

# 5 Frustration With Liberalism? 'Sound' Interventionism in East European Economics

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## INTRODUCTION

'Hangover in the "other" Europe', 'Wild-East Nationalism', 'Communist Restoration: The Neo-Socialist Syndrome' – one has rarely been able to open a newspaper in London or Prague, Tokyo or Budapest without being confronted by such headlines during the last three years. While 1989 and 1990 were euphoric years of political revolutions in Eastern Europe, 1991 and 1992 saw a growing disillusionment with the long-awaited Great Transformation. According to some analysts, the big question of the years 1993, 1994 and 1995 was whether anything one might be proud of from the achievements of 1989 had survived. The current post-communist or neo-socialist regimes do not, in their bad days, seem to differ much from the former communist regimes in their good days.<sup>1</sup>

Frequently, it is exactly those who, some years ago, glorified the 'triumph of liberalism' in the region, are reporting a general frustration with liberalism today. Liberals and conservatives in the West are concerned about the collectivist-statist leanings of the new political elites in Eastern Europe and the return of the communist *nomenklatura*. Furthermore, they are apprehensive about the sluggish establishment of the rule of law in the new democracies and the twists and turns of economic deregulation. Social democrats were shocked by the harsh stabilization measures of the first non-communist governments, the lack of welfare guarantees, and the weakness of industrial democracy. Christian Democrats in the West have discovered that their sister parties in Eastern Europe tend to adopt authoritarian-nationalist-populist policies. Finally, a number of social scientists over the world, who had put much faith in one of the unexplored 'Third Roads' which the former communist states might have taken during the 1990s, have been frustrated to see that those roads may lead back to the 1930s. Weimarization, Balkanization and Latin-Americanization have become conventional labels in the literature.

Many observers claim that most of the predictions that were made prior to 1989 about the fate of Eastern Europe have proved to be misleading: markets are still under state tutelage and being dominated by post-communist mafias; parliaments are run by the old-new ruling oligarchies; the state replaces civil society, just as chauvinism replaces patriotism and church bureaucracy replaces religion. Imitation – frequently of outdated patterns – serves as a substitute for social innovation. Invention is suppressed by improvisation and spontaneous evolution by social engineering. Many of the anti-communist heroes of yesterday have become anti-heroes of post-communism today. Paradoxical as it may be, Eastern Europe can provide everyone with a sufficient amount of pessimism, regardless of whether they come from the east or the west, from the left or the right.

The fact that none of the once celebrated scenarios – the (neo)liberal breakthrough, the upsurge of social democracy, the renaissance of civil society – have been implemented so far, suggests that the liberal potential of the late communist economies and societies was grossly overestimated. Similarly, analysts put too much faith in the imaginary pendulum which should have shifted Eastern Europe from the one extreme, of a command economy, to the other, of *laissez faire*. 'Tit for tat' is how the logic of this thesis could be irreverently rephrased. To put it in the language of the daily newspapers: the more Stalinist the economy and economics used to be, the more Thatcherite they should become.

This chapter examines those roots of disillusionment which, according to many area specialists, should be connected with a neoliberal breakthrough in Eastern European economic thought and policy.<sup>2</sup> To do this typical discourse of post-Soviet economics will be analyzed to show that – contrary to the conventional image of the 'Reign of Chicago Boys Beyond the Iron Curtain' – there has been, in fact, no neoliberal (libertarian) turn in economic science and policy in the region. Even standard liberal or social-liberal programmes are lacking in many countries. The repeated reference made by self-appointed libertarian 'transformers' to the beauties of the market must not mislead the observer. It therefore seems futile to look for the causes of current popular discontent, and the upswing of neo-socialism, in Eastern Europe in general frustration with economic liberalism.

## THE ILLUSION OF SYNERGY

What had been used in the singular became plural. Eastern Europe in 1996 is witnessing transitions instead of one single kind of transition. We may even apply the term 'transformations' to express a variety of changes which lack clear and predetermined directions. Not capitalism but capitalisms or, more

precisely, quasi-capitalisms and post-communist mutants or neo-socialist hybrids, are in the making.<sup>3</sup>

In 1989, no serious analyst believed, of course, that the transition process would turn out to be uni-dimensional. During the past couple of years, complex societal systems have been undergoing change from Warsaw to Ljubljana, from the Central Planning Office down to the smallest village council, from military doctrines to family behaviour. Nevertheless, it was generally expected that the changes in the individual dimensions would point in the same direction and thus be mutually reinforcing.

