METU Studies in Development, 24 (1) 1997, 129-138

The challenges of post-communist transformation for the World Bank

Ayşe Buğra

Ekonomi Bölümü, Boğaziçi University, 80815 Bebek Istanbul

A few years ago, in the beginning of the process of socio-economic transformation in the former centrally planned economies, neither the dimensions nor the difficulties of this unique historical event were well appreciated. In general, economists tended to think that markets would naturally emerge as central planners left the scene. They also thought that markets, as coordinating mechanisms, had a "natural affinity" with private ownership and, consequently, rapid privatization of public enterprises would generate the necessary conditions for an efficiently functioning market economy.[1] In the

1 The most blunt formulation of such ideas are perhaps to be found in the work of Jeffrey Sachs. See, for example, "What Is to Be Done?", *Economist*, 13 January 1990 and *Poland's Jump to the Market Economy*, Cambridge, Mass.: Harvard University Press, 1993. Yet the market faith and the belief in rapid and extensive privatization were also shared by many others. For example, it was Janos Kornai who has argued that strengths and weaknesses of social organizations could be explained with reference to the strengths and weaknesses of the affinity between forms of coordination and forms of ownership. Following this argument, he has suggested that "robust" linkages exist only between private ownership and market coordination or between central planning and state ownership, with the weakness of other possible linkages limiting the range of viable choices among alternative socioeconomic arrangements. In this approach, cooperative ownership, labor management or associative coordination constitute examples of weak third forms and, as Kornai has written, "No search for third forms of ownership and coordination mechanisms allows one to avoid the real tough choices", which are necessarily between the two robust forms.

meantime, Western capital and Western advice would be made available to accelerate the process in which old institutions and behavioral regularities would be replaced by those appropriate for the smooth functioning of the market system. In this system, with political democracy as its integral component, a productive social dynamism would be unleashed that led to rapid growth.

The experience of the few years following the transformation process has shown that the process was not that easy, that smooth nor that predictable. Consequently a whole new body of economic literature drawing on the lessons of the societies in transformation has emerged and challenged some of the established views on social change and economic development. The last *World Development Report* of the World Bank (1996) which features the socio-economic transformation of the former centrally planned economies makes an interesting contribution to this literature. Unlike the usual format of these reports which, since 1978, are published annually to present a general picture of the problems of international development, we have, for the first time, a World Development Report exclusively dealing with a specific group of countries. This choice of subject matter is unusual, but quite understandable given the obvious importance of the problems encountered in the economies under investigation.

The way the subject is presented, however, is quite intriguing since the Report incorporates a large body of evidence supporting the structuralist case for industrial policy which, nevertheless, is disregarded in its policy conclusions which continue to fully adhere to the well-known tenets of neo-classical theory. In this review article, I will take issue with this problematic position by discussing, first, the contributions of the Report in three areas where its findings challenge the established wisdom in neo-classical theory and policy. These areas are: I) the nature of the market economy which is much more than a spontaneous order that functions on the basis of the allegedly universal motive of individual self interest; ii) the contrast between the complex problems that privatization presents and the simplistic manner in which it appears as a natural component of neo-classical policy suggestions for the rationalization of all economic systems, and iii) the overwhelming significance of socio-political problems that all attempts at economic restructuring and systemic change should address. I will discuss, second, the problems that emerge as a result of the Report's failure to draw lessons from the observations it incorporates in these three areas. These problems pertain, in particular, to the timing and sequencing of reforms as a crucial determinant of long term political and economic implications of short term policy choices.

The discussion presented in this article points at a particular methodological bent which is especially common in the social sciences where the objective of protecting an established paradigm from contrary evidence frequently dominates the attempts to learn from experience. In the case of the World Development Report under review, the paradigm in question is essentially that of the economic modernization theory. It reflects a particular conception of socio-economic change as a linear historical process which follows a natural course through similar policy choices to be made in similar institutional environments. This approach regards culture and institutions as "things" which can be manipulated and changed according to the requirements of the path toward a developed market economy. From this perspective, the whole process of transformation is seen as one of massive "social engineering"- a term which appears repeatedly in the Report- for which a blueprint is available.

