

The Political Economy of “Big Bang”: Free Market vs. New Keynesian Perspective

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1. Introduction

The most vocal debate on the transition of Eastern Europe to democracy and capitalism has been, of course, one between those who believed in the aim of establishing a capitalist market economy (whether or not unencumbered with a dose of state intervention) and those who would rather see post-communist countries moving along some more or less unspecified “third road”. This put both free marketeers and new Keynesians, whose macroeconomic views dominate the thinking of international financial institutions, in one camp. Both criticised the so-called gradualists who, directly or indirectly, usually showed their sympathy for the search for alternatives.

However, within the camp of those who preferred capitalism to the “third road” (that, according to the saying of Vaclav Klaus, leads only to “third world”) there were sometimes substantial differences on various issues. This article tries to highlight the impact of these differences on respective assessments of the political economy of transition, that is, on the feasibility of accomplishing the desired shift to capitalism in the light of the resistance of (social) matter.

□ Warsaw (Poland).

2. The “Big Bang” versus Gradualism Revisited: A Political Economy Perspective

Architects of the “heterodox” stabilization *cum* liberalization, *i.e.* new Keynesians, and free marketeers have been much closer on other than macroeconomic management issues and could therefore agree on a range of arguments in the area of general economic theory and institution-building, including privatization. These arguments largely supported the “big bang” concept and its political economy implications.

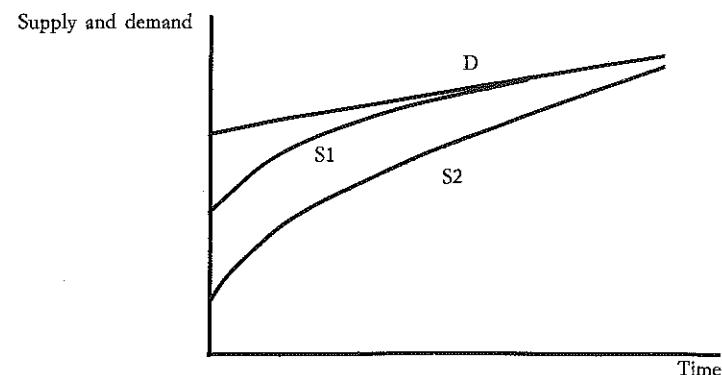
To begin with, both groups of analysts agreed with the argument of interrelatedness that spoke in favour of a “big bang”. The economy is an interrelated whole, not an unrelated collection of bits and pieces, as stressed by a free market-oriented practitioner, former minister of finance and architect of New Zealand’s far-reaching liberalization (Douglas, 1989 and 1990). The same views were expressed by economists belonging to both persuasions (see, *e.g.*, Dornbusch, 1990, and Blanchard *et al.*, 1991 on the one hand; *e.g.*, Siebert, 1991, as well as Winiacki, 1989a and 1992a, on the other). Most of them could agree on general equilibrium grounds, except for Hayekians and Schumpeterians, who questioned the usefulness of the general equilibrium approach, but agreed on interrelatedness on other grounds.

An economic argument about the interrelatedness of an economic system leads to a *political economy argument* based on the difference between the time of sowing, *i.e.* creating market institutions, and time of harvesting, *i.e.* reaping benefits of better performance of the economy (Winiacki, 1992a). As there is a time lag between these two periods, it makes good politics to start with a critical mass of measures, or as large a package as possible, to cut short the time span between the beginning of each period. It is also a strong argument in favour of “big bang” and against gradualism. This is best explained in Figure 1 (taken from Winiacki, 1993a).

As stressed elsewhere by this author (Winiacki, 1992a), demand for capitalist-economy institutions is very great from the start, while supply – in spite of strenuous efforts – grows only with the passage of time. Improved performance, however, is a result of a substantial narrowing of the gap between demand for and supply of these institutions, illustrated in a stylized manner in Figure 1 as a decrease in the distance between S1 and D. The start, with a large package of measures, influences the pattern of narrowing this gap.

FIGURE 1

DEMAND AND SUPPLY OF MARKET ECONOMY INSTITUTIONS



In contrast, spreading the range of measures over a longer period, as suggested by “gradualists”, has adverse implications for performance. It means less coherence between the – necessarily interrelated – rules of the game and less efficient performance of the emerging capitalist market economy over a longer time span. This is illustrated in a stylized manner in Figure 1 by narrowing the gap between S2 (supply of institutions under a gradualist alternative) and D.

