In the early 1990s, anybody who said they knew how to transform a centrally planned economy and one-party state into a market economy and democracy was lying. In each country affected the task was vast and there was no body of specific knowledge or theory to draw on because such a transformation had not been attempted before. Yet the challenge was posed in over two dozen countries, in all of which the previous political system had collapsed within a period of barely two years.

This issue of the IDS Bulletin takes stock of developments since then with a series of articles looking at specific aspects of the transition, many of them case studies, in countries spread from Albania via Russia to Kyrgyzstan and Vietnam. It arises from an initiative taken by alumni of the institute who have worked in such countries, many of them saddened and frustrated by the lack of developmental perspective they encountered. With the recent foundation of a lively IDS Alumni Association, this bulletin is intended as the first in an occasional series of IDS bulletins to be inspired and edited by the institute’s former students.

Of the articles printed, four were contributed by IDS alumni (two of them with non-IDS collaborators), and a fifth is by the director. Of the four alumni, one has a university position in the UK and three are practitioners in aid and advisory work. The other four articles are written by university researchers from elsewhere, including transition countries, one of them a lawyer at Sussex University’s European Institute.

The articles mainly cover the economics of transition and its social effects. With one notable exception, the countries analysed are those of the former Soviet bloc and Yugoslavia, where the previous order collapsed and the transition has been led by a new form of government (or a completely new state after independence). The main emphasis is on the poorer transition countries, and general statements made here do not necessarily apply to more advanced countries such as the Czech Republic, Poland or Slovenia. This introductory article next discusses the dominant theory of transition, and presents the articles that comprise this bulletin. Finally, some thoughts are offered about the developmental character of transition.
1 Transition orthodoxy and the transition

If in 1990 nobody knew how to undertake the transition, few were prepared to admit as much. The major international institutions had a ready-made formula to hand: the so-called Washington Consensus through which the problems arising from the international debt crisis had been tackled in the 1980s. Financial support and aid to the ex-communist countries were to come from the International Monetary Fund and the World Bank, which prescribed essentially the same medicines as in developing countries a few years before. Since the emphasis of Third World structural adjustment in the 1980s lay in opening economies up to the outside world, getting their prices right and reducing state intervention, there was a superficial logic in bringing the same package to places where a closed, state-administered economic system had been so dramatically overthrown. The record of structural adjustment was, however, mixed, even in countries with established market institutions and well integrated in the world economy. The appropriateness of its instruments in countries which lacked such a framework for their application was even more open to doubt.

In line with structural adjustment, the main elements of orthodox transition policy came to be macro-economic stabilisation, the liberalisation of prices and foreign trade, and the privatisation of enterprises. But these came up against what a recent article in the Oxford Review of Economic Policy called the five ‘surprises of transformation’ (Ellman 1997: 26). It is worth examining these surprises in some detail since they reveal much about the thinking behind the orthodox view.

The first surprise, according to Ellman, lay in ‘how much the populations of those countries have been prepared to put up with’. This indeed surprised domestic commentators as often as foreign observers: the present author has lost count of the number of times since 1990 that either local or foreign commentators in Russia and neighbouring countries have assured him that on current policies, a social explosion or civil war was inevitable. Yet only in Albania in 1997 has there actually been an explosion (see Holland’s article below); and although there have been civil wars, and unusually brutal ones too, they were largely confined to three regions: the mountains of the Pamir, Caucasus and Balkan ranges.

What conclusion can be drawn from this first surprise? It surely lies in the political character of the societies which moved into transition. Although in many countries the collapse of communism found mass support, active opposition to the former regime was generally restricted to intellectuals. In the final days and months, many members of the elites also could see advantages for themselves in a new system based on private property.Mass mobilisation occurred only in a few countries where there was a particularly strong sense of having been colonised (e.g. Estonia, Latvia and Lithuania) or where new trade unions developed alongside the democratic movements (in Poland back in 1980, and later in Azerbaijan, the coal-mining areas of Russia, and to an extent in Bulgaria). In general, the political passivity engendered by communism has outlived it, which can only strengthen doubts about the speed with which democracy can develop.

