PART TWO

FROM PLAN TO MARKET: THE TRANSITION PROCESS AFTER 10 YEARS

PAPERS FROM THE ECE SPRING SEMINAR, MAY 2000

INTRODUCTION AND SUMMARY OF DISCUSSION

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The UN/ECE's third Spring Seminar was held in Geneva on 2 May 2000 and, as in previous years, brought together a large number of economists, policy advisers and policy makers from universities, research institutes, government ministries and central banks, as well as some representatives of the private enterprise sector. The topic chosen for the Seminar by the member governments of the Commission was a review of 10 years of the transition process in central and eastern Europe and the countries formerly part of the Soviet Union. This is obviously a huge topic for a one-day seminar: there are 27 member countries of the UN/ECE with economies in transition and they differ considerably both with respect to the conditions and problems that were facing them at the start of the process and to the actual progress that has been made in establishing viable and efficient market economies. For all of them, the problems have proved to be more numerous and complex than envisaged by most commentators and policy makers in the immediate aftermath of the fall of the Berlin Wall, and for the majority the creation of market economies and of the foundations for sustained growth has been much slower than expected. Economists and other social scientists have not been slow to publish their analyses of the process, and their advice on how to advance it, with the result that there is already a considerable literature on the economics of transition, or "transformatology" as Professor Berend has tagged it.

The 2000 Spring Seminar approached this complexity by selecting a small sample of themes referring to what might be called different levels of "aggregation" of the transition process. The first focuses on the process as one of systemic or regime change and places it in an historical and societal context which goes beyond the narrower categories of mainstream economic analysis. In fact one of the questions arising here is whether the prevailing economy theory in 1990 was really capable of fully comprehending the nature and requirements of such radical systemic change. At the next level the attention moves to macroeconomic policy and the extent to which countries have succeeded in creating a stable framework for instigating and sustaining high rates of fixed investment and economic growth. The third theme is about the changing structure of the transition economies, both in the sense of how the product composition of output and exports have changed since 1989 and of how behavioural relationships have altered in response to the new patterns of relative prices, property rights, and to the structure of incentives in general. Finally, the focus turns to the impact of these radical changes in economic and political organization on individuals and various subgroups of the population. The promise of systemic change is increased welfare and higher living standards for all, but distributional outcomes are rarely equal: there are winners and losers, and the latter are often those who bear a disproportionate share of the costs of economic adjustment. The focus on social costs and the consequences of economic change reflect not only issues of morality and social justice but also concern to generate and preserve popular support (and thus legitimacy) for the new configuration of democratic institutions and market economies.[97]

In the opening paper ***Professor Ivan Berend***, of UCLA California and the Hungarian Academy of Sciences, places the attempts to create market economies in eastern Europe in a broad historical context. He argues that the region's attempts to catch up with the levels of development in western Europe have a long and unsuccessful history: efforts to integrate with the western economies in the second half of the nineteenth century were based on laissez-faire and free trade but they had limited success and were replaced by protectionism and extensive state interventionism after the First World War. State socialism and central planning after the Second World War intensified the economic nationalism of the interwar years but despite some transitory success in the 1950s and 1960s these economies were still unable to compete on world markets and lacked the institutional and other capacities required to sustain the process of catching up with the west. Between 1870 and 1989, the economic position of central and eastern Europe relative to western Europe was virtually unchanged.

From this perspective, Berend criticizes what he sees as a widespread assumption of policy makers and policies in the early 1990s that a change of economic regime and the adoption of laissez-faire policies would automatically trigger a release of entrepreneurial energies on a scale sufficient to lead to economic growth and, eventually, levels of prosperity matching those in the west.[98] Sustained growth and catching up does not "automatically follow when a country adopts the western market model". Berend's analysis also leads him to a

[97] For an early stress on the importance of these issues see, UN/ECE, "Popular support for the transition process", *Economic Survey of Europe in 1992-1993*, pp. 10-15.

