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BOOK REVIEWS

Winiecki, J.
Transition Economies and Foreign Trade
London and New York: Routledge, 2002, 150 pp.

Jan Winiecki's book explores one of the major factors behind the economic success of post-communist societies as they transition into the international community. The author pays meticulous attention to foreign trade and its (non)development under the communist system, its systemic transformation and its role in the overall growth of East-Central Europe, examining the historical and institutional relationship between them stage by stage.

The title of the *first chapter* is "Remnants of the Past". The peculiarly inefficient output structure that emerged under the communist system was a result of a continuous "excess demand and shortage" (p. 6) that basically drove the so-called centrally planned economy, where the *political* took precedence over the *economic*. This vicious circle of excessive demand created pressure to quantify output while disregarding quality. The persistence of shortages encouraged businesses to obtain more input than necessary, and the central plan could never account for this as a result of the absence of an information structure: all activities, put bluntly, were detached from one another. Unsurprisingly, the outcome was systemic waste. Winiecki, based on his own calculations, demonstrates this using the example of the inefficient use of steel and energy. The communist system required twice the amount of input for the same amount of output under a market economy.

Instead of taking advantage of the division of labour, communist countries pursued import-substitution, again due to political reasons. This produced unsustainable industrial growth which is not typical for non-market economies. Winiecki calculates that – unlike in market economies – the industrial share of the economy and the employment rates in the sector did not diminish in size in communist economies in the long run. More and more intermediate products were produced internally without the optimisation of the final product. This pattern led to the over-expansion of low-quality engineering output. At the same time, intra-industry trade reduced efficiency in all sectors of the economy. Rather than comple-

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menting each other, different industries attempted internal import-substitution, and produced too many kinds of products, whereby decreasing the already almost non-existent benefits of economies of scale.

What followed was a self-induced technological backwardness. Businesses had no incentive to modernise. Referring to his older analysis, Winiecki shows the lack of entrepreneurial spirit and risk-taking, since these could alter the status quo negatively in the short-term, and managers would face losing expected perquisites (p. 13). The author borrows figures from Eliasson and Carlsson to highlight the positive link between technological advancement and production output.

Winiecki effectively links the level of economic development and consequent production capabilities to patterns of trade. The more developed the economy, the more it produces capital-intensive as opposed to labour-intensive goods in its industry (p. 18). This theory of Heckscher-Ohlin holds true for market economies, exemplified by Japan's foreign trade, but not for communist systems, due to distorted incentives, atypical output patterns, and the dire effects of import-substitution on the general economic structure under central planning as described above.

Despite low-quality production in communist countries, the author points out, continuous trade still existed, but instead of gaining external markets through competition, the enterprises traded dualistically (p. 21). In other words, machinery, engineering products and other intermediate products were sold to and were strongly demanded by other communist economies regardless of quality. The author once again refers back to his previous statement that the Burenstam-Linder theory of 'preference for similarity' holds true: the communist enterprise could trade mostly with the economies that had a similarly distorted demand structure, where products did not face the challenges of competition and consumer preference. Winiecki offers detailed statistics on the composition of exports divided by geographical markets.

These system specific shortcomings contributed to the gradual decline of earnings from exports to western markets. Winiecki provides a detailed example of how even the GDR, Poland and Czechoslovakia, despite being "advanced" economies within the communist bloc, gained less and less from their sales in the markets of the European Economic Community between 1965 and 1985.

Having discussed the built-in problems in communist economies, the author suggests *four factors* that would have a crucial effect on the ability of enterprises to reorient themselves to market requirements. *First*, the significant specialisation of enterprises, leading to the reduction of costs per input in production, this way sustaining itself in competition. *Second,* only those enterprises whose technology was not too obsolete for production would be able to upgrade their equipment at feasible costs. This leads directly to the *third* factor. Most enterprises using high-tech equipment would find it hard to re-start due to the gap between communist and the more advanced western markets. *Last*, but not least, enterprises that were more communist-economy-oriented would find it difficult to enter the highly competitive market environment (pp. 31–33). Furthermore, considering the actual situation, Winiecki expands the previous factors and deduces more behavioural characteristics for trade patterns: high labour intensity and less sophisticated product trade would increase during transition; few heavy industries would succeed and those that did would not succeed completely; and economic sectors that had a comparative advantage before the advent of the communist era would be able to regain their historical standing in western markets more easily than those created solely under and by a planned economy (pp. 34–36).

In the short-term, the transformation has been considered a blow for the economic status quo only if one disregards the past *(Chapter 2)*. Winiecki emphasises that this happened due to the assessment of the radical drop in the amount of foreign trade, when analysts began to lament the lack of macroeconomic policies to sustain existing levels of trade and the non-existent coordination of trade with other post-communist states, or members of COMECON. However, the author presents a good analytical case to explain that when systemic problems of production and trade in communist economies are taken into account it becomes clear that neither macroeconomic tools nor mutual coordination would help sustain past levels of trade.