The second surprise cited by Ellman lies in the importance of the banking system and financial fragility. Over the early years of the return to capitalism in these countries there have been several major banking crises (e.g. in Bulgaria, the Czech Republic, Kazakhstan, Lithuania and Russia) as well as mass frauds using pyramid investment schemes (in Albania, Bulgaria, Romania and Russia). Ellman (1997: 27) points out that ‘With some exceptions ... there was little attention in initial policy proposals and policy discussions to the role of the banks’. True as this may be, it does seem odd. Where after all does the essential difference between central planning and a market economy lie? Surely in the role played in the latter by money, prices and credit, which serve to allocate resources that under communism were centrally administered. Even if it were not obvious at the start how the transition was to be undertaken overall, it seems hard to understand why the creation of effective financial systems was not seen as a central priority.

Ellman’s third surprise is the need for ‘a limited but strong state’ and ‘effective public administration ... The general tendency among local neo-liberals and their international backers was to concentrate on building the market sector and neglect the need to maintain and develop the state’ (Ellman 1997: 27).
Quite so. But this seems to have ignored decades of debate among economic historians, political economists and development theorists about the role of the state in economic transformations. The domestic strength of communist states disappeared with the removal of their backbone (the ruling party) and the disempowerment of their main organs of social control (the secret police). In all too many cases (especially in the former Soviet Union, or FSU), the state has become weak and now represents few social interests beyond the people who work in it, or it is easily captured by powerful unrepresentative forces such as big finance. Lacking developed institutions of accountability, and mistrusted and even despised by its own citizens, such a state is in a poor position to lead the mammoth operation of transition.

The fourth surprise quoted by Ellman 'is that the transformation is a long and difficult process', which he relates to 'the inattention of many economists to institutions and the specifics of the institutional inheritance of the transformation countries'. If that is so, then the process ought not to have been left in the hands of economists. This writer clearly recalls reading in 1990 a persuasive paper by a group of distinguished economic historians and others, which argued that this transformation could only be a long and arduous task.¹ For what is it, if not the wholesale replacement of one set of economic, social, political and even cultural institutions by another? This transformation is characterised, more than almost any deliberately undertaken before it, by its sheer breadth and scale, affecting virtually every aspect of society and not the economy alone. So it was surely bound to be long and difficult; to have seen it otherwise in 1990 seemed then (and seems now) bizarre.

Finally, Ellman (1997: 27) states that it came as a surprise that the privatisation of inherited large-scale state-owned enterprises was unimportant for economic growth, when compared with the rapid development of new private firms. The Washington Consensus took the quick privatisation of such enterprises as 'an article of faith'. Ellman notes that a few individual writers did not see it that way; but neither did every international institution. The UN Economic Commission for Europe in 1991 divided the economic transformation between 'urgent', 'desirable speedy' and 'longer-term' tasks. In the third category came 'starting the process of "large privatization" through the outright sale of state-owned enterprises', although their 'corporatization' and 'commercialization' were in the second category and the beginning of their restructuring in the first: 'The sale of state assets can ... be regarded as the final stage in this process' (UNECE 1991: 127–33).² Like its neglect of the state, the neo-liberal consensus seemingly considered that a formal change of ownership was enough in itself: if people had private assets to play with, that alone would provide the required incentive to manage them effectively and earn good returns. In practice, quite apart from delapidated machinery and shortages of equity and working capital, turning around such enterprises has hit innumerable institutional and cultural obstacles.

In the light of these events, Ellman (1997: 29) points to 'the gradual emergence of a new conventional wisdom', dropping the insistence on rapid privatisation and positive real interest rates, but continuing to stress the need for fiscal discipline, rapid price and trade liberalisation and the restraint of inflation. This new wisdom also recognises the importance of public administration, corporate governance, the banking system, new private enterprises, modest tariff protection in some circumstances, public goods and transfer payments.

