

JUSTICE AND TRANSITION PRAVEDNOST I TRANZICIJA

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Abstract: *Open social conflicts are not frequent in countries in transition. This is surprising given the scale of the redistribution of resources and the increase in inequality. It is argued here that this is the consequence of the dominance of allocative over the distributive justice in post-socialist transitions. In the future and especially due to the integration with the European Union it can be expected that issues of social, distributive, justice will become more prominent.*

Apstrakt: *Otvoreni socijalni konflikti nisu česti u zemljama u tranziciji. Ovo je iznenađujuće kad se ima u vidu nivo redistribucije resursa i porast nejednakosti. Ovdje ćemo tvrditi da je to posljedica dominacije alokativne nad distributivnom pravdom u zemljama post-socijalističke tranzicije. U budućnosti, a posebno zbog integracija u Evropsku Uniju, može se očekivati da pitanje socijalne, distributivne pravde postane istaknutiji.*

Key words: *Transition Economies, Institutional Reform, Justice, Development.*

Ključne reči: *privrede u tranziciji, institucionalne reforme, pravednost, razvoj.*

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Introduction

Social conflicts are not particularly characteristic for transition economies. At least not the open ones, e.g., mass strikes, demonstrations, riots or massive economic disruptions. This observation¹ leads to the hypothesis that issues of allocation may dominate those of distribution in post-communist transitions.

¹ I am not aware of a comprehensive study of social conflicts in countries in transition. But I have not done any thorough research of the literature so my observation is just that, an observation. Social conflicts should be distinguished from severe political ones, see Gligorov (1994). It may also be observed here that pre-transition, socialist or communist, economy and society were characterized by deep conflicts and pervasive repression that periodically incited mass expressions of dissent, though it is often assumed nowadays that those were rather harmonious albeit quite inefficient economies and societies. In other words, it seems to be believed still that they traded efficiency for social equality.

European integration, however, does present post-transitional economies with a dilemma when it comes to the institutionalization of the system of social justice. The issues of social justice and fairness will in time emerge as important for other reasons too.

Distribution vs. Allocation

Not all problems of development and institutional reform are the same. There are at least three ways to approach them.²

1. One is perhaps the typical problem of development. It can be seen as being characterized by *multiple equilibria*. There is an underdeveloped equilibrium and the growth equilibrium. Those may or may not be Pare-

² Elementary clarification of concepts used in this paper can be found in appendix I.

³ For an overview see Hoff (2000). For poverty traps see Azariadis (2004).

to-ranked. The problem of moving from one to another is not essentially connected with the issue of social justice or with that of equity of the distribution of expected benefits. Typical problems with the take-off of an underdeveloped economy are often connected with the lack of institutions, with the low level of skills and with wrong policies, that is with the problems of allocation rather than with sharp and prevailing distributional conflicts.³

The ideal-type case is that of two equilibria, a stagnant and a growth equilibrium, which are Pareto-ranked, that is everybody is not worse off and some (perhaps most) are better off in the growth equilibrium than in the stagnant one, but the latter is an equilibrium, i.e., there are no internal reasons or mechanisms to move out of it and switch to the growth equilibrium. Theoretically, this kind of a developmental problem can exist due to some kind of coordination, institutional or policy failure even if growth equilibrium is not just more efficient but is also fairer, more just or more equitable.

Here perhaps it makes sense to comment on the difference between two widely used concepts of fairness, those of the distribution of opportunities and of capabilities. The problem of just distribution takes resources or outcomes to be determined by the influence of nature (i.e., circumstances), society (i.e., institutions) and individual choice and effort.

If it is assumed that people or individuals

(i) have capabilities that can be fully revealed or articulated in proper or fair social institutions (e.g., in free institutions),

(ii) can be compensated (procedurally or in kind) for natural differences in capabilities, and that

(iii) there are reward mechanisms that connect efforts and outcomes justly,⁴

then policies that open up opportunities⁵ to everybody are all that is needed, the responsibility for the outcomes is the matter of individual choice.⁶ This is the approach of equality of opportunities and it fits well with the idea that the problem of development is that of solving coordination or other institutional and policy failures.

Equality of opportunity thesis: If opportunities are opened up to all, i.e., are freely available on equal terms, a society will move to the Pareto-superior or growth equilibrium.

If, however, it is assumed that these circumstances of fairness and equal opportunities exist, there will still exist the problem of the development of capabilities. Those are indeed, in the most fundamental sense, determined by nature, society and individual choice. Assuming that there are circumstances of equal opportunities in a society, that still may not be enough for the development of capabilities, which is the problem usually addressed by development and growth economics. There could be multiple equilibria, that is an equilibrium of equal opportunities at each level of development of capabilities.

Capabilities thesis: Opportunities do not necessarily develop capabilities.

The capability approach can be seen as not being concerned so much with such outcomes as welfare, utility or even equality. It may also not be concerned primarily with procedural justice, as is the case with the idea of equality of opportunity. It is mainly concerned with the ancient idea of having a life worth living that is based on a specific conception or anthropology of human beings. In that sense, it is a version of outcome justice: the outcome being the truly human being.

2. The other type of the problem of development is often to be found in some developing countries – i.e., in countries that are moving towards the growth equilibrium – and has been extensively studied in for instance the case of Latin America. On the development path there is a set of social alternatives which are neither equilibria nor are Pareto-ranked. This may be because every alternative is characterized with a certain level of social injustice and thus produces or sustains social

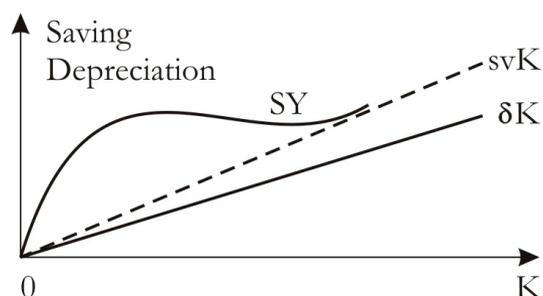
4 For instance in the Aristotelian sense that rewards are proportionate to efforts (“equals should be treated equally and those that are unequal should be treated unequally”).