[98] For a similar line of argument see UN/ECE, "Economic reform in the east: a framework for western support", *Economic Survey of Europe in 1989-1990*, pp. 5-26.

different interpretation of the post-1989 "transformational recession" whose length and depth was not foreseen by most analysts and policy makers in the early 1990s.[99] Some, such as János Kornai, see it as an unavoidable and necessary component of the change in regime, in relative prices and so on, while others have argued that its severity was to a significant extent due to neglect of the "institutional hiatus"[100] created by the rapid collapse of the old system and its slow replacement by the new institutional framework. Berend however sees the "transformational recession" as an outcome of the chronic economic problems of the area and, in particular, as an extension of the economic crisis in which the centrally planned economies had been mired since the oil shocks of the 1970s. More generally he sees most of the transition economies as caught in a chronic structural crisis, a crisis of the European periphery, in which their capacity to adjust to a developing world economy is limited or non-existent.

How should policy makers respond to this pessimistic diagnosis? Berend stresses the importance of an effective state in the process of creating an effective market economy and achieving integration with western Europe. At least for a time, "a mixed economy with a restructured and efficient state-owned sector" is the appropriate target combined with a state capable of introducing appropriate regulation, setting out the "rules of game" and generally creating a national environment which will prove attractive to foreign direct investment (FDI). In common with other countries on the European periphery, the transition economies of central and eastern Europe have never been more than minor centres of technological innovation and they are therefore dependent on adopting foreign technology to achieve their development goals. Thus, for Berend, FDI is the key to breaking out of the structural crisis in which central and eastern Europe has been stuck for decades. Here he joins company with the "mainstream" policy advice of the 1990s which also attached strategic importance to FDI in achieving the transition, but the crucial difference is that he does not believe that the other components of the "mainstream" package were conducive to creating the necessary environment for attracting foreign investors.

Professor Berend's paper provoked a lively discussion in which there were large measures both of agreement and disagreement over his principal theses. Some of the critics felt that he was suggesting a degree of historical and geographical determinism which underestimated the possibilities for growth and the importance of policy in creating the conditions for take-off. Both ***Erik Berglöf*** and ***Jan Svejnar*** emphasized that "policy matters", but Berglöf agreed to a large extent with Berend on the important role of the state in creating the institutional, regulatory and enforcement conditions for growth, in taking care of distributional issues, and in building a constituency for sustaining the reforms. Svejnar accepted the desirability of an "efficient state sector implementing effective regulation and policies" but he was sceptical that this was feasible in the early 1990s: the available staff in the former planning ministries did not have the relevant skills and in sectors where the state was still an owner and regulator performance was poor.

Berglöf and Svejnar also thought that Berend had not stressed sufficiently the considerable intercountry variations in performance among the transition economies. Svejnar, in particular, thought these variations were due more to policies than to "deterministic, long-term phenomena", but, as ***Paul Welfens*** points out, this still leaves open the question as to whether we really understand why some countries are able to push ahead with successful policies and others not. Perhaps Erik Berglöf gets closer to the nub of the issue in his remark that "optimal policies cannot be thought of independently of how they can be implemented and sustained". If good institutions are necessary for the implementation of optimal transition policies, then much of the argument over whether institutions *or* policies matter is more largely redundant. Nevertheless, this discussion suggests the need for much more careful research into why a few transition economies have been able to forge ahead while many more have suffered major failures in their efforts at transformation.

The other area which appears to require a lot more research is FDI. This might seem surprising given that a huge literature on the subject exists, but as Berend, Berglöf and Welfens emphasize, FDI varies a lot in its effectiveness: it is not always beneficial, and the spillovers to the rest of the domestic economy vary considerably both in size and sign. Although the benefits of FDI are often taken as axiomatic, the matter is essentially an empirical one and so more detailed research into the conditions in which it is beneficial could be especially helpful to policy makers.

