulations. Similar to the historic opportunity to choose free a new beginning, transition countries should not only imitate rules from developed countries, but also experiment and eventually innovate, leading to inter-jurisdictional competition<sup>19</sup>, and to better institutions and outcomes than those in western models. Up to now, to be fair, we have not seen much of this, even in transitional success stories<sup>20</sup> like Estonia, the Czech Republic or Hungary. By comparing results of transition countries with those of other countries one can see that the success is moderate.<sup>21</sup>

Now, more explicitly about the *role of the state* during transition, that is a question closely related to the previous one. Without the assistance of the state, some

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<sup>19</sup> Cf. Vanberg & Kerber 1994.

<sup>20</sup> These three countries taken as a group fare better in the light of standard economic parameters (like GDP growth rate, FDI *per capita*, capital and labor productivity growth rates, etc.), than a group of any other three transition countries. If one checks the performance on the country by country bases, Estonia, Hungary and the Czech Republic fare as a rule better than their transition rivals, although this rule have several exceptions. For example, Slovenia had higher growth rates than Czech Republic for period 1997-2000; Poland has the level of FDI *per capita* nearly comparable to Hungary and Czech Republic, etc. It can be argued, that the economic results in countries called “success stories” are the predictable outcome of deeper and more consistent liberalization. According to the **Index of economic freedom** for 2001, Estonia, the Czech Republic and Hungary are ranked 14<sup>th</sup>, 27<sup>th</sup> and 42<sup>nd</sup> respectively among 163 nations, well ahead to Poland, Slovak Republic or Slovenia, ranked 54<sup>th</sup>, 59<sup>th</sup>, and 63<sup>rd</sup> respectively.

Cf. <http://database.townhall.com/heritage/index/indexoffreedom.cfm>, pages 1-2. The 2000 annual report of the Fraser Institute under the title **Economic freedom of the world 2001** ranks Estonia, Hungary and Latvia as 36<sup>th</sup>, 43<sup>rd</sup> and 46<sup>th</sup> among 121 countries of the world. The Czech Republic, Lithuania, Slovak Republic, Slovenia and Poland are 60<sup>th</sup>, 62<sup>nd</sup>, 70<sup>th</sup>, 75<sup>th</sup> and 86<sup>th</sup>, respectively. Cf. [http://www.fraserinstitute.ca/publications/books/efw\\_2001](http://www.fraserinstitute.ca/publications/books/efw_2001), Ch.1, p. 9.

<sup>21</sup> Some successful transition countries enjoy more economic freedom than a number of countries which are members of the European Union. Index of economic freedom for 2001 ranks Estonia behind Ireland, Luxembourg, UK, Austria and Denmark, and ahead of all other EU-countries. Cf. Index at the address mentioned in Fn 19. According to the Fraser Institute, Estonia is just ahead of Greece, and behind all other countries. Even better comparative results the transition economies have achieved in some specific areas, like tax policy, competition policy, etc.

rules cannot be established and enforced, but the state should restrict its job to just some general rules, and allow individuals to find their own way in markets, since nobody can enforce rules which individuals resist to some higher degree. In economic issues, the state should withdraw, leaving room for market forces. It is not up to the government to decide which firms are to be medium and small, and which large; which prices are just (including the price of labor and interest) and which are not; which land is to be used for agriculture and which for manufacturing; which firms are to be consolidated before privatization and which are not; which banks, firms or universities are allowed to operate and which not, etc. All these jobs should be decided by market forces; otherwise, it will result in large mistakes and corresponding costs. Those who have advised the Croatian government to implement a privatization scheme in order to obtain 1 million shareholders in a population totaling 4m, did so badly, since the U.S. has 80m and Germany some 8m shareholders, in populations of 270m and 82m respectively. Advisers also persuaded the Sloven government to prefer the EU market (in order to achieve this the government has offered a lot of subsidies), although profits elsewhere could be higher; it is not up to advisers and bureaucrats, but up to market, to decide such issues.

The creation of some new institutional instrument requires a whole range of private and government activity. For example, it is widely believed, mortgages cannot be developed until the state enforces private contracts, until it is known whether a contract could be just a person's word, with or without witnesses, or eventually it must be written in some form on paper and sealed by a licensed authority. How mortgages will be designed depends a lot on informal rules. For example, the mortgage market in Serbia was divided into formal and informal parts. The informal market was illegal and punishment for that type of activity was severe. Nevertheless, the informal market was much stronger than the formal one during 1990s. Some registered firms made formal contracts, while on the informal market the proof of the existence and content of a contract was enough either to have one witness or to have the borrower's writing done on a piece of paper, sometimes provided from an empty tobacco box. It took approximately the following form: "I confirm, that I took the credit from person X worth \$ 20.000, and that I will pay back \$ 25.000 until day Y." The enforcement mechanism on the formal market was the selling of mortgaged property, while the same function on the informal market has involved privately hired blackmail squads. Such a squad first tried to get back money politely, but became progressively violent, if

previously used methods remained unsuccessful. For a significant amount one could be even killed. However, the application of violence for these purposes have been rarely reported in the media or in informal conversations, suggesting that the informal market has worked well. Creditors just asked for money to be paid back. They were not entitled to the borrower's property, and so unable to sell it. This in effect led to the practice that borrowers themselves sold their property in order to be able to pay back, a practice that could be considered as a modification of the mortgage institution under a condition of illegality. Clearly, the informal mortgage market worked not only without any assistance of the state, but also despite the will of the state.

