



# Alternative paths to the transition process

The transition process

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## Abstract

**Purpose** – The purpose of the paper is to develop alternative paths to the transition process as a result of alternative models of transition.

**Design/methodology/approach** – A political economy methodology to the transition process results in alternative transition models. As a result five alternative models of transition come into being.

**Findings** – Transition models can be distinguished on the basis of economic analysis, speed and the political structure. Each model recommended a set of economic policies to facilitate the transition process. The adoption of gradualist processes of transition – except in the case of shock therapy – requires a sequence by which the reforms should be introduced.

**Originality/value** – The paper contributes to the transition literature by developing a set of economic policies combined with a sequence path for each transition model.

**Keywords** Politics, Economic policy, Transition management

**Paper type** Conceptual paper

## Introduction

The transition process in the economic literature appears to be an over-simplification of the complexities involved. Economists, as a rule, writing on the transition process have reduced it to an isolated variable of the economic sphere; such as price policy, fiscal policy, monetary policy, investment policy or unemployment, thus ignoring the interrelated nature of economic institutions and behaviour. An alternative view of the transition process is adopted in this paper, which avoids the single-isolated economic variable approach. Instead the transition process is viewed as a holistic process due to the interrelated nature of the reforms.

The aim of this paper is to develop alternative paths to the transition process as a result of alternative models of transition. A political economy approach would be adopted, as the transition process involved not only reforms in the economic structure but also in the political structure. A political economy approach results in the development of alternative models of transition. Alternative models of transition arise as a result of different methods of economic analysis, different speeds of implementing the transition policies and different political structures. As a result five alternative models of transition come into being:

- (1) The shock therapy transition model.
- (2) The neoclassical gradualist transition model.
- (3) The post-Keynesian transition model.



- (4) The pluralistic market socialist transition model.
- (5) The non-pluralistic market socialist (the Chinese model of transition).

The analytical framework developed, which proposes different economic models of transition and different paths of transition makes it possible to understand the transition process from a new and more enlightened perspective. It provides a better understanding of the complexities involved in the transition process and the differing opinions between economists.

The first step is to analyse each model by using what I define as the primary and secondary elements of the models of transition. The primary and secondary elements give rise to alternative models of transition.

### **Alternative models of transition based on primary elements**

The reforms in Central, Eastern Europe and the former Soviet Union (CEEFSU) provided an exceptional example to investigate economic theories in distinct circumstances (Murrell, 1995, p. 171). The elements of the transition process were equally important and must be interconnected, and thus consistent. Viewing the transition process in its totality, our terms of analysis are not the narrow economic “independent” variables, but rather the whole politico-economic spectrum. Nevertheless, this hypothesis does not deny developing transition models on the basis of different priorities and sequencing of the elements of the reform program.

The success of the transition process depended not only on specifying the necessary economic conditions, but also on whether certain conditions were satisfied with respect to the political structure. For this reason, the analysis adopted in this paper is in the tradition of political economy, which incorporates the interaction between political institutions within the framework of economic relationships. Political economy stresses that making economic sense and understanding economic relationships is infeasible without explicit awareness of politics. However, a political economy approach eventuates in disagreement and in alternative transition models since “this inherently political dimension of economic analysis renders it prone to fundamental disagreements” (Argyrous and Stilwell, 1996, p. 51).

The basis on which different models are distinguished from each other is on what I identify as primary elements that differentiate transition models. The primary elements of each model are distinct to and characteristic of a specific model. The primary elements are economic analysis, speed and the political structure. As a result five alternative models of transition are developed, based on three different views of economic analysis, two different speeds of implementing the reforms and two different political structures.

The neoclassical model of transition encompasses an approximation of competitive capitalism as a vision of a good society and uses neoclassical economic analysis. Within the neoclassical model we can distinguish between the shock therapy and the gradualist model of transition. A critique of the neoclassical model gives rise to an alternative model based on post-Keynesian propositions. The aim will be to develop a comprehensive model of transition, broadly defined as “social democratic”, which overcomes the weaknesses of the neoclassical model and is also both realistic and feasible, as argued by post-Keynesian economists.

