The Review of Austrian Economics, 15:1, 61–74, 2002.

Is There an Austrian Approach to Transition?

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Abstract. This paper discusses the meaning of the term "transition" and its implications for policy making. It is suggested that an Austrian view would enhance a better understanding of what has been happening in Central and Eastern Europe in the past decade. Within this framework, the analysis should be based on three criteria: acquisition of knowledge, individual responsibility, free entry. It concludes that future transition analysis should devote more attention to the way a number of subjectivistic features drive institutional change, as well as to the features of the new opportunity sets made available to individuals.

JEL classification: P20, A11, B41.

1. The End of Transition and its Consequences

Central and Eastern-European Countries (CEECs) are still referred to as "transition economies". In this context, the term "transition" is of course meant to convey the notion of continuous structural change, say from a central-planning archetype to a free-market ideal. Yet, ten years have already gone by since the political collapse of the centrally-planned regimes. Although the traits of these countries show constant change (as it happens in any economy), some general features have already come to the surface fairly explicitly. As such attributes become clearer and clearer, the more misleading and harmful it is to assign the post-communist economies a special standing, worthy of special treatment and support, allegedly to ease and speed up their conversion. Put differently, we believe that if transition were over, transition policy would be inappropriate to say the least.[1]

This paper discusses the usual approaches to transition and questions the very meaning of this term. It is maintained that in its present form the orthodox literature doesn't provide many insights into the way CEECs work and evolve, and may actually lead to wrong conclusions from the normative standpoint. At the same time, it is argued that the transition literature may still play a role, but only if it addresses entirely different issues, possibly derived from an Austrian perspective.

Transition is currently defined as the period of time it takes for new institutions and organizations to be introduced and upheld,[2] for agents to learn how to operate according to a reformed system of property rights and adjust to hitherto virtually unknown rules of the game. This applies to the man in the street, as well as to policy makers and bureaucrats.

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I am grateful to K. Leube, S. Pejovich and J. Vromen and two referees of this journal for their comments on a preliminary draft of this paper. Previous versions were presented at seminars organized by ICER (Torino), by the Berger International Program (Cornell Law School), by the University of Gent.

1.1. On the Orthodox Economics of Transition ...

In order to evaluate the time span of transition, two extreme views can be appraised. Let us call them the public-choice and the institutional pictures, respectively. According to the former, one would argue that all economies are always in transition, for institutions change continuously under the pressure of interest groups. Some agents are then active to promote or resist change, others strive to adjust to new situations. Further groups may be trying to violate the constraints imposed by the given rules and search for supposedly better solutions.

On the other hand, the institutional view considers (economic) transition as the relatively short period of time which follows an unanticipated shock. During this period a significant change in the constitutional system takes place, e.g. from a one-party system to a multi-party, Parliamentary democracy. Innovative rules of the game are therefore introduced. The composition and bargaining power of the various coalitions are affected, and new evolutionary paths can be detected.[3]

1.2. ... and its Limits

In these terms, transition economics *per se* does not advocate any particular teleological or methodological feature. At most, it refers to the analysis of the gap between the declared objectives of the technocrat or the policy-maker, and the actual state of the country. It then follows that the role of the transition economist is to monitor the so-called transition agenda, offer proposals as for the best way to accelerate the reform process, identify intermediate steps, possibly revise the set of objectives that are supposed to be attained. By and large, this is actually what economic commentators do on a daily basis on virtually all Western newspapers. And it is perhaps not surprising that this is also the traditional view about the economics of transition in Central and Eastern Europe.

The proposals generated by this orthodox attitude are of course far from uniform. But they all try to focus on the questions briefly outlined above. For instance, both shock-therapists and gradualists—to name but the two most important parties—end up by offering more or less feasible policy solutions to the observed bottlenecks, sometimes combined with sophisticated analyses or attempted answers required by the inevitable institutional abnormalities.

