

ECONOMIC SYSTEMS

Revised version: p.m. 21 Mar 03

Grzegorz W. Kolodko, **From Shock to Therapy: The Political Economy of Postsocialist Transformation**. Oxford and New York: Oxford University Press, 2000. 457 pp. n.p. Grzegorz W. Kolodko, *Post-Communist Transition: The Thorny Road*, Rochester: University of Rochester Press, 2000. 199pp. n.p.

Reviewed by David Lane,
Faculty of Social and Political Sciences,
University of Cambridge

From Shock to Therapy and other books¹ written at about the same time, attempt to evaluate the successes and failures of policy making and the transition from state socialism. While there is much debate, there is little disagreement over two major matters. First, the most favoured model on which change was predicated is the "Washington consensus"². Advisers from the West advocated a transition to an Anglo-American type of capitalism. This involved the introduction of markets for commodities, assets and labour, a low level of government intervention in the economy, exposure to foreign competition, monetary stability and exchange convertibility. Monetary stabilisation was an important goal, as markets could not operate under conditions of high inflation which would deter investment and encourage financial speculation, and would exacerbate inequality. Privatisation of economic assets was to be introduced to create a self-motivated business class. The stock exchange would become a crucial institution channelling investment to companies to meet consumer market demand. Second, there is general agreement that, in the first ten years of transition, there have been achievements and disappointments; a market society of varying kinds has been introduced, a competitive party electoral system has been created, but the expected shift to wealth and higher per capita income has been much slower to materialise than expected and in some cases severe decline has occurred. Countries nearer the border of the European Union have done very much better than those to the east: the economic decline in Ukraine and Russia has been a major failure which has also led to widespread corruption, growing inequality and poverty.

Why these negative features of transformation have occurred is a contested issue. One argument is put by those who have persistently advocated the neo-liberal policy. Their claim is that the policy was basically correct but that the implementation of system change was faulty. Anders Aslund, perhaps the best example of the unreformed neo-liberal, concludes that no country has suffered from too radical reforms' (p.445). He argues that liberalisation and financial stabilisation were "economically effective and socially desirable" (p. 140). In some instances, things have gone wrong, he contends, because liberalisation did not go far enough and the move to the market was not radical enough.

Even if we concede, with Aslund, that the catastrophic decline in GDP in Russia and Ukraine does not measure undisclosed production and that a smaller GDP under post-communism involves more choice and the better allocation of goods, the registered falls in GDP of between 40 and 60 per cent over a ten year period are still real and have led to decline on a scale greater than the depression in the USA in the 1930s. The deleterious effects of transformation for the people on the ground are outlined in ethnographic accounts such as those collected in Hann's book (see reference 1). For Aslund and the advocates of neo-liberalism, state failure and corruption are the principal reasons for transition failure.[443] Rent seeking in Russia and Ukraine (the failures) rather than profit maximisation, as in Poland and Estonia (the success stories), characterise reform. [448]

The weakness of the argument here, however, is that the neo-liberal policies encouraged, or even facilitated, rent-seeking and corruption. Grzegorz Kolodko and Joseph Stiglitz have been the most articulate critics of the neo-liberal position and in doing so they adopt a neo-institutional approach. Both contend that, without strong states and a sound institutional framework, a market cannot operate efficiently and effectively. Stiglitz's stance is that mass privatisation was premature, the transition countries did not have an adequate institutional framework to facilitate a just privatisation of state assets. Consequently, destatisation was conducted in ways that were widely regarded as illegitimate and, in an environment which lacked the necessary institutional infrastructure, led to corruption and inequity in the transfer of public property - subsequently undermining the whole process of transformation.

Kolodko's books make the most sustained criticism of shock therapy and the case for gradualism. *From Shock to Therapy* (quotations which follow are taken from this book) is a major contribution to the political economy of transformation and is paralleled by *Post Communist Transition*. The former book is an overview of the transformation process from the early attempted reforms of state socialism to conjectures about long-term prospects of the post-communist states. The latter book contains detailed policy-oriented research papers ranging from an outline of transformation in Poland (with Mario Nuti), to fiscal policy and entrepreneurship. In *From Shock to Therapy* not only does the author outline the early periods of change under state socialism (mainly in respect of Poland), but he also makes useful comparisons with China and Vietnam. The early 'within socialism' reforms and

aspirations for a 'social market' economy, he contends, could not be sustained and a systemic change (a move to capitalism) was inevitable for four main reasons: a market economy entails not only a market for products but also one for labour and capital; • contemporary capitalism requires integration into the global economy, the backing of Bretton Woods institutions (the IMF and World Bank, particularly) would be politically and economically necessary, and only a 'full-fledged capitalism' would satisfy them.