Yet the Report also includes information and statements that indicate that such a blueprint, in fact, does not exist. Albeit quite unsystematically, it documents that countries under investigation are very different in their socio-economic diversity. It also makes scattered references to different policy options and institutional arrangements, with their advantages and disadvantages which vary according to the context in which they are to be applied. All these insights, however, do not modify "The Report's core message" which, we are told, "is that firm and persistent application of good policy yields large benefits" (World Bank 1996: 5).

The Report is organized in three parts: The first part, "The Challenges of Transformation" looks at the economic developments in different groups of former centrally planned economies and presents a comparative analysis of liberalization, stabilization and privatization policies. In the last chapter of this first part, labor market developments are analyzed and problems of unemployment, inequality and poverty are discussed with reference to different structural characteristics and policy choices of different societies. The second part, "The Challenges of Consolidation" presents both the problems and the ways of dealing with the current institutional vacuum in the legal system and in the financial system, in the realm of health and education. The necessary redefinition of the role of government in society naturally forms part of this discussion of institutional reform. Also discussed in this second part is the international context of the transformation process. The real challenge, however, comes in the third part where the writers try to draw conclusions from the uneasy discussion of their own empirical evidence which often refuses to fit in the "good" policy statements that remain unquestioned in the text.

Even in spite of this basic methodological problem which marks the Report, three points of crucial significance emerge and reveal some important aspects of the reality of socio-economic transformation. The first point has to do with the nature of the market economy. The Report clearly shows that a market economy is much more than a series of self-regulating markets where atomistic individuals exchange marketable rights to maximize their own self interest. The market system requires a whole set of market institutions both to enable the functioning of the market and to regulate or supplement it in order to protect social peace. As explicitly recognized in the Report, the disappearance of planning institutions before new market institutions could develop constitutes a significant part of the problems recently encountered in former centrally planned economies. The fact that some of these problems could be avoided in China, too, is explained, at least in part, by the more gradual dismantling of old institutions in these countries (World Bank 1996: 26-27). The problems generated by the absence of proper legal and financial institutions, as well as the social and human costs generated by recently deteriorated education and health services, largely constitute the subject matter of the second part of the Report and they reveal how important market-supporting institutions are. The discussion, especially in this second part, clearly shows that a market economy does not emerge spontaneously, but needs to be instituted by deliberate state intervention. Quite expectedly, there is no reference to Karl Polanyi's work in the discussion of these issues. Yet, the following statements from the *Great Transformation* would fit in very well: "There was nothing natural about laissez-faire; free markets could never come into being merely by allowing things to take their course.... The road to the free market was opened and kept open by an enormous increase in continuous, centrally organized and controlled interventionism. To make Adam Smith's 'simple and natural liberty' compatible with the needs of a human society was a most complicated affair" (Polanyi, 1957: 139-140).

The discussion on privatization, too, is of a nature to challenge several widely shared misconceptions concerning this issue. The experience of privatization in former centrally planned economies as it is presented in the Report shows, first, that there are different methods of privatization and the success of enterprise restructuring depends on which method is chosen. The right method, in its turn, depends on the circumstances which vary between countries and industries. Second, the information presented in the Report indicates that state economic enterprises can be reformed and can function efficiently regardless of the ownership form. Related, to this is that successful economic performance is possible without extensive privatization of public enterprises. In fact, countries which are, according to the writers of the Report, among the most successful reformers, namely Poland, China and Vietnam, are those where extensive privatization of state economic enterprises remains limited (World Bank, 1996: 46 and 49). Third, the writers argue that "privatization is not the end but the beginning of the enterprise reform process"(World Bank, 1996: 5) and the development of regulatory systems, especially in the area of natural monopolies is important (World Bank 1996: 57). The discussion on privatization, in its totality, indicates that privatizing public enterprises, especially large and medium-sized ones is not at all easy. It is especially not easy without causing discontent among workers, that might lead to important social tensions and political problems.