1.3. Towards an Austrian Approach to Transition

Nevertheless, the institutional approach is susceptible of an interesting extension. If transition is identified with the constitutional moment immediately after the breakdown of the incumbent institutional system, the focus need not be on whether the desired results have been obtained. Instead, and consistently with the Austrian approach, the emphasis can easily shift away from institutional engineering, towards the analysis of the set of formal and informal constraints which affect individual behaviour. Indeed, from an Austrian perspective the features of the optimum—i.e. desirable—institutional arrangement(s) have no relevance at all, since the presence of substantial transaction costs makes sure that such an optimum state will never be reached. By contrast, the incentive structure is much more important, for it determines the economic and institutional dynamics of the country, irrespective of whether the outcome is desirable or not. Hence, the important question to debate is no more whether transition is successful and how long it takes for it to be successful; but whether the change in the incentive structure evolves continuously, or just in the presence of significant shocks.

The essence of the paper is thus the following. It will be argued that the change in the incentive structure tends to be discrete, rather than continuous; and that it is usually triggered by exogenous shocks. As a consequence, the economics of transition tends to apply to fairly short periods of time. The standard approaches may be relevant in order to analyze situations whereby there exist persisting gaps between intended results and actual results; or when a catch-up process is under way. Their descriptive power may even be considerable. But they have limited explanatory capacity in terms of positive economics, and virtually no normative implications.

2. The Positive and Normative Economics of Transition

2.1. The Neoclassical Failure

There is a rich and still growing literature on the neoclassical approach to transition, and on why it failed to perceive both the initial situation in Central and Eastern Europe, and the dynamics of transition afterwards. Therefore, only the main points will be mentioned here.

As a matter of fact, it is hard to identify the features of the positive neoclassical economics of transition. The cause for that are the simplistic assumptions and rigidities of this theoretical framework. By assuming transaction costs to be some sort of a short-term nuisance, no uncertainty, and virtually no role for entrepreneurial behavior, neoclassical economists have little reason to differentiate between the various kinds of economies. In particular, a communist economy is deplorable in that relative prices are distorted by the central planner, so that the economy performs well inside the production-possibility frontier it might have attained if free-market principles had been followed. Transition is thus "*the rapid, or gradual, move from a position well inside the 'production possibility frontier' to a more efficient position close(r) to the frontier.[....] a major change in the coordination and allocative system [...], a change in efficiency*" (Allsopp and Kierzkowski 1997:5).

Different distortions may apply to a developing economy—or indeed—to a developed country. In all such cases, however, there remains little scope for neoclassical positive economics, apart from highlighting the nature of the distortions and perhaps the potential gap from the neoclassical free-market ideal. In other words, the neoclassical vision includes just one sort of positive economics: That which describes the system of equilibria in the so-called Nirvana state.[4]

It follows that the normative implications for transition put forward by the neoclassical school are fairly simple. The objective of transition is identified in the transformation of all post-communist economies into free-market systems in the shortest "possible" period of time. The term "possible" reflects of course the presence of some adjustment costs. But these tend to have no practical relevance other than in the short run. And the timing of neoclassical transition turns out to be just a function of the size of the adjustment to be carried out, i.e. of the existing price and budgetary distortions, and of the opportunities to reduce such costs. Hence, the emphasis on foreign aid and loans, as a way to reduce adjustment costs and speed up transformation.

As has been mentioned earlier, the very same recipe would apply to as different countries as Russia, Georgia and Poland alike; and would not be much different from those suggested to most developing countries in the past thirty years. Indeed, it is not a coincidence that most Western economists responsible for the management of transition programs in the CEEC region were those who suggested similar programs to Asian and African developing countries, despite the questionable results accomplished.[5]

2.2. The Institutional Inadequacy

Sharp disagreement with the neoclassical approach originated mainly from institutional quarters. As is known, the institutional school perceived very clearly that the systematic failures scored by traditional development economics and textbook adjustment policies could not be explained just by referring to incompetent policy-makers or unjustified political pressures. Contrary to what is commonly claimed, however, the main thrust of the institutional objections was not on the allegedly modest role of institutions in the neoclassical context.[6] Rather, the core of the institutional tenet is the idea of path-dependence, whereby past history is supposed to affect the way an economy develops in the future.

In short, the task of the institutional economist boils down to the analysis of the rules of path-dependency. Three implications result from a positive viewpoint. First, the better one understands a given path-dependence process (variables and parameters), the greater becomes the capacity to predict the future behaviour/evolution of an economy. Second, there exist very many different path-dependent patterns. Each of them defines an economic system, which may or may not be associated with a given country or nation. Finally, when exogenous shocks occur, the functional specifications of the path-dependent process are altered. The evolution of the system after the shock can therefore be predicted only if the new specification is known well enough.

