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Original scientific article

ON THE LOST PURPOSE OF TRANSITION

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ABSTRACT

After a quarter of a century, it is not a waste of time to reassess the effects of the transition process. Have we missed the purpose? The transition can be given scrutiny through different models, but also through the integration process which runs danger of falling into the pit of constructivism. The transition was (or should have been) about moving from a hampered into an unhampered market society in the first place. It is obvious that we are far from there. The new political global landscape in the making will probably drive further away. That is why some international financial organisations and academics seem to be changing their focus. Probably logically so, but the true question is whether the process and the policy-making is about letting an individual make decisions freely, or about reconstructing paternalism in different forms including the battle between those who want to close down to the globalisation and those who claim the opening up is an inevitable process. Reducing corruption and increasing transparency along with long haul education reforms that spur entrepreneurial spirit in order to make political and market reforms sustainable, may be a quest to seek the lost purpose of transition.

KEY WORDS

Transition; Human action; Individual; Paternalism; Corruption; Education.

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INTRODUCTION

Transition, both in historical and global sense, is a complex phenomenon. Philosophically speaking, one can say it is a process that never ends. However, if we tend to see it that way, then it becomes difficult to separate transition from evolution. Undoubtedly the western civilisation and dominant values of the western society stem from the age of humanism and renaissance. The period in which monopoly over knowledge started definitely to crumble. A certain transition of values which took a while, profoundly transformed society and influenced modern economic relationships, as well as the creation of the market system in particular. Colombatto tracks three periods in the past millenium in search of the legitimacy of institutions that brought about the current state of affairs. He distinguishes three periods from the 11th century onwards: the Gregorian era of divine legitimacy, the age of secularism and the current age of social responsibility (Colombatto, 2011). The latter obviously affects the transition process.

For the sake of focused analysis, however, one can say that the transition is a phenomenon that unfolds after a shock and is characterised by the generation of stabilising mechanisms. As there is normally an institutional void, those mechanisms operate through the process of institutions development that are supposed to facilitate the functioning of a new socio-economic system. Therefore we can speak of a historywise relatively short period of time. There are different reasons that could lead to a shock, but it is primarily because of the loss of legitimacy the former institutional arrangement once had. If one takes the example of the transition from the socialist system², then it seems apparent that the stabilising process is supposed to take the form of democratisation of the society, liberalisation of the economic system and when it comes to values, the creation of the critical mass of society members that make the set of new core values, necessary to establish a new institutional arrangement, legitimate. The process of the transition of the once socialist countries from a centrally planned into a market society, or in the Misesian terminology the introduction of dealing with human action, from a hampered into an advanced market society (Mises, 1963), belongs to the so-called third wave of the democratisation

² Historywise it is possible to give scrutiny to several processes that might be classified as transitional, with a long-lasting effect on the further development of the western civilisation. Classical examples are the French and the October revolutions and the immediate periods that followed them. It is interesting to get acquainted with the reflections of Edmund Burke on the topic (Burke, 2001).

that began with the fall of the junta in Greece, similar changes in Portugal and Spain, up to a certain extent in South Africa as well (Huntington, 2004).

With regards to the segment of the political transition, it can be said that most people agree that the political process should lead to a state of the freely elected government, division of powers limited by a constitution and the rule of law (Aslund, Djankov, 2014; Darmanovic, 2002). There is however another question, a Hayekian sort of one, whether upon the end of this exercise the system is based on the principle of a negative or of a positive concept of liberty. To put differently the issue of discussion is whether everything is free unless it is precisely forbidden by the law, or do we must abide the laws that determine what one can do (Hayek, 2002).

It is regardless of the underlying process of the institutional set up, either the evolutionary long haul impact, changes under democratic pressure, through the interaction of the interest groups or the Coasean bargaining (Djankov et al., 2003), when economic system is concerned indicators should show the existence of a continuous structure of stimuli that let individuals meet their needs through the exchange in the market. From the values point of view it means that the majority of people accepts new setting, making it legitimate. Such a newly established reality is supposed to be the purpose of the transition towards a market system. Is that purpose actually lost?

