

The Speed of Large-Scale Transformation of Political and Economic Institutions: Insights from (Post-)Transitional European Union Countries

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Despite the predominant inclination towards the gradualist approach to reforms in the initial transition years, economic indicators suggest that big bang reformers have

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demonstrated a superior performance over the last (few) decade(s). Still, the approach to (post-)transition processes should be multidimensional and include more than the speed of transformation and key economic indicators. Therefore, a quantitative analysis covers several aspects related to socioeconomic change. The scores for the quality of democracy, market economy, and management performance in post-socialist EU member states indicate that over the last decade, the countries that applied the shock therapy approach have performed significantly better in all these areas. This suggests that slow reformers are lagging behind in the development of democratic institutions and modern market economies, and presumably have insufficient capacities to rapidly catch up with fast reformers. Further research should scrutinise the institution-building related aspects of large-scale transformation, the deep roots of development, and distinctive circumstances in particular.

Keywords: post-socialism, institutions, reforms, gradualism, shock therapy

1. Introduction*

New Institutional Economics (NIE), complemented by insights in the fields of economic sociology and political economics, helped to understand post-socialist transformation. Moreover, transition economics facilitated a new understanding of capitalism. Transition processes have raised numerous issues for which economic theory did not initially have ready answers. Policy-makers and incumbent governments were faced with two main challenges: the first was the choice of new institutions and the pace at which old ones would be replaced, while the second was their eagerness to find quick fixes that had

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worked in Western countries. However, in retrospect it became evident that the legacy of the socialist system had been underestimated.

This article compares the applicability of both gradualist and shock therapy approaches to reform implementation in large-scale change. Using quantitative data, it aims to provide more evidence of the lessons learned from post-socialist transformation. Consequently, it adds a theoretical and empirical contribution to the body of literature on great transformations, with a particular focus on their speed and the acceptability of their policy solutions.

The article is structured as follows. Section two portrays the role of institutions and institutional economics in post-socialist transformation by emphasising the importance of (un)expected key success factors. In section three, two opposite schools of thought addressing post-socialist changes are presented, complemented by recent theoretical and empirical contributions. Section four goes on to provide a quantitative analysis of post-socialist EU member states grouped according to their choice of (early) reform strategies, and discusses the superior results of the big bang reformers. Section five concludes the discussion.

2. Institutions and Post-Socialist Transformation

The large-scale economic transition from socialism to capitalism has helped institutional economics to establish a mainstream position (Aligić, 2006; Kornai, Matyas & Roland, 2008). Listing key milestones in development economics since the 1950s, Rodrik (2010) points out North's work on institutions as a foundation for the wave of economic reforms emphasising improved governance. Rodrik (2009, p. 154) is convinced that the central question is no longer 'Do institutions matter?' but 'Which institutions matter and how does one acquire them?' Still, having listed the numerous achievements of New Institutional Economics, O. Williamson (2000, p. 608) stated: "Broad reach notwithstanding, the NIE is not and does not pretend to be an all-purpose construction, as the reform of the economies of Eastern Europe and the former Soviet Union illustrate." He finds further confirmation of his statement in the Nobel Prize lectures held by Coase in 1991 and two years later by North.¹

¹ "... what we have is a very incomplete theory. All this is beginning to change and in this process I am glad to have played my part. The value of including such institutional

Opper (2008) claims that transition economies provide rare windows of opportunity to examine institutional change, which by radically changing institutional foundations leads towards an emergent market economy. Similarly, post-socialist economies are also considered useful laboratories for the change of economic systems (Djankov & Murrell, 2002). Moreover, increased research on transition could be explained both by its policy importance and by its relevance to economic theory that reaches an even better understanding of capitalism (Roland, 2000). At the outset, post-socialist transformation was faced with very limited theoretical support, while at the same time the societies in question “faced a complex, multi-level process, in which constitutional, legislative, institutional factors and informal social networks, and cultural values and attitudes, were all part of the problem ... the ‘awesome challenge’ of simultaneously reorganising political, economic, and legal systems, and redefining national, ethnic, and cultural identities” (Aligicia, 2006, p. 36).

Roland (2004, p. 110) seems to fully agree, stating that “the transition experience of the nineties was both a testing ground for the traditional body of economic theory and an invaluable source of new information about conditions for successful capitalist development.” In retrospect, it became evident that transitional events had resulted in a better understanding of institutions, their dynamics, and policy relevance (Roland, 2001, 2002; Opper, 2008).

Noting that post-socialist transition had triggered an analysis of institutional transformation and later extended to development issues, Brousseau, Garrouste & Raynaud (2011b, pp. 13–14) analyse two major approaches: the top-down and the bottom-up approach. In the top-down approach of administered change, key actors attempt to implement insti-

factors in the corpus of mainstream economics is made clear by recent events in Eastern Europe. These ex-communist countries are advised to move to a market economy, and their leaders wish to do so, but without the appropriate institutions no market economy of any significance is possible. If we knew more about our own economy we would be in a better position to advise them” (Coase, 1991).

“The implication is that transferring the formal political and economic rules of successful western market economies to Third World and eastern European economies is not a sufficient condition for good economic performance. Privatization is not a panacea for solving poor economic performance ... an essential part of development policy is the creation of polities that will create and enforce efficient property rights. However, we know very little about how to create such polities because the new political economy (the new institutional economics applied to politics) has been largely focused on the United States and developed polities. A pressing research need is to model Third World and eastern European polities” (North, 1993).

tutional change within a shorter time period, whereas in the bottom-up approach social groups make long-term attempts to implement institutional change. The top-down and bottom-up processes may happen simultaneously and have either synergistic or blocking effects. Easterly (2008) also notes that these two views are actually extremes and that most approaches lie somewhere in between. In addition to the previous explanation, Easterly's focus in respect of the top-down view is on creating new institutions from scratch and/or importing an accepted set of institutions from more developed countries and putting them into effect instantaneously.

At the same time, in the bottom-up approach change is usually incremental because it considers existing institutions to be influenced and limited by preceding ones. This makes this view evolutionary rather than revolutionary (shock therapy). In the top-down view economists are required to recommend an optimal set of institutions that are usually completely new to a certain country, whereas in the bottom-up approach economists have the more specialised task of recommending steps of desirable gradual change that will not disrupt the functioning of society and take into account the historical evolution of institutions.

