Emil J. Kirchner (*editor*)
DECENTRALIZATION AND TRANSITION IN THE VISEGRAD
Poland, Hungary, the Czech Republic and Slovakia

David Lane and Martin Myant (*editors*)
VARIETIES OF CAPITALISM IN POST-COMMUNIST COUNTRIES

Tomasz Mickiewicz (*editor*)
CORPORATE GOVERNANCE AND FINANCE IN POLAND AND RUSSIA

Tomasz Mickiewicz
ECONOMIC TRANSITION IN CENTRAL EUROPE AND THE COMMONWEALTH OF INDEPENDENT STATES

Milan Nikolic
MONETARY POLICY IN TRANSITION
Inflation Nexus Money Supply in Postcommunist Russia

Julie Pellegrin
THE POLITICAL ECONOMY OF COMPETITIVENESS AND ENLARGED EUROPE

Stanislav Poloucek (*editor*)
REFORMING THE FINANCIAL SECTOR IN CENTRAL EUROPEAN COUNTRIES

Gregg S. Robins
BANKING IN TRANSITION
East Germany after Unification

Johannes Stephan
ECONOMIC TRANSITION IN HUNGARY AND EAST GERMANY
Gradualism and Shock Therapy in Catch-up Development

Johannes Stephan (*editor*)
TECHNOLOGY TRANSFER VIA FOREIGN DIRECT INVESTMENT IN CENTRAL AND EASTERN EUROPE

Hans van Zon
THE POLITICAL ECONOMY OF INDEPENDENT UKRAINE

Adalbert Winkler (*editor*)
BANKING AND MONETARY POLICY IN EASTERN EUROPE
The First Ten Years

Studies in Economic Transition
Series Standing Order ISBN 0–333–73353–3
(*outside North America only*)

You can receive future titles in this series as they are published by placing a standing order. Please contact your bookseller or, in case of difficulty, write to us at the address below with your name and address, the title of the series and the ISBN quoted above.

Customer Services Department, Macmillan Distribution Ltd, Houndmills, Basingstoke, Hampshire RG21 6XS, England

Transition and Beyond

Essays in Honor of Mario Nuti

Edited by

Saul Estrin
London School of Economics, UK

Grzegorz W. Kolodko
Kozminski Business School, TIGER, Warsaw, Poland

Milica Uvalic
University of Perugia, Italy

palgrave
macmillan

2007

Contents

List of Tables

al Transition Trajectories?

ba

roduction

of analytical social science is such that the search for the right one of its core elements. For this reason the two decades of trans- communist to market order has been revolving around the big of whether it could have been done better. Once we reject the wide- d self-condoning *post hoc ergo propter hoc* type of argumentation, ion if and to what degree, things could have been better done, if e excessive, or results less than justified, must figure eminently on da. In the present chapter we try to address some of these norm- sues. Both descriptive and interpretative evaluations of this historic abound, and a 'final word' is as much unlikely to be spoken as over nch Revolution, for that matter.[1]

e onset of systemic change two trends of the literature attempted to these concerns. One was the debate over shock therapy versus gradu- , and the second was related to the social costs of transformation. The strand of literature was rather emotional and loaded with immediate ical misgivings about the nature any comprehensive change may trigger established and urbanized society, such as those in Central and Eastern ope. While the fact that the collapse of the Soviet empire was not foreseen most observers, nor the depth and multi-dimensionality of its crisis prop- ly understood by most contemporaries hold, still the question remains of ow far and how fast' socio-economic changes were bound to go.

Interestingly, as observed by contemporaries (Murrell, 1992), political conservatives were more in favor of social engineering, which is about the opposite of what we observe in the West. And by contrast social demo- crats, the successors of enlightenment with its belief of the inherently good features of human nature, were in favor of more cautious steps.

Whatever we think about the merits and de-merits of the discussion of the early years, it has become quite clear that certain measures take longer than others. For institutional reforms cannot be introduced by fiat, and nobody familiar with the nature of structural reforms has advocated it, even if coming from the radical camp. Furthermore it has become clear that the nature of changes is such that these must go much deeper than the adjustment programs of the International Monetary Fund (IMF), including the more ambitious – though less successful (Krueger, 1998) – structural adjustment programs. Changing *informal institutions*, such as rule-abiding or rule-averting behavior, creating trust in the place of general distrust, gaining credibility for a previously non-existent system of financial intermediation, or bringing about conditions of the rule of law where lawlessness used to be the name of the game, are obviously challenges that cannot be mastered over a few months or even years. And even if we abstract away from the fallacy that dominated the Western literature of the first 4–5 years, when stabilization was equaled to institutional reforms, the depth and the time dimension of the required changes have only very gradually been understood, not only by policy-makers, but also by the guild of analysts.