To someone with a training in development studies rather than pure economics, what seems surprising about many of these 'surprises' is that they should have surprised any thoughtful analysts at all. The problem lay less in economics as such than in the economic dogma which dominated at the time. It was the ex-communist nations' bad luck to require vital advice from abroad just when the influence of neo-liberalism was at its peak; to domestic opponents of communism, neo-liberal simplicities seemed to confirm their aversion to any role for the

¹ The paper was borrowed from a colleague and I did not keep its reference.
² The same report called the commercial banking infrastructure an 'urgent' requirement, arguing: 'A market economy also requires a means of allocating assets, that is a capital market. This will have to be created from scratch and is likely to be difficult... the most elementary functions of banks in a money economy have to be firmly established.' (UNECE 1991: 128)
state in the economy and their dream of gaining the benefits of advanced capitalism overnight. Much of what was neglected in the Washington Consensus was in fact pointed out by others early in the transition process. But no doubt because those that pointed it out lacked influence in the right places, it was ignored; and when their analysis later proved correct, this was labelled a 'surprise'. The next section of this introduction presents the articles in this bulletin in the light of these comments.

2 The evidence of this bulletin

The first articles in this bulletin discuss major economic themes of the transition, including macroeconomic policy, enterprise case studies, and science and technology. There follow four articles examining the non-economic environment, starting with the development of commercial law and going on to new entrepreneurs, social relations in Albania and the rural poor. The final article places the news media in their economic context.

As a backdrop for the remaining articles, this bulletin includes an abridged extract from the United Nations' annual Economic Survey of Europe of 1995, reviewing the progress made over the first five years or so of reform. As already indicated, the UNECE's secretariat can claim a proud record in identifying many of the problems of the transition before they occurred, rather than being taken by surprise like others. Perhaps this was because it already had a long experience of those economies. This record means that its later analyses deserve to be read with respect.

The article printed here makes it clear that by the mid-1990s, the mood was of disillusionment as the economic benefits of reform had not spread far: most citizens encountered falling living standards, rapid inflation and declining job opportunities. There has been some improvement over the intervening three years. Economic growth in the most successful countries is now rapid (8 per cent in Estonia and 7 per cent in Poland in 1997) and, even in Russia, the economy has stopped shrinking for the first time since the 1980s (Economist, 18 April 1998). But the legacy remains, and the UNECE's article provides a full survey of the reasons for the disappointments encountered as well as their likely consequences.

Lines' article examines Russia's continuing profound difficulties. He is not alone in arguing that Russia's transition has already failed. The reasons are no doubt complex and deeply rooted in history, but an important proximate cause lies in the rapid inflation which followed sudden price liberalisation in 1992 and the way it was handled. The inflation destroyed savings, while associated tight monetary policies contributed much to a chronic liquidity shortage, the demonetisation of the economy, and the present crisis in government revenues. The growing prevalence of barter and payments in kind was, like other aspects of demonetisation, entirely unexpected; it was more reasonable to expect that the development of market relations would marginalise such habits.

The importance of Russia's policies transcends its position as one transition country among several. This is not just the largest country in the region but it provided the model, heart and muscles of the former system. Its influence over the rest of the FSU remains strong; and although many neighbours had grave doubts about rapid price liberalisation, in 1992 they still shared a common currency and many other ties and so had little choice but to go down the same path.

Both the UNECE and Lines discuss in passing the failure of many transition countries to ensure that companies become more efficient by reducing the amount of labour employed per unit of output. Azad & Boysan examine Kazakhstan with two case studies of companies producing consumer goods, one an inherited enterprise and the other, more successful one, a new firm established in 1990. They also point to the limited extent of restructuring in the traditional industrial company. The new firm, however, rapidly expanded employment by producing high-quality goods for much lower prices than did importers. This was not all achieved by extra efficiency, however: sales fell when its close relationship with the Kazakhstan authorities failed to prevent the liberalisation of imports. Azad & Boysan recommend government intervention to assist the restructuring of firms in Kazakhstan. A further thought provoked by this article is that privatisation may have been grossly overemphasised as a policy instrument of restructuring.
The next two articles look at industrial development in two very different countries, Russia and Vietnam. Couderc & Franceschi provide a case study of high-technology firms set up by scientists in the Siberian research city of Akademgorodok. This appears to have been largely a distress development arising from the loss of state funding for science after the collapse of the Soviet Union. A muddled but market-led response was able to emerge, even in Russia's depressed conditions.

Bezanson looks at science and technology from the other end, as it were. In a smaller country where the former political system remains intact, he considers the issues involved in a government policy to promote science and technology for industrial development. The discussion is set in the context of globalisation, which at once makes the establishment of such intervention more difficult and renders a subtle version of it more important if Vietnam is to develop export-led manufacturing against even sharper competition from East Asia after the 1997 crisis. There is an implied assumption that the government will have the administrative capacity to pursue such a course: this may well be true in Vietnam, but it would not obviously be so in many transition countries further west.