5 To call them equal in this context is almost tautological.

6 This implies compatibilism, i.e., that determinism and free will are compatible. More on that see Risse (2002).

conflicts. In those circumstances, the issue of equity or social justice may be central to the whole process of development. In terms of opportunities and capabilities, it is the case where the lack of opportunities curtails the development or sheer use of capabilities.

Figure 1.



3. The third type is that which is perhaps characteristic of countries in transition. In the case of the post-communist transitions, the sensitivity to the issues of social justice or distributional equity are not all that pronounced because the starting point is one of inequity and is also not an equilibrium state of affairs. Thus, transition provides for the increase in efficiency and, in that sense, it is seen as a Pareto-improvement. Of course, there are winners and losers but their conflict of interest does not as a rule have the intensity of the social conflicts usually to be observed when the issue of equity in distribution is predominantly at stake.

Thus, post-communist transition is a move from a state of social injustice to a state of increased efficiency: the increase in efficiency (allocative justice) by itself may be seen as leading to an improvement in social justice.

In that sense, it may be the case that in post-communist transitions issues of allocation dominate those of distribution or, to put it differently, allocative justice solves some problems of distributional justice and does not, at least initially, open up the usual issues of distributional justice.

Justice and Conflict

The above typology assumes certain things about justice, fairness or equity. For instance, in the case of multiple equilibria, each of these equilibria may be just, though the concept of justice may differ from one equilibrium to another. For instance, traditional social system may not be based on any notion of social justice and especially not on that of equality of opportunity while the growth equilibrium may increase the importance of justice in distribution. The possibility that ideas of what is equitable may differ leads to the existence of at least three types of social conflicts over social justice.⁷

1. One is between what could be called the communal idea of justice, both in terms of allocation and of distribution, and an emerging conception of social justice. This was the theme studied extensively in the early sociological literature, where custom was contrasted to contract as the source of just allocation and distribution, and has been revived in a certain sense with the reintroduction of the concept of social capital.⁸

2. The other is between the conception of equity or social justice that is accepted by the society and the performance of the actual institutions that determine the distribution in a society. In that sense, it can be argued that the institutions of that society may lack legitimacy. Clearly, communist states lacked legitimacy in that sense: the predominant conception of justice went against the principles on which the main institutions of the communist societies were based. Similarly, the social conflicts that characterize typical distributional problems in developing countries can be of this kind. There may exist a widespread conception of social justice that may not be embedded in the existing social institutions. Thus, social norms may conflict with the norms on which formal institutions are based. As it is sometimes put, informal norms may conflict with the formal ones or, in other words, morals may conflict with institutions.

⁷ On conflicts over justice see Hampshire (2000).

⁸ More on this concept in appendix II.

Here, there are several cases that may be of interest. One is that of social resentment due to the belief that institutions are not just. Here the Aristotelian idea that it is not necessary to know what is just to recognize injustice is important.⁹ The very removal of injustice, e.g., through liberalization or increase of freedom, may be seen, at least temporarily, as an increase in social justice. The other may in fact follow from the former one: the new state may be seen as unjust too, so that there is a move from one unjust to another unjust state of social affairs. Finally, there may exist a tyranny of social justice that may be seen as being inimical to individual freedom. In the latter case, the very increase in freedom or liberty may be seen as leading to the increase of social justice.

There are then the following possibilities:

A. A take off from a state of no-social justice to socially just or unjust institutional set up.

B. A removal of the cause or causes of social injustice.

C. A move from one socially unjust distribution to another socially unjust distribution.

D. A change from socially unjust to socially just set of institutions.

The canonical case is the increase of social justice by the simple that of the rejection of social injustice. The classical case of sociology of modernization is that of traditional communities with no sense of social justice transiting to societies with or without just institutions. The case of one unjust state of affairs following another one is perhaps characteristic of states in prolonged social crisis. The last is the case that corresponds to the Whig theory of history as persistent growth of liberty.

3. A different type of a social conflict over just distribution is when the ideas of what is just or equitable differ or change during the process of development. For instance, the concept of equity based on the equality of re-

sources may conflict with the conception that stresses the equality of opportunity.¹⁰ The latter may be interpreted as a version of negative freedom while the prevailing conception may be that of positive freedom. In other words, along the path of development and indeed along the path of social progress in general, a choice between different conceptions of equity or social justice may have to be made.

Thus, there are at least three types of social conflicts centered around the issues of equity. One is between communal and social justice. The other is between the prevailing social idea of equity with the performance of the existing social institutions; this is the conflict over legitimacy. The third is between the existing and the emerging conceptions of social justice; this is the conflict over the appropriate institutionalization of one or the other conceptions of social justice.

In the case of post-communist countries, the initial conflict was the one over the legitimacy of communist institutions. The new, emerging conflict may be, for instance, between the meritocratic conception of justice and the one based on social equality.¹¹ The former may be that of equality of opportunity and it may conflict with the belief in the inherent worth of equality of resources.

In general, the idea that equality of opportunity is the proper conception of social justice, even if it can be defined unambiguously, can always be contested because it does not or cannot adequately take into account the two other factors that can influence the justness of a distribution.

The first is that of luck or other external influences. The other is that of the very possibility to reward efforts justly in such a way that the rewards are proportionate to the individual effort, i.e., there is a question whether individual contributions can be measured properly. The former is the problem of the influence of nature that makes for equal treat-

⁹ Aristotle could be credited with the idea, that may not be explicit in his writings, that everybody knows what injustice is even if nobody knows what justice is. Rawls argued that there is no moral value to differences in ability that are the product of the natural lottery.