13.2 The broader framework and its applications

By 1999–2001, a stage of overall reassessment had emerged. On the one hand, international agencies have also understood the imminent need to revise their conventional wisdom, for shorthand the Washington Consensus. Capitalizing on the failures and shortcomings of policy reforms across the globe, but not least in the post-communist world, the so-called Post-Washington Consensus emerged (Kolodko, 2000, pp. 119–40), where institutional features, social safety net, environmental and gender issues as well as overall sustainability considerations have come to the fore. Although the interpretation of the precise meaning of the new consensus has remained open to debate, for example on the relative importance of traditional components of solid policies *vis-à-vis* institution building, or about the complementarities versus concurring nature of both areas of change (Havrylyshin and van Roden, 2003), there seems to have been a relatively broad *common understanding* over what needs to be done and how. This convergence of views has been strengthened by the fact that frontrunners in transition were successfully applying for membership in the European Union (EU). Being a specific model of the market economy itself, the acquis of the EU has been playing a formative role for the acceding countries in a large number of policy areas, from monetary policy to environmental protection. Furthermore, since accession has been granted, to a large degree, on the basis of promises or further commitments, this role is unlikely to evaporate any time soon, notwithstanding the more recent erosion of the implementing capacity of the EU against its core member states.[2]

One of the underlying reasons for the appreciation of the role of institution building has been the insights stressing the importance of *sustainability* in all major policy areas, not only in fiscal and monetary policy. The more we care about the time dimension, the higher relevance we attribute to the precise and transparent formation of the rules of the repeated games,

as well as to their implementation capacity (an aspect highlighted particularly by the last book of North, 2005). So if early debates tended to focus on macroeconomic policies and stabilization, later discussions focus on the quality and nature of new institutions, the quality and outcomes of privatization, the efficiency enhancing features of the regulatory framework and its components ensuring favorable outcomes. Judging by the convergence of previously polar positions, such as for example those of the Economic Commission for Europe on the one hand, and IMF and EBRD on the other, *at least at the level of the theory of economic policy*, a substantial amount of agreement has emerged over the basic question, what needs to be done. For instance, appreciating the role of competition, of independent regulatory agencies, standard reporting and transparency requirements, counted among the common insights. Likewise the renewed emphasis on the social side, in terms of employment and a social safety net alike, education and Research and Development (R&D) accounted for the rapprochement.

This consensus has been strengthened by the nature of *Europeanization*. For one, the regular and organized interactions with incumbent EU polity, from the level of cabinet members to more frequent encounters among scholars on a large number of occasions, has obviously contributed to the evolution of a common *language* of analysis, common *agendas* and a degree of commonality of *perceptions*. On a more practical level, both the stage of acquis screening and the process of accession has included a fair amount of *direct imitation and adaptation* of pre-existing arrangements, even monitoring and checking the sincerity and success of implementation 'on the ground'. This circumstance may be evaluated both as a plus and a minus. It has been a plus insofar as the substantive features of regulation could be implemented, and not only on paper. Thus a *higher quality institutional setup* emerged than in comparable cases, be that the New Independent States, Southeast Europe or the Mediterranean. On the other hand, the 'domestic ownership of reforms', to use the parlance of the Wolfensohn Presidency of the World Bank, has not always been ensured. For this reason the *identification* of domestic actors as a side condition for sustainability has not been secured. For example, the dodging of environmental regulations, or even watering down the new features of common agricultural policy favoring rural development against traditional production subsidies, has been anything but unusual.[3]

13.3 The derailment to populism

It is all the more puzzling against this background to find that *policies* that could have followed from the common insights *have not materialized*. Most conspicuously, a quick adoption of the single currency seems to have been one of the fundamental consensus points of the economic policy debates. For if there is consensus in terms of the desirability and feasibility of lastingly low inflation policies in catching up economies, the arguments in favor of joining in become overwhelming. The more we accept the bipolar view that has become dominant in the financial literature, namely that only corner solutions in exchange regimes are sustainable in the long run, the more we would see as an imperative for any small open economy to bring about conditions for joining monetary integration.[4] If for no other reasons, the substantially decreased likelihood of a speculative attack on the local currency, the abolition of the exchange rate constraint, the probability – and in the longer run inevitability – of interest rate convergence, and not least the elimination of the balance of payments constraint on economic growth, together add up as a weighty package of arguments in theory and policy practice alike. It seemed, at least at the time of striking the accession deal at the Copenhagen Council of December 2002, that this was part and parcel of the common understanding. For this reason each applicant agreed to adopt the entire EU acquis including monetary union, though with a timely derogation. In other words, unlike Britain or Sweden, the new members accepted the implicit obligation to meet the criteria for European Monetary Union (EMU) entry as part of EU entry 'within foreseeable period of time'.

