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Transition Economies

Transition economics are countries with economies in transition that abandoned state socialism and central planning and have been attempting a move to capitalism. The central process of economic transformation typically involves three fundamental, revolutionary, systemic changes, including liberalization, macroeconomic stabilization, and structural adjustment through commodification, marketization, privatization, and the reduction of the role of the state. Broader mechanisms of economic transition involve the incorporation of transition countries into the world economy as well as the establishment of cultural attitudes, political, legal, and societal institutions supportive of and conducive to the continuous accumulation of capital through profit and investment. The successful creation of a thoroughly new, capitalist mode of social and economic organization should herald the formal end of transition economies as a meaningful descriptor.

In general, 34 countries and areas have been identified as economies in transition. They spread from Berlin to Beijing, Tallinn to Tashkent, across central and eastern Europe, Russia, Transcaucasia, and central, east, and southeast Asia. Somewhat similar to the emergence of markets in the developing world, the declared rationale behind the transition economies' drive to capitalism lies in the ultimate goal to achieve developmental catch-up with the industrialized nations of the West.

Transition: From Plan to Market

Prior to the start of gradual market-oriented reforms in China in 1978 and before the radical anticommunist revolutions in Eastern Europe of 1989–91, state socialism was the primary doctrine of economic development and modernization across Eurasia. The main features of state socialism as a society included a state-owned, centrally planned economy, administered and controlled by a dominant communist party. On the basis of the ideology of Marxism-Leninism and through the capacity of the state, the Communist Party sought to mobilize the population to build an industrial and classless society. Despite considerable achievements of state socialism in terms of industrialization, economic development, low income differentials, full employment, good education, and health care, by the 1980s, it had become clear that capitalism was proving to be more successful as a system of production and consumption on a global scale. State socialist countries had failed to catch up with the core of the capitalist world economy. In response, most of these economies rejected central planning and embarked on a transition to capitalism.

To build capitalism, the transition economies were provided with policy advice, reform guidance, and some monetary assistance by the Western donors and international financial institutions such as the International Monetary Fund (IMF), the World Bank, and the European Bank of Reconstruction and Development (EBRD). The structural adjustment program, which had previously been implemented in Latin America, was consequently redesigned in 1989 in a more comprehensive fashion to fit the task of building capitalism from scratch. Dubbed the "Washington consensus" because of the location of the IMF and the World Bank in the U.S. capital city, the radical all-out transition approach called for rapid price and trade liberalization, accompanied by strict macroeconomic stabilization; the privatization of state-owned enterprises; the liberalization of labor and capital markets; tough monetarist fiscal consolidation through ending subsidies and cutting public services; rapid deregulation; and creation and the immediate opening of markets to entry by newly-created private businesses and foreign transnational corporations.

Simultaneously, a wide range of other structural and institutional changes, such as destatization, the market-oriented reform of the social protection sector, the tax system, the legal system, accounting standards, and so forth, had to be initiated as well. These "shock therapy" measures became a general prescriptive mechanism to ensure the transition of post-communist countries toward the economic model of the so-called free enterprise economy epitomized in the Anglo-American system of competitive capitalism and limited government involvement. The widely held belief at the time

was that a rapid expansion in total output and a progression from a lower to higher level of development, understood broadly as raising the living standards of individuals in those countries, would follow almost immediately after the government restrictions on people's commercial activities were removed.

The 1990s

Contrary to such popular expectations, however, the 1990s turned out to be a lost decade for most transition economies. The ensuing transitional recession was to last for six years on average across central and eastern Europe and the former Soviet Union, ranging from two years in Poland to 10 years in Moldova and Ukraine. In terms of its scale, the deepest slump in output was suffered by Bosnia and Herzegovina (with a decline of 88 percent), Georgia (minus 75 percent), Armenia (minus 69 percent), and Moldova (minus 68 percent). Only four countries (the Czech Republic, Uzbekistan, Poland, and Slovenia) managed somewhat milder recessions, loosing between 15–20 percent of Gross Domestic Product (GDP), whereas the scale of depression in the other remaining economies in the region ranged between 30–60 percent.

It has been argued that because of the often substandard quality of Soviet bloc production, the real welfare-reducing impact of the transitional depression was lower than the official GDP figures seemed to indicate. Yet the collapse of production also meant the end of employment, and the resultant job losses were massive. Large proportions of the redundant labor force had to withdraw from economic activity altogether, either migrating abroad or relying on informal survival strategies at home. Unemployment levels reached double digits in most transition economies, peaking around 20 percent in relatively successful Poland and Slovakia, and rising above 40 percent in the areas affected by civil strife and political instability. All the evidence based upon the broader human development indicators, including life expectancy, infant mortality, demographic growth, income distribution, headcount poverty, and educational attainment suggest a very significant social cost to transition across the region.

