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The Transition According to Cambridge, Mass.*

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According to Stanley Fischer (1:237), the standard reform prescription for an ex-socialist country is to proceed as fast as possible on macroeconomic stabilization, the liberalization of domestic trade and prices, current account convertibility, privatization, and the creation of a social safety net, while simultaneously creating the legal framework for a market economy.[1] Lawrence Summers (1:252–3) perceives economists as showing "a striking degree of unanimity" on this advice to the reforming countries.

In the volumes under review, 18 essays debate how to administer this prescription effectively and how the medicine worked in the first two years of treatment. There are, for example, discussions of the mechanics of privatization programs (Andrei Shleifer and Robert Vishny, 2:137–160; Andrew Berg, 2:165–186), of the specification of stabilization and fiscal policies (Michael Bruno, 1:19–49; Alain de Crombrugghe and David Lipton, 2:111–133; Roger Gordon, 2:37–66), and of policy and performance in individual nations, the last appearing in six country studies. But these are debates about details, compared to an apparent agreement on essentials. At the center of this consensus is a confidence in the ability of economic technocrats to design feasible, if painful, solutions to the central problems of reform.[2] To the extent that failures are perceived and autopsies performed, the diagnosis usually centers on the political sphere, with dilatoriness, rent seeking, and lack of policy credibility the prime suspects. Sometimes socio-political systems simply get in the way of sensible economics.

When discussion turns to administering the standard prescription in the small newly independent states, none of the contributors considers the modest proposal of a takeover by a wealthy Western nation, as tutor, benefactor,

* *The Transition in Eastern Europe*: Vol. 1. *Country Studies*; Vol. 2. *Restructuring*. Edited by OLIVIER JEAN BLANCHARD, KENNETH A. FROOT, AND JEFFREY D. SACHS. Chicago and London: U. of Chicago Press, 1994. Vol. 1: Pp. ix, 284. $39.95. ISBN 0-226-05660-0. Vol. 2: Pp. ix, 384. $46.00. ISBN 0-226-05662-7.

[1] There are two volumes in the book under review. For brevity, page references are given as in this first example "1:237" with the volume number followed by the page number.

[2] In this review, I comment extensively on the tenor of the book as a whole. These comments describe a dominant view, rather than that of every single author. For example, on the present point, Richard Freeman (2:19) is an important exception: ". . .economics does not have sufficiently compelling theory or empirical knowledge to answer questions about the institutional design of advanced capitalist economies, much less economies in transition." The views ascribed to the book are especially applicable to Volume I, which contains the six country studies and the editors' introduction.

and disciplinarian. But this provides an ideal solution—an existing political system imparting credibility, a stable convertible currency, laws and institutions imported wholesale, a managerial and business class to facilitate privatization and restructuring, and the deep pockets of the rich country for a social safety net.[3]

Rudiger Dornbusch and Holger Wolf (1:155–182) provide a balanced and informative account of the consequences of such a takeover, which occurred when Eastern Germany gained access to the institutions, the policy credibility, and the social welfare system of its capitalist sister state. This takeover was heralded with widespread optimism, not surprisingly given that it afforded an effective method of applying the standard prescription, while eliminating road blocks that were all too apparent elsewhere. No doubt forecasts of a *Wirtschaftwunder*—a repetition of 1948 and thereafter in the Federal Republic—eased the political decisions to move fast.[4]

The *Wirtschaftwunder* did not happen. Eastern Germany is mired in a massive depression. The cautions of Ralf Dahrendorf (1969, p. 426) are still surprisingly apt, although framed in an era very different from today:

> the satisfactory solution of the problems created by [reunification] would be probable to the extent to which its predictable elements are previously recognized, discussed, and mastered in the Federal Republic.

From the information offered by Dornbusch and Wolf, it is difficult to make a robust case that the economic aspects of reunification fit squarely in that set of predictable elements. Nevertheless, despite the depression on the production side, there are still the comfortable expectations provided by the presence of the German social safety net. The recession "economically, although not socially, dwarfs the Depression of the 1930s" (Dornbusch and Wolf, 1:155).

Contrary to these expectations, Eastern Germany is experiencing deep social trauma, parallel to that on the production side. Nicholas Eberstadt (1994, p. 137) describes "population patterns [that] have been jolted by precipitous, anomalous, and in some respects historically unprecedented shocks." The demographic data on Eastern Germany are indicators of a society "convulsed" by the stresses of transition (Eberstadt 1994, p. 149).[5] The historical parallels identified by Eberstadt are astounding—China after the Great Leap Forward, Berlin from 1942 to 1946, and Spain during its civil war.

The unexpected is routine during the transition. Even where technical problems seemed least, in Eastern Germany, the effects of the standard prescription were hardly as anticipated. Inherited arrangements, functional and pathological, Eastern and Western, had a profound influence on outcomes, reminding us that history and society, as well as sensible economics, are important actors on transition's stage. These lessons are to be found in the book under review, although they are not the ones that the editors and contributors emphasize. I return to these lessons in the concluding sections of this essay.

I. The Transition in Eastern Europe: *General*

The two volumes under review stem from an NBER conference convened in February 1992. Then, Poland was struggling through a deep winter of discontent, two years after its burst of shock therapy. Hungary appeared to be a gradualist success story (Kemal Dervis and Timothy Condon, 1:123). Two months after the stabilization program introduced by Yegor Gaidar's team of academics, there was an air of optimism about Russia, despite some criticism of the inattention to privatization.

Given the relative speeds of reform and of publishing, new books on transition are at risk of quickly becoming passé. Whereas the

[3] This is, in the large, what the multilateral institutions provide in the small.

[4] See, for example, *Die Zeit*, Apr. 20th, 1990, which reports on the consensus of the major West German research institutes.

