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# The Political Economy of Transformation

With 8 Figures

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## Which Institutionalism?

### Searching for Paradigms of Transformation in Eastern European Economic Thought

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#### 1. Supply and demand

Until recently, predictions about future intellectual and methodological patterns of economic science in Eastern Europe have usually been based on dubious assumptions concerning “Western” supply of and “Eastern” demand for scholarship. Almost exclusively, the triumph of liberal thought in the economics of the region has been visualised by the observers as a neoliberal breakthrough of Austro-American style. It was tacitly (and simplistically) supposed that—if the Easterners do not want to return to their communist or market socialist utopias—they will opt for Hayek, Friedman or Buchanan. To reinforce this assumption, it was also presumed, with condescending praise or critical reservation, that after so many years of collectivist indoctrination, Eastern European economists can’t help joining this neoliberal current: the imaginary pendulum *must* swing to this direction (cf. Hankiss 1990, Rupnik 1988, Galbraith 1990, Etzioni 1991, Bowles 1991, Blackburn 1991; see also Wiles 1991).

In the light of these assumptions, supply and demand of economic ideas between East and West converge perfectly. To put it bluntly, Václav Klaus is the ideal-type of liberal economist under post-communism; Jeffrey Sachs is an agent of neoliberalism, and the anomalous fact that in Eastern Europe one hardly finds a political party or a government which has not included a form of *Soziale Marktwirtschaft* (instead of free market ideas) in its program yet is conceived simply as a matter of political rhetoric.

These are, I am afraid, rather shaky propositions. What is even more doubtful, those insisting on these assumptions have had to disregard at least one half of the actual transformation processes in the region, i.e., the *regulation* of deregulation, *planned* marketization and *state-led* privatization. Yet, peculiar as they may be, such ambiguous programs have been vehemently advocated by leading economists of Eastern Europe and accepted by a great majority of the scientific community in these countries.

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## 2. Interventionist legacies and temptations

In some of my recent writings (Kovács 1990a, 1990b, 1991, 1992a, 1992b) I tried to support the following theses:

1) On the "demand side" a fairly ambiguous rediscovery of liberal thought has taken place in the past decades. Even a radical socialist reform economist (market socialist) was no "closet capitalist": his approach to the market and private ownership was pragmatic rather than fundamentalist while his anti-interventionism was largely confined to criticizing the intervention by the communist party-state. As a reformer he took up liberal ideas in addition to (rather than instead of) his socialist commitment, somewhat reluctantly in the trial and error process of reforming the Soviet system. Attempts at "stimulating", "introducing", "building up" the market, as well as thinking in terms of Grand Designs were always an integral part of the reformist tradition in Eastern Europe. Sociologically, economics flourished in the neighborhood of practical reform making rather than the academia, which made the scholars not only interested in institutionalist master plans but also less distrustful with political compromises in economic theory.

2) Since 1989, the activist and constructivist elements of the reformers' intellectual legacy have partly been reinforced by the interventionist temptations inherent in postcommunist economic transformation. In the last couple of years, a great many arguments have been formulated in Eastern Europe about the need for sound state interference. Accordingly, the government's functions would range from managing the dismantling of the old regime (including the prevention of "nomenklatura capitalism" and new "third way" experiments) through stabilizing and restructuring the economy, organizing the privatization process and creating market infrastructure (including the coordination and sequencing of these innumerable and often contradictory measures) to redistributing the social costs of the transition and resisting the mounting pressures from below against this redistribution.

These social engineering tasks are accepted by many economists in the hope of only temporarily substituting for the missing (natural) agents of capitalism. The majority of former reform economists have been offered the chance of becoming influential advisers to the "chief engineers" of the transformation, a fairly elitist/vanguardist role, to which they had already shown some predisposition under one-party rule. Sociologically, the new political parties and government structures provide ample space for them to go on with reform-making/mongering, albeit not as socialist reformers but rather as would-be capitalist "transformers". The attractiveness of this activity is enhanced by the rapid impoverishment of academic research in the transforming countries.

3) The stabilization programs elaborated by Jeffrey Sachs and his colleagues in many countries of the region—although they include powerful shock treatment type liberalization measures (affecting prices, exchange rates, foreign trade,

etc.)—presuppose resolute state intervention in other areas (e.g., wage policy, industrial restructuring, social services) and flirt with quasi-collectivist techniques in privatization. The latter apply to Václav Klaus' transformation scenario, too, in which the long-term program of establishing free markets actually hides a kind of "first push" theory in the short run, a theory of state-administered deregulation (a "negative reform") and monetarist rigor for the first stages of the transition in the hope of spontaneous market processes evolving afterward.