But *reality has become quite different*. The commitment to sustainable public finances, of fiscal consolidations, and to accepting these as preconditions for lasting growth has become increasingly feeble in the period immediately following establishment of the EMU. This is not a theoretical nor a generally valid statement, but a politically weighty one, as it does relate to the three *core economies of the EU* – France, Germany and Italy. It is interesting to observe that it was the core EU economies where domestic developments have led to ebbing out of reforms, although EMU could, in theory, have called for their intensification. By contrast, Scandinavians outside the EMU framework have tended to adopt policies of reform and consolidation, even tougher than EMU membership would have required (Aiginger and Guggenberger, 2006).

It would require a separate analysis (de Haan *et al.*, 2003; Buti and Franco, 2005) to elaborate how the change in the domestic balance of forces in the core EU states has led to the previously unthinkable practice, of the very major players finding various pretenses and sideways to dodge the self-imposed fiscal discipline of the Stability and Growth Pact (SGP). Whatever we may think about the substance of the SGP, the fact of the matter remains that regular breaches have developed immediately before, during and following eastward enlargement. The reference to reform fatigue is customary, but less than fully convincing in view of the rather marginal changes that occurred in the major trespassing countries (as against the new members and Scandinavians alike).

What really matters from our perspective is the *negative synergy* that emerged in the two interrelated, though quite different, practices. At the immediate level, it has become crystal clear, especially following the November 2003 Council decision not to start excessive deficit procedure against France and Germany (later overruled by the European Court of Justice), that it is, indeed, *possible to get away with non-compliance*. It is not that imposing sanctions of last resort, such as the actual fining of the two with a penalty equaling to 0.5 per cent of GDP, as envisaged originally in the Treaty of Amsterdam, would have been required. However, the circumstance that governments obviously and openly flouting the letter and the spirit of the coordinated fiscal rules of the game could get away without even a formal reprimand has made the impression that the fiscal framework meant to support the EMU is a dead letter, which is not invoked if anybody of importance is involved.

Second, all new members, themselves struggling with the disequilibria owing to reforms and policies alike, have faced the *demonstration effect* of the major countries. Quite irrespective of the need to join the euro quickly or not so quickly, they could observe the locomotives of the EU to dodge reforms, basically for reasons of short-term political considerations. Under a competitive political system and facing the gradual disintegration of governing parties on the left and right alike, it seemed trivial for them to replicate the experience of the 'frontrunners'. The cost, in terms of power, of joining the single currency later, and not meeting the criteria now, that were seen as by and large arbitrary and irrelevant anyway, has not seemed to be prohibitive. For this reason the oft-invoked 'straightjacket' nature of Maastricht and the SGP has not been at work at all, since participation in the coordinated fiscal framework has not and could not exert any disciplinary influence over the new members.

This is not to put the entire blame for the populist derailment of frontrunner transition economies on any of the external factors, that included, inter alia, the historic low of *international interest rates*. The fact that in the last Greenspan years the FED prime was the lowest in 46 years was basically an outcome of an attempt to avoid a recession in the USA. But for the new member states this created an opportunity for, and a lure of, bridging domestic disequilibria from cheap external sources, irrespective of the sobering Polish and Hungarian experiences of the 1970s and 1980s.

Analyzing the Hungarian experience, Györffy (2007) points to the low institutionalization of the budgeting procedure, the lack of professional and political understanding, the perhaps too quick adoption of creative accounting of advanced economies, and the relatively low professionalism of public debate over public finances among the causes.[6] While these factors may and perhaps also do vary by the Visegrád countries, the overall feeling of economic issues becoming less pressing must have played a role.

Last but not at all least, it is worth noting that in the 1990s successful transition countries have, to some degree, transformed their economic problems into social ones. When wages grow slower than productivity, capital income and wealth emerge, and so does mass unemployment and open poverty, joined with conspicuous consumption at the other end of the social spectrum, so macrodata seem often irrelevant for the man in the street. While in terms of macroeconomic indicators it would be hard to dispute the primacy of Poland (in terms of increments over the 1989 levels in GDP per capita, consumption, and so on),[7] it was precisely that country where strains had become manifest already years before the rightist–populist turn of 2005.

On the base of established economic insights it is anything but surprising to see the deceleration of growth, the sustainingly low activity levels, and the ensuing phenomena of *jobless growth*. Since the growth of the Visegrád countries in the 2000s has increasingly been export- and FDI-led, while the latter evolved around a capital-intensive pattern, this implies limitations on the demand side. On the supply side of labor one could observe the extension of higher education in terms of quantity, irrespective of labor market demands (replication of the experience of the 1970s and 1980s in core EU). Meanwhile traditionally competitive secondary schooling and vocational training tended to be neglected. Cultivation of skills, particularly important for employability, such as foreign languages, computer literacy, the ability and willingness to cooperate (even under unusual circumstances and with persons from different cultures), have tended to be neglected. Thus the relatively favorable numbers on formal education, such as the next to general spread of secondary education, or the quantitative expansion of tertiary education, tell little about the actual outcomes in terms of economic potential. The production of degrees has become a rather poor reflection of the state of human capital (Polónyi and Tímár, 2001). The above sketched circumstances may account, at least in part, for the emergence of jobless growth by the 2000s in Central Europe.