¹⁰ The notion of equality of opportunity has to be made very precise if it is not to remind of the famous line in Orwell's *Animal Farm* that "everybody is equal, only some are more equal than the others." Whether that is at all possible is an open question.

¹¹ On that see Alesina and Angeletos (2004a and b).

ment of those who are unequal. That can be seen as unjust. The latter is the issue of how the product of a common effort can be divided according to individual contributions. In general, that is not really possible. These two problems may explain the fact that equality, in the sense of equality of resources or income, has such an important role in most every conception of equity or fairness.

Transitional Justice

The lack of significant social conflicts in transition is that much more remarkable because of the steep initial decline of production, sharp rise of unemployment, significant increase in inequality, the restructuring of public obligations, and a comprehensive redistribution of resources. The initial decline of overall welfare and the increase of poverty are also well documented though there has been some debate about the figures due to the reliability and inadequacy of the official statistics. In any case, there is no doubt that a very significant redistribution has taken place during transition.¹²

As argued above, one reason for the lack of significant social conflicts is that of allocative justice. After the initial contraction, the industrial production and the GDP have been growing in many transitional economies at a relatively high level. Also, wages and other incomes have grown steadily. Social security payments have also remained significant and the overall public sector has remained quite large especially if compared with other countries on a similar level of development.¹³

In addition, political and social changes have increased the overall freedom and have had three important consequences from the point of view of social justice:

1. Political equality has increased. This may not be so important in authoritarian or

dictatorial regimes, but in a communist regime economic inequality is dependent on political inequality. Therefore, the introduction of political freedoms and of democratic rules bring significant increases in equality.

2. Increase in individual freedom. Again, in the case of communist states, the system was designed to work against the rule of law. Therefore, the increase in individual freedom and in the possibility of social association together with the commitment to rule of law have increased the feeling of social justice.

3. Increase in political power of the citizens. Finally, as can be seen from the frequent changes in government, the power of the citizens has increased, which again has an effect of the increase in social justice.

Here a more general point may be in order. It is increasingly being argued that democracy is less important than the rule of law for growth and development. More specifically, political equality is less important than the protection of private property. This is not true for post-communist transitions in Europe. Communist states lacked both political equality and rule of law (in fact were inimical to them both). Therefore, authoritarian implementation of the rule of law, in the restricted sense of the protection of private property, lacked any legitimacy. Democratization has proved to be the necessary condition for the introduction and strengthening of the rule of law and for the legitimization of the redistribution of resources and of the increase in inequality.

In other words, the increase of political liberty was a substitute for social conflicts over just distribution of resources. In cases in which this did not happen, violent political conflicts as well as significant social conflicts could be observed.

Democracy is not without distributional consequences, however. Two stylized facts could be of some interest here.

One is that the public sector is quite large in most European economies in transition and the structure of public expenditures indicates that the issues of equity are relevant in transition. In general, public expenditures as a percentage of GDP are higher than in other

¹² For some evidence on the rise in inequality see Milanovic (1998). For evidence on employment and unemployment across countries and social groups see appendix III.

¹³ On some discussion of these issues see Gligorov (2000).

countries on the similar level of development. Also, transfers and subsidies are significant. Finally, public employment is also quite high.

The other is that changes in the government are frequent, which perhaps indicates that social dissatisfaction is channeled politically rather than through social conflicts such as strikes or demonstrations. Indeed, in a number of cases, an increase in unemployment has given rise to the change in government. Thus, issues of social justice are important.

In early discussions about post-communist transition it was assumed that issues of social justice will be important in transition because of the high level of social equality and because of the increased awareness of the problems with distribution that the process of privatization will bring. Also, and perhaps most importantly, it was feared that the liberalization of the labor markets and the increase of unemployment will threaten the whole process of transition. These assumptions turned out to be mostly wrong. Though privatization produced as many scandals as it was expected it would do, the whole process proved sustainable and indeed had proceeded with remarkable speed. The issues of justice in privatization have played some role, but not as much as was expected.¹⁴ Also, increased unemployment was an important political issue, as already stated, but did not lead to sharp social conflicts, in any case such that would put at risk the newly emerging political and economic institutions.

The reasons for these developments are perhaps to be found also in the lack of institutions for social conflict and in the fact that communist institutions were not believed to be fair too. There is a difference between equality and fairness in this respect. Social equality may be desirable but the actual institutions that deliver it may not be deemed to be fair. For instance, if prices are repressed and there are shortages then the increased equality that rationing may bring may not be seen as fair because of the way queues are administered and because of the incentives for corruption

that they bring in. Liberalizing prices in that case may increase the inequality, but the resulting distribution may be considered to be fairer.

Liberalization of prices in general may have the same effect. Even in the case of the labor market, liberalization may be seen as leading to a fairer distribution of jobs though the rate of unemployment may increase significantly. To see how this may work a simple conceptual analysis may be helpful. Let us assume that there is no unemployment in a communist economy, but significant amount of employment is involuntary. Let us also assume that in a transition economy there is in addition involuntary unemployment. The prevailing judgment of the relative fairness of the labor situation before and after transition will not depend just on the rate of unemployment and not even just on the rate of involuntary unemployment but on the relative rate of voluntary vs. involuntary employment and the share of those who were involuntarily employed becoming involuntarily unemployed (and of whether they prefer one over the other). In case the distribution of jobs was not very voluntary in a particular communist economy and the number of formerly involuntarily employed people becoming involuntarily unemployed in the transition economy being smaller, then the increased unemployment and the increased income inequality may not be seen as less fair but in fact as an increase in social fairness.