The foregoing means, in political economy terms, that the costs of transition are borne by the society over a longer period, while the benefits of improved performance come later. Since the political capital of new governments is strongest at the beginning of transition, when there is a lot of enthusiasm about newly-regained freedom and the memory of past failures of the Soviet-type economy (STE) is still strong, lengthening the time span between the start of transition and the time when the new economic system begins to perform satisfactorily strains the patience of the population. As such, “go slow” approach of gradualism endangers the success of transition.

The rapid transition has other political economy benefits as well, also stressed by theorists of both persuasions. It is, thus, emphasised in institutional terms that the fast speed of transition, characteristic of “big bang”, gives little time to organized interest groups to mount the effective counter-offensive. This argument is also mentioned by practitioners (see Douglas, 1989 and 1990), as well as political scientists (see, *e.g.*, Haggard and Webb, 1993) but it is doubtful whether this argument retains its strong validity in the post-communist era of transition to democracy and the capitalist market economy.

It should be kept in mind that in these countries there has not only been a deficit of market institutions, but also of political and other institutions mediating between economic agents and those between economic agents and the state. Strenuous efforts have been made to create the former; at the same time, the process of self-organization of society has been taking place. Thus, in the early transition period, when the political capital of new governments has been very high, they faced a largely unorganized society. Old institutions were discredited and, as such, not an effective conduit for demands of group interests, while new ones were in the making (only the Polish "Solidarity" trade union has been an exception but even that was not very vocal in the early period of high political capital of "Solidarity"-emanated government).

Yet another argument acceptable to both persuasions was the credibility-enhancing role of the "big bang". Free market-oriented practitioners agreed, too (see Douglas, 1989 and 1990, as well as Polish deputy prime minister in 1989-1991 period Balcerowicz, 1992, and Czechoslovak minister of finance and currently Czech prime minister Klaus, 1990). Interestingly, political scientists see in a large package the opportunity to offer some "sweeteners" to reduce the resistance of some important interest groups (see, *e.g.*, Waterbury, 1989, and Haggard and Webb, 1993), while no practitioner quoted so far dwelled on this aspect of the "big bang". On the contrary, the "big bang" was seen as a strong signal to the population that the government was serious about transition, and the breadth of measures included in the particular package excludes the probable rollback, as often happened with various piecemeal reforms in the communist past.

Representatives of both theoretical persuasions, as well as practitioners, saw the need to proceed with privatization as fast as possible, even if not all practitioners agreed on what was the speediest way possible (see Gruszecki and Winiecki, 1991 and Winiecki, 1992d). Theorists of both persuasions agree that speed is essential. As Dornbusch (1990) rightly stressed, in the case of privatization it was more important to do it fast than to do it right. Therefore various shortcuts should be tried. Usually the Czechoslovak style "citizens privatization" was preferred, but political economy considerations added important concessions to employees as a necessary part of any shortcut privatization (see, *e.g.*, Lipton and Sachs, 1990, on the one hand and Beksiaik *et al.*, 1989, and Giersch, 1991, on the other).

There were, however, it should be noted, staunch critics of *any* shortcuts also among free market-oriented economists (see Kornai, 1990).

Yet another aspect of privatization could be used as a political economy argument in favour of a "big bang", including as fast privatization as possible in the package. As is argued convincingly, the allocation of resources by non-owners is not only less efficient because of wrongly structured wealth incentives and the skewed distribution of risk, but also due to the great opportunity for corruption resulting from the situation where old controls by the state apparatus are even less strong than in the communist past, while opportunities for corrupt deals, profiting managers at the expense of the owner (ultimately, society) increase sharply. Since cases of unjustified enrichment by the *nomenklatura*-appointed managers provoked much of hostility (see, *e.g.*, Winiecki, 1989b), the reduction of that opportunity through rapid privatization seemed preferable (see Schrettl, 1991). Nonetheless, at the same time there was the understanding that doing things fast meant that not all would be done well – and that governments should be prepared to take the flak on the various occasions where (unavoidable) errors were made (see DeMuth, 1990).

It is interesting, however, that although arguments in favour of a "big bang" were compelling both in terms of economics and political economy, they did not help to establish (or coalesce around) some rudiments of transition theory. The next section tries to put the foregoing into some systematizing format, using both neo-institutional classical writings and recent publications.