The opposite views should be taken into account as well, despite the fact that they did not focus on post-socialist European countries. The opponents of the 'institutions matter' approach claim that the discussion regarding the importance of institutions has been dangerously oversimplified (Sachs 2003a; 2003b). The main criticism is rooted in a strong correlation of economic growth and demographic variables with geographical and ecological variables, scarce natural resources, and malaria transmission in particular. Yet, it is claimed that "[i]nstitutions may matter, but they don't matter exclusively" (Sachs, 2003b, p. 28) and that good institutions surely matter, but bad ones can deteriorate the economic situation, even one starting in favourable conditions (Sachs, 2003b). Nonetheless, studies showing institutions as the key determinant of wealth and long-term growth have vastly contributed to the 'institutions matter' stream (Hall & Jones, 1999; Acemoglu, Johnson & Robinson, 2001; Easterly & Levine, 2003; Rodrik, Subramanian & Trebbi, 2004).

Discussing economic reforms, Murrell (1991a) issues a strict warning that blanket prescriptions should be treated with scepticism or avoided. Instead, one should rely on an economic reformer's expertise and intuition when deciding between competing ideas and learning from experience. Rodrik (2009) also advocates the avoidance of 'big ideas' and understanding that they do not translate easily into policies. Much additional lo-

cally-relevant input is needed in order to produce a high-quality policy recommendation that fits a local economic and political context.²

Hausmann, Rodrik and Velasco's (2005) growth diagnostics methodology, which has become accepted for countries at various levels of development, is based on the idea that different barriers to growth are not equally binding and that a proper strategy should focus on the most dangerous ones. This diagnostics is also strongly advocated by Popov (2009), with the aim of identifying the subsequently elaborated missing ingredient. Rodrik (2010) stresses that successful countries have taken two major steps: first, they have identified the most serious barriers, and second, they have removed them with locally appropriate remedies. Furthermore, he claims: "Diagnostics requires pragmatism and eclecticism, in the use of both theory and evidence. It has no room for dogmatism, imported blueprints, or empirical purism" (Rodrik, 2010, p. 37).

Regarding methodology, diagnostics should show which random experiments need to be undertaken. Because of the series of causes any developmental failure may have, it is important that the intervention under research should prove to be the remedy for the crucial causes, i.e., that it should pass the test of relevance. However, Rodrik (2010, p. 42) claims that diagnostic tools are still an insufficiently researched area.

In order to summarise this part of the literature review, it is valuable to note that the key determinants of economic and political transformation should be found along these suggestions: first, in selecting the most relevant institutions, adopting them and putting them into effect; second, in enhancing the understanding of institutions and their dynamics; third, in understanding the local circumstances; fourth, in recognising the largest obstacles to reform implementation; and fifth, in identifying locally appropriate treatments for the removal of barriers and putting the selected institutions into effect. Finally, from the perspective of political economy, any reform is determined by the interaction between the policy-makers' reform objectives and a set of economic and political institutions that are not directly under their control (IMF, 2004, p. 109). Therefore, in order

² "Local conditions matter not because economic principles change from place to place, but because those principles come institution-free and filling them out requires local knowledge" (Rodrik, 2009, p. 55); "... the institutions that have emerged in the Western world ... do not have to be faithfully copied in developing countries. The key is the incentive structure that is created, not the slavish imitations of Western institutions" (North, 2005, p. 159); "the introduction of new institutions that fit poorly with underlying norms can make gradual changes in attitudes unlikely as people observe the costs of markets and bureaucracies" (Rose-Ackerman, 1999, pp. 320–321).

to debate the potential effects of reform on economic performance, it is necessary to take into consideration factors that affect reform implementation strategy: primarily the speed at which reforms are carried out.

3. Reform Speed and Implications Thereof for (Post-)Transitional³ Societies

Early on in the transition, the speed of transitional reforms was one of the most discussed topics among incumbent governments and scholars in post-socialist societies and their advisors in the Western community. Roland (2000, pp. 330–331) compares the postulates of the Washington Consensus (in other words, the big bang or shock therapy approach) on the one hand, and the Evolutionary-Institutionalist Perspective (EIP) (also named the gradualist or incrementalist approach) on the other hand, in order to present two opposing views of transition. The former was mostly applied in Central Europe and the Baltics, whereas the latter approach was predominantly implemented in Southeastern Europe and some former Soviet republics (Table 1). It is important to stress that despite the fact that reform speed is a dominant feature in the above synthesis portraying opposing approaches, it is actually only one of the several aspects addressing reform strategy choice.

Roland (2000; 2001) states that at the beginning of the transition EIP was predominantly supported by academics, whereas the Washington Consensus⁴ approach was applied by international organisations. It had initially been developed for Latin American countries and was subsequently applied to Eastern European countries in the early 1990s. Rodrik (2010) considers the Washington Consensus to be the result of a presumptive mindset that, besides all of the previously elaborated features (comple-

³ In recent years some authors have started to use the term *post-transition countries* for the group of countries that started their post-socialist transformation in the late 1980s and early 1990s. Simultaneously, there has been a growing debate regarding the end of the transition. Hereinafter *transition countries* will be used for that group of countries. This choice of wording was additionally prompted by the fact that the same term is used by established scholars in numerous works, for instance, the volume *Economies in Transition: The Long-Run View*, edited by G. Roland (2012).

⁴ The Washington Consensus has raised many serious issues and debates, particularly regarding covert intentions disguised behind the beneficiary effects on targeted countries, yet this topic is outside the scope of this work.

mentarity of reforms instead of sequencing and prioritisation, and the like), is biased towards universal remedies, best practices, and rules of thumb. The experimentalist approach is the opposite approach, being explicitly diagnostic in its strategy to identify barriers to development and to monitor and evaluate the experimental reforms undertaken in order to select focused reforms. It attempts to discover and implement locally applicable policy innovations and shortcuts that diminish political complications. Numerous authors (Rodrik and Roland among others) emphasise China as a good illustration of the experimentalist approach, i.e., an evolutionary-institutionalist perspective. Roland (2000, p. 329) explains EIP to be rooted in “1) the institutionalist perspective given by modern economic theory and its methodology shaped by the development of non-cooperative game theory, 2) themes of the evolutionary approach to economics..., 3) a philosophical scepticism, influenced by Hayek and Popper, with a strong emphasis on our relative ignorance of economic and social systems and their transformation, an emphasis on the uncertainty associated with societal engineering, and a strong aversion toward any kind of Bolshevik-style campaigning in large-scale institutional transformation.”

Table 1. *Countries grouped by reform speed in the (early) transition period*

Sustained Big Bang	Aborted Big Bang	Gradualism (Advance Start/ Steady Progress)	Gradual Reforms	Limited Reforms
<i>Estonia</i>	Albania	<i>Croatia</i>	Azerbaijan	Belarus
<i>Latvia</i>	<i>Bulgaria</i>	<i>Hungary</i>	Armenia	Uzbekistan
<i>Lithuania</i>	Macedonia	<i>Slovenia</i>	Georgia	Turkmenistan
<i>Czech Republic</i>	Kyrgyzstan		Kazakhstan	
<i>Poland</i>	Russia		Ukraine	
Slovakia			Tajikistan	
			Romania	

Source: Adapted from Havrylyshyn (2007, p. 6) and Lenger (2008, p. 10); the same classification is also used in Havrylyshyn, Meng & Tupy (2016). The analysed countries have been italicised by the authors.

