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TITLE: WINNERS TAKE ALL: THE POLITICS OF PARTIAL REFORM

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Executive Summary

Much of our current thinking about the politics of economic reform is based on a recognition of the problem of the losers. Economic reforms are expected to generate high costs in the short term for the promise of future gains. The political challenge, therefore, is to implement and sustain economic reforms over the anticipated opposition of the short-term losers from those reforms. This conventional view has led to policy prescriptions designed to marginalize the losers, if only temporarily, and to insulate the state from short-term political pressures until the economic reforms have had sufficient time to create a constituency of winners capable of sustaining them over time.

Yet in the post-communist transitions, more comprehensive reform programs appear to have inflicted lower transitional costs in the short term than intermediate or slow reforms. Moreover, it has been precisely those countries in which the political leaders have been most vulnerable to the demands of the short-term losers that have adopted and sustained the highest levels of economic reform. Governments that have been insulated from electoral pressures and that have enjoyed a high level of tenure security -- the type of governments that have traditionally been seen as the most capable of initiating necessary, but costly, economic reforms -- have proven to be the laggards in the post-communist economic transitions.

This paper explains these outcomes by reframing the politics of economic reform in the postcommunist transitions to highlight the problem of the winners. Though reforms do entail high transitional costs in short term, they also generate extraordinary short-term gains for particular groups, namely those in a position to take advantage of a range of market distortions associated with partial economic reforms. Though these winners do gain an early stake in the reform process, they also develop an interest in preserving the very distortions of the initial reforms that can impede the realization of the efficiency gains of a fully functioning market. Rather than pursuing further market reforms, these winners may have incentives to freeze the economy in a *partial reform equilibrium* that generates concentrated gains to a narrow range of groups, while imposing substantial costs on the rest of the population.

The paper presents evidence from the postcommunist transitions to demonstrate that the main challenge to economic reform has not come from efforts by the losers to reverse reforms once implemented, but by the inability of some countries to move beyond the initial stage of partial reforms. Countries that have maintained partial or intermediate reforms over time are shown to have generated a unique pattern of more concentrated gains and higher overall social costs than those countries that have pursued either more comprehensive or minimal economic reforms.

Based on this evidence, the main political challenge of the reform process is recast from one of marginalizing the short-term losers to constraining the short-term winners. Paradoxically, the most effective means of achieving this goal has been to guarantee the political inclusion of the very constituency that most existing political economy models seek to exclude: the short-term losers of

reform. The paper demonstrates that states that are more inclusive and more susceptible to the short-term pressures of the losers -- through competitive elections, frequent government turnovers, and broad coalition governments -- have been more effective economic reformers

One of the fundamental tenets of the politics of economic reform has always been to create a constituency of winners with a stake in sustaining and advancing the reform process. Yet a comparison of the post-communist transitions suggests that the winners can do far more damage to the progress of economic reform than the losers. Though the winners have no interest in returning to the status quo ante, they do have an incentive to exploit the uneven pace of change in the various components of market reform to maximize their private gains, but at considerable social cost. As a result, the success of the process of economic reform depends on both creating winners and constraining them. Paradoxically, the most effective means of constraining the winners in the post-communist transitions has been

This new approach provides an explanation for the positive relationship between democracy and economic reform in the postcommunist transitions.

The recognition that the process of economic reform is threatened less by the short term losers than by the short term winners has important implications for our understanding of the political institutions that enable or impede economic reform. While conventional political economy models have emphasized the importance of insulating the state from the pressures of the losers through various forms of state autonomy, the partial reform model stresses the need to restrain the winners by dissipating their concentrated rents through increasing competition with other groups or by restricting their ability to unilaterally veto reform measures. In this view, expanding political participation to include the losers in the policymaking process could place limits on the concentrated political power of the winners and prevent them from sustaining a partial reform equilibrium. This paper has shown that post-communist systems with a higher level of political participation and competition have been able to adopt and maintain more comprehensive economic reforms than states largely insulated from mass politics and electoral pressures.

This paper recasts the central political challenge to economic reform in postcommunist transitions. While the conventional approach assumes that the primary threat to economic reform comes from those who lose from reforms in the short term, I show that the greater threat comes from those who are the biggest winners of reform in the short term. The short term winners of reform have strong incentives to try to freeze the economy in a state of partial reforms to preserve the extraordinary gains they enjoy from arbitrage opportunities in the partially reformed economy. As a result, the postcommunist countries have suffered less from the pressure of the losers to prevent the initiation of costly reforms or to reverse those reforms once implemented, than from the pressure of the losers to preserve a partial reform equilibrium that generates high private gains to the winners, but high social costs for the economy at large.

The paper tests to determine whether the implications of conventional models of the politics of economic reform have any explanatory power for the postcommunist cases. These conventional models predict that governments more susceptible to the pressures of the short term losers are less likely to adopt comprehensive economic reforms and more likely to reverse them at some future point if they are adopted.

WINNERS TAKE ALL: THE POLITICS OF PARTIAL REFORM[2]

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Much of our analysis of the politics of economic reform is based on an assumption about the distribution of the costs and benefits of reform, known informally as the J-curve. Simply stated, reforms are expected to make things worse before they get better. In the short term, economic reforms are believed to generate "transitional costs" in the form of high unemployment, price increases, and production declines as the economy adjusts to the tremendous institutional and policy changes necessary to achieve the long term efficiency gains of an effectively functioning market. Yet the timing of the costs and benefits of reform presents a serious political problem: how can politicians initiate and sustain reforms that demand severe sacrifices in the short run for the mere promise of future gains? Surely, losers in the short term will take their revenge against reformers at the first opportunity and spark a backlash against reform. Anticipating this reaction, politicians in democratic systems are understandably reluctant to undertake radical economic reforms. Therefore, the central political challenge of reform, as expressed in Adam Przeworski's apt metaphor, is to traverse the "valley of the transition" in order to climb the "higher hills" of the reformed system. (Przeworski 1991, p. 138) This logic has led to a series of political prescriptions centered around the same theme: to insulate the state from the pressures of the short term losers until the reforms have created a constituency of winners powerful enough to sustain them.[1]

Though economic reforms in the post-communist countries have certainly created more than their fair share of transitional costs, the expected political dynamics normally associated with these costs have been much less evident. The most radical reform programs in the region have been introduced and sustained in the most competitive political systems, where politicians have been most vulnerable to electoral backlashes by the short term losers. Though in many cases, voters have rejected radical reform governments in the first post-reform elections, the reform programs themselves have endured and, in some cases, even intensified. More surprisingly, the politics of post-communist economic reforms has not been dominated by striking workers, resentful former state bureaucrats, impoverished pensioners, or armies of the unemployed -- the traditional short term losers of economic transition.

Instead, the most frequently mentioned obstacles to the progress of economic reform in post-communist transitions have come from very different sources: from enterprise insiders who have become new owners only to strip their firms' assets; from commercial bankers who have opposed

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macroeconomic stabilization to preserve their enormously profitable arbitrage opportunities on distorted financial markets; from local officials who have prevented market entry in their regions to protect their share of local monopoly rents; and from super-rich "mafiosi" who have undermined the creation of a stable legal foundation for the market economy. These actors can hardly be classified as the short term losers of economic reform. On the contrary, they were its earliest and its biggest winners. Though they did not oppose the initiation of the reform process nor have they sought a full scale reversal of reform, they have opposed further reform measures that threaten to eliminate the special advantages and market distortions upon which their early reform gains were based. Instead of forming a constituency in support of advancing reforms, the winners in the short term have attempted to stall the economy in a *partial reform equilibrium* that generates concentrated rents for themselves, at the same time imposing high costs on the rest of the population.

While conventional models of the politics of economic reform are driven by the incentives of the short term losers, the post-communist transitions appear to have faced far more serious obstacles to reform from the short term winners. Moreover, the obstacles have come less in the form of ex ante opposition to the onset of reform or ex post electoral reversals of reform, than in the prolonged maintenance of partial reforms and their associated market distortions. If the political challenge to economic reform comes not from the short term losers reacting to the transitional costs of reform, but from the winners seeking to preserve the rents from partial reforms, then the prescriptions derived from conventional political economy models about the political institutions most conducive to reform need to be reexamined. This paper suggests that the emphasis on insulating the state from the short term losers of reform -- the major conclusion of many existing models -- needs to be replaced with a recognition of the importance of restraining the winners of the early stages of reform.

This paper begins by testing the applicability to the post-communist transitions of a model of the political economy of reform based on a J-curve distribution of the costs and benefits of reform, in which reform generates concentrated costs in the short term and dispersed gains in the long term. It examines both the ex ante and ex post political constraints on reform predicted from such a model. As for the ex ante political constraints, the evidence from these transitions suggests that countries with more frequent elections and shorter expected executive tenures, i.e., those most susceptible to electoral challenge from short-term losers, have been more likely to adopt comprehensive economic reforms than states with greater insulation from electoral pressures. As for the ex post constraints, annual rankings of the progress of economic reform are examined to demonstrate the weakness of the threat of electoral reversal of reform in the post-communist transitions.

The paper then presents a model of the politics of economic reform in which the primary political challenge derives from the short term winners. The model is based on the recognition that partial economic reforms produce a pattern of concentrated gains and dispersed losses rooted in distortions of the emerging market economy that create incentives for the short term winners to

oppose further measures to ameliorate these distortions. This pattern of gains and losses is demonstrated with recent evidence on changes in the concentration of incomes in the post-communist countries since the onset of reforms. Transition economies that have undergone only partial reforms have experienced a higher redistribution of income to a narrower group of winners than those countries with either more comprehensive reforms or few reforms at all. The paper concludes with an analysis of the political institutions that are most conducive to sustained progress in economic reforms given the challenge of the winners.