MODELS OF TRANSITION

It is possible to identify several models of transition against the experience of different countries in the early stage of the process based on the role played by the key actors – radical regime moderates, high profile members of the communist nomenklatura that are in favour of the profound reforms; moderate regime moderates that urge changes to the benefit of preserving the core of the system; moderate regime hardliners ready to accept certain reforms in order to keep privileges; radical regime hardliners prone to defend continuity uncompromisingly; and in some cases there is also a radical system opposition, which wants to break the system and a moderate opposition made of a wide coalition. The latter form of the opposition is usually keener to accept gradual reforms, and these are the actors. Based on the

game the actors play one can deduce a model of the transition. One way is to have a model of transaction (i.e. Spain, Russia) worked out by regime reformists and moderate hardliners. The other option can be the model of negotiations where a deal is made at the round table by the regime moderates and moderate opposition (Poland, Hungary). The model of collapse takes place upon a collision between regime hardliners and radical opposition (Czechoslovakia) (Aslund and Djankov, 2014; Darmanovic, 2002). From a today's perspective, most of the countries that started transition in the late 80's or the early 90's are consolidated democracies, particularly the ones that have become state members of the EU.

The attitude towards the rule of law or the economic freedoms cannot be the same in societies with collectivistic tradition. One of the models that helps explain the process of the transition is through the trade-off between disorder and dictatorship (Djankov et al., 2003). The level of disorder falls with the increase of the state's engagement. The point (so called Institutional Possibility Frontier, a tangent to the institutional possibilities curve) itself where the balance is achieved depends on number of factors and may be different from one society to another as determinants range from culture to the structure of a society related to the marginal productivity of the government's action. Different countries react differently as this pendulum swings along the trade off. That is why transition countries are found in various positions (i.e. Russia compared to Visegrad Four). Their respective ITFs' are different taking into account their historical background (Djankov et al., 2003). Ideally ITFs' should be eventually equal for all the countries, but that never happens due to the differences in the prevailing pattern of values in respective countries leading to various gaps. Transition ends in a deadend if treated as a technocratic task.

When it comes to the political transition segment the approach is more or less of the same sort everywhere. The transition or political demonopolisation is about substituting the rule of law for the rule of a certain group of people through the process of multiparty elections, the creation of a new constitution and a system of institutions and procedures. A precondition is that everybody accepts the result of free and fair elections. It is only then that the democracy starts to operate and produce the rule of law. It may take some time, just as it takes time to fully implement the concept of minority rights or to see the civil society blossom (Prokopijevic, 2001). The process of democratic consolidation has no predetermined timeframe. Some

countries have been more or less successful. In some countries the process was at times suspended (Aslund and Djankov, 2014; Darmanovic, 2002). The end result also may vary greatly depending on how much a country succeeds in dealing with the corruption problem which is immanent to the rule of people model. It affects the happiness in a society too (Djankov, 2015) as it inhibits institutions in providing services at an economically justified costs making the goal of the unhampered market unattainable. The situation becomes even more depressive if a failure to deal with corruption is due to the entrenchment of the phenomenon which means that corruption has legitimacy in a society. That may be actually true in some countries as only 7% of the people in the Western Balkans countries perceive corruption as a dominant problem in the region (IPSOS, 2015)³. That may lead to the conclusion that the primary issue for members of a community is not how to get rid of it, but how to get access to corrupting mechanisms. Over the years most of the transition countries have progressed in tackling the problem although unequally. Some were quite or relatively successful (Poland, Romania, Latvia, Estonia, Croatia, Serbia, Montenegro), some could do better after a decent start (Czech or Slovak Republic, Lithuania), some stagnate (Bulgaria). CIS countries are still a bit behind while CIS non reformers are pretty far behind. (IMF, 2014; Djankov, 2015). Obviously all of the countries still have a big manouvering space to do ever more in this field, but the more one goes to the south and east he finds the bigger opportunity to improve as it is evidently tougher to introduce new values.