The author also suggests additional factors that influenced the output decline: falsification of production statistics in communist countries, excessive use of inventories due to the distorted structure of the economy, and reduction in military output (pp. 44–47).

Winiecki advances the argument to an analytical level and challenges one of the main debates on the role of COMECON and whether its integrity could have been sustained in order to cushion the negative influence of trade decline. Some analysts at the time argued that had the communist trade area countries stuck together, they could have continued trading with each other. However, based on his analysis of the nature of the economy, production and trade structure, Winiecki clearly demonstrates the impossibility of the preservation of COMECON. As soon as communist countries began their economic reforms, the functioning of the economy would have drastically changed due to liberalisation and market pressure. Previous trade existed because the economic structures in the tradable sectors of the economy complemented each other; the whole system was glued together politically, and therefore could not be sustained at times of change.

An insightful statistical comparison is made with an example of geographical shift in trade: the trade orientation of Bulgaria, the Czech Republic, Hungary, Poland and Romania is analysed from 1928 to 1996 (p. 57). There is a clear shift in the direction of trade towards the East with the enforcement of communist planning, but with the collapse of the system, trade again shifts towards the West, as it used to be before the radical political changes in Europe.

According to the author the general explanation that the changes in the composition of foreign trade were complementary to the overall liberalisation and marketisation process does not necessarily explain how particular trade patterns shifted and why there was a drastic unexpected increase in trade with the West *(Chapter 3: Microeconomic Success).* Nor has there been any attempt among economists to explain this change (p. 64).

It is implied that to understand the tradable output one has to look at economies with similar level of development. As described earlier, the centrally administered economies produced far below the Pareto level of efficiency, akin to "partially developed" economies. Consequently, just like in initially laggard countries of the European Community, the highly tradable products of transition economies were the more labour-intensive goods. Moreover, Winiecki asserts, Central and Eastern European countries with pre-communist comparative advantages should have been able to regain their export market shares, as long as such advantages had not been completely wiped out under the past system (pp. 64–67). He goes further to suggest that one could also expect that some enterprises could even compete in the new markets with intermediate goods of medium level of complexity due to the clear division in the structure of intra-industry trade in general. Another interesting factor that would affect trade is that, contrary to past non-communist countries undergoing liberalisation countries, there was a wide range of tradable goods. Thus the concern for future enterprises was to be one of "saleables" from among the tradable goods (p. 67).

To test the above propositions, the author takes Benacek's (1997) analysis of the ratio of light/heavy manufactured goods of the Czech example and looks at the case of Hungary: unsurprisingly, he finds that ratio of light industry traded goods expanded (pp. 68–69).

Having looked at the changes in the composition of manufactured goods, he goes on to tackle the question of how some successful businesses were able to sustain and even increase exports into Western markets. It was believed that enterprises employed the so-called strategy of "distressed sales". According to this claim, enterprises vying to survive under market pressures re-directed their saleable goods to the Western markets. Economists accepted this trend in the behaviour of enterprises as an explanation for the growing amount of trade with the West; however, as more data was available, this argument gradually lost ground (p. 71). Although some statistics support the distressed sales argument and Winiecki admits the possibility of such a strategy, he builds a rational case for the unsustainability of this technique in the medium term. The simple fact is that any enterprise that specialises in exporting only for the sake of exporting cannot do well against any economic rationality: enterprises cannot gain from such sales because it means exporting at any cost, without necessary profit. There has to be another or at least additional explanation, Winiecki asserts, as to why trade persistently increased with the West (pp. 73–75).

Again, expanding on Benacek's analysis of the Czech enterprises, Winiecki shows that an additional strategy of "distressed non-replacement of capital" could be useful to demonstrate the increase in trade. "Distressed non-replacement of capital strategy" means that (new) business owners who suddenly emerged with the privatisation of state enterprises – be they insiders or other owners who were able to gain a windfall benefit – could in fact sustain the enterprises while still making losses. Since they obtained the company for no or very little costs, they could afford to run these private businesses until all the equipment or other internal advantages of the enterprises would be used up. In short, the purpose of some of the new enterprise owners was not to regain the capital investment or make a profit. They benefited simply by driving these companies out of business completely. Winiecki agrees with Benacek that this explains why distressed sales was viable for longer periods of time (pp. 77–78). Nevertheless, for Winiecki, the key to the question lies elsewhere.

The explanation lies in the "impact of newcomers" (p. 81). In a manner consistent with his focus on the past, the author's argument is based on the fact that the centrally administered economy was oversized and had too many businesses. Thus when FDI became available, it went into the most attractive state-owned enterprises. These were companies that did not only exploit distressed sales or distressed non-replacement of capital strategies but were willing to adjust to market demands. Therefore, enjoying the benefits of direct western owners through FDI, some enterprises were able to partially recover their production and even surpass other businesses (p. 82).