[5] Analogous, although less pronounced, phenomena are widespread across the ex-socialist countries. UNICEF (1993, p. 15) refers to "abrupt and radical changes in the field of family formation and stability, reproductive behavior, mortality and migration."

economic, legal, and institutional basis for a market economy can apparently be established in one year (Jeffrey Sachs 1991, p. 236), over two years passed before the conference papers appeared in the bookstores! Now, Poland is the success story, perhaps even to be characterized as a gradualist one (Murrell 1993). In Moscow, a government led by a member of the old industrial elite revisits the issue of stabilization, after two years of looming hyperinflation and a truly revolutionary bout of privatization.

Despite the small problems of timing, these two volumes provide an extremely valuable set of essays. The quality of writing and of presentation is uniformly high. Much valuable information is presented, not least because many authors participated in the reforms on which they report. The essays constitute a cross-section of the styles of economic literature spawned by the transition. This book should be on everybody's transition reading list.

The first volume primarily comprises *Country Studies*. The second, labelled *Restructuring*, examines specific issues such as privatization, taxes, bankruptcy, etc., with reporting of relevant developments. With stabilization a dominant concern in the immediate postcommunist period, a rough alternative characterization of the division between the two volumes is between macroeconomics and microeconomics. Of the six elements of the standard prescription listed above, the social safety net and the legal framework receive relatively little consideration. Inattention to the social safety net is not unusual in the transition literature, perhaps reflecting revealed priorities in reform. The relative neglect of the institutional environment is more specific to these volumes than to the transition literature in general. (For a contrast, see Christopher Clague and Gordon Rausser 1992.)

While each volume has one essay on Russia, the western rim of Eastern Europe provides the geographical focus.[6] Moreover, the experience of Poland is central, an approximate estimate indicating that Poland is the subject of almost half the writing. This is not happenstance. Before 1989, Poland's intellectual life was less constrained than elsewhere in the Soviet bloc. Travel was relatively easy. There were extensive contacts with multilateral economic organizations. These characteristics simultaneously prepared Poland for post-Communist reforms and made the terrain congenial for Western economic advisers during those reforms. This suggests a sample selection problem in the dominant use of Polish evidence, unless the historical legacy is presumed irrelevant to the progress of reforms and to the applicability of the standard prescription.

The dominance of Poland is understandable in light of one aim of the conference, inclusion of participants involved actively in reforms (Olivier Blanchard, Kenneth Froot, and Sachs, 1:2). Such involvement can add value for readers, given the possibility of presentation of documentary evidence not easily obtained by others. This is especially important because, at the present stage of reforms, clear presentation of the evidence will probably provide the greatest contribution to understanding. These volumes score very high on this criterion, which must be due in part to the inside access of many authors. It is easy to imagine several essays becoming standard references for this reason alone.

But the dual role of activist and academic also has its dangers, given the strong personal, political, professional, and possibly financial stakes involved. This point came most strongly to mind when reading the essay of Boris Pleskovic and Sachs on Slovenia. There is some contention over the facts of the Slovenian case, not least because the activities of foreign economic advisers were associated with the resignation of members of the government, including the highest ranking economist, a Deputy Prime Minister.[7] The contentious facts simultaneously have bearing on the role of foreign advisers and on intellectual issues. For example, there is dispute

[6] Bulgaria and Romania are almost absent from the book.

[7] I have no personal knowledge of the facts of this fascinating case and was looking forward to some clarification from this book. The Deputy Prime Minister in question has confirmed to me that the facts are still a matter of dispute (Joze Mencinger 1994).

over how much of the work on monetary reform preceded the arrival of Western advisers, which also reflects on judgments concerning how quickly reforms can progress. There is disagreement on the genesis of the deadlock over privatization, whether Western advisers contributed to this deadlock or whether it was purely a result of post-Communist stakeholder politics. There is enough correlation of intellectual and personal commitment here to make a cautious reader wary.[8]

One reaction to this problem might be to question whether those with a strong involvement in events should present the facts at a supposedly dispassionate academic event. This does not get us far. These are exactly the contributors that can offer the most valuable information. However, there is an obvious need for presentation of alternative, challenging views, which a conference can provide through discussants.

Most of the essays in the two volumes are accompanied by the formal comments of discussants and by a summary of the subsequent informal discussion. But, the comments themselves do not suggest an effort to schedule discussants who have a particularly critical view of the papers in question.[9] Although some comments are informative, their inclusion in the volumes is debatable. This is especially so because exclusion of all discussion and of two essays already published elsewhere, plus firmer editing, could have reduced a 650–page two volume set to a 450–page one volume work. In the world of scholarly presses, the invisible hand is concealing itself remarkably well.

II. *The Literature on Transition: A Taxonomy*

Apace with reforms, the pertinent economics literature has undergone its own transition, one exhibited by the spectrum of essays in this book. On the fall of communism, *normative* papers were the most common. Such papers seek lessons on the strategy or tactics of reform that follow from some element of the Western economics literature. Often far removed from the particulars of time and place, these essays do not offer immediately implementable recommendations, but a perspective that might establish a useful conditioned reflex for policy makers. The essays by Froot on foreign investment, Philippe Aghion, Oliver Hart, and John Moore on bankruptcy, and Gordon on fiscal policy belong to this category.[10]

As some countries moved with dispatch on reforms, a *descriptive* literature resulted, portraying the character of the local terrain and of policy and its early consequences. This descriptive literature could have an important influence on economics because the transition is likely to generate episodes that rival the Great Depression or the 1948 German currency reform as salient facts that orient theorizing. In time, a few of the descriptive papers will provide the conventional wisdom on these episodes. Examples of this genre are the essays on Polish privatization by Berg, on Eastern German privatization by Wendy Carlin and Colin Mayer, and on labor market institutions by Freeman.

