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WINNERS TAKE ALL
The Politics of Partial Reform in Postcommunist Transitions

By JOEL S. HELLMAN*

MUCH of our analysis of the politics of economic reform is based on an assumption about the distribution of the costs and benefits of reform, known informally as the J-curve. Simply stated, reforms are expected to make things worse before they get better. In the short term economic reforms are believed to generate transitional costs in the form of high unemployment, price increases, and production declines as the economy adjusts to the tremendous institutional and policy changes necessary to achieve the long-term efficiency gains of an effectively functioning market. Yet the timing of the costs and benefits of reform presents politicians with a serious problem: how can they initiate and sustain reforms that demand severe sacrifices in the short run for the mere promise of future gains? Surely losers in the short term will take revenge against reformers at the first opportunity and spark a backlash against reform. Anticipating this reaction, politicians in democratic systems are understandably reluctant to undertake radical economic reforms. The central political challenge of reform, as expressed in Adam Przeworski's apt metaphor, is therefore to traverse the "valley of transition" in order to climb the "higher hills" of the reformed system.[1] This logic has led to a series of political prescriptions centered around the same theme—to insulate the state from the pressures of the short-term losers until the reforms have created a constituency of winners powerful enough to sustain them.[2]

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[1] Przeworski, *Democracy and the Market* (New York: Cambridge University Press, 1991), 138.

[2] Variations on this theme have stressed the virtues of autonomous states (Peter Evans, "The State as Problem and Solution: Predation, Embedded Autonomy, and Structural Change," in Stephan Haggard

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

Instead, the most common obstacles to the progress of economic reform in postcommunist transitions have come from very different sources: from enterprise insiders who have become new owners only to strip their firms' assets; from commercial bankers who have opposed macroeconomic stabilization to preserve their enormously profitable arbitrage opportunities in distorted financial markets; from local officials who have prevented market entry into their regions to protect their share of local monopoly rents; and from so-called mafiosi who have undermined the creation of a stable legal foundation for the market economy. These actors can hardly be classified as short-term net losers in the overall reform process. On the contrary, they were its earliest and biggest winners. These net winners did not oppose the initiation of the reform process, nor have they sought a full-scale reversal of reform. Instead, they have frequently attempted to block specific advances in the reform process that threaten to eliminate the special advantages and market distortions upon which their own early reform gains were based. Instead of forming a constituency in support of advancing reforms, the short-term winners have often sought to stall the economy in a *partial reform equilibrium* that generates concentrated rents

and Robert R. Kaufman, eds., *The Politics of Economic Adjustment* [Princeton: Princeton University Press, 1992]); powerful executives (Stephan Haggard and Robert Kaufman, *The Political Economy of Democratic Transitions* [Princeton: Princeton University Press, 1995]); insulated technocrats (John Williamson, "In Search of a Manual for Technopols," in Williamson, ed., *The Political Economy of Policy Reform* [Washington, D.C.: Institute for International Studies, 1994]); and substantial external assistance (Jeffrey Sachs, "Western Financial Assistance and Russia's Reforms," in Shafiq Islam and Michael Mandelbaum, eds., *Making Markets: Economic Transformation in Eastern Europe and the Post-Soviet States* [New York: Council on Foreign Relations, 1993]). Przeworski himself does not support such a view, which he believes will lead to problems in the consolidation of democracy; Przeworski, "Economic Reforms, Public Opinion, and Political Institutions: Poland in the Eastern European Perspective," in Luis C. B. Pereira, Mario M. Maravall, and Adam Przeworski, *Economic Reforms in New Democracies: A Social-Democratic Approach* (New York: Cambridge University Press, 1993).

for themselves, while imposing high costs on the rest of society.

While conventional models of the politics of economic reform are driven by the short-term incentives of the net losers, the postcommunist transitions appear to have faced far more serious obstacles to the progress of economic reforms from the net winners. Moreover, the obstacles have come less in the form of ex ante opposition to the onset of reform or ex post electoral reversals of reform than in the prolonged maintenance of partial reforms and their associated market distortions. This suggests that the prescriptions derived from conventional models about the political institutions most conducive to economic reform need to be reexamined. This paper concludes that the emphasis on insulating the state from the short-term losers—the major focus of many existing models—needs to be replaced with a recognition of the importance of restraining the winners in the early stages of reform.

The paper begins by testing the applicability to the postcommunist transitions of models based on a J-curve distribution of the costs and benefits of reform. It examines both the ex ante and ex post political constraints on reform predicted from such a model. As for the ex ante constraints, the evidence from these transitions suggests that those countries with more frequent elections and shorter executive tenures, that is, those most susceptible to electoral challenge from short-term losers, have been more likely to adopt comprehensive economic reforms than states that are more insulated from electoral pressures. As for the ex post constraints, annual rankings of the progress of economic reform are examined to demonstrate the weakness of the threat of electoral reversals of reform in the postcommunist transitions.

The paper then presents a model of the politics of economic reform in which the primary political challenge derives from the net winners in the overall reform process. Partial economic reforms are shown to produce market distortions that generate a pattern of concentrated gains and dispersed losses in the short term. Winners have an incentive to try to preserve these sources of considerable rents as long as possible by blocking any measures to eliminate these distortions. Recent evidence on changes in the concentration of incomes in the postcommunist countries is used to confirm this pattern of gains and losses. Transition economies that have introduced only partial reforms have experienced a higher redistribution of income to a narrower constituency than have those countries with either more comprehensive reforms or few reforms at all. The paper concludes with an alternative view of the political institutions most conducive to sustained progress in economic reforms given the challenge posed by the winners.

THE J CURVE

Most existing models of the politics of economic reform are based on an analysis of the costs and benefits of reform that conforms to a J-curve, depicted in Figure 1. The simple, compelling idea is that economic reforms generate transitional costs in the short term before they begin to produce their promised economic gains. The magnitude of these costs is believed to be positively correlated with the comprehensiveness (or radicalness) of the reforms adopted. Inefficient enterprises must be closed or restructured, state subsidies and social spending must be reduced, and domestic prices must be raised to world levels—a program that in the short term is expected to generate unemployment, sharp declines in production, and falling living standards. Only when the economy begins to adjust to the new structure of incentives can one expect any amelioration of the situation. Indeed, some analysts even expect the onset of reforms to increase the misallocation of resources in the short run, as poorly defined property rights, the absence of developed financial markets, the continued presence of monopolies, and insufficiently developed human capital distort the response to market incentives.[3]

The depiction of the costs and benefits of reform as a J-curve is particularly compelling from a political standpoint, as it provides a plausible explanation for the central paradox of the political economy of reform: if reforms ultimately make all or a majority of a country's citizens better off, why are they so politically contentious, especially in democratic systems? The standard answer has been that reforms are subject to a time inconsistency problem, requiring actors to accept losses in the short term for the mere promise of future gains. If the government cannot make a credible commitment to maintain those reforms until the promised benefits arrive or to insure that those gains are not confiscated once they do arrive, then it may be rational for economic actors to reject the reforms ex ante.[4]

The J-curve distribution of costs and benefits is also assumed to create a collective action problem that generates political obstacles to economic reform. It is commonly argued that the losses from economic reform are concentrated among specific groups—namely, those who were privileged or subsidized by the previous status quo—while the

[3] This is one of the arguments made against the radical or "big bang" approach to economic reform. For a review of the political economy case against such an approach, see Gerard Roland, "The Role of Political Constraints in Transition Economies," *Economics of Transition* 2, no. 1 (1994).