Winiecki suggests that when speaking about trade one should emphasise the fact that the arrival of multinational corporations (MNCs) and FDI opened up new markets. This, compatible with the economic theories of intra-industry trade, explains how MNCs used the CEE to cut costs on the production of some parts of their products. To do so, the MNCs imported, exported, re-imported and re-exported both intermediate and final goods, which increased the flow of trade. One particular example among many used by the author in this text is the case of the Italian car manufacturer *Fiat.*

Yet to solidify the overall proposition that in the medium to long-term newcomers had a significant impact on trade patterns, Winiecki also emphasises the role of new firms, and especially small and medium-size enterprises (SMEs). Since the new firms emerged under the new concept of economic behaviour, taking efficiency and profitability into account, these firms gradually gained a large share of mostly labour-intensive manufactured goods. Data in Poland demonstrates that as early as 1994 SMEs had over a 50% share of overall exports in such sectors as textiles, clothing, agriculture and furniture production (p. 90).

Considering the fact that foreign trade does not take place independent of all other aspects of the economy, Winiecki stresses the importance of analysing economic policies implemented by the governments of Eastern and Central Europe *(Chapter 4).*

Referring to the research studies of Kaminski et al., Winiecki underlines that what influenced trade was the overall "transition of a given economy in transition to the market". Stabilisation, liberalisation, hard state budget constraints – all have positively correlated with the growth of trade in various economic analyses (pp. 113–114). Already mentioned, but again emphasised by the author from a general economic viewpoint, is the role of FDI as an indicator of structural reforms in transition countries of Europe. FDI sought out those economies that were able to create an overall business-friendly institutional and policy environment and regulatory framework (pp. 116–117).

The desire to join the EU among the countries of Central and Eastern Europe can be seen through an economic lens as a possibility to bridge the gap between the economic development of Eastern and Western Europe. Also, CEE countries are geared towards converging with the EU. It is generally believed that accession would speed up this process *(Chapter 5).* Its success would depend on four factors – one of which is negative – trade, FDI, structural funds of the EU, and the restrictive nature of EU institutions and policies.

The possibility of further increasing the existing levels of trade looks promising if one takes into consideration the membership of (then) less-developed Portugal, Spain and Greece. Data shows that the foreign trade of these countries with other EU members augmented following their accession (p. 120). However, considering what happened to Greece, one must also stress that membership in the EU will not necessarily bring rapid economic improvement. It will strongly depend on the country's own willingness to implement appropriate reforms. Instead, membership should be seen only as a potential positive factor (p. 121).

Following the same logic, the FDI would more likely go to member countries of the EU rather than to outside of the Union. The EU already offers established institutions, transparency of rules and important policies. As a member of the EU, the CEE would increase its credibility and become more attractive to FDI. The empirical justification for making this assumption comes from real experience in transition countries. Available data shows a strong and positive relationship between the advance of structural reforms in successful CEE countries and the inflow of foreign capital (p. 125).

However, when it comes to the most appealing prize that CEE countries would obtain as members of the EU, the author calls for caution. Structural funds of the EU may have negative consequences for the accession countries, and may not help them in catching up with the more developed members. Again, the example comes from Greece. Since Greece received more funds from the EU than Portugal and Spain initially, these funds artificially drove public consumption up. The author also draws attention to Lord Bauer's criticism of financial aid. Bauer was very sceptical about aid being distributed through the state structures since it would increase the power of the latter *vis-à-vis* the civil society (p. 128).

To sum up, it bears repeating that Winiecki builds a coherent case of how and why the past is important in understanding present trade issues in transition countries. He makes a wide use of economic research in the field, but at the same time, often draws upon his previous contributions to the subject. The same is true for the statistical information that he uses in the text to back up his arguments. Although some of the data is not always available for all countries under scrutiny, the arguments do not necessarily lose their validity. The statistics, drawn from a wide range of sources, is used rather to complement his analysis.

First and foremost, the author's overall argument is constructed as a thought framework. Having analysed past issues in foreign trade, both on the macro and micro levels and in connection with the expansion of the EU, the author offers many interesting insights into the decade of transition. These insights may be used by laggard post-communist states in their own policymaking.

The author's approach to the matter clearly falls into the institutionalist trend within mainstream economics. This offers a sound explanation of how the past of Central and Eastern European countries has affected their transition to market economy, in particular foreign trade. It is important to stress that the author's institutionalist take on foreign trade does not produce a well defined outcome. On the contrary, despite the fact that trade has become relatively sustainable in successful transition countries, further institutional and policy choices cannot be simply prescribed. As these economies grow out of the transition period *per se,* they increasingly face challenges similar to those of developed countries.

