The Transition Economies: Eastern Europe and Central Asia

After the fall of the Berlin Wall in 1989, a neoliberal counter-revolution occurred within most of the former Central and Eastern Europe including the former Soviet Union. The countries in this region rejected all hybrid forms of market socialism on the grounds that this so-called ‘third way’ had proved to be unworkable. Kornai (1986) played a major role in that radical shift of Eastern European elite on the efficiency and reformability of socialist systems.

Neoliberalism has been implemented abruptly (as in Poland) or through a more gradual economic transformation (as in the case of Hungary). This predominant ideology has been invoked to legitimize the privatization of the state-controlled economy, the liberalization of trade and external payments, and deregulation and stabilization policies. In the transition economies, the shock therapy model was defended as a means of ensuring high rates of economic growth, to lock in economic reforms, to boost investor confidence and to protect the transition process from vested interests.

There were obvious political considerations behind the one-leap school, which could also be captured by the images of ‘big bang’ or shock therapy. Its partisans argued that it was essential to make a clean break with the past and to take maximum advantage of the ‘window of opportunity’ created by the euphoria following the collapse of the Berlin Wall (Sachs, 1993, 1995; Klaus, 1997). Eastern European reformers, the Bretton Woods institutions and individual international advisers argued that it was imperative to exploit an exceptional moment to reach a point of no return in the process of transition. Radical systemic changes were possible during the time
period when popular support for transformations was strong. Indeed, the historic context was purportedly unique and marked by strong expectations of long-repressed populations for a better life. The deterioration in living conditions was accepted as temporary and linked to the necessary changes viewed as prerequisites for a 'healthy' growth.

5.1 The socioeconomic cost of transition

The reformers in charge of the systemic transition have clearly condemned a past social policy that was associated with an economically irrational and premature welfare state (Kornai, 1997). The inter-systemic reforms led to the destruction of the socialist welfare states through the development of the labour market, privatization, the end of subsidies for basic commodities and the redefinition of the role of the state. Forecasts of the advocates of shock therapy about a rapid recovery turned out to be wrong. Both the economic recession and the social costs have been greater than anticipated (Bhalla and Lapeyre, 1999). Output and employment slumped to a degree unknown in Europe since the Great Depression. During the early 1990s real gross industrial output fell by about 40 per cent in Eastern Europe as a whole (UNECE, 2000 p. 228), unemployment reached unprecedented proportions, and poverty and inequality increased massively throughout the region (see Chapter 3, Table 3.2). Notwithstanding differences between advanced and less advanced reformers in respect of the phasing of reforms, large degradations in living conditions occurred throughout the region and a stagnant pool of jobless and poor people has emerged (Cornia, 1996).

The most remarkable event during the first phase of transition was a tremendous contraction of output experienced by all the countries of the region (Mundell, 1997). The break-up of the communist political and socioeconomic system and the building up of market systems through, in many cases, shock therapy supported by the Bretton Woods institutions was followed in practically all countries by draconian falls in production, employment and public social expenditure. Between 1989 and 1993, real GDP fell by 15 per cent in the five countries in Central Europe, 32 per cent in Southeast European states, 42 per cent in the Baltic States and 30 per cent in the ex-Soviet Union republics (UNECE, 1997, p. 89).