CRCE CENTRE FOR RESEARCH INTO POST-COMMUNIST ECONOMIES

A LIBERATING ECONOMIC JOURNEY: POST-COMMUNIST TRANSITION

Essays in Honour of Ljubo Sirc

The Constitution of the CRCE requires that its Trustees and Advisers dissociate themselves from the analysis contained in its publications, but it is hoped that readers will find this study of value and interest.

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A Liberating Economic Journey:
Post-Communist Transition

Essays In Honour of Ljubo Sirc

A Collection of Papers

Edited and Introduced by

Andrzej Brzeski & Jan Winiecki

to mark the

Eightieth Birthday

of

LJUBO SIRC

Director of CRCE

and formerly

Senior Lecturer in Political Economy

at Glasgow University

evil they have done is not interred with their bones, but lives on after them. Hence the concern of the authors of this symposium with the transition to freedom, what Dr Sirc in *The Failure of Communism* called 'the damage decades of communist economic mismanagement had done'.

Our best tribute must be fearlessly to follow his example in cheerfully keeping before us his vision of a liberal economic order based on dispersed initiative operating under the impartial rule of law.

Ralph Harris
November 2000

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A DECADE OF TRANSFORMATION:

Russia and Hungary Compared

Introduction

It would be difficult to find two countries more unlike than Russia and Hungary. Size, history, factor endowments, the role of ideology or of ethnic and regional strains are all different. Still, at a certain level of abstraction, it may be fascinating to compare the endeavours and accomplishments of policies and the related spontaneous developments in the two countries. All the more so as their starting point was actually the same. As I tried to argue earlier (Csaba, 1995, chapter 2), both of them were integral parts of the same system: the Soviet empire. Systemic change in Hungary but also in Russia can not be meaningfully interpreted without mentioning the historical changes that took place in the second half of the 1980s, culminating in the eclipse of the empire. Likewise the professed priorities of policy makers in both Russia and Hungary have been the same: 'The return to normalcy', or in other words, 'becoming a normal European country'. Also the road taken to get from here to there contains a series of similarities: with varying degrees of success the standard panacea of stabilisation, liberalisation and privatisation accompanied and followed by institution building constituted the backbone of overall transformation policies.

In the present essay I want to take a bird's eye view of the truly historic rearrangements in both countries. In recent years serious and reliable economic reporting on the twists and turns of current economic developments has emerged, not least owing to the massive involvement of such organisations as the IMF, the World Bank, the OECD and

and each involving a large number of officials and professional journalists as well as statisticians. And while one can always argue about bits and pieces, and offer alternative interpretations, we do possess fundamental knowledge to be able make an overall evaluation.

According to comparable data (ECE, 1999, appendix, adjusted for preliminary 1999 data) GDP in Russia stands at 54% of the pre-transition level, while Hungarian GDP has recovered. In terms of consumer expenditure, Russia stood at 84% in 1998, while Hungary was at 90%. In terms of investment, real gross capital formation in Hungary was 115.4% of the 1989 level in 1998, while in Russia it was only 18.5%. Inflation in Hungary in 1999 was in the single digit range, while in Russia it was about 80% on a year-on-year basis. Unemployment in Russia was 13.3% in 1998, in Hungary 9.1%, with the Russian figure tending to grow and the Hungarian to diminish. In terms of FDI Russia attracted US $10 billion, while Hungary had received US $20.5 billion. Total exports of Russia grew from US $47 billion in 1991 to US $58 billion in 1998 but fluctuated widely over the years, while Hungarian sales abroad grew from US $9.6 to $23 billion between 1989 and 1998. The share of SITC 7 (machinery and equipment) was below 5% in Russian and over 53% in Hungarian exports in 1998. These are signs of structural rigidity in one, and structural improvement in the other case.

Whatever we think about individual indicators, *i.e.* the pre-transition output level with an entirely different output structure, or the way one could possibly convert inconvertible currency trade into dollars, the divergence of development paths seems incontrovertible. One wonders how to explain this in economic terms. This is an important issue if we want to eschew the widespread flight to anthropological, cultural or historical-philosophical grand

explanations where economics is just one of the elements of the picture.

In the following pages we try to offer an explanation in terms of transformation strategies. The underlying assumption is that the interrelated set of policies and institutions jointly and aptly called in German *Ordnungspolitik* does matter. While obviously not the sole explanatory variable, this set of factors is able to interpret *both* cases in standard economic terms, without having to resort to exogenous variables, historically predetermined schemes or world conspiracy theories, all falling outside the scope of standard scientific reasoning.

Our adherence to comparative economics does not make other approaches superfluous. On the contrary: historiography will have a lot to explain about why and how individual decisions were taken. Sociologists are likely to theorise further on the group formation and interest representation that have moulded the outcomes. Many other approaches seem equally appropriate.

The comparative systems approach operates with stylised facts. We try to present these, which may sufficiently well describe the salient features of transformation strategy. This approach is strictly descriptive, *i.e.* it does not attribute normative values, nor does it approve them in a *post hoc, ergo propter hoc* fashion. The model we try to build is a verbal one, and is neither all-embracing nor exhaustive. It aims at highlighting those features, which form the backbone of the actually emerging order reflecting *Ordnungspolitik, i.e.* the actual measures aimed at shaping policies and institutions channelling the predominantly spontaneous processes of systemic transformation.

It is important to highlight the dominant spontaneity of the overall process, insofar as a large and growing part of the literature tends to attribute all or most outcomes to

explains the fashion of trying to devise new and alternative philosophical and policy frameworks, even new paradigms for interpreting – primarily – the Russian failure.

This is obviously wrong, for at least two reasons. First, in terms of epistemology, theory building deserves its name only if it is able to offer an interpretation for successes and failures alike within the same theoretical frame. Second, as has been documented several times, the eclipse of the empire was a historic cataclysm. In a way, nobody could predict it, as far as timing and scope as well as its trajectories were concerned. Therefore, policy makers but also households and companies had to adjust to conditions of extreme uncertainty. Governments often receive reliable – *i.e.* final – statistics only 9-18 months after they have instituted the related measures. Likewise, households and companies had to adjust to fast changing signals, such as positive and negative rates of interest, widely divergent profitability of various activities and the like. Therefore – reflecting the crisis-born and thus inevitably chaotic nature of changes – conscious policies have had fairly limited influence over the outcomes. Policies matter, of course, but certainly they do not matter as much as they do in a standard model. Calibrating macrovariables was a hopeless task for most of the period under scrutiny.