The institutional approach is undoubtedly much closer to reality than the traditional (neoclassical) view. Nevertheless, its appeal is weakened in two respects. First, although it does emphasize the importance of incentives (the rules of the game, institutions), it also recognizes that the same rules often yield diverse outcomes in different countries and in distinct historical periods. Recent research has indeed tried to overcome these ambiguities. In particular, the study of the conflicts between formal and informal institutions is promising, and may well provide conclusive answers. However, the results are not yet entirely satisfactory, and the present state of the art is either generic theories which try to explain the rules of economic behaviour, or taxonomies. As North (2000:4–5) puts it, "*We are still a long way from having a theory of economic change and the accumulated evidence we have from fragmented stories of different countries does not add up to giving us firm convictions.*"[7]

Second, this approach offers inadequate predictive power and little normative prescriptions. Economic performance turns out to be some sort of a stochastic process, possibly with a drift (the path-dependent component). Of course, shocks play an important role. And when these are substantial enough, they lead to institutional change. Their nature and the mechanics remain nevertheless uncertain.

As regards transition, the institutional view is therefore attractive in that it emphasizes that (1) the shock provoked by the collapse of the communist regime leads to new rules of the game, which nevertheless remain more or less unknown *ex ante*; (2) possible contrasts between the formal and the informal rules of the game in the various countries are likely to lead to highly differentiated outcomes; (3) the effects of the post-communist shock are over when a clear path-dependent process can be detected, although the features of path-dependency are not necessarily desirable.

But institutional economics doesn't provide recipes for change and improvement and provides only vague instruments to predict future development. While it offers a rationalization of what happens (and has happened), in fact it transforms the problem of transition into the analysis of a shock.

3. An Austrian View on Post-Communist CEECs

From an Austrian perspective, the collapse of a totalitarian regime such as the Soviet empire is a matter of interest if individuals acquire new opportunities to formulate and satisfy their preferences. In particular, if rule by means of violence disappears. In contrast with the standard views, transition is thus perceived neither as an exercise in social engineering, nor as the period of time it takes for a new path-dependent process to emerge after a shock. Indeed, it is even questionable whether a transition problem exists at all. In turn, this statement leads to two sets of claims. One concerns what the Austrian school has to say about what one usually labels as "transition economics". The other focuses on the normative implications of such judgment.

More precisely, in order to asses whether the collapse of the Communist regimes can be understood as a transition shock, a Hayekian approach would require the appraisal of three criteria: acquisition of knowledge, individual responsibility, and free entry into the market place, both economic and political.

3.1. The Acquisition of Knowledge

The Communist regime was a system in which individuals were discouraged from revealing—let alone expressing—their preferences. Institutions were designed so as to satisfy the preferences of the *élite*, restrict entry into the political market, create a *nomenklatura* who would shield the decision-makers from the citizens. The acquisition of knowledge was controlled by the political leaders and the top managerial nomenklatura, who restricted the acquisition and the exchange of information, so as to enhance their discretionary power and the opportunities for rent-seeking activities, at the firm level as well. People's mobility was also limited, especially to the West and under the rule of Stalin, when the fears of a violent counter-revolutionary movement were particularly vivid.[8]

There is no doubt that in many Central European countries the acquisition and the exchange of knowledge became much easier after the downfall of the Communist regime.

Freedom to travel, access to the foreign press and to electronic communication has enhanced the discovery process by individuals. Interactions became more intense, old preferences became legitimate,[9] and were revealed in the political arena as well as in the market place. New preferences were uncovered. Finally, expectations about the possibility of satisfying old and new needs were also raised. Within this framework, it is of course irrelevant to assess how much knowledge has been acquired by individuals, or to what extent expectations have been fulfilled. This is neither part of the shock problem, nor of the transition problem. Instead, the real issue is whether the post-communist world has made it possible for the discovery process to take place. Unfortunately, there is no straightforward answer to this question.

It can indeed be claimed that the downfall of the Communist system unleashed the discovery process in most Central European countries. Radio, television, inter-war capitalist memories, cultural heritage and sometimes deep-rooted religious beliefs had made sure that Communist ideals never succeeded in cancelling individual identities and ambitions. Despite extensive efforts, the discovery process had never been erased by the Communist leaders. It had just been paralyzed for decades. As a result, it is plausible to claim that the shock did take place in these countries, for previous biting constraints have been broken through.