Fairness is not necessarily social justice, though. If the unemployment is structural, the perception may change in time, because the point of reference will change too. Similarly, the perception of increased social inequality being fair may change in the absence of other reasons to justify them. It will then become important what conception of social justice a society may come to accept.

Merit and Luck

It has been argued by a number of authors, most recently by Alesina and Angeletos, that the conception of social justice in Europe is different from the one to be found in the USA. In

¹⁴ For an early assessment see Gligorov (1992).

the former, social justice is needed to correct for the influence of luck, nepotism and corruption, while in the latter it is believed that the institutions screen people fairly and award them on their merits. That may explain the fact that welfare state is much larger in Europe than in the USA.

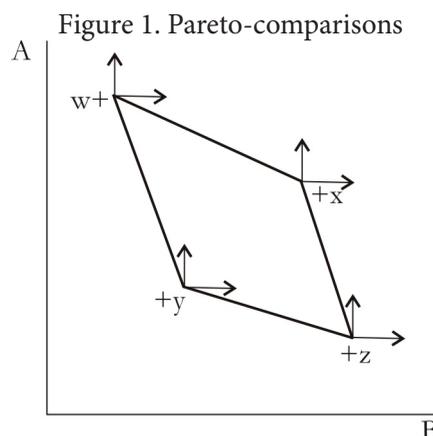
In the case of the countries in transition the meritocratic conception of justice may be initially prevalent, but it may eventually change in line with the dominant conception of justice in the European Union. As a consequence, social conflicts may become more important with the integration of the countries in transition into the European Union.¹⁵ The case of former Eastern Germany may provide a good example. Unlike most other European post-socialist countries in transition, where meritocratic justice was emphasized through processes of liberalization and privatization, in former Eastern Germany a version of equality of opportunity and also of income was adopted with huge transfers flowing from the West to the East. This was perceived as neither just nor fair. It also proved not to be efficient.

Similar problems, though on a smaller scale, may appear with the transition countries joining the European Union. Issues of distributive justice may become more important than those of allocation of effort and income according to merit. That may not lead to the level of dissatisfaction with integration to be observed in Germany because there is no place from where transfers could flow. That, however, may prove to be a problem for the stability of the enlarged European Union precisely because of the frustration with low amounts of social and other transfers that should highlight the significance of social justice, equality of opportunity and the insignificance of historical legacies for the capabilities, opportunities and welfare of individual citizens.

Appendix I: Pareto-Choices

It may be useful to illustrate the various Pareto-concepts that are relied on in this pa-

per and some of the most common problems that they may give rise to. The following figure can be useful for that. A and B are two actors (persons, families or other social groups and social actors, firms, parties, states, international organizations). They are to choose from four social alternatives: w, x, y and z. It is assumed that they rank these alternatives though not necessarily in terms of welfare. They can be valued to be "better than" or "more useful than" or "larger than" or whatever is the criterion of comparison. It is also assumed that these alternatives are social in the sense that they can be realized only if both actors act (refraining from action being considered as an action too). The actors do not have to cooperate, however; they can conflict too. Thus, they may produce, trade, contract, fight or engage in just about every possible social relationship.



Four alternatives are considered, though three are enough to illustrate the problems of Pareto-comparisons and -choices. This is not really restrictive. Given the social character of the problem, it is natural to assume that two individual rankings will give at least four social possibilities: a *status quo*, a social improvement and two points at which one actor is better off and the other is worse off. These four social states can be characterized in Pareto-terms and in terms of the equilibrium in the following way:

Pareto-optimal states: w and z. This is because a move from either one of them to any other three would make one actor better off

¹⁵ More on that in Gligorov (2004).

and the other worse off. A state is Pareto-optimal if there is no alternative state in which at least one of the actors is better off and none is worse off.

Pareto-inferior state: y. Because y is worse than x for both actors.

Pareto-superior state: x. Because x is better than y for both actors.

Equilibrium: w, z and y. The former two because the move to some other state is not acceptable to one of the actors. The most interesting is the state y because it can be an equilibrium even though it is a Pareto-inferior state. To see this, the preferences of the actors A and B should be spelled out. Assuming that they prefer more to less, P standing for preference, they will rank the four alternatives in the following way:

$$\begin{aligned} \text{A: } & wPxPyPz \\ \text{B: } & zPxPyPw. \end{aligned}$$

Which gives the structure of preferences characteristic of the prisoners' dilemma.

Table 1. Prisoners' Dilemma

		Actor A	
		Cooperate	Not-cooperate
Actor B	Cooperate	x	w
	Not-cooperate	z	y

If the two actors are to choose from the four alternatives, they will – in accordance with the argument for the non-cooperative outcome in the prisoners' dilemma – choose y . This they will do even if they initially find themselves at x . Thus, the Pareto-inferior social state is an equilibrium. Which then leads to the following characterization of x :

Disequilibrium: x. Though x is Pareto-superior to y and thus the move from y to x is a Pareto-improvement, x is not an equilibrium state of affairs.

The reasoning is that at y both actors will prefer w or z to x and would not agree to forgo the possibility of reaching their best choice in order to settle for the second best. As they

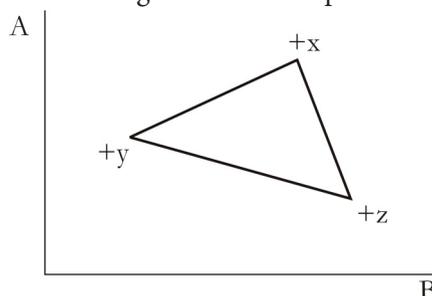
cannot reach an agreement, they will settle for y . The same reasoning will destabilize x . Attempting to reach their best choices, the two actors may not agree to stay at x but move to y .

In terms of this classification, it could be argued that a reform move from y to x is equal to a **miracle**; the move from y to either w or z is the **canonical case** of development and may be free of social conflicts if compensations can be found for the losing actor; and a movement from x to y is akin to a **disaster**. A move from w to z or *vice versa* is characteristic of social conflicts with significant equity problems.