[4] In the expected utility function of any given actor, the benefits of reform would be discounted by the probability that the reform will be reversed prior to the receipt of the benefits. For a review of this problem in the politics of economic reform, see Mariano Tommasi and Andres Velasco, "Where Are We in the Political Economy of Reform?" (Manuscript, Cambridge, Mass., 1995).

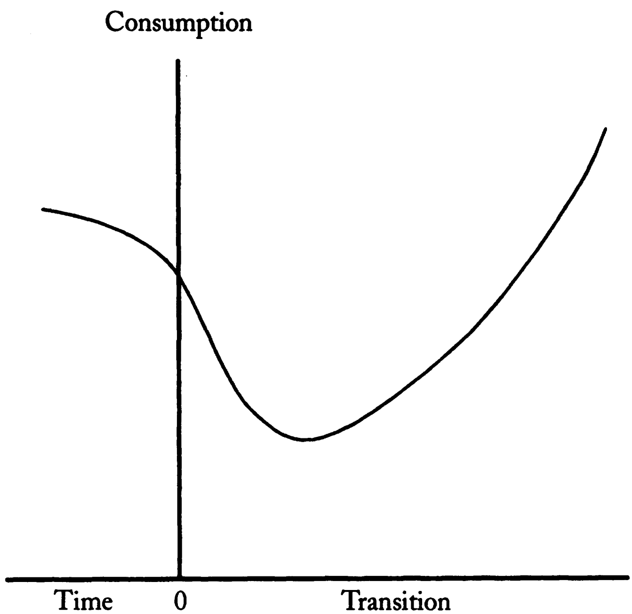

FIGURE 1
THE J CURVE

SOURCE: Przeworski (fn. 1).

benefits of reform are more widely dispersed. Low inflation, increased availability of goods and services, a stable currency, and so forth—these nonexcludable benefits accrue to society as a whole and thus have the characteristics of public goods. If the losses are concentrated and the gains dispersed, then the losers should have greater selective incentives to engage in collective action than the winners.[5] Thus, the losers' political opposition to economic reforms is expected to be more effective than the winners' political support of reform, even if the latter outnumber the former.

The time inconsistency and collective action problems are believed to produce both ex ante and ex post political obstacles to reform. Politicians in democratic systems will be reluctant to introduce any reforms whose benefits will not be realized before the next elections. Since radical reforms are believed to generate higher short-term costs, if they are adopted they are expected to face a high likelihood of ex post reversal as the losers react to the high costs. Politicians are therefore expected to favor more moderate reform programs.

[5] Haggard and Kaufman (fn. 2, 1995).

These ex ante and ex post political constraints on reform have led many analysts and reform practitioners to emphasize the benefits of insulating reform governments from the pressures of the losers, at least in the initial stages of the reform process. In the earlier literature on the politics of reform, this was the basis for the view that authoritarian governments had an advantage in implementing economic reforms. This has largely been replaced with an emphasis on the benefits of state autonomy, the concentration of executive power, and the delegation of power to technocrats for the adoption of economic reforms.[6] Yet the justification for both views is the same: political institutions need to be structured to shield state actors from the pressures of the short-term losers until the realization of gains from the reforms creates the necessary political constituency to sustain them.

Although the implications of the J-curve approach to the politics of economic reform have been widely accepted, they are based on a number of assumptions that have not been subjected to systematic empirical tests.[7] This approach assumes that economic reforms will generate transitional costs prior to the realization of benefits and that these costs will be greater with the adoption of more extensive reform programs. On the political dynamics of reforms, this approach leads to a simple hypothesis: political systems in which reformers are more susceptible to the reaction of the losers are less likely to adopt extensive economic reforms and more likely to suffer reversals of reform if such measures are adopted. The postcommunist transitions provide an ideal opportunity to test these assumptions about transition costs and the behavior of reformers on a new set of cases.

The recent availability of reliable cross-national data from the postcommunist transitions allows us to test some of the economic assumptions inherent in models based on the J-curve.[8] Though the data

[6] On the earlier literature, see the classic treatment of this issue in Samuel Huntington, *Political Order in Changing Societies* (New Haven: Yale University Press, 1968); and the review in Stephan Haggard, *Pathways from the Periphery: The Politics of Growth in the Newly Industrializing Countries* (Ithaca, N.Y.: Cornell University Press, 1990). The recent work on the advantages of state autonomy and insulation is voluminous. Some prominent examples are Evans (fn. 2); Haggard and Kaufman, "Economic Adjustment and the Prospects for Democracy," in Haggard and Kaufman (fn. 2, 1992); idem (fn. 2, 1995); and the contributions to Williamson (fn. 2).

[7] Nelson argues that this approach can be directly applied to the postcommunist transitions; Joan M. Nelson, "The Politics of Economic Transformation: Is Third World Experience Relevant in Eastern Europe?" *World Politics* 45 (April 1993).

[8] Broad, cross-national comparisons of the postcommunist transitions include EBRD, *Transition Report, 1994* (London: European Bank for Reconstruction and Development, 1994); idem, *Transition Report, 1995* (London: European Bank for Reconstruction and Development, 1995); and World Bank, *World Development Report, 1996* (Washington, D.C.: World Bank, 1996). Other studies include Anders Åslund, Peter Boone, and Simon Johnson, "How to Stabilize: Lessons from the Postcommunist Countries," *Brookings Papers on Economic Activity* (1996); Martha de Melo, Cevdet Denizer, and

TABLE 1
CHANGE IN GDP

	1989	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*
All countries	1.55	−4.50	−10.45	−17.17	−9.29	−7.74	−0.84
Excluding war	1.93	−3.20	−10.65	−13.79	−6.67	−6.02	0.11

SOURCE: EBRD (fn. 8, 1995).

confirm that the introduction of economic reforms entails substantial transitional costs, they challenge the assumption linking the magnitude of these costs to the extensiveness of the reforms adopted. Table 1 presents data on the average annual growth rates for the entire set of postcommunist cases, as well as for those transition countries not affected by war. The transitional costs of reform as reflected in declining growth rates do appear to follow a J-curve pattern. The average growth rate for the region begins to fall in 1990 (−4.5) dropping to its lowest level in 1992 (−17.7 percent), and then beginning a gradual recovery. However, an examination of the postcommunist countries grouped by the extent of their economic reforms reveals an unexpected picture.

The World Bank has developed a set of indicators to measure the extent of liberalizing reforms adopted in three broad areas (internal prices, external prices, and private sector entry) across all the transition economies.[9] On the basis of these indicators, the transition economies can be separated into four main groups: advanced reformers, high intermediate reformers, low intermediate reformers, and slow reformers.[10] Figure 2 compares the average annual change in growth rates for each group. It is not the advanced reformers that have suffered the sharpest declines in real GDP, as the J-curve approach would predict, but the intermediate reformers. Indeed, the advanced reformers have the lowest overall output declines and the most rapid recoveries.[11] The average ratio of real GDP in 1994 to the 1989 level in the advanced reform group was 83 percent. The average ratio declined to 65 percent for the high intermediate reformers, 57 percent for the low intermediate reformers, and 72 percent for the slow reformers.[12] Among the postcom-

Alan Gelb, *From Plan to Market: Patterns of Transition*, World Bank Policy Research Working Paper, no. 1564 (1996); and Stanley Fischer, Rajiv Sahay, and Carlos Vegh, "Stabilization and Growth in Transition Economies: The Early Experience" (Manuscript, Washington, D.C., 1996).

