

# Social Change versus Transition: The Political Economy of Institutions and Transitional Economies

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**Abstract** The “transition” process in Eastern Europe and the former Soviet Union (EEFSU) was one of the most dramatic non-marginal adjustments in economic systems ever experienced. During the transition process, elements of centrally administered socialism and embryonic market relations co-existed. This made traditional economic theory irrelevant. The purpose of this paper is to discover policy concerns and outcomes that orthodox “transition” literature ignores. Stanfield’s contribution to the economic literature, a cultural-holistic approach of radical institutionalism, makes it possible to understand the “transition” process from a new and more enlightened perspective. Stanfield provides a better understanding of the complexities involved, since the nature of change in the EEFSU is social and everlasting, not an end-state in the form of “transition”. Students of transition and of international development would benefit from this novel approach, which dismisses “transition” and substitutes “social change”, as the proper designation and manifestation of what actually took place in EEFSU.

**Keywords** Transition process · Holistic approach · Institutions · Social change

## Introduction

The “transition” process in Eastern Europe and the former Soviet Union (EEFSU) was one of the most dramatic non-marginal adjustments in economic systems ever experienced. During the transition process, elements of centrally administered socialism and embryonic market relations co-existed. This made traditional

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economic theory irrelevant, albeit orthodox economists did not take no for an answer and persisted with the applicability of orthodox-neoclassical economics. The complexities involved certainly did not have any historical parallels, even though there was such an attempt by orthodox economists. The adoption of market relations following the collapse of centrally administered socialism in EEFSU has been commonly referred to as the “transition” problem. The word transition implies movement toward an end-state. For most economists, this end-state was, and is, associated with the establishment of a capitalist economic system in which market relations are dominant, the majority of property is private, and effective property rights are respected and enforced. As long as these elements are achieved, the transition is complete. Obviously, this is a very narrow conception of the social changes that took place and are still taking place in the transitional economies of EEFSU.

From an institutional point of view, it is clear that the entirety of legal and institutional surroundings will condition how the economy really works in transitional societies. In the “transition” literature, as with orthodox economics, “too little attention has been accorded to social stabilization and the development of effective institutional understanding of the relationship, behavior, and nuances of the market exchange economy. Too little attention has been given to the development of the social welfare and regulatory complex without which the market economy is simply impractical because of its extreme consequences for human beings, the ecological issue of all life, and the cultural continuity of a people” (Stanfield 1998: 18).

The purpose of this paper is to discover policy concerns and outcomes that orthodox “transition” literature ignores, as “orthodox economics has been unable to provide a theory of institutional change in market capitalist society. Its theories lack social context because they are concerned with the market society and not market-capitalist society. The market adjective is important in that it indicates the prevalence of decentralized decision making. But the adjective capitalist is required to complete the picture. It indicates the nature of power and social stratification” (Stanfield 1979: 77). The issues of concern developed in this paper are based on a cultural-holistic approach of radical institutionalism, a synthesis of the ideas of Stanfield-Tool-Polanyi: the initial conditions, history, interdependence of human actions, cultural path-dependence, circular causation in social evolution, humanistic behavior, justice, social stabilization, democratic economic planning, participation in institution building and institutional change, the cultural continuity of the people, the establishment of a regulatory environment, collective action, poverty, social welfare and participatory democracy. Hence, transitional “... economics is ultimately political economics” (Stanfield 1979: 154).

Stanfield’s contribution to the economic literature makes it possible to understand the “transition” process from a new and more enlightened perspective. The Stanfield-Tool-Polanyi perspective of radical institutionalism provides a better understanding of the complexities involved, since the nature of change in the EEFSU is social and ever-lasting, not an end-state in the form of “transition”. Most notably, “only through an adequate theory of social change can the path of social change be consciously managed” (Stanfield 1979: xiii). Students of transition and of international development would benefit from this novel approach, which dismisses “transition” and substitutes “social change” as the proper designation and

manifestation of what actually is taking place in EEFSU. Hopefully, the paper will also serve as a guide for the people in EEFSU to manage social change they are still experiencing.

### Social Change, Institutions and Transitional Economies

The complexities of the transition process did not have any historical parallels (Yu 1993: 2); however, few economists of orthodox persuasion attempted to approximate the initial conditions of centrally administered economies with the stabilization programs initiated in the mature market economies. Incidentally, there was disagreement on whether the transition process should take into account the historical and cultural factors which underlined the unique features of each economy or whether there were analogies between different countries in, supposedly, similar states of their economic, political, and social development (Aslund 1992: 24). For example, Sachs (1993: 3) argued that “the prototypical case in Europe that I will refer to is that of Spain, which in many ways provides a kind of guidepost to the path that the countries of Eastern Europe should follow”. Edwards (1992: 131) argued that “the large number of stabilization attempts in Latin America during the last four decades provides a wealth of lessons—both positive and negative—on different aspects of anti-inflationary programs”. As well as, “an analogy is presented by what Central and Eastern Europe encountered just after World War I” (Aslund 1992: 26).

The attempt to approximate any of the initial conditions of the centrally administered economies with the experience of any mature market economy was, in my view, unwise. The stabilization programs initiated in mature market economies were based on a, more or less, well-functioning market with developed institutions and the dominance of private property, inflexible prices and wages in the short run, and forward-looking economic actors motivated by self-serving material incentives. The initial conditions of centrally administered economies—such as dominance of state property, central control of the whole economy and the encouragement of non-material incentives—did not approximate the conditions of any mature market economy. Therefore, the question arose: “What is the impact of strategy and policy, and sequencing, as opposed to country-specific initial conditions such as politics, pattern of industrialization, or institutional structure?” (Parker et al. 1997: 3). Herr and Westphall (1991: 323), Share (1995: 577), Kagarlitsky (1993: 88), Barratt-Brown (1995: 169) and Frydman et al. (1997: 44) argued that the efficiency and feasibility of any transition strategy depended on the specific conditions prevailing in the individual countries. In contrast, Sutela (1992: 87) argued that experience had revealed that the basic elements of a market economy could have been adapted to different historical and cultural environments. Recognizing the distinctiveness of each country as well as the limitations of economic models makes us aware of the need for a balance between specificity and generalization. In sum, the transition process was characterized by uncertainty (Thomas and Wang 1997: 223) and the absence of any historical paradigms. Hence, the *Economist's* (Anonymous 1990: 18) metaphor about the transition process was that there was no known recipe for unmaking an omelet.