In this context, it would also be appropriate to consider a market socialist model of transition. As the name of the model states, it is a combination of a market system and socialist principles. The market socialist model incorporates a different method of economic analysis, mainly Marxist analysis, thus having a different view of how the economic system functions. Within the market socialist model we can distinguish between the pluralistic and non-pluralistic approach. The pluralistic market socialist model introduces reforms after discussion, debate, compromise and consent; for example, the Gorbachev reforms. While non-pluralistic market socialism introduces reforms after the decision is made by the leading role and correct line party, as for example in China. The distinguishing features of the alternative transition models based on the primary elements are presented in Table I.

### The secondary elements of the transition models

After identifying the primary elements unique to each transition model, the next step is to identify the elements of each model with respect to the desirable reforms.

#### *Price liberalisation-stabilisation*

The transition models implied alternative processes of price liberalisation. The shock therapy supporters advocated an immediate price liberalisation and, thus, the removal of any restrictions on prices. Advocates of the remaining models supported price controls and the gradual removal of administrative controls over prices.

In addition it was extremely important to determine the role of the state within the stabilisation process. State intervention can take a variety of forms. Firstly, the state could have a minimal role in the market process, which neoclassical economists favour. In this case, there would be no need for state intervention; it would be inactive in terms of the market outcome, except in cases of market failure, and the market would function freely. Secondly, state intervention could be in the form of industry policy designed to assist enterprises in confronting competitive forces through the provision of information, tax concessions and tariff protection. Industry policy encourages enterprises indirectly, through market incentives, to reach a market outcome that is desirable from a societal point of view. Thirdly, state intervention could be through regulation, which restricts enterprise choice. Post-Keynesians are in favour of using both industry policy and regulation. However, market socialists argued that industry policy and regulation were totally ineffective in a capitalist system because the state did not have the power to enforce its decisions. Power resides with the owners of capital. Consequently, in order to succeed, state intervention, which used society's

Primary elements	Models of transition				
	Shock therapy	Neoclassical gradualism	Post-Keynesian	Pluralistic market socialism	Non-pluralistic market socialism (Chinese model)
Economic analysis	Neoclassical	Neoclassical	Post-Keynesian	Marxism	Marxism, Maoism
Speed	Shock therapy	Gradualism	Gradualism	Gradualism	Gradualism
Political structure	Pluralism	Pluralism	Pluralism	Pluralism	Non-pluralism

**Table I.**  
Alternative models of transition based on primary elements

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benefit as a yardstick, required the elimination of the sources of power; that is, private property. This could only be achieved in a socialist system, the market socialists argued. State intervention in a market socialist system takes the form of market planning. Meanwhile, the non-pluralistic market socialists would implement, in addition to market planning, non-market instruments to allocate resources through central directives.

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#### *Privatisation*

Most economists identified the privatisation of state enterprises as the most pressing issue to be solved. This faith in private property is based on the incentives that it produces, which always guarantee the efficient use of resources and eliminate shortages (Campbell, 1991, p. 206).

The shock therapy model was in favour of the immediate privatisation of state enterprises through restitution, auctions and free distribution of vouchers. Conversely, neoclassical gradualists were in favour of a slower pace of privatisation through auctions. Post-Keynesian economists were in favour of a gradual privatisation process, which would involve restitution, the free distribution of vouchers, and the transferring of ownership to financial intermediaries that were state controlled. A combination of both methods, the free distribution of vouchers and the transferring of ownership to state financial intermediaries and labour-managed firms, was also favoured. Pluralistic market socialists favoured transferring ownership to the workers and, thus, encouraging the development of labour-managed firms to enhance participation and retain a large percentage of state-owned enterprises together with leasing land and capital equipment and the privatisation of small enterprises. However, non-pluralistic socialists suggested the retention of state enterprises and encouraged the development of co-operatives in the form of township and village enterprises (TVEs) and private enterprises in special economic zones together with the leasing of land.

#### *Institutional structure*

A radical change such as moving towards a market economy required reform in the institutional structure consistent with the institutional arrangements that were fundamental for the proper functioning of a market economy (Frydman *et al.*, 1997, pp. 45-46; North, 1990, p. 134).