[9] World Bank (fn. 8).

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

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

[12] De Melo, Denizer, and Gelb (fn. 8).

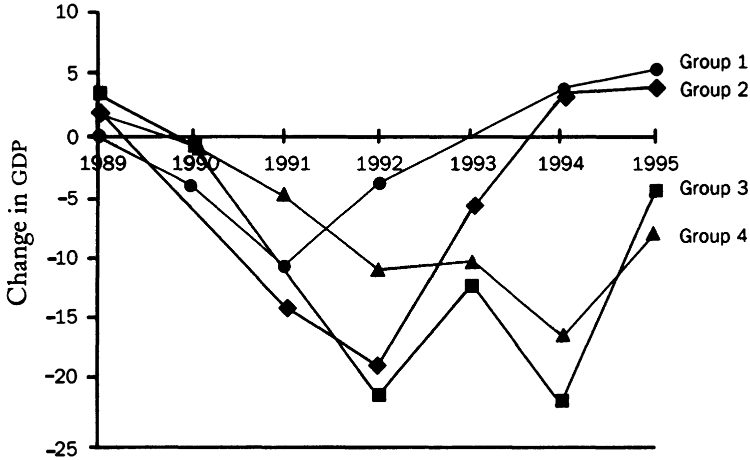

FIGURE 2
GDP BY REFORM GROUP

munist countries the preliminary evidence suggests that the deeper the economic reforms adopted, the less steep is the valley of the transition in terms of overall transitional costs. In other words, the costs of reform are not positively correlated with the extensiveness of the reforms adopted.[13]

The pattern of unemployment among the postcommunist countries—generally seen as a critical factor shaping the politics of economic reform—conforms more closely to the expectations of the J-curve approach. Table 2 presents data on registered unemployment in the postcommunist countries, grouped by their scores on the World Bank's liberalization index.[14]

The countries that have undertaken reform do exhibit considerably higher unemployment than the slowest reformers, but the relationship between the extensiveness of adopted reforms and the level of unemployment is less clear. Åslund, Boone, and Johnson find no statistically significant correlation between the extent of economic reforms and unemployment rates once some basic control variables are included in the regression.[15] In addition, the evidence from individual cases is mixed. Despite having introduced and maintained one of the most compre-

[13] Åslund, Boone, and Johnson (fn. 8) find no direct statistical correlation between the extent of economic reforms adopted and the magnitude of cumulative output declines once some basic control variables are added to the regression. They do not test for the existence of a nonlinear relationship as Figure 2 would suggest. Nevertheless, they reach the same conclusion through comparative case analysis.

[14] Unemployment data from the postcommunist countries have serious reliability problems and therefore must be used cautiously.

[15] Åslund, Boone, and Johnson (fn. 8).

TABLE 2
UNEMPLOYMENT

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

SOURCE: De Melo, Denizer, and Gelb (fn. 8).

hensive reform programs, the Czech Republic has kept its unemployment rates quite low. At the same time, less comprehensive reformers, such as Albania, Bulgaria, and Romania, have suffered from relatively high unemployment. States of the former Soviet Union (FSU) have generally maintained lower unemployment than those of Eastern Europe, but the most comprehensive reformers within the FSU (the Baltic states) have had the highest unemployment rates.

The political implications of the J-curve model have never been tested systematically. If ex ante political incentives are an impediment to the adoption of comprehensive economic reforms, one would expect politicians facing greater electoral pressures and having a shorter expected tenure to be less likely to initiate such reforms. As Haggard and Kaufman argue, from the politician's point of view, some degree of security of tenure "would appear to be a minimal requirement of successful reform, since a high degree of insecurity shortens time horizons and increases the discount rate to future payoffs [from economic reforms]."[16]

Table 3 presents data on the number of executive turnovers and the average length of government tenure in the postcommunist states, excluding those affected by war.[17] Again, the countries are grouped by their World Bank liberalization scores. The first column indicates the number of executive turnovers that has occurred from the onset of the transition through the end of 1995.[18] Both the advanced and the intermediate reformers have an average of just over three and half executive turnovers, while both groups of slow reformers average no more than one turnover in the same period. Poland, one of the most celebrated cases of radical reform in the region, has had seven prime ministers and three presidents between 1990 and 1997. The Baltic countries, which have been the most advanced reformers of the FSU, have all had no fewer than four prime ministerial turnovers since independence. While other advanced reformers have had more stable governments, all of them have experienced some turnover in their prime ministers since the beginning of their transitions. In contrast, among the slow reformers, Ukraine and Belarus are the only countries that have changed their chief executives since the onset of the transition.

The differences in executive turnovers are reflected from another vantage point in the evidence on the tenure of postcommunist governments from Table 3.[19] The countries of the first two reform groups had

[16] Haggard and Kaufman (fn. 2, 1995), 156.

[17] Postcommunist cases affected by war are excluded because executive turnovers are much more likely to be affected by the dynamics of war.

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

[19] Government tenure consists of the number of months in which the leading executive (president in presidential systems and prime minister in parliamentary and semipresidential systems) has remained in office.

TABLE 3
GOVERNMENT STABILITY

	Executive Turnovers	*Average Government Tenure (# Months)*
Advanced		
Poland	6	14
Slovenia	2	34
Hungary	3	26
Czech Republic	2	35
Slovakia	5	14
Average	3.6	24.6
High intermediate		
Estonia	4	17
Bulgaria	6	13
Latvia	4	15
Lithuania	5	14
Albania	2	27.5
Romania	1	67
Average	3.7	25.6
Low intermediate		
Kyrgyzstan	1	62
Russia	1	54
Moldova	1	61
Kazakhstan	0	69
Average	0.8	61.5
Slow		
Turkmenistan	0	62
Ukraine	2	24
Uzbekistan	0	62
Belarus	2	26
Average	1	43.5

an average government tenure of approximately twenty-five months. Six of the eleven countries in these two groups had an average government tenure of less than eighteen months. While some of the most successful reformers—the Czech Republic, Hungary, and Slovenia—have had individual governments with relatively long tenures, these governments do not necessarily fit well with the standard image of reform governments as strong, streamlined, and relatively autonomous, with the capacity to push through reforms despite bureaucratic and popular opposition. In Slovenia the Drnovsek government, which has been in office since May 1992, began as an explicitly transitional government until parliamentary elections in December 1992. Since the elections Drnovsek has headed a fragile, five-party coalition government that has been subject to frequent no-confidence votes and whose continued survival has often been tenuous.[20] In Hungary the government of Josef Antall, though quite secure, rejected the radical approach to economic reform and pursued an explicitly gradual strategy that benefited from Hungary's prior history of communist-era reforms.[21] The only case of radical economic reform pursued by a stable government with a high degree of security and autonomy is the Klaus government in the Czech Republic.[22]

The slow reformers generally have political leaders with the longest and most secure tenures in the region. With the exception of Belarus and Ukraine, all of the slow reformers have been ruled continuously by the same respective presidents since the start of their transitions.[23] Among the advanced and intermediate reformers, Romania had a similar unbroken presidential rule until the recent defeat of Ion Iliescu in the November 1997 presidential election.[24]

The postcommunist countries with more frequent executive turnovers and shorter government tenures have generally been the most far-reaching economic reformers. Politicians with shorter expected time horizons have nevertheless been far more likely to adopt economic reforms.[25] Those political leaders with the greatest security of tenure have

[20] On Slovenia, see Sabena Petra Ramet, "Slovenia's Road to Democracy," *Europe-Asia Studies* 45, no. 5 (1993); and Boris Pleskovic and Jeffrey D. Sachs, "Political Independence and Economic Reform in Slovenia," in Oliver J. Blanchard, Kenneth A. Froot, and Jeffrey D. Sachs, eds., *The Transition in Eastern Europe* (Chicago: University of Chicago Press, 1994), 1.