3. A Systematic Approach to Political Economy-Sensitive Transition Strategy

Some most recent writings by Balcerowicz (1993) and Levy (1993) seemingly try to correct this deficiency. To begin with the former, Balcerowicz points to the existence of what he calls periods of "extraordinary politics" following major discontinuities in countries' history. During these periods the level of readiness of a society to accept far reaching economic changes increases sharply. Over time, however, the "extraordinary politics" gives way to the ordinary

politics as described by public choice theorists, and readiness to accept radical changes (with their inevitable economic and non-economic costs) declines also to a level normal for a given society (Bruno, 1992, calls it the effect of "reform fatigue"). The strategy of a politician who tries to accomplish such radical changes is to try to implement as large a package of measures as possible during the period of "extraordinary politics", thus tapping the political capital of the period following a discontinuity.

Unfortunately, the implementation of various components of a "big bang" package takes more time in some than in others, institutional change (and especially privatization) requiring much more time than stabilization and liberalization. Therefore, an important part of the transition has to take place under much less propitious circumstances, *i.e.* after the political capital of the period of "extraordinary politics" has been exhausted. However, Balcerowicz does not offer a clue as to how to pursue transition strategy afterwards.

Although Balcerowicz presented his scheme within the framework of transition of post-STEs, it certainly has a more general validity. So has another scheme presented by Levy within the framework of his study of political and organizational capabilities as determinants of trade and investment reform programs in LDCs, using a two-variable scheme that is reproduced in Figure 2.

FIGURE 2

THE IMPACT OF POLITICAL AND ORGANIZATIONAL CAPABILITIES
ON THE DESIGN OF REFORM PROGRAMS

		Political flexibility	
		Low	High
Organizational capability	Low	I. Limited prospects for reform	II. Promote liberalization and dismantling
	High	III. Promote roundabout reforms	IV. Abundant menu of variable policies

Levy defines *political* obstacles as those related to costs imposed on interest groups in the society that are important to government or even to the stability of the regime. *Organizational* obstacles stem from the fact that government bureaucracy is unable to implement successfully the reform-related tasks. The tabular form of Figure 2 with its dichotomous High/Low classification immediately separates uninteresting and interesting cases. Quadrants I and IV, where both capabilities are alternatively low or high, obviously belong to the former category. Levy rightly stresses that in the case of low political and organizational capabilities the probability of success is close to zero, while in the alternative case success seems assured.

Much more interesting are cases from Quadrants II and III. Levy's prescription for the case of high organizational capability and low political capability (Quadrant III) is to apply Hirschman's (1963) concept of *roundabout reforms*. Rather than tackling head-on powerful interest groups benefiting most from inefficient policies, the government should try to strengthen the constituency for further reforms by providing opportunities for efficient economic agents. Cases from Quadrant II face the opposite problem, namely low organizational capability and high political capability. Levy's approach here is to concentrate on a few tasks essential for success of reforms which should be pursued with the support of specialists from abroad, while all other elements of the package should not be organizationally intensive (Levy calls them "stroke-of-the-pen reforms").

The scheme is interesting as it brings another variable (organizational capability) into the picture. However, its disadvantage is that it is static. There is no time frame. Countries belong either here or there. We learn nothing as to what happens, for example, if political capability declines over time (although some answers are implicit in Levy's scheme).

Therefore, the present writer sees an advantage in amalgamating both approaches by drawing on Balcerowicz with respect to the *time frame*, that is, stages of transition, and on Levy with respect to the *level of competence frame*, that is, the organizational capability associated with preferences for certain types of measures.

Neither the scheme proposed by the present writer nor those of both authors referred to above are completely new. The situation Balcerowicz refers to is best understood within the framework of North's (1979) concept of "social reformers". The presence of such

reformers signifies the departure from the situation, where the state acts in a predatory manner, thus enhancing attempts to reduce transaction costs in the economy. Also, following Olson in his *Rise and Decline of Nations* (1982), the scheme in question stresses major discontinuity as a source of improved performance made possible by the weakening of interest groups resulting from the discontinuity in question.

Apart from the previously mentioned relationship to Hirschman, Levy's scheme also bears some similarity to another, albeit less well known Olson's concept. In Olson's (1987) view, it is only at a more developed stage, when organizational capability improves significantly, that the state can afford to become more interventionist, launching various sophisticated schemes which are impossible to implement properly and at a bearable cost at lower development levels. As seen from the last two paragraphs, the schemes in question have a distinguished neo-institutionalist pedigree. The present writer posits that we may gain some understanding of the political economy of transition by applying Olson's modified scheme, based on changes of political capital over time and changes in organizational capacity (also over time), to transition measures.