The question that needed to be answered by the transition modelling process was, how would an appropriate institutional structure be developed in the transition economies? Would it involve government action? As Lin (1989, p. 4) and Kregel *et al.* (1992, p. 28) argued, institutions often emerge spontaneously and through repeated social interaction, however, in most cases they have to be made by conscious state action, a statement with which the post-Keynesians and the pluralistic market socialists would agree. However, Rapaczynski (1996, p. 87) and Dietz (1992, p. 34) disagreed with this argument, stressing that institutions are largely the product of market forces, rather than the result of government action. The neoclassical model would follow this argument. However, institutional development in transition economies did not only involve the development of formal but also informal institutions. The development of informal institutions could only be gradual. Strangely enough, the Chinese process of transition placed emphasis on informal institutions, in

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contrast to CEEFSU, which emphasised the formal institutions of private property rights.

### *Monetary policy and financial system*

In addition to privatisation and the development of institutions there was a need to develop specific institutions, to enforce hard budget constraints. This would be achieved by reforming the banking system, dividing its functions between a central bank and commercial banks. The role of the central bank was a controversial issue. Should the central bank be independent and pursue monetary policy with the aim of achieving a pre-determined target rate of inflation? This question was inexorably linked with the perception of whether the money supply was exogenously determined and, thus, controlled by the central bank, or endogenous. Neoclassical economists highlight the danger associated with the prerogative of commercial banks to create money that, if excessive, will cause excess demand and place pressure on prices. Consequently, there is a need for regulation by the central bank through the imposition of liquidity constraints. The prime aim of the central bank, in the neoclassical view, should be to control the money supply to avoid inflation:

Inflation is not a natural disaster; it is created by government or the political powers behind them, and only the governments and political powers can put an end to it (Kornai, 1990, p. 106).

For the neoclassical economists, the development of a privately owned, competitive and stable financial sector was essential to the operation of a market economy, as it was the centre for the mobilisation and distribution of financial resources and the pricing and allocation of risk.

Meanwhile, “post-Keynesians rank the supportive responsibilities of the central banks above their control duties” (Moore, 1979, p. 126), indicating the need for a state-controlled central bank and a combination of a privately and state-owned banking system. Marxists highlight the need to eliminate the power of the financial establishment so that the government can control the money supply and be able to use it as an effective instrument of discretionary policy. This implies a government-controlled central bank and only state-owned commercial banks.

### *Fiscal policy*

Each transition model had to identify the role of budgetary policy and specify whether there was a link between government expansionary policies and inflation. Further considerations were whether the taxation system should be neutral, attempting to minimise dead weight losses, or whether the government should use its discretionary power to tax people differently, perhaps based on ability to pay.

On the one hand, the neoclassical economists argued that the tax system should be neutral and the budget balanced. It was essential to abolish all subsidies and establish a hard budget constraint, since subsidies distort the market, increase the budget deficit and encourage waste. On the other hand, post-Keynesians favoured the use of the government’s discretionary power to implement fiscal policies to achieve full employment. Post-Keynesians believed that the labour market does not automatically equilibrate independently of the budget. Market socialists argued that the discretionary fiscal policies of the government proposed by the post-Keynesians were totally ineffective. According to market socialists, power was the natural result of

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private property, which was able to neutralise government fiscal policy. Consequently, there was a need, together with discretionary fiscal policies, to have the majority of property in a social form.

*International trade and foreign aid*

Foreign trade was an important ingredient in the development of markets and in fostering structural change and economic growth. The liberalisation of foreign trade was an essential part of the transition process (Sutela, 1992, p. 85; Nuti, 1991, p. 155). The shock therapy supporters favoured the immediate establishment of free trade and a fully convertible exchange rate. They argued that a fully convertible currency would restore faith in the currency, reduce inflationary expectations, and stimulate foreign trade. A fully convertible exchange rate would make it possible to attract foreign investment, which was essential to overcome stagnation, since foreign investment provided resources, technology and expertise (Frydman *et al.*, 1997, p. 68). The neoclassical gradualist economists were in favour of a gradual process of achieving full convertibility through a payments union. The post-Keynesians were in favour of maintaining tariffs through a permanent clearing union. They argued that the principle of comparative advantage was valid only in the ideal world of full employment. Thus tariffs and a discretionary exchange rate policy were essential. Market socialists were in favour of maintaining tariff and non-tariff barriers through a socialist customs union. The non-pluralistic socialists in China, on the other hand, maintained tariffs and non-tariff barriers and implemented a discretionary exchange rate policy.