It is important to underscore that this is not an *ex post* rationalisation of the chaotic outcomes of allegedly mistaken/misperceived public policies in the transition period. Highlighting the inevitably growing spontaneity as a sign of erosion in the coordinating mechanism of the respective countries has been a well documented topic in the periods preceding transition both in Hungary (Antal, 1985) and Russia (Naishul, 1991). Thus it was simply too naive or ignorant to believe that just by having put 'the right men in the right places' everything could or should

have been changed for the better. The fact that such beliefs and expectations have been widespread reflects only on the analytical capability of those sticking to and expressing such beliefs.

Thus the comparative systems approach adopts a narrow but coherent angle of looking at developments from a given perspective, measured against the underlying logic of systemic change. It takes the conventional wisdom, as reflected in the World Bank (1996) and OECD volumes (Zecchini (ed.), 1997), as given. In short, there is a certain set and sequence of transformation measures, which have, both theoretically and empirically, been conducive to overcoming chaos and hyperinflation, and putting those succeeding in these respects on the path of sustainable growth. The latter is not automatic, though. In this latter phase issues of capital formation come to the fore, which implies a regulatory environment supportive of domestic saving, lowering of corporate taxation, and more generally shifting to indirect taxation (applying a small number of rates and widening the tax base).

In this framework transition is not a journey from somewhere unknown to nowhere. While history matters, and the type of capitalism emerging in the long run is likely to differ from country to country, there is a discernible way, a minimum of necessary measures and means – the stabilisation, liberalisation, privatisation (or SLIP) strategy – that can not be neglected by any successful candidate.

It remains of course debatable whether it is historical-institutional legacies which allow or do not allow the 'right' policy mix to be formulated and implemented, or, conversely, whether policies are dominant in shaping institutions, but this is another level of abstraction where issues of philosophy rather than policies aimed at institution building can be discussed. For the present study

we remain at the level of applied economics in comparing and contrasting Russian and Hungarian experiences in the same period.

As a counterfactual but plausible theoretical assumption we may advance the following. According to standard economic theories, Russia has had more favourable conditions for success. Its resource endowments are richer. Its power structure was intact at the outset. International attention and assistance were more forthcoming to a superpower than to a country of 10 million people, if for no other reasons than because of nuclear weapons, environmental decay and the larger threat of migration. In early transition theory the long reform experience of Hungary also tended to be portrayed as a disadvantage, since it had created in-between forms of ownership and made the dividing line between pre- and post-transition conditions unclear.

As textbook assumptions and observable outcomes – as reflected in the statistical bottom line presented above – seem conspicuously incongruous, it makes sense to interpret the two cases as two models. They exhibit opposite dynamics on the transition path described above. Next to a common starting point and the discernible commonalties in all transitions from plan to market, the two models approach makes it possible to find a common dimension for comparison.

The Russian case thus seems to be an earnestly sought but not fully implemented attempt to remodel the Soviet legacy. The basic problem here is not so much the cost in terms of lost output or lost opportunities but the steadily declining support for reforms, the erosion of the 1992 and 1996 reform coalitions and the close-to-consensus professional view, recently summarised in English by Sapir (1999), that reforms have been fundamentally misperceived

and misconceived, not only poorly implemented. In this view Russian failure is a call to rethink economics and the 'conventional wisdom' of transition alike.

One of the several problems with this generalisation is that Hungary does not fit in to it. The same policies delivered completely different results, with the 'conventional wisdom' making increasing sense to growing numbers inside and outside the country. In a way it has been a case of ever more radical reforms gaining increasing support both with the public and the economics profession. Despite obvious discontinuities in terms of social support, ideologies and aspirations, the Németh, Antall, Boross, Horn and Orbán governments all adhered to the fundamentals of a reform policy, adding up to what is called a sustainable policy line in the longer run (for empirical evidence see Csaba, 1998). If Russia is a case of self-destroying, Hungary is one of self-fulfilling reform policies, along the lines of 'conventional wisdom' on transition.

The Stylised Facts

Probably the most conspicuous difference between Russia and Hungary originates from the different role of the state. In the case of Russia the ongoing erosion of the state that has been discernible from the second half of the 1980s is the fundamental factor shaping everything else. A dangerous game emerged in what had been called by contemporary analysts a confrontation between branches and layers of power. In this series of fights – presidency versus communist party under Gorbachev, Russia versus Soviet Union until late 1991, presidency versus parliament (Supreme Soviet) until October 1993, the centre versus local powers in 1994-96, and last but not least the ongoing fight among the various interest groups, the 'oligarchs', in 1997-99, all left lasting wounds behind. In a nutshell, not

only did neither a democratic nor an authoritarian regime emerge, but each fighting party left its adversary weakened. In the end the winners have also been lastingly enfeebled.

This explains to a large extent the recurring problems with the economy as well. The failure of stabilisation efforts in 1995-98 was basically due to the unsustainability of the fiscal stance, which was incompatible with stabilisation-based exchange rate policies that could not be saved by the belated and, in its own terms, insufficient international assistance (for the narrative cf. Malleret, Orlova & Romanov, 1999). Nobody ever believed that a general government deficit in the range of 6-8% of GDP was sustainable with the central government collecting only 10-11% of GDP in revenues. Equally, however, nobody faced the fact that it was no longer up to the will of fiscal planners in Moscow to change the established distribution of tax revenues, with two thirds accruing to local powers and only the rest to the centre. This is not a matter of insight but of power relations.

Since El'tsin conducted a traditionalist policy of buying off opponents, combined with maintaining an atmosphere of crisis which only he was able to manage, the continued weakening of formal structures was an inevitable by-product. As a consequence not only have a wide variety of mostly autocratic regimes been coexisting within the federal state, with the central layer of power having precious little leverage over them (Gelman, 1999), but by the same token the rule of law could not be established on the ruins of communist lawlessness. Quite in line with what has been observed in Italy, China and nineteenth century USA, violent entrepreneurship based on private enforcement techniques (Volkov, 1999) gained the upper hand. This is neither a surprise nor a perverted form of market economy, but it is the way the market functions in

the absence of some underlying institutional conditions normally postulated in economic theory.

The collapse of the totalitarian state has not given way to the free market, as some naive reformers postulated, but quite in line with the neo-institutionalist theories, informal institutions took the upper hand. In other words, strange but *per se* rational in-between forms of coordination emerged, where neither bureaucratic nor market coordination has prevailed.