Synergy was a premise in the logic of transition. In the economy, it was believed that stabilization, marketization, privatization and restructuring would support each other and result in growth and modernization. In the political system, competitive democracy and the rule of law seemed to be a winning combination which would be promoted by local self-government, industrial democracy and – in the case of multi-ethnic states – new federal arrangements. As far as the social aspects of the transition were concerned, comprehensive Social Contracts were envisaged between the social partners, and a new entrepreneurial culture seemed compatible with the principle of solidarity and with other causes, such as environmentalism. The economic, political and social spheres were expected to trigger mutual, positive feedback. For instance, most analysts presumed that the newly emergent private owners would become pioneers of marketization, guarantors of democracy and, as members of a new – socially sensitive – middle class, would do their best to oppose state *dirigism* and moderate the pains of the losers from economic and political liberalization. In other words, the well-known dilemmas of economic liberalism versus political democracy, freedom versus equality and so forth, would be solved through a not too lengthy process of conversion to a system embodying 'capitalism with a human face'.

Perhaps the most frustrating lesson to be learned from the first stages of the post-communist transformation has been that these synergetic effects are frequently neutralized or offset by conflicts between the changes. To cite the one example that has recently most embarrassed the liberal-minded economists in Eastern Europe: market reforms (for example, price liberalization or opening up the economy) have often counteracted privatization; at the same time, private property has sometimes contributed to the perpetuation of distorted markets. If such inherently compatible tasks of transformation, such as privatization and marketization, can disrupt each other, many supporters of change nowadays wonder how one can expect even limited harmony between, for example, these tasks and stabilization policies, not to mention the establishment of the rule of law or social justice. Indeed, it is difficult to accept that basic capitalist institutions, such as private property



and the market, have the best chance for supporting each other automatically once they are firmly established. Until then, the economists in Eastern Europe will continue to ponder whether or not they should rely on what Hayek disliked so much: 'constructivist rationalism' and 'social engineering' to strengthen these institutions

## 'SOUND' INTERVENTIONISM

Can the state economy be deregulated without the help of new state regulations? Can the planned economy be dismantled in an unplanned manner without establishing new bureaucratic institutions? Can the market be created by the market? As years go by without the liberal order becoming firmly established in the region, negative answers to such questions tend to crowd out all the cautiously affirmative ones in the indigenous economic literature on post-communist transition. From the works of Eastern European authors, it is possible to assemble, in no particular order, ten typical arguments which have been adduced for the pursuit of the negative – interventionist – response.<sup>4</sup>

### (1) *Beware of Survivors!*

Strict government supervision is essential both for the assembly of parts of the new economic system and the dismantling of the components of the old one, unless the objective is to make it easier for the ex-communist elite to capitalize – literally – on their former political privileges. Spontaneous evolution would favour the strong, that is, those who accumulated strength under the *ancien régime*. If privatization is spontaneous, the result will be capitalism for the *nomenklatura* and the mafia alone (if in fact these two can be distinguished at all). To ensure equal chances for all, it is necessary, at least in the beginning, to discriminate against the old ruling elite.

### (2) *Checking the Lobbies*

Supervision of the transition will be ineffective unless it is coupled with the systematic dismantling of Soviet-type lobbies, the breaking up of monopolies, and the disruption of the informal networks which previously exercised decisive influence. If we divorce the state-party from the party-state, the result, unfortunately, will not be zero: state ownership will survive. Until the state economy has been fully de-monopolized, a strong hand is necessary to keep the lobbies under control. The old monopolies must not be allowed to strangle, under the banner of *laissez faire*, the 'young markets'. A strong government must discipline the state sector before, during and after privatization, so as to maintain strict budget

constraints. Otherwise, inflation will spiral upwards, capital will leak away before it can be privatized, and stabilization will be obstructed by producers' strikes and financial chaos.