To sum up, I recommend Winiecki's book both for the wider public and for those in academia. The former could gain important insights into the topic, while the latter could build on Winiceki's findings.

Merdan Halilov

Olson, M.
Power and Prosperity: Outgrowing Communist and Capitalist Dictatorship
New York: Basic Books, 2000, 233 pp.

Mancur Olson's writings are original and unique in their theoretical approach. On the one hand, he makes an effort to "re-establish political economy as a central intellectual concern for the social scientists" (Cadwell in foreword, p. xv.) which leads him to provide his own answers to the problems of post-socialist transition. Unfortunately, his untimely death five years ago prevented him from finishing his book so only the posthumously published draft is available for the reader.

The original title *Capitalism, Socialism and Dictatorship,* a variation on Schumpeter's famous book, suggests Olsen's ambition to develop one of the "grand theories" of the state and human development. Olson attempted to formulate an appropriate intellectual framework, which would allow for a systematic understanding of dictatorship, democracy and markets, thus providing answers for transition and development. The questions one asks should be: "What is it that makes some market economies rich while others are poor?" or, put differently, "Why are there innumerable markets in almost every society, yet only a few have rich ones?" (p. xxiii).

Those familiar with Olson's previous work will most likely find the *Power and Prosperity* falling short of this ambition.* The book summarises the key arguments of Olson's previous seminal work, *The Logic of Collective Action* (1971) and *The Rise and Decline of Nations* (1982), and provides an interesting interpretation of the Stalinist economy along the lines of the "institutions matter" theory, which was born during the time Olson wrote his last book (in 1997). At the same time, it does in fact provide the kind of intellectual framework Olson was calling for. But let us start from the beginning.

The logic of power

Olson builds on the consensus that "societies are most likely to prosper when there are clear incentives to produce and to reap the gains from social cooperation through specialisation and trade" (p. 1). The next step is to understand the incentives of leaders to promote an environment conducive to productive incentives. Olson finds logical the self-interest of the ruler/bandit who has power and wants to maximise her tax revenue. Assuming that the bandit is secure and has a long-term perspective to remain so, she makes the rational choice to provide those she robs

* However, one should always bear in mind that the reviewed book was only a "polished draft".

with the two public goods essential for development: secure property rights and protection from other internal and external bandits.

The stationary bandit has a monopoly of coercion and can expropriate whatever she wants. However, it is not in her rational interest to put the tax rate anywhere close to 100 percent, because it would reduce the income generated in her domain and consequently made her a net loser. If she is rational enough, she will not kill the goose which lays the golden eggs. Instead, she will spend on public goods to the point where marginal expenditure is equal to extra marginal revenue. The logic of power rests in the encompassing interest of leaders and it benefits both the population and the bandit herself. Moreover, benefits are not brought about by any social contract or voluntary transaction but simply by the bandit following her self-interest.

When comparing the behaviour of an autocrat to that of the majority or supermajority, Olson concludes that taxation under the rule of the majority will be lower, as their encompassing interest in the well-being of their society is higher. The majority's incentive to redistribute from minorities is constrained, because excessive taxation creates social dead-weight loss, the largest share of which would be born by the majority itself. Conversely, high encompassing interest will also induce the majority to provide an efficient quantity of public goods, as their members benefit most.

The time dimension is of profound importance. Rulers who do not have the prospect of a long time in power will have an incentive to expropriate all wealth to maximise their one-off income. Autocratic regimes, even if instituted in the form of a dynasty, always face the threat of a crisis of succession, thus it is difficult to make its long-term horizon credible beyond the life span of the autocrat. However, the fortunate outcome of this crisis may be an introduction of a democratic, representative government. Olson defines four preconditions: (1) the number of competing leaders is small enough to allow for collective voluntary agreement on representative government (Niskanen 2000, 138); (2) broadly equal dispersion of power that makes it unattractive for any leader to attempt to overpower the other; (3) the separation of potential rulers to create mini-autocracies is not possible; and finally (4) protecting the area where democratic rule is emerging from external conquest.

Being an autocrat is a far more profitable job than being an elected leader, as the leader always has an incentive to gain power for herself. Consequently, the leaders of other groups have an incentive to watch her and prevent her from becoming an autocrat so they can have their turn when the balance of power leans towards their interests. The potential for disputes between the leaders and their respective groups creates the need for an independent judiciary, i.e. a dispute resolution system that protects property and contractual rights from expropriation by the leader. At the end, it is the rule of law that gives democracies the advantage of a long-term horizon without severe succession crises.

Olson finds it important to repeat the argument of *The Logic* to explain why alternative theories of power, such as the Chicago School of Political Economy and the social contracts, do not hold. They assume that rational individuals would arrive to a Pareto-efficient outcome through voluntary bargaining. Olson explains that the result will always depend on the size of the group in question and he also adds some insights to the concepts of the Coase theorem and the Prisoners' dilemma on which alternative theories rely.