The J Curve

Most existing models of the politics of economic reform are based on a depiction of the costs and benefits of reform as a J-curve, as in Figure 1 (page 25). The simple, compelling idea is that economic reforms generate transitional costs in the short term before they begin to produce their promised economic gains and that these costs are directly related to the extent of the reforms adopted. Inefficient enterprises must be closed or restructured, state subsidies and social spending must be reduced, and domestic prices must be raised to world levels. This is expected to generate unemployment, sharp decreases in production, and declines in living standards at least until the economy begins to adjust to the new structure of incentives. Some analysts even expect the onset of reforms to increase the misallocation of resources in the short run as poorly defined property rights, the absence of developed financial markets, the continued presence of monopolies, and insufficiently trained human capital distort the response to market incentives in the early stages of reform.[2]

The depiction of the costs and benefits of reform as a J-curve is particularly compelling from a political standpoint, as it provides a plausible explanation for the central paradox of the political economy of reform: if economic reforms ultimately make all or a majority of country's citizens better off, why are they so politically contentious, especially in democratic systems? The recognition of the time dimension of the costs and benefits of reform suggests that economic reforms are subject to a *time inconsistency problem*, i.e. they require actors to accept losses in the short term for the mere promise of future gains. If the government cannot make a credible commitment to maintain those reforms until the promised benefits arrive or to insure that those gains are not confiscated once they do arrive, then it may be rational for economic actors to reject the reforms ex ante.[3]

The J-curve distribution of costs and benefits is also assumed to create a collective action problem that generates political obstacles to economic reforms. It is commonly argued that the losses from economic reform are concentrated on specific groups -- namely, those that were privileged or subsidized by the previous status quo -- while the benefits of reform are more widely dispersed. Low inflation, increased availability of goods and services, a stable currency, etc. -- these nonexcludable benefits accrue to society as a whole and, thus, have public goods characteristics. A pattern of concentrated losses and dispersed benefits suggests that losers will have greater selective incentives

to engage in collective action than the winners. (Haggard and Kaufman 1995) Consequently, the political opposition of the losers against economic reforms is expected to be more effective than the political support of reform by the winners, even if the latter outnumber the former.

The time inconsistency and collective action problems are believed to produce both ex ante and ex post political obstacles to reform. If economic reform produces short term losses for the promise of future gains, then politicians in democratic systems with necessarily short time horizons will be reluctant to adopt reforms that will not produce benefits before the next elections. Moreover, they will have weaker incentives to adopt the most radical economic reform programs given their higher short term costs. If radical reforms are adopted, they are expected to face a high likelihood of ex post reversal as the losers react to the high short term costs once the political euphoria of the early stages of the transition begins to subside.

These ex ante and ex post political constraints on reform -- based on the reaction of the losers to the short term costs of reform -- have led many analysts and reform practitioners to emphasize the benefits of insulating reform governments from the pressures of the losers at least in the initial stages of the reform process. Though earlier literature suggested that authoritarian governments had an advantage in implementing economic reforms, this has been largely replaced with a recognition of the benefits of state autonomy, the concentration of executive power, and the delegation of power to technocrats for the adoption of economic reforms.[4] These institutional features are believed to protect politicians from the pressures of the short term losers until the realization of gains from the reforms over the long term creates the necessary political constituency to sustain them.

Though the implications of the J-curve approach to the politics of economic reform have been widely accepted, they are based on a number of assumptions that have not been subjected to systematic empirical tests.[5] This approach assumes that economic reforms will generate transitional costs prior to the realization of benefits and that these costs will be greater with the adoption of more extensive reform programs. On the political dynamics of reforms, this approach leads to a simple hypothesis: political systems in which reformers are more susceptible to the reaction of the losers are less likely to adopt extensive economic reforms and are more likely to suffer reversals of reform if such measures are adopted. The post-communist transitions provide an ideal opportunity to test these assumptions on a new set of cases.

Several recent studies based on cross-national data from the post-communist transitions have already begun to examine the economic assumptions of the J-curve model and their results will be briefly reviewed here.[6] Though these studies confirm that the introduction of economic reforms entails substantial transitional costs, they challenge the assumption linking the magnitude of these costs to the extensiveness of the reforms adopted. Table 1 (page 26) presents data on the average annual growth rates for the entire set of post-communist cases, as well as for those transitions not affected by war. The transitional costs of reform -- as reflected in declining growth rates -- do

appear to follow a J-curve pattern. The average growth rate for the region begins to fall in 1990 (-4.5%) dropping to its lowest level in 1992 (-17.17%) and then beginning a gradual recovery. However, an examination of the post-communist countries grouped by the extent of their economic reforms reveals an unexpected picture.

The World Bank (1996) has developed a set of indicators to measure the extent of liberalizing reforms adopted in three broad areas (internal prices, external prices, and private sector entry) across all the transition economies. On the basis of these indicators, the transition economies can be separated into four main groups: advanced reformers, high intermediate reformers, low intermediate reformers, and slow reformers.[7] Figure 2 (page 27) compares the average annual change in growth rates for each group. It is not the advanced reformers that have suffered the sharpest declines in real GDP, as the J-curve approach would have predicted, but the intermediate reformers. Indeed, the advanced reformers have the lowest overall output declines and the most rapid recoveries.[8] The average ratio of real GDP in 1994 to the 1989 level in the advanced reform group was 83%. The average ratio declined to 65% for the high intermediate reformers, 57% for the low intermediate reformers, and 72% for the slow reformers. (De Melo, Denizer et al. 1996) Among the post-communist countries, the preliminary evidence suggests that the deeper the economic reforms adopted, the less steep is the "valley of the transition" in terms of overall costs and the less difficult it is to traverse. The transitional costs of reform have not been directly proportional to the extensiveness of the reforms adopted.[9]

The pattern of unemployment among the post-communist countries -- generally seen as a critical factor shaping the politics of economic reform -- conforms more closely to the expectations of the J-curve approach. Table 2 (page 28) presents data on registered unemployment in the post-communist countries, grouped by their scores on the World Bank's liberalization index.[10] Though the countries that have undertaken reform do exhibit considerably higher unemployment than the slowest reformers, the relationship between the extensiveness of adopted reforms and the level of unemployment is less clear. Åslund, Boone, and Johnson (1996) find no statistically significant correlation between the extent of economic reforms and unemployment rates, once some basic control variables are included in the regression. In addition, the evidence from individual cases is mixed. Despite having introduced and maintained one of the most comprehensive reform programs, the Czech Republic has maintained quite low unemployment rates. At the same time, less comprehensive reformers -- such as Albania, Bulgaria, and Romania -- have suffered from relatively high unemployment. States of the former Soviet Union have generally maintained lower unemployment than those of Eastern Europe, though it has been the most comprehensive reformers (the Baltic states) that have had the highest unemployment rates.

Though evidence from the post-communist transitions has already been used to challenge some of the basic economic assumptions about the transitional costs of reform, the political implications of

the J-curve model have not been examined systematically. The high short term costs of efficiency-enhancing reforms present both ex ante and ex post political obstacles as described earlier. On the one hand, politicians facing electoral pressures in the short term have strong ex ante disincentives to adopt potentially costly economic reforms whose gains may appear only after they've been voted out of office. On the other hand, radical reforms, once adopted, are highly susceptible to ex post reversal as voters reject the high short term costs for the mere promise of future gains.

If the ex ante incentives are an impediment to the adoption of comprehensive economic reforms, then we would expect that politicians facing greater electoral pressures and with a shorter expected tenure would be less likely to initiate such reforms. As Haggard and Kaufman (1995, p. 156) argue, from the politician's point of view, some degree of security of tenure "would appear to be a minimal requirement of successful reform, since a high degree of insecurity shortens time horizons and increases the discount rate to future payoffs [from economic reforms]."

Table 3 (page 29) presents data on the number of executive turnovers and the length of government tenures in the post-communist states, excluding those affected by war.[11] Again, the countries are grouped by their World Bank liberalization scores. The first column indicates the number of executive turnovers that have occurred from the onset of the transition through the end of 1995.[12] Both the advanced and intermediate reformers have an average of just over three and half executive turnovers in the post-communist period, while both groups of slow reformers do not average more than one turnover in the same period. Poland, the most celebrated case of radical reform in the region, has had seven prime ministers and three presidents in the past seven years. The Baltic countries, which have been the most advanced reformers of the former Soviet Union, have all had no less than four prime ministerial turnovers since their achievement of independence. While other advanced reformers have had more stable governments, all of them have experienced some turnover in their prime ministers since the beginning of their transitions. In contrast, Ukraine and Belarus are the only countries among the slower reformers that have changed their chief executives since the onset of the transition.

The differences in executive turnovers are reflected from another vantage point in the evidence on the tenure of post-communist governments from Table 3.[13] The countries of the first two reform groups had an average government tenure of approximately 25 months. Six of the 11 countries in these two groups had an average government tenure of less than 18 months. While some of the most successful reformers -- the Czech Republic, Hungary, and Slovenia -- have had individual governments with relatively long tenures, these governments do not necessarily fit well with the standard image of reform governments, i.e. strong, stream-lined, and relatively autonomous governments with the capacity to push reforms through bureaucratic and popular opposition. In Slovenia, the Drnovsek government, which has been in office since May 1992, began as an explicitly transitional government until parliamentary elections in December 1992. After the elections,

Drnovsek headed a fragile, 5 party coalition government, that has been subject to frequent and serious no-confidence votes and whose continued survival has always been tenuous.[14] In Hungary, the government of Josef Antall, though quite secure, rejected the radical approach to economic reform and pursued a gradual course of reforms that benefitted from Hungary's prior history of communist-era reforms.[15] The only case of radical economic reform pursued by a stable government with a high degree of security and autonomy is the Klaus government in the Czech Republic.[16]

The slow reformers have tended to have political leaders with the longest and most secure tenures. With the exception of Belarus and Ukraine, all of the slow reformers have been ruled continuously by the same respective presidents since the start of their transitions.[17] Among the advanced and intermediate reformers, only Romania has had similar unbroken presidential rule.[18]

The post-communist countries with more frequent executive turnovers and shorter government tenures have been the most far-reaching economic reformers. Politicians who faced more frequent and more formidable electoral challenges, which should have led to shorter political time horizons, have nevertheless been far more likely to adopt economic reforms.[19] Those political leaders with the greatest security of tenure have generally introduced partial economic reforms or have delayed reforms altogether, even though they would appear to have faced the weakest threats of an electoral or popular challenge to reforms. Though this evidence cannot support a causal link between executive turnovers/government stability and economic reform, it does challenge the notion that the threat of electoral revenge against the short term costs of economic reform is a substantial ex ante obstacle to the adoption of reform in the post-communist transitions.