All schools of thought recognised that foreign aid and credits could have assisted in avoiding a crisis in transition economies. Sachs (1993, p. 6) stated that “the West cannot escape responsibility for the changes ahead”. Neoclassical and post-Keynesian economists highlighted the need for conditional foreign aid to assist with the transition process, while market socialists were suspicious of the terms and conditions associated with the provision of foreign aid. For the market socialists, only non-conditional foreign aid could be accepted. However, capitalist market economies and international organisations dominated by a capitalist free market approach were not willing to assist in the development of a market socialist system.

*Social policy*

The development of a social policy was urgently required to avoid hardship due to the transition process. Most importantly, social policy played a political, as well as social welfare role, by helping to protect large numbers of unemployed people from major declines in their standards of living and, at the same time, maintain support for the reform program (Graham, 1997, p. 327).

For the neoclassical economists, the introduction of welfare benefits had to be non-discriminatory and available for a limited period, to discourage dependence. The social program was only a “safety net”. In this context, neoclassical gradualist economists argued that discretionary measures were necessary as long as a gradual transition process was taking place, which, hopefully, would only endure for a short period of time (Kornai, 1990, p. 147). For the post-Keynesians, the welfare state, which was an expression of the common good and the result of government discretionary power, was the means of attaining the equity objective of society. The market socialists were very critical of the effectiveness of the welfare state, particularly because

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capitalists always avoided tax payments, thereby creating a fiscal crisis for the government. An effective welfare state required the elimination of power in society and the establishment of a basic-liveable income for all, independent of individual economic conditions. For the Chinese model of non-pluralistic market socialism, welfare provision took the form of the enterprise funded “iron rice bowl”.

The schematic representation of the secondary elements of alternative models of transition appears in Table II.

### **Alternative paths to the transition process**

The adoption of a gradual process of transition would not only involve specifying the required policies of a successful transition but would also entail a process: a sequence by which the reforms should be introduced. There was a need for a strategy by which the reform program would be implemented, stipulating the order of reforms based on the interconnectedness of transition policies. Consequently, a gradual process of transition necessitated a process of the sequencing of reforms. This would make the transition process more complex, because the modelling process involved a judgement not only with regard to the program of reform, but also in relation to the priority of necessary reforms. The shock therapy approach to transition avoided this problem since all the reforms were introduced in one shot.

The time framework for the completion of the transition process was a disputed issue. The time framework adopted in this paper is for phasing the transition process over a ten-year period. As such the time framework is not important, but rather the sequencing. The schematic presentation of Table II provides the setting of the policy instruments of each transition model and indicates that the next step of analysis is to present the alternative paths to transition based on the alternative priorities associated with each model. In the following the alternative paths to the transition process is analysed.

#### *The shock therapy path to the transition process*

The shock therapy model of transition recommended:

- immediate price liberalisation;
- immediate privatisation;
- immediate establishment of a hard budget constraint and an independent central bank;
- immediate privatisation of state banks;
- immediate achievement of a balanced budget and the establishment of a tax structure;
- the immediate introduction of free trade and a fully convertible flexible currency; and
- the immediate establishment of a social safety net and private welfare providers.

Throughout the transition process, foreign aid would support the introduction of the economic policies to fund the safety net. The formal and informal institutions could only be the result of a gradual process. Using Jeffrey Sachs statement that Poland's goal was to establish the basis for a private-sector market economy in just one year (Sachs, 1990, p. 19) shock therapy process of transition is presented in Figure 1.