The Coase theorem may not work even if all transaction costs are fully covered by some external party. If the group with the common interest is small, then the combination of selective incentives and strategic interaction is likely to be sufficient to arrive to and enforce a mutually advantageous bargain. However, "if a group is sufficiently large, its members will not have any incentive to engage in the costly bargaining and strategic interaction that would work out …. a Coaseian bargain. … [A]ny expectation that the Coaseian bargain would be made would generate a game without a core – a continuing effort of all rational individuals to be in a subgroup that obtained the largest gains, the coalition of free riders" (p. 87).

The Prisoners' Dilemma suggests that there may be no agreement even if only two parties are involved in a transaction of their common interest. Olson points out that this holds only if they cannot communicate and therefore agree on a common strategy. This is a highly superficial assumption; usually the two parties can even sign an enforceable contract.

Olson's logic of power can be summarised as follows: under reasonable assumptions rational autocrats with encompassing long-term interest will reach an equilibrium extortion rate which will maximise their revenues over the long run. This equilibrium will not only be beneficial to leaders but also to the population in their domain, which will benefit from public goods. Notably, leaders will provide public goods not for any noble intention, but to maximise their self-interests.

Law enforcement and corruption

The chapter on law enforcement and corruption bridges the gap between the logic of power and the analysis of the communist system. Olson asks the question: why is it that tax revenues may not be sufficient to cover the cost of the legal system and the maintenance of order? Under normal circumstances such costs should not be more than a fraction of revenues but Olson points to *two reasons* why they might be much more expensive.

First, there may be a fight for dominance among several groups of similar strength. This is, however, unlikely if the state is already established, either by credible rules of succession or as a democratic regime. In this case its policing power should grow sufficiently to avoid internal challenge. *Second,* factors reducing the cost of maintaining order come from "powerful private-sector incentives to greatly reinforce the government's efforts at law enforcement and bear much of the costs of maintaining law and order in the private sector" (p. 103). The private sector has an incentive to invest in property rights protection, be it simply a lock or a well-written contract which complements the ruler's effort. However, if the ruler insists on policies which are contrary to market logic, then the private sector invests in avoiding the consequences of policies contrary to market demands and consequently the costs of policy-making skyrocket as the leader has to spend more to regulate the normally compliant private sector.

Stalin's tax innovations

To address the issues of transition, Olson turns his attention from the general theoretical framework to the specific features of the Soviet system, which dictated the initial conditions for the countries of transition. Olson's view is a synthesis of his original description of the Stalinist system, as well as this theory presented in *The Rise and Decline of Nations*.

Brutal innovations enabled Stalin's dictatorship to make more resources available for the purposes of the leadership than any other society in history. Stalin was a dictator with a comprehensive, long-term interest, who managed to extract much more than what could be perceived as the maximum tax. The key features of Stalin's implicit taxation system were: (1) expropriation of all natural resources and capital, thus providing all non-labour related income to its recipients; (2) circumvention of the influx of investments, which would normally follow such an expropriation, by forcing consumption to, or even below, subsistence level, which in turn created artificially high savings used for investments in industrialisation; and (3) imposition of implicit taxes on labour income that reached unprecedented levels and the introduction of tax-price discrimination capturing higher proportion of the economic rent created by more productive individuals. Moreover, implicit taxes on extra hours of work were low, as opposed to the higher taxes on standard hours, thereby giving an incentive to increased labour participation and work hours. These were increased further by the fact that wage rates for standard hours were set below subsistence levels.

To make the implicit tax system stable – i.e. to ensure the survival of the exploited population – a supply of cheap food products and strict monitoring was necessary. The former was achieved by the nearly perfect expropriation of farmers and peasants through collectivisation and the latter by monitoring various mechanisms, ranging from bank-controlled payment systems to the centralised provisions of automation in agriculture. Furthermore, Stalinist terror played a key role, but Olson does not mention it explicitly.

The Soviet regime managed to mobilise "a fantastic amount of resources, but did not use them well" (p. 132). As it reached a more stable phase the forces of social ossification started to work, reducing the efficiency further until the complete paralysis of the system and its subsequent collapse.

Inevitable ossification

The collective action of various actors within the Soviet bureaucratic hierarchy had to start very tacitly as a covert conspiracy. The incentives for conspiracy were to reduce quotas assigned to them by central planning and to save some resources for themselves. Moreover, as the brutal monitoring mechanisms of the Stalin era continued to weaken, collusion was proliferating from the top down to the bottom layers of society. As cheating became less dangerous and more widespread within the system, the power shifted from the centre into the hands of conspiring interest groups. They had a monopoly on information and the autocrat – the Politburo – could no longer enforce its will without their consent.