If the political threat to economic reform is primarily ex post, then we would expect to see economic reforms reversed or otherwise moderated in the next electoral cycle after their initial adoption. Przeworski argues that the high short term costs of reform are likely to spark an electoral backlash and subsequent reversal or moderation of reforms. This creates a familiar stop-go pattern of economic transition in which reforms "proceed in spurts: advancing, stumbling, retreating, and advancing again." (Przeworski 1991, p. 179) The post-communist countries have certainly experienced the pressures of electoral backlashes against reform. In three of the five countries in the advanced reform group -- Hungary, Poland, and Slovakia -- reform governments have been voted out of office to be replaced by parties advocating more moderate reforms. Similar reversals of reform governments have occurred in three of the six countries in the high intermediate reform group -- Bulgaria, Estonia, and Lithuania. However, these electoral reversals have not been accompanied by any major reversals in the course of economic reform in these countries.

Table 4 (page 30) presents the annual scores on the three categories of the World Bank's liberalization index for the six countries list above that have suffered electoral backlashes against reform governments. By the end of 1994, there were only 2 instances in which these liberalization scores declined from year to year. In Bulgaria, scores on the liberalization of internal and external

prices declined slightly from 0.9 in 1993 to 0.8 in 1994 (on a 0-1 scale with 1 as fully liberalized), as the non-party government of technocrats led by Luben Berov was replaced after a general election by the Bulgarian Socialist Party. A similarly modest decline in the liberalization score on external prices from 0.9 to 0.8 was recorded between 1992 and 1993 in Slovakia following the break-up of Czechoslovakia. According to the World Bank scores, there were no other substantial reversals of liberalizing reforms in any of the post-communist countries that experienced electoral backlashes against reform governments. Indeed, the two minor declines described above were the only two reversals in reform scores in the entire set of post-communist countries from 1989 to 1994.[20]

Electoral backlashes did occasionally slow the rate of progress in particular areas of economic reform. The speed of large-scale privatization slowed considerably in Lithuania and Poland after the electoral victories of communist successor parties in those countries. Voucher privatization was also delayed in Slovakia after the break-up of Czechoslovakia.[21] Yet there have also been cases in which electoral backlashes against reform-oriented governments were followed by an intensification of reform in some areas. Russia made the greatest progress in large-scale privatization only after the reform government of Egor Gaidar was forced out of office. (Frydman, Rapaczynski et al. 1993) Hungary and Lithuania implemented tough macroeconomic stabilization programs after electoral victories by socialist parties.[22] Estonia has continued its rapid pace of economic reform even after the reform government of Mart Laar was replaced by the far more moderate Vahi government.

Though the introduction of comprehensive economic reform programs did, in most cases, spark revenge at the ballot box against reform governments, the electoral reversals did not generate the expected reform reversals. The image of a "stop-go" reform process in which politicians reverse reforms in response to the popular reaction to high transitional costs only to try and fail with a more moderate reform program has not been evident, to date, in the post-communist transitions.[23]

The experience of the transition economies so far has not conformed to the standard predictions rooted in the J-curve distribution of the costs and benefits of reform. Though the adoption of reforms has entailed substantial transitional costs in the short term -- as evidenced by severe output declines and increasing unemployment levels -- the volume of these costs is not positively correlated with the extent of reforms adopted. The evidence suggests that intermediate reformers have suffered the most severe transitional costs, while more advanced reformers have endured lower overall costs and experienced quicker recoveries. More importantly, this pattern of costs has not led to the anticipated political dilemmas that are often thought to pose the most serious obstacle to economic reform. Politicians with shorter time horizons and greater electoral pressures have introduced more extensive reform programs than their counterparts with more secure political tenures. With the wave of electoral backlashes, such politicians have paid a high personal price for their commitment to reform. Still, electoral backlashes have not produced concomitant reversals of economic reform. Though the losers from reform in the short term may well have taken their revenge against the

reformers, this has not produced the stop-go pattern of reform common in other regions of the world.

The post-communist countries present a paradox in the political economy of reform. In the conventional analysis, comprehensive reforms face ex ante and ex post political obstacles from losers who react against the transitional costs of reform in the short term, regardless of their promised benefits in the long term. Yet in the post-communist transitions, more comprehensive reform programs appear to have inflicted lower transitional costs in the short term than intermediate or slow reforms. Moreover, it has been precisely those countries in which the political leaders have been most vulnerable to the demands of the short term losers that have adopted and sustained the highest levels of economic reform. Governments that have been insulated from electoral pressures and that have enjoyed a high level of tenure security -- the type of governments that have traditionally been seen as the most capable of initiating necessary, but costly economic reforms -- have proven to be the laggards in the post-communist economic transitions. Why have so many post-communist countries chosen a course of partial reforms with a higher social cost in the short term and lower expected gains in the long term? If the pressure to adopt suboptimal reforms does not derive from the traditional losers -- unemployed workers, impoverished pensioners, superfluous state bureaucrats, etc. -- what are the political dynamics driving partial reforms?

The Politics of Partial Reform

The exclusive focus on the short-term losers in the political economy of reform has deflected attention from analyzing the interests and incentives of the winners. The conventional approach to the politics of economic reform is based on a simple, seemingly uncontroversial assumption: economic reforms create winners who gain stakes in defending and extending those reforms. One of the goals of reform, therefore, is to create a constituency of winners in the short term to serve as a political base for reform governments in their ongoing efforts to advance the transition towards a market economy.[24] The most frequently cited problem of relying on the winners in the short term is that the gains from reform are dispersed among the entire economy, while the losses are concentrated on particular groups. The efficiency gains normally associated with economic reform -- reducing inflation, creating a stable currency, lowering fiscal deficits, and increasing the availability of goods and services -- can be considered as public goods. Therefore, the beneficiaries of these policies face barriers to collective action. In contrast, the losers face concentrated costs in the short term and thus have strong selective incentives to engage in collective action against the reforms.[25] Though the winners and potential winners are seen as the best hope of creating a constituency for reform, the pattern of gains from reform in the short term is assumed to weaken their effectiveness as a political force.

However, not all reform programs should be expected to generate a pattern of dispersed gains. This sparks a question that has not been investigated systematically in the political economy of reform: who gains from partial economic reforms?[26] Partial reforms entail the selected introduction of market mechanisms into an economy in which substantial spheres of economic activity still operate according to alternative mechanisms of coordination. It was recognized early in the transition from centrally planned economies that partial reforms threatened to disrupt the stability and effectiveness -- however limited -- of the existing economic system without necessarily generating the efficiency gains associated with fully functioning markets. (Ericson 1991) As a result, partial reforms were predicted to generate higher social costs in the short term than both comprehensive reforms and maintenance of the status quo. At the same time, partial reforms were expected to generate rent-seeking opportunities arising from price differentials between the liberalized sectors of the economy and those still coordinated by nonmarket mechanisms.[27]

Examples of such rent-seeking activities have been ubiquitous in the post-communist transitions. Rapid foreign trade liberalization with incomplete price liberalization has allowed state enterprise managers to sell their highly subsidized natural resource inputs (e.g., oil, timber) to foreign buyers at world market prices. Price liberalization without concomitant progress in opening market entry or breaking up monopolies has created opportunities for some producers to earn monopoly rents. Privatization without reform of the credit mechanism has allowed managers to divert subsidized state credits earmarked to uphold production into short-term money markets at high interest rates. In each case, these arbitrage opportunities have generated rents to those in a position to take advantage of these market distortions. Yet the redistribution of rents leads to the misallocation of resources in comparison with the more efficient rationing that might be expected from a fully functioning market.

To some extent, these rent-seeking opportunities should exist regardless of the reform strategy adopted. The transition from a centrally planned to a market economy requires an extensive set of policy and institutional changes, many of which should be expected to have different time horizons. Clearly, prices can be liberalized far more quickly than monopolies can be broken up. Interest rates can be changed more quickly than new commercial banks capable of evaluating loan requests can be created. Restrictions on foreign and domestic trade can be lifted more quickly than adequate mechanisms for contract enforcement can be put into place. These differentials in the time horizons of various components of comprehensive reform produce temporary market distortions similar to the gaps associated with the explicit introduction of partial reforms.

Both comprehensive and partial economic reforms produce winners in the short term, whose gains are partly or wholly determined by rents generated by the existence of distortions in the developing market economy. Moreover, these rents are highly concentrated, benefiting those in a position to arbitrage between the reformed and unreformed sectors of the economy.

If economic reforms continue to progress over time, then the market distortions that produce these concentrated rents will be gradually eliminated. Further price liberalization undermines arbitrage operations between the fixed price state sector and the free price export sector. The progressive hardening of enterprise budget constraints eliminates the misallocation of state subsidies. Privatization coupled with the creation of an effective corporate governance structure reduces asset-stripping by enterprise insiders. While these measures produce efficiency gains for the economy, they also alter the flow of private gains to the initial winners of reform. The winners give up a concentrated stream of rents generated by the initial market distortions for a share of the overall efficiency gains associated with further market reforms. As a result, progress in the implementation of market reforms could reduce the private gains to the initial winners over time, while increasing efficiency gains for the economy as a whole.