**Table II.**  
Secondary elements of  
transition models

Secondary elements	Models of transition			Non-pluralistic market socialism Chinese model
	Shock therapy	Neoclassical gradualist	Post-Keynesian	
Price liberalisation, stabilisation	Immediate price liberalisation No state intervention	Gradual price liberalisation Gradual removal of sources of state intervention	Gradual price liberalisation Industry and incomes policies and regulation	Gradual price liberalisation Market planning and central directives
Privatisation	Immediate privatisation through restitution, auctions and free distribution of vouchers	Gradual privatisation through auctions	Restitution, free distribution of vouchers, state financial intermediaries, a combination of free distribution of vouchers and state financial intermediaries, labour managed firms	Development of TVEs and private firms in special economic zones. Leasing of land
Institutions	Formal and informal institutions product of market forces	Gradual development of formal and informal institutions product of market forces	Formal institutions product of state action and informal product of market forces	Informal institutions product of market forces
Monetary policy, financial system	Immediate establishment of independent central bank and privately-owned banks	Gradual establishment of independent central bank and gradual establishment of privately-owned banks	State-controlled central bank and privately and state-owned banks	State-controlled central bank and state-owned banks
Fiscal policy	Immediate establishment of neutral taxing system and balanced budget	Gradual neutral taxation system and gradual balanced budget	Discretionary taxation system and discretionary fiscal policy	Discretionary taxation system and discretionary fiscal policy
International trade, foreign aid	Immediate establishment of free trade, fully convertible currency	Payments union Conditional foreign aid	Clearing union Conditional foreign aid	Tariffs and non-tariffs barriers, discretionary exchange rate policy
Social policy	Immediate establishment of safety net	Gradual safety net	Welfare state	Enterprise funded Iron rice bowl





*The neoclassical gradualist path to the transition process*

The neoclassical gradualist model of transition involved:

- gradual price liberalisation;
- gradual privatisation;
- gradual development of formal and informal institutions;
- gradual establishment of a hard budget constraint and independent central bank;
- gradual privatisation of state banks;
- gradual achievement of a balanced budget and a neutral tax system;
- gradual introduction of free trade and a flexible exchange rate through a payments union; and
- gradual establishment of a safety net and private welfare providers.

Throughout the transition conditional foreign aid would support the process.

Thus, according to the neoclassical gradualist approach, as demonstrated in Figure 2, the first priority was fiscal control, in conjunction with several other key initiatives. A tax department had to be established to collect taxes from households and firms and replace the traditional tax base of state-owned enterprises, which would have disappeared. At the same time, the institutional structure both formal and informal would have to have been overhauled, an incomes policy introduced, a payments union established and tariffs for non-payment union members maintained and gradually eliminated. A safety net would have to have been introduced simultaneously. Both formal and informal institutions would have been the result of market forces. Meanwhile, both prices and interest rates would have to have been controlled.

Once the initial reforms were in place, the budget constraints could have been hardened in year 2, with the imposition of self-financing together with the development of an independent central bank. The privatisation of small state enterprises could have been initiated in year 2 and the restructuring and/or corporatisation of large state enterprises could have started. Once the restructuring and/or corporatisation of large state enterprises gained momentum in year 7, price liberalisation, and deregulation of the interest rates and the banking system could have been initiated. With the completion of restructuring and/or corporatisation at the end of year 8, large state enterprises could have been auctioned in year 9. The vacuum in the provision of enterprise welfare services could have been filled by the gradual development of private welfare providers, which would start in year 2.

Before the privatisation of large enterprises, the payments union would have become redundant at the end of year 8 after achieving convertibility, a floating exchange rate, and the elimination of tariffs to establish free trade. The budget deficit would have been funded by conditional foreign aid throughout the transition process.

*The post-Keynesian path to the transition process*

The post-Keynesians suggested:

- gradual price liberalisation and the introduction of industry and incomes policies;
- gradual privatisation;

	0	1	2	3	4	5	6	7	8	9	10
1. Price Liberalisation Stabilisation											
Price Liberalisation											
Incomes Policy											
2. Privatisation											
Privatisation of Small Enterprises											
Restructuring of Large Enterprises											
Privatisation of Large Enterprises											
3. Institutional Structure											
Formal Institutions											
Informal Institutions											
4. Monetary Policy and the Financial System											
Hard Budget Constraint											
Independent Central Bank											
5. Fiscal Policy											
Budget Deficit											
Tax Structure											
6. International Trade and Foreign Aid											
Payments Union											
Tariffs											
Floating Exchange Rate											
7. Social Policy											
Conditional Foreign Aid											
Safety Net											
Private Welfare Providers											

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**Figure 2.**  
The neoclassical  
gradualist process of  
transition

- the immediate establishment of formal institutions through state action and the gradual development of informal institutions;
- the maintenance of state control over the central bank and a few of the state banks;
- the introduction of discretionary fiscal and taxation policies; and
- the establishment of a permanent clearing union and a welfare state.