### (3) *Old-New Socialism*

Because the state economy can be subjected not only to liberal but also collectivistic criticism, neo-socialist hopes, egalitarian endeavours, self-management programmes and populist illusions may re-emerge in the course of the demise of the old order, especially in the event of a profound economic crisis causing rapid social polarization. To protect the liberal path of social progress, it is necessary to restrain the post-communist/neo-socialist tendencies which are reborn along with capitalism. For example, the reviving trade unions should be counter-balanced by the government until strong employers' organizations emerge. Strangely enough, 'Third Road' type programmes can be included in quasi-liberal scenarios of the transformation as well as in more collectivist visions. They can be built on the basis of the shadow economy, with a strong preference given to native, small entrepreneurs. However, the government should prevent these programmes from turning against (international) big business and/or becoming shelters for mafia capitalism.

### (4) *Horror Vacui*

The death of the old is not tantamount to the birth of the new: unless one is careful in sequencing the economic measures of the transition, illiberal wizards, with their self-styled recipes, can easily find their way into the 'no more communism – not yet capitalism' void. There must be detailed plans for pulling down the old house as well as for building the new one, or both might collapse. It is in this 'transitional' stage of the transition that fatal mistakes can be made. Until the rule of law (legal state) is firmly established, it is the state bureaucracy that represents the law. While the market is not fully in place, the state has no alternative but to assist in privatization. Until private property becomes widespread, who else could launch marketization if not the state?

### (5) *Cleaning up the Mess*

Transformation does not start with a *tabula rasa*: the first priority is to clear away the physical, spiritual and moral heritage of communism as quickly as possible. The real work ('unmaking the omelette', 'remaking the aquarium from the fish soup') can only begin afterwards. Over the past decades, things have fallen apart, and detailed instructions are necessary to put them together again, if indeed that is possible at all. On



the assumption that it is possible, reconstruction will probably be facilitated by innovative experimentation. It is therefore a unique historical trick of communism that even the measures which are designed to eliminate it should bear many of its distinctive characteristics, such as central design and guidance.

#### (6) *The Missing Agent*

In the absence of a strong middle class (entrepreneurs, civil society, etc.), the state must act as its temporary substitute. At the same time, it has to produce and train the natural agents of capitalist development. This is not the first time this will have happened in this region – as demonstrated by Alexander Gerschenkron and Karl Polanyi. Once again, a bourgeois revolution has to be launched with the subsequent approval of the emerging bourgeoisie. Indeed, the first thing to be built in the new house is the loft. To use the language of systems theory: the new economic order comes into being in an *autopoietic* way; that is, it creates the preconditions of its own genesis. Man is not born to be an entrepreneur...

#### (7) *Transition Laboratory*

Post-communist transition is an unprecedented venture in the history of mankind. Transformations which might be regarded as similar are either centuries removed from us (early capitalism), are not extremely liberal (South East-Asia), or tend to be unsuccessful (Latin America). Undoubtedly, there have been more recent, more successful and more liberal cases which may be instructive for Eastern European transformers (for example, the reconstruction of modern war economies, the German social market economy, privatization in the United Kingdom). However, their success has rested on institutional conditions which are mostly lacking in Eastern Europe. One thing is for sure: the means to be employed today should be at least as statist as those of the late 1940s and early 1950s, when the German, Italian and Austrian economies were stabilized and freed from the legacy of Nazi (Fascist) rule. Until the appropriate techniques of transformation are found, there is a genuine need for macro-experimentation. At the same time, market simulation no longer works: a 'Monopoly game' for adults played on a 'plastic Wall Street' is no longer feasible. Instead, a choice has to be made between feasible capitalist arrangements, possibly even combining several of these, while enriching them with new ideas.

#### (8) *Time Pressure*

The liberal expedition sets out at a time of acute economic crisis. The distance between the point of departure and even a moderately liberal

stage of transformation is so great, and the expectations of the population are so high (and their limit of tolerance so low), that the transition may easily lose its original momentum. Step-by-step modification may be neutralized, whereas across-the-board changes (such as shock therapy) are technically unworkable and politically risky. Given the interdependence and inertia of – and the frictions between – the tasks related to transformation, the process can be prevented from collapsing only by striving for an effective and immediate breakthrough. Therefore, we have to guarantee the existence of a critical mass of measures at the outset, and we must be adroit in selecting and ranking the subsequent steps in order to accelerate, or at least sustain, the pace of change. 'Once a leg has to be amputated, it should be done at once rather than bit by bit'. A new era of *Sturm und Drang* is being witnessed and this is nothing to be ashamed of.