Polanyi (1975 [1944]) established long ago that the autonomous and spontaneous market is a myth; the historical development of markets and capitalism has always

involved social change. Moreover, the experience of transitional economies also supports Polanyi's arguments. Market relations did not emerge instantaneously wherever central planning directives were removed in transitional societies. Furthermore, in order to accomplish the transition from central administration to market and in order to assess the progress of transitional societies, there are no such criteria present for the existence or absence of a market. As criteria are not in existence, thus far the implicit assumption is that markets emerge spontaneously and supposedly, what is even more problematic, markets came into being as soon as central planning was eliminated (Rosenbaum 2000: 457). Equally, markets are frequently assumed to emerge automatically without social frictions once a set of necessary conditions such as well-defined enforced property rights are established. Oliver Williamson considers the market as a universal category or a primordial system, as the antithesis to the firm, and seemingly as the prior natural order from which all other organizations are derived. Thus, the market is regarded to be in place by definition and therefore there is no need for theoretical justification. This is ingeniously expressed by Oliver Williamson's statement that "in the beginning, there were markets" (Williamson 1983: 20).

The adoption of the market mechanism in the previously centrally administered economies has resulted in ongoing and fundamental social change, not transition. Social change occurs through a process of cumulative causation and evolution mutation (Stanfield 1979: xii). Thus, the starting point of "transition" is the society and not the unfolding market. Society is mirrored in the process of social reproduction based on social relationships, habitual patterns of behavior and technological practices. Transitional economic analysis should start "...from the postulation that society exists as an evolving whole. This material, technological or substantive interpretation of the economic system focuses on society's need for a sustained flow of goods and services to support private and social lives of its constituents. The material meaning of the term economic rather than its calculating or economizing meaning is the point of departure ..." (Stanfield 1979: 113). In addition, competition cannot adequately explain economic behavior, because economic actors are two-dimensional beings—individual and social—articulated, not only through competition, but also through co-operation and reciprocity (O'Boyle 2000: 541). Hence, "as any static vision of a competitive market society is ahistorical and any public policy to achieve a state of competitive bliss is unrealistic" (Stanfield 1979: 43).

The evolutionary and developmental nature of economic processes, the interdependence of human actions and cultural path-dependence requires a cultural-holistic view of "transition". "The holistic view is needed because the various cultural aspects of society are interdependent" (Stanfield 1998: 4). Paraphrasing Stanfield (1979: 110) the lexicon of "transition" must contain words such as social processes, tendencies and forces set in motion. Hence, the "transition" methodology inevitably should be conceptual, descriptive, historical and institutional. It is not surprising that the transition outcomes are so diverse as for example the percentage change in GDP per capita in US\$ from 1989 to 2005 demonstrates: Azerbaijan -8.64, Bosnia & Herzegovina -59.82, Bulgaria -8.28, Croatia -2.36, FYROM -21.27, Georgia -104.93, Kyrgyzstan -18.60, Latvia -4.36, Lithuania -5.26, Moldova -121.27, Russia -16.47, Serbia & Montenegro -70.76, Tajikistan -34.01,

and Ukraine -64.91 (See Table 1). Thus, it is clear that the whole legal and institutional setting, which is dependent on cultural and historical factors, will determine the environment under which the market unfolds in transitional economies. Transition economies varied historically, creating path dependence

**Table 1** Transition outcomes

COUNTRY	Number of years under communist rule	Lowest 1990s GDP as % of 1989 GDP	Year of lowest 1990s GDP	Projected 2005 GDP 1989=100	Average annual GDP growth rate 1989–2005	Estimated 1989 GDP per capita in US\$	Projected 2005 GDP per capita in US\$	Percentage change in GDP per capita in US\$ 1989–2005
Albania	41	60	1992	144	2.31	1,125	1,622	30.64
Armenia	70	43	1993	106	0.36	994	1,053	5.60
Azerbaijan	70	37	1995	92	-0.52	1,195	1,100	-8.64
Belarus	70	63	1995	118	1.02	1,373	1,615	14.98
Bosnia & Herzegovina	41	12	1993	63	-2.85	2,252	1,418	-58.82
Bulgaria	41	66	1997	93	-0.50	2,210	2,041	-8.28
Croatia	41	60	1993	98	-0.15	5,514	5,387	-2.36
Czech Republic	41	87	1992	120	1.13	5,317	6,367	16.49
Estonia	50	62	1994	114	0.83	4,509	5,148	12.41
FYR Macedonia	41	70	1993	82	-1.20	2,235	1,843	-21.27
Georgia	70	25	1994	48	-4.38	1,662	811	-104.93
Hungary	41	82	1993	126	1.46	4,813	6,065	20.64
Kazakhstan	70	61	1995	112	0.70	1,836	2,052	10.53
Kyrgyzstan	70	49	1995	79	-1.06	440	371	-18.60
Latvia	50	52	1995	96	-0.27	4,427	4,242	-4.36
Lithuania	50	53	1994	95	-0.32	4,801	4,561	-5.26
Moldova	50	33	1999	46	-4.84	978	442	-121.27
Poland	41	82	1991	147	2.47	3,560	5,259	32.31
Romania	41	75	1992	105	0.27	2,076	2,167	4.20
Russian Federation	74	59	1996	89	-0.95	3,125	2,683	-16.47
Serbia & Montenegro (Yugoslavia)	41	41	1993	58	-3.29	2,114	1,238	-70.76
Slovakia	41	75	1993	126	1.53	3,603	4,597	21.62
Slovenia	41	82	1992	135	1.67	8,279	10,786	23.24
Tajikistan	70	39	1996	75	-1.82	331	247	-34.01
Turkmenistan	70	53	1997	120	1.14	1,407	1,686	16.55
Ukraine	70	38	1998	61	-3.08	1,725	1,046	-64.91
Uzbekistan	70	83	1995	118	1.01	437	513	14.81