4) The readiness by most Eastern European economists to accept, at least for a provisional period of time, the idea of a strong-medium state makes them extremely receptive to the message of (German) social market economy. For most of them this concept is tantamount to the promise of reaching simultaneous success in all major fields of the transformation—with no real setbacks and within reasonable time. Denazification and *Wirtschaftswunder*, stabilization and social peace, liberal order with strong social commitments, modernization with state support and *Mittelstandswunder*, etc.—in other words, benefits without costs. True, resolute fiscal management and monetary controls, harsh industrial policies (including nationalization), extensive redistribution of incomes, etc., were also part and parcel of the miracle but why should we consider the "visible hand" *ab ovo* harmful?—many Eastern European economists now ask. Wouldn't it be too much for us to target a system more liberal than that of the German social market economy today? Apparently, the self-correcting capacity of the state in the model also contributes to the attractiveness of the doctrine.

The multiple success story of postwar Germany is particularly appealing to potential imitators in Eastern Europe also because of the imperfections of other recent comparable transformations. These were either mostly unsuccessful (Latin America), or primarily political in nature (Southern Europe), or far from being liberal (Southeast-Asia). At the same time, the German precedent has been strengthened by its irradiation to a number of European countries from Norway through Austria to Greece, and also by the fact that the concept of social market economy in broad sense can be comfortably represented by conservative as well as liberal and social-democratic thinkers. In addition, as far as East-Central Europe is concerned, the historical/cultural proximity and the geopolitical influence of Germany may also enhance the popularity of the concept.

What speaks against the spiritual victory of one or another version of the German model in the region? The first proof of the pudding is obviously the former GDR: i.e., whether or not the economic miracle is repeatable in the new lands. Then, the triumphal march could be spoiled by some leading Christian-Democratic and ex-Communist parties in Eastern Europe which first inserted the concept of social market in their programs. These parties tend to mix the original idea with a large amount of authoritarian, nationalist and populist extremism, which may in turn discredit the prototype. Also, *horrible dictu*

some Eastern European economists might discover in the future significant differences between the starting positions of the German economy after 1945 and the Soviet-type systems after 1989 (Marshall Plan, Common Market, low expectations of the population, boom in the world economy, entrepreneurial traditions, high technological level, state controlled capitalist economy versus state socialism, etc., not to mention such soft indicators as "mentality").

### 3. The evolutionary offer

Obviously, the intellectual legacy of "local" economic thought and the day-to-day challenges of the transformation do not explain fully which paradigms of economic science will likely be favored (imported, adapted or (re)invented) by Eastern European scholars in the future. As is well known, in the first stage of the transition, neoclassical theory was excluded (probably too lightly) (cf. Wagener 1992, Murrell 1991a, Streissler 1980) from the rivalry of paradigms on grounds of its sterile/unrealistic world of abstract-axiomatic assumptions and its relation to the idea of the welfare state. In other words, it has been disregarded because of its inherent anti-institutionalism and/or its link with "obsolete" institutional solutions.

A theory of the transformation thus cannot be but institutionalist by nature; the only problem is how to find a doctrine of this kind, which is sufficiently liberal and still down-to-earth—this is, indeed, how one could summarize the research agenda of a growing number of economists in Eastern Europe and their close observers (see, for example, Grosfeld 1992, 1991, 1994; Murrell 1991b, 1992b, 1992a; Kornai 1990, 1991; Pelikan 1993; Poznanski 1992; Stark 1992b, 1992a; Frydman and Rapaczynski 1991). In other words, a research program is sought, which would translate the Hayekian hymn of spontaneity into the turbulent institutional processes of post-communist transition and solve the paradox of reaching a spontaneous order by starting out from an extremely non-spontaneous one without constructivist rationalism.

Disillusioned with the maximalist/fundamentalist discourse of some neoliberal thinkers but, at the same time, opposed to new state dirigism, one is inclined to advocate a theoretical approach to the economic transformation, which would combine the rare advantages of these unwanted extremes without possibly sharing their huge disadvantages. At first sight, what is comprehensively called "new institutional economics", in particular, "evolutionary economics" seems to meet this requirement. They are almost as "Austrian" as the *œuvre* of the neo-Austrian theorists, yet more realistic and historically relevant, and thus, perhaps more operational.<sup>1</sup>

<sup>1</sup> Below I will use a comprehensive concept of new institutionalism (and, later, of Ordo liberalism) to sharpen my basic argument about the competition of the two paradigms. See Nelson and Winter (1982); North (1981, 1986, 1990, 1991); Furuborn and Richter (1984); Langlois (1986); Boulding (1981); Foster (1991).