#### (9) *Technical, Logical and Political Dilemmas*

There are numerous tasks which need to be performed simultaneously. In the economy these include: marketization, privatization, stabilization, modernization and opening up to the West. In politics: democratization, establishing the rule of law, reforming the public administration, institutionalizing social partnership and so on. In society: *inter alia*, assisting embourgeoisment, distributing the social costs of the transition, creating the 'Capitalist Type of Man'. By contrast, the working capacity of those responsible for transformation is limited. Moreover, the required tasks often both support and, at the same time, counteract one another (sometimes logically, sometimes politically), and it is extremely difficult to compare the short and long-term advantages and disadvantages of the qualitatively different processes. Thus, without a constant, and occasionally daring, rearrangement of priorities, the liberal transition will become too costly and painful. For example, economic stabilization may speed up privatization because it attracts foreign investors, but it can also slow it down because it reduces the pressure on the government to sell state assets to balance the budget. Furthermore, while stabilization may decrease popular discontent and diminish the populist demand 'to stop selling off the nation's wealth', it can also induce a clamour to distribute the assets by means of a mass privatization scheme.

#### (10) *Transition is Intervention*

A number of transformation measures require, almost automatically, government intervention in the economy. Resolute central guidance is part and parcel of processes such as macroeconomic stabilization, sectoral restructuring, comprehensive welfare reform, liberalization of foreign



trade, etc. 'Stabilization surgery' cannot be executed by an 'invisible hand'. After all, there must be someone present to regulate wages, consolidate the currency, distribute subsidies, adjust exchange rates, and set taxes and rates of interest. It should not be forgotten that it was the party-state and not the state as such that became discredited during the last half century in Eastern Europe. There is a widespread desire for a strong but democratic government, administered by a highly qualified bureaucracy, which is capable of skilful (although possibly limited and temporary) intervention in the economy. Such types of intervention create an appropriate environment for the market, without either replacing or distorting it. The history of capitalism cannot be started afresh: the free market tends to eliminate itself; it is better to have some minor intervention today than to have a major one tomorrow; the market should be protected from itself; the mixed economy in the West was not born by accident. Or, if more recent examples of state interference are needed, one should look at the European Union's regulation policies in general, or study the forms of governmental involvement in the current streamlining of the welfare regimes of the advanced countries.

These ten arguments incorporate some of the stock expressions of leading participants in the process of transformation of Eastern Europe. They portray the post-communist state as a 'chief architect' of the transition. Furthermore, the state must be prepared to act as a construction manager, dispatcher, programmer, designer, laboratory assistant, tutor and arbitrator. *Horribile dictu*, it may even serve as a security guard (with a much longer job description than that of the legendary night watchman) or rubbish collector.

Evidently, most of these roles could be fulfilled modestly, with wise self-restraint. They could be performed in such a way that, wherever selection is possible, the less illiberal option is chosen, if the choice is politically manageable. This would be a sort of sound (defensive) interventionism; a project Eastern European governments have traditionally been unskilled and disinterested to execute. At the same time, the above arguments provide abundant ammunition to justify even excessive forms of state *dirigism*, especially if economic success supports them. The so-called 'transformational recession' seems to be over in most ex-communist countries, by and large independently of whether they have chosen a post-communist, neo-socialist or liberal path of transition.<sup>5</sup>

It is not the aim of this chapter to predict the degree of state interventionism in the region during future stages of the transformation. For whatever purpose the above catalogue of arguments is used, it includes a considerable degree of 'common sense' in current Eastern European economic thought. Hence, the metaphoric pendulum did not swing to the

extreme of neoliberalism. In theory, it seems to oscillate between various types of interventionism; in reality, however, it has not even modified the essential state *dirigism* in many countries of the region. In the light of the above ten arguments one would be surprised if the economists and politicians who are firmly opposed to social engineering represented more than a negligible minority in Eastern Europe today.