The key difference between the Washington Consensus and EIP is the approach towards uncertainty (Roland, 2000, pp. 329–332). Starting from initial conditions characterised by inefficiency, the Washington Consen-

sus anticipates efficiency gains on the basis of the economic theory that transition leads to such efficiency gains, which is supported by the experience of capitalism in the USA and Europe. On the other hand, EIP takes into account unpredictable coordination models among economic agents and emphasises the limited understanding of large-scale changes and the aggregate uncertainty of transition results, despite best practices of capitalism that are available to be copied. The approach towards uncertainty results in different reform strategies. Washington Consensus protagonists will use early windows of opportunity and push reforms at immense speed, thereby creating irreversibility, whereas in EIP the underlying idea is to implement reforms gradually, thus building continuous and growing support and social cohesion, and at the same time taking the risk that bad reforms will be irreversible. Furthermore, the EIP approach develops transitional institutions appropriate for the starting conditions of a country and gradually allows them to change into better institutions. This process considers path dependence and avoids locked-in inefficiencies.

In contrast, the Washington Consensus initiates sudden large-scale changes by introducing 'best practice' institutions and by counting on their complementarities. Thus the logic of a 'cavalry attack' is used in order to break all existing resistance and the possible sabotage of former incumbent regimes (Roland, 2001, p. 37). The main claims of Washington Consensus proponents are that half-measures will not do and that such partial reforms usually worsen the situation because of second-best reasons (Williamson, 1992).

Regarding the type of institution, the Washington Consensus is mostly focused on property rights and the rights of shareholders, i.e., economic institutions. The EIP view is broader, as it covers political, legal, and economic institutions dealing with legal and financial change, an implementation framework, the organisation of government, as well as informal institutions like self-enforcing social norms that enhance the entrepreneurial spirit, commitment, and trust in a society. This makes the EIP perspective more comprehensive than the Washington Consensus regarding institutional change.

Both approaches place a rather strong emphasis on institutions, yet the shock therapists destroy the institutions of the preceding system and immediately establish new ones that are considered to be the best fit. On the other hand, gradualists take into account existing institutions and take care to evolve these, while simultaneously adding new ones.

Washington Consensus policies finds their main supporters among the owners of newly privatised companies and, in a broader sense, among in-

terest groups that are strong supporters of capitalism, whereas EIP relies more on entrepreneurs and the middle class that usually plays an important role as voters in democracies.

The Washington Consensus represents the neoliberal approach and stands for weaker government aiming to depoliticise the economy. EIP sees the government role in enforcing laws, property rights, and market rules in general, and therefore preventing imperfect competition, state capture, and corruption (Roland, 2000, pp. 329–333). In the majority of its aspects, EIP may be described as a bottom-up approach, whereas the Washington Consensus may be labelled as a top-down approach.

Advocating for an evolutionary paradigm, Murrell (1991b, pp. 7–9) stressed its key elements: persistence in organisational behaviour, external influences on the economic environment that are significantly shaped by the past, selection processes and shifts aimed at the improvement of resources and the environment, greater variety of the types of organisations in society, and uncertainty and limited availability of information in policy-making processes. Murrell (1991b) further explains that the market system is the most productive in the long run but sudden changes may negatively influence the output of enterprises. This phenomenon may not only be found in post-socialist economies that are transitioning from one system to another, but also in capitalist economies when important rules are changed. The distinctive issue regarding Eastern Europe is the number of companies that are forced to change at the same time, resulting in decreased output in one area and the pressure of adversity in another.

Roland (2000, pp. 335–340) also states that when analysing the results in Central and Eastern Europe in the light of the Washington Consensus trinity of liberalisation, privatisation, and stabilisation, one can easily understand the reasons for the growing consensus in the academic community regarding the validity of EIP. Rodrik (2009, p. 55) comments on the results: "... reality has been unkind to our expectations. If Latin America was booming today and China and India were stagnating we would have an easier time fitting the world to our policy framework."

Despite his inclination to experimentalism, Rodrik (2009, p. 165) warns of the dangers of its identification and implementation. First, there is a common confusion between self-conscious experimentalism and a gradual approach or delay aimed at ensuring privileged interests. Such aversion to reform is to be found in the former Soviet Union. In contrast, there have been gradual attempts to use local knowledge in order to better develop reforms for local needs. In that regard, Slovenia is a successful case of gradualism

(Whitley, Jaklič & Hočevar, 2000). A second issue is the direct costs and opportunity costs of experimentation compared to importing blueprints. It is important to thoroughly analyse the costs because the experimentalist approach causes opportunity costs as well, and inevitably influences future institutional development. Even if institutional arrangements are not transferred from other countries, it is possible to learn from these and hence diminish the costs of pure experimentalism (Rodrik, 2009, p. 165). Alston et al. (2010) make the same argument as they discuss the advantages and disadvantages of role models; the problem with the Washington Consensus was the blind importation of policies instead of learning from other countries' experiences and modifying local policies and institutions. Still, shock therapy proponents consider it was already obvious in the 1990s that this approach resulted in better economic performance as shown by the differences in the GDP of Eastern European rapid liberalisers versus the slow reformers (Shleifer & Vishny, 1999, pp. 228–233). Furthermore, they argue that shock therapy vastly contributes to depoliticisation because it eliminates price controls as the main tool of central planners, maintains tougher budget constraints, and diminishes the power that the state exercises over firms. Nonetheless, they warn that shock therapy does not guarantee depoliticisation or transformation of government institutions.

Throughout the 1990s, the overall impression was that the gradual approach was getting an increasing number of proponents among academics, policy advisers, and international organisations. The major concern was that the shock therapy approach caused increased poverty and diminished social capital; i.e., it resulted in increased pain in transition (Murrell, 1996; UNDP, 1998; Stiglitz, 1999). It seemed that the gradualist approach resulted in better performance in the initial stages of transition. However, the decline of economic results in all post-socialist societies was mostly followed by the recovery of fast reformers and negative trends among gradualist reformers. Fischer and Sahay (2000) link fast Central and East European (CEE) reformers with faster recovery and higher economic growth. Analysing the first 15 years of transition, Havrylyshyn (2007) found that rapid reformers had developed better institutions than slow reformers, and shown better economic performance and lower inequality than slow reformers. Ten years later Havrylyshyn, Meng and Tupy (2016) confirmed that rapid reformers outperformed slow reformers in the first 25 years of transition.