From the perspective of the winners, the traditional J-curve is reversed, as in Figure 3 (page 31). Their incomes rise rapidly in the short term as the initial market distortions generate concentrated rents. Yet over time, the progress of reforms gradually eliminates those distortions dissipating the rents from the early stages of reform. The shape of this winner's curve would depend on the comprehensiveness of the reform at the start of the transition and the continued pace of reforms over time. In Figure 3, the solid line, W_p, represents the winners' income curve in a country that began the transition with partial reforms. The dotted line, W_c, denotes the winners' income curve in a country that began with a more comprehensive reform program. The flatter curve suggests that comprehensive reforms generate less concentrated rents for the winners in the short term and less steep income declines as the reforms progress.

By adding these winners' curves to the traditional J-curve, a different picture of the political economy of reform in post-communist transitions emerges. If partial reforms generate higher social costs in the short term, then the increasing concentration of rents to the winners should entail a corresponding decrease in the incomes of the losers. In Figure 4 (page 32), the losers' income curve in a partially reformed economy, L_p, is the mirror image of the winners' curve, W_p. As the private gains to the winners from partial reform increase, the costs to the losers increase as well. If the distortions of partial reform are gradually eliminated over time, then the winners face a reduction in their rents, while the losers share in the efficiency gains of further market reforms, thus narrowing the gap between the two curves. Countries that adopt more comprehensive reforms at the start have a narrower gap between the income curves of the winners and losers, W_c and L_c. The transitional costs of reform in the short term are lower than under partial reform and the losers begin to see gains from reform at an earlier point in the process and at a higher level.

In the standard J-curve approach, the political obstacle to reform comes from the losers. If elections are called prior to the point at which the reforms have begun to produce benefits for the majority of voters, then the voters will react to the short term costs by casting their ballots for a

reversal or moderation of the reforms. Yet the addition of the winners suggests a different approach to the political obstacles to economic reform. The politics of economic reform is usually portrayed as a set of choices between omnibus reform programs (radical vs. gradual) at key junctures in the political process (namely, elections) in which voters play the deciding role. Yet the process might be more realistically depicted as a sequence of many distinct choices over time on separate components of an overall reform plan -- liberalization, stabilization, privatization, and many more -- that do not necessarily coincide with the electoral calendar. In such a process, the winners with their concentrated gains in the short term would be expected to play a more decisive role, given their greater resources, smaller number, and their selective incentives for collective action. Indeed, it is reasonable to assume that the winners might have an implicit veto power in the decisions over separate components of economic reform, especially those that affect their existing rent streams.

Returning to Figure 4, if the process of reform consists of a sequence of decisions over time, then the winners will continue to support the advance of reforms until time t_1. Beyond t_1, the winners have an incentive to veto any reform proposals that move the economy closer towards more comprehensive reforms, since such measures will begin to decrease the rents they gained from the earlier stage of the reform process. The winners prefer to advance the reform process to t_1 and no further, since any additional steps on the reform path negatively affect the flow of private gains from the initial steps. Thus, the winners prefer to "freeze" the emerging market economy in some partially reformed state that maximizes the concentration of rents to themselves, though at a significant social cost. While the political challenge of the J-curve was to maintain reforms through the "valley of the transition," the challenge of partial reform is to sustain the momentum of reform past the "peak of the transition," i.e., the point at which further reforms threaten the rents accruing to winners from the distortions created by earlier reforms.

This model of the politics of economic reform differs sharply from the standard approach based on the J-curve distribution of the costs and benefits of reform. While the J-curve approach assumes that the costs of reform are concentrated and the benefits are dispersed, this model begins with the opposite assumption. The gains from reform are highly concentrated to a narrow group of winners in the short term and are dispersed over time only if the reform process progresses. The costs of reform, in contrast, are dispersed across the entire economy from the start. The J-curve approach assumes that the transitional costs of comprehensive reforms in the short term are greater than more gradual reforms, while this model again assumes the opposite. The conventional approach characterizes the politics of economic reform as a choice between omnibus reform programs made by voters at key points in the political calendar. This model portrays the reform process as a sequence of decisions on separate components of reform that is continuous over time and in which the winners who gained from earlier decisions have the decisive voice.

On the basis of these alternative assumptions, the partial reform model presented here suggests a very different characterization of the political obstacles to economic reform in the post-communist transitions. The political dilemma of economic reform is not how to sustain reform in the face of opposition from the short term losers, but how to advance reform in the face of efforts by the short term winners to preserve the market distortions upon which their initial gains were based.

Evidence

One of the key predictions of this new approach is that countries that have maintained partial reforms should exhibit a greater concentration of gains to the winners and a higher level of transitional costs both in the short term. Partial reforms are defined as the selected introduction of market mechanisms into an economy in which substantial spheres of economic activity still operate according to alternative mechanisms of coordination. Partial reforms are not defined simply by the overall pace of reform, but by variation in the rate of progress across separate components of economic reform in each country. These imbalances in the reform process are what generate the short term rents and the concomitant social costs described above.

To measure the extent of partial reforms, it is necessary to break down the reform process into independent components and compare the variation in the progress of reform across the different components for each country. The EBRD's transition indicators measure progress on a 1 to 4 scale in 9 basic areas of economic reform: privatization (large- and small-scale), enterprise restructuring, price liberalization, foreign trade liberalization, competition policy, banking reform, securities market reform, and legal reform. (EBRD 1995) By taking the variance of the ratings in all 9 categories for each of the post-communist countries, we can measure the dispersion of the transition indicators around the mean in each case. The variances are reported in the first column of Table 5 (page 33). Higher variances indicate unbalanced progress across the different categories of economic reform with high ratings in some categories, but low ratings in others. Lower variances indicate more similar rates of progress (or lack thereof) across the different components of economic reform. The average variances for each of the four groups of countries show a curvilinear pattern among the groups. Both the advanced and the slow reform groups have low variances across their reform scores, while the intermediate groups have considerably higher variances suggesting more uneven progress in economic reform.

If the countries of the intermediate groups have maintained the most uneven or partial economic reforms, then they should demonstrate a higher concentration of gains from reform along with higher overall social costs. Though highly incomplete, recent data on inequality and concentration of income during the post-communist transitions show some interesting trends.[28] The process of economic reforms in the post-communist countries has sparked an extremely rapid redistribution of income. Since the beginning of the transition, the level of inequality has risen in

every post-communist country with the exception of Slovakia. The average Gini coefficient -- the standard measure of inequality -- for the entire region jumped by a third from 24 in 1987-88 to 32 in 1993-94 at a pace virtually unprecedented in the post-war era. (Milanovic 1996, chap. 4) In a 5-7 year time span, the transition economies have moved from inequality levels below those of most OECD countries to, in several cases, levels on par with or higher than the most unequal OECD countries. The Gini coefficients are listed in Table 5.

The dimensions of the redistribution differ across the reform groups. From 1987-88 to 1993-94, Gini coefficients increased in the two intermediate reform groups by 43% (high intermediate) and 53% (low intermediate), as compared to 18% among the advanced reformers and 30% among the slow reformers. The highest Gini coefficients in the transition economies are among the low intermediate reformers, while the most advanced reformers have maintained the lowest levels of inequality. Among the transition economies, Russia stands out having doubled its degree of inequality during the period and attaining a Gini coefficient that exceeds the United States.

Figure 5 (page 34) relates the average changes in inequality among the reform groups to their average variances on the EBRD transition indicators. The curvilinear pattern is roughly similar. Though this evidence cannot support any causal claims, it does suggest an interesting relationship between the imbalances associated with partial reforms and increasing levels of inequality among the post-communist countries.

The increase in inequality in the post-communist transitions has been driven by a substantial concentration of incomes to the highest income group, though data on income concentration is less complete than on overall inequality. Table 5 reports the change (in percentage points) of total income share for the top income quintile between 1987-88 and 1993-94. The increase in income share for the top quintile in the intermediate reformers exceeds that of the advanced reformers with the exception of the Czech Republic. The top quintile in the high intermediate reformers increased its income share by an average of 7.8 points, while the average share increased by only 2.8 points in the advanced reform group. The two countries among the low intermediate group for which such data is available also show substantial increases in the concentration of income. Again Russia stands out with a remarkable 20 point increase in the income share of the top quintile. With the exception of Hungary and Slovakia, all of the post-communist countries have experienced a highly regressive redistribution of income since the start of the transition. Yet the evidence suggests that this redistribution reached a considerably higher magnitude in those countries that have maintained partial reforms.

The variation in the pattern of inequality and concentration among reform groups is closely matched by the cumulative output declines during the transition, the standard measure of the costs of reform. The last column of Table 5 lists the ratio of 1993-94 GDP to 1989 GDP for the post-communist countries. The average cumulative decline in GDP for the two intermediate reform

groups exceeds both the advanced and the slow reformers. By 1994, GDP had fallen by an average of 43% among the countries of the low intermediate reform group and 35.2% among the countries of the high intermediate group. The advanced reformers suffered a much lower average GDP loss at 19.4%, while the slow reformers fell by an average of 28.3%. As Figure 6 (page 35) suggests, the average declines in GDP across the reform groups match the percentage increases in inequality as measured by the average Gini coefficients for each reform group.