Paul Welfens largely agreed with Berend's analysis and his interesting extensions to the paper are not summarized here. But *à propos* of the question raised in the opening paragraphs above, namely, whether the mainstream economics of 1990 was really up to the task of analysing systemic change in eastern Europe, he stresses two points: one, that the economic transformation was accompanied by a radical change in political arrangements and that modern economics has a poor tradition of analysing the interdependence of economic and political change; and, two, that the standard neo-

[99] One of the participants queried whether the transformational recession was really as steep as was suggested since the data for 1989 and earlier were of dubious value. Professor Berend said that he based his statements on calculations and adjustments made by Angus Maddison and Professor Paul Bairoch: although there was always a margin of error he was confident that they were reasonably comparable with the figures for later years.

[100] R. Kozul-Wright and P. Rayment, "The institutional hiatus in economies in transition and its policy consequences", *Cambridge Journal of Economics*, Vol. 21, No. 5, September 1997, pp. 641-661.

classical economics is essentially concerned with the analysis of marginal change, while the transition is essentially about very many large, discrete changes. On both counts, mainstream (neo-classical) economic analysis appears to be an inadequate instrument for analysing the transition process.

Professor Berend replying to the discussion, emphasized that he was not making deterministic forecasts for eastern Europe but he did insist that history was very important for understanding current problems – “you cannot understand the 1990s from the 1990s”. Nor was he suggesting a geographic determinism – the examples of Sweden between 1870 and 1914 and the more recent cases of Ireland and Spain demonstrated that countries on the periphery could very well catch up with the west European core – but he was arguing that this was only likely to occur under certain international conditions, and especially those which favoured international investment.

Professor Stanislaw Gomulka, of the London School of Economics and Adviser to the Minister of Finance of Poland, looks back over the 1990s to present a stocktaking of macroeconomic policies during the transition process and draws some lessons that might be relevant to those countries which are still striving for macroeconomic stability. Gomulka’s analysis recognizes many of the factors stressed by Ivan Berend: the importance of initial conditions, particularly the accumulation of structural problems in large state owned enterprises which were so complex as to be virtually incapable of being restructured without large-scale foreign investment; the crucial importance of the need to create the institutional and legal conditions to encourage the growth of a new private sector and stimulate the recovery of output; and the need to attract foreign investment in significant quantities to boost technology transfer as a key element in a catch-up strategy.[101]

Gomulka, however, argues that for central Europe and the countries of the former Soviet Union there was little choice but to adopt a strategy of rapid adjustment. (Shock therapy he sees as only being applied in the former German Democratic Republic and gradualism only in China.) Within the group of rapid adjusters he distinguishes a “strong variant”, which was applied in the Baltic states, Croatia, the Czech Republic, Hungary, Poland, Slovakia and Slovenia, and a “weak variant” in all the others including Russia. In the group of strong variant adjusters, prices and international trade were quickly liberalized, and the conditions created for the growth of the new private sector; hard budget constraints were imposed on enterprises; and a fair degree of macroeconomic stabilization was achieved fairly quickly. In the weak variant of rapid adjustment, typified by the Russian experience, privatization was introduced early and rapidly, but it was done before the full liberalization of prices and trade, before the imposition of hard budget constraints on enterprises, and before significant progress had been made with macroeconomic stabilization. But Gomulka also observes that central Europe and the Baltic states benefited from “pre-existing rules and institutions (workers’ councils, a commercial code, a legal system)” and that elsewhere institutional deficiencies were severe and made policy-making extremely difficult. Thus, echoing Erik Berglöf’s point above, policy effectiveness depends on effective institutions, and where institutional deficiencies are considerable, macroeconomic management will be all the more difficult. Initial conditions, including of course the institutional legacy of the previous regime, may therefore explain most of the intercountry variations in economic performance in the 1990s. Indeed, one of the key lessons Gomulka draws from the 10-year history of the transition process is that success “depends above all on the rapid creation of conditions – institutional, legal, microeconomic and macroeconomic – which are conducive to the development and growth of a new private sector...”.