Varieties of Emerging Capitalism

The spatial impact of economic transition was very uneven. The transition to capitalism produced a great divergence in outcomes between the different geographical blocs of transition states, between different individual countries, and between urban and rural areas within those countries. Most of the initial variation in the output performance of central and eastern Europe, compared with the former Soviet Union in the 1990s, is explained by the inherited structural liabilities and exogenous "transition shocks" caused by the collapse of centralized planning and the communist trade system, the disintegration of the Soviet Union, and the associated detrimental effects of disorganization and trade implosion on the respective transition economies. It is notable in this regard that the sharpest decline in output occurred amid chaos in war-ravaged countries like Bosnia and Herzegovina, Georgia, Armenia, Moldova, and Tajikistan. By contrast, the gradually reforming transition economies of east and southeast Asia, as well as the three former Soviet republics (Belarus, Turkmenistan, and Uzbekistan) that did not follow the "shock therapy" approach, generated a very different growth trajectory, either postponing the potentially severe economic dislocation or, perhaps, avoiding it altogether.

Despite substantial differences that exist among the transition economies, since 1999, all of these countries have been on a steady path of growth, with the majority enjoying a rapid economic recovery and further expansion. In terms of prospects for catch-up development, the average income disparity between the richest and the poorest transition economy grew during the transitional depression, peaking in 1999; yet it slowly decreased since, dropping from the ratio of 21:1 to 14:1 by the end of the 2000s. With respect to approaching Western standards of living, the transitional depression of the 1990s proved to be a major setback, as these economies' average per capita income on the purchasing power parity basis dropped to just 15 percent of the U.S. level. Within the following decade, the original income differential was restored and projected to reach up to 30 percent of the U.S. level by 2013.

Beyond Transition

On a more disaggregate level, four different post-transitional regime types can be identified as a succinct way to summarize the major outcome of transformation across post-communist Europe and Eurasia. The first regime type includes politically unstable, war-damaged countries that have had to rely on substantial foreign assistance and workers'

remittances to sustain a model of chaotic uncoordinated capitalism. In the second group of gradual or "lagging" reformers, state-led or statist capitalism has emerged in combination with firm authoritarian rule. These transition economies all appear in the low- and lower-middle-income groups within the World Bank's development classification scale. Most of them have remained on the medium level of human development as well. However, in sharp contrast to the uncoordinated capitalist economies, state-led capitalism has been characterized by high growth rates propelled mainly by strong manufacturing exports.

Another distinct type of the newly emerged market economies covers the whole of Central Europe, the Baltic states, and the outlying parts of the Balkan region. These countries have already reached or have closely approached both the average Western standards of income and consumption, as well as of human development. In contrast to all the other post-transitional regimes, countries in this third group are usually described as consolidated democracies, with well-established pluralist and civil society tendencies. Capitalism in these states has acquired a certain affinity with the continental European model of coordinated market economy. The notable exceptions are the deregulated liberal market economies of the Baltic region. In general, the third group of transition countries has firmly allied itself with the European and Euro-Atlantic economic, political, and military structures.

Finally, there is a very diverse intermediate fourth group of the transition economies, covering primarily the former Soviet republics. These countries are broadly positioned in the middle of the global developmental ladder. Politically, they are not formally allied with the West, although these economies' dependence on the Westbound export-driven growth has been by far the most considerable among all other transition states. Despite some spectacular exceptions, these countries generally have not continued with the adoption of a Western-style polyarchy. Institution-wise, these economies are characterized by open trade and fluid product, labor, and capital markets. However, the level of political involvement in the economy is more evident in this post-Soviet group than in Central Europe and the Baltics. An additional feature of these intermediate grouping is that its richest economies have benefited greatly from exporting primary commodities and raw materials, including oil, gas, ores, and minerals.

The future developmental prospects and potential of transition economies depend ultimately upon the progress achieved to date, favorable global market conditions, and the overall sustainability of their social formations, types of emergent capitalism coupled with particular modes of political regulation. Nonetheless, because economic development is a cumulative, combined, and unequal phenomenon, a lot of the economies in transition will hardly ever be able to catch up with the rest. Hence, for them transition is to become a permanent condition.

See Also: Capitalism; Chicago School/Chicago Boys; Core; Dependency Theory; European Bank for Reconstruction and Development; Periphery; Socialism; World Bank.

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