Adapted from EBRD (2005)

during the transformation process and producing diversity in the institutional arrangements (Knell and Srholec 2007: 55). Therefore, within this context the unfolding of the market process will greatly influence the performance of institutions such as property, wages and working conditions, the financial system and credit provision, domestic and international trade, the interventionist state and social welfare. In addition, as the market process is not self-protective, conscious social control of the market becomes a natural outcome and not a distortion of its allocative postulates. The economy is a social creation and, as such, it is manipulated by collective action (George 1993: 476).

Waters (1988: 113–20) contrasted the premises of orthodox economics (law of nature, individual, certainty and contracts) with the premises of social economics (institutions, person, uncertainty and status) to demonstrate the embedded nature of economic behavior within a social framework. For example, institutional embeddedness (legal rules, state policies and cultural patterns) is a more pertinent factor in firm's profit-making behavior than are property, capital and interrelated economic variables (Zafirovski 1999: 53–4). Thus, the study of "transition" cannot be reduced down to the study of the economic factors alone. Instead, what is called for is a perception of the economy that incorporates the market, although the market is not the only boundary to social participants. The "transition" is a cultural, holistic, historical, dynamic and comparative process in nature and, as such, a social perspective would seem essential. History, then, is the cumulative product of action, conflict, and changing working rules; human action creates social order. "[The] Ahistoricity [of orthodox economics] is a major cause of the structural anomaly" (Stanfield 1979: 35) encountered in transitional economies. A social change perspective comprehends the operation of circular causation in social evolution and, thus, a Stanfield-Tool-Polanyi social perspective would be more appropriate in explaining the nature of social change that EEFSU experienced and is still experiencing.

Veblen's quest was to develop a theory of the cumulative life process in which the meaning and the direction of the process are both assigned by human inspiration and action is quite relevant for the "transition" economies. Ever lasting processes—not transitions—may, or may not, result in benevolent outcomes for society: cumulative change could result in cumulative deterioration or it could lead to cumulative improvement. Evolution, to Veblen, did not mean progress. In contrast to Marx, Veblen's theory is an existential theory of the cumulative cause and effect of human action of blind drift, not a teleological theory of progress. Veblen described human institutions as absurd phenomena, products of a sequence of opaque cause and effect. So when he used the term "evolutionary", the meaning he assigned to it was much closer to the meaning of the term "absurd" than to today's meaning of the term (Dugger 1989: 13). "This examination yields insight into Veblen's view of waste and the labor process and is the cornerstone of his theory of economic crisis and the pathology of finance or monopoly capitalism" (Stanfield 1989, 83). Meanwhile, the implementation of transition strategies in the centrally administered economies ignored the evolutionary and "absurd" character of institutions and resulted in "maximal dislocation" of the existing institutional fabric of transition economies, which produced in regressive institutional changes associated with corruption, crime authoritarianism and undemocratic practices. For example, the Polity IV Institutional

Democracy Index for 2004 and 2006 was zero for Azerbaijan, Belarus, Bosnia & Herzegovina, Turkmenistan and Uzbekistan, while for Kazakhstan it was reduced from one to zero (see Table 2). Corruption is prevalent and part of everyday life in most transition economies with a Corruption Perception Index (CPI) in 2006 below three in: Albania with a CPI 2.6, Armenia 2.9, Azerbaijan 2.4, Belarus 2.1, Bosnia & Herzegovina 2.9, FYROM 2.7, Georgia 2.8, Kazakhstan 2.6, Kyrgyzstan 2.2, Russia 2.5, Tajikistan 2.2, Turkmenistan 2.2, Ukraine 2.8 and Uzbekistan 2.1 (see Table 2).

Economics, in Stanfield writings, is identified with the study of humanistic behavior. This involves an understanding of economic relationships as embedded in non-market and non-monetary social relationships based on reciprocity (Laville 2003: 400; Waters 1993: 280). For example, government intervention and/or social customs and norms in the labor market, rather than demand and supply factors, may cause significant wage differentials with minor consequences for employment (King 2001: 68–9). “Consequently, an economy is not composed of markets on the one hand and non-market exchange situations on the other, but may include a variety of exchange situations from wholly unstructured singular exchanges at one end of the spectrum, through to ‘ideal-typical’ markets on the other” (Rosenbaum 2000: 475). In addition, “the tendency to take values as given is to construct a static theory” (Stanfield 1979: 36). Hence, the recognition that justice is a basic element of the socio-economic organization results in judgments and valuations that are essential for the improvement of human life and human progress: “... justice is a basic element of socio-economic organization. It is, indeed, far more important than allocative efficiency. Inefficient societies abound and endure on the historical record but societies that lack widespread convictions as to their justness are inherently unstable (Stanfield 1979: 164). As well, ‘social justice’ is the active and sometimes creative response to economic change” (Waters 1993: 277).