## DISILLUSIONMENT WITH LIBERALISM?

If it is true that most of the economic transformation programmes in Eastern Europe do not reflect neoliberal wishful thinking, then there may be something wrong with the 'frustration hypothesis': i.e. explaining the post-1989 public disillusionment by reference to the adoption of 'too much liberalism' by the policy-makers, at least as far as economic thought and policy are concerned. The hypothesis typically rests on three pillars:

- a) on the premise of a powerful neoliberal challenge, bordering on the brainwashing of citizens by western advisers and their domestic allies;
- b) on the presumption of high expectations of the population with regard to the fast and cheap transition promised by the same 'neoliberals';
- c) on the thesis of inevitable dissatisfaction with private ownership and the market, which leads directly to the election of illiberal, neo-socialist parties.

This is what journalists originally liked to call the Lithuanian-Polish syndrome; extended, from 1994 onwards, to incorporate Lithuania, Poland and Hungary, and, latterly, the Lithuanian-Polish-Hungarian-Russian syndrome.

It could be argued that this diagnosis tends to misinterpret both the nature of the expectations which were raised by the fall of communism and the recent fashion for expelling the first non-communist regimes in Eastern Europe. The interpretation of the author is slightly different and does not rely on a vast fluctuation of popular values and attitudes. Rather, it starts from the assumption that, originally, the citizens of the former Eastern bloc wanted to 'social democratize' or 'social marketize' their economies and societies. If most of the opinion surveys conducted during the first years of the Great Transformation can be assumed as reliable, people did not wholeheartedly believe in the intrinsic virtues of the free market.<sup>6</sup> Similarly, party formation or, more exactly, the great number of mixed political organizations (social-liberal, national-liberal, Christian-liberal and so on) suggests that a large portion of collectivist/communitarian aspirations have survived despite the occasionally heavy libertarian rhetoric used by some of the party leaders.



As a consequence, the neo-socialist syndrome does not reflect a complete turnaround in the popular mind. On the contrary, it expresses a high degree of intransigence, a kind of insistence on a rapid arrival at the utopia of 'capitalism with a human face'. The people and their policy-makers in the countries of Eastern Europe could not become turncoats because they have never been dedicated liberals, not to mention neoliberals. In some countries they accepted the post-communists, in others they have simply changed vehicles on the journey toward the welfare state of their dreams, saying: the liberals and the national-conservatives failed, now let us try the neo-socialists. In addition, and this makes the Hungarian (and in part the Polish) case really interesting, one could vote for the neo-socialists – apart from trusting in stronger state interference – in the hope of more westernization and business-like government, as opposed to the nationalism, ideological dogmatism and state clientelism of the first democratically elected regimes.

Without doubt, there is widespread frustration in the countries of Eastern Europe as they undergo transformation. However, popular discontent has not been caused by the costs of the liberal transformation per se but by the level and distribution of these costs (and benefits!) between winners and losers across time, space and the social structure. Also, the delay, or even the complete absence of such a transformation, may prove to be even more expensive.<sup>7</sup> As far as expectations are concerned, the few liberal parties in the region were rather cautious with their prognoses: in the short run (and frequently also for the medium-term) they promised blood, sweat and tears, while most others were talking about a 'smooth transition'. Furthermore, it is clear that the political parties which are profiting from the change in voters' behaviour cannot be described as conventional social democratic organizations. Nevertheless, it would be too early to attach to them the label of 'vanguards of communist restoration'. Therefore, the second and third components of the frustration hypothesis need substantial refinement by sociologists and political scientists.

It is worth, finally, returning to the current history of economic thought in Eastern Europe, in order to raise doubts about the first premise of this same hypothesis, which refers to a kind of 'neoliberal conspiracy'. Five key points should be made.<sup>8</sup>

- (1) There has been no neoliberal breakthrough in Eastern European economics. The imaginary pendulum did not swing in this direction; consequently, it does not inevitably have to 'swing back' to the other extreme.
- (2) The intellectual traditions of the Eastern European economists (the majority of whom were socialist reformers under the old regime) are more sympathetic to the idea of social engineering than to that of Hayekian spontaneity. They were not 'closet capitalists', and their statist-collectivist

inclinations have been reinforced by the interventionist temptations inherent in the post-communist transformation.