The main argument for applying evolutionary economics in Eastern Europe today is based on the assumption that economic transformation is *by definition* a problem of evolution of institutional orders, i.e., a problem of gradual/organic selection of new institutions while sorting out old ones. Frequently, no ideological fervor is involved: government failures compete with market failures, large organizations with small ones, regulation with deregulation, public with private ownership, hierarchies with markets, etc. The emphasis is—according to the traditional Schumpeter-Hayek framework—on change, rivalry, information, discovery, knowledge and entrepreneurship in a dynamic context. Market and private property are not intrinsically good: they have to prove their superiority in a search for greater economic efficiency in a process of flexible adaptation and restructuring. The capacity for information processing under uncertainty and responding to the unpredictable changes in the economic and political environment are important variables in the assessment of the institutions' performance. Institutional pluralism due to changing sociological/historical preconditions (attitudes, values, norms, routines, skills, etc.) is also generously tolerated.

While wholeheartedly agreeing with the "institutional relativism", dynamism and sociological/historical sensitivity of evolutionary economics, I ask whether a) it provides sufficient theoretical ammunition for devising comprehensive and viable transformation programs; b) it does not deliver easy justifications for some interventionist/collectivist moves of the transformation; c) it is really digestible by Eastern European economists.

Here I shall focus only on the last question. Briefly, my conclusion will be twofold: 1) post-communist transformation is indeed an evolutionary problem but it can be—I would almost say, unfortunately—interpreted as an issue of economic policy as well; 2) the transformers do have an institutionalist background inherited from the reformist times but this resembles the institutionalism of German Ordo liberalism rather than that of evolutionary economics.

Let me make another short digression on market socialism. Elsewhere I experimented with the term "speculative institutionalism" (see Kovács 1992a) to describe the traditional reluctance of most reform economists to engage in either abstract-analytical or genuinely empirical research. Due to the fact that almost from the beginning, mainstream style model-building proved unsuitable to understand the workings of communist economies under the institutional dominance of the party-state, the reformers started to use institutionalist concepts (mechanism, centralization, bargaining, property rights, etc.) almost instinctively—cf. the Marxist preconditioning of market socialists—in most cases without either analytical precision or empirical clarity. The means of this peculiar kind of institutionalism were not empirical enough to comprehend actual economic behavior, yet too empirical to use the formalized apparatus of modern economics. As a consequence, there emerged a large set of "soft" (pseudo-abstract and pseudo-empirical), that is, inoperational and subanalyt-

ical categories such as the central concepts of reformist discourse, plan and market.

On the eve of the transition, a great many Eastern European economists found themselves in a dual theoretical vacuum. On the one hand, some of them felt the need of catching up with their Western colleagues in "new institutional economics", certain subdisciplines of which (economics of the property rights, theory of the firm, etc.) they had just started to discover when formulating the first proposals for privatization during the last years of the old regime. On the other, they had to realize that this catching up is paradoxically contingent upon a thorough knowledge of the neoclassical synthesis, which has not only been criticized but also complemented by the new institutionalists.

In the optimal case, that is, in the case visualised by the proponents of evolutionary economics in Eastern Europe, the transformer will preoccupy himself with learning the sophisticated analytical techniques of modern economics to abandon traditional verbalism and "harden" his conceptual apparatus. This scholarly investment has, however, a long gestation period. In the light of the massive penetration of low quality education and scholarship in mainstream economics in the region, one can hardly expect in the near future more than some second hand application of evolutionary solutions, or a takeover of only the verbal/historical components of new institutionalist thinking.

#### 4. The "counter-offer" of Ordo liberalism

All the more so, if we take into consideration that verbalism, historical approach, etc., are also offered by another influential school of economics in the West, which is also strongly rooted in liberal thought, not fundamentalist either, and has the unique advantage of having been supported in retrospect by the success story of many West European mixed economies. The Ordo liberalism of the Freiburg school and its followers has proven operational: it was not only evolution oriented but also economic policy centered. Moreover, it also provided active political roles to the theoretical economists themselves (cf. Peacock and Willgerodt 1989; Barry 1989; Johnson 1989a, 1989b; Zweig 1980; Eucken 1989, 1990; Müller-Armack 1976).