There is a consensus among economists today about the importance of knowledge and education for success in the world economy; some go so far as to define knowledge as a fourth factor of production. It has also been long accepted that one of the greatest successes of the Soviet Union and its allies lay in education and science. Yet the huge literature that now exists on the transition has little to say about how in future such resources might be harnessed to development. Especially in the FSU, they are allowed to wither on the vine. Teachers leave schools for better-paid jobs, scientific research goes unfunded, while the equipment base of surviving industry and agriculture is debilitated. Like management development and corporate governance, these vital micro-economic needs have been overshadowed by policy emphases on the macro-economy.

Dragneva examines the development of another essential support for the market economy, commercial law, and in particular the arrangements for resolving disputes over contracts. This has as important a role to play in imposing hard constraints on enterprises as the use of bankruptcy law. In Russia, the present writer has heard a commercially successful farmer insist to others that an essential part of her skill lay in the readiness to take bad customers to court rather than accept second-best solutions such as late payment or payment in kind. This requires effective commercial courts or non-judicial disputes procedures. Dragneva traces the development of these in Bulgaria, showing how it has been delayed by political confusion and the inevitable difficulties of gathering judicial experience in a country where commerce was outlawed for nearly half a century. This points again to the long, painstaking nature of the institution-building required. The article illustrates the danger of a hasty approach to the transition: if the old system is broken up before new institutions can be established, this plays into the hands of vested elite interests who can manipulate uncertainties in the situation to their advantage.

The final four articles examine further the broader domestic context. In the first of these, Roberts & Tholen report on a sociological survey of young entrepreneurs in seven countries, three of them in the FSU and four in East and Central Europe (ECE). They reach two important conclusions. One lies in how the common points in the business environment in all seven countries set them apart from established market economies. But secondly, major differences were found between entrepreneurs in the two groups of countries. The ECE group were more likely to foresee a long-term career in private business. Those in the ex-Soviet countries were more highly educated but operated more as generic businessmen or dealers, seeking to make money quickly out of fear for the future security of commerce. They were more likely to operate in the informal sector, while business was dominated by sub-legal networks (which were exclusively male).

Roberts & Tholen draw a broader conclusion, that the ECE economies will grow in time to resemble those of Western Europe, while the mafia-style capitalism of the FSU will form a type apart. For it to develop otherwise, a reform of politics and state administration will be required first.

The next two articles look at small, formerly isolated countries which are a long way apart: Albania
and Kyrgyzstan. Holland's study of Albania examines a case where the breakdown of law and order went further than that witnessed by Roberts & Tholen in the FSU. Holland examines the difficulties of establishing cooperation among farmers in a rural development project, and sets this against the general issue of interpersonal trust. The historical lack of such trust, she argues, holds back this society's ability to create strong institutions and networks capable of handling the difficulties of transition.

The very title of Howell's article hints at the need to examine transition societies at the micro-level. The author provides a vivid survey of the impact of the early years of transition on the everyday life of poor households in a remote country with few resources. She draws out the differences in experience between social groups and between different places. What she found was a variety of personal initiatives to find new sources of income, with evidence of distress selling such as the reduction in size of livestock herds. The impact on social facilities is examined, including the effect on children, whose education has been affected, for example, by a reduction in the number of books that the country can afford to publish.

Babunski assesses the media's relationship with the new political and economic forces in another small, landlocked country, Macedonia. Afflicted for a period by a double embargo, with its main trade routes to the north and south closed by external political forces, the international setting for Macedonia's transition has been among the hardest. The consequent delays in the transition, Babunski argues, have forced media outlets into continued dependence on state patronage and, by weakening their economic base, compromised their chances of aiding the development of civil society.