Economics, especially transition economics, thus becomes as a consequence a moral science, value-directed, ameliorative and, of course, holistic (Dugger 1993: 490). The concept of workable (or effective) competition replaces perfect competition as the yardstick to measure efficiency and social benefit (Waters 1993: 267). In addition, unmet physical needs threaten human dignity, as the transition outcomes demonstrate. People in need have a moral claim on economic resources and failure of the state to respond has acute implications for the social structure (O’Boyle 1994), as it is clearly demonstrated in transitional economies. Consequently, social well-being in transitional societies cannot be based on naïve faith in the spontaneity of equilibrium and full employment. Even if the economy was gravitating toward equilibrium and full employment, it would never have time to get to equilibrium because a new shock would strike it before equilibrium was reached. “Equilibrium was temporary; change was permanent. Essence is ephemeral; existence is real. Questions of essence are pseudoquestions; mere riddles or word puzzles, games to divert boredom—not worthy of serious attention. Questions of human actions, conflicts, and social problems are real questions” (Dugger 1989: 13).

## The “Transition” Experience

The orthodox approach to the “transition” process has been inadequate to explain the negative outcomes experienced in EEFSU. Actually, orthodox economists were

**Table 2** Polity IV index and corruption perception index

COUNTRY	Polity I V institutional democracy index <sup>a</sup> 2000	Polity IV institutional democracy index 2004	Corruption Perception Index <sup>b</sup> (CPI) 2000	Corruption Perception Index (CPI) 2004	Corruption Perception Index (CPI) 2006
Albania	6	7	N/A	2.5	2.6
Armenia	6	5	2.5	3.1	2.9
Azerbaijan	0	0	1.5	1.9	2.4
Belarus	0	0	4.1	3.3	2.1
Bosnia & Herzegovina	0	0	N/A	3.1	2.9
Bulgaria	8	9	3.5	4.1	4.0
Croatia	7	7	3.7	3.5	3.4
Czech Republic	10	10	4.3	4.2	4.8
Estonia	7	7	5.7	6.0	6.7
FYR Macedonia	6	9	N/A	2.7	2.7
Georgia	5	7	N/A	2.0	2.8
Hungary	10	10	5.2	4.8	5.2
Kazakhstan	1	0	3.0	2.2	2.6
Kyrgyzstan	1	1	N/A	2.2	2.2
Latvia	8	8	3.4	4.0	4.7
Lithuania	10	10	4.1	4.6	4.8
Moldova	7	8	2.6	2.3	3.2
Poland	9	10	4.1	3.5	3.7
Romania	8	9	2.9	2.9	3.1
Russian Federation	7	7	2.1	2.8	2.5
Serbia & Montenegro (Yugoslavia)	7	6	1.3	2.7	3.0
Slovakia	9	9	3.5	4.0	4.7
Slovenia	10	10	5.5	6.0	6.4
Tajikistan	2	1	N/A	2.0	2.2
Turkmenistan	0	0	N/A	2.0	2.2
Ukraine	7	6	1.5	2.2	2.8
Uzbekistan	0	0	2.4	2.3	2.1

Adapted from [www.cidcm.umd.edu/polity/](http://www.cidcm.umd.edu/polity/) and <http://www.transparency.org/>

<sup>a</sup> Polity IV contains coded annual information on regime and authority characteristics for all independent states (with greater than 500,000 total population) in the global state system and covers the years 1800–2004. In the Polity IV Institutionalized Democracy Index, democracy is conceived as three essential, interdependent elements. One is the presence of institutions and procedures through which citizens can express effective preferences about alternative policies and leaders. Second is the existence of institutionalized constraints on the exercise of power by the executive. Third is the guarantee of civil liberties to all citizens in their daily lives and in acts of political participation. Other aspects of plural democracy, such as the rule of law, systems of checks and balances, freedom of the press, and so on are means to, or specific manifestations of, these general principles. The Democracy indicator is an additive eleven-point scale (0–10). The operational indicator of democracy is derived from codings of the competitiveness of political participation, the openness and competitiveness of executive recruitment, and constraints on the chief executive using the weights.

<sup>b</sup> CPI Score: relates to perceptions of the degree of corruption as seen by business people, risk analysts and the general public and ranges between 10 (highly clean) and 0 (highly corrupt).



strangely surprised by the results of shock therapy and neoclassical gradualism as demonstrated in Table 1.

The construction of Table 1 uses the European Bank Reconstruction and Development report of 2005, as the previous year eight Eastern European countries joined the European Union<sup>1</sup>. All transition countries experienced a reduction in GDP as the lowest 1990's GDP ranged from 12% of the 1989 GDP for Bosnia and Herzegovina to 87% for the Czech Republic. In 14 out of 27 transition economies, the projected GDP level for 2005 was less than that of 1989, which is the year prior to the initiation of the transition process; the average annual growth rate for 1989–2005 was negative and the percentage change in GDP per capita in US\$ between 1989 and 2005 was negative. The highest percentage change in GDP per capita in US\$ between 1989 and 2005 was 32.31% for Poland.

In addition to the poor economic performance of the transition economies, the residual authoritarian institutions and processes in these societies are quite prevalent, especially in Russia and the former Soviet Union. This constrained productivity and prosperity as well as social justice. Democratization thus far has developed within a relatively narrow terrain and has not yet penetrated deeply into civil society, with detrimental effects on prosperity as well as equity (Elliot 1993: 521). As Table 2 reveals, out of the 27 transition countries using the Polity IV Institutional Democracy Index to measure the progress toward democracy, only four countries achieved the highest score of 10, while five achieved the lowest score of zero in both years 2000 and 2004. The index increased between 2000 and 2004 for seven countries, for six countries the index remained the same and for five countries the index decreased. Hence, the progress toward democracy is not encouraging, as only eleven countries have either increased their index or have achieved the maximum, while the remaining 16 have experienced no change or a decreasing index. What the transition economies need to realize is that an enhancement of positive freedom requires redistribution of property and, thus, government intervention. "Whether we like it or not, we rely very much on government for what we often accuse it of depriving us, namely, freedom" (Waters 1993: 275).