The transition process would be supported throughout by conditional foreign aid.

The post-Keynesians would have started the reform process by reforming the institutional structure. The institutional structure involved formal institutions, the regulation of the financial system incorporating a state controlled central bank and the tax system. Once the formal institutional structure has been developed by the end of year 1, individuals would develop informal institutions lasting throughout the transition period. After the development of the formal institutional structure, the process of the restructuring of state enterprises, the privatisation of small-medium enterprises and the establishment of the clearing union should have taken place in year 2 in accordance with the newly established formal institutions under fixed prices, protection and fixed exchange rate. Discretionary monetary and fiscal policies and industry-incomes policies, as part of the overall market planning, should have been initiated throughout the reform process in order to assist with the restructuring of enterprises and the achievement of full employment. To assist individuals with the transition costs the income assistance and other assistance programs, such as retraining, should have been established in line with the restructuring of enterprises. In this way, restructuring of state enterprises could have gone ahead without substantial resistance by workers. The gradual price liberalisation should have taken place only after enterprises are restructured in year 6. Conditional foreign aid was essential throughout the reform program. The sequencing of the reforms is presented in Figure 3.

#### *The pluralistic market socialist path to the transition process*

The market socialist transition policies incorporated:

- gradual price liberalisation and the introduction of market planning in the form of industry and incomes policies;
- the restructuring of large state enterprises, the transformation of medium enterprises to cooperatives and the privatisation of small enterprises;
- the immediate establishment of formal institutions through state actions and gradual development of informal institutions;
- the maintenance of state control of the central bank, the immediate introduction of financial regulation and tax structure;
- the establishment of discretionary monetary and fiscal policies; and
- the establishment of a socialist custom union and the maintenance of tariffs with capitalist countries and the establishment of the welfare state based on guaranteed basic-liveable income.

According to the market socialist approach to the transition, the first priority was the establishment of the institutional structure to assist the development of the socialist market that would have facilitated the development of informal institutions. At the

		0	1	2	3	4	5	6	7	8	9	10
Price Liberalisation Stabilisation	Price Liberalisation											
	Industry Incomes Policy											
2. Privatisation	Restructuring State Enterprises											
	Privatisation of Small and Medium Enterprises											
3. Institution	Formal Institutions											
	Informal Institutions											
4. Monetary Policy and the Financial System	Financial Regulation											
	Discretionary Monetary Policy											
5. Fiscal Policy	Discretionary Fiscal Policy											
	Tax Structure											
6. International Trade and Foreign Aid	Clearing Union											
	Tariffs											
7. Social Policy	Conditional Foreign Aid											
	Welfare State											

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**Figure 3.**  
The post-Keynesian  
process of transition

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same time, the establishment of financial regulation, the tax structure, guaranteed basic-livable income and the founding of the socialist customs union should have been initiated. The privatisation of small firms and the transfer of medium firms to labour management could have followed in year 1. The restructuring of large state enterprises could have been initiated in year 2 lasting to the end of year 3. Discretionary fiscal and monetary policy together with incomes and industry policies would be maintained throughout the transition process. After the restructuring of state enterprises was completed in year 4, together with the gradual liberalisation of prices, tariffs with the capitalist countries would have been permanent. The market socialist process of transition is demonstrated in Figure 4.