The importance of political problems that the process of transformation involves is another issue which is extensively discussed in the Report. As the writers argue, the process is essentially political because it creates winners and losers and generates conflicting interests that must be managed in the absence of a social security system (World Bank 1996: 5). In such a setting, the social and human costs of economic reform, such as unemployment, absence of social security, increasing inequality and poverty, might create a widely shared discontent about the transformation process. Such discontent would be enhanced if, as it is discussed in the Report, enterprise reforms lead to the concentration of "economic and political power in the hands of a domestic elite or foreign investors rather than expanding an independent and decentralized middle class" (World Bank 1996: 53). The writers of the Report are clearly aware of the dangers that such public cynicism might entail and they argue that it is extremely important to convince the masses that they are to benefit from socio-economic change. In fact, the very last sentence of the report highlights the significance of public approval of reforms: "In the last analysis, transition's reforms will not bear fruit unless they are underpinned by a broad political and social consensus. Developing this is perhaps the greatest priority of all" (World Bank 1996: 147).

It is impossible not to appreciate the significance of these three points that come out of the discussion presented in the Report. Yet the position that the Report adopts on some policy issues with long term implications often contradicts and seriously undermines the insights mentioned above. In certain areas its general policy approach appears especially problematic.

The timing and sequencing of reforms is one of these areas. In this area, the Report discusses, first, the views in favor of rapid or gradual reform and opts for rapid, determined, and sustained reform policies in the realm of liberalization and stabilization while admitting that privatization can take more time and institutional reform will inevitably be completed at a later stage. This position, in fact, is not very different from the one adopted in The World Development Report 1991 (145-146) and it is maintained in spite of the experience of economies, which meet the writers' criteria of economic success such as China and Vietnam, where a cautious attitude toward liberalization and stabilization was adopted and a gradual path to reform was chosen. In this regard, the Report suggests that the path to gradual reform was not open to European countries and to the former Soviet Union because of political and structural reasons (World Bank 1996: 10-11). This point, which might be a valid one, is not developed at length and the position in favor of rapid reform is sustained more on the basis of theoretical conviction and of passing references to experiences of fast recovery and rapid growth in some developed market economies than on the basis of empirical evidence from former centrally planned economies (World Bank 1996: 41). It is thus argued that "strong liberalization and stabilization help transition economies to correct inherited inefficiencies and macroeconomic imbalances and move to a path of secure and rapid growth" (World Bank 1996: 41) As to the timing of privatization, although the Report recognizes that it might be delayed, it is nevertheless suggested that the subsidies to public enterprises should be cut and restructuring of public enterprises before their privatization is not to be recommended.

This position is very problematic in the light of the recent experience of the severe recession experienced in countries where the fast reform option was accepted. The Report itself documents the dimensions of the economic crisis and shows that in many ways it was worse than the Great Depression (World Bank 1996: 26). Yet, a fatalistic attitude is adopted in this regard and the totality of the disasters including increasing disease and mortality rates due to dietary deficiency, inadequate health care, and unbearable stress following rapid social change are treated as unavoidable short-term consequences of transformation. To morally justify such an attitude is difficult in itself. Moreover, as several economists have argued in detail, the recessionary impact of rapid liberalization and stabilization in an atmosphere of almost total institutional vacuum was devastating not only in the short term, but also for long term growth and development.

The recession was extremely harmful for long term social progress because it came at a moment when the development of civil society was on the agenda. This was a project which had, as its necessary condition, the involvement of the masses in the reconstruction of society. In societies formerly dominated by communist parties, the task was difficult enough (Hausner, 1995; Wallace, 1995). Mass participation in the reform process has become almost impossible after the recession because the latter, with all the human costs it has entailed, has made the majority of people naturally feel that the reform process was leaving them behind. The abrupt cut in the subsidies to public enterprises, which not only created unemployment but also dismantled much of the enterprise based social security, was of a nature to accentuate these feelings of alienation. These subsidy cuts are defended in the Report not only for the success of stabilization policies, but also "for freeing workers to respond to market signals" (World Bank 1996: 47, 48, 76-77, 84). The workers, who were supposed to do this when markets with appropriate signals were still being formed and when private investment was severely curtailed in the recessionary environment, naturally found it quite difficult to appreciate this new freedom. Thus, the nature of the newly emerging forms of citizenship and the modification of the relationship between the state and the individual were seriously affected, in a very negative way, by the priority given to the success of short term economic policies.