When it comes to the economic transition, however, the most debated dilemma has always been whether it is better to put through reforms immediately as a shock therapy, or gradually. Both however neglect circumstances under which a transition takes place, human capital or informal institutions (Colombatto, Macey, 1997). Advocates of the big bang reforms support quick liberalisation, fiscal consolidation and compression of the social benefits as pillars of a new economic policy (Vukotic, 2004). From a practical point of view the shock method is well represented by the so called Belcerowicz plan after a Polish reformist from early 90s⁴ (Belcerowicz, 1995; Aslund and Djankov 2014; IMF, 2014). Essentially it is a form of a quickly implemented social engineering through core measures such as privatisation. (Belce-

³ To be fair, most of the people perceive unemployment and other economy related problems as most important, which is logical. At the same time, however, most of them expect interventionist policies in resolving related problems and that is quite often an open door to the festering corruption.

⁴ Of course Jeffrey Sachs was one of the most known promoters but later changed some views.

rowicz, 1995; Vukotic 2004). Gradualists suggest the step by step acceleration of the liberalisation of an economy where the most critical role is played by the state. The guiding principle is that the transition towards the market society is too bumpy a road and painful to make it happen in one strike. Therefore it should be the role of government to intervene in order to distribute income throughout the society and meet the goal of the low unemployment (Colombatto, Macey, 1997).

However, reforms need to be swift as early reformers witnessed the threat of rents and the suspension of reforms (Djankov, 2015). Actually, a whole new window of opportunities is open for the hunt for rents, and the public administration always finds reasons to enlarge. Aid, technical support and other mechanisms would not really sort out the problem of unemployment. The entrepreneurship or economic freedoms have been always a secondary thing dealt with in technical terms (Colombatto 2001). The role of a “western expert” was seen to implement new institutions, and then the growth would come any moment now. Eventually, 25 years since the beginning of the transition despite evident increase in the standard of living in most of the transition countries, structural problems fester as it is acknowledged by the IMF. Along with demographic changes, pension or labour market challenges are big. The level of government expenditures in average is above 40% of GDP which suggests only a partial success in reaching the unhampered market economies. Some case studies even point out the backsliding when it comes to the pursuit of market solutions for the impact of the economic crisis (Hungary vs Latvia) (IMF, 2014).

EUROPEAN INTEGRATION – IS IT A SUSTAINABLE TRANSITION?

The transition outcome and the process of the integration of the former socialist countries in Europe are inseparable. Countries that strive to become state members of the EU need to meet Copenhagen criteria set in 1993. It is a combination of political and economic criteria. Those preconditions are the establishment of the liberal democratic institutions, the rule of law, respect for human and minority rights and a functional market economy. Naturally with the flow of time, the way the implementation of those criteria is monitored has changed. Today the Enlargement Strategy insists on three pillars: the rule of law, public administration reforms and the economic governance (European Commission, 2014).

However, Brexit and even the prospect of the Union's dissolution, the protracted economic crisis, troubles with the euro, the rise of nationalism⁵ and migration, the issues related to fundamentalism and religion intolerance open a whole new stream of dilemmas. Does the combination of the above mentioned actually feed the value of paternalism, the fostering innovation deficit in the transition countries, and the lack of crucial support for understanding that competition and profit are the only viable mechanism to direct a truly market economy? Additionally, if the process of institution transplantation deals with a country with a lack of government transparency, press freedom or bureaucratic efficiency, we end up with excessive regulation and intervention which hinders transformation and establishment of new values (Djankov et al., 2003).⁶ A process of transition cannot eventually be successful unless political and market reforms do not create new set of values that sustain the new institutional framework in the long run.

Many dilemmas that unfold about the EU future are inevitably reflected in some of the EU aspirant countries where transition has not been completed yet. While in most of the Western Balkans states people supported EU membership, ranging between 90% in Albania to 49% in Serbia, they do not have favourable opinion about the EU now, ranging between 88% in Albania to 42% in Serbia. At the same time, in average, people do not expect quick accession (IPSOS, 2015). A paradox? Discussion on the future of the Union opens the issue of the desired or preferred level of integration.