Description often requires more than a simple ordering of facts. In transition economies, there is a pressing need to collect information beyond that readily available from the authorities. Thus, Simon Johnson's paper uses data from surveys, which are proving much more common in the study of the ex-socialist countries than in the study of Western economies. Similarly, Dani Rodrik's examination of evolving trade patterns requires use and adjustment of a variety of data sets on foreign trade. Several other papers include data that is not easily available from standard statistical sources.

Description can quickly become an exercise in pursuit of a broader theoretical agenda. The victors in the theoretical and policy debate will be those who establish the

[8] There is little indication of these disputes in the essay by Pleskovic and Sachs, which refers to their reply to their critic (Pleskovic and Sachs 1993), but not to the criticism itself (Mencinger 1993).

[9] This hardly sets this conference apart from others.

[10] Inevitably, all the essays in the book overlap the categories of my classification. But a single element is usually predominant.

salient facts through the murk of reform. For example, Pleskovic and Sachs' essay on Slovenia inextricably intertwines detailed description and conclusions derived from their observations. This paper lies on the borderline of descriptive and a third category, which I will call *positivist* for want of a better term. Positivist papers aim to advance knowledge by deriving lessons from the great natural experiment of transition, lessons that are relevant not only for reforms, but also for economics in general. Through such works, the transition will cast new light on existing theoretical debates and pose questions that nudge new theories into existence.

The papers in these volumes appeared rather early in the reform process for positivist lessons to be the driving force. Nevertheless, some aim at strong conclusions (I discuss these below). For example, Berg and Blanchard's discussion of Poland can be interpreted as an argument for using standard stabilization policies in nonstandard environments. Similarly, Dervis and Condon orient their paper on Hungary around the theme that gradualism can work. In a different vein, Shleifer and Vishny's essay on privatization in Russia shows how deliberations on privatization inevitably lead to much deeper theoretical refections, on the nature of property rights and their reallocation. That essay provides an example of theory stimulated by transition.

Of course, all these themes—normative, descriptive, and positivist—are present in some combination in many papers in these volumes. This is most clearly the case for the *country studies* that occupy most of Volume 1, the relative balance of the three elements reflecting how far each country has progressed.

III. *A Sampling of the Papers*

The present section provides a more detailed description of a sample of the book's papers, following the above taxonomy. The goal is to give a flavor of the specifics of the essays, which are somewhat representative of the transition literature. There are eighteen detailed essays on diverse topics and there is space to describe only a few. It thus bears repeating that the papers are of uniformly high quality.

Aghion, Hart, and Moore analyze the economics of bankruptcy. After briefly describing the role of bankruptcy, the authors lay out the desirable properties of bankruptcy procedures. They consider the problems with the procedures presently used in capitalist countries, concluding that Eastern Europe can do better than by picking the best policies presently implemented in the West. The primary justification for this conclusion is the presentation of a scheme designed by the authors, which incorporates the most important elements of present U.S. law, but provides a better balance between liquidation and reorganization than presently available. The procedure would be suitable for use in either East or West.

This analysis of bankruptcy is inspired by the needs of Eastern Europe, where the desire to keep all enterprises alive led both to the neglect of bankruptcy procedures and to a stock of enterprises due for bankruptcy when market reckoning came. But, as the authors acknowledge (2:216), the paper is quite removed from the specifics of Eastern Europe. How then might such a paper be useful? One interpretation is that the ex-socialist countries are especially ripe for the application of innovative procedures, because each country provides a tabula rasa on which one can sketch a new society. Certainly, a significant part of Western policy advice has been presented in this utopian spirit, which is hardly consistent with the policy process in the societies from whence that advice arrives (Murrell 1992b). Alternatively, one might argue that the process of institutional construction is greatly aided when policy makers constantly bear in mind an ideal solution, even though that process inevitably involves comprises resultant from building on existing structures.[11] In this latter case, the tabula rasa paper acts as intellectual discipline on the policy maker, simultaneously affording the author an opportunity to follow a style more congenial to intellectual life.

[11] Either interpretation is consistent with the analysis of Aghion, Hart, and Moore, as is the case for many papers in this genre.

Peter Diamond's paper on pension systems also lies in the normative category. It is a model of the constant interplay between very specific institutional detail (the application is to Poland), clarification of a broad reform agenda, and use of analytical insights to trace the effects of specific reform proposals. There is detailed consideration of specific proposals for the reform of the Polish system, unscrambling the effects on budgets, incentives, etc. There are lessons from the mundane—record keeping—to the profound—the development of capital markets. Diamond also examines the Chilean system, because Chile's pension reform has become something of a model, an undeserved one according to this paper.

One can imagine Diamond's paper forming the background to a policy briefing and greatly affecting reforms. But, because of this direct emphasis on real problems, the paper lacks a simple message and a lean intellectual aesthetic, as the author seems to acknowledge (2:102). Given that papers in the style of Aghion, Hart, and Moore are more common in the transition literature than those similar to Diamond's, it seems that the advice given by Western academics to the reforming countries might reflect academic culture as much as the realities of the policy process.[12]

Berg describes the Polish privatization experience, which has been marked by raucous debate, many proposed schemes, and slow progress. He presents a clear and concise summary of the properties, the costs and benefits, and the progress of each scheme. Paradoxically, given that this paper reviews only schemes that have been seriously considered in a single country, it provides almost a compendium of methods of privatization. Berg argues that the lack of institutional infrastructure leads to feeble administrative capacity when undertaking the complex task of privatization. Simultaneously, privatization involves reassigning very real, albeit customary and ambiguous, property rights. Given that weak administration faces such a demanding task, it is hardly surprising, in retrospect, that most privatization occurred largely outside the political arena in a "bottom-up" process stimulated by the enterprises themselves, more or less unaided by the principal privatization bodies and their army of foreign advisers (Berg, 2:178). Berg (2:184) concludes that too much caution was exercised in choosing privatization schemes, when the condition of the state enterprises was deteriorating.