It is worth noting some of the basic features of this arrangement. It has facilitated unprecedented levels of rent seeking (Aslund & Dmitriev, 1999), something that has two faces. On the one hand it did create the (in)famous first million dollars in wealth and a capitalist class that many sociologists considered impossible, given the long decades of Soviet rule and indoctrination. On the other hand it robbed the market order of legitimacy of any sort. Non-market parties are likely to remain strong or dominate the Russian legislature for a long time. And nearly all try to legitimise themselves with market-restraining ideologies and rhetoric.

Meanwhile, the state was not in fact instrumentalised by the new business groups, as is often asserted in Russia. Schroder (1999, pp. 980-981) convincingly demonstrated that the financial oligarchs were concerned basically about their own businesses. Their involvement remained restricted to their areas of primary concern, like limiting foreign penetration, securing rents of various sorts, *etc.*, but fell conspicuously short of producing an ideology, shaping foreign policy or defence priorities, or state affairs in general outside their narrow economic interests.

Pursuing these interests was hardly possible without resort to enlisting the state's power, since devolution of authority and the rule of law have not emerged. The Russian market

economy is a state capitalist model, where neither the free market nor a state run economy is feasible any longer, but without continuous penetration of the state no strategic economic interest can be asserted (Csaba, 1998b). This has two implications, retroactively supported by the Kirienko-Primakov-Stepashin-Putin episodes. First, there is no way back to full-fledged authoritarian rule, while reformist break-throughs are equally blocked. Second, an acceptable level of moderate inflation is a common and joint interest of all players, whereas economic growth is neither necessary nor possible under these conditions. Where less than 1% of savings is going through the formal capital market, continued accumulation of fixed assets is the economically rational strategy.

In the case of Hungary the role of the state has been slowly but steadily growing. With the steady decline of the share of public property from 75 to 15% of GDP in 1989-99, traditional vested interests and ambitions in the spheres of production and distribution have withered away in all areas except for the still overregulated – and contracting – farming sector. Thus the real role for the administration is regulation, not ownership. Those who could secure a say in the ways and procedures of privatisation deals could influence the outcomes in a much more lasting fashion than those deciding on market protection or public investment.

Arrangements for the contemporary Hungarian state have emerged in a process of negotiated revolution (Tokes, 1997), *i.e.* it lacked dramatic ruptures. All participants around the national round table have been fearful of disintegrative processes. Thus, the handing over of the reins of power improved the position of the bureaucracy, while the successor party to the communists could not play a significant role. Following the deal between the two major non-communist parties in 1990, the constructive vote of non-confidence was introduced. This arrangement,

borrowed from Germany, implies that the Premier alone is responsible for governance. He can be removed only on condition that those voting him down can immediately agree upon setting up a new government. This is highly unlikely, partly owing to the strong majoritarian element in the election system. Thus the full four-year term of any elected government has been secured.

In contrast to Russia, it is legal arrangements rather than political factions in the power structure that ensure smooth functioning of the Hungarian state. One of the important innovations of the negotiated revolution was the setting up of the Constitutional Court with basically unlimited jurisdiction. The court can overrule any law passed by the parliamentary majority, if it is not in line with the basics of the constitution as interpreted by the court. In this way a *de facto* second chamber is instituted, which is free from elements of interest representation. Its only interest is in serving the rule of law. Judges serve nine years on a non-renewable mandate basis. Thus a very large degree of depoliticisation and judicial independence is obtained.

This complex arrangement allows short-term contests to be separated from longer-term reform projects. The latter require, as a rule, two thirds of the votes of MPs, which means cross-party agreement on the fundamentals. These features do not allow party politics and short-term voters' moods to dominate decision making. Governments are in a position to take unpopular decisions that serve the longer-term interest of the community as a whole. Large-scale privatisation deals, social security reforms and adjustment packages may serve as examples.

This arrangement allowed the national central bank to emerge as a truly independent institution. The bank is far from the only institution constraining the freedom of the government; it is only one of the checks and balances. It

institution preoccupied with monetary stability alone.

The major accomplishments of the central bank are the following. First, Hungary was not forced to resort to hyperinflation to eliminate the post-communist monetary overhang. Inflation in Hungary peaked in 1991 at 32% on an annual basis. Following the surprise inflation of 1995 – 28.2% – needed as part and parcel of an adjustment package, inflation has been steadily decelerating from 18% in 1997 to 14.3% in 1998 and around 9.5% in 1999. Disinflation seems to be sustainable, and the crawling peg devaluation of the forint, introduced in 1995, has been steadily diminishing by a quarter each year. Elimination of the crawling peg is likely by the end of the year 2000, and Hungary has the potential for low single digit inflation rates to emerge by 2002, when the country plans to join the EU.

Under these circumstances the rollback of the state did not mean a disproportionate loss of revenue. Owing to the reforms of 1987 as well as the avoidance of hyperinflation and the retained strength of the public administration taxes could be collected. Of course, collection can be hampered, but the meltdown of state revenues has not been a major problem for Hungary. Whenever overspending occurred, corrective measures on both the revenue and expenditure sides were feasible, though not always popular. Hungary's public debt peaked at 84% of GDP in 1995 and has come down to below 60% in 1999. Debt repayment policy has constantly been attacked by some political forces calling for more spending, but the prudent policy was sustained, thanks to the institutional anchors and the retained power of the centre. Certainly, Hungary is ethnically nearly homogeneous and its territory is small. Yet both the fact that local business groups could not capture the state for their purposes and the strong

presence of foreign ownership, currently owning over 35% of national assets, made bargaining with the state economically decreasingly relevant.

Another major difference between Russia and Hungary is the role of special interest politics. Pluralism obviously does require the formation and representation of special interests in an organised fashion. However, there is a world of difference whether these capture or merely influence the workings of the polity.

If we include both regional and sectional interest groups, the predominance of these is clearly widespread in the Russian case. Local powers in terms of regulatory peculiarities, relevant legislation, even in terms of tax rates or the freedom to trade in foreign currencies, have become dominant throughout the 1990s in Russia. Within the centre, at the level of 'high politics', the presence of interest representation is palpable, whilst the formation of more established political parties, typical of mature democracies, that reflect ideologies, lifestyles and values rather than sheer interests, is still in its infancy, after an entire decade of democratisation. Power groupings clearly dominate over ideologically-oriented parties, the most prominent of the latter being Yabloko. The Communist Party itself is a conglomerate of fractions and is a lasting formation primarily by virtue of representing important segments of losers in transition, like the traditional agrarians, the army and pensioners.

Under these circumstances it is probably not very realistic to expect rules to emerge that are in reality neutral, meant 'for eternity and for all', and thus stable, rather than adjustable to each and every case. This is not only a legacy of traditional Russian imperial legislation but also a reflection of the predominantly special interest politics in Russian democracy.