[21] On Hungary, see David L. Bartlett, "Stabilization, Adjustment, and Reform: The Political Economy of Transition in Hungary" (Manuscript, 1995); Laszlo Bruszt and David Stark, "Remaking the Political Field in Hungary: From the Politics of Confrontation to the Politics of Competition," in Ivo Banac, ed., *Eastern Europe in Revolution* (Ithaca, N.Y.: Cornell University Press, 1992); and Valerie Bunce and Mario Csanadi , "Uncertainty in the Transition: Post-Communism in Hungary," *East European Politics and Society* 7, no. 2 (1993).

[22] Even Vaclav Klaus has faced strong electoral pressures, as evidenced by his poor performance in the 1996 parliamentary elections. Klaus' s three-party coalition government lost its majority share and has been governing as a minority coalition. On the Czech Republic, see Mitchell Orenstein, "Out of the Red: Building Capitalism and Democracy in Post-Communist Europe" (Ph.D. diss., Yale University, 1996).

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

[24] Romania is a semipresidential system in which the popularly elected president shares considerable powers with a parliamentary government. Since 1990 Romania has had three prime ministers with an average tenure of twenty-one months each. On Romania, see Katherine Verdery and Gail Kligman, "Romania after Ceausescu: Postcommunist Communism?" in Banac (fn. 21).

[25] In a recent paper on the politics of stabilization in postcommunist systems, I show that stabilization programs are as likely to be introduced just before elections—the moment of greatest insecurity in a politician's tenure—as immediately after electoral victories; see Joel S. Hellman, "Competitive Advantage: Political Competition and Economic Reform in Post-Communist Transitions" (Manuscript, 1996).

tended to introduce partial economic reforms or have delayed reforms altogether, even though they would appear to have faced the weakest threat of electoral or popular challenge to more comprehensive reforms. Although this evidence cannot support a causal link between executive turnovers, government stability, and economic reform, it does challenge the notion that the threat of electoral revenge against the short-term costs of economic reform is a substantial ex ante obstacle to the adoption of reform in the postcommunist transitions.

If the political threat to economic reform is primarily ex post, then we would expect to see economic reforms reversed or otherwise moderated in the electoral cycle following their initial adoption. Przeworski argues that the high short-term costs of reform are likely to spark an electoral backlash and subsequent reversal or moderation of reforms. This creates a familiar stop-and-go pattern of economic transition in which reforms "proceed in spurts: advancing, stumbling, retreating and advancing again."[26] The postcommunist countries have certainly experienced the pressures of electoral backlashes against reform. In three of the five countries in the advanced reform group—Hungary, Poland, and the Slovak Republic—reform governments have been voted out of office to be replaced by parties advocating more moderate reforms. Similar reversals of reform governments have occurred in three of the six countries in the high intermediate reform group—Bulgaria, Estonia, and Lithuania. However, these electoral reversals have not been accompanied by any major reversals in the course of economic reform in these countries.

Table 4 presents the annual scores on the three categories of the World Bank's liberalization index for the six countries listed above that have had electoral backlashes against reform governments. By the end of 1994 there were only two instances in which these liberalization scores declined from year to year. In Bulgaria scores on the liberalization of internal and external prices declined slightly from 0.9 in 1993 to 0.8 in 1994 (on a 0–1 scale with 1 as fully liberalized), as the non-party government of technocrats led by Luben Berov was replaced after a general election by the Bulgarian Socialist Party. A similarly modest decline in the liberalization score on external prices from 0.9 to 0.8 was recorded between 1992 and 1993 in the Slovak Republic following the breakup of Czechoslovakia. According to the World Bank scores, there were no other substantial reversals of liberalizing reforms in any of the postcommunist countries that experienced electoral backlashes against

[26] Przeworski (fn. 1), 179.

TABLE 4
SELECTED CLI SCORES

	1990	*1991*	*1992*	*1993*	*1994*
Hungary					
Internal prices	0.8	0.9	0.9	0.9	0.9
External prices	0.7	0.9	0.9	0.9	0.9
Private sector entry	0.3	0.5	0.6	0.7	0.8
Poland					
Internal prices	0.7	0.7	0.9	0.9	0.9
External prices	0.9	0.9	0.9	0.9	0.9
Private sector entry	0.5	0.6	0.9	0.7	0.8
Lithuania					
Internal prices	0.3	0.5	0.8	0.9	0.9
External prices	0	0.2	0.5	0.9	1
Private sector entry	0.1	0.3	0.4	0.6	0.8
Estonia					
Internal prices	0.3	0.5	0.9	0.9	0.9
External prices	0.1	0.3	0.7	1	1
Private sector entry	0.2	0.2	0.4	0.6	0.8
Slovakia					
Internal prices	0	0.9	0.9	0.9	0.9
External prices	0	0.8	0.9	0.8	0.8
Private sector entry	0.4	0.7	0.8	0.8	0.8
Bulgaria					
Internal prices	0	0.9	0.9	0.9	0.8
External prices	0.5	0.9	0.9	0.9	0.8
Private sector entry	0.1	0.2	0.3	0.3	0.4

SOURCE: World Bank (fn. 8).

reform governments. Indeed, out of the entire set of postcommunist countries the two minor declines described above were the only two reversals in reform scores from 1989 to 1994.[27]

Electoral backlashes did occasionally slow the rate of progress in particular areas of economic reform. The speed of large-scale privatization slowed considerably in Lithuania and Poland after the electoral victories of communist successor parties in those countries. Voucher privatization was also delayed in the Slovak Republic after the breakup of Czechoslovakia.[28] Yet there have also been cases in which electoral backlashes against reform-oriented governments were followed by an

[27] Similarly, the EBRD's transition indicators measuring progress in economic reform in six categories in 1994 and nine categories in 1995 do not reflect any backtracking on reform scores in any of the postcommunist countries; EBRD (fn. 8, 1994, 1995).

[28] For detailed accounts of the privatization process in Central Europe and the Baltic states, see Roman Frydman and Andrzej Rapaczynski, *The Privatization Process in Central Europe*, 2 vols. (Budapest: Central European University, 1993).

intensification of reform in some areas. Russia made the greatest progress in large-scale privatization only after the reform government of Egor Gaidar was forced out of office.[29] Hungary and Lithuania implemented tough macroeconomic stabilization programs after electoral victories by socialist parties.[30] Estonia has continued its rapid pace of economic reform following the replacement of the reform government of Mart Laar by the far more moderate Vahi government.