In this context, Kolodko argues that the expectations generated by policy makers and politicians were unrealistic. He is particularly critical of the 'excessive optimism' of the Bretton Woods institutions and liberal financial newspapers and magazines in supporting radical plans, particularly with respect to privatisation and stabilisation. Of particular importance, and a theme which runs through Kolodko's books, is that the neo-liberal transition policies were 'misguided'. It is extremely difficult and perhaps impossible to solve the problems inherited from the statist central planning system on the basis of liberal market policy guidelines (p.46). Trade liberalisation and tariff abatement, and foreign exchange undervaluation, he claims, for example, were excessive. A fundamental lack of understanding was shown, he contends, by foreign advisers making the wrong assumptions based on 'ignorance of post-socialist reality' (p.97). Moreover, these were not simply errors of econometric forecasting, but also reflected political interests in outcomes of transition.

His proposals are to lower expectations and to adopt 'gradual steps' to improve economic efficiency. Long term policies are necessary and should be tailored to fit specific conditions. But Kolodko signals a more fundamental critique of the policies underlying the 'new Washington consensus'¹³ of the late 1990s. An underlying shortcoming in Western policy follows from the fact that it was predicated on the experience of Latin American countries at the end of the 1980s. Hence the primary policy objectives - fixing the financial fundamentals and privatising state assets - were inadequate. The process of privatisation has been a significant policy fault. Not only was it often not feasible for technical and political reasons, but also there are significant obstacles related to sequencing, distribution of costs and benefits and the exercise of corporate governance (p.121), which were exacerbated by the lack of institutional structures. The process was seriously undermined by interests intent on securing assets at low prices. Following Joseph Stiglitz, institution building, particularly corporate governance needs to be at the centre of policy. Hence, concludes Kolodko, 'rent-seeking' -profit-seeking under non-competitive conditions -is due to 'bad institutions' rather than bad behaviour (p.193).

The scenario advocated by the author involves a greater priority to growth, more emphasis on equity than privatisation, less concern with financial stability and more with effective state intervention. Government led development policy and effective and relevant institutions should be at the fore of transition policies. He criticising the half-baked piece of advice (p. 268) that 'the sooner government becomes small the sooner the market economy can begin to rise and expand', he calls attention to the positive role of the state in the development of advanced Western economies and he calls for a 'partnership between governments and markets' (p.255).

Despite his caveats about misguided policy, Kolodko believes that lessons can be learned and that Poland should become a model for other transition countries. He likens the significance of emerging markets of Asia and Europe for global capitalism as similar to the discovery of the New World in 1492 for European capitalism (p. 302). It is here perhaps that Kolodko is too optimistic. His policy recommendation that 'integration with the world economy is indispensable' will only lead to growth and development in the new transition economies if the conditions are appropriate for them. It is certainly to be hoped that Bretton Woods' institutions should reconsider their approach and that a 'post-Washington consensus' should include more partners than those organisations based in D.C. However, as he reminds us in other places, '...the strongest support is behind not truth and logic, but money and power' (p.136). The kind of post- Washington consensus called for here is a long way off.

As to the future, Kolodko speculates that the 'transition itself may create a wholly new type of market economy'(344). Here the book would have benefited from more exposure to the . debates about different models of capitalism (German, Japanese, Scandinavian) and also the extent to which they may survive the convergence tendencies brought about by internationalisation and globalisation. This is a book that deserves to be widely read and noted. It is well argued and takes opponents seriously, the documentation (including detailed statistical appendixes for individual transition countries) and bibliography will aid readers in future research. My one complaint is that it is over long and in places repetitive.

References

1. Anders Aslund, *Building Capitalism: the Transformation of the former Soviet bloc*. Cambridge: Cambridge University Press, 2000. xvii + 508. J. Stiglitz, 'Wither Reform? - Ten Years of the Transition', Chapter 4 of *The Rebel Within: J. Stiglitz and the World Bank*. London Anthem Books, 2001. See also *Globalisation and its Discontents*. Oxford -and New York; Oxford University Press, 2002. C.M. Hann (ed.) *Postsocialist: ideals, ideologies and practices in Eurasia*. London: Routledge, 2002.
2. John Williamson, "What Washington Means by Policy Reform". in J. Williamson (Ed.), *Latin, American Adjustment. How Much has Happened?* Washington D.C. Institute for International Economics. 1990.

3 Italics added. For details see: John Williamson, "The Washington Consensus Revisited". In Louis Emmerij (ed.). Economic and Social Development into the XXI Century. Washington DC: Inter-American Development Bank 1997.