

# The ECONOMIC JOURNAL

Vol. 112, No. 477 (February 2002)

Michael Kaser  
University of Birmingham and Oxford

Review of books

*Incentives and Institutions: The Transition to a Market Economy in Russia.* By Braguinsky (Serguey) and Yavlinsky (Grigory). (Princeton, NJ: Princeton University Press, 2000. Pp. xi+282. ISBN 0 691 00993 7.)

***From Shock to Therapy. The Political Economy of Postsocialist Transformation.* By Kolodko (Grzegorz W.). (Oxford: Oxford University Press, 2000. Pp xi+457. ISBN 0 19 829743 2.)**

In the ten years since 29 countries (22 of them newly to become politically independent and one, the GDR, to federate into Germany) took the path of systemic transformation towards democratically-governed market economies, most economic analyses of their policies and experience have been written by those resident outside the region, leaving competent economists of the region in the main to devote their professional efforts to managing, or advising on, the transition in their own country. Both books under review benefit from the personal engagement of their authors in national political life: Yavlinsky, a Deputy Premier under President Gorbachev, was a presidential candidate in 1996, and leads a reformist party in the Russian parliament; Kolodko was Minister of Finance and First Deputy Prime Minister in Poland's most dynamic reform period, 1994-7. Each has a chapter posing the question of choice of destination, 'Where do we want to go?' in the one and 'Where to?' in the other. Both agree that it was not being reached along the transition path initially mapped by the 'Washington Consensus' of the international financial institutions (IFIs), and conclude that 'they probably do not share a similar destiny in terms of institution building or economic and cultural development' (Kolodko, p.344). The exemplar for Braguinsky and Yavlinsky is Russia, but Kolodko considers all 29 transition economies in relevant detail and reflects also on Cambodia, China, Laos, North Korea, and Vietnam, the five communist-run states where political demonopolisation has not accompanied varying degrees of economic decentralisation. Drawing upon publications of the IFIs, the EBRD, and a consultancy firm (PlanEcon), Kolodko amply fortifies his analyses by statistical tables and a forecast to 2002. On the other hand, Braguinsky and Yavlinsky offer just two short tables on Russian finance, while illuminating their theoretical propositions with a wealth of graphs of behavioural, cost, and production functions. That contrast indicates the books' respective strengths: one, as befits a volume sponsored by the research institute of the United Nations University, is the most comprehensive empirical survey yet published of world-wide transition policies, and the other formulates an impressive theoretical apparatus on policy choices and outcomes under imperative (in the extreme, dictatorial) planning and under markets with autonomous 'post-state-owned enterprises'. Where once an analyst of the Soviet economy could write the 'administrative economy seems an intractable problem for economies in its present form' (Campbell 1966, p.203), Braguinsky and Yavlinsky argue that a fundamental inefficiency (by comparison with outcomes from a market mechanism) of the 'hierarchical ownership of

assets' arises when the innovations which would induce growth in a market economy are inhibited by the distance (isolation) of the hierarch and close associates (the central planners) from the activities that can be enhanced by such innovations, and when heavy deadweight costs are incurred as the former – *qua* principal – monitors the economic activity conducted by the latter – *qua* agents. Pursuing their argument of conflicting motivations into political economy, they show 'hierarchical ownership' is incentive-incompatible with free democratic elections. Kolodko also begins his book with incompatibilities inherent in the former planning mechanism, notably by the inability of the principals to impose hard budget constraints on their agents. Reviewing the history of the communist countries, he sees until the 1980s governments applying elements of a market system to correct the shortcomings of central planning, whereas in the reformist countries of the 1980s central planning was intended to be employed only to correct the perceived negative effects of a market mechanism.

The core of each book is explanation of the change of institutions and the recession of economic activity of the 1990s – in all relevant states of Kolodko and in Russia by Braguinsky and Yavlinsky. Contrastingly, the former praises gradual institutional change as having in Poland yielded in that period the quickest recovery of measured GDP, while the latter find in Russia a case of insufficient institutional change 'which locks the transition economy into the inefficient path' (page 14). Thus starkly put, the one advocates, in the terms of the policy debates of the early 1990s, 'gradualism' and the other 'shock therapy'. Kolodko, indeed, is scathing in criticism of the policy of his ministerial predecessor, Leszek Balcerowicz – 'one giant queue of unemployed replacing the innumerable queues for goods, while the welfare of employed workers was worsened by job insecurity' (page 106) – and of attempts by governments in eastern Europe and their IFI advisers to minimise the losses endured after 'shock without therapy': 'the systemic and development policies were wrong and the market failed' (page 108). For Braguinsky and Yavlinsky the Russian economic structure was insufficiently changed after decontrol and deregulation in 1992 and its transition was 'not yet to a market economy, but rather to its 'post-planned' state' (page 107), the incentives within which were dysfunctional with respect to both welfare and efficiency. Both books in this phase of their analyses investigate the role of the 'parallel' economy, i.e. legal (other than in tax avoidance) and illegal activities which are not registered in official statistics. But they offer opposing explanations for its growth during transition, one because government is too 'small', the other because it is too 'big'. Kolodko points *inter alia* to its negative effects on allocative efficiency, propensity to save and income distribution, and sees it as having arisen from the withdrawal of state control and regulation which 'usually means that institutions are weaker and that the shadow economy is larger' (page 259). Braguinsky and Yavlinsky perceive it as a substitute 'of a very crude, harsh and above all inefficient nature' for market relations inhibited by the 'rent seeking and other predatory activities' of government officials, who themselves preferentially serve the interest of corporate 'oligarchs' (pages 194-5).

Braguinsky and Yavlinsky closed their account of their country's 'inefficient 'quasi market' economy' before Boris Yeltsin was replaced in the Russian Presidency by Vladimir Putin, who early promised to 'distance the oligarchs from power', but they envisage another book to describe the measures needed for 'the creation of a polity with built-in incentives for its members to act as social coordinators, not as private profit maximisers, as most members of this polity currently do' (page 267). Kolodko, also writing before the presidential change, regards Russia as 'caught-up in a systemic vacuum, with neither the plan nor the market' and concludes for those countries not candidates for early entry into the European Union that 'at least a generation is probably needed to complete a successful transition from postsocialist economy to a market economy' (pages 345-6).

MICHAEL KASER