13.4 The quality of institutions and policies matters

One of the possible answers that may be given as a partial solution to our puzzle may lie in the quality of policies and institutions. In short, the process of accelerated structural change in Central Europe has been externally imposed on the respective societies. This involves *a number of factors*, starting up with the collapse of the Soviet Empire, which has been *extraneous* to those societies.[8] When the largely unforeseen changes of 1989–91 occurred, analysts both inside and outside the region tended to be rather unprepared for the challenges. *Local economists* did have a lot of tacit knowledge of the system and experience with manipulating reforms, which included a fair amount of policy skills for timing and sequencing. External experts tended to have two types of knowledge, which remained largely disconnected in most of the cases. *Sovietological* knowledge was extensive in anthropological and cultural terms, but tended to be backward in analytical economic backing. By contrast, *mainstream* and also developmental economists, active in policy advise and in international financial organizations, tended to have very limited if any region-specific experience. Knowledge of the Soviet-type economy was limited and schematic, and this contributed to a tendency

underestimating the time dimension, as well as the complexity, of post-communist change.

True, with the passage of time, the *interaction* of the above listed different strands of knowledge tended to improve, inter alia by way of learning by doing, or *trial and error*. Several ideas have been tested on the transforming societies (for better or worse), and this experience has finally contributed to the improvement of global economic knowledge. The learning process has been accelerated by the spread of standard knowledge and business expertise in the region (Pleskovic, 2007) at the formal level, and via interaction with IMF, the World Bank and not least the EU and multinational corporations at a more practical level. From the point of view of social learning, the latter, more pedestrian, variant has been equally, or even more, important than formal knowledge transfer. The above listed institutions have contributed to the evolution of relevant *professional knowledge*, via assistance programs, involvement, conditionality and simple on the spot learning (which was mutual), both in the region and globally.

With all due respect for those involved on both sides, it should be observed that change in the region has remained to a large degree *externally determined*. Learning at the expert level has been much quicker than at *the social level*. And while one may bemoan the relatively slow and shallow acquisition of cutting edge knowledge, even this speed tended to be breathtakingly quick for the formerly closed and stagnant ex-communist societies.

Learning has been anchored to a large extent in the process of Europeanization, that is, the interaction of EU and candidate country structures and policies. Ever since the signing of the trade and cooperation agreements in 1988 the EC/EU has been involved openly and deeply in the formation and restructuring of domestic institutions in Central Europe (Balázs, 1996, Part V). Since the accession to EU has been one of the very few consensual points among the divided local elites, the EU has gained an *unusually strong bargaining position* in the period leading up to accession. By the same token, technicalities stemming from the autochthonous development of the acquis communautaire and extraneous to domestic concerns, and the dynamics of transition, have played a major role. Perhaps the first and most conspicuous warning example of the mismatch was the White Book of the Commission of 1995, when it first listed the major tasks for candidates. The latter included, in the same order, such issues as the need to treat national minorities properly, to ensure the independence of the monetary authority, and the qualities tea boilers have to meet. Whereas the latter was clearly a reflection of the nature of any bureaucracy, the outcome has remained the same.

These and other examples may explain why the adoption of Western, that is mostly EU norms, has been *rather formal*. In making the choices, the stick and the carrot of the EU, as represented by the Commission and a few major members, played a decisive role. Therefore, considerations of an appropriate fit to the acquis rather than coherence with national norms, even the Constitution, remained subordinate (on the latter, see Sajó, 200 On the other hand, the limited administrative capacity of the Commis Directorate General (DG) for enlargement, and also the relatively mar significance of enlargement issues in the overall agenda of the EU in 2002–04, together allowed for the acceptance of lastingly formal adaptation Even if the EU experts Commission had its doubts, political and *strategic considerations* tended to sweep these under the carpet.

The best example of this approach has been the option for big bang rather than small group/incremental enlargement in 1999 in the Helsinki Council By *de facto* giving up the principle of differentiated treatment, the EU has rejected an important bargaining chip in the process. By contrast, local politicians tended to adopt a minimalist approach. Rather than echoing the concerns of the founding fathers, they considered it necessary to deliver whatever was required, but not a penny/inch more. This approach, often dubbed in the more academic EU literature as the return to intergovernmentalism, has not caused the lapses, but it has undoubtedly contributed to them.