Though in most cases the introduction of comprehensive economic reform programs did spark revenge at the ballot box against reform governments, the electoral reversals did not generate the expected reform reversals. The notion that politicians would be forced to reverse reforms in response to the popular reaction against high transitional costs has to date not been evident in the postcommunist transitions.[31]

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

[29] Ibid.

[30] For assessments of macroeconomic policy in Hungary and Lithuania, see the country sections in EBRD (fn. 8, 1995).

[31] Of course, this does not preclude such reform reversals in the future, nor is it necessarily advantageous for the creation of a stable democracy. Przeworski (fn. 2) expresses the concern that electoral backlashes against reformers that do not lead to backtracking on economic reform can be politically destabilizing in emerging democracies. If voters continue to find that their votes are not reflected in policy changes, then they could lose confidence in the democratic process and be more attracted to authoritarian solutions.

The Politics of Partial Reform

The exclusive focus on the net losers in the political economy of reform has deflected attention from analyzing the interests and incentives of the net winners. The conventional approach to the politics of economic reform is based on a simple, seemingly uncontroversial assumption, that economic reforms create winners who gain stakes in defending and extending those reforms. One of the goals of reform, therefore, is to create a constituency of winners that will support ongoing efforts to advance the transition to a market economy.[32] The most frequently cited problem of relying on the winners in the short term is that the gains from reform are dispersed throughout the entire economy, while the losses are concentrated within particular groups. The efficiency gains normally associated with economic reform—reducing inflation, creating a stable currency, lowering fiscal deficits, and increasing the availability of goods and services—can be considered as public goods. Therefore, the beneficiaries of these policies face barriers to collective action. By contrast, the losers face concentrated costs in the short term and thus have strong selective incentives to engage in collective action against the reforms.[33] Though the winners and potential winners are seen as the best hope of creating a constituency for reform, the pattern of gains from reform in the short term is assumed to weaken their effectiveness as a political force.

This raises a question that has not been investigated in the political economy of reform: who gains from partial economic reforms?[34] Partial reforms entail the selected introduction of market mechanisms into an

[32] This assumption is especially important in political economy models that are designed to highlight the advantages of gradual reforms. Roland argues that the best political strategy of reform is to start with measures that produce winners in the short term who gain a stake in the reform process that they will continue to defend once more costly measures need to be adopted down the road. See Gerard Roland, "Political Economy of Sequencing Tactics in the Transition Period," in Laszlo Csaba, ed., *Systemic Change and Stabilization in Eastern Europe* (Aldershot, U.K.: Dartmouth Press, 1991); and idem (fn. 3). This is also the spirit of Murrell's critique of the shock therapy reform program; Peter Murrell, "Conservative Political Philosophy and the Strategy of the Economic Transition," *East European Politics and Societies* 6, no. 1 (1993); and idem, "Evolution in Economics and in the Economic Reform of the Centrally Planned Economies," in Christopher Clague and Gordon C. Rausser, eds., *The Emergence of Market Economies in Eastern Europe* (Cambridge, Mass.: Blackwell, 1992).

[33] Haggard and Kaufman (fn. 2, 1995), chap. 1, emphasize this collective action dilemma in the political economy of reform.

[34] The only work that explicitly examines the dynamics of partial reform is Kevin M. Murphy, Andrei Shleifer, and Robert Vishny, "The Transition to a Market Economy: Pitfalls of Partial Reform," *Quarterly Journal of Economics* 57, no. 3 (1992). Ronald I. McKinnon touches on this issue in his analysis of different sequences of economic reform; see McKinnon, *The Order of Economic Liberalization: Financial Control in the Transition to a Market Economy* (Baltimore: Johns Hopkins University Press, 1991). Richard E. Ericson discusses the social costs of partial reforms in the specific context of the transition from centrally planned economies, though he does not explore the distribution of gains from such reforms; see Ericson, "The Classical Soviet-Type Economy: Nature of the System and Implications for Reform," *Journal of Economic Perspectives* 5, no. 4 (1991).

economy in which substantial spheres of economic activity still operate according to alternative mechanisms of coordination. It was recognized early in the transition that partial reforms threatened to disrupt the stability and effectiveness—however limited—of the existing economic system without necessarily generating the efficiency gains associated with fully functioning markets.[35] As a result, partial reforms were predicted to generate higher social costs in the short term than both comprehensive reforms and maintenance of the status quo. At the same time, partial reforms were expected to generate rent-seeking opportunities arising from price differentials between the liberalized sectors of the economy and those still coordinated by nonmarket mechanisms.[36]

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

To some extent, these rent-seeking opportunities should exist regardless of the reform strategy adopted. The transition from a command economy to a market economy requires an extensive set of policy and institutional changes, many of which have different time horizons. Clearly, prices can be liberalized far more quickly than monopolies can be broken up. Interest rates can be changed more quickly than new commercial banks capable of evaluating loan requests can be created. Restrictions on foreign and domestic trade can be lifted more quickly than adequate mechanisms for contract enforcement can be put into

[35] Ericson (fn. 34).

[36] The fact that such market distortions exist does not guarantee that actors will be able to take advantage of them in these partially reformed economies. It is possible that a highly restrictive state could build walls between the liberalized and more highly controlled spheres of the economy, preventing actors from gaining access to these rent-seeking opportunities. This is often the explanation for the success of China's partially reformed economy, though press reports of high levels of corruption within China's state sector suggest that there are limits to the state's capacity to enforce such restrictions; Murphy, Shleifer, and Vishnay (fn. 34).

place. These differentials in the time horizons of various components of comprehensive reform produce temporary market distortions similar to the gaps associated with the explicit introduction of partial reforms.

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

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

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

By adding these winners' curves to the traditional J-curve, a different picture of the political economy of reform in postcommunist transitions emerges. If partial reforms generate higher social costs in the short

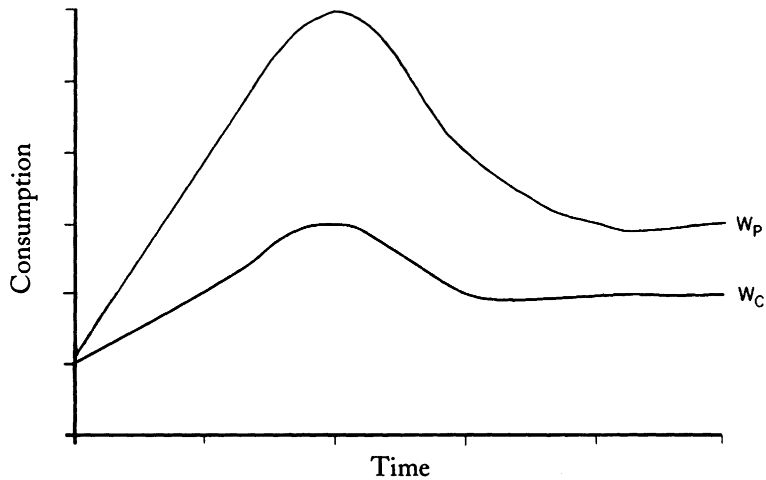

FIGURE 3
THE WINNER'S CURVE

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

In the standard J-curve approach, if elections are called prior to the point at which the reforms have begun to produce benefits for the majority of voters, the voters will react to the short-term costs by casting their ballots for a reversal or moderation of the reforms. Yet the addition of the winners suggests a different approach to the political obstacles to economic reform. The politics of economic reform is usually portrayed as a set of choices between omnibus reform programs (radical versus gradual) at key junctures in the political process (namely,

