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Alternative Politico-Economic Models of Transition

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Abstract

A political economy approach to the transition process gives rise to alternative politico-economic models of transition. The alternative models of transition are distinguished on the basis of what I define as primary elements: economic analysis, what makes a good society, speed, political structure and institutional structure. The secondary elements of the transition models consist of the economic policies relating to price liberalisation, privatisation, monetary policy and the financial system, fiscal policy, international trade and social policy. This analysis is in contrast to the perception of orthodox economists that the transition process could only had taken the form of shock therapy, which was imposed by the International Monetary Fund (IMF), World Bank and mature market economies.

Introduction

The collapse of 'socialism' in the Soviet Union and Eastern Europe initiated the movement from a centrally administered to a market economy, which is commonly referred to as the transition process. The word transition, the passage from one state to another, in this case, from a centrally administrated to a market economy, might seem appropriate, it did not explicitly capture all the complexities involved. The transition process entailed superseding the essential properties of the centrally administered economy, consequently destabilising the economic system and replacing with a market economy.

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Any exposition of the transition problem in the economic literature must necessarily be a simplification of the complexities involved. One approach taken in writings on the transition process reduced the issues to an isolated variable of the economic sphere. The various aspects of the transition problem were pigeon-holed in thematic sub-categories, thus ignoring the interrelated nature of economic institutions and behaviour. Some economists took an alternative approach, and provided a solution to the problem by explicitly or implicitly (mostly implicitly) assuming specific behavioural assumptions and/or economic relationships. Thus, modelling of the transition process was highly subjective and based on value judgements. Further, consideration of the impact of the political process was omitted from the analysis of transition, since the shock therapy approach, which did not show any interest in the political outcomes of the economic policies implemented, dominated the economic literature.

The aim of this paper is to overcome those weaknesses by proposing an alternative conceptualisation of the transition process. This involves substituting a more holistic approach for the 'pigeon-hole' methodology. The elements of the reform program are interdependent, mutually supportive and interactive. This paper emphasises the interrelated nature of the reforms which result from the interrelated nature of economic institutions and behaviour. Because of this interrelatedness, there were grave dangers associated with making one or more elements of the reform program dominant. But despite the limitations of the economic analysis, the transition process itself was never restricted to the economic field. Market relations are not independent of other social relations. It would seem that the political aspects of the transformation were fundamental. Indeed, economic reforms cannot be understood or assessed in narrow economic terms.

The paper is restricted to the development of theoretical and conceptual models of transition. Each model is a construction based on the values and beliefs, to which most economists of the particular model subscribe. Each model is a stylised version of the view of how the economy operates, with reference to the transition from a centrally administered to market economy, suggested by the economic analysis in question. As such, empirical evidence will be incorporated selectively. The analytical framework developed in this paper, which proposes different models of transition, makes it possible to understand the transition process from a new and more enlightened perspective. It provides a better understanding of the complexities involved in the transition process and the differing opinions between economists.

The paper is structured in the following manner. First, I argue that a political economy approach is most suitable in analysing the transition process. However, a political economy approach gives rise to alternative models of transition, which are then presented. Non-market alternatives are not considered in this paper. The penultimate section presents the alternative economic policies recommended by each model. Finally, the practicality and usefulness of the political economy approach, as adopted in this paper, is expounded in the conclusion.

A Political Economy Approach to Transition

The success of the transition process depended not only on specifying the necessary economic conditions, but also on whether certain conditions were satisfied with respect to the non-economic elements. In general, reformers are constrained by the lack of sufficient information, the social, legal, cultural and economic institutions, the physical environment and systematic factors (Haddab 2002, p. 1). For this reason, the analysis adopted in this paper is in the tradition of political economy, which incorporates the interaction between political institutions, social consciousness and ideas within the framework of economic relationships. The transition process is holistic, historical, dynamic and comparative in nature and, as such, a political economy approach would seem appropriate. Political economy stresses that making economic sense and understanding economic relationships is not feasible without explicit awareness of power, institutions and values (Heilbroner 1996, p. ix). A political economy approach to the transition process contests the traditional belief that economics and politics are interested in distinct terrains within the society and that they employ different methods of analysis. However, a political economy approach generates disagreement and results in alternative transition models since 'this inherently political dimension of economic analysis renders it prone to fundamental disagreements' (Argyrous & Stilwell 1996, p. 51). As such, economists disagree what defines a good society and thus, they disagree about the different weights assigned to economic performance indicators (Haddab 2002, p. 4).