In several CEECs living standards do continue to be as poor as in the Communist times, if not lower. Nevertheless, it is fair to say that even in such countries individuals have the opportunity to develop and express their preferences, pursue their own desires. The results are certainly less than impressive in—say—some former Soviet Union countries. But it would be hard to claim than in most of them information is systematically denied and that people are forbidden to develop interaction, discussion, should they wish to do so.[10] Therefore, the rather disappointing results which characterize these economies cannot be ascribed to the lack of a shock as regards the individual opportunities to engage in a discovery process. Satisfactory explanations must then be looked for elsewhere. The presence, the nature and the size of transaction costs must be evaluated; and the incentives to overcome them appreciated. For instance the role played by the technical and institutional barriers which continue to slow down foreign direct investment can hardly be overemphasized. It follows that although information and knowledge may indeed be accessible, in many a domain their transfer remains burdensome and therefore relatively modest.

3.2. Individual Responsibility and Self-Determination

As is known, the quality of free-market institutions is measured according to their capacity to (1) internalize externalities and (2) allow free entry, both in the economic and in the political arena. The former set of issues is discussed here, while the latter question will be analyzed in Section 3.3.

The role of institutions as regards externalities is by all means a very "Austrian" topic. For although this issue is often treated as an economic technicality, in fact it draws heavily on disciplines which do not belong to the economic domain, strictly speaking. This fallacy is due to the fact that the quality of institutions is usually measured in absolute terms, or at most with reference to criteria dictated by constitutional constructivism or neoclassical social engineering.[11] This would indeed be acceptable if externalities were a function of the institutional framework only. But they aren't.

Non-internalized externalities are the consequence of individual behaviour *lato sensu*. It is surely true that individual behaviour is affected by institutions. But it is also true that the effectiveness of institutions is determined by their perceived legitimacy, which is the core of their credibility and stability. In turn, such legitimacy depends on the extent to which the public at large consider the rules of the game consistent with tradition, culture, history, ethics. As De Jasay (1985:77–78) suggests, institutional legitimacy is the capacity to make people behave in certain ways even in the absence of legal sanctions.

The intrinsic circularity—if not inconsistency—of the traditional concept of institutional legitimacy—based on constructivism and legal engineering—is thus manifest. For on the one hand an institutional framework is acceptable if it is legitimate; on the other hand it is legitimate if it is accepted, i.e. if the institutional framework does not constrain behaviour. In this framework one may therefore wonder why people need (formal) institutions at all. In fact, they wouldn't, unless one of the following circumstances occur.

The first deviation from this general rule of irrelevance applies to interactions among economic agents within a closed community. When people maintain frequent and repeated ties, personal and business relationships are certainly not immune from cheating. But the short-run benefits associated with the violation of a contract tend to be less than the long-run costs it involves. Ostracism is the obvious example. Although it is clear that a system of repeated interactions gives way to a Misesian process, whereby a market system comes to the surface even in the absence of an explicit institutional framework, a formal set of rules is required when newcomers enter the picture, i.e. when production factors are allowed to move from one region to another. This is particularly true when a newcomer comes from different cultures, so that he cannot build up on its own previous experience in order to evaluate the features of possible future interactions. These difficulties can be overcome, but the cost of doing so may be substantial and discourage otherwise mutually profitable transactions. The role of a formal institutional framework is to enable new entrants to acquire better information as regards an economic system. For a (formal) institutional structure to develop this role, it must therefore codify and guarantee enforcement of (informal) rules which are already in place and widely accepted, but relatively little known to outsiders. However, attempts to enforce formal rules in contrast with those already in place would create conflicts within the incumbent agents and provide wrong and/or unreliable signals to the outsiders.

Institutions also play a role when they apply to international-trade issues. Even when only one buyer and one seller are involved, successful achievement of such simple transactions still depends on a variety of other agents. These may be harmed (competing producers) and fight to defend their rents. Or may have nothing to do with the transaction, but be powerful enough to extract a rent or a quasi-rent, from the buyers, from the sellers, or from both groups of agents. In all these cases institutions serve the purpose of reducing uncertainty, of providing a more or less temporary shield against discretion wielded by the mightier pressure groups.