The limited evidence available on changes in inequality, the concentration of incomes, and GDP across the post-communist countries support the predictions of the partial reform model. Though post-communist economic reforms have clearly generated high costs in the short term, whatever gains they have produced have been highly concentrated to a narrow group of winners. Countries that have adopted and maintained partial reforms have had the highest concentration of these gains, while at the same time experiencing the highest short term costs among the transition economies. The short term winners have gained more relative to the losers in partially reformed economies than their counterparts among either the advanced or slow reformers. Moreover, as the variances of the EBRD transition indicators demonstrate, these gains have been associated with imbalances in the adoption of reforms and the market distortions that they create. If the correction of these distortions through further market reforms threatens to reduce the rent flows to the short term winners, then they should be expected to oppose such measures as long as their share of the efficiency gains generated by further reforms does not exceed the lost rent flows. The winners have an incentive to maintain a partial reform equilibrium in order to maximize the concentration of rents in the emerging market. While existing analyses of the politics of economic reform tend to assume that the short term winners constitute a political constituency in favor of sustaining and advancing market reforms, the partial reform model suggests that these winners could constitute a powerful obstacle to the progress of reform.

The main political implication of the partial reform model is clear: to the extent that the reform process produces winners from partial reforms in the short term and these winners have a veto power over policy, then the transition should result in a partial reform equilibrium with concentrated gains to the winners at a high overall social cost.[29] Therefore, the primary challenge of reform in this model is to restrain the short term winners. The model predicts that political systems in which greater power is concentrated in the hands of the winners should be more likely to preserve partial reforms over time. In contrast, political systems more open to the participation of the losers in the policymaking process should have a more thorough dissipation of these rents in the early stages of reform, leading winners to find the efficiency gains from comprehensive reforms more attractive than the reduced rent flows from the partial reform equilibrium.

It is difficult to measure with any precision the concentration of power in the hands of the short winners of reform in post-communist political systems. One option is to try to measure the

continued power of the former communist elite, since partial reforms are believed to benefit precisely those who are in a position to arbitrage between the highly regulated and subsidized state sector and the less constrained free market sector -- such as, state enterprise managers, collective farm chairmen, ministerial bureaucrats, and party officials. It is possible to measure the remaining political power of the former communist party and its successor organizations in post-communist political institutions. Alternatively, the extent of personnel turnover from the communist era to the transition period in government posts or key economic sectors could be surveyed. However, such measures would miss the influence of other groups of winners benefiting from partial reforms, whose gains need not be linked to their positions in the previous communist system, such as new commercial bankers, investment fund managers, and a whole range of private entrepreneurs. In many post-communist systems, these actors have also made extraordinary short term gains from distortions in the developing market economy and are believed to wield substantial political power.[30]

Another approach to this problem is to measure the extent to which post-communist political systems are open to pressures from the short term losers. This assumes that the greater the participation of the losers in the political process, the more constrained will be the power of the winners. Greater participation of the losers can be expected to check the power of the winners to veto reform measures that do not coincide with the latter's short term interests. More importantly, politicians that face regular, genuinely competitive elections may be constrained from pursuing policies that concentrate gains to a narrow segment of the electorate while generating high social costs.

Figure 7 (page 36) presents a scatterplot relating the level of democracy to the extent of economic reforms in the post-communist countries. The economic reform scores are based on the EBRD's cumulative transition indicators for 1994. (EBRD 1994) The measure of democracy is based on the average of each country's annual score on the Freedom House index of political rights over the course of the transition. (Freedom House 1994) The Freedom House index measures individual rights to participate freely in the political process, focusing especially on the political inclusiveness of the electoral system. The scatterplot reveals a strong positive correlation between political rights and economic reform ($r = 0.78$). More inclusive political regimes have adopted and sustained higher levels of economic reform than those with more restrictive political rights. Given that losers outnumber winners in the short term, we can assume that a more inclusive political regime gives the losers of the economic reform process greater opportunities to influence political outcomes.

Another more specific proxy measure of the inclusiveness of the political system focuses on the size of coalition governments. As the number of political parties in a coalition government increases, the number of actors whose agreement must be coordinated for effective policymaking increases as well.[31] This tends to weaken the concentration of power in the hands of any single political party or

group. Broader coalition governments should have a lower risk of being captured exclusively by the short term winners of reform than single party dominant governments. The size of coalition governments in the post-communist cases can be measured according to a scale developed by Roubini and Sachs (1989; 1989) in their studies of coalition governments and budget deficits in OECD countries.[32] Figure 8 (page 37) shows a scatterplot of the relationship between the size of coalition governments and the sum of the 1994 EBRD transition indicators for each post-communist country. There is a strong positive correlation ($r = 0.72$) between coalition governments and economic reform. As more political forces are brought into the policymaking process, governments appear to be more likely to adopt and sustain more comprehensive economic reforms.

Neither of the proxy variables -- the extent of political liberties and the size of coalition governments -- directly measure the relative power over government policymaking of the short term winners and losers of economic reform. However, they do measure the extensiveness of political participation in the policymaking process. Political inclusion could alter the dynamics of the reform process in two possible ways. First, greater political inclusion could lead to a greater dissipation of the rents from partial reforms, as more groups demand their share of short term gains. As the private gains to specific groups decrease, the advantages of partial reforms over comprehensive reforms are also reduced. Second, the greater the degree of political inclusion into the decisionmaking on economic reform, the less likely it is that the winners will be able to impose policies that bring them private benefits at a high social cost. Political inclusion can act as a constraint on the short term winners to undermine their capacity to hold the economy in a partial reform equilibrium.

Conclusions

Though many of the post-communist countries have made tremendous strides towards the creation of a market economy in a remarkably short period of time, the costs of this transition, even in the best of cases, have been substantial. To varying degrees, each country has faced some combination of high inflation, high unemployment, declining real incomes, decreasing state services, and increasing uncertainty -- a mix of hardships that has produced a familiar stop-go pattern of economic and political reforms in other regions of the world. Yet in contrast to the political dynamics of economic reform in these regions, the losers in the post-communist transitions -- those who have had to bear the high transitional costs of reform for only the promise of future benefits -- have not constituted the main political obstacle to the progress of reform. This paper has shown that it is precisely those countries in which governments have been most vulnerable to the losers' threat of an electoral backlash against reform that have adopted and sustained the most comprehensive reform programs. In contrast, governments insulated from electoral pressures have made, at best,

only partial progress in reforming their economies. Moreover, economic reforms, once adopted, have rarely been reversed, even when the reform governments that initiated them have been ousted.

Though post-communist transitions have not suffered the standard ex ante and ex post political obstacles to reform, they have witnessed an equally difficult set of challenges from an unexpected source. Actors who enjoyed extraordinary gains from the distortions of a partially reformed economy have fought to preserve those gains by maintaining the imbalances of partial reforms over time. Bankers who gained from financial liberalization have been a powerful force opposing macroeconomic stabilization. State managers turned private owners who were the big winners from privatization have prevented the creation of effective corporate governance structures and thus have delayed much needed enterprise restructuring. Rising financial-industrial conglomerates reconstituted on newly emerging securities markets have used their power to block new market entry. New entrepreneurs *cum* mafiosi who have made tremendous gains from the liberalization of domestic and foreign trade have undermined the formation of a viable legal system to support the market economy. In each case, the winners from an earlier stage of reform, who gained concentrated rents based on temporary malformations of the developing market economy, have striven to block additional reform measures that would correct such distortions. In effect, they have tried to prolong the period of partial reforms to preserve their initial flow of rents, though at a considerable social cost.

This paper has shown that the challenge of the winners is based on a different set of assumptions about the costs and benefits of reform than the conventional J-curve pattern upon which most existing models of the political economy of reform are based. The J-curve assumes that economic reforms generate concentrated costs in the short term and dispersed benefits over the long term. This paper has demonstrated that in the post-communist transitions, economic reforms have tended to produced highly concentrated gains to particular groups in the short term, while dispersing the transitional costs of reform throughout the economy. Over time, the progress of economic reform is expected to dissipate the initial concentration of rents as the complementary elements of a market economy are all put into place. As a result, while the winners have acquired an early stake in the reform process, they have also developed a stake in the very distortions that impede the realization of the efficiency gains of a fully functioning market.

The recognition that the process of economic reform is threatened less by the short term losers than by the short term winners has important implications for our understanding of the political institutions that enable or impede economic reform. While conventional political economy models have emphasized the importance of insulating the state from the pressures of the losers through various forms of state autonomy, the partial reform model stresses the need to restrain the winners by dissipating their concentrated rents through increasing competition with other groups or by restricting their ability to veto unilaterally reform measures. In this view, expanding political

participation to include the losers in the policymaking process could place limits on the concentrated political power of the winners and prevent them from sustaining a partial reform equilibrium. This paper has shown that post-communist systems with a higher level of political participation and competition have been able to adopt and maintain more comprehensive economic reforms than states largely insulated from mass politics and electoral pressures.

The partial reform model offers an explanation for a number of puzzling aspects of the post-communist transitions. It explains why some countries have maintained partial reforms over time, even though the short term costs are higher and the overall gains are lower than those associated with more comprehensive reforms. It explains why post-communist countries in which the short term winners of the reform process appear to have significant political power over economic policymaking nevertheless have remained mired in a partially reformed economy. Finally, it provides one possible explanation for the strong link between democracy and economic reform among the post-communist transitions that stresses the advantages of including the very groups that suffer most from the transitional costs of reform.

One of the fundamental tenets of the politics of economic reform has always been to create a constituency of winners with a stake in sustaining and advancing the reform process. This has been a common strategy both for making the reforms irreversible and for building up the necessary political support for further reforms. Yet a comparison of the post-communist transitions suggests that the winners can do far more damage to the progress of economic reform than the losers. Though the winners have no interest in returning to the status quo ante, they do have an incentive to exploit the uneven pace of change in the various components of market reform to maximize their private gains, but at considerable social cost. As a result, the success of the process of economic reform depends on both creating winners and constraining them. Paradoxically, the most effective means of constraining the winners in the post-communist transitions has been to guarantee the political inclusion of the very constituency that most existing political economy models seek to exclude: the short term losers of reform.