4. "Big Bang" and Later: Changes in Political Capital over Time *cum* Organizational Capability Perspective

A look at the critical mass of measures called "big bang" from this perspective brings a better understanding of various transition phenomena. First of all, it supports the "big bang" approach as such *vis-à-vis* the "gradualist" alternative. At the start, political support for radical change was undoubtedly very high (to be more precise, this author refers only to countries where political change had already been accomplished before the beginning of economic change; see Winiecki, 1990 and 1992e). As proper for the period of "extraordinary politics", such a situation called for a *large package* of measures whose *composition*, however, should be decided on the basis of another variable in our scheme, namely organizational capability.

By and large post-communist countries cannot be said to have high organizational capability in terms of modern public administration. It varies across countries, of course, as some of them (the

Czech Republic and, to a smaller extent, Hungary) had the tradition of good public administration in pre-communist times, but even there half a century of corrosive communist influence did great damage. Therefore, Levy's prescription should apply here, namely that absolutely essential organizationally-intensive measures should be included in the package, while all other measures should emphasize the dismantling of existing barriers rather than modifying complex schemes.

In the view of the present writer, both stabilization *cum* liberalization and institutional change (including privatization) as parts of the "big bang" fit reasonably well into the prescriptions generated by the scheme. Organizationally-intensive essentials of establishing foundations of macroeconomic management had to be pursued regardless of difficulties. At the same time, other measures were of the *deregulation* type, *i.e.* dismantling existing barriers. Price liberalization, foreign-exchange liberalization (introduction of limited convertibility), elimination of a large part of production subsidies, etc. are precisely the "stroke-of-a-pen" reforms – in Levy's term – that are absolutely essential but, fortunately, do not require high organizational capability.

On the institutional-change side, almost all the measures require high organizational capability (changes in the taxation system, customs system, changes in or – indeed – the establishment of a rudimentary financial system, etc.). Therefore they had to proceed at a rather slow pace. An exception was the dismantling of barriers to expansion of the "generic" private sector, that is, the one established from scratch (rather than being transformed into private from state or cooperative ownership). This process is sometimes called privatization "from below" (see, *e.g.*, Gruszecki and Winiecki, 1991).

A questionable departure from the organizational capability-based prescription has been various schemes of wage control, criticised by free marketeers. Let it be noted that these schemes are questionable also from the political capital time-frame viewpoint. As stressed already at the start of transition (see, *inter alia*, Beksiak *et al.*, 1989, Beksiak and Winiecki, 1990), these schemes are also political capital-reducing ones, as they shift the conflict from the microeconomic to the macropolitical level. It is the government that becomes a party to every conflict resulting from wage claims in state-owned enterprises. As a result, political capital tends to be dissipated at a faster rate than under the wage-liberalization alternative.

In reality, the outcomes were far worse. The said departure – that is, unfortunately, at the same time a linchpin of a “heterodox” programme – not only contributed to faster erosion of political capital but, in consequence, also shifted politically difficult decisions from the period of “extraordinary” to that of “ordinary” politics. *Closing unprofitable firms, especially large SOEs is always difficult.* It might have been easier, however, to do it when people were more ready to make sacrifices.

But the rejection of free marketeers’ reasoning that the price of labour should be freed together with freeing other goods and factor prices (at least in the competitive sector), led to *de facto* postponement of bankruptcies. Wage controls of one sort or another made it more difficult for enterprises to price themselves out of the market *via* wage and, consequently, cost and price increases that were negatively verified by the market. With fewer (Hungary) or almost no (former Czechoslovakia and Poland) enterprises going bankrupt in the period of early transition euphoria, the politically very sensitive task was shifted to a period when its implementation was known to be much more difficult. Delays in structural adjustment and structural change resulting therefrom make the political economy of transition under the “heterodox” programme much more difficult than under its free market alternative.

The application of the modified Balcerowicz/Levy scheme helps to explain the relative success of some measures *vis-à-vis* others included into the package. Price liberalization, as a “stroke-of-a-pen” measure, is easier to implement than, say, tax-system changes, and although the latter belong to essentials they cannot be expected to succeed in the time span of “extraordinary politics”. Continued in times of “ordinary politics” they become an object of criticism from those who tend to lose from proposed changes (quite apart from criticism of more or less obvious conceptual and implementational errors!).