Let me list just the *major policy areas* where improvements have proven to be *formal and fragmentary!* The obvious starting point is *public finance* where, as discussed above, the incentive to joint the area of single currency (a technocratic argument) has become subordinate to redistributory concerns (a socio-political argument). While new member states have long been involved in the rituals of the EU aimed at ensuring compliance with the letter and spirit of EMU – such as the elaboration of Broad Economic Policy Guidelines, the Fiscal Convergence Programs, since 2004 even the Excessive Deficit Procedures (some of them), and moreover their representatives being present during the deliberations of Ecofin in elaborating the Financial Perspective and in the co-decisions of the European Parliament – all these exercises have obviously fallen short of preventing the new members from the derailments already immediately upon their accession.

Membership in the EU has not contributed, as many of us would have expected, to a qualitative *improvement of the system of financial intermediation.* The story starts with the monetary authority, whose independence in real terms has proven lower than the ECB would have liked. It follows with the limited role of the State Audit Offices in correcting fiscal malpractices. Competition agencies are active, but their role is more supplementary than formative in shaping decisions of macrostructural nature (Bara, 2006; Kravtsenniouk, 2002). The slow if any progress in EU-wide financial services sector liberalization has contributed to keep a large segment of the economy closed. This is only in part counteracted by the fact that the banking sector in the region is one of the most transnationalized by global standards (Gém, 2004). This had to do with the need to import professional knowledge and strategic investors, whose capital is sufficient to ensure the solidity of the local banking system.

But the shortcomings of similar sorts could be listed in a number of *non-economic areas,* such as rule of law. Here the discontinuity with the interwar period has been particularly manifest, though differing by the country. While many aspects of legal culture have survived the Communist period, or have been revived in the early years of transition, the substantive components of application remain fragmentary. Business surveys of various sorts continue to name red tape, corruption, clumsy and inefficient legal arrangements, among the major components limiting competitiveness of the new member states, over and above the respective levels of unit labor costs or statutory tax rates.

Microeconomic reforms have also slowed down in the years during and after EU accession. To list a few: tax reforms prevented the collapse of state revenues that could be observed in the New Independent States prior to the emergence of the oil windfall and centralization of power structures, but were of limited success. With the exception of Slovakia, the system of public dues has remained rather non-transparent, serving a multitude of ad hoc purposes. For these reasons most business surveys contain repeated complaints against the tax system, and even more against the arbitrariness of administration, despite the well established fact that the consolidated level of public dues of Visegrád countries is among the lower ones in the OECD area. In the administration of investment-related tax holidays, a strange development could also be observed. Following the competition policy guidelines of the EU, the Commission pressed the new members to abolish the lavish tax holidays granted to big investors. While these ceased to grant new benefits since the end of 2002, a competition for FDI has intensified. At least in some of the industries, notably in automobiles, the often prestige-driven race for new big investment did trigger a series of concessions granted to the big investors, contrary to the declared principles and contrary to commonsensical and elementary economics (as documented in Kolesár, 2006). The workings of courts has remained slow, inefficient and often insensitive to the needs and time considerations of business. Support for small and medium-sized enterprises (SMEs) has been vocal, but neither the money allocated, nor the institutions specifically tailored to their needs, were able to overcome the numerous obstacles to bottom-up entrepreneurship and its growth (Dallago and McIntyre (eds), 2003).

Also in the broader socio-political sphere, *the stagnation of reforms* has become observable once the formal requirements of the EU were, by and large, met. For instance in Hungary, the agency supervising the media worked for 4 years without involvement of the opposition, although the stipulations require their presence. In Poland and Hungary, the monetary policy board has been widened so as to enhance governmental influence. Corruption cases abound, most prominently in the Czech Republic, when prime ministers and other high officials had to resign due to involvement. In Slovakia, several of the reforms of the Dzurinda government could be easily reverted, such as the symbolic flat tax, showing the weak institutionalization of policies. The politicization of civil service has become manifest in all four countries, with changes in the top triggering wholesale restructuring reaching even the lowest levels. Most affected were the ministries of culture and foreign affairs, but these are by no means singular/exceptional cases.

The spread of populism in overall political approaches has paved the way to, what was once termed in the USA during the Reagan period, woodoo economics. Calls for tax cuts and parallel expenditure increase abounded in left and right wing parties or governments alike. The ballooning of deficits, most manifestly in Hungary, has been a clear indication of how dire the consequences of such policies can be. For if the government regularly overspends and crowds out private investment, the deceleration of growth rates is anything but surprising, especially in the medium run.