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ENDNOTES

1. Variations on this theme have stressed the virtues of autonomous states (Evans 1992), powerful executives (Haggard and Kaufman 1995), insulated technocrats (Williamson 1992), and substantial external assistance (Sachs 1993). Przeworski himself does not support such a view, which he believes will lead to problems in the consolidation of democracy. (Przeworski 1993).

2. This is one of the arguments made against the radical or "big bang" approach to economic reform. For a review of political economy case against such an approach, see Roland (1994)

3. In the expected utility function of any given actor, the benefits of reform would be discounted by the probability that the reform will be reversed prior to the receipt of the benefits. For a review of this problem in the politics of economic reform, see Tommasi and Velasco (1995).

4. On the earlier literature, see the classic treatment of this issue by Huntington (1968) and the review in Haggard (1990). The recent work on the advantages of state autonomy and insulation is voluminous. Some prominent examples are Evans (1992), Haggard and Kaufman (1992; 1995), and the contributions to Williamson (1994).

5. Nelson (1993) argues that this approach can be directly applied to the post-communist transitions.

6. Broad, cross-national comparisons of the post-communist transitions have been produced by the EBRD (1994; 1995) and the World Bank (1996). Other studies include: Åslund, Boone, and Johnson (1996); de Melo, Denizer, and Gelb (1996); and Fischer, Sahay, and Vegh (1996).

7. The groups exclude those countries affected by war: Armenia, Azerbaijan, Croatia, Georgia, Macedonia, and Tajikistan.

8. Similar results can be obtained by replacing the economic reforms ratings of the World Bank with transition indicators developed by the EBRD that measure progress in six categories of reform. (EBRD 1994) The EBRD measures include more institutional variables in their ratings.

9. Åslund, Boone, and Johnson (1996) find no direct statistical correlation between the extent of economic reforms adopted and the magnitude of cumulative output declines once some basic control variables are added to the regression. They do not test for the existence of a nonlinear relationship as Figure 2 would suggest. Nevertheless, they reach the same conclusion through comparative case analysis.

10. Unemployment data from the post-communist countries have serious reliability problems and, therefore, must be used cautiously.

11. Post-communist cases affected by war are excluded because executive turnovers are much more likely to be affected by the dynamics of war.

12. Executive turnovers consist of the number of times the country's chief executive has been replaced during the time period. In presidential systems, presidential turnovers are counted. In parliamentary and semi-presidential systems, prime ministerial turnovers are counted. A count of zero signifies that the same executive governing the country under communist rule was still governing the country through the transition, thus indicating no executive turnovers at all.

13. Government tenure consists of the number of months in which the leading executive (president in presidential systems and prime minister in parliamentary and semi-presidential systems) has remained in office.

14. On Slovenia, see Ramet (1993) and Pleskovic (1994).

15. On Hungary, see Bartlett (1995), Bruszt and Stark (1992), and Bunce and Csanadi (1993).

16. Though even the indestructible Klaus has faced strong electoral pressures as evidenced by his poor performance in the recent 1996 parliamentary elections. Klaus' 3 party coalition government lost its majority share and has been governing as a minority coalition. On the Czech Republic, see Orenstein (1996).

17. This should not be taken as a proxy measure for the continued dominance of excommunist rulers in the post-communist era. Not all of the slow reformers have faced continuous rule by excommunist leaders. Kazakhstan, Turkmenistan, and Uzbekistan did continue to be governed by chief executives who were former first secretaries of their respective communist parties prior to the transition. The first leader of Ukraine, Leonid Kravchuk, was formerly second secretary of the Ukrainian communist party. In Belarus, Kyrgyzstan, Moldova, and Russia, new chief executives were elected, most of whom held previous positions -- though not the leading positions -- in the communist parties of their respective republics prior to the transition.

18. In addition, Romania is a semi-presidential system in which the popularly elected president shares considerable powers with a parliamentary government. Since 1990, Romania has had three prime ministers with an average tenure of 21 months each. On Romania, see Verdery (1992).

19. In a recent paper on the politics of stabilization in post-communist systems, I show that stabilization programs are as likely to be introduced just before elections -- the moment of greatest insecurity in a politician's tenure -- than immediately after electoral victories. (Hellman 1996)

20. Similarly, the EBRD's transition indicators measuring progress in economic reform in 6 categories in 1994 and 9 categories in 1995 do not reflect any backtracking on reform scores in any of the post-communist countries. (EBRD 1994; EBRD 1995)

21. For detailed accounts of the privatization process in Central Europe and the Baltic states, see the volumes by Frydman and Rapaczynski (1993; 1993).

22. For assessments of macroeconomic policy in Hungary and Lithuania, see the country sections in the EBRD's *Transition Report* (1995).

23. Of course, this does not preclude such reform reversals in future nor is it necessarily advantageous for creation of a stable democracy. Przeworski (1993) expresses the concern that electoral backlashes against reformers that do not lead to backtracking on economic reform can be politically destabilizing in emerging democracies. If voters continue to find that their votes are not reflected in policy changes, then they could lose confidence in the democratic process and be more attracted to authoritarian solutions.

24. This assumption is especially important in political economy models that are designed to highlight the advantages of gradual reforms. Roland (1991; 1994) argues that the best political strategy of reform is to start with measures that produce winners in the short term who gain a stake in the reform process that they will continue to defend once more costly measures need to be adopted down the road. This is also the spirit of Murrell's critique of the shock therapy reform program. (Murrell 1992; Murrell 1992)

25. Haggard and Kaufman (1995, chap. 1) emphasize this collective action dilemma in the political economy of reform.

26. The only work that explicitly examines the dynamics of partial reform is Murphy, Shleifer, and Vishny (1992). McKinnon (1991) touches on this issue in his analysis of different sequences of economic reform. Ericson (1991) discusses the social costs of partial reforms in the specific context of the transition from centrally planned economies, though he does not explore the distribution of gains from such reforms.

27. The fact that such market distortions exist does not guarantee that actors will be able to take advantage of them in these partially reformed economies. It is possible that a highly restrictive state could build walls between the liberalized and more highly controlled spheres of the economy, preventing actors from access to these rent-seeking opportunities. This is often the explanation for the success of China's partially reformed economy, though press reports of high levels

of corruption within China's state sector suggest that there are limits to the state's capacity to enforce such restrictions. (Murphy, Shleifer et al. 1992)

28. The World Bank has collected the only detailed data on inequality and the concentration of income during the post-communist transitions on the basis of household surveys. Unfortunately, data is not available on the entire set of post-communist countries making any statistical tests on this small sample of countries impossible. Milanovic (1995; 1996) presents the data and provides a fascinating analysis of the relationship between inequality and poverty. Data on inequality among post-communist countries requires more than the standard caveats in this field, given the strong incentives to hide income from taxation and other forms of predation at all levels. Gini coefficients from the pre-reform period would be expected to be biased downwards given the ideological constraints on revealing inequalities in socialist systems and the numerous forms of perks in kind available to the nomenklatura. In the transition period, Gini coefficients would also be expected to be biased downwards, as higher income groups have greater outlets to hide income than those in lower income groups.

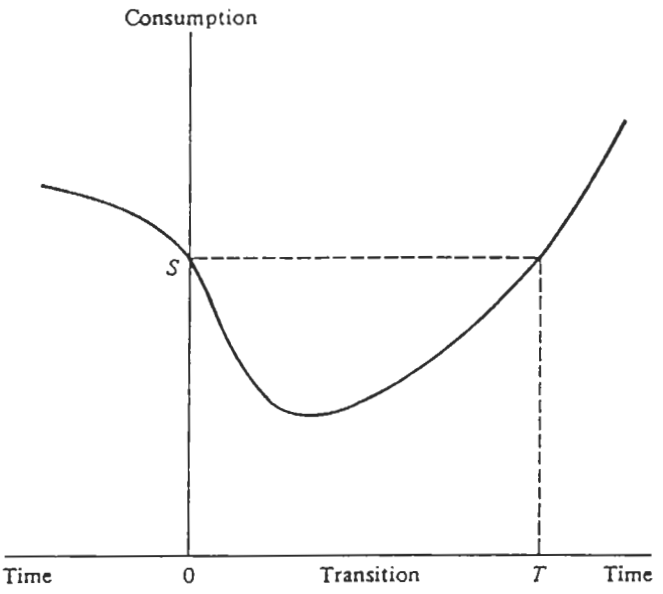
29. Countries that adopt radical economic reforms from the very start are not necessarily immune from this problem. Even the most radical reform programs are composed of multiple elements each with a different time horizon giving rise to temporary market distortions and arbitrage opportunities that produce concentrated gains in the short term. Since the reform process is not composed of a single choice of reform proposals, but a sequence of numerous choices on separate elements of reform over time, there are still many opportunities for the short term winners to scale back the intentions of radical reformers.

30. The latest example of the political strength of these "new" actors is in Russia following the re-election of Boris Eltsin. Under the new chief of the presidential staff, Anatolii Chubais, representatives of a powerful group of young bankers have been given key posts overseeing the economy. In a recent interview, Alexander Livshits, the new finance minister, complained that Russian commercial banks, who made extraordinary profits during the period of runaway inflation, were exerting powerful "pro-inflationary pressure" to undermine the country's recent macroeconomic stability which eliminated their earlier gains. (*Financial Times*, November 2-3, 1996, p. 2). Dmitriev, et al., (1996) provides a detailed analysis of the rents to banks directly related to the lack of macroeconomic stabilization in the context of a highly liberalized financial system and how quickly those rents declined as the economy began to stabilize.

31. Tsebelis (1995) argues that increasing the number of parties in a coalition government increases the number of veto points in the policymaking process.