How should this development be encouraged? Whereas Berend argues for state intervention and a mixed economy, Gomulka sticks to a fairly orthodox agenda: price liberalization, hard budget constraints and reduction of entry barriers to stimulate a new, competitive private sector; a tight fiscal policy, preferably in conjunction with an independent monetary authority, as an essential component of a disinflationary strategy, and also aiming to meet the Maastricht criteria for budget deficits and public debt; an exchange rate sufficiently flexible to stimulate the competitiveness of the new private sector, discourage speculative inflows of foreign capital, and generally maintain external credibility; and labour markets made more flexible “e.g. by reducing hiring and firing costs”. Gomulka puts considerable emphasis on the links between the various elements of a coherent macroeconomic policy and the growth of the new private sector, which he sees as the essential microeconomic foundation for sustaining both macroeconomic stability and economic growth. In the same vein, he sees a significant role for the public sector in promoting investment in infrastructure, research, education and other areas where there are positive externalities for the private sector. Increased public expenditure in these items should be offset by reductions in spending on social transfers, defence and subsidies.

George Kopits (Assistant Director of the Fiscal Policy Department of the International Monetary Fund) agreed that the effectiveness of macroeconomic policy, especially in the early stages of transition, depended on the presence of effectual transmission mechanisms which in turn depend on the development of the appropriate institutions. In their absence governments had to improvise with alternative policy tools such as quantitative credit limits, taxes on wages increases, etc. Kopits stresses how much progress has been made by

[101] Both Berglöf and Gomulka agree that for the candidate countries the prospect of EU membership should also enhance the former’s policy credibility and thus, by reducing the risk premia to both domestic and foreign investors, should boost investment and growth.

the advanced transition economies in developing effective institutions and macroeconomic policy tools, but ***Sylvana Malle*** (Director of the Non-member Economies Division, OECD) points out that Gomulka's paper fails to assess the extent to which the central European and Baltic economies are capable of facing the pressures that will arise from fuller integration into a global economy. A few may be able to do so, but she felt that most were still relatively vulnerable to a combination of external shocks and domestic structural weakness.

Kopits also raised the perennial topic of shock therapy versus gradualism: he agrees with Gomulka that the former German Democratic Republic was an extreme case of shock therapy, but argues that there were important elements of shock in the other central European economies, especially in their tradeables sectors, which were subject to rapid trade and price liberalization.[102] This is perhaps a warning of the dangers of dualistic categorization, a tendency which has been quite common in the analysis of the transition process – shock therapy versus gradualism, institutions or policies, etc. The categories are rarely homogeneous and they may well be in symbiosis rather than opposition. ***Professor Joze Mencinger*** (Ekonomski Institut Pravne Fakultete, Ljubljana) in his comments, is especially critical of such categorization, not least because many transition economies have not really followed any consistent model at all.

Kopits agrees with Gomulka that stabilization and growth are mutually re-enforcing, largely by lowering risk premia, and Malle agrees with Gomulka's emphasis on the new private sector in creating the conditions for sustainable growth. However, she queries whether we understand enough about the factors behind the development of this sector – why does its growth vary so widely among the transition economies and why, after a decade, is the density of small- and medium-sized enterprises, even in the advanced transition economies, so much lower than in western Europe? Liberalization is necessary, but it may not be sufficient – and how it is done, privatization for example, also matters. Initial conditions (including the record of reform efforts before 1989) also seem to matter and experience suggests that a critical mass of reforms needs to have been undertaken before the new private sector can take off. Malle also makes the point, which is not always made by those who accept the importance of initial conditions, that the fundamental question is not "whether the government should stabilize, consolidate the budget and create a good institutional environment for business" but how this can be done in countries in very different conditions and from very different starting points. In other words, contingency and context matter, and this is obviously important for the many economies in the CIS and in south-east Europe where general policy packages have not proved very successful.