Lack of consensus, low credibility and insufficient commitment have made joining the eurozone illusory in each of the countries by the time of writing. While this step was seen around 2002 as a given, the nature of policies has evolved in such a way that the floating of the entry date is the adequate option, since nobody can make quantifiable and thus checkable commitments on macroeconomic targets, especially the ones enshrined in the Maastricht and the following Nice Treaty on the EU. This should not be a major problem per se, if only we had not considered two circumstances. For one, the above listed shortcomings reflect the weakness of new democracies. Furthermore, they also reflect *a missed opportunity* in the period of relatively high growth. Instead of implementing the painful but necessary third generation reforms, or at least paving the way for the latter, the policy-makers of the region opted for short-sighted policies, despite the formal commitments made, explicitly and implicitly, during the accession process. On the other hand, at times of increased capital mobility, these small open economies – the Visegrád Four – who had also opened their capital markets by the early 2000s, are increasingly subject to the *volatility of international capital markets*. Under these circumstances sustaining a national currency becomes an expensive and dangerous luxury, as the potential number of targets for speculative attacks has been on the increase. Furthermore, in such small open economies the sovereignty of monetary policy has become by and large an illusion anyway, since room for conducting policies, other than accommodating the ups and downs of international markets, has become narrow or even next to nil. This can be tested any time they wish to follow a different line, for example in order to reflect domestic balance of power considerations, such as trying to keep the prime rate low in order to help finance the government deficit.[9]

13.5 What is the terminus?

The mere listing of the above-sketched issues may already justify our doubts about the uses of the term 'transition'. The semantics of the word would imply that we know by and large not only *the starting point*, which is the case with the benefit of hindsight, but also *the end point of the process*. Under this assumption, the real question is only that of the trajectory, in two planes. At one level we may ask if societies have indeed come closer to their production frontier, if they have rejoined the mainstream of human progress, or if they have entered the path of sustainable development, whether they allow for applying the concept of the World Bank and others that is broader than sheer quantitative growth (and includes environmental, social and financial equilibrium considerations). At the other level we may compare, at least *ex post*, actual policies with those that could, in theory, have been implemented. This second exercise is of course to a large degree speculative. However, it allows for identifying alternatives against which the self-congratulating tone of the official accounts can be replaced with analytically better elaborated insights.

The above list is by no means meant to be exhaustive, and could be extended perhaps at will, with further issues such as the problem of social exclusion, the major dilemmas of developing physical infrastructure, the need to turn education into a component of competitiveness, and many others. However, the mere enumeration of issues reflects a new reality: namely, that countries of Central Europe face by and large *the same type of challenges as the incumbent EU-15*. In other words, transition, as a specific set of tasks leading to EU maturity, is basically over. However, the EU itself has come to a certain stagnation in both policy and institutional planes. At the *policy level* major items of common or coordinated policies have been subject to doubts and disagreements, from common foreign and security policy (over Iraq) via the above-described flouting of the fiscal framework, to the open questioning of the *rationale* of common agricultural policy, in terms of size and funding alike, by the net contributors. Meanwhile, *at the institutional level*, the rejection of the Constitutional Treaty by the Dutch and French electorate, and the ensuing freezing of ratification in such major member countries as Britain and Poland, have sent a clear signal to policy-makers that the seclusive, elitist, non-responsive style of European governance has reached its clear limits.

In short, what seemed to be a safe haven for the new members only a few years ago has become a sea of rather troubled waters by the time they have arrived. The stagnation of the EU as an institution follows, by and large, from *the stagnation of domestic reforms* in some – though by no means all – core member states such as France, Italy and Germany. The challenges, such as reforming the welfare state model (broadly conceived), and introducing fiscal sustainability while regaining global competitiveness, bear considerable similarities between old and new members.

For this reason it is legitimate to ask, if and to what degree, the *Lisbon Strategy*, as re-launched in March 2005, is an adequate answer to these challenges.[10] The new agenda can be read at least in two ways. At a more narrow *technocratic* level, it is a collection of measures that are relatively loosely dovetailed. The two basic innovations at this level are the so-called open method of coordination, namely the rejection of previously predominant centralized methods, stemming from the French and German traditions in public administration. For this reason annual programs are decentralized to the national level, and this is where funding for most initiatives is being secured. This also is an important novelty, reminding the new members of the fact that the EU is decreasingly about redistribution. What used to be a British peculiarity (ever since the famous exclamation of Baroness Thatcher: 'I want my money back!') is by now general practice. Maximizing transfers from EU funds does not qualify as a meaningful, not even a feasible, integration strategy, as the coffers are basically empty. The Financial Guidelines for 2007–13 allow for a redistribution of a mere 1.045 per cent of Gross National Income (GNI) despite the joining of two poor countries, Bulgaria and Romania in 2007.