All the transition economies experienced the negative phenomenon of corruption and with it a rise in crime. This compromised the economic reform program and led to inflation, inequalities and disillusionment, with the transition goals in the eyes of the people. According to a World Bank study, half the Russian economy was in the hands of the Mafia by 1999 (Kingston-Mann 1999: 35). As Table 2 demonstrates, the Corruption Perception Index (CPI) for 2000, 2004 and 2006 is very low for nearly all the countries. The highest index achieved in 2006 is from Estonia at 6.7, followed by Slovenia at 6.4 and Hungary at 5.2. The remaining countries have an index below five, with Belarus and Uzbekistan experiencing the lowest index of 2.1. The increasing CPI for 18 out of 27 countries, while positive, is counterbalanced by the very low indices and small increases.

It is quite interesting to note how an orthodox approach explained the escalation of corruption and crime during transition. Sachs (1995: 22), a shock therapy

<sup>1</sup> The 2004 enlargement of the European Union concerned the simultaneous accessions the following ex-"socialist" economies: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia together with Cyprus and Malta.

supporter, argued that this was because civil society was weak and disorganised. Of course, corruption was not something new, as shock therapy supporters pointed out. The members of the party, under the previous state of affairs, used their political power for their own betterment by exploiting the country's resources. With the establishment of political pluralism, however, corruption could not be hidden under the party shield of protection. For shock therapy supporters, the origins of corruption remained the same: the old guard, using the positions of power it had inherited, was able to build wealth illegally. Most importantly for the shock therapy supporters, corruption was allegedly the result of implementing a gradual process instead of a shock therapy approach. For example, there was no doubt for the shock therapy supporters that the gradual and ill-defined process of reform in Russia induced and was indeed often motivated by corruption (Boone and Fedorov 1997: 186). The ill-defined laws and legal procedures, the piecemeal removal of price controls, the subsidies provided by the government, the maintenance of trade barriers and the inconsistent regulations, were all the result of a gradual approach, which led to the growth of corruption at every level of government. In reality, there was no reliable legal system (Aslund 1997: 199). "Such blatant increases in wealth, as well as their often dubious sources, add intense feelings of injustice to the hardships of the middle and lower classes. Indeed, that sense of injustice may well be more corrosive of confidence in democratic institutions and market solutions than the hardship itself, which many people (particularly members of the middle classes) are prepared to view as temporary" (Nelson 1995: 59). The only way to avoid becoming a Mafia economy, and in order to cure corruption and crime was, and still is, radical liberalisation for the shock therapy supporters (Aslund 1992: 174; 1995, 170). As is understandable from a cultural-holistic perspective of radical institutionalism, this is a very narrow explanation for the escalation of corruption and crime during transition.

Gradualist neoclassical economists accept Coase's theorem that clear property rights, preferably private property rights, were essential for a well-functioning market economy in Eastern Europe. For market capitalism to consolidate and function efficiently, it was imperative that the institutional structure protected private property, enforced contracts, imposed financial discipline and generally created a stable legal environment. By definition, economic justice meant nothing more than respect for private property and only free market outcomes were just (Caporaso and Levine 1993: 204). Having market oriented institutions in place while old institutions were torn down was crucial for reforms to be effective (Thomas and Wang 1997: 218). Institutional changes would be apparently initiated by the market process, albeit slowly (Vasiliev 1997: 37).

Gradualist economists argued that the transition to a market economy needed to be facilitated by an institutional structure, the development of which had to be gradual, natural, organic and voluntary as opposed to the constructivist, state-directed establishment of institutions (Kolodko 2000: 274; Murrell 1992: 80). A gradual process allowed time to clarify the institutional principles and to test institutional adjustment. Institutional development was a complex evolutionary process, causing the ineffective institutions to wither away and choosing as survivors the ones truly fit for the task (Nelson 1995: 78, 82). Market-supporting institutions aimed to make the transition more effective and harder to reverse.

For the neoclassical gradualists, the implementation of the shock therapy process without any institutional fundamentals in place resulted in "bandit capitalism" in the

transition economies (Kolodko 1999b: 249). The rise of criminal activity and Mafia methods of imposing financial discipline was “alarming and intolerable” (Kornai 1993: 327; 1995, 153). However, it could partly be explained by the harmful side-effects of a healthy process, namely the abolition of the police state. At the same time, the establishment of democracy and markets “opened the curtains and made crime more visible”. It revealed an unexpected amount of official corruption and Mafia-style crime which was not compatible with the mature market economies (Olson 1995: 438, 457). While the neoclassical gradualist accept that the increase in crime was the result of weak institutional arrangements (Blankenagel 2000: 115; Kolodko 1999a: 33), they present these negative outcomes as necessary and due to the presence of new-founded democracy. Again, from a cultural-holistic perspective of radical institutionalism, this is a very narrow explanation for the escalation of corruption and crime during transition.

Nevertheless, the development of the institutional structure of the shock therapy and the gradualist neoclassical process appear to be quite similar. While both argued that market institutions can only result from market forces, gradualist neoclassical economists allow institutions to develop concurrently with market relations; markets with institutions. For shock therapy supporters, the goal was the development of market relations firstly with the assumption that institutions would follow in due time. The gradualist neoclassical argument suffered from the same flaws. Gradualist neoclassical writings fail to offer a concrete process of institutional development. They simply leave the end-state to be determined by the market, assuming that the most efficient institutions would emerge. The gradualist neoclassical break with shock therapy was far less complete than it appeared to be (Marangos 2002, 2005a; Smyth 1998: 387).