After describing the functioning of the hierarchy, Olson returns to the issue of law enforcement and corruption. The Soviet economy ignored the market's demand, creating incentives to conspire against the prevailing law to the mutual advantage of the parties involved. There was no private property and therefore no incentive to complement the state's efforts with private investments for the protection of any other property except the personal one. The Politburo, an effective owner of all non-labour rents, needed an army of watchmen and those who watched the watchmen. These, however, had a strong incentive to scheme with already colluding parties and share their gains from these illegal activities. Inevitably, with time the whole pyramid became corrupt and the plan became a virtual reality – without being involved in the black market it was nearly impossible to produce or purchase anything.

In effect, people stole back what the system had stolen from them and the motto of the system became "who refrains from taking state property is robbing his family" (p. 152). The all-encompassing interest of the bandit was substituted with the partial interests of conspiring groups. This is, according to Olson, one of the crucial legacies from the final years of communism in Central and Eastern Europe.

Ossified legacies in transition

Olson contended that Stalinism was not about ideology but about implicit taxation. Using the same logic he claims that transition is not about replacing the ideology that governs the system by another one. To him the key question is what to do with the sclerotic status of societies dominated by powerful interest groups. The author draws on his knowledge of the transition in Russia and explains several adverse and unexpected outcomes of the early transitional period with reference to the theory of collective action.

High inflation is usually explained by the observed fact that the government prints money to finance the budget deficit. However, it does not explain why a rational government with an all-encompassing interest would pursue such a distorting policy. Olson points out that Stalin was able to extract an unprecedented proportion of GDP, as opposed to Gorbachev. His tax revenue could have been negative, since businesses which in the 1950s produced large surpluses required large subsidies in the 1980s. Due to the power shift the bandit was unable both to resist demands for subsidies and to collect revenue. The collapse of the one-party rule weakened the centre even further, forcing the governments of transition countries into an even weaker position than Gorbachev.

Privatisation to insiders can also be explained by examining the powerful interest groups. These groups were most concerned with staying in control of economically nonviable enterprises in order to keep their access to soft credits (hidden subsidies). As these were not threatened by liquidation, the groups in control did not mind exchanging informal entitlements for property rights.

The initial idea was that after abolishing the irrational processes of the Soviet economic system, transition economies would swiftly get on the path to growth. This seemed to be supported by the post-fascist as well as Chinese transition experience. Contrary to expectations a steep decline followed. Olson finds the explanation in the initial conditions. While fascist interest groups were virtually wiped out by the end of the war, and so were the corrupt pre-cultural revolutionary elite in China, the peaceful transition process in Central and Eastern Europe left many interest groups in power who were able to block important reforms that would have facilitated the start of growth.

Order of the day

Olson distinguishes between *two types of markets*. First, the self-enforcing spot markets, which emerge spontaneously, exist everywhere and are virtually indispensable. These, however, allow only for limited gains from trade and therefore are not the source of wealth of nations. Second, there are socially contrived markets, which emerge only if a society maintains supportive institutions over the long-term. These markets allow for multiparty, multi-period trades, which are crucial for prosperity.

Olson provides the following answer to the logical question: what institutions are needed to support socially contrived markets? "To realize all the gains from trade, then, there has to be a legal system and political order that enforces contracts, protects property rights, carries out mortgage agreements, provides for limited liability corporations, and facilitates a lasting and widely used capital market that makes investments and loans more liquid than they would otherwise be. These arrangements must also be expected to last for some time" (p. 185).

The institutions listed above are a prerequisite but not sufficient for the emergence of sophisticated markets. Olson joins ranks with development economists, who claim that individual rights are not a luxury developing countries cannot afford. Olson's reasoning is based on the existence of uncertainty, which can only be effectively controlled if entrepreneurs are able to take risks and fail until they find the most profitable solution for themselves. Such processes are impossible without individual rights.

However, due to uncertainty, sometimes winners and losers are picked by pure luck. Therefore, Olson calls for some redistribution in the form of social insurance. It improves incentives to take entrepreneurial risks and at the same time it also helps to secure the support of meaningful reforms by those who fail. Social insurance therefore facilitates the reallocation of resources to more beneficial uses.

Recapitulation

In a nutshell, Olson lays down the following conditions for a successful transition:

(1) Well-defined individual, property and contract rights of the people and corporations, both local and foreign, enforced by an independent judiciary system.
(2) The absence of exploitation of any kind. If the individual rights hold there is no exploitation by the government or other private parties. But in a stable democracy there can still be exploitation caused by lobbying, accommodation of special interest demands or cartelisation of groups, which lack encompassing interest and therefore only bear a miniscule portion of the consequent social losses.

The most likely environment where the two conditions are satisfied are "secure, right-respecting democracies where institutions are structured in a way that gives authoritative decision making as much as possible to encompassing interests" (p. 198). Over time such democracies are prone to hardening (sclerosis), which by no means is inevitable, especially if we are aware of the problems and academics and other professionals face strong selective incentives to analyse these affairs and to contribute to collective action needed to avoid the hardening of societies.