But seen in a *broader perspective,* the Lisbon Agenda is a call for rejuvenating Europe, for it contains a refocusing of priorities to the high tech industries, to education and competitiveness in general. The Lisbon Agenda does not contain big investment projects in physical infrastructure, but it calls attention to a number of major issues. It adopts a *back to basics* approach by calling for more growth, and for more growth deregulation of factor and product markets. It also stipulates the use – rather than the production – of information technology across the board, also in traditional industries and households. It conceives education as a strategic sector, one whose major function is not to keep entire cohorts of young people out of the labor market, but prepare them for more and better jobs, for non-traditional forms of employment, for life-long learning and for working with different corporate cultures. It sustains the previous concerns about gender equality and social protection, but the previous bureaucratic approach of plan indicators has been softened and even given up.

If we accept that this rather general agenda, just owing to its high level of abstraction, is perhaps best suited to address the *diverse concerns* of the member states, and that its reformist quest and focus on global competitiveness reflects the basic coordinates of strategy, this translates into a call for *further reforms within the member states, old and new.* The tasks of attaining fiscal sustainability as a side condition for a viable welfare state is a big challenge, but a manageable one, as the experience of the Scandinavian countries has convincingly demonstrated. The concept of 'flexsecurity', as the combination of flexibility with retraining and decent living conditions, coupled with the expressed willingness to work originating from Denmark, is perhaps a sign of what needs to be done.

One of the remarkable features of *international competitiveness studies,* such as those by the World Economic Forum in Geneva and the International Management Institute in Lausanne is clear evidence, at global scale, of the viability of distinctly different roads to success. For instance the leading players, such as Singapore, the USA, or Finland, Denmark and Switzerland, have markedly different arrangements at the macro- and microlevels alike. Similarly, if we look at labor market data, even the EU liberal arrangements, such as those in Ireland and Hungary, may be equally effective as more regulated arrangements, as in Denmark or Austria. In sum, the lasting diversity of the routes to success seems to be a sustaining feature of transition.

If this is the case, we cannot and *should not speak,* even at the more abstract level, about a well-defined terminus in the singular. Perhaps it makes sense to talk about termini, in plural, within the established traditions of Pryor, Montias and Bornstein, namely the defining figures in comparative economics. This non-mainstream approach has now in part been revived in comparative political science by the 'varieties of capitalism' approach (Iversen, 2005; Bohle and Greskovits, 2007). The message of all these – in part competing, in part complementary – approaches is that there is nothing wrong or surprising to see the end point of 'transition' being inherently different by the country and *even open-ended in historical perspective.*

If this is the case, the question mark in the title of this essay remains legitimate. For the past, we may still want and perhaps are obliged to ask, if the costs could have been lower and the gains higher. As in standard economic analysis, the answer is often[11] affirmative. For the future, however, *we have lost the standard, the rod of measure.* Most probably we can run the standard analyses to find the usual suspects in bringing about less than ideal outcomes. However, the lack of a clearly defined end-point, as well as allowing for *path dependence,* and even more for *public choices* that may differ by the country and the generation, will render the concept of optimality less than operational. Perhaps the difference between micro- and macroeconomic concepts and levels of interpretation is likely to remain a lasting feature in understanding real-world developments, such as the historic change from communism to the EU. Once we give up the implicit assumption that Georgia should as equally end up being a version of Sweden as Slovenia, there is nothing surprising about the divergent paths and also of the different end-stations. To judge the difference may remain, to a large degree, *a matter of value judgment,* not liable to quantitative checking.

Notes

1. For own reading of events, see Csaba (2007).
2. Not only the Stability and Growth Pact is recurrently flouted, but so are a number of other regulations, such as those envisaging the single market or environmental protection. The Commission produces regular monitoring reports, naming and shaming trespassers, which include not only and not primarily the new member states.
3. For instance, in the case of Hungary in 2004 and 2005, funds originally earmarked for regional development projects have been re-channeled by the Ministry of

Agriculture for production subsidies, in one case, for example, to support the notoriously crisis-ridden poultry sector.

4. It is a different issue that shortcut solutions such as unilateral euroization or the currency board option may be counterproductive (Nuti, 2002).
5. In this line of reasoning, meeting EMU criteria does not imply any additional burden, as it is a synthesis of stability and growth promoting tasks that need to be implemented anyway (Csaba, 2001).
6. According to an opinion poll of spring 2006, only 18 per cent of the voters of the governing Socialists believed that fiscal deficits constitute a problem (while the actual magnitude of the latter was above 10 per cent by the end of the year).
7. More on this issue in Kolodko (ed.) (2005).
8. Earlier attempts to modify the boundaries set by Moscow, such as the 1956 Polish and Hungarian uprisings, the 1968 Prague Spring, or the 1980–81 Solidarity movement, all foundered on the constraints set by the geopolitical situation. Changing of the latter was not entirely independent of what happened in Central Europe, but it would be an exaggeration to attribute the erosion of the system to factors within the satellite states.
9. This experience has perhaps been the most palpable in the 1980s when the Maroy Government in France and the Papandreu Government in Greece attempted to revitalize the economy following old-fashioned Keynesian recipes. The openness of the economies as well as the size and depth of international capital markets has only increased, and capital controls abolished.
10. A recent special issue of the monthly of the Hungarian Academy of Sciences has been devoted to elaborating various aspects of this set of issues from a number of disciplinary perspectives by articles written by leading authorities on the subject in *Magyar Tudomány*, 167 (2006), 9.
11. One of the first econometric analyses comparing the potential to the actual outcomes (de Melo *et al.*, 2001) has actually found a number of cases, for example Mongolia and Kyrgyzstan, which have outperformed their potential in terms of reforms of the 1990s.