Therefore through the integration process countries get used to new rules but also start to get used to, or start to retrieve pro-business values and habits such as liberty, responsibility, the need to save in order to invest, entrepreneurship. The danger is if the transition process becomes a to-do list reflected in different action plans and the population is left behind. This may lead to an increase of transition transaction costs implying slow economic development and the lack of understand-

⁵ The recent surge in the center and illiberal parties fuels the debate about values about the EU. Hungary, Sweden, Finland, the Netherlands, Austria, France, Germany to name but few countries where anti EU values parties are on rise.

⁶ For example, Montenegro has been for almost 10 years on the accession road towards the EU membership. Still, as many find the freedom of expression or independence of judiciary legitimate, there is much to do to really implement those values in practice. However when it comes to the role of the government many favour heavy intervention in providing jobs, while the young prefer the civil service, despite the pro market reforms and continued efforts to ease on doing business according to the WB surveys over the years (Luksic, Katnic, 2016)

ing of the purpose of the process, because different actors of the transition industry will all pull in their own interest direction. Of course it is easier to say it is needed than to provide for a truly inclusive approach. At the same time as lessons show, if not battled corruption can hinder transformation, if privatisation does not move on rent seeking festers, unless new people arrive to step up the process of values development, a society remains locked down and if reformists shun populists the process can get easily reversed (Djankov, 2015)⁷.

Therefore, the consequence of the integration constructivism could be reflected in very dear reforms and the establishment of institutions that might be perceived as a foreign body as they collide with a different culture, customs, habits, moral code and other elements that are the source of the human action. The disregard of such institutions can result in the growth of the overall and across the board transaction costs. The way forward is inevitable neoetatism and the rule of the interest groups. The lack of optimism within the Western Balkans population is already evident as less than 30% believe the respective governments do not fail the expectations (IPSOS, 2015).

As new formal rules get established in the process of the transition, earlier interest relationships tend to change. The system moves away from the equilibrium tendency and then it takes to redefine contractual relationships in order to internalise recent externalities (Buchanan, 2002). Since the process of redefining the constitutional contract implies the reassignment of property rights it is inevitable that different people will end up in different positions. Some might be better off, some worse off. The transition is a chance that groups with vested interests use to negotiate with the lawmakers about the contents of the new formal rules. There are many who adapt their actions in order to secure the new rent. Therefore instead of a system that generates unhampered market exchange that looks to meet consumers' needs, the rent trade is established.

In transition countries the hunt for rents is afoot. Therefore it is no surprise that the new Enlargement Strategy of the EU insists on fundamentals, that is the

⁷ The introduction and measure of the Doing Business Index has done a lot in moving countries to work out reforms on business environment. It may be worthwhile to think through the approach by enhancing it or by interrelating it with the measure of corruption, or with how much of efforts are invested in breeding the entrepreneurial culture through the education.

rule of law, proper economic governance and the reform of public administration. But the point is to make the system more transparent, and not to use the transition to redistribute rents in a relatively reliable legal system where growth in the long run and individual freedoms may suffer. It is important to understand that the production of the public goods becomes the secondary function of a government in a market economy. This however is not a prevailing view about the transition, and at the same time has not been the interest of the EU to posit, which then in turn stimulates rent-thirst as an externality of the transplanting of institutions as shown by different historical episodes (Djankov et al., 2003). The new constitutional contract is supposed to define the limit of the Leviathan, and to focus on the protective function, rather than enable that the state remains one of the key owners of the means of production. In other words, the new social contract should define the clear dividing line between the private realm and government (Buchanan, 2002).

One may then deduce that the duration of transition does not count as long as the direction taken is good. On the contrary, slow transition may also be disapproved which stimulates populists and politicians of that kind to ask for the need to re-examine the course. This brings the risk of politicians shunning the populists anxious of their electoral success which has to be avoided (Shleifer, 2012). Democratic government might enter a discussion and reopen dilemmas which may lead a step back further complicating legitimacy of the just established institutions, while an undemocratic government would just stick to its guns reluctant to let reassignment of the rents take place (Buchanan, 2002).