Models of Transition

A political economy approach to the transition process gives rise to alternative models of transition. This paper develops three alternative models of transition, based on three different views of economic analysis: the neoclassical, Post Keynesian and market-socialist models. The neoclassical model of transition encompasses an approximation of competitive capitalism as a vision of a good society and uses neoclassical economic analysis. Within the neoclassical model we can distinguish between shock therapy and the gradualist model of transition. The shock therapy approach requires an immediate and rapid transition to the market, while the gradualist model favours an evolutionary process towards a market system. The fact that there is disagreement about whether competitive capitalism is an appropriate goal, and whether it is feasible, gives rise to the need to consider alternative models. Consequently, a critique of the neoclassical model which assesses its weaknesses and inadequacies gives rise to an alternative model based on Post Keynesian propositions. The aim here is to develop a comprehensive model of transition, broadly defined as 'social democratic', which overcomes the weaknesses of the neoclassical model and is also both realistic and feasible, as argued by Post Keynesian economists.

In this context, it would also be appropriate to consider a market socialist model of transition. As the name of the model states, it is a combination of a market system and socialist principles. The market socialist model is concerned with the optimal combination of centralisation and decentralisation, of markets and planning, of individualism and the common good, and of public and private property. The market socialist model incorporates a different method of economic analysis – mainly Marxist analysis – and thus takes a different view of the way the economic system functions. Within the market socialist model we can distinguish between the pluralistic and non-pluralistic approach. The pluralistic market socialist model introduces reforms after discussion, debate, compromise and consent; for example, the Gorbachev reforms. Non-pluralistic market socialism, on the other hand, introduces reforms after the decision is made by the leading role and correct line party, as for example in China.

The distinguishing features of the different transition models based on a political economy approach are presented in Table 1.

Table 1: Alternative Models of Transition

<table>
<tr><th rowspan="2"></th><th colspan="5">MODELS OF TRANSITION</th></tr>
<tr><th>Shock Therapy</th><th>Neoclassical Gradualism</th><th>Post-Keynesian</th><th>Pluralistic Market Socialism</th><th>Non-Pluralistic Market Socialism</th></tr>
<tr><td>Economic analysis</td><td colspan="2">Neoclassical</td><td>Post-Keynesian</td><td colspan="2">Marxist</td></tr>
<tr><td>What is a good society?</td><td colspan="2">Competitive capitalism</td><td>Social-democratic capitalism</td><td colspan="2">Market socialism</td></tr>
<tr><td>Speed</td><td>Shock therapy</td><td colspan="4">Gradualism</td></tr>
<tr><td>Political structure</td><td colspan="4">Pluralism</td><td>Non-Pluralism</td></tr>
<tr><td>Institutional structure</td><td colspan="2">Product of Market Forces</td><td colspan="3">Product of State Action</td></tr>
</table>

The Issue of Speed

The movement towards a market economy may take two forms: the 'shock therapy' approach and the 'gradualist' approach. The issue of speed addresses the issue of human consciousness and perceptions when a dramatic change in behaviour is required, such as the transition from central administration to markets. The opposing views, with regard to speed, reflected the different beliefs about individual responses, which can either be rapid or time–consuming. The distinction with regard to speed was relevant only for the neoclassical model, since both Post Keynesians and market socialists were in favour of a gradual approach. They agreed with the neoclassical gradualist economists that change had to be slow since institutions, organisations and patterns of behaviour and thinking could not be changed immediately (See Table 1). In the following an analysis of the alternative adjustment paths takes place.