The contrast becomes more acute between the neoclassical gradualist approach of markets with institutions, and the Stanfield-Tool-Polanyi argument of social change. The former believes that “markets with institutions” is enough to instigate proper property rights and provide public goods, while the Stanfield-Tool-Polanyi perspective espouses participatory action from below (not just with markets) as an aspect of institutions, so that mafia capitalism does not become dominant. The adding of the adjective “participatory” to democracy is necessary to secure the core meaning of democracy, as there is a tendency of elitist groups to disguise their power under the democratic rhetoric (Tool 2001 [1979]: 207). “Participatory democracy encompasses a fundamentally different view of people and of the kind of leadership which is pertinent to their lives and well-being. The justification of locating discretion with the whole people rests on the demonstrable contention that people are educable, are capable of effective participation, and are able to judge the adequacy of adjustments made in response to real problems. Their sense of what is just reflects their own experience with justice” (Tool 2001 [1979]: 208). The cultural-holistic approach of radical institutionalism is concerned with the issues, outlined in this paper: the initial conditions, history, interdependence of human actions, cultural path-dependence, circular causation in social evolution, humanistic behaviour, justice, social stabilization, democratic economic planning, participation in institution building and institutional change, the cultural continuity of the people, the establishment of a regulatory environment, collective action, poverty, social welfare and ultimately participatory democracy. The neoclassical gradualist approach of

markets with institutions is unable to incorporate the aforementioned “transition” issues, as their analytical framework is inadequate; the neoclassical gradualist approach of markets with institutions eventually assign institutions characteristics of an economic good produced “efficiently” by the market.

As the automatic benevolence of the market is irrelevant, the institution of democratic economic planning becomes essential, all the more so for transitional economies to avoid the “transitional recession” that is “necessary” for orthodoxy. Institutionalists dismiss the arguments by orthodox economists that planning and markets are not compatible co-ordination mechanisms; rational planning is impossible according to Carrington (1992: 23) because of the diverse interests of individuals and subsequently, the only mechanism for co-ordination is the market as it is based on the signals provided by relative prices. Conversely, “the market process is not self-protective. Society instead requires protection from the market and this will require conscious social control, that is, planning. Clearly, interventions may be multiplied as infinitum, but they will never constitute planning” (Stanfield 1979: 78). Thus, state intervention in the form of national, democratic planning is crucial to turn the transition process around toward social benefit (Dugger 1989: 14). Ayres (1952: 190) had asserted that “planning is itself a manifestation of the technological process”. Adequate and reliable information, combined with the recognition of the impact of technological change, confirm Keynes’s justification for government intervention in the form of planning (Gruchy 1984: 162). Tinkering with the market and in its supporting institutions, though preferable than “free markets”, will not meet social requirements (Dugger 1989: 16–7) in transitional economies. Nonetheless, “if the overall macroeconomic guidance baby is not to be thrown over with the over-centralized micro planning bathwater” (Elliot 1993: 523), planning cannot be narrowly conceived as only purposeful guidance of the allocation of resources but rather as a more expansive concept as planning incorporates and requires democratic and planning institutions and planning ideology (Stanfield 1979: 74). Nevertheless, “conscious, democratic planning would not produce heaven on earth, but it just may enable democratic industrial society to avoid a living hell” (Stanfield 1979: 105). It is interesting to note that both shock therapy and neoclassical gradualism reject economic planning in transitional economies. Surprisingly, both approaches recommended that at the beginning of the reform program, a tax-based wage policy, actually an incomes policy, should be implemented to encourage wage increases below the increases in inflation so to avoid a wage-price spiral due to hyperinflation. In other words, both approaches denied the institution of collective bargaining as a means of settling disputes and establishing labor-management relations. Effectively, the centrally determined incomes policy under the transition conditions created the preconditions to oblige workers to “voluntarily” adhere to the specific maximum wage increase and decrease in their living standards (Marangos 2009). Hence, “to be of use for long-term planning, economics would have to view economic processes from an evolutionary and developmental perspective” (Stanfield 1979: 33).

Poverty was also institutionalized as is the reserve army of the unemployed in transitional economies. Measures to reduce poverty and unemployment within the unfolding capitalist structure, while desirable, have proven to be inadequate in transitional economies, as “neoclassical economics simply does not affirm the person of others in need and the moral claim on economic resources” (O’Boyle 1994: 291).

Just as poverty and unemployment were institutionalized, they must be deinstitutionalized. Power, status, authority and oppression are crucial elements in understanding the process of social change against the tide of poverty and unemployment in transitional economies; power, status, authority and oppression have the capacity to influence the allocation of society's resources and therefore the quality of existence in society (Stanfield 1979: 37). "If political economy is understood as the resolution of conflicting values or claims, the anomaly of power is not only more than economic, it is also more than political economic" (Stanfield 1979: 26). Power and status must be fundamentally restructured in transition economies to ensure that the poor and unemployed are not just more productive, but that they also are able to appropriate their fair share of society's wealth. "At any rate, neglect of the aspect of power with respect to the formation of valuations is at least as serious for economists as the inability to cope with the resolution of value conflicts" (Stanfield 1979: 26). Most importantly, community progress, when it comes, moves from the bottom-up, never from the top-down; as Tool (2001 [1979]: 173) stressed, "Only 'evolutions from below' can succeed", which is in total contrast with the foundation of the shock therapy model of transition, as "[T]hose whose behavior is to be revised must themselves understand the need for it, concur with it, and participate in it. Otherwise nothing substantive changes; the canons, codes, customs, and conventions remain largely as before", as the "transition" experience demonstrates as well. In actual fact, "the transition to a market economy can only succeed if the mass of the population participates in the success and failures of the process with solid understanding of the issues involved...So a second concern of the institutional analysis of the transition process is a cultural focus upon the capacity of people to participate in the emerging market economy" (Stanfield 1998: 17). Progress is not based on charity, but on equality. Hence, redistribution of power and status are essential element to progress in transitional societies, as equality is instrumental (Dugger 1989: 11). These elements of social change were ignored by the orthodox transition strategy.