A frequent danger for contractual arrangements consists in phenomena like *ex ante* and *ex post* opportunism that is a part of "private ordering" or private regulation in contrast to the state one. *Ex ante* opportunism is related to strategic behavior of the party dictating contractual terms until the contract emerges among parties. *Ex post* opportunism is related to strategic behavior of the party inferior during contractual bargaining, but superior after the contract is made. For example, a bank can exploit *ex ante* opportunism by offering credits on the "take-it-or-leave-it-basis", while borrower can exploit *ex post* opportunism, in looking for ways to evade or at least to relax its contractual obligation. Countries short of capital are a trap for foreign banks and investment funds, which in entering such markets undergo the illusion, that they can dictate credit conditions in favorable terms for themselves. They ignore the fact that it is easy to lease the money under (allegedly) good terms, but it is difficult to get it back, since such countries are notorious for capital destructive habits, like the dominance of personal and family connections in business, the privileged position of debtors over creditors, flawed legal rules, non-workable judicial system, and all sorts of corruption. The dominance of such bad habits explains why these countries are short of capital and why interest is significantly higher, since it needs to reflect larger risks.

*Ex ante* and *ex post* opportunism are just a part of a much larger environment surrounding every business operation, where it is difficult to provide evidence in court if necessary, if some party violates the contract. Contractual obligations disappear in such an environment like a handful of water into desert sand, if they are not supported by informal rules the transactors share. And since any business move is deeply embedded in the structure of formal and informal institutions, business operations are sensitive at any corner. It is difficult to collect evidence on all such informally backed challenges for doing business, but it is feasible to enumerate some of

them, like informal codes on protection of reputation and private property, *caveat emptor*-codes, debtors codes, *pacta sunt servanda*-codes, the codes of complete compensation for damages, arbitration codes, and last but not least, secret business operation codes and cheating codes.

To sum up, it is up to the government to establish the rules of the game, respecting local circumstances like habits, social capital, microeconomic performance, macroeconomic data, geographic environment, and by doing so to have a sensibility for feed-back, making necessary adjustments, but it is not up to the government to take part in the game, either directly via state-owned enterprises or indirectly, via assistance (subsidies) to some firms, including regulation favoring some firms. This is not easy to be done, since special interests influence government policies, and if they succeed in forming decisive pressure upon government, some groups will profit at the expense of the rest of individuals in society. For reformers it is again important: the less concessions possible, the better.

About the *tempo* of reforms. Let us assume that privatization and reform will be profound, and it is just a question on how quickly we let them happen. To this question probably there is no single, unitary answer. Something could be done quickly, like lifting restrictions on market operations, convertibility of currency or liquidation of long-term losers. But if a new economic order is to be born spontaneously, this can not be achieved overnight, since the evaporation of old institutions and firms and the emergence of new ones requires time. In other words, only imposed reform and privatization according to some scheme, implemented by a bureaucracy, can be introduced quickly in the big-bang, top-to-bottom manner. Spontaneous, bottom-to-top reform and privatization, are time consuming, since they require time for experiments, discussion and research, and they are accompanied with faults and mistakes as an inescapable burden. Rather than the arrogance of almighty “economic” knowledge, this attitude requires a relaxed and skeptical attitude, similar to what D. North points out in a fragment cited above. However, this approach is not to be confused with piece-meal-engineering gradualism, like that represented by Arrow. They are different in several essential points. First, piece-meal-engineering relies on a step-by-step imposed reform, while the spontaneous approach allows the market order to emerge from below. Second, technocratic gradualism sends the message that privatization and reform will be slow by necessary, while spontaneous evolutionist reform sends the message that the reform and

privatization will be decisively supported and carried on, but the tempo will be decided by the market itself, which is not hindered by bureaucrats.

If spontaneous privatization cannot emerge quickly - and it cannot - something else can be done almost immediately, and this is an instant, credible, decisive and enthusiastic commitment to privatization and reforms. Such a commitment is a signal on which type of reform can be expected in the future. How credible the signal is in the first moment, people can conclude just from two sources. One would be the reputation of the prime minister, and for this, essential is his past record. For example, in Czechoslovakia and Estonia everyone was sure that reform would be profound when Vaclav Klaus and Mart Laar declared their intentions. They were well-known for their sincerity and enthusiasm for free markets, and people in and outside these countries were sure they are not going to change their attitudes during reform. A second source of evidence would be, the consistency of the reform program. Inconsistent program is a signal that reformers are not sure which way to go. The more consistent and clearer the program is, the better.

It is easy to design a program for profound reform at the beginning, but it is much more difficult not to deviate from it during reform, when painful and unpleasant occurrences strike people. The risk for reform at that point consists in reducing the ambition and commitment to reform. Broad protests in the streets and in the media can cause a conflict in the cabinet or among coalition partners forming a government.