The above leads to an important preliminary conclusion. The role of institutions is crucial in a truly opening economy. That is, if a country wants to be the object of a relatively fast and smooth globalization process, which affects both factor movements and international trade.[12] If so, the primary question to ask does not concern the (very simple) precepts of globalization, but rather the actual willingness to pursue such objectives. This is not just rhetoric. For globalization and free trade generate benefits only if free-market rules are accepted overall. In turn, these rules require that agents realize that the main purpose of economic activity is to reduce transaction costs, enhance entrepreneurial discovery, provide stimuli and signals to agents ready and willing to capture them.

As is known, during the Communist time in many CEECs individual welfare depended on the existence of transaction costs as a means to create rent-extraction opportunities for those who had the power to reduce such costs. Entrepreneurial activities were discouraged, acquiescence and passive obedience held in high esteem, the economic benefits due to personal interactions and trust ignored, if not denied.[13] Since the only counterpart of the individual was the State, there existed little sense of duty—let alone trust—vis-à-vis other individuals. Cheating, shirking, were and in many cases remain a matter of course. On the contrary, change was and is still feared, for it requires flexibility, entrepreneurial abilities, some willingness to accept risks and live along with uncertainty. As has been suggested so far, these features are not so common in all CEECs.

It follows that the willingness to accept the principle of self-determination and a free-market system should not be taken for granted in all CEECs. The individual behavioural patterns which are necessary in order to enforce and benefit from free-market institutions are to be ascertained. Colombatto and Macey (1998) have indeed suggested that the transition process itself can be understood as a bargaining process between different interest groups, say “old nomenklatura” and “reformers”. The final outcome is therefore affected by the relative power of such coalitions, by their perceived legitimacy and by time-inconsistency issues. Hence, it is not surprising that the old nomenklatura enjoys substantial opportunities to buy a slow or partial transition process even from the toughest reformers, who will be induced to change their initial stance, especially when support for a truly free-market regime is fragile.

Of course, mixed situations can occur. It may well be the case that individuals understand and appreciate trust and honesty not only as moral values, but also—and more importantly for the purpose of this analysis—as a way to reduce transaction costs and thus enhance welfare. But these very individuals may not have developed enough entrepreneurial qualities, may dislike uncertainty, and have a strong preference for stability. Should this be the case, they would then lack both the flexibility and the resolution necessary to undergo the textbook transition process. The opposite case—whereby flexibility and entrepreneurial abilities are present, but ethics of the market is in short supply[14]—is perhaps better known, and tend to promote crony capitalist activities, if not outright crime. The examples of some of the former Soviet Republics is telling in this respect. The existence of entrepreneurial capacities cannot be denied, as well as traits of flexibility and adaptability in important strata of the population. Yet, a substantial part of these efforts has been directed to the creation of rent-seeking opportunities, rather than to the development of a free-market economy.

Although it would lie beyond the scope of this paper, it is evident that much work needs to be done in this direction. In particular, there is a strong need to identify and understand the variables which drive individual behaviour towards market culture rather than towards crony capitalism, given the existence of significant entrepreneurial resources.

3.3. Free Entry

The third Austrian criterion to evaluate the Communist shock concerns entry (and exit) into (out of) the economic and political markets. As regards the economic side of the question, this appears to be strictly connected with the argument put forward in the previous paragraph. When entrepreneurial attitudes are scarce, and the desire for stability prevails, free entry is prevented more successfully than in other contexts. Indeed, restricted entry becomes a way to secure consensus on a very wide basis, with little need to form rent-seeking pressure groups to support political action. Incumbents producers are helped through direct subsidies, appropriate regulation, trade barriers. Inefficient producers do not necessarily disappear. Enhanced market opportunities for the newcomers often fail to materialize. Furthermore, protectionism awarded to industries under attack from foreign competition makes sure that substantial amounts of resources are locked in relatively inefficient industries, so that factor supply to the remaining industries is lower than it would otherwise be the case. In short, potential entrants are discouraged from pursuing entrepreneurial discoveries, for the expected remuneration of their "alertness" is relatively low, possibly negative. Not only bad producers fail to be displaced by better producers. But it occurs that low-productivity industries are not replaced fast enough by high-productivity industries.