a. **Shock therapy.** The shock therapy approach was characterised by a rapid implementation of reforms, minimisation of time intervals between measures, and fast correction of policy mistakes. 'The main issue is to cross the rising river as fast as possible in order to reach the other shore and establish a firm foundation for the construction of a new economic system based on the market' (Aslund 1992, p. 87). The shock therapy approach assumed that the transition process did not necessarily imply a reduction in output: important reforms in economic structures were not necessarily associated with a reduction in living standards (Olson 1992, p. vii). Thus, it was argued that the stabilisation program and the institutional reforms should have taken place at the same time. Lipton and Sachs (1990, p. 100) quoted Bolivia's former Planning Minister, Gonzalo Sanchez de Losada, who in 1986–89 administered the reform process in his country and stated that, 'if you are going to chop off a cat's tail, do it in one stroke, not bit by bit'. Getting the prices right from the beginning would encourage entrepreneurship under hard budget constraints. The underlying assumption was that individuals would always respond quickly to the incentives provided, even when dramatically new behaviour was required (Clague 1992, pp. 7–8).

b. **Gradualism.** Neoclassical economists who were in favour of the gradualist approach, along with the Post Keynesians and the market socialists, argued that the changes in the economic system, which were required to complement the introduction of market relations, could not be introduced rapidly: these changes inherently take time. There was need for gradual change, since institutions, organisations and patterns of behaviour and thinking would not change immediately. These elements could only take shape and function after an 'organic historical development' (Kornai 1990, p. 52). So the process of change had to be slow. It could be speeded up, but nevertheless needed to be slow. Otherwise 'artificial transplants hastily forced upon these societies will be rejected by their living organisms' (Kornai 1990, p. 20). Haddab (2002, p. 271) insists that complementarity between reforms requires gradualism not shock therapy; in addition, institutional reforms are slow-moving processes. The gradual approach allows people, in particular potential losers, to adjust their behaviour and thinking with minimum psychological costs; thus reducing their resistance to change. '…therefore it is easier to start with and implement gradualist reform packages' (Haddab 2002, p. 270).

The Role of Institutions

A radical change such as moving towards a market economy required a reform in the institutional structure consistent with the institutional arrangements fundamental for the proper functioning of a market economy (Frydman, Rapaczynski & Turkewitz 1997, pp. 45–6; Kolodko 1999; Kolodko 2000). This was because any 'attempt to account for the diverse historical experience of economies or the current differential performance of advanced, centrally planned economies and less-developed economies without making the incentive structure derived from institutions an essential ingredient appears to me a sterile exercise' (North 1990, p. 134).

The role of economic institutions is to make individuals responsive to the economic environment and make the economic environment responsive to individual actions. The institutional structure determines the rules of the game in a society, which are human-devised restrictions that mould human interaction (North 1990, p. 3). It identifies the constraints in which rational economic actors comprehend, plan and endeavour to achieve their goals. Institutions encourage competitive or co-operative behaviour, reduce or increase transaction costs and provide the organisational foundation for production and exchange (Caparaso & Levine 1993, p. 149). In addition, society's interests are embedded in the institutional structure and change as institutions change in accordance with customs, regulation, ideology and *ad hoc* decisions by those who hold power (Nee 1996, pp. 908–9). 'Indeed, the market cannot properly be understood separately from the economic, social and political institutions necessary for its functioning and its legitimacy' (Stilwell 1996, p. 95), Hence, under the new economic conditions of emerging markets, economic actors struggle to establish institutions to facilitate competition and to serve their interests through both informal arrangements and formal institutions.

The question that required to be answered by the transition modelling process was, how would an appropriate institutional structure be developed in the transition economies? Does it involve government action, as Kregel (et al., 1992, p. 28) argued that institutions 'often emerge spontaneously and through repeated social interaction but in many cases they have to be made by conscious action': a statement with which the Post Keynesians and the market socialists would agree. However, Rapaczynski (1996, p. 87) disagreed, stressing that institutions are '...largely the product of market forces, rather than government fiat'. Dietz (1992, p. 34) also argued that 'exchange communication alone is capable of generating boundaries (identities and environments)', which is consistent with the neoclassical model (See Table 1). Neoclassical economists, following Hayek, interpret the presence of institutions as an outcome of 'human action' rather than 'human design'. As such, the likelihood of designing institutions, as Post Keynesians and market socialists argue, is regarded 'as utopian, a self-conceited exercise, that not only will not work but will be counterproductive' (Haddab 2002, p. 268).