- (3) Although the stabilization programmes which were introduced in many countries of the region included powerful shock treatment measures of a liberalization type (affecting prices, exchange rates, foreign trade regimes), they presupposed resolute state intervention in other areas (for example, wage policy, industrial restructuring, social services) and flirted with quasi-collectivist techniques of privatization. Restrictive, deflationary policies of crisis management must not be mistaken for a neoliberal turn in Eastern European economics.
- (4) It is very telling that even the most devoted advocates of spontaneity (who were also the least limited in their political influence: the team working with the Czech prime minister, Václav Klaus), acted with a kind of 'delayed liberalism' when cautiously defining the stages of 'laying the foundations of capitalism'. They asserted that: (a) spontaneous market selection is unsuitable for the rapid deregulation of an over-regulated state economy; (b) resolute, so-called, 'negative' reform measures should be taken by the government to accelerate (or decelerate) deconstruction, and control the social costs caused by it; (c) from among the components of monetarism, emphasis, during the first stage of the transition, should be placed on austerity; (d) the initial steps of marketization and privatization have to be taken under strict government control; (e) to serve the right goal – the creation of a 'market economy without adjectives' – there should be no recoil from necessary quasi-collectivist solutions; (f) the withdrawal of the state should be undertaken only gradually, after the 'first push' has been made and when the appropriate economic and legal infrastructure for market self-regulation has been established.<sup>9</sup>
- (5) The growing readiness of most East European economists to accept the idea of a 'medium-strong' state makes them extremely receptive to the message of the German social market economy with all its *Ordnungspolitik*. Based on a half-Marxist, half-reformist institutionalist legacy, they seem to be inclined to borrow from 'ordo-liberalism' rather than new institutionalism.<sup>10</sup>

The conclusion which a neoliberal observer would draw from these theses is that current East European policy-makers are typically *not* ultra-liberal: rather they are not sufficiently liberal. A neoliberal observer would also contend that the high costs of the transformation and the present frustration are essentially due to inconsistent, and distorted, liberalization rather than liberalization as such.<sup>11</sup> If disillusionment prevails, it is not disillusionment with liberal ideas or policies but with what is believed by the public to be liberal ideas and policies.

One should not go that far, however. Liberalization, as a process, is by definition, inconsistent. Both the ruins of the old, illiberal regime, and the construction of the new, liberal one may provoke disillusionment. To separate these two effects, the diabolic figure lurking in the 'frustration hypothesis' – the allegedly neoliberal transformer – needs first to be disenchanted. Otherwise, neo-socialism will remain an enigma for good.

## NOTES

1. In what follows, a distinction is made between post-communism and neo-socialism. The post-communist regimes follow their predecessors directly and show a striking continuity with them, albeit under formally pluralist rule (eg., Bulgaria, Romania, Serbia and many of the post-Soviet republics). The neo-socialist ones on the other hand restore certain informal elements of the communist system after a relatively short interlude of non-communist rule and resemble left-wing social democracies (eg., Lithuania, Hungary, Poland).
2. On the supposed neoliberal breakthrough see *inter alia* Blackburn (1991); Bowles (1991); Pereira et al. (1993); Comisso (1991); Etzioni (1991); Galbraith (1990); Hankiss (1990); Przeworski (1992). See also Wiles (1991).
3. Further discussion of this point can be found in Stark (1996).
4. More detailed discussion of the arguments paraphrased in the text can be found in Amsden et al. (1994); Aslund and Layard (1993); Balcerowicz (1993, 1994); Grosfeld (1994); Keren and Ofer (1992); Kochanowicz (1995); Kornai (1990, 1992a, 1992b, 1993); Kregel et al. (1992); Murrell (1992a, 1992b); Offe (1991); Pelikan (1992); Poznanski (1992a, 1992b, 1993, 1995); Singh (1991); Stark (1992); Svejnar (1995); Szelényi (1989, 1990).
5. For evidence of this see Kornai (1993), Holzman et al. (1995), Gligorov and Sundström (1994), Winiecki (1991).
6. On the 'Sleeping Beauty' of collectivistic values, see Csepeli *et al.* (1993); Csepeli and Örkény (1994); Smolar (1994); Mateju (1996); see also Rychard's and Boni's contributions in the foregoing special issue.
7. On this see Balcerowicz (1996).
8. Constraints of space do not allow a lengthier exposition of this argument but see Kovács (1990, 1992a, 1992b, 1992c, 1994a, 1994b).
9. For statements of these beliefs see Klaus (1991, 1993, 1994), Klaus and Jezek (1991).
10. See Barry (1993); Gray (1993); Kovács (1994a).
11. See, for example, Pejovich (1993, 1994).



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