

ECONOMIES OF TRANSITION

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Summary

The economic development and transition in eastern Europe and in the former Soviet Union varies across countries and depends on institution building (private property and market-based trade), geography (e.g. their proximity to Western markets and their natural endowments), history, culture, norms, values, and human capital. The transition has been based on stabilization (anti-inflationary), liberalization, and privatization policies in the 1990s. Not enough attention was paid to institution building, and a new consensus among policy-makers in both Eastern and Western countries is emerging, focusing on institutions and called the post-Washington consensus.

1. Introduction

This entry deals with issues of political economy of the so-called transitional economies in eastern Europe. Economists, political scientists, and social scientists in general agree that the developments in post-communist eastern Europe are among the most fascinating issues of contemporary world politics. The ongoing economic and political transformation in these countries is accompanied by changes in all spheres of their societies. Their main political problem is how to make these changes smoother and less painful. As John Maynard Keynes commented more than half a century ago: “The political problem of mankind is to combine three things: economic efficiency, social justice and individual liberty.” This is the main dilemma in the context of the present transition in eastern Europe and the former Soviet Union.

If one looks today at the outcomes of the economic and political changes in the region after 1989 one is struck by how different these are, and how different democratic transition has been across central and eastern Europe, Russia, and the former Soviet republics. Three main regions can be distinguished—central Europe (the so-called Visegrad group, the Baltic countries, Slovenia), southeastern Europe (Bulgaria, Romania, Albania, former Yugoslavia), and Russia in search of a post-imperial identity and the former Soviet republics struggling with economic disaster. Among the different

situations certain patterns emerge. This contribution discusses the main problems, dilemmas, and challenges of transition faced by all three groups. As mentioned, the outcomes are different, as literature for the individual countries reveals.

2. Fundamental Problems and Challenges of Economic Policy

By way of introduction, a general observation should be made on the challenges for research on post-communist economic transition. Scholars working on the political economy of eastern Europe are constrained by a lack of a profound theoretical framework for assessment of the challenges of, and responses to, the transformation. The same was true to some extent of the former centrally planned economies. Economic theory is in essence a collection of models: simplified representations of reality. Do we have a model or models for the transformation? The answer is definitely no. As the former Czech prime minister Vaclav Klaus stated in a recent presentation: “there has been almost no serious academic research concerning transition from communism to a free society..., and the quality of available research has not been superior to the former sovietologists’ literature which we—living in communist countries—did not find very helpful either.” The policy-makers in eastern Europe, Russia, and the former Soviet Union have been advised by a group of people best described as policy entrepreneurs. They often offer advice and solutions where the professional economists (mostly academic and writing for their colleagues in the profession) are not sure that any solution is easy. As Klaus states: “...the academic analysis has been made up for by a nonacademic one. The debate about transition economies (and emerging markets) has been dominated by a very powerful rent-seeking group of advisors and consultants, of investment bankers, of powerful auditors and of bureaucrats of international financial organizations. They all have a vested interest in prolonging transition as much as possible and not letting transition countries do it domestically (which means without the help and influence of this group).”

Regarding the main challenges of the eastern European transition in the past decade, the acute short- and long-term *problems* are evidenced most clearly by:

- the deep recession (sharp declines in investment and savings)
- high unemployment
- financial crisis (budget deficits, no clear financial strategy, and external debt)
- low productivity
- lack of functioning fundamental institutions of market economies
- breakdown of trade with the former trading partners
- last but not least, nationality conflicts

In fact, the great slump in eastern Europe suggests that instead of *deep recession*, the term *true depression* should be used.

The problems of transition indicate three main *challenges* for the post-communist economies and societies:

1. Stabilizing the economy (without being obsessed with *targeting monetary aggregates*), coming out of the deep depression, and urgently avoiding long-term unemployment.
2. Achieving more efficient use of resources.
3. Improving the prospects for better long-term economic growth performance with special attention being paid to institution building.

More than 10 years after the political changes in the region began, the eastern European countries still need to clearly define their strategies for dealing with these problems and challenges, and creating the necessary macroeconomic environment for changes in investment, savings, labor, and management. The challenges for economic policy-makers in the eastern European countries with their inexperienced economic and political elites, and for the Western advisors and financiers in this context, have been enormous.

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Biographical Sketch

Iliana Zloch-Christy Ph.D. Econ. (University of Vienna, Austria) is a former faculty member at Harvard University, Oxford University, Stanford University, and economist with the World Bank, the IMF and the UN. She is the author and editor of six books published with academic publishers in the UK and in the US.