32. The scale is slightly modified for the post-communist countries to include a category for single party governments in which party competition is explicitly restricted. The scale is as follows: 1 = one party authoritarian government (competition restricted); 2 = one party majority parliamentary government or united presidential government; 3 = two party coalition government or divided presidential government; 4 = three or more party government; and 5 = minority government. Monthly coalition government scores were coded for each post-communist country beginning with the first free election or the formal declaration of independence. A weighted average of the monthly scores is used in the scatterplot graph.

FIGURE 1: THE J CURVE



Source: Przeworski (1991)

Table 1: Change In GDP							
	1989	1990	1991	1992	1993	1994	1995
All Countries	1.55	-4.50	-10.45	-17.17	-9.29	-7.74	-0.84
Excluding War	1.93	-3.20	-10.65	-13.79	-6.67	-6.02	0.11

Source: EBRD (1995)

Figure 2: GDP By Reform Group

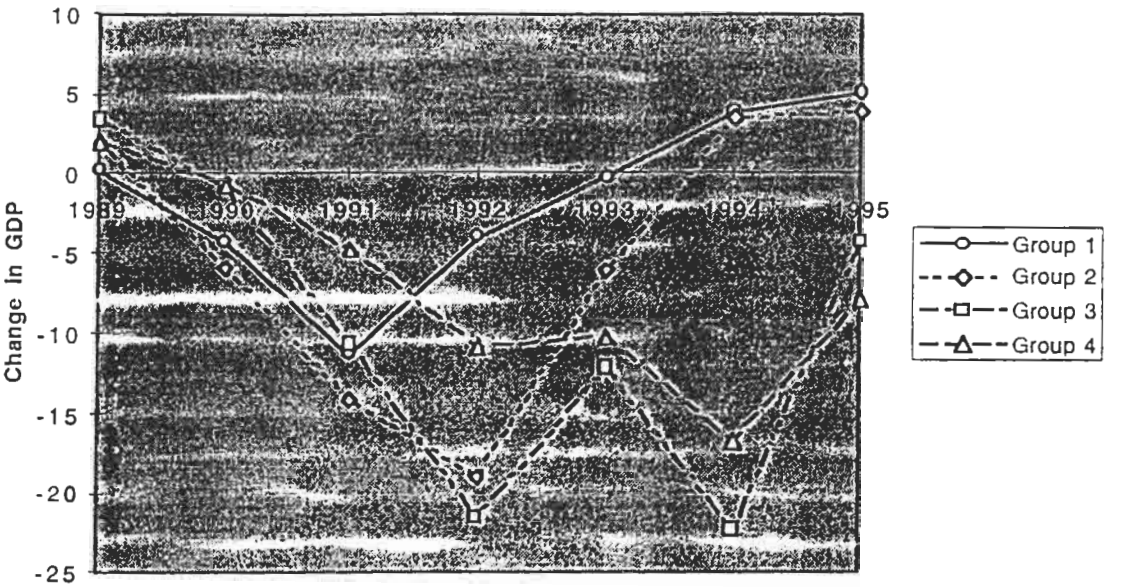


Table 2: Unemployment

	1990	1991	1992	1993	1994
Group 1					
Poland	6.1	11.8	13.6	16.4	16
Slovenia	4.7	8.2	11.1	14.5	14.5
Hungary	2.5	8.0	12.3	12.1	10.9
Czech Repub	0.8	4.1	2.6	3.5	3.2
Slovak Repub	1.5	11.8	10.4	14.4	14.8
Average	3.1	8.8	10.0	12.2	11.9
Group 2					
Estonia	0.0	0.1	4.8	8.8	8.1
Bulgaria	1.5	11.1	15.3	16.4	12.8
Lithuania	0.0	0.3	1.3	4.4	3.8
Latvia	0.0	0.1	2.1	5.3	6.5
Albania	7.7	8.6	26.9	28.9	19.5
Romania	0.0	3.0	8.4	10.2	10.9
Average	1.5	3.9	9.8	12.3	10.3
Group 3					
Kyrgyzstan	0.0	0.0	0.1	0.2	0.7
Russia	0.0	0.1	0.8	1.1	2.2
Moldova	0.0	0.0	0.7	0.8	1.2
Kazakhstan	0.0	0.1	0.5	0.6	1.0
Average	0.0	0.1	0.5	0.7	1.3
Group 4					
Uzbekistan	0	0	0.1	0.2	0.3
Ukraine	0	0	0.3	0.4	0.4
Belarus	1	1	0.5	1.5	2.1
Turkmenistan	0	0	0	0	n.a.
Average	0.3	0.3	0.2	0.5	0.9
War					
Armenia	1	3.5	3.5	6.2	5.6
Azerbaijan	0	0.1	0.2	0.7	0.9
Georgia	0	0	5.4	8.4	n.a.
Tajikistan	0	0	0.3	1.1	1.7
Croatia	9.3	15.5	17.8	17.5	18
Macedonia	n.a.	18	19	19	19
Average	2.1	6.2	7.7	8.8	9.0

Source: de Melo, et al., (1996)

Table 3: Government Stability

	Executive Turnovers	Average Gov't Tenure (# mos)
Group 1		
Poland	6	14
Slovenia	2	34
Hungary	3	26
Czech Repub	2	35
Slovakia	5	14
Average	3.6	24.6
Group 2		
Estonia	4	17
Bulgaria	6	13
Latvia	4	15
Lithuania	5	14
Albania	2	27.5
Romania	1	67
Average	3.7	25.6
Group 3		
Kyrgyzstan	1	62
Russia	1	54
Moldova	1	61
Kazakhstan	0	69
Average	0.8	61.5
Group 4		
Turkmenistan	0	62
Ukraine	2	24
Uzbekistan	0	62
Belarus	2	26
Average	1	43.5

Table 4: Selected CLI Scores					
	1990	1991	1992	1993	1994
Hungary					
Internal Prices	0.8	0.9	0.9	0.9	0.9
External Prices	0.7	0.9	0.9	0.9	0.9
Priv Sector Entry	0.3	0.5	0.6	0.7	0.8
Poland					
Internal Prices	0.7	0.7	0.9	0.9	0.9
External Prices	0.9	0.9	0.9	0.9	0.9
Priv Sector Entry	0.5	0.6	0.9	0.7	0.8
Lithuania					
Internal Prices	0.3	0.5	0.8	0.9	0.9
External Prices	0	0.2	0.5	0.9	1
Priv Sector Entry	0.1	0.3	0.4	0.6	0.8
Estonia					
Internal Prices	0.3	0.5	0.9	0.9	0.9
External Prices	0.1	0.3	0.7	1	1
Priv Sector Entry	0.2	0.2	0.4	0.6	0.8
Slovakia					
Internal Prices	0	0.9	0.9	0.9	0.9
External Prices	0	0.8	0.9	0.8	0.8
Priv Sector Entry	0.4	0.7	0.8	0.8	0.8
Bulgaria					
Internal Prices	0	0.9	0.9	0.9	0.8
External Prices	0.5	0.9	0.9	0.9	0.8
Priv Sector Entry	0.1	0.2	0.3	0.3	0.4

Source: World Bank (1996)