The recession, by hampering the growth of private investment, both domestic and foreign, has also created important problems for the restructuring of production. These problems are clearly revealed in the deindustrialization observed in countries where rapid reform option was accepted, but *not* in gradual reformers like China and Vietnam. The Report documents this process of deindustrialization (World Bank 1996: 33), but, somewhat surprisingly, it does not give any information about the sectors that are hit by this process of deindustrialization. Similarly, there is no information areas where the economies under investigation can or cannot be competitive in international markets. However, there are several studies which suggest that among the damaged industries, there are those which are competitive or have potential comparative advantage (Gowan, 1995; Nielsen, 1995; Taylor, 1994). The position of the former centrally planned economies in the international economy largely depends on the effective restructuring of such industries which should not be sacrificed to the success of short term policies of liberalization and stabilization. The abrupt cut of subsidies to public enterprises, should also be considered in the light of viable long term industrial strategies.

Nevertheless, it is precisely the basic elements of such industrial strategies that are not included in the Report which has a clear position against industrial policy. According to the writers of the Report, successful industrial policy requires, "disciplined and well-trained bureaucracies, stable and prudent macroeconomic policies, and a long-standing emphasis on export promotion and international competitiveness. In their absence, a proactive industrial policy runs the risk of continuing the costly subsidization of firms with political clout while shutting out others with the potential to succeed" (World Bank 1996: 47).

I believe that the empirical reality of the transformation process calls for a serious consideration of the inverse argument. In the absence of well-functioning markets with proper market signals, in the absence of developed capital markets and other financial institutions, and given the danger of destruction that potentially strong enterprises face in an environment of uncertainty that hampers the new entry of equally strong ones, industrial policy is especially important for the restructuring of the economy (Nielsen, 1995). It is precisely "stable and prudent macroeconomic policies" and the "emphasis of export promotion and international competitiveness" which require that the arguments for industrial policy should be taken seriously.

Successful industrial policy, in its turn, requires a thorough appraisal of the productive potential of the economy where it is to be implemented. This productive potential includes not only the material structure of capital and technological know-how, but also institutional and behavioral regularities which are historically given. It includes, in other words, people's ways of competing and collaborating with each other, their ways of acquiring and processing information, their ways of defining their expectations of and responsibilities toward each other. Some of the society specific habits that shape individual and institutional behavior in these areas might not be conducive to economic efficiency and some unlearning in these areas can indeed be desirable. Some of them could, however, be successfully mobilized in the process of socio-economic transformation. What seems to be impossible is the imposition of a totally new set of behavioral regularities in complete disregard of the existing ones.[2] One would expect, therefore, to find, in such a comprehensive document as the last *World Development Report*, some information about the society specific ways of doing things in different countries as the basis of organizational reform and industrial restructuring. Nevertheless, in the Report, the legacy of central planning is discussed almost exclusively with a view to repeat the very widely known inefficiencies of the system.[3]

This last statement should perhaps be qualified with reference to those

---

2 This is perhaps better recognized by those working in the field of organizational analysis than anybody else. See, for example, Child and Czegledy (1996).

3 The inefficient, as well as unfair and undemocratic nature of the "actually existing socialism" is, of course, undeniable. It is, in fact, all the highly unpleasant features of the former system which have, at least in part, made it possible for Western experts to impose a pure model of market economy, which has not been successfully implemented in any Western country, on the former centrally planned economies without much critical reaction and popular opposition. On this subject, see, especially, Glasman (1994).

passages in the Report where the achievements of centrally planned economies in high levels of basic education and health are recognized. Even in these areas, however, radical changes are recommended with reference to the inappropriateness of existing education and health institutions for "the flexible and ever-changing demands of freely competitive markets" (World Bank 1996: 123). In the area of health and education, as elsewhere, it is on the basis of the requirements of these demands of freely competitive markets that the writers of the Report argue for a wholesale transfer of policies, institutions and managerial practices from the West to the East.