Conclusion

Olsen's *Power and Prosperity* is composed of an array of hypotheses accompanied by scattered historical anecdotes and no empirical support. It appears to be logically consistent, as long as one accepts some overstretched generalisations, which are due to the breadth of the topic. One way to look at the book is to note that it only vaguely applies to transition notions already established in the Olson's other two famous books. This may be true, but it overlooks the fact that the role of interest groups in transition is one of the most neglected topics in the field and yet one of the most important since any explanation of the non-trivial transition outcomes avoiding the role of interest groups merely scratches the surface.

Olson is right in pointing out that there is no systematic framework for the analysis of special interests under different political and economic regimes and therefore no framework to analyse the transition process from one regime to another. The book takes a large step in this direction. However, to make a much-needed breakthrough it would need to include three times as many pages as it currently has packed with more detailed and empirical evidence. Then there may be a chance for it to create a new "grand" economic theory of a state based on encompassing long-term self-interest.

The author leaves us with a theory and a research agenda, which has yet to prove its viability. There is plenty left to be added and explained. For example, he warns against sclerosis, but says little about prevention, except for suggesting that because we study it we are aware of it. To rely on the rational response of autocrats and ruling majorities to produce incentives seems of utmost importance, especially in the context of a transition where uncertainty is overwhelming and the timeframe is short. Can we do something to improve the likelihood that those in power will create the institutions needed for sophisticated markets that would develop and contribute towards growth and development? The book just formulates the question.

Olson in the preface and Cadwell in the foreword create higher expectations than could be fully satisfied by the end of the book. One can only hope that others will take the challenge and build on this book, which could possibly become a cornerstone of a deeper understanding of the political economy of both the transition and development of economies.

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Krizsán, A. – Zentai, V. (eds)
Reshaping Globalization – Multilateral Dialogues and New Initiatives
Budapest: Central European University Press, 2003, 327 pp.

This book is a result of the Central European University conference on globalisation held in Budapest in October 2001. The book is a collection of 15 essays by scholars and professionals who attended the conference from all over the world, and it also contains an introduction by the editor. Following the agenda of the conference, the volume discusses *five major themes:* (1) the production of global knowledge, (2) social values and public goods, (3) the global trade system and development, (4) new sources of funding, and (5) the issue of whether there is a need for global governance. What is unique here is that almost none of the contributions to this work discusses directly the question of globalisation itself. Instead they focus on numerous issues that are more or less closely related to the process of globalisation. Accordingly, the book's chapters organised around the above-mentioned five topics are independent from one another, i.e. the reader can make his choice in selecting the topics he is interested in.

The editors' aim was to bring together ideas not only to reveal the dark side of globalisation but to contemplate the possibilities of positive actions as well. This is an ambitious purpose since there has been an enormous amount of discussion on the effects of globalisation and the reform of the global economic architecture since the East Asian crisis in 1997. The 1997 financial crisis was very important because it revealed some serious risks that globalisation posed, mainly to developing countries. Some economists – the most famous of them being Joseph Stiglitz, former chief economist of the World Bank and Chairman of the Council of Economic Advisers under the Clinton era – argue that the underlying source of the crisis was the liberalisation of the capital market (Stiglitz 2003). According to these views, it is global economic institutions such as the IMF and the World Bank, together with the U.S., the leading developed country, that have been most often blamed for the negative effects of globalisation. This view was also shared by the participants of the numerous street demonstrations starting in Seattle, in the United States. This volume takes a different route and offers a well-balanced view regarding the pros and cons of globalisation, which is its major virtue. According to the editors "this volume is an intellectual position, which resists apocalyptic imagery and upholds the quest for democracy, the rule of law, and prosperity in a global social space" (p. 21).

It is impossible to give a detailed account of all the 15 contributions to this book, so below is a short overview of some papers selected subjectively.

Bob Deacon's (University of Sheffield, UK) essay titled *The Prospects for Equitable Access to Social Provision in a Globalising World* is the first contribution to the chapter Social Values and Public Goods. Deacon's concern is about the place of universal social provisioning in the global discourse concerning desirable national social policy. A key question is whether globalisation influences or determines national social policies and whether it limits the choice of social policies available to governments. By offering various arguments and empirical evidence, Deacon came to the conclusion that globalisation is not incompatible with universal social provisions and even in a globalising world it is possible to achieve equitable social provisioning both in the North and South. He also explains the tensions existing between the North and the South in discussing how public goods are to be protected in global trade.