Certainly one may look at things from various angles. Shevtsova (1999) has recently argued, with some justification, that it is precisely the strong presence of interest groups in policy making which excludes any return to the previous totalitarian practices in the post-El'tsin period, even under a worst case scenario. But she emphasises equally strongly how exactly the same circumstance excludes the emergence of a truly Western-type democracy and market economy in Russia. A trend towards an authoritarian solution is strongly on the cards.

In the case of Hungary special interest politics used to be a dominant feature of goulash communism. One of the reasons why the Kádár regime could survive decades without resorting to massive violence, and why it let changes happen in a negotiated way, was the strong presence of quasi-formal interest representations. In the case of support for systemic change, the presence of an entrepreneurial stratum with managerial skills and aspirations to become owners coincided with the priorities of the Westward-looking intellectuals heading the opposition movements.

Interestingly, the strength of the state institutions described above implied the decline of special interest policies. The blossoming of the small business sector and the emergence of mass unemployment eroded the position of the trade unions. With big business gradually handed over to foreigners, medium-sized and other local entrepreneurial interest representations found themselves fighting each other for an ever smaller part of the cake. With the state continually selling the best parts of its assets, intra-public sector bargains were by definition constrained to clashes over the remnants.

This state of affairs made bargaining with the state as a general survival strategy increasingly unattractive. Beyond

doubt, conditions of privatisation did matter a lot. Likewise, regulatory terms were also quite important. For instance, with very tough banking and capital market rules from 1992, business failures of banks and brokerage firms were dominant, while government-induced crises such as the August 1998 crisis in Russia have been non-existent in Hungary. With the privatisation of big banks there remained no implicit bail-out clause for the public sector. When the politically overloaded Hungarian replica of Credit Lyonnais, the Postabank, was denationalised in late 1998 the reason behind the move was not cronyism but concern about the fate of the bank possessing the second largest retail banking network in the country. It would be hard to establish which group was directly favoured by this action, as the bail-out operation actually started in February 1997, under the centre-left government, and was concluded by their successors 19 months later.

Operating an open trade regime since 1989 and a gradual liberalisation of the financial sector, culminating in OECD membership in 1996, created very tough competitive conditions across the whole Hungarian economy. What probably could not have been attained by any anti-trust agency has been secured by foreign competition. Since no major defences against foreign competition would be sustainable, this took care of what shortcomings Hungarian regulations might have displayed.

The *modus operandi* described above implies that there is less and less that special interest groups can extract directly from public authorities. The transparent regulatory framework emerging in the context of OECD membership and EU accession leaves precious little room for such manipulation. Beyond doubt, one can easily document repeated attempts by special interest groups to secure market protection, or slow down privatisation, especially in the energy sector. They have also attempted to roll back

financial liberalisation, or advocated a spending spree that would run counter to stabilisation. Reforming the pension schemes to introduce a partially funded system has also triggered serious conflicts of interest. The bottom line, however, is that these could never roll back the process *in toto*. The more often such attempts failed, the less lucrative it became for lobbyists to engage in direct 'high politics'. In other words, special interests do not constitute the fundamentals of the system, but willy-nilly adjust to the overall rules of the game that are not set directly by them.

This also implies a strong party system, where political parties, rather than chambers or unions or informal groups, are the major channels of efficient interest representation. Unlike in Russia, the Hungarian party landscape seems to have settled. No new parties have managed to establish themselves since 1989. Six major parties – currently reduced to four – have withstood the twists and turns of parliamentary elections. Thus interest groups have to take them as given, and try to 'win' them to their cause.

A third factor shaping transformation in the longer run is its genre. Whereas in Russia capitalism had to be imposed by design, the negotiated revolution in Hungary implied the emergence of capitalist institutions in an evolutionary manner.

Recalling the highlights of change may easily substantiate this point, which remains valid even though spontaneity has played a major role in both cases. Still, in Russia not until the adoption of the December 1993 constitution could it be explicitly stated that the target model of reforms was a market economy. Symptomatically, even at the time of finalising the present text the basic law of the Russian Federation does not entail guarantees for private property in land, freedom of contract enforceable *via* courts, and the

freedom to start any economic activity without licensing by the authorities (as different from registration, where officials do not have the right to pass judgment on the 'social necessity and desirability' of the given activity).

This development has a long history, and is explicable by the series of compromises to which President El'tsin was forced to resort throughout his tenure. This fact of life, however, has serious repercussions. Without firmly defined basic principles, like private property, rule of law, freedom of the individual and the sanctity of contract, regulators, confronted with a variety of situations and caught in the middle of conflicting interests, possess no firm point of orientation about what to do. This applies quite independently of the alleged or real penetration of the judiciary and the state administration by the mafia, corruption and criminality.

As an important side effect, several items of the Soviet penal code are still on the statute books. The former prosecutor general, Skuratov, could hardly have collected over 800 cases of severe economic crime 'in the environment of the President' and at the central bank under Dubinin had he not had recourse to such clauses as the ones prosecuting arbitrage, speculation, and many other operations quite normal in a market economy, including switches among currencies, portfolio investments and their management.

While the constitutional anchor was missing, each reformist Russian government had an *ex post* documentable vision of precisely what kind of market order it preferred and how it was intending to introduce it. This was most extensively debated in the Gaidar case (Dabrowski (ed.), 1993), and it was equally easy to reconstruct from the policy measures and declarations of Primakov more recently (Csaba, 1999). While these projects all had to be

subject to amendments and compromises with various special interest groups, the constructivist approach has been just as predominant as the decisive role played by the *nomenklatura* capitalists. The latter does not necessarily imply embeddedness in the Communist Party: for one, Berezovsky is well known to have been a lecturer in mathematics, and Chubais a research fellow in economics. Still, what is truly decisive is that the great leap forward was made feasible by instrumentalising the power of the state apparatus, by converting political positions into economic advantage, rather than producing a series of Russian Bill Gates and George Soros.

In Hungary by contrast, largely due to the lack of grand designs, closeness to the heights of power has not proved to be a major factor in recruiting the new economic elite. As recent sociological surveys (Robert, 1999) have demonstrated empirically, cultural capital and/or ancestors anchored in the entrepreneurial class of the pre-war period have proved to be more important than political capital. The latter has been playing a diminishing role ever since the late 1970s. Interestingly, following systemic change, the political factor has not returned to its earlier importance either (this is in contrast with what some on the extreme right believe to be 'the theft of the revolution'). Business experience in running companies, rather than the communist party card or closeness to the highest decision-making centre, mould the careers of those who have recorded longer-term successes as entrepreneurs.