Economic Policies of Alternative Politico-Economic Models of Transition

After identifying the alternative models of transition, each model would recommend a set of desirable reforms consistent with the assumptions and goals of the relevant economic analysis. This is because 'policies and decisions are never made in a social vacuum' (Haddab 2002, p. 1). Each model had to provide a policy solution to the following economic issues which were fundamental to the transition process. The pigeon-hole literature identified that the transition problem involved solutions to: price liberalisation-stabilisation; privatisation-property relations; monetary policy and the financial system; fiscal policy; international trade and social policy.

Price Liberalisation-Stabilisation

Alternative transition models would recommend alternative processes of price liberalisation. The shock therapy supporters would advocate an immediate price liberalisation and, thus, the removal of any restrictions on prices resulting in an immediate elimination of shortages. The remaining models would argue for maintaining price controls – at least for necessities – and for the gradual removal of administrative controls over prices. While price liberalisation was directly linked with the primary element of speed, it also had features that were quite independent of speed. Issues required to be solved by the transition modelling had to do with the process of developing market relations through price liberalisation. In regard to the development of market relations, we need to highlight the choice between alternative market structures. In addition, it was extremely important to determine the role of the state within the market process. 'The redefinition of the state's role in Eastern Europe is, thus, only very imperfectly captured by the metaphor of 'withdrawal'' (Frydman, Rapaczynski & Turkewitz 1997, p. 42). State intervention could take a variety of forms. First of all, there may be a minimum role for the state in the market process. Neoclassical economists are in favour of this approach. In this case, the market outcome is always acceptable and desirable, and there is no need for the state to intervene. The state remains inactive with regard to market outcomes: the market functions freely, except in the cases of market failure. In the absence of government and market failure, the operation of a competitive market results in efficient scarcity prices, which are indispensable to the operation of the market system (Giersch 1989, pp. 7–8). Secondly, state intervention may take the form of industry policy in assisting enterprises to confront competitive forces by disseminating information, providing tax concessions and tariff protection. Industry policy encourages enterprises indirectly, through market incentives, to reach a market outcome that is desirable from a society's point of view. Thirdly, state intervention may take the form of regulation, which results in directly restricting enterprise choice. Post-Keynesians are in favour of using both industry policy and regulation. Industry policy was essential, as Post Keynesians argued, due to the inability of the market system to pick winners. Hence government intervention was essential, because the state was responsible for economic performance (Amsden 1996, p. 257; Arestis & Sawyer 1993, p. 3).

However, market socialists argued that industry policy and regulation were totally ineffective in a capitalist system since the state did not have the power to enforce its decisions. Power resides with the owners of capital. Private owners would refuse any attempt to influence their decision-making process, especially if these decisions contradict their goals such as profit maximisation. Economic and political power would have tended to undermine the successful implementation of Post Keynesian policies; therefore, there was no Keynesian solution for transition economies (Cox 1998, p. 9). Consequently, to have any chance of success any state intervention, which uses as yardstick society's benefit, required the elimination of the sources of power – that is, of private property. The market socialists argued that this can only be achieved in a socialist system. State intervention in a market socialist system takes the form of market planning. Plans are definite, over-arching, governing guidelines, constructed regularly at certain periods for the development of a large number of mutually varied dependent economic activities. Non-pluralistic market socialists would, in addition to market planning, also use directives decided by the leading role correct line party.

Privatisation-Property Relations

The first problem of transition that was highlighted by most economists as urgently requiring to be solved was the privatisation of state enterprises. 'The success of privatisation will be decisive for the Russian reform program'

(Chubais & Veshnevskaya 1997 [1993], p. 76). Private property is the foundation of market economies; without private ownership the market cannot exist, and vice versa. However, the establishment of private property did not exclude the development of other forms of property. Whether the majority or minority of property should be privately owned depended on one's view of a good society. But all forms of ownership are dependent on, among other things, the varying degree of concentration of the productive forces. Diverse forms of technology give rise to diverse forms of socialisation. If the structure of ownership is in conflict with economic conditions, this will have a negative effect on economic development. Thus, to impose a common form of ownership is inconsistent with objective economic reality.