It is clear from the "transition" experience presented in both qualitative and quantitative terms that independently of the process of transition, shock therapy or neoclassical gradualism, the outcomes were quite the same, but not to the same degree. Some economies that implemented shock therapy performed worst than economies that implemented gradualism and quite the opposite. Some economies that implemented gradualism performed worst than economies that implemented shock therapy. For example, contrast the shock therapy Bulgaria, Czech Republic, Latvia, Poland and Russia with the lowest GDP as a percent of 1989 GDP at 66%, 87%, 52%, 82% and 59% respectively, with the gradualists Hungary, Kazakhstan, Romania, Slovenia, Ukraine, Uzbekistan at 82%, 61%, 75%, 82%, 38%, 83% from Table 1. Thus, while shock therapy promoted social and economic instability and hence poor performance, the shock therapy supporters, meanwhile, argued that "real shock therapy" was never implemented, especially in Russia (Aslund 1997: 200; Balcerowicz 1994: 87; Sachs 1997: 127). Many economies did not institute shock therapy *a la* the fundamentalist neoclassical model, yet change was too rapid (in certain fashion) promoting a disembedded economy. The reason behind of the negative outcomes independently of the process of change has to do with the conceptualization of change as "transition" and not as "social change". Social change is concerned, with the dynamics of political-economic processes; hence "this argues for a moderate pace

and magnitude of reform, so as to foster popular support and participation and an egalitarian mode of privatization, so as to promote social justice and widespread engagement in acts and projects of productivity enhancement and X-efficiency” (Elliot 1993: 522). Meticulous cultural-holistic analysis would not endorse shock therapy or neoclassical gradualism, which both emphasize spontaneous development of the private sector, and would consider it to be inferior to a gradual approach of the Stanfield-Tool-Polanyi participatory action from below. Not surprisingly for radical institutionalists, as the process of disembedding of the market has been initiated, with its all-increasing capitalist characteristics, it results in the destruction of trust, the rise of corruption, and the development of an inefficient and dishonest economy coupled with authoritarian tendencies, as Table 2 demonstrates.

### Problems for Future Research

An approach employing social change instead of transition also reveals exciting and interesting problems for future research, as the “transition” is not complete but ongoing. Even if the legal and institutional frameworks can appear similar in different countries, still they may have different meanings in varying environments (Lane and Myant 2007: 1). There appears to be an institutional learning curve that the population must climb in order to become effective participants in the market economy. The shape of this learning curve is determined by a variety of factors, but rapid and unbalanced economic restructuring at the expense of massive social instability almost certainly flattens the learning curve and makes more strenuous the task of learning the new system of communication and sanction. Stanfield (1998: 20) referred to this learning curve in terms of the development of *effective institutional cognizance* (EIC). Institutional cognizance refers to the population’s understanding of the communication and sanction system by which their subdivided labor is integrated. Effective cognizance indicates that is it not simply the volume of knowledge of operations of the market economy that is important, but the extent of this knowledge in relation to the degree of the impact of the market relationships on daily life. A market participant can have a degree of effective institutional cognizance, even though they know little about the operation of markets, if they live in a society that makes little use of markets in integrating the division of labor. A market participant’s know-how can be significant, and still leave them ill equipped, if the market is suddenly dominant in determining their economic destiny.

EIC is determined by the openness of the population to change, the clarity of the change they are asked to undertake, the pace at which they are asked to do so, the security they are able to achieve in the process, and the sense they have as to whether or not they are given the opportunity to participate in the decision-making and in the new institutional forms that are being established (Stanfield 1998: 21). The historical background of the population will affect the population’s readiness to undertake economic change. This is a factor that should not be overlooked in designing economic restructuring. The political leadership and the clarity of popular understanding of the changes in motion are critical, and the time factor is decisive as well in this context. Adequate security is essential to popular acceptance, thus redistributive measures are crucial before initiating a major restructuring of the

“transition” type. The transition is inevitably stressful, and this makes popular participation all the more vital. Psychological studies demonstrate that stress is not detrimental to people who sense they have the capacity to perform and carry tasks for which they are put under pressure (Stanfield 1998: 21–2). Amateur athletes experience the excitement to perform and eventually prevail under pressure. Quite the reverse though, when stress is imposed with no clear course of action it is severely detrimental to human health, as the “transition” experience demonstrates (Marangos 2009: 153). Such widespread stress, associated with the orthodox model of transition, “will effectively short circuit the transition process” (Stanfield 1998: 21). Meanwhile, the speculative commotion and insider privatization did not reward understanding of the market process; they rewarded those in position to control resources in the old system and in the black economy. “Rapid change may well induce conservatism and atavism and undermine commitment to the transition” (Stanfield 1998: 21).

Thus, with regard to the transition process, we can specify EIC to be a function of the degree of cultural adaptability and the pace of marketization. EIC is positively related to cultural adaptability and negatively related to the pace of marketization.

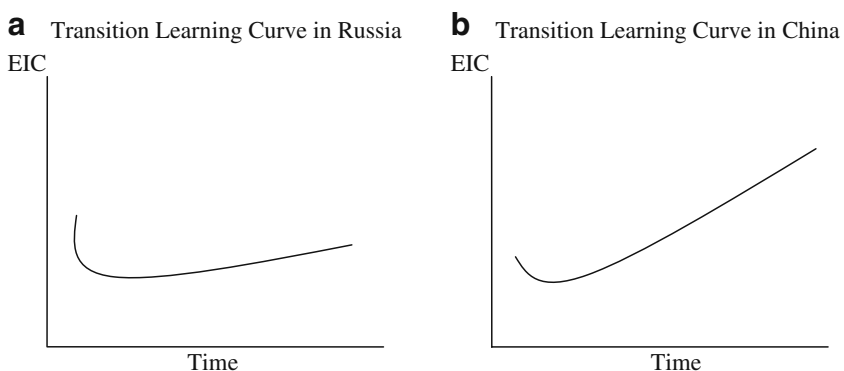
EIC reflects people’s understanding of market behavior in relation to the impact of market relations on their lives.