Joze Mencinger sees the rapidity with which the transition process was initiated as a major mistake, and on this he sides with Professor Stiglitz's critique. Sylvana Malle's point, that national context and initial conditions must be taken into account, was ignored in the formulation of policy, which was influenced more by *assumptions* about actual conditions and by ideology in setting immediate objectives. Mencinger stresses the importance of the informal interactions between civil society and economic and political institutions and the gradual development of the norms and patterns of social behaviour on which the efficient operation of market institutions ultimately depends. He argues that the initial macroeconomic policy prescriptions for the transition economies were based on the false assumption that aggregate demand exceeded supply: stabilization through restrictive monetary and fiscal policies, wage restraint, anchoring of the exchange rate, and rapid liberalization, actually deepened the transformational recession. Mencinger suggests that in assessing the sustainability of growth in central Europe much greater attention should be paid to growth in relation to the current and capital accounts, i.e. the growth rate which can be achieved without depending on foreigners for capital or asset sales, rather than the more common criteria of inflation, interest rates, liberalization of capital flows, etc. Only Slovenia appears to be meeting this criterion and, after discussing developments there, Mencinger concludes that "gradualism, pragmatism and risk aversion in the wake of the devastation of the old system have created the proper mix for a rather successful transition in Slovenia" – a provocative conclusion for policy makers in countries lagging behind in the transition process.

Leonid Grigoriev (Bureau of Economic Analysis, Moscow) agreed with much of what both Berend and Gomulka had said about institution building and the necessary conditions for economic growth to take off; he emphasized the importance of initial conditions and highlighted the dilemma facing policy makers, namely that reforms cannot wait for the slow pace of institution building, but without effective institutions the reforms will not be sustained. Grigoriev argues that there is no single solution to the problem of simultaneously creating institutions and achieving macroeconomic stability and growth, and insists that, in privatization for example, there is a trade-off between speed and the quality of the results. He would thus appear to side with Mencinger in stressing the need for pragmatism and gradualism.

Among the initial conditions faced by all the transition economies in the early 1990s was a heavily distorted industrial structure, which reflected the preferences of planners rather than comparative advantages as revealed in competitive markets. The

[102] This issue was also raised in the general discussion, with participants from the floor pointing out that the policies introduced in Poland in 1991 were widely regarded as shock therapy. But Gomulka replied that this was not really the case as policies were softened soon after their introduction: disinflation to a monthly 1 per cent inflation rate was originally supposed to have been achieved in one year, but in fact it took 10; the fiscal targets were not met either, with some expenditures, such as pensions, rising much faster than planned and leading to a larger budget deficit.

central planners had often shown a strong bias towards heavy, energy-intensive industries and energy, transport and other intermediate costs were kept artificially low. Once prices and trade were liberalized much of the capital stock of these industries was no longer economically viable at the new structure of relative prices: they either had to close down or to seek subsidies in one form or another from the government (which the latter was willing to provide in many cases when it feared the social consequences of mass lay-offs). In a few cases, restructuring was possible with the help of foreign investors but, as Professor Gomulka remarked, the scope for this was limited. This restructuring – the collision of the old central planning structure with market-determined relative prices – is often referred to as "passive restructuring". In contrast, the emergence of the new private sector, emphasized by Gomulka, should lead to new investments determined by market signals and thus to a changing product or industrial distribution of total output and employment.