The sale of state property had the aim of achieving various objectives, such as providing revenue to the government, stimulating the restructuring process and enticing foreign investors to become active participants. Before 1989, there was no historical experience of privatisation starting from a centrally administered economy with no private property and/or without a capitalist class. The lack of any historical parallels gave rise to a new set of problems, such as: whom to sell to; how to sell; what to sell; and whether considerations of equity and fairness should be taken into account. The answers to these questions were linked to the alternative ways in which privatisation could take place. These were:

1 **Restitution.** There was a legal entitlement for the property to be returned to the rightful owners, where former owners existed and could prove their past ownership before the state expropriated their property. Alternatively, compensation might be provided. The success of the restitution process depended on the ability to find past owners, the existence of appropriate documentation to substantiate claims, and the preparedness to make political judgments about which claims of acts of expropriation to redress.

2 **Sale of state property.** Kornai (1990, p. 83) argued that the transformation of state property into private property could only take place by auctioning state enterprises and selling them to the highest bidder. In this way, all individuals would have the opportunity to become owners at real market prices. Foreigners would also have the ability to participate so long as some guidelines were imposed to protect the nation's interests, which of course depended on one's view of what is a good society. This national policy, however, should not be based on isolationism or xenophobia. Chubais and Veshnevskaya, (1997, p. 74) argued strongly in favour of the auction of state enterprises since there were a 'number of

advantages in using the competitive approach as the cornerstone of the Russian privatisation program'.

3 **Financial intermediaries.** This involved the transfer of ownership of enterprises to financial intermediaries whose ownership structure may consist of pension funds, worker and/or management funds, citizen funds, or private financial institutions such as banks and governments. The advantage of this method was that it was fast and could be viewed as equitable. However, a loss of government revenue was involved. There was also a shortage of experienced financial managers operating in a market environment who could administer these financial intermediaries efficiently.

4 **Distribution of vouchers.** The voucher scheme supplied every member of the society with vouchers that could be used at a share auction to buy shares in the enterprise in which they worked, to subscribe to investment funds, or to be sold for cash. This was privatisation by free distribution of shares to the whole population, since all citizens had contributed to the development of state enterprises through taxes. Privatisation through free distribution of vouchers was adopted in Czechoslovakia, Lithuania, Mongolia, Poland, Romania and Latvia (Aslund 1992, p. 83). Free distribution may be justified on the basis of equity, since those who were able to purchase property were likely to have accumulated wealth either illegitimately or by abusing their power under the previous regime. The advantages of this method were speed, relative transparency, and the creation of an instant capital market, less political opposition from insiders, and popular support for the reform process. In addition, it would develop a share-holding culture and, at the end of the process, it would be more difficult for any future government to reverse the situation.

5 **Combination of free distribution with the participation of financial intermediaries.** The free distribution of shares might be accompanied by the development of holding companies quoted on the stock market, which play the role of core shareholders, with a clear mandate to restructure the firms and divest themselves of the firms in their portfolio in some time (Blanchard et al., 1992, pp. 7, 42–9). Using holding companies as a means of privatisation can be achieved by the following guidelines: the government creates a number of holding companies, enough to ensure competition and limit market power; each holding company has a roughly similar diversified portfolio of individual firms and full control of these firms; shares in the holding companies are distributed freely and equally to all citizens; the purpose of the holding companies is to restructure and divest; and, finally, managers of holding companies are free to make the

appropriate business decisions, restricted only by anti-monopoly laws. The government hires the managers of the holding companies. Each holding company is subjected to an explicit termination date. When the termination date for holding companies arrives they can be transformed into private companies.