As a further characteristic, a very high degree of turnover among the top entrepreneurs has been registered. Those star entrepreneurs who dominated the news in the late 1980s are nowhere today. Those who had made quick gains in the spontaneous privatisation have also tended to fall behind (Voszka, 1997). The major reason is quite simple. The abilities which were important in bargaining with the

state or exploiting loopholes in the regulations are not a great help in coping with more standard problems of the market. One of these is, of course, the optimal rate of business expansion. Misjudging this – an overdose of empire-building – is one of the most frequent determinants of business failures in Hungary.

This might support the otherwise contested thesis (Szelnyi, 1996) describing Russia in terms of political capitalism and Hungary in terms of post-socialist managerialism. While the precise scientific operationalisation of these terms may be subject to debate, the message on the different role of political capital and thus of political orchestration is clear.

The rhetoric and the reality differed. One of the fundamental differences shaping the outcomes of Russian and Hungarian reform policies is that of design and implementation, and the interaction between them. Russia has been characterised by a series of very radical (sounding) projects. From the '500 days' programmes of Shatalin and Yavlinsky in 1990 to the Kirienko plans of achieving single digit rates of inflation and a stable exchange rate in the economy, no Russian government could be accused of a lack of ambition. On the other hand, implementation has been shown to be half-hearted or purely formal.

In the case of Hungary the language of successive governments was usually mild. The country has a long tradition of cultivating the golden middle in economics and politics alike. Meanwhile, as I tried to document elsewhere in detail, in 1989, in 1992, in 1995, and most recently in 1998 with the launching of the private pension schemes, very radical packages have been implemented. The reasons for this are twofold. On the one hand, the opportunity created by the legally cemented position of the government allowed it to entertain radical options. On the other, the

long-standing Hungarian professional consensus on neo-liberal fundamentals has enabled like-minded projects to stand a chance of implementation in differing political settings.

This is not to say that the Hungarian way has been politically more innocent or less controversial. Speaking softly while acting harshly implies very strong *ex post* resistance on the side of vested interests. It is hardly by chance that no reformist government succeeded in gaining re-election over the past 10 years. Conversely, the presidential regime in Russia allowed a degree of continuity that was useful for keeping Russia together as a federal state. Yet it enabled political continuity at the price of dominance of short-term considerations over longer-term ones.

Thus the accommodation to the status quo proved to be stronger. The non-systematised and non-consolidated deals granting a variety of economically hardly justifiable tax concessions to various units of the federation are prime examples of cases where both horizontal and vertical equity, as well as elementary efficiency and transparency of budgetary considerations, have been lastingly sacrificed in return for political bargains of questionable quality and stability. Aslund (1999) is quite right in blaming these compromises rather than the much repeated but never proved overdose of liberalism for the failure of Russian reforms to bring about more efficient ways of combining resources and accordingly more growth and welfare.

The next important and continuing difference between the two cases concerns the role of money. While a lot of time and intellectual effort have been spent on explaining, or conversely discovering, the vices and virtues of monetarism in Russia, reality has been shaped by the ever growing significance of barter trade, state intervention in

production and payments, and last but not least the universal spread of payment in convertible currencies. The latter applies to private households, enterprises and government agencies alike.

When the conventional wisdom stresses the need to enhance the role of money, more often than not it is done with the local currency. However, barter, interventionism and a parallel currency all mean just the opposite. The more these are widespread, the lower is the efficiency of monetary policy in managing actual flows in the real economy. If these features persist, the fundamental SLIP tasks remained unattended, no matter how large the amount of goodwill and effort that has been devoted to solving them. Monetisation of the Russian economy has been going on hand in hand with demonetisation, ending up in a quite typical Third World dual currency economy. In the latter the modern sector – in this case primarily Moscow – is integrated in the global economy and functions accordingly, whereas the traditional sector continues to function in an archaic – in our case Soviet – fashion.

The capital market crisis of August 1998 has therefore had a much less devastating impact on the Russian economy than most external observers would have suggested. First, large chunks of Russian society have been benefiting from the backwardness, *i.e.* from not having been integrated into modern global economic intercourse. Whatever the fiscal and monetary authorities in Moscow have or have not done, it had little if any influence over those who run survival ventures, which means most Russian farms and SMEs. It had next to no impact on large corporations bartering with each other or conducting their transactions abroad through Western banks and in hard currency. The underdeveloped state of financial intermediation, as well as the overall distrust in banks, have long established the practices of using cash rather than any form of intermediation in

Russian business. This was also the feature that has saved much of Hungary's trade with Russia up until very recently. By the same token, substantial cash holdings of companies, as well as their foreign deposits acted as a buffer against the aims of the Central Bank to subject all of these to the imminent cash needs of the central authorities.

Those who did suffer were primarily private households who held either high-yielding short-term claims of various sorts, advertised by the banks up until the very last moment, or those who kept their currency holdings with Russian banks. As over two thirds of private savings are in hard currency, this is not a negligible stratum of society. By the spring of 1999 complicated swap and guarantee deals between commercial banks and the Central Bank allowed them to regain about a third of the original value of hard currency deposits – which also means that there is 'life after death'. Nor did the value of shares denominated in roubles and held by the Moscow banks collapse in relative terms, so the dominant standing of banks in owning industries has also been maintained.

The estimated over 80% inflation in 1999 is also a typical Third World economy parameter, with a weak government, but also one caring about the only leverage it has, thus avoiding at any cost the slide into hyperinflation. This is exactly what the policies of the Central Bank, supporting the exchange rate at fairly constant levels, the debt rescheduling agreements, as well as the continuous pre-election budgetary bargains were all aiming at. The windfall doubling of oil prices in 1999 alone has provided the leeway needed for this kind of balancing act.

If Russian developments need explanation, the Hungarian case is more of the traditional textbook example of 'how to stabilise'. As the monetary overhang inherited from the reform socialist period was insignificant, what needed to be

managed were the double shocks of corrective inflation, due to price and wage liberalisation in 1989-92, compounded by the macroeconomic shock resulting from trade reorientation. Managing these did not need inflationary treatment. But these shocks also precluded smooth stabilisation, lasting only 6-9 months, as in developed nations. Also, the correction of relative prices in the non-tradable sectors has been a lengthy process, with items like health care and housing reaching realistic levels of depreciation and profitability only after a decade. The continuous need to manage the external indebtedness (which peaked in 1995) and the 1995 adjustment package also required devaluation, pushing up the price level.