It is interesting to note that within a prisoners' dilemma there is an Arrow-problem. If either w or z are removed, three alternatives are left that are ranked, if it is assumed that w is removed, as follows:

$$\begin{aligned} \text{A: } & xPyPz \\ \text{B: } & zPxPy. \end{aligned}$$

Figure 2. Arrow triple



Agreement which is not dictatorial is impossible because though both agree that x is to be preferred to y , they do not agree on any of the other choices. Indeed, if they were to rank the alternatives, they will end up with the social ranking that reflects only the individual ranking of one or the other of the actors, but not with a common ranking. Thus, again, the Pareto-superior choice cannot, in general, be made.

Both configurations of preferences, those of the Prisoners' Dilemma and of the Arrow paradox, are at the heart of the famous Sen's Pareto-liberal paradox, which is at the foundation of his stress on capabilities rather than on opportunities.¹⁶ This can be seen easily. In

¹⁶ The connection between the two is emphasized in Pettit (2001). See also List (2004). For a recent detailed criticism of Sen's capability approach see Pogge (2004). For a different capability approach see Nussbaum (2003).

the case of Arrow preferences, if one person is given a right to determine a certain social outcome, the same right cannot be given to another person because there is room only for a dictatorial solution and only one person can have all the rights with nobody else having any right at all. Thus equality of opportunity understood as equal rights makes no sense within the theory of social choice. Equally, if individual rights are granted to two people facing a Prisoners' Dilemma they will end up choosing an outcome that is Pareto-inferior; indeed, the distribution of preferences in the canonical case of Sen's paradox is that of the Prisoners' Dilemma. Indeed, Sen's paradox as most other problems with the principles of justice are just interpretations of difficulties with social coordination and aggregation of preferences well known from game theory and the theory of social choice. Sen's paradox is particularly useful because it flashes out the conflict between liberty and welfare that is crucial for development as he has shown.

Appendix II: Institutions, Social Capital and Path-Dependence

Institutions are now mostly defined as "rules of the game" or less precisely as "the way things are done". This procedural definition is only a part of what is needed for an instrumental definition. Instrumental rationality, generally characterized as:

If y is to be achieved, x should be done, requires the specification of the goals in order for procedures, for instance, to be meaningful. This is perhaps easier to see within the interactive setting of game theory both because the "rules of the game" definition comes from there and because it is inherently social relying as it does on inter-dependencies.

In that context, it is easy to see that the idea of institutions being rules of the game does not mean all that much because the rules do not by themselves define the game. At least the specification of the pay-off structure is necessary to have an idea of at least the game-form that is being considered. That is why some argue that a meta-game should be

specified and then various institutions should be seen as strategies chosen by social actors to play their particular games. Of course, the specification of this meta-game is not an altogether straightforward task. Most that have been proposed beg the question of where does that meta-game come from and if it is to be chosen by the players then that choice would have to be made within a meta-meta-game and so on *ad infinitum*. There are other problems with this game-theoretic definition of institutions that come from general problems that game theory faces. Particularly important is that of multiple equilibria which is often what is being meant when cultures and institutions are being mentioned.

It is argued in the literature on social capital that culture could serve as a vehicle to move from a particularistic to generalized trust.¹⁷ This begs a number of questions, one being that of how society is constructed. Here, very often the traditional sociological distinction between community and society is relied on. The former being based on the culture of collectivism and the other on the culture of individualism. However, the traditional literature highlighted the role of the legal norms in the creation of society while trust played a more important role in communities. In that context, the notion of social capital may be a way to bridge the gap between the communities and the wider society, in a sense constructing social bonds from communal ones. Thus, social trust somehow emerges from people bowling together or from similar activities in local communities.

It is not clear how useful the idea of social capital really is if it is conceptualized in this way. These communal and societal bonds may complement each other, but they may also be substitutes for each other. In other words, it may be the case that the weakness of social bonds leads to the increased importance of communal trust. Thus, it may not be the case that strong communities support strong societies but they may be the sign that societies in which they are to be found are in fact weak.

¹⁷ On this and on social capital in general see Duraluf and Fauchamps (2004) and Fauchamps (2002). For the history of the concept see Farr (2004).

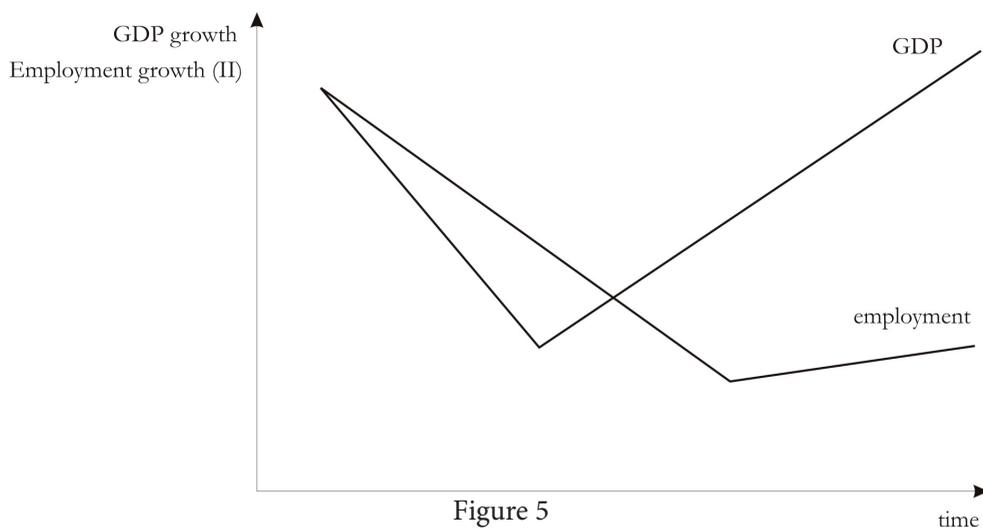


Figure 5

In the game-theoretic context, it may not be rational to trust or build up the reputation to being trustful because trust and trustfulness may introduce incentives to cheat. This is why the supply of trust is almost always dependent on (i) interest in the outcome, (ii) one or the other type of collateral, and (iii) on the effectiveness of enforcement. Thus, apart from interest, two key issues are the availability of collateral and the supply of enforcement. Without going into these issues, the point to be made here is that trust is very much endogenous to other economic and social factors.¹⁸