The scheme also helps to explain the relative success of privatization “from below” (expansion of the generic private sector) versus privatization “from above” (ownership transformation). The dismantling of existing barriers to entrepreneurship comes easier due to the nature of necessary measures that are not organizationally intensive, while privatization requires a very dense legal, administrative and financial framework of rules, as well as private and public sector suppliers of necessary privatization-related services. As an

aside, it should be noted that even various privatization “shortcuts” are markedly more organizationally intensive than the simple dismantling of barriers. For these reasons, the fast-growing share of the private sector in employment and GDP in post-STEs is to a much greater extent the outcome of privatization “from below” than “from above”.

The scheme also gives us political economy-based clues as to how to proceed when political capital changes over time, *i.e.* its level falls from the heights achieved during the period of “extraordinary politics” to the level more normal for periods of “ordinary” politics. However, before entering the field of policy recommendations, this author turns first to the political economy consequences of the legacy of the STE past for the transition process. For it is the opinion of the present writer that only after combining insights from the preceding considerations with those from system-specific knowledge of the past may a clearer set of recommendations emerge.

As stressed strongly by this author (most recently in Winiecki, 1993c), the use of knowledge about the STE past would strongly affect predictions of the outcome of early “heterodox” stabilization programmes applied throughout East-Central Europe. Output would be expected to fall sharply (as it duly did) and inflation, after an initial sharp acceleration and deceleration, would continue at a relatively high rate for quite some time. Such expectations of the behaviour of a real economy must of necessity alter political economy reasoning of governments and ruling coalitions in countries in transition.

A strategy based on catchy slogans such as: “First, a short period of severe belt tightening and later a marked improvement” (a promise of the first Polish post-communist government) was clearly not viable in the medium run. *Medium*, not short run, because a period of macroeconomic difficulties would obviously – in terms of the scheme applied in this article – stretch beyond the period of “extraordinary politics” and the associated greater willingness of the public to bear the costs of transition. Policy-makers would have to face the fact that severe problems would still persist under politically much more difficult conditions, when the population’s dissatisfaction increased significantly, while political opposition and newly formed (or reformed) representations of interest groups began to press their demands with greater force than before.

The use of STE knowledge, if applied in economic policy-making of post-STEs, might result in some *positive corrections of*

actual outcomes. Somewhat less stringent monetary restraint at the start and later avoidance of large swings in money supply (see, *inter alia*, Winiecki, 1992e and 1993c) would create a better environment for adjustment of state and private enterprises. Furthermore, the proposed limitation of access to credit for the largest state-owned enterprises (SOEs) would improve that access for relatively more efficient medium-sized state enterprises, reinforcing their capacity to adjust. Also, better understanding of the pattern of SOEs' profitability at the beginning of transition could result in some fine-tuning of the process of reducing the level of subsidies.

However, the present writer is convinced that the effects of all these corrections to macroeconomic policy would *counterbalance only in part* the output, employment and wage level-reducing impact of unavoidable fundamental adjustment of post-STEs in transition. This, in turn, means that not only institution-building, including privatization, but also a difficult macroeconomic situation – even if somewhat less difficult than has been the case – would be carried into a period of “ordinary politics”.

5. Recommendations for the Period of “Ordinary Politics”

Some policy recommendations are – as signaled in the preceding section – implicit in the modified Balcerowicz/Levy scheme applied here. Once the early enthusiasm evaporates and resistance to change increases, the bunching of a large package of measures (“big bang”) ceases to be a viable option. Even a continuation of the same package may meet too strong a resistance of absolute or relative losers, whether short-term or long-term ones. Evidently, at least some modifications of the strategy are called for.

The modified scheme calls for increasing the role of “stroke-of-pen” measures, not requiring high organizational capacity, in the mix of transition measures. Also, following Hirschman's (1963) concept of “roundabout reforms”, the second phase of transition should promote *measures that strengthen the position of efficient economic actors in the economy.* It is these actors that, by and large, make a constituency in favour of a transition to the capitalist market economy, and their increasing numbers and better performance im-

prove the probability of success. Thus, the strategy for the second phase should avoid – to the extent possible, of course – head-on conflicts with interest groups hostile to change (first of all with the public enterprise sector, especially large SOEs that were traditionally the beneficiaries under the STE regime).