However, the approach to transition reforms should be more nuanced than a mere dichotomy (as it may seem at first glance): big bang versus gradualism or the market versus the state. The essence of transitional pro-

cesses lies in institution building (Kolodko, 1999; Popov, 2000, 2006; Trivić & Petković, 2015; Stiglitz, 2016). Optimal transitional policies are context- and path-dependent and require a properly diagnosed ‘missing ingredient’ because it is crucial for development and growth (Popov, 2009). In retrospect, “... the story of the successes and failures of transition is not really the story of consistent shock therapy and inconsistent gradualism. The major plot of the post-socialist transformation ‘novel’ is the preservation of strong institutions in some countries (very different, in other respects, from central Europe and Estonia to China, Uzbekistan and Belarus) and the collapse of these institutions in the other countries. At least 90 per cent of this story is about government failure (strength of state institutions), not about market failure (liberalization)” (Popov, 2009, p. 13).

4. Empirical Analysis Beyond Key Economic Indicators: The Last Ten Years in (Post-) Transitional Economies

Using quantitative data, this article investigates the effects of opposite approaches to reform implementation in post-socialist European Union member states during the period 2006–2016. This is done by analysing the findings of the Bertelsmann Stiftung Transformation Index (BTI), a global ranking of democracy, market economy, and political management. We compare the performance profiles for Bulgaria,⁵ the Czech Republic, Estonia, Latvia, Lithuania, Poland, and Slovakia (grouped together as “shock therapy” countries), analyse the trajectories of these countries over time and compare them to Croatia, Hungary, Slovenia, and Romania (grouped together as “gradualist” countries). We thus seek to examine whether and how these two groups differ or possibly converge. This multidimensional comparison should provide quantitative evidence as to the lessons learned from post-socialist transformation.

The authors are aware of the shortcomings of aggregate data despite their widespread use. First, as noted by Rodrik (2009, pp. 188–189), measurements of institutional quality predominantly reflect the perception of how rules function – not their substance. In addition, they are influenced by many aspects of the economic environment as a whole. Reverse causality

⁵ Bulgaria is the only country in the group that did not sustain shock therapy; yet, as can be seen in the previous section, it is most commonly categorised in the shock therapy group.

also plays a very important role, particularly in times of strong economic growth or in a period of crisis. A more challenging difficulty when analysing these measurements is that the results do not show the specific rules that have caused the institutional outcome that is being measured. A second issue is the reality of the data obtained by the measurement. Shirley (2010, p. 91) finds that the *Doing Business Survey*, for instance, fails to measure both the opportunity costs of certain procedures necessary for business development and the need to engage facilitators and lawyers in order to complete certain bureaucratic processes. Third, when analysing respondents, there are common biases found in both the surveys of the experts and of the general public. On the one hand, experts usually know the benchmark position of the surveyed country, they may be influenced by recent information from the media, they may be in favour of a certain opinion for reasons that are not relevant, and may also use the knowledge from their particular field to answer questions from other fields. On the other hand, ordinary people may also be biased by the media and other sources of information, by their poor or inadequate knowledge and memory in certain areas, by the way questions are asked, and by the tacit metric that is largely dependent on the person being asked (Shirley, 2010, p. 89). Fourth, partly in line with Rodrik's claim in the first shortcoming, criticism is also expressed regarding indicators measuring the effect of institutions on economic performance; these are deemed to be "often based on subjective evaluations, contain significant noise, are suspiciously volatile, and are likely to be biased or contaminated by perceptions of a country's economic performance", yet many institutional indicators are considered to be "completely objective or generated formulaically from objective data and therefore less subject to the contamination problem" (Jellema & Roland, 2011, p. 108). Finally, despite numerous advances, it is considered that measuring institutions is overall still in its early stages. Most of the data can be used to follow macro developments over time, but not to analyse certain micro developments. The current measures still need to be refined in order to be useful for a deep understanding of institutions (Shirley, 2010, pp. 79–99). Yet, having studied the development of market-friendly institutions and the progress of macroeconomic stabilisation in transition economies in the 1990s, Havrylyshyn and Van Rooden (2003) concluded that the selected indicators⁶ measuring institutional

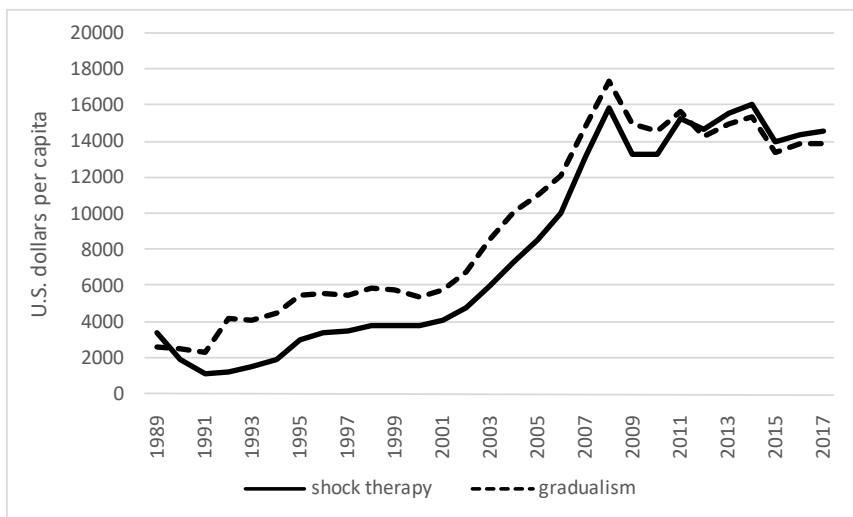
⁶ They used the following indicators: Index of Economic Freedom published by The Heritage Foundation; Political and Civil Rights, Democratic Freedom, Economic Freedom, Rule of Law and Public Administration published by Freedom House; Reform Index and

quality showed a high consistency, which could also mean their consistency in making the same mistakes. Nonetheless, despite the fact that some countries have been ranked differently than one would expect, Havrylyshyn and Van Rooden (2003) considered this great similarity of results to be a good sign of the indicators' quality. Nee (2003, p. 53) stresses the additional value of firm-centric data for the development of institutional analysis, primarily through the measurement of transaction costs as a central concept of NIE: "much of this work to date has involved qualitative historical analysis of one or two case studies. While such work has led to advances in understanding the relationship between institutions and economic behaviour, the use of quantitative methods moving beyond case studies to engage systematic cross-national firm-level studies can contribute to specifying and explicating how variable features of the institutional environment affect firms' behaviour in the global economy ... using firm-centric data opens the way for a more differentiated account of how the institutional environment influences economic behaviour ... The problem with national level aggregate data is that it does not measure the effect of variation in institutional conditions on the firm and entrepreneur."