#### *The Chinese path to the transition process*

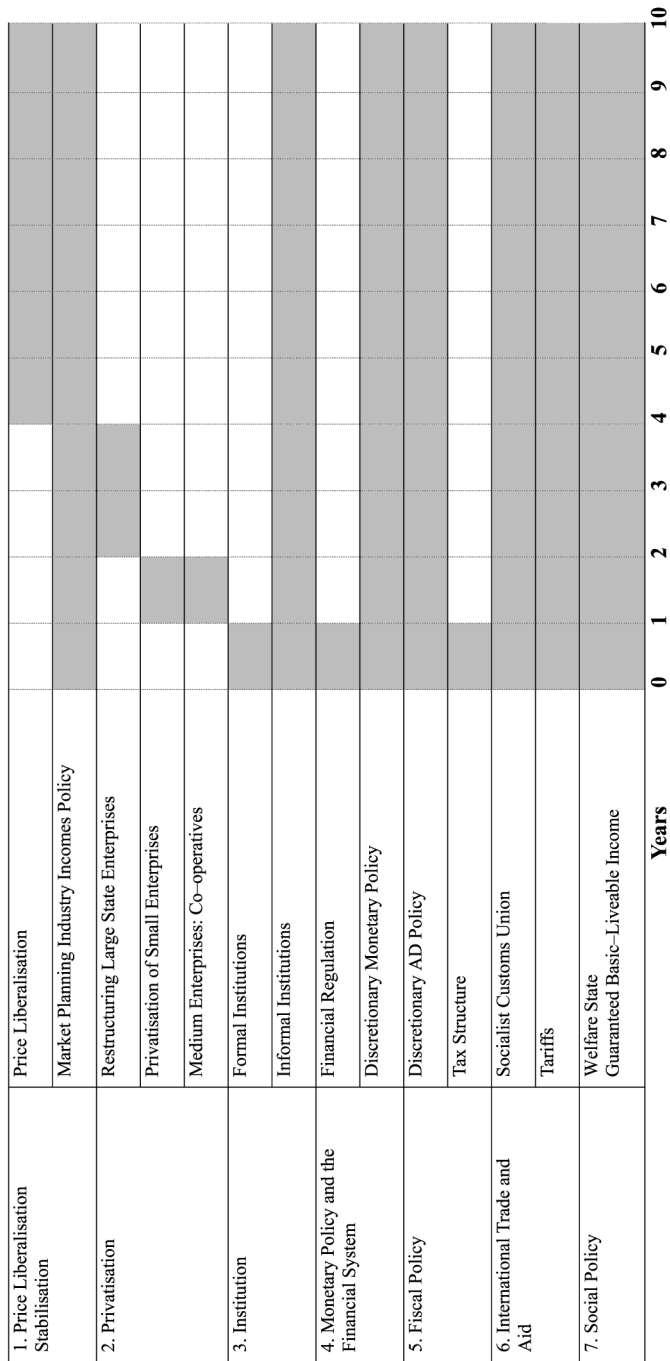
The Chinese process of transition involved:

- gradual price liberalisation with market planning and the maintenance of central directives;
- the development of TVE's and the leasing of land;
- the gradual establishment of informal institutions;
- a state controlled central bank and state-owned banks;
- discretionary fiscal policy and taxation system; and
- the maintenance of tariff and non-tariff barriers and discretionary exchange rate policy and the maintenance of the enterprise funded "iron rice bowl".

A process of transition towards a market economy can be established in the form of the Chinese non-pluralistic model of transition as summarised in Figure 5. The initiation of the transition process would take place with the establishment of a dual-track price system, which would be maintained throughout the transition process and the removal of restrictions on new entry, which promotes the establishment of non-state enterprises. The promotion of non-state enterprises is only required for three years from zero to three, after which the market process would be adequate in stimulating new enterprises. Concurrently, the development of informal institutions would unfold, with the formation of the TVEs and private enterprises being subject to hard budget constraints. The hard budget constraint for non-state enterprises would be maintained throughout the transition process, while soft budget constraints would exist for state-owned enterprises. After the promotion of non-state enterprises in year 4, the privatisation of small state enterprises is followed for the next two years (year 3 to 5) together with the restructuring of large state enterprises, lasting until the end of the transition process in year 10. Tax reform would then be initiated after the privatisation of small state enterprises in year 5. Throughout the reform process, central planning, incomes policy, soft budget constraints for large state enterprises, discretionary monetary and fiscal policies, tariffs and the "iron rice bowl" funded by enterprises were maintained.