As has already been aired earlier on, restrictions to free entry are questionable from a neoclassical viewpoint and outright harmful from an Austrian perspective. Nevertheless, there is enough evidence to support the thesis according to which restrictions in CEECs are imposed with approval from the overwhelming majority of the population. Today CEECs do exhibit Wicksellian majorities behind government policies to support job security, "fair" competition, globalization "with a human face", assistance to ailing firms and industries. There are certainly significant differences across and within countries as regards the acceptable amount of such policies. But high minimum amounts of protection are being asked for, so as to avoid pressure for change and flexibility. And the desirability of such protection is taken as a matter of course.[15] Put differently, the shock was indeed unquestionably welcome *per se* in virtually all CEECs, but the same does not hold true for the consequences most observers had taken for granted.

Of course, this does not justify the fact that the old and new nomenklaturas managed to uphold or create significant monopolistic conditions in several areas of the economy, which in turn were tolerated or even encouraged by the new politicians, so as to create rents to share. But it does explain why these rent-seeking opportunities could be maintained and defended with no need to recall collective-action arguments. The need for protection against—say—the wild side of globalization proved to be enough.

As anybody with even a superficial knowledge of "Western societies" knows, this feature is not typical of CEECs only. The difference between the East and the West, however, is twofold. First, lack of adequate flexibility forces any system to fall back—or adapt—to the previous conditions. This is not a particular source of problems for the Western economies, apart from the missed opportunities for growth, as the EU situation in the past decade demonstrates. But it may be much more troublesome for countries which have nothing to fall back upon, or which adapt to some revitalized (or concealed) version of the previous regime. In addition, expectations play an important role in the post-shock dynamics of the CEEC economies. Unlike what happens in the West, in most CEECs certainty and stability are not appraised as a substitute for growth, but rather as features which should be guaranteed along with growth, and which may even be preferable to growth (not to continued economic decline, though). In other words, satisfactory growth is a good enough reason to win the elections, but lack of certainty is a good enough reason to lose them.

To sum up, free entry is surely limited. But this is not the consequence of incomplete transition or bad policy-making. Rather, it follows from individual attitudes. Low entrepreneurial abilities and individual risk-aversion reduce opportunity costs, especially in the less-tradeable sector.

As regards the political domain, free entry is indeed allowed in most CEEC countries. In order to maximize power politicians and policy makers must indeed compete in the electoral market by providing certainty, reducing interference with the informal institutional framework, and possibly enhancing growth. At first sight this may not seem much different from the previous regime, which also supplied certainty,[16] as well as benign neglect (if not consideration) vis-à-vis the informal rules of the game. The crucial distinction lies however in the degree of accountability. Policies and outcomes often appear to be questionable—to say the least. But in most situations leaders are today by and large accountable to the electorate, rather than to the Party leadership, as was the case in the past. The very fact that short-run, income-maximizing politicians suffer much greater exposure than in the past, and enjoy reduced chances of getting elected again provides encouraging evidence in this respect. As long as this remains true, free entry and exit is guaranteed. Sometimes even more so than in a number of Western “democracies”, where accountability is actually relatively weak, since political leaders and policy-makers are less accountable to the public at large than to other political leaders, policy-makers, interest groups. The example provided by the proliferation of the layers of government—say, in the European Union—is telling in this respect.

4. Two Normative Conclusions

4.1. Does Transition Economics Still Make Sense?

This paper has argued that the traditional approach to transition oscillates between two extremes. One is the neoclassical version, whereby the economics of transition appears to be pretty close to an exercise in social engineering. Although there exist several variants,[17] they all occur following a two-step procedure. First comes the design of the optimum rules of the game in an ideal, frictionless, full-information world. Then the analysis confronts the problems raised by the introduction of such rules in the real context. Transition is over when all the rules have been introduced, or when the social planner gives up hope of accomplishing further progress.

The other version is the institutional view, whereby the analysis starts from an initial shock, after which an evolutionary, path-dependent process follows; until another shock occurs. In this light, the term transition usually refers either to the shock itself, or to the ongoing evolutionary process, including the birth of the new institutional framework. Although it is undeniable that the institutional approach has acquired a distinctive and important role within the literature on transition, nothing would be lost if the term transition were ignored altogether. As a matter of fact, this kind of investigation can apply to any country or bloc of countries. The only difference among the CEEC area and other regions of the world seems to be the length of time elapsed since the last shock occurred.