The foregoing means that measures *strengthening the private sector*, especially the non-agricultural private sector, should weigh much more than in the earlier phase. Only the fast expansion of the private sector may, over time, alter the balance of power in domestic politics to the advantage of those in favour of transition.

There are still some inherited idiocies from the communist past, the dismantling of which may facilitate the expansion of the private sector. However, over time, the weight of organizationally-intensive measures supporting the private sector will necessarily increase. Thus, first of all, the second stage of transition should include institution-building measures creating a financial sector more responsive to the needs of small and medium-sized firms. Also, support should be given to private entrepreneurs willing to buy SOEs. It is obvious that profits generated in their original, even fast expanding, private firms would be insufficient to take over SOEs with much higher asset value.

Here, however, conflicts are probable, since neither managers and trade unionists, nor workers in targeted state-owned enterprises are often willing to accept external owners. The former would usually lose their position or influence, while the latter would have to work harder. And, after decades of moral corrosion under communism, better pay and opportunities for advancement (without *nomenklatura!*) may not necessarily be seen as an acceptable *quid pro quo*. Wherever such resistance is encountered (strongest in Poland, Slovenia and in successor states to the former Soviet Union), a “roundabout” approach should be used in privatization.

If no other option seems able to overcome the resistance of insiders (managers, trade unionists and workers), employee-share ownership (ESOP) should be offered to pacify the resistance (on this, see Winiecki, 1992d). The present writer's expectations, reinforced by experience, are that, in the short-to-medium run, these enterprises would be threatened at worst with bankruptcy and at best would encounter an investment barrier to even simple reproduction, let alone expansion. In such circumstances *external core investor would become much more welcome.* And it is only then that financial op-

opportunities for a private entrepreneur willing to undertake such buy-in would become available.

This author agrees with a possible criticism that some of those enterprises may turn out to be beyond rescue after their ESOP experience but this criticism goes only so far. In the second phase of transition, first-best solutions from the economics viewpoint are often unavailable and, accordingly, second-best ones should be implemented (in fact, some first-best solutions may not be available even in the first phase of "extraordinary politics"). And second-best solutions are clearly more costly.

Next, promoting further economic openness and/or defending against encroachments upon it belong to the same category of measures crucially important for the performance of a much more flexible and outward-oriented private sector. Openness of the economy is very important for its further growth through export orientation.

Some otherwise popular measures such as *strengthened law enforcement* also indirectly favour the private sector whose ability to pursue business opportunities is hampered by the rules' instability, non-uniform application of these rules, and, last but not least, corruption. Strengthening the judiciary, the establishment of a framework allowing for private arbitration, as well as improving enforcement – all belong to that category. Less popular will be measures promoting the shift of private economic activity from the unregistered ("grey") to the registered economy. This writer agrees with Kornai (1992) that modifications of fiscal rules should *increase incentives to obey the law*. Senseless persecutions will only push many of those operating in the "grey" economy deeper into illegality, and deter many others even from trying to be entrepreneurial. Clearly, *both carrot and stick should be used* in the attempts to bring the "grey" sector within the law. Even the proposal of partial tax abolition, however, meets with indignant howls of believers in "absolute" justice in some countries (e.g. Poland).

It is worth noting that there are interlinkages between various private sector-strengthening measures recommended here. Turning again to Kornai (1992), private businessmen look at the possible shift to the registered economy in terms of a trade-off. They may consider giving up some income (that is, pay taxes) in return for legal protection, and an opportunity to benefit from facilities whose use is

impossible while they remain in a "grey" economy. For example, the already recommended improved access of entrepreneurs to the services of the financial sector (better access to credit and other financial services) may become a carrot, enticing private entrepreneurs to move out of the shadows of "grey" economy.

The inverse of recommendations to strengthen the more efficient private sector through the use of "roundabout" measures should be recommendations to weaken (or reduce the extent of losses resulting from the activities of) politically strong but economically inefficient economic agents in the public enterprise sector. These are located within that sector in large SOEs. The strongest political pressure against change comes from that quarter and, with reduced room for manoeuvre for the government, the *strategy of attrition* seems the most suitable.