$EIC = f(C, M)$ ; positive relation to  $C$ , negative relation to  $M$ .

$C$  cultural adaptability (openness & leadership)

$M$  marketization (pace of change)

Figure 1 illustrates the general pattern of EIC in Russia (1a) and China (1b) during their recent decades of change and transition. In this context, Stanfield (1998: 23) explains that the Russian EIC is depicted as dipping dramatically in the early stages of the transition, after Yeltsin’s advisers initiated shock therapy in January 1992. Thereafter, the decline in Russian EIC bottomed out and then gradually began rising. In East Germany, people “... exhibited a psychological reserve *vis-à-vis* the new institutions” (Schmidt 2007: 96), implying a very flat EIC somewhat like that of Russia. The Chinese EIC is depicted as falling slightly following the introduction of the contract responsibility system and other changes of the late 1970s and early 1980s, but then rising fairly steeply.



**Fig. 1** Effective Institutional Cognizance (EIC) in Russia (a) and China (b)

Cultural adaptability, and hence EIC, is influenced by social values, in particular the level of cooperation in society, which in turn determines institutional cognizance. Weitzman and Xu (1994) used a prisoner's dilemma game to demonstrate the influence of cooperative culture on property rights theory. Lambda ( $\lambda$ ) represents the parameter used to determine the degree of cooperation among a particular societal group or society. Lambda is useful in determining whether there is a need and reliance for well-defined ownership within a broad range of cultures. Weitzman and Xu (1994) suggested that there was much anecdotal evidence that could be cited to argue that Asian countries are high-lambda societies relative to countries in Europe, which by comparison are more of low-lambda societies. Traditional Chinese cultural values, which are rooted in the Confucianist, Taoist and Buddhist philosophies, consist of a sense of order, vertical and horizontal relationships, obligation to the group and the preference for harmony and cooperation in interpersonal relationships.

Marangos (2005b), by using the notion of cooperative culture, demonstrates that economic reform does not need to rely on well-defined property rights in the short run. China's cooperative culture and institutional cognizance allows for the development of efficient and successful informal institutions creating a rising and steep EIC curve without the aid of standard conventional property rights. This lack of property rights is a unique trait to countries that have a high-lambda, and the degree of this cooperation is rarely seen in countries that would have a low-lambda. My argument is that cultural adaptability is influenced by social values in particular the level of cooperation in society, which in turn affects the EIC. Note, however, that this is not a one-directional approach. Given the fact that transition is a social change that is ever-lasting, the social values (e.g. the level of cooperation) may themselves be influenced and re-structured by the social change at least in a long-run. So, we need to consider the evolution of social values themselves and how they are constituted through social process. The analysis encompasses the dialectical character between social values and social change.

The level of cooperation moulds and forms social change as much as it is a reflection of it. For example, as a process of disembedding of the market has been initiated in China, with its all-increasing capitalist characteristics, it results in the destruction of trust, the rise of corruption and the development of an inefficient and dishonest economy reducing the level of cooperation influencing the EIC. Even the IMF (2005: 129) has accepted that reforms need to be launched based on local conditions and need to take into consideration the specific constraints that influence the speed of reform and the particular form that institutions unravel. Different initial conditions have strongly influenced, based on IMF assessment, the approach to ownership transformation in China and EEFUSU. "First, the initial conditions matter and, therefore, reform strategies need to be country specific" (IMF 2005: 129). The concept of institutional cognizance will prove to be a useful concept in determining the differentiated outcomes of "transitional" societies.

## Conclusion

Orthodox economics fails to grasp the evolution of human values, needs, technology and resources (Stanfield 1979: xiii) and hence "transition". This is because the



methodology adopted by orthodox economics is obsessed with the ideal of rational economic participants who have pre-established preferences and prearranged resources, innate personality characteristics to trade and maximize utility and profits in the absence of market power exercised by household, firms and government. However, “failure on the part of the state to respond to the physical need that is unmet by the private sector has profound implications for the social values of freedom, equality, and community and thus for the personhood of those in need” (O’Boyle 1994: 296), as experienced in transition economies.

More realistically, economic behavior is embedded in processes of cumulative and evolving preferences and resources, personality characteristics are formed gradually by a trial-and-error (not by shock therapy), and market power is inherently present and exercised by economic actors to influence the market outcomes. Social and economic behavior is based on informal rules and organizational cultures due to computational and information competency limitations. Orthodox economics is unable to recognize that productive behavior is induced by cultural and social context and that this inducement must be nurtured in order to sustain social provisioning. The cultural-holistic approach of radical institutionalism is concerned with the issues, outlined in this paper: the initial conditions, history, interdependence of human actions, cultural path-dependence, circular causation in social evolution, humanistic behaviour, justice, social stabilization, democratic economic planning, participation in institution building and institutional change, the cultural continuity of the people, the establishment of a regulatory environment, collective action, poverty, social welfare and ultimately participatory democracy.

In this context, “progress is not automatic, but neither is it impossible. Progress must come, not through coercing others into accepting our own metanarrative and not through giving up on the whole idea of progress, but through empowering others to pursue their communal and cultural ideals” (Dugger 1993: 500). Mainstream economic theory focuses on low-level needs for people at low levels of human development (Pressman 2001: 109) contrary to the needs, aspirations and educational level of the people in transition economies. At the end, “... in any case, whatever progress a shock therapy policy regime eventually achieves, it does so at a cost of massive social dislocation, avoidable human misery, and the risk of social and political collapse” (Stanfield 1998: 23–4).

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