The Austrian approach represents the alternative to the range of possibilities included between the two extremes outlined above. It focuses on the nature and the meaning of the shock, rather than on the process of transition. More precisely, the shock is here perceived as the moment when new sets of opportunities are made available to the individual. Consumers have new possibilities of buying new sets of goods and services. Producers undergo substantial changes as regards their freedom to produce, to choose among the production techniques available, to discover new goods and new techniques. Owners of production factors are offered new constraints (or no constraints at all) as regards where and at what price factors are allocated. All this does not require that the outcome of economic activity change drastically. For the very fact that the opportunity set expands does not necessarily imply that agents choose and act differently with respect to the past. Thus, a new economic regime is not one which performs better (or worse) in comparison with the previous one. It is "just" one where the opportunity frontier is significantly different with respect to the past. And a shock is identified in the creation of such a new opportunity frontier.

Hence, the aftermath of the shock—transition—regards a story which differs from the usual ones, and may be of less interest to economists than to other social scientists. Perhaps more appropriately, transition could be understood as an anthropological or sociological problem with important economic consequences. It is of course hardly worth mentioning that this conclusion would be pretty much in line with the Austrian approach, which would identify transition as the investigation of why some communities may be more prone than others to take advantage of the existing opportunities and strive to expand the opportunity frontier further. It follows that transition analysis should also examine to what extent these subjectivistic features may drive institutional change, and interact with the set of variables which have been studied by—say—Downs (1957) and Olson (1965).

4.2. Where do We Go from here?

One can sum up the various points presented in this paper by arguing that although transition remains an important and interesting topic, the economics of transition should be subordinate to the analysis of the changes in the opportunity sets, and to the willingness of the actors to take advantage of such new opportunities. The quantitative outcome of these choices is surely relevant for statistical and descriptive purposes. But it cannot be the main object of economic investigation. For the many figures and graphs we have become acquainted with do not really teach much about the very nature of the underlying processes.

On the other hand, the wealth of surveys about the new rules of the game in many CEECs is often misleading. Despite great attention to the formal aspects, it is a fact that in the CEEC region confusion and ambiguities are still widespread. The role played by the informal rules of the game remains by all means significant. CEEC bureaucracies have maintained enormous powers when it comes to interpreting and enforcing the rules; sanctioning the violations. Discretion by post-communist *nomenklaturas* persists. As a consequence, the importance of the new opportunities available may be easily overestimated.

Much less has been made available by economists as regards the actual preferences of the CEEC agents. Although surveys about the ambitions and priorities among the post-communist populace have been carried out, it is not clear whether they refer to changes in preferences or to changes in reactions vis-à-vis a new institutional environment. Once again, it is not denied that the efforts to create the *homo sovieticus* failed. But it is a mistake to believe that the collapse of the communist system has created a new ethics overnight (greed and selfishness were already distinctive features of the Soviet regime), or millions of perfectly rational, utility- and profit-maximizer agents. Resources made available by foreign governments and international organization do not create a market culture. Quite the opposite. Foreign investments can be realized in months, if not weeks. But it takes years, perhaps decades, for people to understand how a market economy works and possibly change their preferences and attitudes accordingly. Financial institutions can be created overnight, but it takes much longer to see the difference between a casino and the stock exchange.

At first sight, it might look as if the Austrian approach had little new to say about transition, apart from joining with the institutional school in resisting attempts to introduce free-market rules by fiat. Yet, one should not overlook the Austrian emphasis on the preservation and warranty of individual freedom as the fundamental policy-making principle which should guide all normative prescriptions. Whereby everybody should enjoy the possibility of expanding the set of opportunities through knowledge and access into the economic and political markets. And should also bear full responsibility for his actions.

It appears that these basic rights are still denied in most CEECs. Two policies may thus be called for. On the one hand, efforts should be devoted to making individuals in CEECs aware of the expanded opportunity sets that a post-communist world can offer. By and large this has been done, or perhaps overdone, if one has to judge from the widespread CEEC illusion whereby free-market means higher living standards at no costs and no ethics (responsibilities).