What general conclusions can be drawn from this series of studies? An immediate one lies in the broad similarity of the issues faced in countries which are long distances apart and had widely varied histories before 1917 or 1945: this is a set of variations on a common theme. We see the sheer difficulty of the transition and the obstacles that have lain in its path. Macedonia is very different from Kazakhstan, yet in both (as well as in Bulgaria and the ex-Soviet countries described by Roberts and Tholen) we see for example the importance of personal links between successful businesses and the state. In the FSU, the results of a strategy built narrowly on price reform, stabilisation and formal privatisation appear generally to have been of uncertain value, leading to corrupt, criminalised economies with at best limited gains in productive efficiency. In general since 1990, new opportunities have opened up for two groups of people: those able and willing to expose themselves to economic risk as entrepreneurs (see Azad & Boysan, Couderc & Franceschi, Roberts & Tholen), and those in a position to extract an economic rent from the control of assets (Babunski, Dragneva and Holland). Many ordinary people, on the other hand, have faced great distress, with a sharp decline in living standards and the sudden loss of former sources of security (see Couderc & Franceschi, Holland, Howell, Lines and UNECE).

Regional, national and even local circumstances differ, and several authors point to the importance of both research and policy initiatives at the micro-level (Holland, Howell and Roberts & Tholen). We also witness the primordial importance of long-term institutional change: inherently a developmental question. And in very different contexts, we find advocacy of government intervention to stimulate industrial development (or redevelopment), albeit by different means in Kazakhstan (Azad & Boysan) and Vietnam (Bezanson). Couderc & Franceschi, however, describe a case where the market is finding its own solution for science and technology, research and development.

3 Transition and development

It is useful to consider the relationship between the transition of formerly communist countries and economic development in general. In the early years of transition, ex-communist countries were observed with a degree of suspicion by developing countries and many of their advocates abroad. Countries of the South feared competition for tight resources from traditionally richer societies which were considered to be already scientifically advanced and industrially developed.

This attitude was fully understandable in the circumstances but was surely based on a misapprehension. While centrally planned economies were
by the 1980s not underdeveloped, perhaps they could be described as misdeveloped. And their subsequent experience has often been one of undevelopment: people have grown significantly poorer and less secure and the economy has slipped down the developmental ladder. Much of manufacturing industry (especially light industry) has collapsed, ceding markets to producers from other parts of the world. This threatens to turn the countries back into producers of primary commodities for world markets, despite the formidable upheaval of forced industrialisation earlier this century. Russian economists call this process primitivirovaniye, or primitivisation.

Many of the articles in this volume point to the damaging lack of a long-term, developmental perspective in the approaches taken to post-communist transition (e.g. Holland, Lines and Roberts & Tholen). This introductory article concludes with a discussion of the relevance of some of the traditional themes of development thought.

**Multi-disciplinarity.** The replacement of central planning and one-party police states by market economies, democracy and the rule of law is eminently multi-disciplinary: it is a complex set of interdependent problems, affecting nearly all aspects of the economy and society. The central task involves the replacement of one set of social, political and economic institutions by another; but as argued by Ellman, the economists who have dominated the transition discourse have tended to overlook institutional questions, which might be better addressed by specialists from other disciplines. Even within economics, there is the suggestion that macro-economic approaches have taken too much of the stage to the detriment of micro-economic work with enterprises.

A multi-disciplinary approach therefore seems essential, including its counterpart: it must be geared to the specifics of each situation. This, oddly, explains the reluctance of some of the best development professionals to get involved: while there are many points of overlap, the historical background and developmental problems faced by transition countries differ from those of most developing countries, making the scene unfamiliar to such people. Yet it is partly by virtue of their situation-specific methods that their skills are needed.

**Catching up.** This term is most often applied to the requirements of countries which have not gone through the industrial and agricultural revolutions, or only partially, and want to emulate countries which have. As such, this applies to few ex-communist countries, since they entered the transition with broad industrial bases, relatively high educational standards and good welfare indicators. Some of this has been dissipated already in the process of transition (Russian male life expectancy at birth fell from 64.2 years in 1989 to 58.0 years in 1995; Yaqub 1998: Table 3). But they have a different, equally urgent need to catch up, arising from the experience of between 40 and 75 years in closed, centrally planned economies and closed societies. At the start of the transition, there was a limited understanding of many concepts which people brought up in market-based societies take for granted, such as the link between a product's price and its costs of production. Methods of management under central planning were very rudimentary, and personal experience suggests that even skills such as office management barely existed. There was no interaction with the international economy, except at senior levels in capital cities. The more remote and formerly closed the society involved, the bigger these disadvantages appear.