To conclude, although attempts to measure institutions (and reforms) by means of aggregating various variables and constructing indices from different areas (labour/product/financial/other markets) are characterised by many disadvantages usually associated with composite indices (for details see OECD, 2008), the existence of such indicators opens up the possibility of comparing the degree of reform of economic and political institutions (both across countries and over time) and analysing the impacts of this on selected economic performance indicators. Hence, bearing in mind the scope of this paper and all of the arguments provided, composite indicators appear to be an appropriate choice in the given circumstances – the availability of sources in particular. In the research strategy employed, an effort has been made to consider countries as 'configurations' of interacting institutions in a comparative analysis, as suggested by Kogut (2010). In that sense, none of the factors are labelled essential in determining performance but this does not imply that they are equally important. Moreover, based on Havrylyshyn (2007) and Havrylyshyn, Meng & Tupy (2016), countries are considered to be affiliated with the same group of fast or slow reformers since the beginning of transition.

Legal Index by EBRD; Property Rights and Public Administration by World Bank; and Political Risk by Euromoney. The countries included were from Central and Eastern Europe, the Baltics, and Commonwealth of Independent States.

Graph 1. *Nominal GDP per capita (in US dollars): Shock therapy versus gradualist approach countries, 1989–2017*



Source: IMF; authors' calculation.

Note: there are no available data for Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Slovakia, or Slovenia for the period 1989–1991.

The data in Graph 1 show that the shock therapy countries lagged behind the countries using the gradualist approach until the beginning of 2008, after which the trend changed and the shock therapy countries actually surpassed the gradualist ones (although the difference in the level of GDP per capita between the selected groups of countries is not significant). The fact that the year 2008 was the first year of the global economic crisis surely had a significant effect on the choice of further reform strategies that rely on previously implemented reforms. According to this line of reasoning, Krueger (1995, p. 125) points out that the economic situation may be viewed as a demand for reform, where this demand is less pronounced under favourable economic conditions. Thus economic crises may encourage reform, because the economic downturn constitutes a further suggestion that the existing policies are no longer viable. Consequently, crises introduce an element of urgency into the policy process, weaken resistance to reform, and increase the cost of reform failure (Lora, 2000; Drazen & Easterly, 2001; Alesina, Ardagna & Trebbi, 2006; Høj et al., 2006; Zemanek, Belke & Schnabl, 2009).

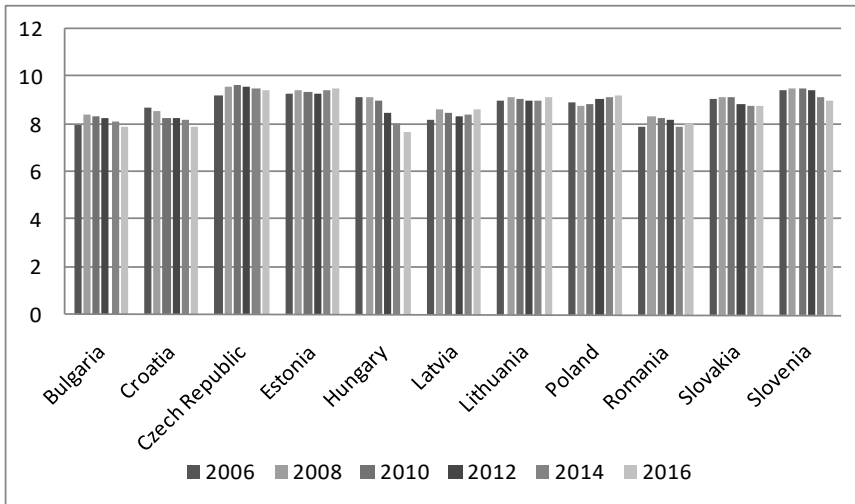
Therefore, moving beyond the GDP analysis, this paper attempts to present a broader picture by incorporating the recognised deficits of the dichotomy

of the speed of reforms, and providing insights into institution-building capacities. With this goal in mind, we use the BTI index, which analyses and evaluates whether and how developing countries and countries in transition are steering social change towards democracy and the market economy. The BTI captures many relevant aspects of reform implementation that are intrinsic to shock therapy versus gradualist views (as presented in previous sections). The BTI is published every two years for 129 countries. Generally, the BTI aggregates the results of this comprehensive study of transformation processes and political management into two indices: the Status Index and the Management Index (Bertelsmann Stiftung, 2017). The Status Index, with its two analytic dimensions of political and economic transformation, identifies where each of the 129 countries stands on its path towards democracy under the rule of law and a social market economy (Bertelsmann Stiftung, 2017). Focusing on the quality of governance, the Management Index assesses the acumen with which decision-makers steer political processes (Bertelsmann Stiftung, 2017). Furthermore, the Management Index consists of five criteria, which are based on 20 indicators. A government's management performance is weighted with the level of difficulty, which is derived from three qualitative and three quantitative indicators. These indicators reflect the observation that each country's quality of transformation is influenced by structural constraints (Bertelsmann Stiftung, 2017). Finally, according to Bertelsmann Stiftung (2017), difficult conditions and the scarcity of resources in a given country are factored into the equation for political management performance.

Graphs 2 and 3 report the Status Index scores for selected European countries (divided into the shock therapy group versus the gradualist approach group) for the period 2006–2016. The data for the two analysed groups of countries are calculated based on the arithmetic mean of the observed index. The analysed data show that there is a continuous and growing gap in evidence between these two groups of countries. More precisely, the countries that applied the shock therapy approach recorded better results on the observed index over the entire observed period. The continuous decline of the gradualist approach countries is visible and has been more pronounced since 2008. Specifically, the Czech Republic achieved the best results and Romania scored the worst in the observed period. In addition, the largest drop in the index from 2006 to 2016 was recorded by Hungary and Croatia. Additionally, according to the Status Index, in 2016 the Czech Republic, Estonia, Latvia, Lithuania, Poland, Slovakia, and Slovenia were classed as highly advanced. On the other hand, Bulgaria, Croatia, Hungary, and Romania were classed as advanced economies and this claim partially confirms previously elaborated findings on the necessity of a more

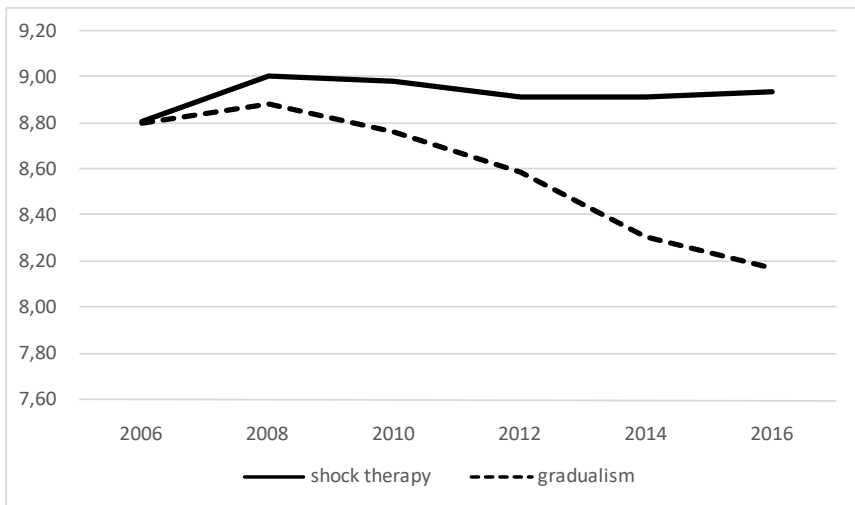
nanced approach as opposed to a merely dichotomic one when analysing and grouping countries based on their reform strategies.