These weaknesses notwithstanding, money has been continuously gaining in relevance in Hungary. The abolition of quantitative restrictions in all walks of life, in factor prices, in trade and in new entry to markets, both *via* trade liberalisation and privatisation to foreign owners and competition as a system-forming element have been maintained. With the deceleration of price increases to the single-digit level and thanks to the maintenance of continuously high positive real rates of interest, saving in local currency has become an attractive option – and lastingly so. Liberalising financial transactions, except for short-term portfolio investment, has created a control mechanism disciplining governmental policies and business decisions alike. The application of the law on bankruptcy and liquidation led to dramatic market 'clearing' (witness thousands of closures in 1992-96). Employment and traditional business protection considerations have been continuously losing ground against profitability considerations that have speeded up structural change. The mechanism through which it happened was money. Its role has thus become dominant for households (giving up the parallel currency), corporations (constrained by

profitability and asset value maximising considerations) as well as macropolicies (bringing down public debt from 85 to 59% of GDP in 1995-99).

As a consequence of the above the role of credibility of policies has been showing contrasting trends in the two countries. While in the Hungarian case the growth of credibility is demonstrable through the evolution of the expectations of players on the money markets, regularly buying government paper with rates of nominal return below the rate of inflation of the day, in the case of Russia it works the other way around. The Hungarian crawling peg system of devaluation proved to be sustainable, with no unplanned/surprise devaluation since its introduction in March 1995. The current account situation of the country has also proved sustainable since then. By contrast, the exchange rate regimes in Russia proved unsustainable and surprise devaluations periodically occurred.

There is an extensive debate in the international financial literature on the causal relationship between exchange rate regimes and credibility. As a recent cross-country analysis of countries with the most diverse forms of exchange rate regime has convincingly demonstrated (Szapáry & Darvas, 1999), it is credibility that matters. Wide bands cannot save exchange rates whose credibility is lost, while narrow bands can prove sustainable in the face of a currency crisis (of 1997-99) if the regime as a whole is credible. In the Hungarian case overall credibility mattered more than the exchange rate arrangements.

Likewise in Russia in 1998 it was not the monetary authority *per se* which lost its credibility, but the overall arrangement. Fiscal mismanagement, originating in the foot dragging of opposition-dominated legislative organs, had undermined the credibility and sustainability of Central Bank policies. While it remains an open issue to

what extent the mismatch was foreseeable and inevitable (with the benefit of hindsight everybody is wise), the Russian example demonstrates indirectly the need to rely on a broader concept. And conversely: empirical evidence of low credibility supports the view recently elaborated by the analysts of Moscow Business School (Rossiiskaya, 1999) calling for a renewed emphasis on institution building and evolutionary dynamics, rather than on stabilisation, as the longer-term way out. The problem with this proposition is that it seems unlikely that higher floors can be built without laying the foundations – and this is what conventional SLIP is all about.

Credibility is not a feature emerging spontaneously. It must be earned by conscious policies, at the level of the individual business venture or of a governmental agency alike. In the Russian case, where arbitrariness, rent seeking and abuses taking advantage of inconsistent legislation have had a long history, this seems to have developed into a particularly serious problem, inhibiting progress in the longer run. And, conversely, for Hungary the major attraction of joining the EU is in its enhancement of the credibility of its regulatory environment (broader than just economic institutions).

At this point we have come to a major component of growth in any economic theory, namely capital formation. In the Hungarian case we see the signs of a developmental virtuous circle emerging; the Russian case is the opposite. In the Hungarian case improvement of the regulatory environment and, perhaps even more, the perception of further improvements, appreciated by hundreds of thousands of economic actors inside and outside the country, are likely to create more investment. This has already been happening in the post-1995 period, with not only external but also domestic investment recovering. Favourable expectations translate into a bullish business

mood, appreciating previously cheap asset prices, thinking big and long term, and investing in R&D and fixed assets of various sorts. The relocation by both GE and Nokia of some of their research base to Hungary is just as telling as the spread of new hypermarket chains. They make sense only if purchasing power is likely to grow steadily in the medium to long run. Investment in big banks, where the first three or four years is likely to be loss-making owing to the need to invest in physical infrastructure, is sensible only if demand for financial services can conservatively be estimated to grow exponentially. Likewise, investments in the utility sectors are typically long-run ventures. Trust and positive expectations are therefore quite important determinants of whether and to what extent physical capital formation is likely to evolve.

In the Russian case the miserable investment figure already quoted is a sign of a developmental vicious circle. The credibility-regulation-expectations chain is at work here too, but it is functioning in the opposite direction. Exacerbated by inflated expectations, deeply disappointed or deliberately deceived investors have been spreading the bad news among potential newcomers. With the prospect of economic recovery and stabilisation, which looked promising in 1997-98, now gone, capital flight remains the only realistic way out. As we have documented several times, the central government has very limited leverage over Russian resources of various sorts, financial resources, especially cash (*zhivye den'gi*) being a particular problem. This is important to underscore as both in the Western and in the Russian literature there is an influential body of opinion advocating the East Asian pattern as a cure for Russian illnesses. In fact, this option presupposes a qualitative jump in precisely this area. We can not really see how the present Russian state could act in the fashion of Baron Münchausen and transform itself into a

developmental dictatorship of the pre-East Asian crisis type.

This is particularly bad news since the most widespread idea of how to cure Russian decay is through statist schemes of various sorts. These all presuppose that the state is – or should be – able to collect revenues and plan priorities in a way private markets never allow. The trouble is that in the Russian case market failure is a consequence of state failure. Thus there is no way the public authorities could influence the capital that flees their very arbitrariness and expropriatory practices. As a consequence neither physical nor human capital formation is likely to be adequate.

One of the attractions of the evolutionary platform (Rossiiskaya, 1999) is that it takes the weak state as given. It offers step by step remedies, although such basic ideas as transparency or equal treatment of actors are known to presuppose an arbiter who is not himself deeply involved in the rent-extracting game of the conflicting parties. It seems doubtful whether the vested interests talking about the collapse of both communism and capitalism on Russian soil can indeed organise themselves into a new driving force as some ('Russland...', 1999) would like to see them do. Without such an Archimedean point it is hard to visualise how self-reinforcing vicious circles could be broken, no matter how desirable it would be for Russian citizens and the external world alike. It seems somewhat cynical to assume that capital will 'simply' return, provided the conditions improve and the West stands by (Fischer, 1999), since there is no built-in mechanism through which such a desirable turnaround in deeply rooted disruptive tendencies could come about.