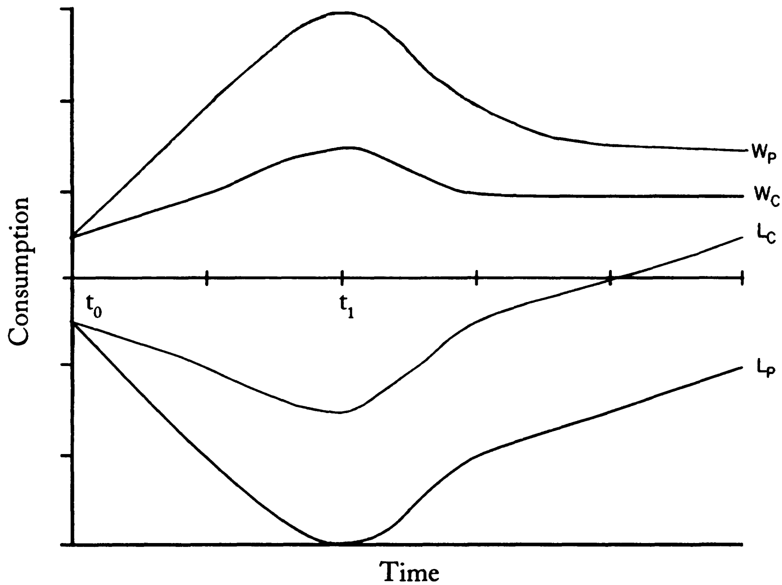

FIGURE 4

elections) in which voters play the deciding role. Yet the process might be more realistically depicted as a sequence of many distinct choices over time on separate components of an overall reform plan—liberalization, stabilization, privatization, and many more—that do not necessarily coincide with the electoral calendar. In such a process, the winners with their concentrated gains would be expected to play a more decisive role, given their greater resources, their smaller number, and their selective incentives for collective action. Indeed, it is reasonable to assume that the winners might have an implicit veto power in the decisions over separate components of economic reform, especially those that affect their existing rent streams.

Returning to Figure 4, if the process of reform consists of a sequence of decisions over time, then the winners will continue to support the advance of reforms until time t_1. Beyond t_1, the winners have an incentive to veto any reform proposals that move the economy toward more comprehensive reforms, since such measures will begin to decrease the rents they gained at the earlier stage of the reform process. Thus, the winners prefer to freeze the emerging market economy in some partially reformed state that maximizes the concentration of rents to themselves, though at a significant social cost. While the political challenge of the J-curve was to maintain reforms through the valley of the transition, the challenge of partial reform is to sustain the momentum of reform past the "peak of transition," that is, the point at which further reforms threaten the rents accruing to winners from the distortions created by earlier reforms.

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

On the basis of these alternative assumptions, the partial reform model presented here suggests a very different characterization of the political obstacles to economic reform in the postcommunist transitions. The political dilemma of economic reform is not how to sustain reform in the face of opposition from the net losers in the short term, but how to advance reform in the face of efforts by the net winners to preserve the market distortions that produced their gains in the short term.

EVIDENCE

One of the key predictions of this alternative approach is that countries that have maintained partial reforms should exhibit a greater concentration of gains to the winners and a higher level of transitional costs than those countries that have pursued more comprehensive reforms. One way to gauge the degree of partial reforms is to examine different levels of progress in each of the separate components that are generally considered to constitute a comprehensive reform program. The European Bank for Reconstruction and Development (EBRD) defines nine separate dimensions of the reform process: privatization (large- and small-scale), enterprise restructuring, price liberalization, foreign trade liberalization, competition policy, banking reform, securities market reform, and legal reform.[37] The EBRD provides a rating of cumulative progress along each dimension on a 1–4 scale. By taking the variance (that is, the dispersion around the mean) of these ratings for each of the postcommunist countries, we obtain a very rough measure of imbalances in the level of progress across the separate dimensions.[38] The variances are reported in the first column of Table 5. Higher variances indicate more unbalanced progress across the different dimensions of economic reform and, hence, a greater degree of partial reforms. The average variances for each of the four groups of countries show a curvilinear pattern among the groups. Both the advanced and the slow reform groups have low variances across their reform scores, while the intermediate groups have considerably higher variances suggesting more uneven progress in economic reform.

If the countries of the intermediate groups have maintained the most uneven or partial economic reforms, then they should demonstrate a higher concentration of gains from reform along with higher overall social costs. Though highly incomplete, recent data on inequality and income concentration across the transition economies show some interesting trends.[39] The transition in the postcommunist countries has sparked an extremely rapid redistribution of income. Since the beginning of the transition, the level of income inequality has risen in every postcommunist country with the exception of the Slovak Republic. The average Gini coefficient—one of the standard measures of inequality—for the entire region jumped by one-third, from 24 in 1987–88 to 32 in 1993–94, a pace virtually unprecedented in the postwar era.[40] In a time

[37] Of course, these are not the only components of comprehensive reform, but they do encompass what are generally considered to be the key elements of reform. See EBRD (fn. 8, 1995).

[38] Such a measure assumes that the distance separating the thresholds of the 1–4 scale within each dimension are directly comparable across all the dimensions, which may not necessarily be the case. As a result, this measure of partial reform should be interpreted with considerable caution. Given the potential measurement error in gauging partial reform, it would not be appropriate to use these data in any sophisticated statistical tests. Rather, at this stage the data are more suggestive of trends that are worthy of further empirical investigation.

[39] The World Bank has collected the only detailed data on inequality and the concentration of incomes in the transition economies based on household surveys. Unfortunately, because data are not available on the entire set of transition economies, it is impossible to make any statistical tests on this small sample of countries. Branko Milanovic presents the data and provides an interesting analysis of the relationship between inequality and poverty. See Milanovic, *Poverty, Inequality and Social Policy in Transition Economies*," World Bank Policy Research Working Paper, no. 1530 (1995); and idem, *Income, Inequality and Poverty during the Transition*, Transition Economies Division Research Paper Series 11 (1996). Data on inequality among postcommunist countries require more than the standard caveats in this field, given the strong incentives to hide income from taxation at all levels. Gini coefficients from the prereform period should be biased downward, given the ideological constraints on revealing inequalities in socialist systems and the numerous forms of perquisites in kind available to the *nomenklatura*. In the transition period Gini coefficients are likely to be biased downward, as higher income groups have greater access to outlets for hiding income than do those in lower income groups.

[40] Milanovic (fn. 39, 1996), chap. 4.

TABLE 5
PARTIAL REFORM AND INEQUALITY

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

SOURCE: Milanovic (fn. 39, 1996), 58.

span of five to seven years the transition economies have moved from inequality levels below those of most OECD countries to, in several cases, levels on a par with or higher than the most unequal OECD countries. The Gini coefficients are listed in Table 5.