It is obvious that giving in to all demands for the abolition of old debt and new credits and/or subsidies would push economies in transition back to where they started. Thus, the strategy should be to give as little money as politically feasible to state mastodons, support people rather than inefficient production, and if inefficient production cannot be avoided for the foreseeable future, then money should be given on *quid pro quo* basis, i.e. in return for the (enforceable) promise to slim down oversized enterprises. Redundancies should be instituted – to the extent possible – through a wide exit from employment in these enterprises (the departure of pensioners, voluntary departures, etc.) and tightly controlled entry. Attrition, quite apart from *economic benefits* (lower budgetary expenditure) would generate *political benefits* over time, since increasingly smaller unprivatized state enterprises would be ever less able to influence political resource allocation (i.e. through the state budget or state-determined credit allocation).

Finally, it should be realized that the resistance to privatization at any cost, including cannibalization of assets by enterprise management and workers, is not necessarily as bad as it is sometimes portrayed. For enterprises whose managers and workers resist privatization, through selling assets and leasing empty factory and office space to obtain money that will enable them to continue as before without privatization, *do in fact little else but privatize!* Assets that are sold or leased find themselves in the hands of the expanding private sector, while resisting SOEs dwindle into insignificance in terms of assets and output. At a certain point, there will be little else

to sell and political clout will not save most of them from bankruptcy. Remaining valuable assets will be sold, again to private entrepreneurs (on this paradox, see Winiecki, 1993b).

Again, an experienced analyst will object here that bankruptcy is not always the most efficient way of reallocating resources – and will undoubtedly be right. The sale of a restructured (and slimmed down!) enterprise as a going concern is quite often more efficient since it allows the retention of a large part of *human capital* created in the old firm. This more efficient solution is, however, not always a feasible solution in the case of politically-strong state mastodons that resist privatization (or attempts at restructuring by the state before privatization). A more costly solution is simultaneously a more feasible one – and one in accordance with the recommended tactics of avoiding head-on collision with politically strong but economically weak economic agents.

6. How to Improve the Odds through Effective Communication Strategy

Outside the framework applied here, or, more precisely, alongside the framework in question, are measures that improve the outcome at *each* stage of transition, not only at the second stage of “ordinary politics”. Effective communication strategy, coupled with clear understanding of the political economy advantages of some messages, has proved to be a strong weapon on the side of some social reformers. An example, contrasting the behaviour of government economic teams in Poland and the Czech Republic (formerly in Czechoslovakia), supplies both negative and positive examples.

In Poland, a cabinet-type policy was pursued under Balcerowicz (and in fact throughout the whole period of transition) with only rare public appearances all over the country – or even TV appearances – of top economic policy-makers attempting to convince the general public of the policies pursued. In Czechoslovakia, the opposite was the case. As stressed by Klaus (1992), he spends half of his time communicating with the general public all over the country. On this basis alone, one could expect greater political economy-type problems in Poland than in Czechoslovakia.

Apart from the *willingness* to communicate, the political economy advantages of a *message* to be communicated are of crucial importance. A different approach to coalition-building in Poland and Czechoslovakia on the side of economic leadership has been clearly visible from the very start of transition to democracy and the market. Thus, the crucial issue of privatization has not only been dealt with differently in terms of *substance* (privatization proposals) but also in terms of political economy (using privatization as an instrument of coalition-building).

In Poland, in tune with the cabinet-type approach to policy making, the privatization team started with consecutive versions of the privatization law that, in terms of substance, concentrated on the public sale of shares of privatized enterprises as the dominant privatization method. In Czechoslovakia, privatization had already been announced as a goal in the first weeks after the “velvet” revolution of November 1989. Not only was communication strategy better from the start but the content of the message was also more attuned to the political economy needs of transition. The “citizens’ privatization”, or free distribution of shares to citizenry, was underlined throughout the early transition period. The stress on making every citizen willing to participate in the scheme a property owner generated strong support for privatization as a whole in Czechoslovakia, a feat never achieved in Poland (see Gruszecki and Winiecki, 1991, and Winiecki, 1992d).