The main reason why the public choice explains well transition and the failures of the integration process lies in the fact that the state accounts for a very big part of the overall consumption in economy. Accession talks with the EU would not solve the problem. In fact one may argue that it gives it a boost. Therefore, the possibility of extracting rents is in direct proportion to the level of the public expenditures. This in turn highlights the role of politicians and bureaucracy. The quest for re-election dominates priorities, as it turns out that the goal is to maximise utility for politicians not voters, and frequently leads to an inappropriate coalition with the special interests (Buchanan, 2002). In that case even a market where laws are sold will eventually fail, and the political system serves the need of transferring income generated by the economy in favour of coalitions (Colombatto, 1996). De-

veloped countries can sustain such a model of operation through the attainment of the tolerable levels of growth (Colombatto, Macey, 1998). Reforms are only minor and when necessary. This is not *modus vivendi* for the transition countries because their populations require a much higher growth. As politicians are unable to deliver it, it starts to swirl as if in a vicious circle. Unhappiness swells, but does the understanding of the reasons for it? (Djankov et al., 2015) The transition towards democracy flows faster than other streams, enabling strong presence of the interest groups and foiling the growth of economic freedoms.

THE PRAXEOLOGICAL VIEW (IT'S ABOUT PREVAILING VALUES)

Transition is not a mechanical process and the outcome varies in different countries. The main goal of transition should be to set up reliable rule of law institutions that are able to protect individual rights. It is important to understand however that the farther one travels east and southeast it is more difficult as one is faced with the non-existent rule of law and market economy tradition (Pejovic, 2003). Of course, the introduction of some formal rules by fiat is expected if there should be an organised transition process. However, as it has been shown above, this process always depends on the more or less established structures which determine whether the imminent changes are inevitable. If there is no private property, thought, rule of law, freedom of contracts, entrepreneurial activity that seizes opportunities seen in market prices there is no unhampered market society neither. For all of them to truly take roots in a society it takes time. The private property is *conditio sine qua non*, but if it does not ignite the development or return of a dominant capitalistic culture then the effort fails. The failure of privatisation in some countries happened because it did not help really generate the culture of capitalism, individual liberty and responsibility for one's future (Djankov et al., 2003; Pejovic, 2004). By poring over the transition process in the past 25 years one can draw different conclusions. One interesting conclusion that can be drawn is that despite incentives it has to be about the emergence of the new generation that can take the process further (Shleifer, 2012). In some cases it can be spontaneous, but in other examples the application of lustration laws opened the door for profound changes (Djankov, 2015).

Therefore, the process of transition means that institutions should operate so that they support inventivity, innovativity and creativity. Welfare cannot be separated from the welfare of individuals, from the way they perceive the underlying realities and make decisions accordingly (Kirzner, 1996). It can only gradually remove the collision between the collectivistic values and the values of a market society. There has to be a critical mass of individuals that follow the new rules or they expect them to be followed. Society has a different way of resolving the problem of knowledge from the entrepreneurial one, as Kirzner explains. More superior institutions not necessarily replace the inferior ones, unless individuals support it, whereas entrepreneurs act in accordance with a revealed chance (Kirzner, 1996). This holds true when applied to the transition. Optimal or preferred arrangement can never be attained due to the transaction costs and therefore cannot be kept in focus. It is more important if there exists a structure of stimuli as it determines economic and institutional dynamics (Colombatto, 1999), but also, as reminded, there has to be a new generation that can turn the stimuli in new entrepreneurial pattern of values (Djankov, 2015; Shleifer, 2012).

The prevailing culture of the former socialist countries goes against individualism, it is supportive of the equal outcome and consequentialism, putting social problems first as well as the role of the state. Simply said, it is a fertile soil for the transition into a paternalistic state (Djankov et al., 2015; Pejovic, 2003). Therefore, the expected outcome is a mixture of old culture and free market. Not more nor less a society wants of the capitalism (Pejovic, 2003). From the praxeological point of view it is fine, but sooner or later dissatisfaction grows and either even more paternalism is asked for, or a further step towards free market may take place.