In addition, one should make sure that individuals are allowed to allocate their purchasing power following their preferences, rather than those of the majority (or minority). The real world shows that this result is much more difficult to achieve. One may think of an international organization with the power to defend individual rights against the will of the majority. Its failure would be an easy prediction, though; for reasons which are too obvious to deserve further explanation. More realistically, all individuals should be guaranteed the right to express their preferences at least with their feet, and shop among a well diversified supply of different cultural contexts and institutional arrangements. Unfortunately, much remains to be done in this domain. As the experience of the last ten years demonstrates, most efforts have been devoted to making sure that pressure to vote by walking out remains low. Indeed, the main concern of the so-called developed world has been directed to eliminating the chances for immigration from the CEEC area, and protecting domestic workers in relatively inefficient industries from foreign competition. In this light, one may actually wonder whether at least part of the West is not suffering from a transition process which has failed to take place within its own frontiers.

Notes

1. There is a substantial body of literature arguing that transition policy would be inappropriate even if transition were not over. See for instance Pejovich (1997) and the post-war record of failures which has characterized the so-called developing countries, which provides extensive evidence about the fallacies of standard development economics.
2. See for instance Winiecki (1991) and Colombatto-Macey (1997).
3. Put differently, "*institutional changes depend on the existence of groups of individuals and organizations that find it in their self-interest to bear the cost of overcoming the status quo*" (Pejovich, private correspondence). Surely, such a change also includes new rules as regards the role and the means of government intervention in the economy, e.g. from central planning to the so-called indicative-planning regime, or to a free-market system.
4. A short time after the collapse of the Communist regime in Russia, Lipton and Sachs (1992:214) were claiming that tight monetary and fiscal policies would have been enough to stabilize and transform the economy, and that the "*The tight financial policies would be accompanied by rapid privatization of enterprises and swift opening of international trade to enforce domestic competition, spur exports... Similar prescriptions are demonstrating their efficacy in much of Eastern Europe*".
5. See for instance the five-point strategy for successful reform provided by Fischer (1992:85–86), who probably indulged in involuntary sarcasm when boasting that "*the Russian government has been able to draw on the [...] analysis by Western economists and the experience of Eastern European, Latin American, and other stabilization programs*".
6. As a matter of fact, the neoclassical school would surely accept that institutions and politicians play an important role in an economy. This is in particular the position held by the supporters of gradualism, according to whom a big-bang solution would have been useless—or even harmful—unless the appropriate institutions were already in place. Of course, that also included regulatory bodies, so as to make sure that alleged market failures could be compensated for.
7. Indeed, the recent well-known contribution by Stark and Bruszt (1998) shows that the institutional efforts to overcome typologies can easily verge on Utopian Third-Way temptations.
8. For such travels would have made it easier to acquire information about consumption possibilities and thus about the high opportunity costs of the Communist regime. See Kaminski (1990, ch. 5).
9. For instance, in the domain of education.
10. Of course, there are still several post-communist countries where freedom of speech is *de facto* restricted, and where the ruling *élite* makes it difficult to acquire information, to express preferences, to pursue one's own inclinations. In this case, of course, the downfall of Communism was little different from a *coup d'état* whereby totalitarian leaders replace other totalitarian leaders; or where the very same totalitarian leaders just change the name of the political party and/or of a few governmental offices.
11. See however Pejovich (1999) for an important recent exception.
12. This is obvious in a small country, where many economic relations are bound to involve international transactions. But it also applies to a large economy "opening within", i.e. striving to develop domestic trade on free-market criteria.
13. The Soviet-type system was unable to create a new man, the *homo sovieticus*, who was supposed to have no other mission other than to enhance the power of the Party and of the State, whatever that may mean. But the Soviet system was probably successful in destroying social ties, in weakening the sense of individual responsibility and entrepreneurship.
14. A similar concept has been discussed by Smyth (1998:367–368), who refers to "market culture".
15. Even those politicians who initially displayed a strong commitment to the principles of a free society have been forced to revise their previous ideological stand in order to bolster their political careers. The case of former Prime Minister V. Klaus in the Czech Republic is telling in this respect.
16. It has been argued, that discretionary power was higher—and certainty lower—within the Communist party/nomenklatura system, than under the current multi-party regime. This is however questionable. Certainty in the business environment was provided by a well-established and fairly reliable system of bribes and perks. At the same time, individual certainty was guaranteed by life-time employment and an all-comprehensive welfare system.
17. See Winiecki (1998) for a new appraisal of the shock-therapy vs. gradualist debate.

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