Less demanding and easier to conceptualize is the idea of institutional inertia or path-dependence. It relies on the problem that the fixed cost may present for investing in a change or a reform. An established institution has an advantage over an alternative institution because the costs of the maintenance of the former may be much lower than those needed to introduce the latter. There is an element of a public good in an institution. Thus, there could be an undersupply of new institutions. Thus, the idea of the institutional inertia supports the activist role of the state in reforms and transitions.

Appendix III: Optimal speed of transition and inequality

The literature on transition is almost devoid of considerations of issues of equity and inequality. The general model looks at the speed of reallocation of assets and labor from

the state to the private sector and to the attendant fiscal problems both on the revenue and on the expenditure sides. It models the speed of transition as the optimal combination of, on one side, job destruction in the state sector and job creation in the private sector and, on the other side, the increase in expenditures on unemployment benefits and the increase of the tax burden. A particularly simple version looks at the level of employment as a function of the sustainability of the fiscal balance. Assume that

$$E = E_s + E_p \quad (1)$$

that is, total employment, E , is a sum of state, E_s , and private employment, E_p (there is also informal employment that is put aside here). Assuming that s is the rate of job destruction (or the number of jobs lost) in the state sector and p is the rate of job creation (or the number of jobs gained) in the private sector, the rate of unemployment or the number of staying unemployed, u , is equal to the difference in this two rates or numbers, that is:

$$u = p - s. \quad (2)$$

Unemployed receive benefits, U_b , that are covered by taxes, t , that fall on labor. In the simplest case, the budget consists of unemployment benefits only or, more realistically, the change in the amount of public expenditures reflects the

change in unemployment benefits, b , which reflect the speed of labor shading, s . That is

$$s = b = t. \quad (3)$$

By choosing the tax rate, government determines s and to that extent the rate of unemployment. With given private employment, low tax rate leads to low unemployment benefits and thus to a low speed of transition from state to private sectors. The expansion of the private sector depends also on its higher productivity. Lower taxes mean lower wages and thus faster expansion of the private sector. That increases the speed of transition and dampens the rate of unemployment.

If unemployment benefits are low, so are wages and thus profits are higher, transition is faster and unemployment is lower, but inequality between those employed in the state and private sectors increases. Thus, faster transition implies greater inequality. Summing up, it is to be expected that faster growth through higher productivity, lower unemployment and lower taxes devoted to subsidies and unemployment benefits will lead to greater inequality.

Growth of productivity is the easiest to document. Initially, in most cases, employment does not decline as fast as the GDP and thus productivity declines even more than GDP. Later on, productivity and GDP growth go hand in hand, while employment growth comes with a lag.

Inequality has increased significantly, though in some countries more than in the others, as the theory would predict. In table 1 the GINI coefficients and other simple indicators of inequality are shown for selected countries at the turn of the 21st century. The GINI coefficients were as a rule below 25 and often closer to 20 (for instance 21 in Hungary before 1989). In some cases, the increase in inequality is particularly high (e.g., Estonia, Russia, Bulgaria, Croatia).¹⁸ Most of the cases in which inequality has increase are countries

that have seen quite fast transition. In some cases, these are countries that have gone through a serious crisis, which have lead to the decline of public revenues and thus to the decline in unemployment and other benefits. In some cases, the increase of inequality is the consequence of the way the state assets were privatized. Interesting cases are Russia, where inequality has increased quite dramatically as a consequence of the series of crisis and of the method of privatization, Bulgaria where crisis has played the key role in the steep increase in inequality, Hungary where wages and benefits were reduced significantly in the reform in mid-nineties and Croatia where the key role was played by privatization. In countries with high unemployment rates, inequality is not particularly higher than in those with lower unemployment rates. In some case, this is the consequence of the more generous unemployment and other social benefits. Thus, the limited evidence on the inequality in transition seems to indicate that the predictions that can be based on the speed of transition literature is correct: higher benefits are connected with more unemployment, slower transition and lower social inequality.

The development of the public sector is much more difficult to analyze. Stylized facts may perhaps be summarized as follows: public expenditures are rather high, as a share of GDP, but are declining; budget deficits are significant, but public debt (as a share of GDP) is mostly stagnating due to high growth rates; expenditures on wages and salaries have decreased significantly, though data is not very reliable; expenditures on subsidies vary across countries, but are low by most standards; expenditures on health and education have declined: finally, expenditures on pensions and other dependent persons have declined quite significantly. Investments tend to be significant because of the need to upgrade the infrastructure in the wide sense of that term. Overall, in most cases, the state sector is still quite large.