Figure 3: The Winners' Curve

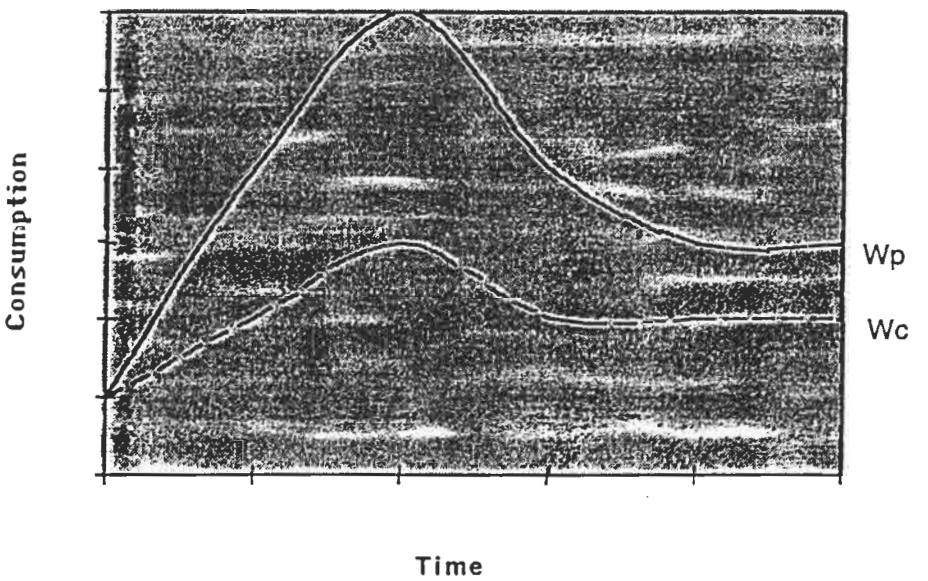


Figure 4

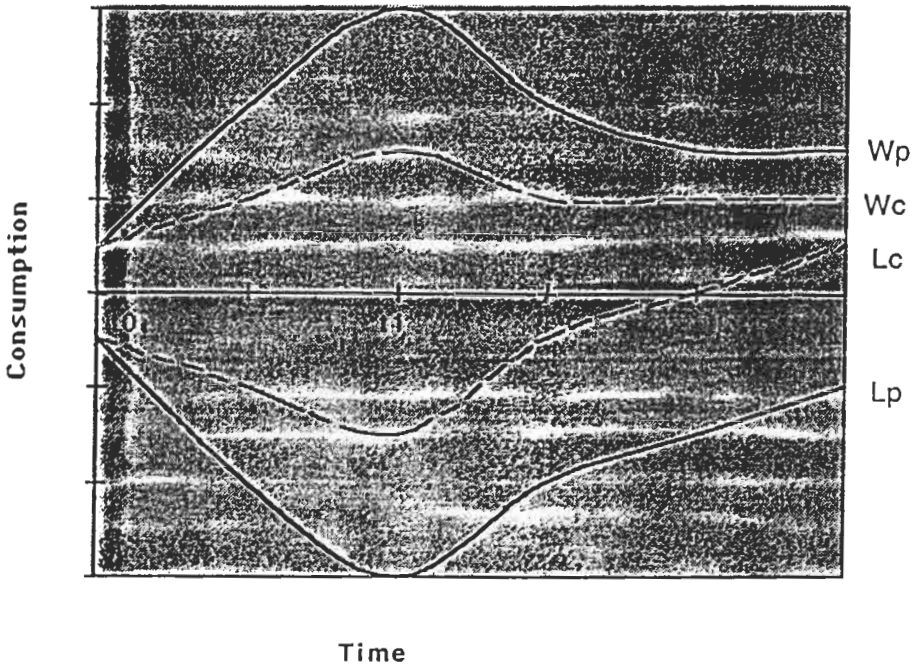


Table 5: Inequality

	Variance in EBRD Scores	Gini Coeff 1988-89	Gini Coeff 1993-94	% Chg in Gini 1988-1994	Chg in Income Share Top Quint	GDP 1993-94/ GDP 1988-89
Group 1						
Poland	0.25	26	31	0.19	3.43	88
Slovenia	0.36	24	28	0.17	3.76	84
Hungary	0.28	21	23	0.10	1.07	81
Czech Repub	0.28	19	27	0.42	5.77	81
Slovakia	0.19	20	20	0.00	-0.10	79
Average	0.27	22	25.8	0.18	2.79	82.6
Group 2						
Estonia	0.44	23	39	0.70	13.61	73
Bulgaria	0.53	23	34	0.48	7.78	69
Latvia	0.75	23	27	0.17	4.01	60
Lithuania	0.69	23	36	0.57	9.75	44
Albania	1.25	n.a.	n.a.	n.a.	n.a.	74
Romania	0.78	23	29	0.26	4.08	69
Average	0.74	23	33.0	0.43	7.85	64.8
Group 3						
Kyrgyzstan	0.94	26	35	0.35	n.a.	61
Russia	0.53	24	48	1.00	20.02	57
Moldova	0.53	24	36	0.50	8.89	53
Kazakhstan	0.36	26	33	0.27	n.a.	57
Average	0.59	25	38.0	0.53		57.0
Group 4						
Turkmenistan	0.11	26	36	0.38	n.a.	69
Ukraine	0.19	23	33	0.43	n.a.	56
Uzbekistan	0.25	28	33	0.18	n.a.	89
Belarus	0.11	23	28	0.22	n.a.	73
Average	0.17	25	32.5	0.30		71.75

Source: Milanovic (1996), p. 58

Figure 5: Reform and Inequality

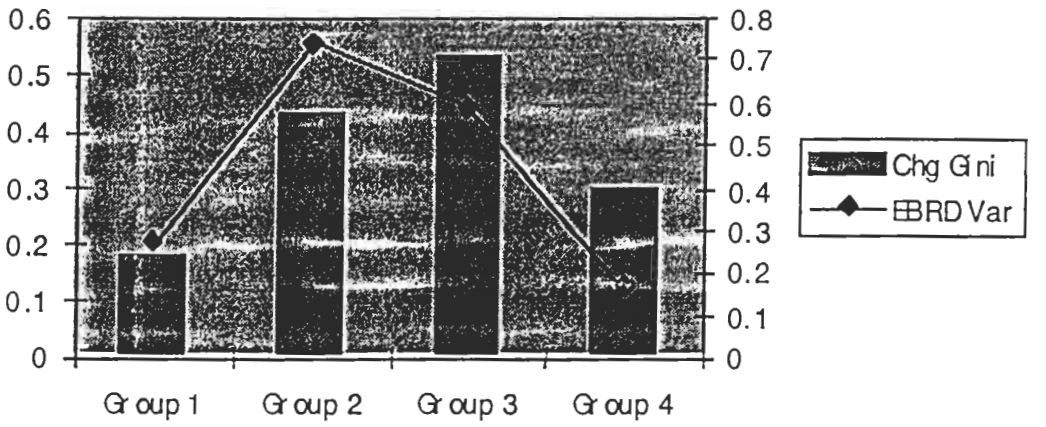


Figure 6: Inequality and GDP Growth

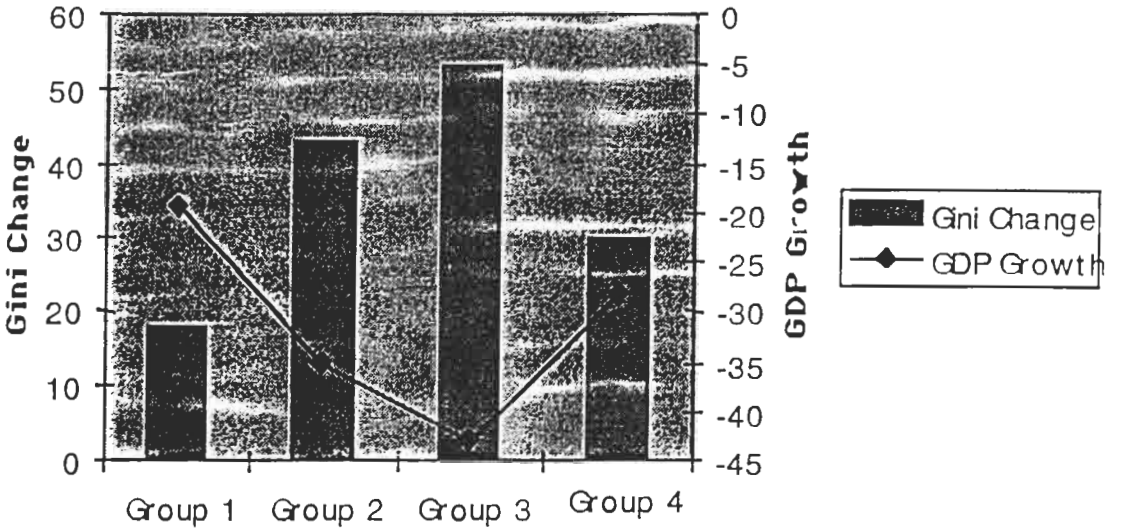
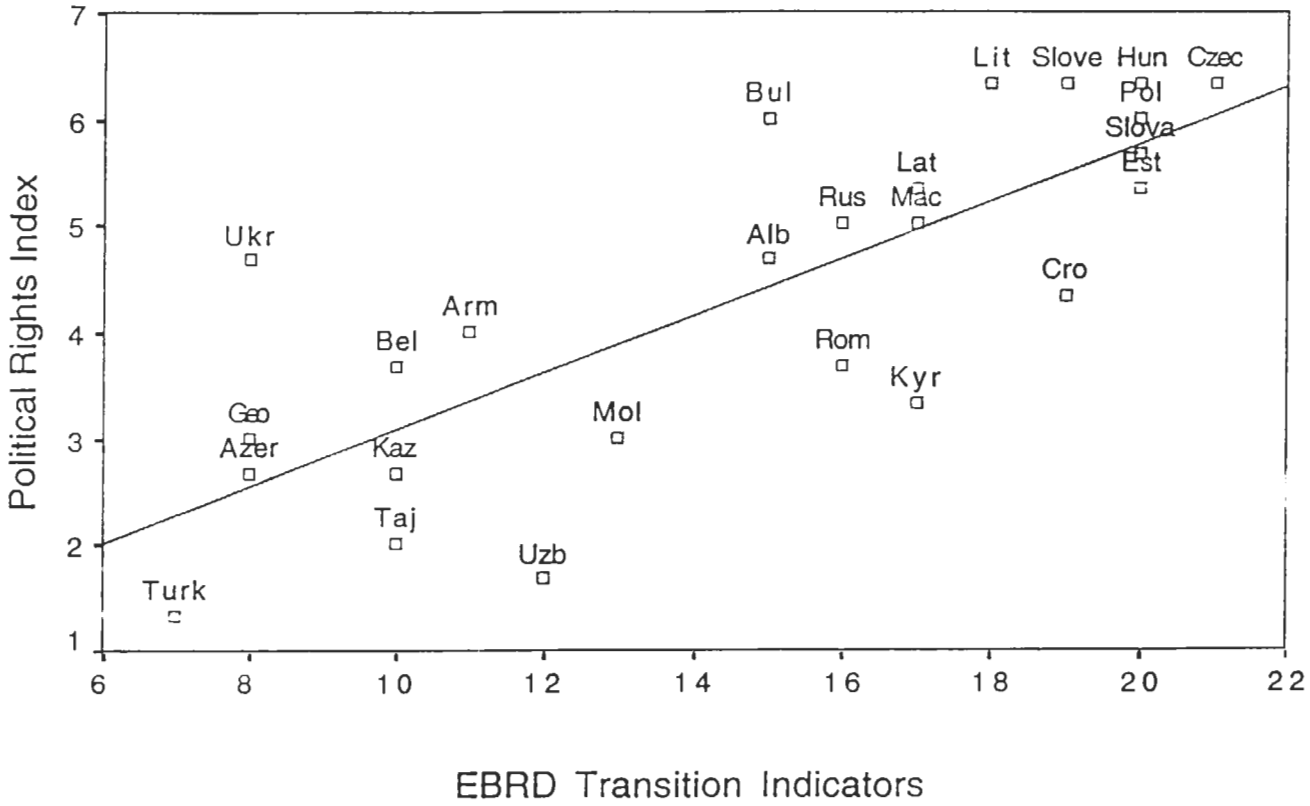


Figure 7

Democracy and Economic Reform



Sources: EBRD (1994); Freedom House (1990-1994).

Figure 8

Coalition Government and Economic Reform