However exploitative the relationship between world markets and developing countries may have been, at least a relationship was there, providing some understanding of how markets operate. The transition countries, on the other hand, face an immense task in catching up on the half-century or more of growing sophistication in the capitalist system that took place while their backs were turned.

**State v. market.** This introductory article has touched on a revised form of the traditional development debate of the 1960s and 1970s. Clearly, in this context the debate no longer opposes a free-market model against full state ownership and control of the economy. But questions remain: how fully and quickly markets should be (or should have been) liberated, what are the appropriate forms of state intervention in the new circumstances, and how these can be addressed. These questions are posed in one form or another in several articles in this volume (e.g. Azad & Boysan and Bezanson).
The developmental state. The previous question leads on directly to another set of questions which have been widely overlooked in the transition debate: what is the nature of the states that have risen from the ashes of one-party rule, how appropriate is it to developmental functions, and how (if at all) can it be reformed to take up those responsibilities? The creation of a developmental state in this setting is one of the most challenging requirements of all. The state in former times was domineering, meddlesome and all-powerful, and its officials in many countries are still accustomed to working in that manner. To win even an understanding of the concept of an enabling state, as understood in liberal societies, can be difficult; to achieve corresponding alterations in policy and behaviour is substantially more so. In many cases, the best that can be expected is for the state to pull back from former functions entirely, and reform later in a more sensitive and focussed way. This can be terribly wasteful and risks a continuation of chaos in the meantime; but it is often a better solution than to allow any understanding to endure that the accustomed methods can achieve the goals of a liberal society.

Dutch disease. Many ex-communist countries face for the first time specific economic risks which are well known to developing countries, and do not have appropriate experience to recognise them. One of these is that inward direct investment can bring as many problems as benefits. Another is associated with the aforementioned tendency of some countries to slide down the developmental scale, turning from manufacturing or industrial processing to primary products. Many countries (e.g. Azerbaijan, Kazakhstan and Turkmenistan) foresee future prosperity from exploiting minerals such as oil, gas, gold, aluminium, nickel and palladium. Many of the most prosperous companies in Russia are in this sector, and they exert a strong influence over its politics, economics and finance. The trade surplus is partly needed to finance payments on the international debts inherited from the Soviet Union, but it has also contributed to a rising real value of the rouble on foreign exchange markets. This in turn renders the environment for producers of other tradeable goods all the more difficult, further reducing the chances of maintaining a broad industrial base.

Arguably, Russia already suffers from a variant of Dutch disease. In recent years it has built up a substantial trade surplus (US$21.2 billion in 1997; Economist, 28 March 1998), largely through the export of products such as oil, gas, gold, aluminium, nickel and palladium. Many of the most prosperous companies in Russia are in this sector, and they exert a strong influence over its politics, economics and finance. The trade surplus is partly needed to finance payments on the international debts inherited from the Soviet Union, but it has also contributed to a rising real value of the rouble on foreign exchange markets. This in turn renders the environment for producers of other tradeable goods all the more difficult, further reducing the chances of maintaining a broad industrial base.

Transition to what? There is no satisfactory general term for the countries discussed in this bulletin. References to their past, such as ex-communist or post-communist, may accurately allude to a common set of problems, but are inappropriate when looking to the future. They can also be unpopular in the countries themselves. The term which has become most widely used is 'transition' countries, and it is adopted in this journal for the sake of convenience. However, it begs its own set of questions: in many mouths, it seems to presuppose a direction towards an ideal type of free-market economy, on a model which is in some sense thought to be represented in the capitalist West. But is this a desirable direction to head in? Are the Western countries adequate models? Can their pattern of liberal, market-based pluralism be reproduced in the circumstances created by the collapse of communism? In this volume, Roberts & Tholen argue that the form of capitalism developing in Armenia, Georgia and the Ukraine already appears to be different from Central and Eastern Europe. Lines points to the dangers of applying a simplistic neo-liberal formula to the complex requirements of institutional change, while both Holland and Howell illustrate the often negative impact of change on ordinary citizens.

It is well past time to abandon the idea of a quick transit into what Marxists would call another mode of production; the notion of restarting development, with all its complex and multiple directions, ought to take over.
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