18 More details in Milanovic (1998).

Table 1. Indicators of inequality from Human Development Report, 2004

	Gini	Top 20%/bottom20%	Top 10%/bottom 10%
Albania	28,20	4.1 times	5.9 times
B&H	26,20	3.8 times	5.4 times
Bulgaria	31,90	5.8 times	9.5 times
Croatia	29,00	4.8 times	7.3 times
Macedonia	28,20	4.4 times	6.8 times
Romania	30,30	4.7 times	7.2 times
Slovenia	28,40	3.9 times	5.9 times
Czech Republic	25,40	3.5 times	5.2 times
Poland	31,60	5.8 times	9.3 times
Hungary	24,40	4.9 times	8.9 times
Slovakia	25,80	4 times	6.7 times
Lithuania	31,9	5.1 times	7.9 times
Latvia	32,40	5.3 times	8.9 times
Estonia	37,20	7.2 times	14.9 times
Russia	45,60	10.5 times	20.3 times
Ukraine	30,30	4.3 times	6.4 times
Turkey	40,00	7.7 times	13.3 times

Note: VAD = value added; NMS = new member states; Czech Republic (CZ), Hungary (HU), Poland (PL), Slovakia (SK), Slovenia (SL), Estonia (EE), Latvia (LV), Lithuania (LT), Bulgaria (BU), Romania (RO).

Source: WIIW.

Appendix III: Some Statistics

After the initial transitional recession, the growth in transition economies was driven by increases in productivity. Figures 3 and 4 illustrate that for the NMS (New Member States) and separately for Bulgaria and Romania where the same process emerges somewhat belatedly. The decrease of employment and increase of unemployment is certainly one indicator of increased inequality.

Figure 3

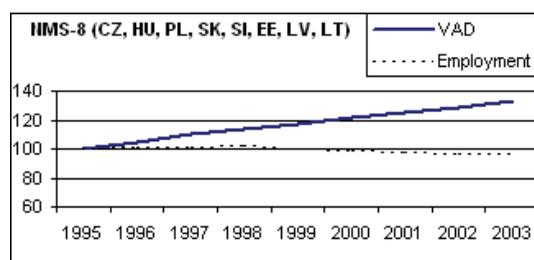
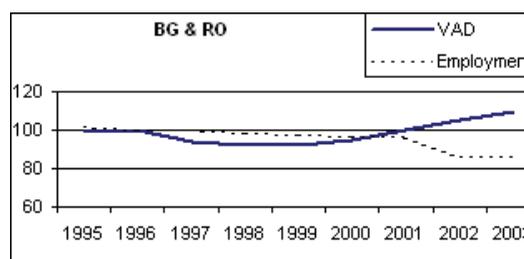


Figure 4



In addition, adverse development in employment have been more pronounced among women, the young and those who have been out of work for a longer period of time. Tables 2-6 illustrate that. Countries have performed differently in different periods, but most of them do not differ very much in their political performance or in the level of social conflicts.

Table 2. Employment rates in new EU member states/candidate countries, LFS
(employed in % of working age population 15-64)

	1996	1997	1998	1999	2000	2001	2002	2003
Czech Republic	69,3	68,7	67,3	65,6	65,0	65,0	65,4	64,7
Hungary	52,1	52,2	53,7	55,6	56,3	56,2	56,2	57,0
Poland	58,4	58,9	59,0	57,6	55,0	53,4	51,5	51,2
Slovakia	61,9	60,8	60,6	58,1	56,8	56,8	56,8	57,7
Slovenia	61,6	62,6	62,9	62,2	62,8	63,8	63,4	62,5
Bulgaria	54,0	54,1	53,7	51,2	50,4	49,7	50,6	52,5
Romania	65,5	65,4	64,2	63,2	63,0	62,4	57,6	57,6
Estonia	64,9	65,4	64,6	61,5	60,4	61,0	62,0	62,9
Latvia	57,1	59,8	59,9	58,8	57,5	58,6	60,4	61,8
Lithuania	60,3	62,6	62,3	61,7	59,1	57,5	59,9	61,1
EU(15)	60,3	60,7	61,4	62,5	63,4	64,1	64,2	64,3
EU(25)	.	60,6	61,2	61,9	62,4	62,8	62,8	62,9

Source: WIIW.

Note: LFS = labor force survey.

Table 3. Employment rates in the NMS/candidate countries by gender, LFS
(employed in % of working age population 15-64)

Male								
	1996	1997	1998	1999	2000	2001	2002	2003
Czech Republic	78,1	77,4	76,0	74,0	73,2	73,2	73,9	73,1
Hungary	59,5	59,7	60,5	62,4	63,1	62,9	62,9	63,5
Poland	65,2	66,8	66,5	64,2	61,2	59,2	56,9	56,5
Slovakia	69,2	67,7	67,8	64,3	62,2	62,0	62,4	63,3
Slovenia	66,0	67,0	67,2	66,5	67,2	68,6	68,2	67,4
Bulgaria	57,7	58,0	57,5	55,1	54,7	52,7	53,7	56,0
Romania	72,6	71,9	70,4	69,0	68,6	67,8	63,6	63,8
Estonia	69,8	70,7	69,6	65,8	64,3	65,0	66,5	67,2
Latvia	62,3	64,9	65,1	64,1	61,5	67,9	64,3	66,1
Lithuania	.	68,4	66,2	64,3	60,5	58,9	62,7	64,0
EU(15)	70,4	70,7	71,2	72,0	72,8	73,1	72,8	72,5
EU(25)	.	70,2	70,6	70,9	71,3	71,3	71,0	70,8
Female								
	1996	1997	1998	1999	2000	2001	2002	2003
Czech Republic	60,6	59,9	58,7	57,4	56,9	57,0	56,3	56,3
Hungary	45,2	45,4	47,2	49,0	49,7	49,8	49,8	50,9
Poland	51,8	51,3	51,7	51,2	48,9	47,7	46,2	46,0
Slovakia	54,6	54,0	53,5	52,1	51,5	51,8	51,4	52,2
Slovenia	57,1	58,0	58,6	57,7	58,4	58,8	58,6	57,6
Bulgaria	50,4	50,3	49,9	47,5	46,3	46,8	47,5	49,0
Romania	58,4	59,1	58,2	57,5	57,5	57,1	51,8	51,5
Estonia	60,2	60,4	60,3	57,8	56,9	57,4	57,9	59,0
Latvia	52,4	55,0	55,1	53,9	53,8	55,7	56,8	57,9
Lithuania	.	57,2	58,6	59,4	57,7	56,2	57,2	58,4
EU(15)	50,2	50,8	51,6	52,9	54,1	55,0	55,6	56,0
EU(25)	.	51,1	51,8	52,9	53,6	54,3	54,7	55,0

Source: EUROSTAT; WIIW incorporating national LFS

Note: NMS = new member states; LFS = labor force survey.