Rodrik examines foreign trade performance and policy in Czechoslovakia, Hungary, and Poland. His paper is a model of diligent sifting of evidence, creative use of simple analytics, and judicious conclusion-making. This last feature is exemplified by the introductory statement that "few solid conclusions emerge" (2:319) in an essay that deploys as much evidence and pinpoints as many intriguing patterns as any in these volumes. His reasoning is that the data are too unreliable, the official statistics too slow in tracking the vast institutional changes, and the number of causal factors too many to treat conclusions as other than tentative.

Rodrik begins by surveying foreign trade policies, emphasizing the essential similarity across countries of measures that resulted in a "dramatic liberalization" (2:320). This is followed by an empirical examination of the character of the large changes in trade. He provides estimates of the cost to the economies of the Soviet trade shock (Czechoslovakia 8% of GDP, Poland 4%, and Hungary 9%); examines the extent to which goods formerly exported to the East now reach Western markets (little); explores the sources of the spurt in exports to West (domestic demand reduction, with exchange rate changes a secondary factor); and investigates whether trade liberalization had an effect on price discipline or industrial restructuring (little). However, in summarizing I have stated these conclusions with much less nuance than does Rodrik's essay.

The contribution of Dervis and Condon on Hungary spans the divide between descriptive and positivist. This paper is typical of the six country studies in that it concentrates on presentation of facts. The reader will learn

12 The effects of this phenomenon reach further than academia, because the academic literature has a direct effect on the multilateral economic institutions and other aid organizations.

much about the Hungarian reform from this paper. In addition, this paper, like several others in the book, has potentially significant general conclusions. While focusing mainly on the details of policy and performance, the authors argue that:

> There is also little doubt that the path followed by the Hungarian systemic transformation has been very different from both the theory and practice of the transition policies adopted by the other East European countries. (Dervis and Condon, 1:124)

The tentative conclusion on Hungary is suggested in the rhetorical question embodied in the paper's subtitle "The Emergence of a 'Gradualist' Success Story?," to which I return in the ensuing section.

Dervis and Condon provide a comprehensive overview of Hungarian policy, arguing that Hungary's policies were gradualist not out of some element of design, but because of uneasy compromises as the country extricated itself from socialism. They identify Hungary as having a comparative degree of success in a region experiencing economic crisis, weathering an impending debt default in the late 1980s and the CMEA collapse in the early 1990s with reasonable output losses. This relative success was especially due to impressive performance in attracting foreign investment and in dramatically increasing levels of foreign trade. Describing the vicissitudes of the privatization process, Dervis and Condon emphasize that the major obstacles are practical, not political (1:140), a conclusion that is partially consistent with Berg's analysis for Poland (2:183), but at odds with that of Pleskovic and Sachs for Slovenia (1:191).

Shleifer and Vishny begin their paper on Russian privatization by suggesting that delays in privatization in Eastern Europe were primarily due to disputes between stakeholders and government. The workers' and managers' customary property rights conflict with the state's formal rights. From the efficiency perspective, the blurring of rights means that productive reallocation through bargaining is unlikely. Hence, the authors conclude that there must be reassignment in a clear way, hopefully to those who would use the assets most productively.[13] From the viewpoint of the practicalities of the privatization process, the implication is that there will be political gridlock unless the most powerful stakeholders receive compensation. Then, Shleifer and Vishny view the role of the technocrats within the privatization apparatus as clarifying and restructuring property rights, aiming at efficiency within the degree of latitude afforded by stakeholder politics. Stakeholders are paid off—given cash flow rights in exchange for control rights—in a manner that vests immediate control in the hands of productive asset managers, who are provided the flexibility to strike efficient bargains over property rights in the future.

Shleifer and Vishny's paper is a complex entanglement of the normative, descriptive, and positivist. The normative combines the economics of property rights and of corporate governance, tinged with ideological crusade, as when worker ownership is viewed as "evil" (2:155).[14] The descriptive is an overview of the first months of Russian property rights reform, highlighting the structure of ownership and control in enterprises and showing how the privatization program reflects the alignment of stakeholders. Simultaneously, there are interesting reflections on the nature of property rights and their reform, apparently generated by the authors' perceptions of Eastern European privatization experience and their own inside efforts in Russia.

The essay by Shleifer and Vishny is the first in a series that can lay claim to being the freshest theoretical enquiry spurred by transition itself. (See Shleifer, 1994, for the latest summary.) Questions of how property rights

[13] Distributional concerns in this process are downplayed, in the same manner that social safety nets receive relatively little attention. But this neglect might vitiate the efficiency arguments that the authors use. The question of which assignment of property rights is efficient inevitably involves analysis of the income distribution resulting from that assignment, as the "new welfare economics" of the 1940s first made clear.

[14] This is just one example of how the highly contentious issues of reform seem to have altered the tenor of academic debate. This tone is especially hard to justify in view of the fact that the indicated evil seems largely a theoretical one, rather than one verified by empirical studies (John Bonin, Derek Jones, and Louis Putterman 1993).

are established, secured, and efficiently reassigned are often downplayed when examining stable capitalist societies, or they receive mundane technical answers. These questions generate new interest and new forms when examining a society that has only informal, unclear, and tangled property rights. There is a need to understand which formalization of stakeholder rights affords the highest probability of efficient bargains being struck in the future. Clarification of the role of customary property rights in economic activity is essential. One must grasp exactly why politically inspired interventions (or corruption) reduce economic efficiency. Reformers must ask which process is likely to lead to the formation of a social consensus that endorses a system of secure property rights. These are all issues raised most directly by the transition, but reflection upon them will surely lead to advances in our understanding of capitalist societies in general.