The extent of the redistribution differs across the reform groups. From 1987–88 to 1993–94, Gini coefficients increased in the two intermediate reform groups by 43 percent (high intermediate) and 53 percent (low intermediate), as compared with 18 percent among the advanced reformers and 30 percent among the slow reformers. The highest Gini coefficients in the transition economies are among the low

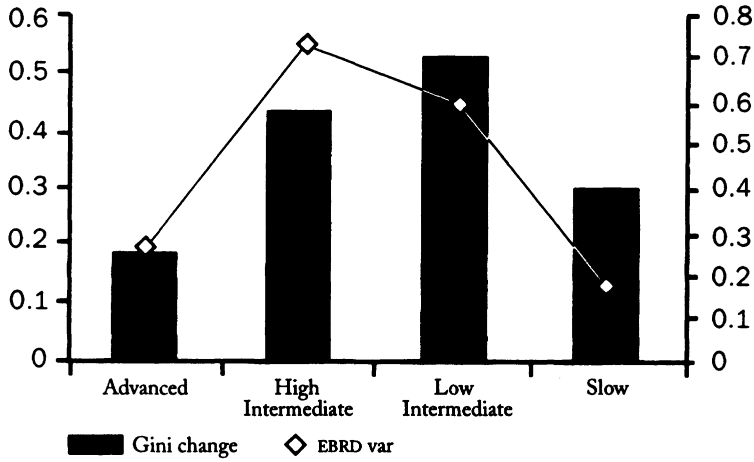

FIGURE 5
REFORM AND INEQUALITY

intermediate reformers, while the most advanced reformers have maintained the lowest levels of inequality. Russia stands out among the transition economies for having doubled its degree of inequality during the period.

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

The increase in inequality in the postcommunist transitions has been driven by a substantial concentration of incomes in the highest income group, though data on income concentration are less complete than for overall inequality. Table 5 reports the change (in percentage points) of total income share for the top income quintile between 1987–88 and 1993–94. The increase in income share for the top quintile in the intermediate reformers exceeds that of the advanced reformers with the exception of the Czech Republic. The top quintile in the high intermediate reformers increased its income share by an average of 7.8 points, while the average share in the advanced reform group increased by only 2.8 points. The two countries among the low intermediate group for which such data are available also show substantial increases in the concentration of income. Again, Russia stands out with a remarkable 20-point increase in the income share of the top quintile. With the

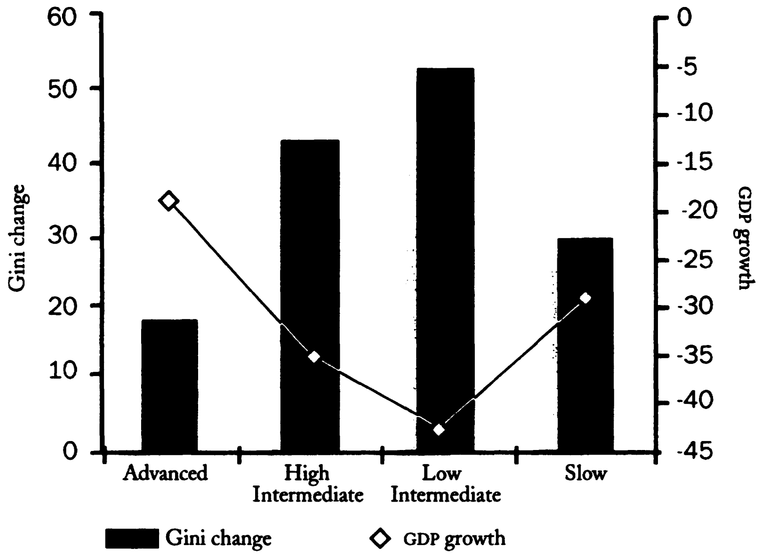

FIGURE 6
INEQUALITY AND GDP GROWTH

exception of Hungary and the Slovak Republic, all of the postcommunist countries have experienced a highly regressive redistribution of income since the start of the transition. Yet the evidence suggests that this redistribution reached a considerably higher magnitude in those countries that have maintained partial reforms.

The variation in the pattern of inequality and concentration among reform groups is closely matched by the cumulative output declines during the transition, the standard measure of the costs of reform. The last column of Table 5 lists the ratio of 1993–94 GDP to 1989 GDP for the postcommunist countries. The average cumulative decline in GDP for the two intermediate reform groups exceeds both the advanced and the slow reformers. By 1994 GDP had fallen by an average of 43 percent among the countries of the lower intermediate reform group and 35.2 percent among the countries of the high intermediate group. The advanced reformers suffered a much lower average GDP loss at 19.4 percent, while the slow reformers fell by an average of 28.3 percent. As Figure 6 suggests, the average declines in GDP across the reform groups match the percentage increases in inequality as measured by the average Gini coefficients for each reform group.

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

The main political implication of the partial reform model is clear: if the winners from partial reforms have a veto power over policy, then the transition should result in a partial reform equilibrium that concentrates gains among the winners at a high social cost.[41] Therefore, the primary political challenge of reform in this model is to restrain the net winners. Political systems that concentrate more power in the hands of the winners are more likely to preserve partial reforms over time. By contrast, political systems more open to the participation of the losers in the policy-making process should generate a greater dispersion of the gains of reform. If the initial rents in the early stages of reform are more thoroughly dissipated, then winners might find the efficiency gains from comprehensive reforms to be more attractive than the reduced rent flows from a partial reform equilibrium.

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

It is difficult to measure with any precision the concentration of power in the hands of the short-term winners in the transition economies. One option is to try to measure the continued power of the former communist elite, since partial reforms are believed to benefit precisely those—such as state enterprise managers, collective farm chairmen, ministerial bureaucrats, and party officials—who are in a position to arbitrage between the highly regulated and subsidized state sector and the less constrained free market sector. It is possible to measure the remaining political power of the former Communist Party and its successor organizations in postcommunist political institutions. Alternatively, the extent of personnel turnover in government posts or key economic sectors from the communist era to the transition period could be surveyed. However, such measures would miss the influence of other groups benefiting from partial reforms, those whose gains are not necessarily linked to their positions in the previous communist system, such as new commercial bankers, investment fund managers, and a whole range of private entrepreneurs. In many postcommunist systems these actors have also made extraordinary short-term gains from distortions in the developing market economy and are believed to wield substantial political power.[42]

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

Figure 7 presents a scatterplot relating the level of democracy to the extent of economic reforms in the postcommunist countries. The economic reform scores are based on the EBRD's cumulative transition indicators for 1994.[43] The measure of democracy is based on the average of each country's annual score on the Freedom House index of political rights over the course of the transition.[44] The Freedom House index

[42] Dmitriev et al. provide a detailed analysis of the rents to newly created commercial banks directly related to the lack of macroeconomic stabilization in the context of a highly liberalized financial system and how quickly those rents declined as the economy began to stabilize. See Mikhail E. Dmitriev et al., *Rossiiskie Banki Nakanune Finansovoi Stabiliaztsii* (Russian banks on the eve of financial stabilization) (St. Petersburg: Norma, 1996).

[43] EBRD (fn. 8, 1994).

[44] Freedom House, *Freedom in the World, 1993–1994* (New York: Freedom House, 1994).