6 **Spontaneous privatisation.** The collapse of the centrally administered system conveyed power to the enterprise management and provided managers with the scope to appropriate state enterprises for their own benefit. In other words, those who managed state enterprises took possession of the enterprise's assets and transformed the company into a joint-stock company, thereby effectively becoming owners of the enterprise. This was an easy way out of the complexities involved in privatisation and could be implemented very fast. However, there were problems associated with this process as well. It violated the principles of equity, since managers became owners by, in effect, confiscating the enterprise. In addition, there was a high probability that efficiency might not increase when people who formerly managed these enterprises poorly now owned them. Spontaneous privatisation was motivated by managerial self-interest and there was an inclination for managers to lower the value of the assets as much as possible in order to secure the enterprise at very low price. It was a selective privatisation process without pluralism, consultation or debate: an auto-appropriation process by the few well-informed individuals in a position of power.

7 **Labour-managed firms.** Another alternative was to transfer the ownership of the enterprises from state to the workforce creating labour-managed firms. This had the advantage of very low administration costs, and it could be implemented extremely rapidly. Under this structure, ownership and control are exercised by all members of the co-operative in the form of group property (Breth & Ward 1982, p. 7). All members of the co-operative have an equal right to participation in the decision-making process. The fundamental characteristic of the labour-managed firm is that it is democratically administered. The decision-making process in labour-managed firms is based on the democratic principle of one vote per person, rather than on one vote per share[1]. Kornai (1990, p. 90) argued that this method of distribution is inequitable. Some workers will receive ownership of successful enterprises with surpluses, while others will

[1] Alternative voting systems can be developed; the dominant method adopted is one vote per person rule. It is also the standard, which the International Co-operative Alliance maintains that its members embrace, and it is also the rule used in the theoretical literature (Doucouliagos 1995, p. 10).

receive ownership of enterprises that are heavily in debt or loss making. Meanwhile, pluralistic market socialists would be in favour of having the majority of firms labour-managed.

8 **Asset privatisation through liquidation.** For unsuccessful enterprises that could not be restructured, and for shares of companies that could not be sold, the government initiated liquidation proceedings and sold the physical assets owned by the state enterprise. This process facilitated the reallocation of resources to their most productive activities.

The dominant method of privatisation depends on one's value judgements with regard to equity and speed. The shock therapy model was in favour of immediate privatisation of state enterprises through restitution, liquidation, auctions and free distribution of vouchers; neoclassical gradualists were in favour of auctioning state firms, but later in the process, so as to ensure appropriate owners. Post-Keynesian economists would be in favour of a gradual privatisation process, which would involve restitution, liquidation, free distribution of vouchers and transferring ownership to financial intermediaries, which were state controlled. In addition, they would prescribe a combination of free distribution of vouchers and transfer of ownership to state financial intermediaries as well as encouragement of labour managed firms. Pluralistic market socialists would favour giving the enterprises to the workers and, thus, encouraging the development of labour-managed firms to enhance participation and retaining a large percentage of state-owned enterprises. However, non-pluralistic socialists would retain state enterprises and encourage the development of private enterprises in special economic zones.

Monetary Policy and the Financial System

In addition to privatisation and the development of institutions there was a need to develop specific institutions to enforce hard budget constraints. This would be achieved by reforming the banking system, dividing its functions between a central bank and commercial banks. Enterprise restructuring and privatisation would not be meaningful without reform in the banking sector. A hard budget constraint would be enforced by commercial banks, operating under bankruptcy laws. In this way the banking system would deal with enterprises on the basis of commercial principles, lending only to credit-worthy borrowers for specific purposes and allowing entrepreneurs to finance their long-term economic projects and plan their production and trading activities.

Neoclassical economists highlight the danger associated with the prerogative of commercial banks to create money, which, if excessive, will cause excess demand and put pressure on prices. Consequently, there was a need for some form of regulation by the central bank through the imposition of liquidity constraints. The primary aim of the central bank, in the neoclassical view, would be to control the money supply to avoid inflation. This can only be achieved by an independent central bank, formulating monetary policy independent of political considerations. 'Inflation is not a natural disaster; it is created by government or the political powers behind them, and only the governments and political powers can put an end to it' (Kornai 1990, p. 106). The development of a privately owned, competitive and stable financial sector was essential to the operation of a market economy, since it was the centre of the mobilisation and distribution of financial resources and the pricing and allocation of risk. 'Post-Keynesians rank the supportive responsibilities of the central banks above their control duties' (Moore 1979, p. 126), indicating the need for a state-controlled central bank and a combination of a privately and state-owned banking system. Market socialists would highlight the need to eliminate the power of the financial establishment so that the government can gain control of the money supply and be able to use it as an effective instrument of discretionary policy, which implies a government controlled central bank and only state-owned banks.