IV. The Transition in Eastern Europe: *Conclusions*

Given that reforms in Eastern Europe provide an excellent opportunity to examine old and new theories in a distinctive environment, it is no surprise to find in this book attempts to derive general conclusions. This section of the review identifies and comments on several of these. With the essays written so soon after the beginning of full-scale reforms, it is unsurprising that the relevant evidence is weak. What is surprising, however, is how much evidence in the book itself is inconsistent with these conclusions.

Let us begin with the conclusion that seems to run against the book's main trend, Dervis and Condon's suggestion of an emerging gradualist success story in Hungary. Despite the careful description of Hungarian policy and performance, their argument is unconvincing simply because it does not establish that Hungary's policy was distinctive. Hungary's trade reforms share with those of Poland and Czechoslovakia Rodrik's (2:320) label of "dramatic liberalization," which would certainly be earned in the light of historical experience (see Demetris Papageorgiou, Michael Michaely, and Armeane Choksi 1991). Several authors emphasize the essential similarity of policies in the major reforming countries—Bruno on stabilization programs (1:20–1, 1:46), Johnson on policies toward the private sector (2:246), and Rodrik on the foreign sector (2:320). On privatization, Hungary had probably done more than its neighbors by early 1992 (Kalman Miszei, 1:151). What was missing from Hungary was the cathartic day one of shock therapy and the more systematic approach to reform that appeared in Poland and Czechoslovakia, but that is far different from saying that policies were gradualist.

In discussing Poland, Berg and Blanchard offer what can be construed as an extended argument for applying standard stabilization programs in environments whose microeconomic foundations are quite untypical. Thus, they conclude that Poland's fall in output was due to a drop in aggregate demand, not to dislocations of the economic system (1:60, 63); that the high initial inflation mainly resulted from large relative price adjustments (1:74); and that the continuation of inflation was due to an unfortunate series of shocks, not to structural factors (1:75). These are conclusions of general significance (1:3–4, 1:75) and it is not surprising that other essays reflect on the same points, although not always consistently. For example, Bruno's review of the performance of stabilization programs acknowledges a comprehensive management shock (1:35). Similarly, Dornbusch and Wolf remark on the effects of the breakdown of organization (1:163) in Eastern Germany and conclude that "The disruption of the status quo often translated into bottlenecks in material supplies . . ." (1:164).

Given these observations on other countries, let us examine more closely the Polish evidence, specifically that used to argue that "a drop in aggregate demand rather than dislocations" was responsible for the output decline (1:60). The authors use three pieces of evidence (Berg and Blanchard, 1:57–60). Surveys of enterprises reported demand problems; markups declined; and inventories rose most in those sectors experiencing the largest declines in sales, as one would expect from a demand contraction.

A dramatic turn in policy can produce such evidence by routes other than aggregate demand contraction. Every economic system depends upon social capital, operating in the interstices of the system providing coordination, which can be destroyed by dislocations resulting from large changes in policy or system (Murrell 1992a). Suppose, for example, some event eliminated the credibility of every purchasing agent in a market economy. To each firm, this might appear similar in consequence to a fall in effective aggregate demand, producing competitive reductions in markups and a negative correlation between changes in inventories and changes in sales. But this event would surely be characterized as a dislocation to the system. In fact, an analogous process occurred in Poland, firms claiming that sales fell partly because of the paralysis in the normal trade networks brought on by reforms.[15] If one also gives due acknowledgement to the insights of Guillermo Calvo and Fabrizio Coricelli (1992) on the output-reducing effects of credit contraction, there is ample reason to wonder why the book's editors declare so firmly that: "Contrary to some expectations and fears, the decline in output appears to be due not to supply disruptions but rather to a demand contraction" (1:4).

Several other conclusions offered in the editors' introductory essay seem less than firmly based. In the following, I consider three cases. The first occurs in the editors' summary of Johnson's (2:244–90) essay on the nascent private sector:

> While private activity has been growing steadily in Hungary over the past decade, in Poland the liberalization of 1990 generated a surge of activity so large that Poland has surpassed Hungary in total small-firm private activity. This suggests that a poorly developed private sector does not constitute a valid argument against rapid transition. (Blanchard, Froot, and Sachs, 1:16–7)

When Johnson seeks to explain why the private sector was even more vibrant in Poland than in reforming countries with similar policies, he concludes (2:286) that: ". . .the Communist economic reforms of the 1980s established—probably inadvertently—the basis for sustained Polish private-sector development." Poland was unique in having an agricultural sector that was predominantly private. The relaxation of controls on the nonagricultural private sector was early in Poland, and that sector grew rapidly throughout the 1980s, albeit from a small base. By the fall of Communism, the status of the private sector had advanced far enough that Solidarity's reform program did not have to change the formal legal treatment of the private sector significantly (2:277–8). Because of relatively lax restrictions on foreign travel, ad hoc private trading had flourished for many years. Thus, before the fall of Communism: "There was a rapid accumulation of [private] capital, both financial and human, that was unique to Poland" (2:278). These developments led to a private sector in Poland that Bruno (1:23) judges to be three times the size of Hungary's in 1989. For Johnson, in contrast to the editors, it was pre-Solidarity history, rather than the stabilization of 1990, that was the distinctive element in explaining Poland's private sector miracle.

Second, the introductory essay (1:7–8) suggests that Slovenian experience shows the possibilities for rapid reforms in the early phases of transition. But Pleskovic and Sachs (1:205) declare that:

> there was no need to make a drastic fiscal adjustment in 1991 since the republican budget had been traditionally balanced. . .this also means that the stabilization program in Slovenia did not require "shock" therapy from the point of view of a large fiscal deficit.

Because Slovenia had been a net contributor to Yugoslavia's federal budget, independence offered scope for painless expenditure reductions (1:205). The institutional task also reflected existing conditions: "The new state must also quickly make a central bank, Ministry of Finance, and other institutions, *largely taking existing institutions* and turning them into self-sustaining actors" (Pleskovic and Sachs, 1:206; emphasis added). Slovenia does seem quite far along transition's path, but there is at least as strong a case to be made

[15] See Janusz Dabrowski, Michal Federowicz, and Anthony Levitas (1991, pp. 422–23), which reports on the enterprise surveys cited by Berg and Blanchard.

that this was due to initial advantages, as to the speed with which advances can be made.

