

Shock therapy versus gradualism?

Transition processes in Eastern Europe reviewed

In many post-communist countries in Central and Eastern Europe (CEE), political freedom was followed by economic liberalization leading to more efficient market economies today.

However, the transition from central planning to a free market economy was uneven. In the early days of the transition processes, two schools of thought on economic reforms emerged. On the one hand some economists argued for a rapid break with the past, whereas on the other hand a more gradual approach was favored. After fifteen years of transition, it is now time to review both approaches and to conclude which approach is more suited to manage economic transition. Recently, Oleh Havrylyshyn argued that rapid reforms are more efficient and promising than gradual reforms: „Countries that adopted far reaching reforms tended to experience higher growth rates and lower inflation and received more foreign investment. Inequality increased less among rapid reformers than among gradual reformers. The same is true with respect to poverty rates.” (Havrylyshyn 2007: 1). Therefore, countries like Estonia, Czech Republic, Slovakia that choose a rapid economic transition are outperforming countries that picked a gradual approach (e.g. Russia, Ukraine, Belarus).

Such an argumentation, however, ignores the role that culture, history and path dependency play for economic performance and transition processes (cf. Pejovich 2006). Using findings from a cultural theory of economics the paper aims to show that Havrylyshyn found a spurious correlation. The economic success of rapid reformers does not necessarily stem from the fact that they used a shock therapy for transitioning to a market economy. It rather emerges from the fact that rapid reforms took place in those countries that had underlying informal institutions which are more compatible with the imported Western institutions and are expected to perform much better (according to the analysis of Zweynert / Goldschmidt (2006), compared to Orthodox countries, Catholic and Protestant («Latin») countries in CEE have the advantage of being more compatible with individualistic ideologies and therefore creating more support for the acceptance of an extended, functionally differentiated order).

Applying constitutional economics to the problem of economic policy-making and implementing economic reforms in CEE, I will analyze whether rapid or gradual reforms are more compatible with the existing legal-institutional framework as well as whether rapid or gradual reforms can be more easily integrated within the existing, socially accepted set of rules based on informal constraints. Consequently, I will argue that – in case of cultural conflicts with markets – a constitutional reform should be implemented gradually and in line with people’s previous experiences. This way, it is possible to legitimize the political changes by responding to the citizens’ sovereignty and to reach a more sustainable and stable economic system (cf. Roland 2004).