In his paper ***Professor Michael Landesmann*** (University of Linz and the Vienna Institute for International Economic Studies) examines the evidence for structural change using the detailed statistics in the Vienna Institute's industrial database. His focus is on a relatively small group of transition economies from central and south-east Europe and a key element in his approach is to examine whether the industrial structures of these countries are converging on that of the European Union. At a high level of aggregation there has been a general tendency for a relative decline in agriculture (except for a temporary recovery in Bulgaria and Romania) and an expansion of the services sector. There was also large-scale deindustrialization in the first three to four years of the transition, but from the mid- to late 1990s the leading transition economies appear to have embarked on a process of reindustrialization.[103] Landesmann is careful to stress the considerable diversity of experience among the transition economies in his sample: this applies to the extent to which productivity growth is due to output growth or employment reduction, to whether exports or domestic demand are the principal motors of growth, and to the degree that wage growth lags behind or exceeds productivity growth. Perhaps his major finding is that the more successful economies appear to have been gaining competitiveness in the medium- and high-tech industries and moving away from the low-wage, (unskilled-) labour-intensive activities. The effects of this can be seen in the structure of these countries' exports to the European Union. At the start of the transition in 1989-1990 this structure was similar to that of a developing country trading with the EU, i.e. it was dominated by unskilled labour-intensive and resource-intensive products. But in 10 years this structure has changed considerably – specialization has increased significantly in R&D, skill and capital-intensive activities, while dependence on unskilled labour-intensive products has greatly diminished. This is particularly the case for Hungary, but it is also true for the Czech Republic and Slovenia, with Poland somewhat further behind. This structural adjustment is also reflected in the "quality" of these countries' exports to the EU, as measured by their unit values. In 1989-1990 their products tended to be of very low quality but there has since been a rapid improvement over the past decade. However, the two countries of south-east Europe in Landesmann's sample, Bulgaria and Romania, have shown very little change in this direction: their output and export structures remain dominated by low value, labour-intensive products – a profile more typical of developing countries.

Landesmann relates these shifts in structure towards the medium- and high-tech sectors to FDI: this is concentrated in the leading transition economies and it has gone, not into the low-wage, labour-intensive branches but into the skill-, capital- and export-intensive sectors of industry. Whether this FDI is generating positive spillovers to domestic enterprises or creating dual-structure economies is not clear and is an important question for future research. Landesmann also recognizes the need for a deeper analysis of the interaction between institutional and behavioural changes, and between political, economic and cultural developments – and he shares this concern with Professors Berend and Gomulka.

Commenting on Landesmann's paper, ***Professor Paul Hare*** (Heriot-Watt University, Edinburgh) pointed out that judging a country to be "advanced" or "backward" in the process of structural change referred in practice to its progress in moving toward a structure judged to be typical or in some sense a valid objective for the economy in transition. But such an approach "requires a degree of caution and humility". Not only may there be perfectly good reasons as to why a country is unable to move any faster in overcoming the effects of the previous regime, but the "structural norm" may not even be valid for it. It would be surprising, for example, if the relevant equilibrium prices for the central Asian republics were to yield the same equilibrium structures as in central Europe. Thus, although Landesmann's paper is useful in describing what has been happening in some of the candidate countries for EU membership, it offers little policy guidance for those unlikely to join in the near future, if at all.

Andras Nagy (Professor at the Institute of Economics, Budapest), thought that Landesmann's paper could have explored more the relationship between institutional change and structural development, and he suggested, following Mancur Olson, that differences in the latter were partly due to the emergence of special interest groups and the persistence of pre-transition mentalities. Landesmann, however, thought it was impossible to quantify the impact of institutional change on economic outcomes, but in any case he said his paper had argued that the relatively strong differentiation among countries with

[103] On this, see also UN/ECE, *Economic Survey of Europe, 1998 No. 1*, chap. 3.3(i).

respect to the speed and direction of structural change was shaped by FDI, domestic factor endowments, proximity to and prospects for membership of the EU. For Nagy, the main message of Landesmann's analysis was that rapid changes in many of the transition economies was underway and these were positively associated with significant improvements in economic performance.