Third, the editors (1:3,5) portray the country studies as providing evidence that: "Largely as a result of slow privatization, there has been less restructuring than was expected and than is needed."[16] This is an interesting *hypothesis*, not a conclusion from evidence. Tests of that hypothesis would require comparative observations of the behavior of privatized and nonprivatized enterprises, or analogous data at the sectoral or country level. Such observations were unavailable at the time of the conference, because privatization then remained largely in the future (1:4).[17]

How can we explain this apparent incongruity between evidence and conclusions? A satisfactory answer to this question is well beyond this review's scope. A proximate answer is that the conclusions reflect the general agreement on the paradigm of transition that conference participants brought to the exercise.[18] With 14 of 18 papers written by authors associated at some time with either Harvard or MIT (that is, at least one coauthor in 14 of the 18 cases), there is a strong possibility that these volumes are produced by a cohesive community of scholars, with an outlook that contains its own distinctive characteristics. Certainly, the "striking degree of unanimity" (Summers, 1:252–3) on transition policy might be a little harder to detect from the distance of California, for example (Ronald McKinnon 1994; Joseph Stiglitz 1994). Paraphrasing Thomas Kuhn, it is entirely normal in science that a community downplays observations contradicting its essential tenets.[19]

What are these tenets? There is great faith in the power of economic knowledge, exemplified by Fischer's (1:249) characterization of the Russians as fortunate in ". . .trying to return to a system that is well understood in the rest of the world." This leads to an emphasis on top-down reforms designed by economists, using similar policies across countries, since market systems are pretty much the same everywhere whether in the Russia of 1913 or the OECD of 1994. For the design of these reforms, history and society are of secondary importance, at most impediments. Standard stabilization programs and fast liberalization policies are unconditionally advocated for the short run, the requisite institutional creation presenting few difficulties. In the longer term, the problem is keeping stabilization on track, accomplished primarily through privatization, which produces both enterprise restructuring and a state with more incentive to discipline producers. Throughout, politics is central, a focus undoubtedly flowing from the emphasis on stabilization and privatization, instead of on the creation of institutions. The legal framework and the social safety net are given a nod, but not stressed. These will fall into place as the market civilizes society.[20]

V. *Expectations Unfulfilled*

The foregoing might leave the reader with the uncomfortable thought that the separate essays convey little in common about the experience of transition, something that might form a conclusion to these volumes.[21] But,

[16] Crombrugghe and Lipton (2:117) make an analogous statement on the relationship between privatization and reductions in wage inflation.

[17] Studies on this important aspect of the effects of transition policies are beginning to appear in large numbers now. A casual impression is that there is mixed evidence on the amount and the causes of restructuring, attributing some importance to privatization in the short run, but an even stronger effect to the general policy environment.

[18] Even the observations on Hungary fit into this context. The conclusion that Hungary implemented a gradualist policy can easily arise against the backdrop of a paradigm that views "as fast as possible on all fronts" (1:237) as standard, but this conclusion is difficult to sustain using comparative evidence.

[19] It is also normal science that there is much contentious debate within the community about details and that this debate greatly elucidates many important issues. This is certainly the case in these volumes.

[20] The point of view summarized in this paragraph is most clearly evidenced in the country studies, where most of the authors are macroeconomists and where the change of a whole system is the issue of concern.

[21] The editors do offer some conclusions that are not mentioned here, because they are already part of common knowledge. There is, for example, the rapid growth of the nascent private sector and the severe output decline in the state sector.

myriad facts appear. Are there not observations that recur, a pattern worthy of note that fits the majority of the essays? The nonfulfillment of expectations is certainly a persistent element. The present section catalogs some of the book's comments on this score, while the ensuing section examines a possible reason for these unfulfilled expectations, also using evidence from the book. This is a return to the themes that opened this review.

Several essays speak of the unexpectedly slow pace of privatization (e.g., Crombrugghe and Lipton, 2:117–9; Berg, 2:164; Dervis and Condon, 1:139; Blanchard, Froot, and Sachs, 1:5). The ubiquity of this observation prompts Michael Dooley (2:133) to remark that ". . . it is hard to find a case where the pace of privatization is not much slower than expected." Such observations no doubt encouraged Shleifer and Vishny (2:156) to forecast that: "With a high probability, there will be very little privatization in Russia in the near future." In the 27 months between the conference and the book's publication, Russia executed privatization at breathtaking speed, privatizing over one third of its industry.[22]

The repercussions of stabilization programs also were far from expectations. Bruno (1:28) argues that:

> there seems to have been overoptimism at the onset of the programs about the speed of the supply response and [the] other behavioral responses that could come in the wake of a drastic change in the economic environment.

Dornbusch and Wolf (1:165) comment that few observers predicted the dramatic fall in Eastern German output. (Indeed, many were predicting a *Wirtschaftwunder*.) Across Eastern Europe, the collapse in output exceeded expectations (Calvo and Coricelli 1993, p. 32), the IMF program in Poland, for example, predicting a decline in GDP of less than half the outcome. On the price side, the initial shock was larger than expected (Blanchard, Froot, and Sachs, 1:4), with "surprising culprits" responsible (Berg and Blanchard, 1:74). In all five Eastern European countries carrying out stabilization programs, target inflation rates underestimated actual inflation by more than 50 percent (Calvo and Coricelli 1993, p. 38).