Some reforms failed because reformers retreated from the reform course by facing first larger troubles, some others for disagreement among the coalition partners (Romania), some for strong opposition (Russia, Ukraine), and some were not prolonged due to a change of those in power during early phases of reform (Poland, Hungary). Until removed from power, reformers need to be deeply committed to reforms, anticipating and covering negative externalities, and giving as few concessions as possible. Even by being opportunists, people generally will appreciate such decisive policies, like patients undergoing surgery, and even if some of them lose confidence in reforms, they will be back with support as soon as benefits from reform start to flow.

At the end, let us briefly consider the question of political acceptability of reform. On first sight it seems that a path to post-communist reform has been traced. Since communism never enjoyed the popular support characteristic of democracies, communist rulers like Stalin, Mao or Tito, did not allow free and fair elections, in order to demonstrate their popularity among voters. If the majority of a population in any

communist country was against communism, does it follow that after the collapse of communism, there would exist a pro-reform majority to be a driving force for reforms? It would be easy for reform if it were so, but it is not so. A number of people opposed communist rule for different reasons: some were communists or socialists of different kinds than the rulers, some were traditionalists, some opposed from the religious reasons, some for having lost relatives and family members in concentration camps, and there was also a tiny fraction of liberals. They all could have been against communist rule, but were not necessarily for reforms along the lines mentioned above. In many post-communist countries nationalist and traditionalist parties became a significant, if not a decisive factor on the political scene. Secondly, the majority of the population in any country will profit from reforms, but this is also not enough to be sure that such a majority will emerge. From the fact that the majority will profit, individuals can not conclude that they will be the members of that profitable majority. There is no change without cost, and individuals can guess rather than predict, how the costs are going to affect them. This explains why the way to reforms after the collapse of communism is not straightforward and guaranteed. And it also explains why there is no serious demand for reforms even in post-communist countries where people live in poverty and hopelessness like the Ukraine, Romania or Serbia. It is not that they are irrational and unable to identify their real interests; the social game among rational individuals frequently ends in sub-optimal social outcomes, as prisoner's dilemma and other non-cooperative games demonstrate.

But even where a pro-reform majority has existed, the socio-political reality can widely differ from country to country, which will have a profound impact on reforms. Czech Republic and Poland illustrate this. In the Czech Republic, interest groups of the previous regime collapsed with the old system. In looking at the society shortly before reforms started, one was able to see just atomized individuals and almost no socially networked interest groups. (Klaus, 1997) It took time for unions and other interest groups that oppose reforms to be organized in a way that was politically relevant. When they became so, the reform was irreversible and in its later phase. A pretty different socio-political situation existed in Poland. The most powerful political organization there was the union "Solidarity", which decisively contributed to the break-down of the whole communist system, opening the way to reform. "Solidarity" consisted of three large fractions – Catholic, pro-unionist and pro-liberal – and all three were for reform before it took place. But after the reform started and the first painful



experiences struck Poles, both Catholic and pro-unionist fractions of “Solidarity” started to distance themselves from the reforms, and finally they opposed them. The pro-unionist fraction did that under the justification, that reformers do not care about social solidarity, about troubles to which workers are exposed, and about the social and cultural dimension of change. Reformers allegedly just considered their laissez-faire ideology and how cheaply to sell factories and national resources to foreigners. The Catholic fraction sided with the pro-unionists by saying, that the church was always with the people. The critical moment for the reform came when parliamentary representatives of the peasants decided to leave the government. Peasants and farmers demanded very high guaranteed prices for their products, and with that demand they provoked a countermove by the government, which freed prices by lifting nearly all control mechanisms over agricultural market. In order to stabilize prices for agricultural products at the low level, the Polish government brought to the market reserves of a number of vital products (rice, corn, wheat, etc.) in large quantities, which stemmed from foreign donations to the pro-reform government. After MPs of farmers left the government, the governing coalition lost the majority, and new elections paved the way for left-wing parties to come to power, which slowed down reform.

It is apparent that the Czech government enjoyed more favorable socio-political conditions for reform than the Polish government, and that the political environment had a significant impact on the speed, quality and integrity of reforms in these two countries.

## **Concluding remarks**

The above deliberations indicate that at least some policy recommendations of some western experts (and those experts from East Europe who support them) are unlikely to work during transition in the East Europe, since they do not take into account specific conditions in these countries, and merely rely on an abstract desideratum of “would be” economic knowledge. It seems that transition countries have little choice but to move toward democracy, the rule of law and market economies, but in so doing that they should not simply imitate developed countries, since conditions are different, and much regulation in the western world does not make sense either from the economic point of view or from the point of view of individual liberty. It is often the result of rent-seeking or wrong objectives of the majority. Transition countries have to

use a unique, historic opportunity to let their systems evolve into a productive order of free individuals, both in an economic and political sense. Up to now this development has been observed in just some countries and to a limited degree, since even success stories like Estonia, the Czech Republic or Hungary, although reached significant results, actually failed in exploring the historic opportunity. One can only hope that a further development of transition will bring better news from more transition countries than up to now.

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