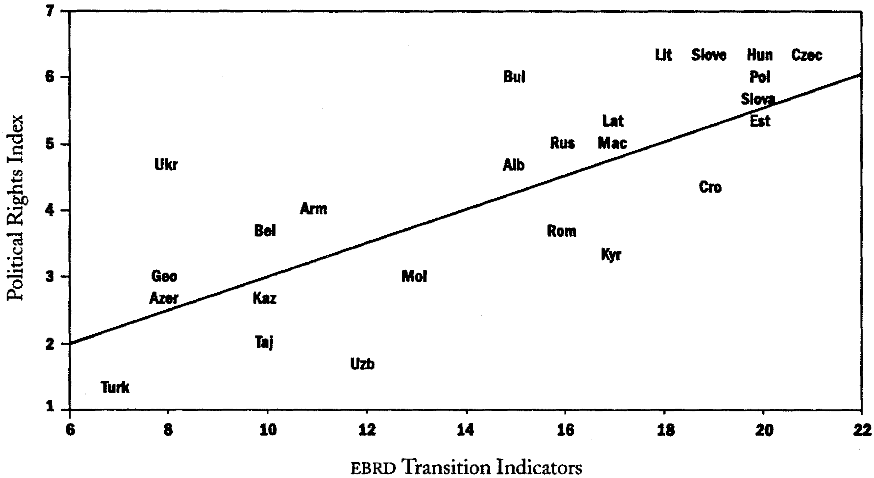

FIGURE 7
DEMOCRACY AND ECONOMIC REFORM

SOURCES: EBRD (fn. 8, 1994); Freedom House (fn. 44, 1990–94).

measures individual rights to participate freely in the political process, focusing especially on the political inclusiveness of the electoral system. The scatterplot reveals a strong positive correlation between political rights and economic reform (r = 0.78). More inclusive political regimes have adopted and sustained higher levels of economic reform than those with more restrictive political rights. Given that losers outnumber winners in the short term, we can assume that a more inclusive political regime gives the losers of the economic reform process greater opportunities to influence political outcomes than a less inclusive regime.

Another more specific proxy measure of the inclusiveness of the political system focuses on the size of coalition governments. As the number of political parties in a coalition government increases, the number of actors and groups whose agreement must be coordinated for effective policymaking increases as well.[45] This tends to weaken the concentration of power in the hands of any single political party or group. Broader coalition governments should have a lower risk of being cap-

[45] Tsebelis argues that increasing the number of parties in a coalition government increases the number of veto points in the policy-making process; see George Tsebelis, "Decision-Making in Political Systems: Veto in Presidentialism, Parliamentarism, Multicameralism and Multipartyism," *British Journal of Political Science* 25 (1995).

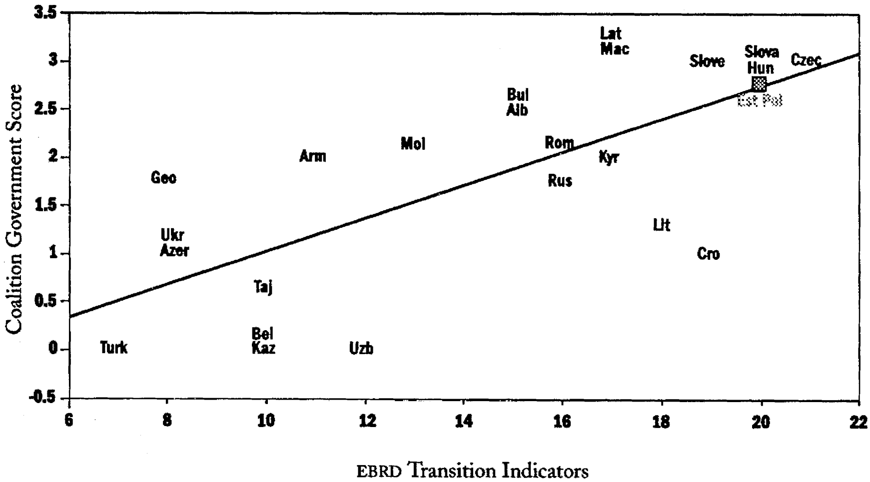

FIGURE 8
COALITION GOVERNMENT AND ECONOMIC REFORM

tured exclusively by the net winners of reform than should governments dominated by a single party. One way to measure the size of coalition governments is a simple scale developed by Roubini and Sachs in their studies of coalition governments and budget deficits in OECD countries.[46] Figure 8 shows a scatterplot of the relationship between the size of coalition governments and the sum of the 1994 EBRD transition indicators for each postcommunist country. There is a strong positive correlation (r= 0.72) between coalition governments and economic reform. As more political forces are brought into the policy-making process, governments appear to be more likely to adopt and sustain more comprehensive economic reforms.

Neither of the proxy variables—the extent of political freedoms or the size of coalition governments—directly measures the relative power of the winners and losers of economic reform over government policy-

[46] The scale is slightly modified for the postcommunist countries to include a category for single-party governments that explicitly restrict party competition. The scale is as follows: 1 = one-party authoritarian government (competition restricted); 2 = one-party majority parliamentary government or united presidential government; 3 = two-party coalition government or divided presidential government; 4 = three- or more party government; and 5 = minority government. Monthly coalition government scores were coded for each postcommunist country beginning with the first free election or the formal declaration of independence. A weighted average of the monthly scores is used in the scatterplot graph. See Nouriel Roubini and Jeffrey Sachs, "Government Spending and Budget Deficits in the Industrial Countries," *Economic Policy* 8 (1989); and idem "Political and Economic Determinants of Budget Deficits in the Industrial Democracies," *European Economic Review* 33 (1989).

making. However, they do measure the extensiveness of political participation in the policy-making process. Political inclusion could alter the dynamics of the reform process in two possible ways. First, greater political inclusion could lead to a greater dissipation of the rents from partial reforms, as more groups demand their share of the short-term gains. As the private gains to specific groups decrease, the advantages of partial reforms over comprehensive reforms are also reduced. Second, the greater the degree of political inclusion in the decision making on economic reform, the less likely it is that the winners will be able to impose policies that bring them private benefits at a high social cost. Political inclusion can act as a constraint on the winners, undermining their capacity to hold the economy in a partial reform equilibrium.

Conclusions

Though many of the postcommunist countries have made tremendous strides toward the creation of a market economy in a remarkably short period of time, the costs of this transition have been substantial, even in the best of cases. To varying degrees, each country has faced some combination of high inflation, high unemployment, declining real incomes, decreasing state services, and increasing uncertainty—a mix of hardships that has produced a familiar pattern of advances and reversals of economic and political reforms in other regions of the world. Yet in contrast to the political dynamics of economic reform in these regions, the losers in the postcommunist transitions have not constituted the main political obstacle to the progress of reform. This paper has shown that it is precisely those countries in which governments have been most vulnerable to the losers' threat of an electoral backlash against reform that have adopted and sustained the most comprehensive reform programs. In contrast, governments insulated from electoral pressures have made, at best, only partial progress in reforming their economies. Moreover, economic reforms, once adopted, have rarely been reversed, even when the reform governments that initiated them have been ousted.

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

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

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

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

One of the fundamental tenets of the politics of economic reform has always been to create a constituency of winners with a stake in sustaining and advancing the reform process. This has been a common strategy both for making the reforms irreversible and for building up the necessary political support for further reforms. Yet a comparison of the postcommunist transitions suggests that the winners can do far more damage to the progress of economic reform than the losers. As a result, the success of economic reform depends both on creating winners and on constraining them. Paradoxically, the most effective means of constraining the winners in the postcommunist transitions has been to guarantee the political inclusion of the very constituency that most existing political economy models seek to exclude: the short-term losers of reform.