The second contribution to this chapter is Andrew Mack's (University of British Columbia, Canada) essay on *September 11, the Anti-Terror Campaign, and the Prevention of Violent Conflict*. There is no doubt that global terrorism aimed at launching attacks on western countries has became one of the major threats of human civilisation. Intensive debates are focused on the nature and the causes of terrorism with many controversial arguments. In his short essay the author focuses on the "root causes" of terrorism. According to Mack, there are three types of response to the threat of international terrorism. While "war" and "criminal justice" focus on destroying terrorist organisations and bringing terrorists themselves to justice, "root causes" address the conditions to create a "fertile ground" for the emergence of terrorism. The author argues that understanding causes is a necessary condition for long-term prevention. Successful prevention creates a need to look beyond the national security paradigm and to take into account the unique circumstances of particular countries. In my view, Mack's reasoning is in line with that of Rathbone and Rowley (2001) who try to analyse the causes of terrorism within a rational-economic-man framework. They use Mancur Olson's logic of collective action to explain how terrorist groups are formed and maintained. When focusing on the rational actions of terrorist leaders we are searching for the "root causes" of terrorism.

Ivan Krastev (Centre for Liberal Strategies, Bulgaria) is the author of the essay entitled *Corruption, Anti-Corruption Sentiments, and the Rule of Law.* At first glance, corruption has nothing to do with globalisation. But, the author makes it clear that "it is impossible to understand the strife for global governance without properly interpreting the meaning of the new anti-corruption sensitivity of the last decade" (p. 135). He analyses corruption in post-communist societies and suggests that it is the lack of the rule of law that explains the spread of corruption in these countries. After giving an account of the nature of post-communist and communist corruption, Krastev concludes that the empirical data is controversial and incomplete in regards to the question whether post-communism is more corrupt than communism. However, this sense is very common in these countries. One major reason behind this, the author argues, is that there is a general disappointment with social and economic changes in these countries, which undermines the legitimacy and trust in institutions.

The third chapter of the book contains three very exciting essays on global trade. When speaking of the issues of globalisation, international trade is one of the most often discussed themes. Jean-Pierre Lehmann (International Institute for Management Development, Switzerland) describes the global market in his work called *Why Trade Must Triumph in the 21st Century: Lessons from the Past*. The essay is in favour of the market. Besides emphasising the virtues of the market, the author also gives an account of the "prerequisites" for the proper functioning of the market, which are: mutual respect between buyers and sellers, tolerance and compromise, appropriate rules, etc. "The market is a highly civilized place" (p. 156) and "is the ideal provider for private goods" (p. 157). In the past, as markets developed and expanded, wealth increased. This insight is in accordance with Vernon Smith's views which created the central argument of the ISNIE* Conference in September 2003 in Budapest. Both authors see globalisation as the worldwide expansion of markets. However, this does not mean to Lehmann that market expansion goes without problems: Third World countries could not gain much from free global trade in the age of globalisation. In order to escape from this situation he proposes that developing countries should invest in creating human capital, and also be open to trade, investments, technology transfer and foreign learning opportunities. The author concludes that "trade must triumph not just because it is the best means, but because it is arguably the only means, for humanity to de-

* International Society for New Institutional Economics. See the report about the conference also in this issue.

velop materially and spiritually through active participation in the global market" (p. 176).

Globalisation and Economic Systems: A Homogeneity Test is the title of László Csaba's part. His focus is on whether the process of globalisation leads to a uniformity of economic systems along the lines of the American model of capitalism. The author starts the examination by providing a clear-cut definition of globalisation: the economic concept of globalisation expresses the worldwide intermingling among markets, among organisations, norms, and standards and forms of communication (p. 197). Then he provides a detailed analysis of these features of globalisation, which is in line with what was discussed in Lehmann's essay. In order to provide an answer to his original question, Csaba demonstrates not only the unifying tendencies in globalisation, but also the factors that induce diversity. His conclusion is that uniformity relates basically to the rules of the game which are the same everywhere, while diversity relates to concrete steps that yield the best outcome. To sum it up, "globalisation is likely to increase, rather than diminish, the diversity of economic arrangements of the world" (p. 212).

Chapter five is about global governance. It is a largely shared view that we need some form of global governance in a globalising world. Accordingly, the question is not whether we need it or not, but what kind of global governance we should have. Cho Khong (Global Business Environment Group, UK) provides an answer in his essay titled *Global Governance and Multinational Business*. According to his work, global governance is not a form of world government, but instead a set of rules to govern an international system based on the present state structures. He also argues that this regime should be enforced by global institutions, essentially the ones we have today. Cho Khong assumes that multinational enterprises would support setting up a global anti-trust authority.

The viewpoints regarding the effects of the process of globalisation and the issues connected to it are quite numerous. It is impossible to discuss all of them in one volume. What we are given in this one is an overview of a relatively wide array of the problems inherent to this process. Since this volume challenges on many occasions the insights of some recently published textbooks on globalisation, it is an exciting read for everybody.

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