Some successes were also unexpected. Bruno (1:39) remarks on the surprisingly robust Polish fiscal performance in early 1990. The forecasts were for a U-shaped profile of revenues, which turned out to be an inverted U. Susan Collins (2:353) observes that most analysts predicted poor trade performance, when in fact there was impressive export performance in the first years after trade liberalization. In a similar vein, although there was widespread optimism about the growth of the nascent private sector, expectations were clearly exceeded, especially in Poland. "The achievements to date have been so remarkable that it is almost possible to speak of a Polish private sector miracle" (Johnson, 2:286). This miracle probably saved the reforms.

Is there any reason to emphasize these unfulfilled expectations? They are somewhat troubling, when viewed against the backdrop of perceived unanimity on dramatic reform programs, on grand schemes of socio-economic redesign incorporating the same judgments that inform those expectations.[23] Indeed, these volumes provide a vivid example of this combination of shaky diagnosis and potent prescription.

After reviewing the reasons for the sluggishness of Polish privatization, including a rule-bound bureaucracy (2:166–7), Berg (2:184) concludes that:

> In retrospect, excess caution has been exercised in choosing the best possible scheme for mass privatization. It is difficult to imagine a plan [for mass privatization] whose implementation would have left the situation in the state enterprises worse than it is now . . . Unless mass privatization takes place . . . the risk of continued economic and political stability will be great.

This is an endorsement of speed above all, a view apparent at the beginning of reforms

[22] See the footnote added by Shleifer and Vishny (2:137) as the volumes went to press.

[23] This is an example of a standard point in Hayek and, more explicitly, in Karl Popper (1971). See Murrell (1992b).

but strengthened by Polish experience, which greatly influenced the advice on privatization given by Western advisers to Russia.

But, expectations have been defied here also: ". . .Polish state enterprises are in many cases not behaving as poorly as many had expected. . ." (Berg, 1994, p. 393). Brian Pinto, Marek Belka, and Stefan Krajewski (1993, p. 255) argue that Poland's experience shows that rapid privatization might be unnecessary. Polish state enterprises have not been the predicted disaster. Poland is everybody's choice for a surprising success story, with the threat of economic and political instability apparently receding. And, within the miasma created by the blurred borders between crime and economic activity in Russia, perhaps there are a few people who would like to see the ponderous privatization bureaucrats that were so troubling to Poland's privatization advisers.

VI. *Tabula non rasa*

Are there any obvious reasons why expectations were awry? I am inclined to think that the surprise at the course of events is mostly an accurate reflection of the state of our knowledge of the processes of system-wide change. This simply says that there is much to learn. Filled with facts, these volumes provide a very productive tool to pursue that learning. We can ask whether those facts provide a clue to the reasons for the misplaced expectations, realizing that we seek a sin of omission, rather than commission.

None of the essays focuses on the societies and polities donated to the transition by history. Even the Communist economic legacy is usually unimportant. In fact, the irrelevance of history for designing a strategy of reform, or at least its minor importance, is a central tenet for many of the book's authors, an essential element of the standard reform prescription. Crombrugghe and Lipton (2:111) exemplify this view by stating that in Poland: "The Solidarity government began the economic transformation by launching a program of stabilization and liberalization at the beginning of 1990."

It is highly misleading to begin an analysis of the Polish economic transformation in January 1990, the date of the first economic program to receive the counsel and imprimatur of Cambridge, Mass. Earlier events are crucial. The failure of collective agriculture in the 1950s meant that agriculture remained private thereafter. The 1970s saw some decentralization from below as the central planners lost control of the economy. Solidarity's first, abortive, mass revolt left workers in a strong position in enterprises. Thus, the Polish economy was already quite decentralized in the early 1980s.

Later, the Communists, aiming to save their hides, undertook reforms that were of considerable significance despite being confused and ideologically constrained. As Johnson argues, these reforms were crucial to the Polish private sector development that was so important in the success of Solidarity's reforms. Further, Solidarity's own reforms did not begin in 1990, as Crombrugghe and Lipton imply. Significant adjustments were made by the government in the latter months of 1989, in beginning to address the terrible macroeconomic legacy of the Communist era (Murrell 1993).

Perhaps an even worse consequence of beginning time in 1990 is the failure to consider the nature of the society and polity implementing economic reforms. The Solidarity episode of the early 1980s established modes of social cooperation and decentralized political behavior that could only be suppressed, not eradicated, by martial law. Even when martial law was still officially in place, this was a country where over one percent of the population managed to assemble, chanting anti-government slogans.[24] During the 1980s, intellectual, cultural, and educational life developed a sub rosa autonomy and Western orientation that flouted Jaruzelski's attempt to reimpose orthodoxy (Garton Ash 1989, pp. 105–19). The preparation for democracy and decentralization was much greater in Poland than in its neighbors to the East.

Polish society was not a tabula rasa. This showed in the negotiated exit from communism, sealed in the Round Table accords of early 1989. Economics had been an impor-

[24] On the occasion of the Pope's visit (Timothy Garton Ash 1989, pp. 47–49).

tant element in the negotiation. But this book perceives the debate about economic reform as "extraordinarily compressed in time" (1:1), simply because it ignores the period before the elections of mid-1989. This compressed debate, dominated by the dire state of the macroeconomy and primarily conducted within a narrow circle of economists, is then taken as representative. Had expectations reflected both the developments in Polish society in the 1980s and the views offered in the Round Table negotiations, perhaps we would have had more accurate predictions on such matters as the progress of privatization.

The book's neglect of existing society leads to significant paradox, politics being curiously ever present and ever absent. Political strategy occupies a central place in theorizing on reform, but real politics is missing. There is no Walesa. The timing of elections and the issues therein seem irrelevant. Discussion of Poland's initial electoral system, which led to a 27–party parliament, are absent. In examining the budget, Crombrugghe and Lipton ignore the parliamentary struggles that were so symbolic in the development of the Polish reforms and eschew mention of the related suspension of IMF programs. Where actual politics does enter the discourse, we get the warmed-over cold-war rhetoric that is fashionable in some circles (Pleskovic and Sachs, 1:192).