Hence, the Report constitutes an attempt to contribute to a process of "transition" whereby the elements of a given social system are converted into those appropriate for a pure market system. As Child and Czegledy (1996) have argued, the problematic nature of such an attempt is implicit in the use of the term transition instead of transformation. Transition implies a linear movement from one well-defined system to another. Transformation, on the other hand, denotes an open-ended process whose results would depend on the balance of international and national forces that act upon each other in different social contexts. The choice of one term over the other in the analysis of the current problems of post-communist countries is not a simple semantic matter. It reflects, rather, dominance of one paradigm of social change over others.

The term transition fits well, of course, in the paradigm of economic modernization that dominates the last *World Development Report*. Nevertheless, the writers are not always able to push aside empirical observations that challenge this paradigm. Thus, they manifest, at times, an awareness of many different policy options and institutional arrangements which cause a good deal of diversity in what is simplistically called "the market system". They discuss, for example, different financial systems of different market economies among which the former centrally planned economies might choose (World Bank 1996:104). Similarly, they suggest that at some point these economies will be faced with the choice between "liberal" and "social" market economy models (World Bank 1996:111). More significantly, they explicitly state, albeit without much elaboration of the statement, that "the mass of centrally planned economies was far from a monolithic entity. It was composed of countries with different histories, cultures, and resource endowments... There is ... tremendous variety in the departure point, strategy and outcomes of transition across countries" (World Bank 1996:.3).

In spite of this very clear statement which points to the possibility of many different paths of historical change, the writers remain exclusively concerned with the imposition of a social model with well-defined institutional and behavioral norms on societies whose historical specificities are simply disregarded. While this concern clearly defines the objective of the Report, the latter cannot disregard all the data provided by the recent experience of the countries under investigation. This evidence highlights the futility of the task undertaken by the writers of the Report which, consequently, appears as a document full of contradictions. The fact that all these contradictions are overlooked in an attempt to rescue a paradigm severely challenged by evidence to the contrary might be explained with reference to economic and political interests of Western developed countries and the role that international organizations such as the World Bank play in promoting these interests. Yet, there is also a second explanation which might be formulated with reference to the literature in philosophy of science and methodology of economics where one can find many examples of the tenacity with which a scientific community often clings to theories which are falsified by empirical facts. I think that both explanations are worth considering in the evaluation of the last *World Development Report*.

References

CHILD, J. and CZEGLEDY, A. P. (1996), "Managerial Learning in the Transformation of Eastern Europe", *Organization Studies*, 17(2), 167-79.

GLASMAN, M. (1994), "The Great Deformation: Polanyi, Poland and the Terrors of Planned Spontaneity", *New Left Review*, 205, 59-86.

GOWAN, P. (1995), "Neo-Liberal Theory and Practice for Eastern Europe", *New Left Review*, 213, 3-60.

HAUSNER, J. (1995), "Contradictions and Dilemmas in the Development of Post-Socialist Societies" in Marguerite Mendell and Klaus Nielsen (eds.), *Europe: Central and East*, Montreal: Black Rose Books.

KORNAI, J. (1990), "The Affinity Between Ownership Forms and Coordination Mechanisms: The Common Experience of Reform in Socialist Countries", *Journal of Economic Perspectives*, 4(3), 144.

POLANYI, K. (1957), *The Great Transformation*, Boston: Beacon Press.

TAYLOR, L. (1994), "The Market Met Its Match", *Journal of Comparative Economics*, 19, 64-87.

WALLACE, C. (1995), "Citizenship and Social Policy in Post-Socialist Europe" in Marguerite Mendell and Klaus Nielsen (eds.), *Europe: Central and East*, Montreal: Black Rose Books.

WORLD BANK (1996), *World Development Report 1996: From Plan to Market*, Oxford University Press.

——— (1991), *World Development Report 1991: Challenges of Development*, Oxford University Press.