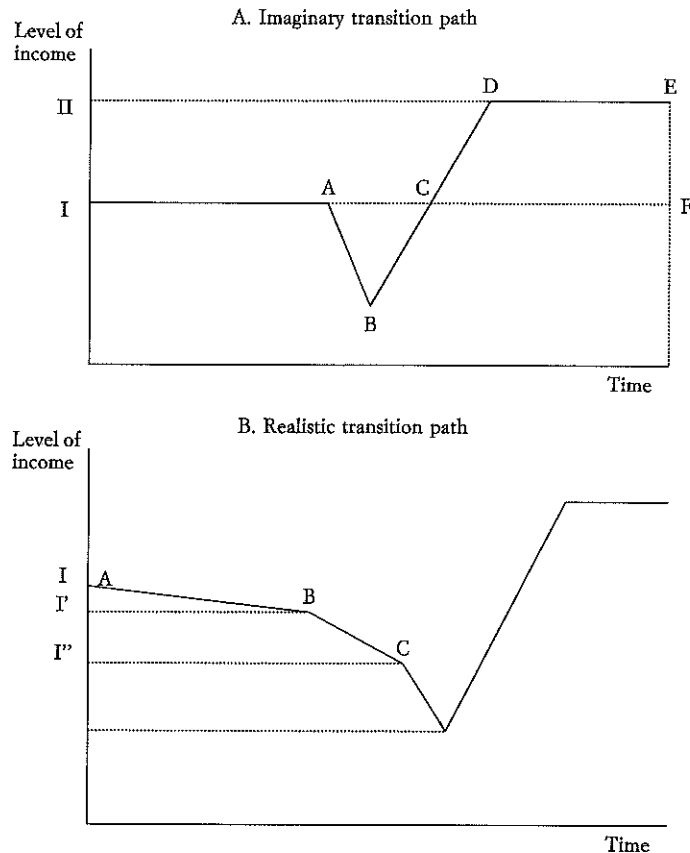
Another message that might have been used to the advantage of transition is one of *non-existence of choice* between the continuation of or return to the STE past, and the shift to the capitalist future. Here, differences are smaller between most successful East-Central European countries but, again, the message sounds clearest in the pronouncements of Czech economic policy-makers. The argument was that the STE ceased to be able to maintain even the achieved level of performance and population’s well-being, let alone to grow in the future (regarding the stress on this point see, *inter alia*, Klaus, 1991b). And, let it be noted, this argument should be the most difficult to sell precisely in Czechoslovakia, where the decline has been smaller and more gradual than elsewhere.

Nonetheless, it is this message that should be emphasised again and again. The STE regime has been in long-term decline for quite some time (on this see, *inter alia*, Winiecki, 1984, 1986, 1987, 1991 and sources quoted therein). Therefore, the views that present the

choice as one between the lower-level equilibrium path of the past and the higher level equilibrium path of the future *plus* a substantial fall in real wages in the preceding transitional period (see, e.g., Wyplosz 1992) are based on a striking lack of knowledge of the STE past. Alternative paths of transition, imaginary and realistic, are presented in Figures 3A and 3B.

FIGURE 3

INCOME LEVELS UNDER IMAGINARY AND REALISTIC TRANSITION PATHS



The issue is far from being only of academic interest. An assumption that there existed some kind of equilibrium in the past suggested the viability of an option to return to "reform socialism" if the transitional wage (or some other) losses were perceived as

being too high a price for future higher-level equilibrium. An argument that STEs had been on a downward slide for some 10-15 years or more and would have collapsed anyway quite soon, even without the political impulses of *perestroika* and the Polish and Hungarian political developments of 1989, undercuts the rationale for backward-looking policy options. Policy choices are, thus, narrowed down to forward-looking options of a more or less free-market nature and a social-democratic mix of market and *dirigisme*, different but not *strikingly* so, from its more liberal alternatives. For the experience of most LDCs from the 1950s to the 1970s and more interventionist and welfarist Western states throughout the post-war period call into question many cherished ideas on the effects of state action and political resource allocation.

Such an approach, coupled with the willingness and ability to communicate effectively, would undoubtedly help to increase the political support of the people in countries in transition for radical – but understood to be necessary – measures. The importance of such an approach has been all the greater since our knowledge of the STE past suggests that output losses will be higher, output recovery – dependent on structural change – will be slower, while inflation will be more persistent than under earlier non-post-STE stabilizations *cum* liberalizations (see Winiecki, 1993c).

The realization that, in such circumstances, painful side-effects of stabilization *cum* liberalization will certainly be felt beyond the stage of "extraordinary politics" gives this "no-return-to-(imaginary)-past-equilibrium" explanation a particularly large role to play. If the message has been well communicated, increased resistance in the period of "ordinary politics" would not lead to retrogression, that is, to some disastrous attempts at recreating the non-existent past equilibrium (an issue particularly relevant in Poland after the 1993 elections!). What might have happened is, at worst, some blunting of the edge of the rapid transition to the capitalist market economy. The message, however, has not been well understood by economists, let alone policy-makers, and, consequently, its use has been rather limited (albeit greater in some countries than in others).

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