Without adding many more items to this non-exhaustive list, it seems clear that the search for their own way is

going to dominate Russian economic theory and practice for many years to come. This has a long history – and not in the economic sphere only. The idea of the special Russian way and mission has always played a prominent role in Russian self-interpretations. Given that Russia has never fitted fully into either the European or the Asian pattern of development, this is more than understandable.

From our perspective the real depth of this cultural and paradigmatic challenge is secondary, as reference to it is likely to be instrumentalised for policies simply unable and/or unwilling to address the basics of SLIP and thus create the foundations of sustainable growth. Theories of national uniqueness prevail in societies stuck in developmental dead ends. Meanwhile among those nations that have taken the highway of economic development a striking similarity of reform issues in terms of institution building and policy mixes has emerged (Buiter, Lago & Stern, 1996).

Looking from this angle there is nothing peculiarly Hungarian in debates on pension reform, tax policies, financeable development projects, the need to secure sufficient provision of public goods or equitable burden sharing. These are by no means trivial questions to be answered by peeping into the appropriate textbook. They pose serious challenges to economic theory and policy making alike. This of course is one of the contrasts with the more traditional issues that emerge in countries where stabilisation or managing the debt burden is still unresolved.

This outcome is easily demonstrable *via* any number of references. While Russian economic theory is focusing on something 'beyond monetarism and beyond the command economy', in Hungary there are no attempts to devise a specifically national model for the economy or its subsystems. Those highlighting national ways imply the need to adjust general principles to particular conditions, such as an aging population, not to find something fundamentally different.

An Interpretative Endeavour

A proper and thorough comparison of the two cases, and a detailed exposition of contrasts between successful and failing transition strategies, would require a monograph. However, some theoretical conclusions, even though rudimentary and preliminary, can be advanced in order to foster further reflections in the profession. It seems that remaining within the constraints set by the paradigm of economics, both cases can be interpreted without recourse to external explanatory factors or historical/cultural determinism.

a) Developments in both cases have obviously been path dependent. In the Russian case this is one of the few consensus points among analysts. The Soviet legacy, as well as Russian traditions, are of major interpretative relevance. For instance the very fact that economic theorising and accessibility to primary sources (including previously published official documents) were severely and systematically constrained in the Soviet period, put severe limits on the evolution of the economics profession (Sutela & Mau, 1998), and consequently also on the economic perceptions and expectations of the public at large including the new policy-making elite and opinion formers.

Likewise, the decisive share of military-related industries and technologies in overall Soviet GDP has rendered any adjustment by definition painful, lengthy and destructive (Winiecki, 1991). Lack of meaningful reforms precluded social learning, pertaining to such elementary items as the

limits to centrally processable information, the difference between rent seeking and profit seeking, or the benefits of free prices, not to speak of the market valuation of assets. For those who have been trained in the labour theory of value, it is not trivial that a large smokestack industry can and often does have negative asset value, despite (in part because of) the large quantity of concrete labour and other inputs invested in it, if there is no market for its output.

Thus, the public perception of privatisation as theft is only partly explained by the much publicised pathologies of Russian privatisation. Korean or Japanese bank-industry linkages might have been equally as intimate as in the Russian case (Sondhof & Mezger, 1998), yet capitalism has certainly not earned such a bad name in either country as it has in Russia. The perception of equity and of what is legitimately to be expected from public authorities does play a fundamental role in the way abstract economic concepts are translated into policy practice.

From that vantage point the favourable educational role of the long socialist reform period in Hungary is prominent. It is not so much the progress made within the economics profession proper which matters. It is the way mass perceptions of what is to be expected from the state, what is the role of risk premia on property, what is the role of entrepreneurship, and more generally the attraction of non-bureaucratic careers for the bright and the young that really matter. The period of reforms served both as a training ground and as a means of proving indirectly why third way options do not work.

From that perspective it is also important that *via* reforms tens of thousands of people employed in the state administration, in banking, in trade and in various economic sectors acquired practical knowledge of techniques that allow market institutions to operate. For

instance such skills as the way taxation is implemented, bankruptcies are pursued, credits are screened and collateralised, payment modes in international trade are selected, or subsidies that can help ailing businesses are applied for are all relevant knowledge that no business courses teach as efficiently as practical experience.

b) In terms of path dependency, Russian transition has been dependent on a very backward Soviet legacy burdened by an over-ambitious ideology. In the case of Hungary, reforms created institutions of the market and also helped a large part of the business community to emerge. They also created societal consensus across the board (except for the marginally important extremes on both left and right) on the need to adopt a market economy based on private property as well as on a multiparty democracy. Such a consensus has never existed in Russia, and if anything, it seems to be evaporating in the post-El'tsin era.

In Hungary the socio-economic costs of transition were seen as the price paid for restoring national freedom and regaining prospects of personal prosperity, and were accepted not least because of a large shadow economy that provided a buffer for those falling out of the official economy. In Russia, by contrast, the internal erosion of the system had become obvious only to a small number of intellectuals, whereas the majority saw the collapse as the result of inappropriate policies, first of Gorbachev and then also of El'tsin. Thus reforms are seen as destructive, and losses as being far greater than the numbers indicated by GDP and consumption expenditure data cited in the introductory section of this essay.[31] Whereas Hungarians see a 'return to Europe' happening, most of the Russian

31 An extreme form of this perception is reflected in Ellman & Kontorovich (eds.) (1997), attributing a consciously active attitude to reformist elite groups.

political class sees transition in terms of dismantling of the *raison d'etre* of the Russian state.

Societal perceptions are known to be crucial when it comes to sustainability of policies. In the Hungarian case the politicians introducing the 'wounding' reforms were punished, but the policies themselves were never reversed. In Russia, policies have frequently been reversed, but politicians often survived under different banners. The dissimilar reactions are at least in part attributable to differences in the process of social learning and the ensuing different perceptions.

c) In the context of the present comparison we cannot escape considering the geographical explanation. The argument is that it is distance from the West, or the centre, that really matters: those on the 'northern rim' of the post-communist world are close to Germany and Austria, and geographical closeness induces cultural closeness, which trickles down to the economy as well.

