

9. What has one learned in over ten years of transition?

- Important initial controversies on strategy (speed and sequencing), privatization methods, role and organization of government, financial reform, ....
- Many initial surprises:
  - output fall
  - strong economic decline in FSU and “great divide” with CEEC’s.
  - economic success of China.
  - extent of insider privatization
  - extent of Mafia development
  - surprises in restructuring (SOE’s plus privatized)
  - breakup of countries

Ten years of experience and research

=> convergence on many issues and many new lessons.

Transition experience not just “area” specific. It concerns our understanding of the workings of the capitalist **SYSTEM**.

Elements of the system introduced at varying speeds, order, under different initial conditions and in different variants.

⇒ Observations on capitalist system “out of steady state”.

⇒ Many potential lessons on complementarities between elements of capitalist system (markets, incentive and governance systems, legal arrangements, social and cultural norms, organization of government...)

Transition also shed light on dynamics of large scale institutional change (decay of old system, emergence and evolution of new system).

Different views of transition reflect to a great deal different views on workings of capitalist system.

Vision of transition has much evolved in 10 years. This evolution has contributed to change of focus in the vision of economic systems.

- Reinforced institutionalist perspective emphasizing importance of various institutions underpinning capitalist system (present with contract theory, law and economics, political economy, regulation theory, corporate finance, ....): shift of emphasis from markets to contracting and to its legal, political and social environment.
- Renewed interest in complementarities between institutions of capitalism.
- Reinforced dynamic, evolutionary view of institutions.

Present evolutionary-institutionalist perspective on transition.

Not methodological presentation but synthetic vision of transition as it cristallized in recent years.

Contrast evolutionary-institutionalist vision of transition to “Washington consensus” view dominant in beginning of transition.

Claim: transition experience reinforces evolutionary-institutionalist perspective and vision of capitalism.

## A simplified presentation of the two different visions of transition

<b>1. The Political Economy of Reforms and reform strategies</b>	Washington consensus view	Evolutionary-institutionalist perspective
Attitude towards uncertainty	Insistence on sure efficiency gains; faith in societal engineering	Insistence on aggregate uncertainty; skepticism toward societal engineering
Political economy emphasis	Use window of opportunity to create irreversibility	Ensure continuous and growing support for reforms
View of partial reforms	Create rents that block further reform progress	Depends on sequencing: can either create momentum or stall reform process

<b>1. The Political Economy of Reforms (continued)</b>	Washington consensus view	Evolutionary-institutionalist perspective
View of reform complementarities	Of absolute importance. Necessity to jumpstart the market economy by simultaneous introduction of all main reforms.	Very important but comprehensiveness of initial reforms not necessary provided initial reforms can create momentum for further reforms. Transitional institutions can develop and evolve gradually toward more perfect institutions.
Main support group for reforms	Owners of privatized enterprises	Middle class and new private sector
Focus of reforms	Liberalization, stabilization, privatization	Create institutional underpinnings of markets to encourage strong entrepreneurial entry

<b>1. The Political Economy of Reforms (continued)</b>	Washington consensus view	Evolutionary-institutionalist perspective
Attitude toward institutional change	Emphasis on adoption of laws	Comprehensive: legal and financial change, law enforcement, reform of organization of government, development of self-enforcing social norms
Attitude toward initial conditions	Create tabula rasa conditions by breaking existing communist state structure	Use existing institutions to prevent economic disruption and social unrest while developing new institutions.

<b>2. Allocative changes</b>	Washington consensus view	Evolutionary-institutionalist perspective
Main view of markets and liberalization	Markets will develop spontaneously provided government does not intervene; supply and demand as focus of analysis	Importance of institutional underpinnings needed to enhance market growth: minimum legal and contracting environment, law enforcement, political stability, building of business networks and long term partnerships; contracting agents and their institutional environment as unit of analysis
Main attitude toward inefficient SOE's	Aggressive closing down	Containment and politically feasible downsizing. Rely on evolutionary development of private sector to shrink state sector.
Main view of government	Weaken it as much as possible to prevent intervention in markets	Role of government in law enforcement and in securing property rights.



<b>3. Governance changes</b>	Washington consensus view	Evolutionary-institutionalist perspective
Focus of privatization	Fast transfer of ownership in private hands via mass privatization to break government power and jumpstart market economy. Faith on market to ensure efficient resale.	Emphasis on organic development of private sector. Emphasis on sales to outsiders to achieve efficient transfer of ownership from the start.
Main emphasis of government reform	Main emphasis is shrinking the size of government	Reform in the organization of government so as to align as much as possible the interests of government bureaucrats with the development of markets.
Hardening budget constraints	Exogenous policy choice that depends on political will.	Endogenous outcome of institutional changes

## Broad lessons.

Consensus view:

- Central Europe success of Washington consensus
- Russia failure of “ “
- China success not attributable to “ “

More precisely:

- Uncertainty: failure of W.C.
- political economy: W.C. supported by Central European experience, E.I.P by Chinese transition, Russia shows downside of W.C. view of irreversibility. Strength of geopolitical factor, new element.
- partial reform and reform complementarities: E.I.P supported by Chinese experience.
- Russian failures show importance of E.I.P themes (broad middle class support, institutional underpinnings for entry, comprehensive view of institutional change, importance of initial conditions).

Output fall not predicted by anyone. Hard to reconcile with mainstream micro theory. Explanatory theories based on weak courts and asymmetric information (Blanchard-Kremer, 1997) and search frictions and investment specificity (Roland-Verdier, 2000a), elements important in the evolutionary-institutionalist perspective.

Chinese dual-track experience shows that output fall was not inevitable.

Was considered in USSR and CMEA but not adopted.

- Government collapse and prolonged decline in FSU not predicted either.
- Experience shows that not only issue of laws but mostly of law enforcement (Roland and Verdier, 2000b)
- Privatization experience, especially with mass privatization shows clear shortcomings of Washington consensus. Asset-stripping in institutionally unstable context, fall in market liquidity, continued soft budget constraints.
- Washington consensus cannot make sense of Chinese TVE experience.
- Russia vs China shows importance of reform of organization of government.
- Soft budget constraints important issue in transition.

How would the transition experience affect Econ 101 textbooks?

- Contracts and transactions as the basis (Coase theorem)
- abuse rather than exchange as the basic problem in contracting.
- Legal, institutional and social environment to protect against private and public abuse.
- political balance of power in society as continuous support for efficient institutions.
- More historical and comparative view of such institutions plus an acknowledgement of their possible diversity.
- Strong focus on institutional contexts in which collective action problems are overcome or cannot be overcome, flexibility vs rigidity of those contexts.

These are common questions in economic history, development, transition.