Since all economic change involves adjustment costs it is important to ask how great are the costs, who bears them, and whether mechanisms are in place to ensure that the winners can compensate the losers. ***Professor Michael Ellman*** (University of Amsterdam), considers these questions in the final paper of the Seminar. Drawing on a wide range of data sources, some of them unavoidably problematic, he shows that the adverse social consequences of the change in economic and political systems have been considerable for large numbers of the population living in the transition economies. (However, he judges them to be generally less severe than those resulting from earlier changes in the system such as the collapse of the Russian Empire and the transition to socialism in 1917-1922, the forced incorporation of the Baltic states into the Soviet Empire in the 1940s, and the transition to socialism in eastern Europe in 1945-1949.) The social costs have many dimensions. There has been a substantial increase in poverty, especially in Romania, Russia and Ukraine, and this in turn has led to significant increases in malnutrition, particularly among children. A more widespread effect of the transformation recession has been large falls in employment, with a disproportionate loss of jobs among women, and substantial increases in unemployment although this has varied considerably between countries. Inequality of incomes has increased throughout the transition economies except Slovakia, but in general the distribution is still relatively more equal than in the OECD countries.

One important feature of the transition in many countries is the deterioration or curtailment of many public services, a development which has particularly affected the poor and those most affected by the negative effects of the transition process. Ellman underlines especially the impact on children. Educational inequality has increased and in several countries the proportion of children receiving education has fallen significantly. This combination of effects has also led to an increase in a number of socio-economic problems such as corruption, crime, alcoholism and drug addiction.

Ellman is careful to point out that the data are not always reliable, that not all the social pathologies are due to the transition process, and that there are considerable differences among the transition economies with some already comparable to the EU in respect of health standards and the prevalence of corruption. Also, the transformation has brought many social benefits, ranging from easier access to modern contraception to a reduction in national oppression. Nevertheless, "the majority of the population of the region lives in the relatively unsuccessful countries" where the costs are more prominent.

These various costs have fallen more heavily on some groups than on others. Ellman identifies the following as being among the worst affected: workers in industry and the public sector; the rural population; women and children; refugees and displaced persons; the Roma; Russians in the non-Russian CIS; and savers. Discussing Ellman's paper, ***Alexandru Athanasiu*** (Professor at the University of Bucharest; Minister of Labour, 1997-1999; and Prime Minister ad interim, December 1999), and ***Martina Lubyova*** (Institute for Forecasting, Bratislava), both added pensioners to the list of major losers from the transition process. ***Alena Nesporova*** (Senior Specialist in the Employment Strategy Department of the ILO, Geneva) stressed that neither employment nor social policies had been effective in mitigating the social costs of the transition shock, mainly because of tax collection and budget problems but also because of poor targeting of social policies and a lack of active employment promotion measures.

Ellman closes his paper by asking why such serious social costs have not led to widespread popular protests and upheaval. Apart from Albania in 1997, they have been remarkably absent. He draws on other work to suggest that the informal economy and emigration have served as safety valves ("exit" rather than "voice"). Also, as already mentioned, the transformation has brought many benefits, not least the greater freedom for self-employment and individual initiative in all walks of life, which may weaken the impulse for political protest. Still, as Nesporova points out, the main winners from the transition are those who are competitive in terms of education, especially the young and active, and those with privileged access to power. The lack of protest by the mass of losers is therefore still a puzzle. Perhaps an important factor here, in addition to a broken tradition of collective protest in many countries, is the weakness of civil society in large parts of the region. Collective political protest requires extensive social networks and coordinating mechanisms – political parties, trade unions, etc. – to be effective. But these are also among the missing or weak institutions of the new politico-economic system. Political leaders, however, might be unwise to ignore the warnings of those who fear a backlash against the social costs of the transition process. To some extent this is perhaps already evident in a number of countries where governments are finding it extremely difficult to build effective coalitions for reform. But one of the key lessons from past experience is that the limits of any given population's tolerance for hardship, real or imagined, is extremely difficult to forecast. The political and economic failures of the communist regimes of eastern Europe had been evident for many years and Professor Berend identified the source of the latest crisis in the mid-1970s – but when the collapse came it took everyone by surprise, politicians, economists, political experts and "Sovietologists" alike.