If we confine ourselves to comparison of transition countries this thesis may well look plausible. However, one of the most fundamental lessons of the last quarter of a century of development economics is precisely the fact that countries with quite different backgrounds could equally attain respectable results. As the seminal survey by Waelbroek (1998) demonstrates in detail, there has been an underlying commonality of what makes up 'good policies and good governance' in all corners of the world. This is what he calls the one world consensus, implying that the same policies which are conducive to prosperity in advanced countries may work also in less developed nations. In this perspective the geographical explanation is a rehash of theories from the infancy of the history of economic thought.

d) Policies matter. We can also observe declining nations in history. Our preceding observation points towards the role of policies. Bringing inflation down is by and large a technical job, which has been successfully mastered under quite different historical conditions. But it did work, generally either as monetary policy-based or as exchange rate-based stabilisation.

Whilst there is a lot of debate on details, there is not a single case where some of the fundamental prescriptions have been ignored and inflation throttled without resorting to reduction of money and credit supply, balancing the budget and freeing factor and commodity prices. In the wake of the East Asian crises there is also less controversy concerning the role of institution building, transparency and regulatory frameworks in bringing about civilised forms of market behaviour.

One of the few consensus points in diagnosing the 'Russian disease' is that the latter factors have been playing a subordinate role in reform theories, and even more so in the actual course of policy-making during the entire transition period. Therefore the outcomes are both foreseeable and economically rational: they do not prove, as *e.g.* Thanner (1999) asserts, the failure of the theoretical framework of transformation economics *in toto*. The very fact that, by and large, the same prescription could be implemented in Hungary is a counterargument. Since we can explain the Russian outcomes within the same paradigm by reference to path dependency and policy mistakes, there is no need to search for new theories.

e) If we recall the exact way the collapse of ruble stabilisation came about, it is hard to see any historical predetermination in the outcomes. Was it really 'inevitable' for Chernomyrdin to be relieved of office amidst a wave of speculation against the ruble? Was it inevitable for the

Duma not to adopt the elementary stabilising package of measures in July 1998? Was it inevitable for the West to hesitate both in terms of the size as well as the channels of financial assistance to the Kirienko package? Was it inevitable for oil prices to reach a 25 year record low precisely in the summer of 1998? Was it inevitable for Russia to be caught in the chain reaction between Thailand and Brazil in 1997-99? Was it inevitable that Russian oligarchs and reformers proved unable to re-formulate the deal that had catapulted El'tsin to the presidency in 1996 in the following three to four years?

Unless we can answer each of these and similar questions in the affirmative, it is hard to argue away the relevance of individual and free policy choices made by varying individuals and agencies in shaping the outcomes. If we do not subscribe to shallow *post hoc ergo propter hoc* reasoning, it is hard to overlook the relevance of these and other decisions made from among competing options. To cite but one: when Korea could get US $57 billion in assistance and Brazil over US $90 billion, it is hard to exclude the technical feasibility of a Russian package of similar size, whether we endorse the policies and the economics behind it or not. In this context the US $4.8 billion tranche of August 1998 was obviously too little too late.

f) Foreign assistance may be harmful. While much of the debate on Russian reform policies has been conducted ever since 1986 in terms of how the West could and should help reformers, this tone is basically at odds with European experience, from southern Italy to eastern Germany. What we do find in common is the emergence of a lasting donor-recipient relationship that both parties are unable and unwilling to change for decades. This state of affairs goes hand in hand with the 'ideology' of being systematically discriminated against that allegedly legitimates the never

ending transfers. However, a precondition for this is a 'Big Brother' able and willing to foot the bill.

One of the advantages of the Hungarian transition pattern has been precisely the lack of external assistance. Annual unilateral development assistance to Hungary has remained at the level of 15 DM per capita. This forced the country, both in terms of structural change and in terms of social perceptions, to stand on its own feet. Since there was absolutely no chance of being financed from abroad, a vigorous adjustment and debt repayment policy could gain political consensus.

In Russia by contrast the idea that the West (whomever that may mean) 'promised' Gorbachev, and later El'tsin, 'compensation for withdrawal' has strongly penetrated the minds of decision makers. But international financial institutions have remained unconvinced of the need for financial assistance owing to the Russian balance of payments surpluses reported continuously ever since 1992.

Not until aid to Russia and its alleged or real misuses came up as a major item in the US electoral campaign has anybody in Russia seriously doubted that Russian state debt needed to be rolled over rather than repaid. This attitude has facilitated lacklustre reform policies, delayed stabilisation and exacerbated political corrosion, in a way replicating what had already been seen in Central and Eastern Europe in the 1970s and 1980s 'socialist reform' period.

Since food was heavily subsidised and imports purchased and distributed through central agencies, the lure and the potential for arbitrage was great. It played a major role in the 'primary capital accumulation' in Russia. But, understandably, this contributed little to the legitimacy of market institutions (nor did insider privatisation that converted political capital into business wealth).

All of these practices have been made easier by the ongoing softness of Western lending policies, readily validating all deficiencies resulting directly from the mismanagement of central state functions and funds. What should have been collected from Gazprom or Vneshtorgbank in taxation has been readily provided by the international community, swallowing without protest recurring breaches of various promises, both quantitative and institutional. Once opportunistic behaviour pays better than law-abiding behaviour, the former will spread.

g) Comparing the Russian and Hungarian transformations provides empirical backing for some new insights of modern economic theory. For instance, the role of social intangibles *vis-a-vis* the earlier dominant physical factor growth theory approach can be highlighted. Social learning could be shown to be more important than any optimal design of institutions or an ideal policy mix at a given point of time. Of course, highlighting the role of institutions and governance does not invalidate the need for sound macropolicies. And the final conclusion might well be just the opposite to what Cohen (1999) recently suggested. Transition economics is not Sovietology without Russia, but embedding the peculiar Russian case in a broader comparative perspective. From this angle we do see that no transition could succeed without having first mastered SLIP. Therefore, it is hard to believe that Russia alone could and should be saved the pains inherent in this operation. Against this broader background it is difficult not to see how little has been accomplished in reality, as against pronouncements of intent, in reshaping the lethal institutional and mental legacy of the Soviet period. The latter was much weaker in Hungary, thus its consequences have been easier to overcome.

The real gain from this neo-institutionalist approach to country studies is that it allows us to endogenise capital

formation, both physical and human. By the same token it allows us to establish the missing link between the ways accumulation comes about and its transformation into investment and to explain longer-run growth prospects. These are shown to be lastingly different, for good reasons, and with technically solid explanations.

All in all, references to the role of history and institutions do not need to be instrumentalist in a defence of poor policies. On the contrary, they may well explain why some societies might be more responsive to standard prescriptions than others, whereas the workings of these medicines remain the same the world over. And final questions, such as whether policies form institutions or institutions shape policies, or both, remain open for further reflection.

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