Graph 2. *Status Index scores in transitional EU countries, 2006–2016*



Source: The Bertelsmann Stiftung Transformation Index (BTI); authors' calculation.

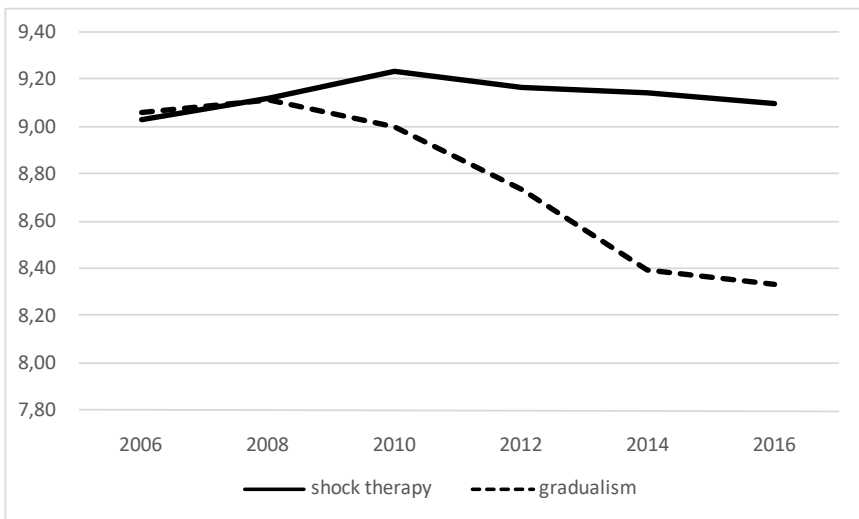
Graph 3. *Status Index: Shock therapy versus gradualist approach countries, 2006–2016*



Source: The Bertelsmann Stiftung Transformation Index (BTI); authors' calculation.

Graph 4 shows the trajectories of the democracy status scores according to previously selected criteria for the period 2006–2016. In this respect, the status of democracy encompasses the following criteria: stateness, political participation, rule of law, stability of democratic institutions, and political and social integration. When data are compared over time, the results indicate a continuous and growing gap between the group of countries that applied the shock therapy approach and the group of countries that applied the gradualist approach (as is the case with the Status Index). According to 2016 data, all countries except Hungary were considered democracies in the process of consolidation. Hungary was classed as a defective democracy and recorded the largest drop in the index in the observed ten-year period. However, among all the democracies in the process of consolidation, Croatia, Hungary, and Romania enjoyed the lowest rank in 2016 (Bertelsmann Stiftung, 2017).

Graph 4. *Democracy Status: Shock therapy versus gradualist approach countries, 2006–2016*

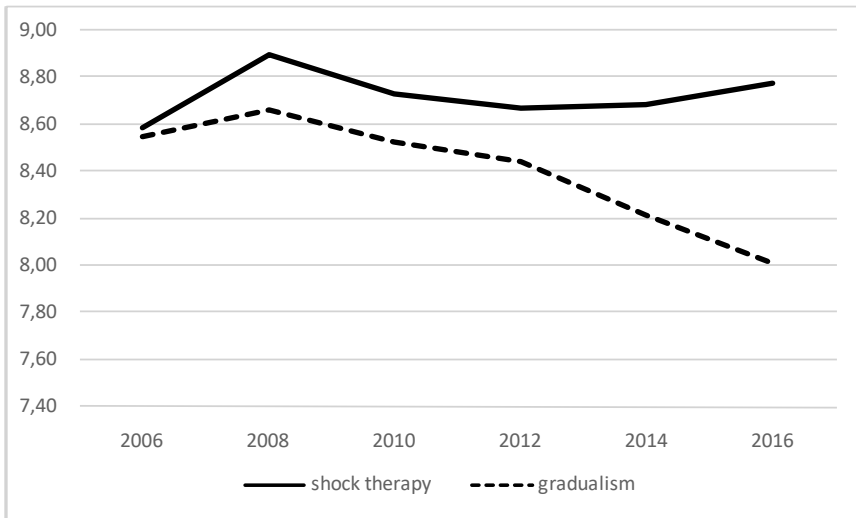


Source: The Bertelsmann Stiftung Transformation Index (BTI); authors' calculation.

The BTI criteria that measure the state of development of a market economy include the level of socioeconomic development, the organisation of the market and competition, currency and price stability, private property, the welfare regime, economic performance, and sustainability. The market economy status is presented in Graph 5. According to the given

data, until 2012 the paths of the observed countries were moving in the same direction. Since 2012 the trajectories have been moving in different directions. More precisely, the countries that applied the shock therapy approach recorded growing index values, whereas countries that applied the gradualist approach recorded decreased index values. Furthermore, according to data from 2016, Bulgaria, Croatia, Hungary, and Romania were classed in the functioning economies category, while the Czech Republic, Estonia, Latvia, Lithuania, Poland, Slovakia, and Slovenia were classed as developed economies. Hungary recorded the largest drop in the index in the observed ten-year period.

Graph 5, *Market economy status: Shock therapy versus gradualist countries, 2006–2016*

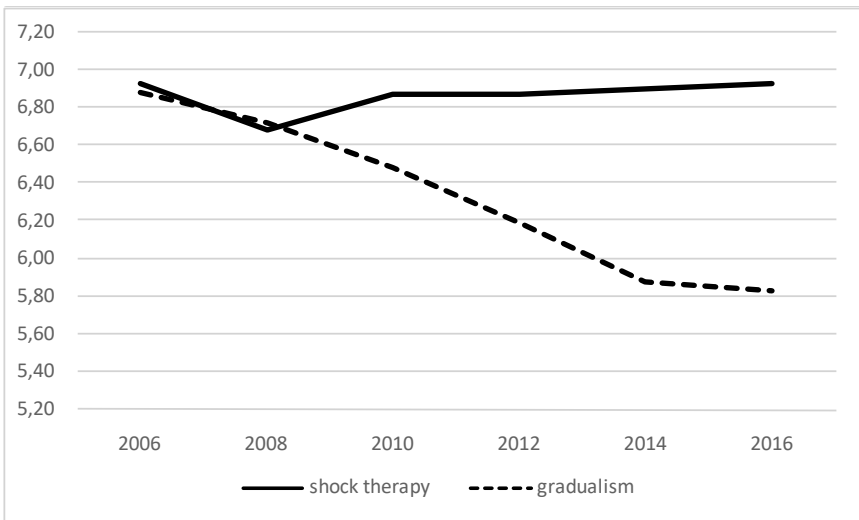


Source: The Bertelsmann Stiftung Transformation Index (BTI); authors' calculation.