Similarly at the microeconomic level, there is little consideration of whether enterprise behavior might be a product of historical development as well as of present incentives. When an enterprise is viewed strictly as a bundle of incentives, cost accounting procedures can become "surprising culprits" in inflation (Berg and Blanchard, 1:74), rather than an expected reflection of the organizational culture inherited from the previous era (Andrzej Kozminski 1993, p. 150). This view of the enterprise also fits awkwardly with Rodrik's finding (2:343) that the first two years of trade liberalization hardy affected price discipline or industrial restructuring in Poland. Perhaps, one might explain the surprise at the slowness of the behavioral response after stabilization (Bruno, 1:28) by the lack of consideration of historically derived features of enterprise behavior (Murrell 1992a). Of course, this is not to argue that history is all important: incentives become paramount eventually, when "things have time to hammer logic into men" (Joseph Schumpeter 1934, p. 80). However, the early effects of historical continuity combined with the gradual encroachment of the logic of incentives can explain the evolving performance of Polish state enterprises. Certainly, this hypothesis is more convincing than a reliance on the speed of privatization as the explanatory factor (1:5).

In other areas, there are enough incidental facts in the book to suggest that the historical legacy is important. Previous sections of this review emphasized the importance of preexisting institutions in Slovenia and the pre-Solidarity reforms in Poland. Across Eastern Europe, there are the labor institutions that display surprising inertia despite new labor laws (Freeman, 2:2). There is Poland's large complement of existing economic laws (Berg, 2:167) and the Polish bureaucrats with surprising standards of behavior (Berg, 2:167 and Froot, 2:297). Even an apparently minor feature such as the absence of earnings records can greatly constrain reform possibilities in the short run (Diamond, 2:77). Similarly, Gordon (2:37–66) describes the effects of existing distortions in the tax system.

Karel Dyba and Jan Svejnar (1:93–8) open their essay with extended reflections on the Czech past. They emphasize the successful democracy of the interwar years, the economic openness in the same period, and the long history of monetary and fiscal conservatism, beginning with the effective measures against hyperinflation in 1919 and continuing throughout the communist era. Their message seems largely implicit however: these features, which were prominent during Czech history, are now characteristic of the present. Dyba and Svejnar (1:117) also remark on the passive acceptance of a painful transition. There are no strikes, no social unrest in the face of a one-third decline in real wages. They attribute this tolerance partly to a government prepared to move swiftly, a characteristic that echoes 1919, and partly to cultural values. Indeed, the architect of

Czech reforms, Vaclav Klaus, rested his reform strategy on such values, the long tradition of private enterprise, the deeply rooted individualism, and the rationality of the Czech people. (Quoted in Mario Blejer and Coricelli 1994, p. 127.) In this view, society produces the effective market.

Fischer's essay on Russia also provides the reader with interesting reflections on history, although the intended implication of those reflections remains enigmatic. He draws parallels between events in the early Soviet years and those of the new Russia, in the sequencing of measures and the economic debates that occurred. However, the reader is left wondering whether those parallels are to be viewed as continuity or analogy. A reader searching for continuity would be intrigued to compare Boris Yeltsin's first economic reform team to the analogous group in 1918 who were "young intellectuals, with little grip on the realities of administration. . ."; and to compare the Bolsheviks' "elemental chaotic proletarian nationalization from below" with today's elemental chaotic privatization by managers and workers. (See Fischer (1:223–40) for the source of these quotes.)

Surely these intriguing parallels are simply coincidence? It is difficult to embrace the proposition that elements of Czech or Russian political and economic culture should survive decades of totalitarianism and reappear to impart a special character to today's reforms. Nonetheless, this proposition is one that we should entertain, judging by the influential work of Robert Putnam (1993), who relates contemporary institutional performance to civic traditions that arose centuries ago.[25]

This is not to suggest that economists must delve deeply into history and society. Rather, the problem with the work under review is that it barely scratches the surface. This is also not an argument that historical legacies are generally important, or even important for all the topics treated in these volumes. But, some authors have chosen to write *country studies* in which a large part of the message is implicitly comparative in nature. Several essays make broad judgments about the sources of national progress, engaging in loosely veiled attempts to show that certain sets of policies are much more effective than others. Such efforts hold a crucial place in the evaluation of which reform policies work and which don't, possessing the potential to have great effect on future economic policies. When, as in such an evaluation, the analysis focuses on institutional development, reform, and comparative country performance, the historical legacy, in politics and society, as well as in economics, has to be an important explanatory factor.[26]

The neglect of history reflects the standard reform prescription, with which this review began. That prescription begins at the endpoint, an idealized market, phrasing everything in those terms, ignoring the crucial question of how reforms engage existing society. The project of the economist is to grasp the tabula rasa and design a new system, to match events against the yardstick of that design, and to diagnose as failures any deviations from design.

The transition is much more than this. After all, who was the Yeltsin we enthusiastically supported as he stood on the tank on the morning of August 19, 1991? The supreme rent-seeker, calculating costs and benefits, or a glimpse of higher, less egoistic values? And who was the Yeltsin we got? An enlightened reformer implementing the standard prescription or a paradoxical product of his country's history? If the economics of transition does not engage these broader elements, the energetic reformer coming to a country seeing it as a tabula rasa, ripe for the application of the latest economic theory, will be continually surprised, for example, that Parliaments insist on having a voice in the redistribution of the country's national wealth (1:4).

[25] Putnam's theory is generally posed. The case study is Italian regional government: "One could have predicted the success or failure of regional government in Italy in the 1980s with extraordinary accuracy from the patterns of civic engagement nearly a century earlier" (Putnam 1993, p. 150).

[26] This is hardly a new point (see Douglass North 1990). It needs emphasizing only because it seems to be rejected by the majority of authors in these volumes.

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