#### **Conclusion**

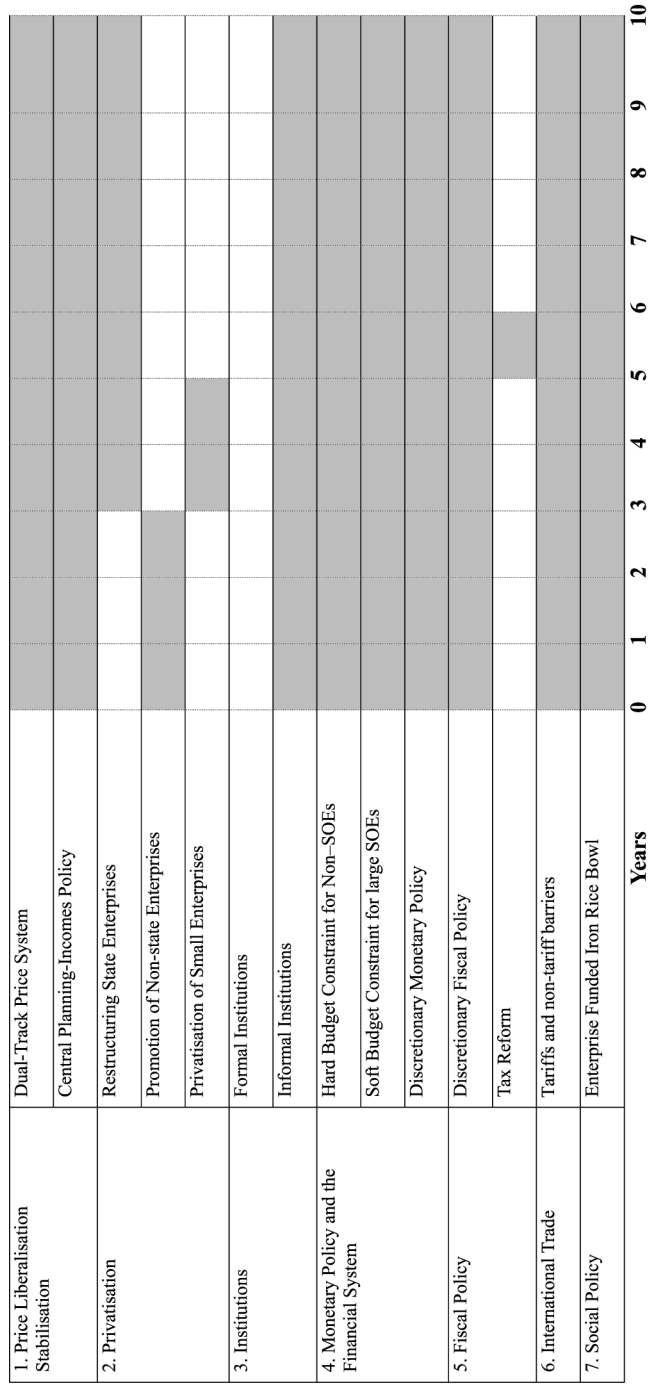
A political economy approach to the transition process did not only result in alternative models of transition but also alternative paths to the transition process. It was demonstrated that transition models could be distinguished on the basis of the primary



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**Figure 4.**  
The market socialist  
process of transition





**Figure 5.**  
The chinese process of  
transition

elements of economic analysis, speed and the political structure. Each model recommended a set of policies with regard to price liberalisation-stabilisation; privatisation; institutional structure; monetary policy and financial system; fiscal policy; international trade and foreign aid and social policy. In addition, the adoption of a gradualist process of transition – except in the case of shock therapy – requires a process: a sequence by which the reforms should be introduced. This is because each model is based on a set of assumptions, which determines how the market economy operates and responds to reforms. The different sequences of transition are also the result of the different priorities and goals of each model. This method of analysis is in contrast to the shock therapy approach, which dominated the transition process due to its simplicity. The shock therapy approach because of its narrow transition policy recommendations – “getting the prices right” and the remaining elements of the economic system would fall into place – was an antithesis of the political economy approach. The shock therapy approach abstracted from the political economy dimension of the gradualist models of transition.

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