References

Aiginger, K. and A. Guger (2006) 'The ability to adapt: why it differs between Scandinavian and continental European models?', *Intereconomics*, 41 (1), 14–25.

Balázs, P. (1996) *Az EU külpolitikája és Magyarország (CFSP of the EU and Hungary)* (Budapest: Közgazdasági és Jogi Könyvkiadó).

Bara, Z. (2006) 'Competition and Hungarian competition policy', *Public Finance Quarterly*, 2 (2), 213–35.

Buti, M. and D. Franco (2005) *Fiscal Policy in Economic and Monetary Union* (Cheltenham, UK and Northampton, Md, USA: Edward Elgar Publishing Co.).

Bohle, D. and B. Greskovits (2007) 'Neoliberalism, embedded neoliberalism and neocorporatism: paths toward tyransnational capitalism in central and eastern Europe', *West European Politics*, 59 (2), in print.

Csaba, L. (2001) 'The euro – a new entry barrier?', in B. Vènard (ed.) *Économie et Management dans les pays en Transition* (Paris-Angers: jointly published by CNRS and ESSCA), pp. 81–102.

Csaba, L. (2007) *The New Political Economy of Emerging Europe* (Budapest: Akadémiai Kiadó/W.Kluver), 2nd edition.

Dallago, B. and R. McIntyre (eds) (2003) *Small and Medium Enterprises in Transitional Economies* (New York: Palgrave).

de Melo, M., C. Denizer, A. Gelb and S. Tenev (2001) 'Circumstance and choice: the role of initial conditions and policies in transition economies', *World Bank Economic Review*, 13 (1), 1–32.

Gém, E. (2004) 'A kelet-európai bankrendszer átalakulása és fejlődése (Transformation and development of east European banking)', *Külgazdaság*, 48 (9), 23–48.

Győrffy, D. (2007) 'Deficit bias and moral hazard on the road to EMU: the political dimension of fiscal policy in Hungary', *Post-Communist Economies*, 1 (1), in print.

Haan, J., H. Berger and D. Jansen (2003) 'The end of the stability and growth pact?', *Munich CES/ifo Working Paper*, no. 145.

Havrylyshin, O. and R. van Roden (2003) 'Institutions matter in transition, but so do policies', *Comparative Economic Studies*, 45 (1), 2–24.

Iversen, T. (2005) *Capitalism, Democracy and Welfare* (Cambridge and New York: Cambridge University Press).

Kolesár, P. (2006) *Race to the Bottom? The Role of Investment Incentives in Attracting Automotive Strategic FDI in CEE*, MA Theses defended at the IRES Department, CEU.

Kolodko, G. W. (2000) *From Shock to Therapy* (Oxford: Oxford University Press for WIDER UNU).

Kolodko, G. W. (2005) *The Polish Miracle: Lessons for Emerging Economies* (Aldershot, Hants, UK: Ashgate Publishers).

Kravtsenniouk, T. (2002) 'Merger regulation in CEE: evidence from Hungary, Romania and Slovenia', *Acta Oeconomica*, 52 (3), 327–46.

Krueger, A. O. (1998) 'Wither the IMF and the World Bank?', *Journal of Economic Literature*, 36 (4), 1983–2002.

Murrell, P. (1992) 'Conservative political philiosophy and the strategy of economic reform', *East European Politics and Societies*, 6 (1), 3–16.

North, D. (2005) *Understanding the Process of Economic Change* (Princeton, New Jersey: Princeton University Press).

Nuti, D. M. (2002) 'Unilateral euroization – an unnnecessary exercise?', *Economics of Transition*, 10 (2).

Polónyi, I. and J. Tímár (2001) *Tudásgyár vagy papírgyár?(Manufacturing knowledge or degrees?)* (Budapest: Új Mandátum Kiadó).

Pleskovic, B. (2007) *Scaling Up Progress in Economic Research and Higher Education in Eastern Europe* (Washington, The World Bank and Budapest: CEU Press), in print.

Sajó, A. (2004) 'Learning cooperative constitutionalism the hard way: the Hungarian Constitutional Court shying away from EU supremacy', *Zeitschrift für Staats- und Europawissenschaften*, 2 (3), 351–71.