Its biggest attraction is probably that it presents the former reform economists of Eastern Europe with the unexpected opportunity of sliding elegantly from the concept of socialist market economy into that of social market economy without a great methodological and ideological cataclysm. By incorporating the elements of large-scale private ownership and political pluralism in the conventional plan-and-market discourse of the reformers, their radical representatives (i.e., the core group of the present transformers) may avoid major cultural shocks even when advocating shock therapy to the politicians. To put it simply, in the conceptual world of Ordo liberalism the former reform economists can, in the worst case, satisfy themselves with a rearrangement of the plan-market mix without starting a new research program.

Seen more closely, Ordo liberalism and its extension to the theory of social market economy is perfectly understandable without preliminary education in elementary macro- and microeconomics. Owing to the holistic concepts (order, state redistribution, public interest, social justice, etc.) used by the disciples of the school, the quasi-collectivist/social message and normative character of the doctrine (cf. end-state versus processual liberalism), as well as the interventionist/Keynesian leanings of its representatives (cf. the "corrective order" regulating the selection of institutions and safeguarding the market from itself) may bring the theory close to the world of ideas of the former reformers. The expressly political economy/economic policy orientation of the Ordo liberals (combining *Ordnungstheorie* and *Ordnungspolitik*), a couple of "soft" concepts (*gesteuerte Marktwirtschaft*, *Marktkonformität*, etc.) applied by them, and a flirt with third-wayism (Röpke) only make the reception smoother (see Barry 1989; Johnson 1989a; Peacock and Willgerodt 1989; Lenel 1989; Wiseman 1989).

These features add up to contrast the more contemplative, individualist, process (rather than system and policy) oriented nature of evolutionary economics with its open-end style institutional solutions and scepticism concerning corrective and just government.

#### 5. National-soziale Marktwirtschaft?

Coming back to the opening question of this paper about supply and demand of economic scholarship, the conventional one-dimensional interpretation may be misleading. On the supply side "Austro-American" neoliberalism is challenged by "German" social liberalism in conquering the minds and hearts of Eastern European economists. As regards the demand side, the least one can say is that Ordo liberalism does not start without any chance in this rivalry. True, a profound theoretical reinforcement of the "Ordo connection" (just like that of any other connections) is still lacking in the region. Nevertheless, even such theorists of the transformation as Václav Klaus or János Kornai who are considered as prominent representatives of the evolutionary option can be read in "German" spirit (see e.g., the idea of strong government during the transition) if one irreverently disregards their rhetorical skills (cf. Klaus' term of "market economy without adjectives"; cf. Kornai 1990, Klaus 1991, Klaus and Jerek 1991).

In any event, three years after 1989, economic science in Eastern Europe is still in a programmatic phase. Accordingly, a careful observer may not put aside the many dozens of new party and government programs [with hundreds of references to the "social market" or social liberalism in general (see, for example, Szannely 1992, Kovács 1991)] saying: let us concentrate our attention on the scientific discourse of the economists. Whether the authors of these political documents prefer to cherish the idea of *Soziale Marktwirtschaft* to

preaching spontaneous evolution primarily because of the political merits of the former (social commitment, marketability, mobilization effect, etc.) may well be the case at this point. I would nonetheless advise to take the programmatic statements of the transformers very seriously given the established tradition of politicization of economic thinking in Eastern Europe. So we can probably avoid being surprised by the emergence of a family of post-communist mutants of the social market doctrine in the future.

Given also the tradition of mixing paradigms, and the partial similarity of the two schools (cf. e.g., Schmidtschen 1984, Vanberg 1988, Schüller 1987, Leipold 1987), I would not even exclude the possibility that the analyst will have to face the bitter task of disentangling some "Ordo-evolutionary" hybrids rather soon. The methodological difficulties of this task, however, would not by far be comparable to the political danger implicit in another hybrid, namely, in the degeneration of the originally liberal idea of social market economy into a kind of *National-soziale Marktwirtschaft* under the authoritarian, populist/corporatist and nationalist pressures in Eastern Europe today.<sup>2</sup>

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- <sup>2</sup> In Norman Barry's opinion "the difficulty with extensions of the social market economy ... is that it is difficult to see any theoretical stopping point to them, so that there is a danger that the disease of statism that the concept was originally designed to cure may reappear in another form" (Barry 1989: 120).
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