Fiscal Policy

This was one of the most contentious issues in economic analysis. Taxes result in dead-weight losses. Thus, the question arose whether the taxation system should be neutral, attempting to minimise the dead-weight loss, or whether the government should use its discretionary power to tax people differently; for example, based on ability to pay. In addition, each transition model would need to identify the role of budgetary policy and, hence, whether there is a link between government expansionary policies and inflation.

The neoclassical economists argued that the tax system should be neutral and the budget balanced. This means that the government should not use the tax system as a means to encourage or discourage certain behaviour, since this would create distortions, except where market failures arise as in the cases of public goods and externalities. If there was a need to subsidise certain activities on welfare grounds, it was preferable to provide income assistance rather than give tax concessions, since taxing results in dead-weight losses. The tax system should not discourage investment or work. It was important to establish a credible and efficient tax system as early as possible to increase government revenue, which was desperately needed. It was essential to abolish all subsidies and establish a hard budget constraint, since subsidies distort the market, increase the budget deficit, and encourage waste. Instead of subsidies, loans from commercial or other institutions, or even from other enterprises, would become part of the normal financial life of each enterprise.

On the other hand, Post Keynesians would use the government's discretionary power to implement fiscal policies to achieve full employment, since the labour market does not automatically reach equilibrium. Market socialists would argue that the discretionary policies of the government proposed by the Post Keynesians are totally ineffective, as power is the natural result of private property, and power is able to neutralise government policy. Consequently, there was a need together with discretionary fiscal policies to have the majority of property in a social form.

International Trade

Foreign trade – the movement of people, capital and technology – is an important ingredient in the development of markets and in fostering structural change and economic growth. The liberalisation of foreign trade was an essential part of the transition process. 'It is also widely accepted that there is no known example of successful inward-oriented economic modernisation. Consequently, it is difficult to find serious advocates of economic autarky in the transition debates' (Sutela 1992, p. 85). However, to realise the benefits from trade there was a need for the presence of institutions already described – institutions that guarantee property rights and enforce the execution of contracts. The dispute was about whether a uniform and convertible exchange rate, with imports and exports moving freely between borders, contributes to economic welfare, as the theory of comparative advantage argues (Aslund 1995, p. 174). Some allowance should also be made for the protection of infant industries, so the state would be able to raise a certain amount of revenue from tariffs. A fully convertible currency would restore faith in the currency, reduce inflationary expectations, and stimulate foreign trade. A fully convertible exchange rate would make it possible to attract foreign investment, which was essential to overcome stagnation, since foreign investment provides resources, technology and expertise. 'As in any capitalist society, the flows of capital were expected to assure that firms restructured (or simply retrenched) their operations' (Frydman, Rapaczynski & Turkewitz 1997, p. 68).

The neoclassical economists would be in favour of the establishment of free trade and a fully convertible flexible exchange rate. The disagreement between them regards the issue of speed. The Post Keynesians would be in favour of erecting tariffs, since they argue that the principle of comparative advantage is valid only in the ideal world of full employment and, thus, tariffs and a discretionary exchange rate policy were essential. Market socialists would be in favour of tariffs and non-tariff barriers, since tariffs might be ineffective in some cases, and implementing a discretionary exchange rate policy.

Social Policy

Different countries require different social policies due to variations in the way poverty is expressed, their institutional structure and their political processes. Nevertheless, several guidelines can be presented that are relevant to the implementation of social policy as with economic reform (Graham 1997, p. 327). The introduction of unemployment benefits and welfare benefits must be, for example for the neoclassical economists, non-discriminatory and available for a limited period to discourage dependence. That is why it is only a 'safety net'. So long as there was a comprehensive tax system, supplementation of income is preferable to food subsidies, which are poorly targeted and also benefit the well-off. In this context, gradualist economists argue that the government may need to restrict price increases to avoid discontent (Kornai 1990, p. 147). Discretionary measures would be necessary in this context as long as the gradual process was taking place, hopefully – for the gradualist neoclassical economists – for a short time.