In a nutshell, to meet the above three factors are relevant: the rule of law, carriers of the institutional restructuring and the moral code (Pejovic, 2001). The rule of law secures protection for the individual rights from the majoritarian tendencies and enables the society of free individuals to develop. The compliance with the rule of law principles as well as the historical heritage determines the course of the transition process. Carriers of the institutional restructuring have to be individuals completely ready and capable of investing their time and effort, prepared to take responsibility for their decisions. This is crucial as individuals make decisions based on their knowledge, and the keener they are the quicker the transition. Moral code

speaks of informal yet very important rules that get developed over time through the interaction of members of a society – tradition, customs, religious convictions, underlying realities frequently determining the course of the human action and eventually the individual happiness with opportunities one encounters. The more harmonious relationship between new formal rules and the existing informal ones the easier to reduce the transaction cost of the transitional undertaking and the more efficient exchange (Djankov et al., 2015; Pejovic, 2001). Therefore, it is of less interest whether the transition lasts for a long or a short period of time and how successful it is from a western perspective of the institution creation, but whether the structure of stimuli that helps shift from a hampered into an unhampered market society exists in a continuity or only after shocks.

FINAL REMARKS

Failure of the neoliberal and neoclassical approach, regardless of the method applied consists of a technical transition based on the construction of new institutions mirroring the western counterparts. The emphasis is on the foreign aid and loans to quicken up the wanted transformation, which opens the window of opportunities to rent seekers. A way out may be seen in the integration process, but it faces a grave risk of relying upon the top-down approach of the similar constructivism without grasping the real purpose of the process.

Alternatively, one has to put focus on the process of the information and knowledge diffusion, through the opening of a society and of an economy. The intensive contact with the outside world as well as the technological advancement may help the structure of individual preferences develop. Additionally, if there is a continuous existence of stimuli that cherish entrepreneurial spirit or help adequate culture of individual initiative and innovation develop, then it will decrease the transaction costs of the transition. This sort of development is more sustainable in the long run and does not correspond necessarily in the short run to the quick growth in the GDP. Eventually, free exchange will enable production of ever bigger amount of goods and services. That is why process of continued structural reforms matter. In contrast, the process of the European integration can support the creation of the fundamentals in terms of transparency, accountability and the rule of law. However

reformers need to be committed or the rent seeking takes over, they should not fear populism (Shleifer, 2012; Djankov, 2015). If the integration process ends up being just a variety to the neoliberal technocratic gradualistic approach, it risks ignoring the problem of the transition transaction costs. Inevitably, the transition process will drag on, becoming more unpopular and painful as well as for the European integration vision. It seems that this has come to be understood in certain circles. The EBRD for example now puts individual companies to the fore as they analyse innovation in the transition economies (EBRD, 2014). Still it is important to conclude that capitalism works even though the economic transformation takes time (Shleifer, 2012).

For all these reasons, the analysis has to turn into scrutiny over the nature of a shock, as it derives plenty of opportunities to individuals (Pejovic, 2001). In fact, the transition is a series of shocks individuals need to see as their chance to employ their knowledge and stand ready to take responsibility for their decisions. That is why the more transparency and protection of individual rights and less interventionism is a favourable combination (Colombatto, 2001). In other words, it is important to watch if institutional opportunities arise rather than to try to meet some idealised benchmarks as the effects of governmental intervention differing from one story to another (Djankov et al., 2003). After quarter of a century there is still a great deal of shocks. Reducing corruption and increasing transparency along with long haul education reforms that spur entrepreneurial spirit in order to make political and market reforms sustainable may be a quest to seek the lost purpose of transition.

Of course, one has to take into account that the views expressed here are related to the transition process from the ex-communist European countries towards liberal democratic constitution based on the market economy and it does not necessarily relate to what might be fully relevant to the other parts of the world.

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