The Management Index captures the level of difficulty, steering capability, resource efficiency, consensus-building, and international cooperation. Its scores are shown in Graph 6. This index ranks countries according to their leadership's political management performance. Based on the graphical data, it may be concluded that both groups of countries have recorded the lowest index values in relation to other observed indices. However, there is also a significant gap between these two groups of countries, which is in favour of the shock therapy approach. Moreover, according to the latest data, Bulgaria, Croatia, the Czech Republic, Lat-

via, Poland, Romania, Slovakia, and Slovenia are classed as countries with good management; Estonia and Lithuania as countries with very good management; and only Hungary (which has also recorded the largest drop in the index in the observed ten-year period) is classed as a country with moderate management. The largest ten-year improvement in the index value may be observed in the case of Poland.

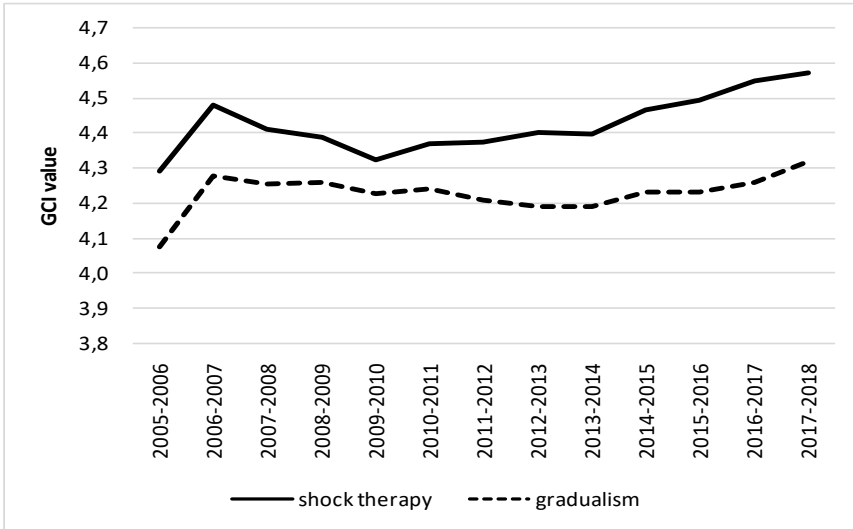
Graph 6. Management Index: Shock therapy versus gradualist countries, 2006–2016



Source: The Bertelsmann Stiftung Transformation Index (BTI); authors' calculation.

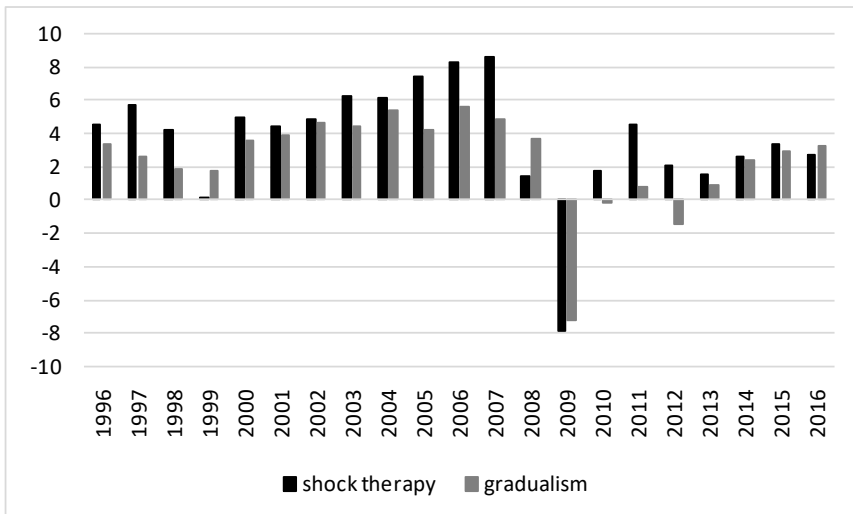
As additional robustness checks, we have compared the global competitiveness results and annual GDP growth rate of the monitored groups of countries. Graph 7 shows the trends of the Global Competitiveness Index (GCI) values that quantify the impact of a number of factors shaping country competitiveness, with a special focus on macroeconomic performance, the quality of the country's institutions, and the state of the country's technology and supporting infrastructure. The data were available for the period 2005–2017, which is considered suitable because of the long-term effects of large-scale reforms.

Graph 7. *The Global Competitiveness Index: Shock therapy versus gradualist countries, 2005–2017*



Source: World Economic Forum. The Global Competitiveness Index dataset 2005-2017; authors' calculations.

Graph 8. *GDP growth rate (%): Shock therapy versus gradualist countries, 1996–2016*



Source: Authors' calculation based on World Bank national accounts data, and OECD national accounts data files.

Graph 8 shows GDP growth trajectories for both the shock therapy and gradualist countries and indicates considerably weaker results for the latter group of countries when compared to the former. The only exception is 2009 with exceptionally low GDP growth rates caused by the global financial crisis. In addition, Estonia, Lithuania, and Latvia had very high negative growth rates in 2009 and this was reflected in the average group result. Overall, the findings of Graphs 7 and 8, which were used as additional robustness checks, are in line with the results based on BTI and GDP per capita data.

This descriptive analysis suggests an evident gap between the countries that applied the shock therapy approach and those that applied the gradualist approach. These findings are supported by the analysis of the quality of democracy, market economy, management performance, competitiveness, and GDP levels and growth. The countries which applied the shock therapy approach have performed significantly better based on all the analysed ratings. This suggests that the countries which applied the gradualist approach (Croatia, Hungary, Slovenia, and Romania) are lagging behind in the evolution of democratic institutions and modern market economies, and presumably have insufficient capacities to rapidly catch up with Bulgaria, the Czech Republic, Estonia, Latvia, Lithuania, Poland, and Slovakia.