For the Post Keynesians, the welfare state, which is an expression of the common good and the result of government discretionary power, is the means of attaining the equity objective of society, especially for minorities and disadvantaged groups. The pluralistic market socialists were very critical of the effectiveness of the welfare state, since capitalists would always avoid tax payments, thereby creating a fiscal crisis. An effective welfare state requires the elimination of power in society and the establishment of a minimum guaranteed income for all, independent of individual economic conditions. For the non-pluralistic market socialists, such as China, welfare provision took the form of the enterprise funded 'iron rice bowl'. The schematic representation of the economic policies advocated by each model appears in Table 2.

Table 2: Economic Policies of Alternative Models of Transition

ECONOMIC POLICIES	NEOCLASSICAL SHOCK THERAPY	NEOCLASSICAL GRADUALIST	POST-KEYNESIAN	PLURALISTIC MARKET SOCIALISM	NON-PLURALISTIC MARKET SOCIALISM
PRICE LIBERALISATION	Immediate Price Liberalisation	Gradual Price Liberalisation	Gradual Price Liberalisation	Gradual Price Liberalisation	Gradual Price Liberalisation
STABILISATION	No State Intervention	Gradual removal of the sources of State Intervention	Industry Policy and Regulation	Market Planning	Market-Planning and Directives
PRIVATISATION	Rapid Privatisation through Restitution, Liquidation, Auctions and Free distribution of vouchers	Auctions	Gradual Privatisation through Restitution, Liquidation, Free distribution of vouchers, State Financial Intermediaries, Free distribution of vouchers combined with state Financial Intermediaries Labour Managed Firms	Gradual appropriation of firm by workers (labour managed firms)	Gradual development of private firms in special economic zones.
PROPERTY RELATIONS	Minimum State	Minimum State	Majority Private with some State Property and Labour Managed Firms	Majority Social with some Private Property	Majority State with some Private Property
MONETARY POLICY AND FINANCIAL SYSTEM	Independent Central Bank and Privately Owned Banks	Gradual Independent Central Bank and Gradual Privately Owned Banks	State Controlled Central Bank and Privately and State-Owned Banks	State Controlled Central Bank and State Owned Banks	State Controlled Central Bank and State Owned Banks
FISCAL POLICY	Neutral Taxing System and Balanced Budget	Gradual Neutral Taxing System and Gradual Balanced Budget	Discretionary Taxing System and Discretionary Budgetary Policy	Discretionary Taxing System and Discretionary Budgetary Policy	Discretionary Taxing System and Discretionary Budgetary Policy
INTERNATIONAL TRADE	Free Trade Fully Flexible Convertible Currency	Gradual Free Trade Gradual Fully Convertible Flexible Currency	Tariffs Discretionary Exchange Rate Policy	Tariffs and Non-Tariffs Discretionary Exchange Rate Policy	Tariffs and Non-Tariffs Discretionary Exchange Rate Policy
SOCIAL POLICY	Safety Net	Gradual Safety Net	Welfare State	Minimum Guaranteed Income	Enterprise funded 'iron rice bowl'

Conclusion

A political economy approach to the transition process gives rise to alternative politico-economic models of transition; thus alternative economic policies were recommended for a successful transition. This is because the development of each model is based on a set of ideas, to most of which individual economists who subscribe to the particular body of analysis would conform. Which model was implemented depended on the values, beliefs and power relationships between the members of the society, mature market economies and international financial institutions. This analysis is in contrast to the perception of orthodox economists that the transition process could only take the form of shock therapy, which was imposed by the IMF, World Bank and mature market economies. A political economy approach makes it possible to understand the transition process from a new and more enlightened perspective. With this approach, we are better able to comprehend the complexities involved and the disagreements between social scientists about the transition process. As Bim points out, 'reforms cannot be treated as purely economic' (1992, p. 190).

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