Nevertheless, we should emphasise some methodological limitations. First, the BTI survey process will always contain a degree of subjectivity, although it is designed to minimise subjective factors as much as possible throughout the process (Bertelsmann Stiftung, 2017). In other words, one of the main strengths of the BTI is that it allows researchers to combine the analysis of participation and equality levels, but there is also a high degree of standardisation in its coding procedures (Fernandez et al., 2015). However, the fact that a single country expert writes a country report addressing 49 questions poses some risks, because it is arguably difficult to find a country expert who is knowledgeable about all the aspects of a given polity to the same degree (Fernandez et al., 2015). Additionally, this approach does not take into consideration that countries could have accelerated (or slowed down) their reforms throughout the period 2006–2016. Still, in order to check the developments of institutional transformation and their results, we have also used competitiveness, GDP per capita, and GDP growth data. For the most recent categorisation we have relied on researchers who have been analysing this topic since its inception, such as Havrylyshyn, Meng and Tupy (2016), and they show no changes in country affiliation. Finally, if countries with a somewhat different degree of development are grouped together, then one group may not only achieve

superior performance, but that aggregation covers some other differences as well. These other differences are outside the scope of this research, as it is deemed that multidimensional transformation as a whole is appropriately addressed by using several data sets mostly presented through composite indices.

5. Conclusion

In the early post-socialist years, the gradualist approach (also named the Evolutionary-Institutionalist Perspective and the incrementalist view) was considered to be more comprehensive and appropriate than shock therapy (also called the Washington Consensus and the big bang approach) to address complex transition processes in Eastern Europe. In the first transitional decade, there appeared to be a growing consensus among academics, policy-makers, and practitioners in this regard. This was partly a result of deteriorating living standards and a sharp fall in the output of countries applying the shock therapy approach. However, 15 years after the transition had begun, the fast reformers had outperformed the slow reformers. At that time, all these countries (Estonia, Latvia, Lithuania, Czech Republic, Poland, and Slovakia) joined the EU together with Slovenia and Hungary (the slow reformers). In subsequent enlargement waves Bulgaria, Romania, and Croatia joined the EU as well. They all have socialist legacies and similar formal institutions adopted through EU accession. Yet their approaches to large-scale transformation were different, regarding both reform speed and other complementary dimensions of change. In line with (recent) theoretical contributions, multidimensional indicators were used to benchmark post-socialist EU member states that had applied either the shock therapy or the gradualist approach. The most recent data indicate that fast reformers are still outperforming slow reformers in all the observed areas. Besides the obviously better results of the fast reformers, this finding implies a non-existing convergence between the analysed groups of countries, despite similar economic and political institutions.

Further research on this topic should tackle the deep roots of socioeconomic development and path-dependent choices (including reform speed), proximity to Western countries, the possible effects of other specific circumstances (such as war), the importance of selected institutions on the performance of post-socialist non-EU members, and other limitations that have remained outside the scope of this paper. The discussion needs to remain open, as institution building is a process that spans several decades.

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THE SPEED OF LARGE-SCALE TRANSFORMATION OF POLITICAL AND ECONOMIC INSTITUTIONS: INSIGHTS FROM (POST-)TRANSITIONAL EUROPEAN UNION COUNTRIES

Summary

This article compares the applicability of both the gradual and the shock therapy approach to reform implementation in large-scale change. Using quantitative data, it aims to provide more evidence for the lessons learned from post-socialist transformation. Hence it adds a theoretical and an empirical contribution to the body of literature on great transformations, focusing on their speed and the acceptability of related policy solutions.

Despite the predominant inclination towards the gradualist approach to reforms in the initial transition years, economic indicators suggest that the big bang reformers have demonstrated a superior performance over the last (few) decade(s). Still, the approach to (post-)transition processes should be multidimensional and include more than the speed of transformation and key economic indicators. Therefore, a quantitative analysis covers several aspects of socioeconomic change. The analysis of the quality of democracy, market economy, and management performance in post-socialist EU member states indicates that over the last decade the countries that applied the shock therapy approach have performed significantly better in all these areas. This suggests that slow reformers are lagging behind in the development of democratic institutions and a modern market economy, and presumably have insufficient capacities to rapidly catch up with fast reformers.

Further research on this topic should tackle the deep roots of socioeconomic development and path-dependent choices (reform speed included), proximity to Western countries, the possible effects of other specific circumstances (such as war), the importance of selected institutions on the performance of post-socialist non-EU member states, and other limitations.

Keywords: post-socialism, institutions, reforms, gradualism, shock therapy

BRZINA PROVEDBE OPSEŽNIH PRETVORBI POLITIČKIH I EKONOMSKIH INSTITUCIJA: SPOZNAJE IZ (POST-) TRANZICIJSKIH DRŽAVA EUROPSKE UNIJE

Sažetak

Rad se bavi provedbom reformi u sklopu opsežnih promjena, te se u tom svjetlu uspoređuje primjenjivost postupnoga pristupa i pristupa provedbe "šok terapije". Kvantitativnim se podacima nastoji doprinijeti znanjima stečenim tijekom postsocijalističke pretvorbe, te se teorijskim i empirijskim saznanjima doprinosi literaturi iz područja opsežnih promjena, uz poseban fokus na brzinu i prihvatljivost povezanih političkih rješenja. Iako se na početku tranzicijskog razdoblja naginjalo gradualizmu pri provedbi reformi, posljednjih desetljeća superiorni ekonomski pokazatelji govore u prilog država koje su reforme provele metodom velikoga praska. Ipak, pristup posttranzicijskim procesima trebao bi biti više-dimenzionalan i uključivati više od puke brzine pretvorbe i ključnih ekonomskih pokazatelja, stoga se kvantitativna analiza bavi nekolicinom aspekata socioekonomskih promjena. Analiza kvalitete demokracije, tržišne ekonomije i rezultata upravljanja u postsocijalističkim državama Europske unije upućuje na zaključak da su one države koje su reforme provele "šok terapijom" postigle znatno bolje rezultate u navedenim područjima. To pak upućuje na zaključak da države koje postupno provode reforme zaostaju u područjima razvoja demokratskih institucija i moderne tržišne ekonomije, te se nameće pretpostavka da nemaju dovoljne kapacitete kako bi uхватile korak s državama koje reforme provode ubrzano. Daljnja istraživanja u ovom području trebala bi se baviti dubinskim uzrocima socioekonomskog razvoja i odabira koji ovise o putu za koji se pojedina država odlučila (a što uključuje brzinu provedbe reformi), blizinom državama Zapadne Europe, mogućim učincima drugih specifičnih okolnosti (npr. ratova), važnosti odabranih institucija u odnosu na rezultate postsocijalističkih država koje nisu članice Europske unije, te drugih ograničenja.

Ključne riječi: post-socijalizam, institucije, reforme, gradualizam, šok terapija