Table 4. Youth employment rates in the NMS/CC
(% of population aged 15-24)

Total						
	1997	1998	1999	2000	2001	2002
Czech Republic	.	41,5	38,3	36,4	34,3	32,3
Hungary	29,6	33,9	34,9	33,5	31,8	30,1
Poland	28,9	28,5	26,6	25,3	24,0	21,7
Slovakia	.	35,0	31,0	29,0	27,7	27,0
Slovenia	40,4	37,5	34,3	32,8	30,5	30,6
Bulgaria	.	.	.	19,7	19,7	19,4
Romania	36,5	35,5	33,7	33,1	32,6	28,7
Estonia	.	35,5	30,0	28,3	28,1	28,2
Latvia	.	33,3	32,3	29,6	28,8	31,0
Lithuania	.	34,0	32,5	26,5	22,9	23,8
EU(15)	37,2	38,2	39,4	40,4	40,8	40,6
EU(25)	36,4	37,1	37,6	38,0	38,1	37,6
Male						
	1997	1998	1999	2000	2001	2002
Czech Republic	.	47,3	42,3	39,3	37,2	35,3
Hungary	33,4	37,6	38,5	37,3	35,7	32,9
Poland	33,9	32,7	30,5	28,3	26,6	24,2
Slovakia	.	38,0	32,9	29,8	28,9	28,7
Slovenia	44,2	39,5	36,3	35,7	34,1	34,4
Bulgaria	.	.	.	21,8	20,0	20,4
Romania	40,4	39,4	37	32,8	35,2	31,4
Estonia	.	40,0	34,9	32,6	33,9	34,6
Latvia	.	37,7	36,9	34,7	32,8	36,4
Lithuania	.	39,7	36,8	29,6	25,2	27,1
EU(15)	40,8	41,8	42,9	43,9	44,2	43,7
EU(25)	40,3	40,8	41,2	41,5	41,4	40,7
Female						
	1997	1998	1999	2000	2001	2002
Czech Republic	.	35,8	34,3	33,5	31,4	29,2
Hungary	25,8	30,2	31,2	29,7	27,8	27,3
Poland	24	24,3	22,8	22,2	21,5	19,3
Slovakia	.	32,1	29,0	28,2	26,5	25,3
Slovenia	36,4	35,4	32,4	29,7	26,8	26,5
Bulgaria	.	.	.	17,7	19,4	18,4
Romania	32,7	31,6	30,4	30,5	30	26,1
Estonia	.	32,0	26,0	24,0	21,9	21,6
Latvia	.	28,8	27,6	24,4	24,6	25,4
Lithuania	.	28,1	28	23,2	20,6	20,5
EU(15)	33,6	34,6	35,9	36,8	37,3	37,4
EU(25)	32,5	33,4	34,1	34,6	34,7	34,4

Source: WIIW

Note: NMS = new member states; CC = candidate countries.

Table 5. Youth unemployment* rates in NMS and SEES, LFS (in %)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Albania	.	.	.	.	.	.	.	.	.	.
Bosnia & Herzegovina	.	.	.	.	.	.	.	.	.	.
Croatia	.	.	26,9	28,4	30,9	36,5	38,4	41,5	35,5	35,9
Macedonia	.	.	69,5	74,2	70,9	62,9	59,9	56,1	58,4	65,7
Serbia & Montenegro	.	.	50,3	50,2	51,5	53,1	49,6	.	.	.
Czech Republic	8,7	7,8	7,2	8,6	12,4	17,0	17,0	16,6	16,0	17,6
Hungary	19,4	18,6	18,0	15,9	13,5	12,4	10,1	11,2	12,6	13,4
Poland	32,5	31,2	28,5	24,8	23,2	31,3	35,1	41,0	43,9	43
Slovakia	27,3	24,8	20,9	21,7	23,6	32,1	35,2	37,3	36,1	32,2
Slovenia	22,2	18,8	18,8	17,6	18,5	17,9	16,8	18,1	16,7	17,4
Bulgaria	44,9	37,7	33,5	34,8	32,2	34,0	35,3	39,5	36,5	28,3
Romania	22,5	20,6	20,2	18,0	18,4	18,9	18,6	17,5	21,7	18,5

Notes: *) 15 to 24 years.

Source: CANSTAT 2003/4, national LFS statistics.

Note: NMS = new member states; SEES = Southeast European states; LFS = labor force survey.

Table 6. Long-term unemployment in NMS and SEES, LFS
(More than 12 months, in % of total unemployed)

	1996	1997	1998	1999	2000	2001	2002	2003	2002	2003
Albania 12m+	76,0	84,0	89,0	90,2	89,6	91,8	93,1	92,6	93,1	92,6
Bosnia & Herzegovina	.	.	.	.	.	.	.	.	.	.
Croatia	41,1	44,2	44,7	49,2	52,1	55,9	54,8	53,4	54,8	53,4
Macedonia	80,7	83,2	82,9	83,8	83,3	86,9	84,5	85,1	84,5	85,1
Serbia & Montenegro	78,8	74,1	79,5	79,6	81,7	74,8	75,6	.	75,6	.
Montenegro	85,5	82,2	83,9	81,6	80,1	85,0	86,0		86,0	
Serbia	78,1	73,3	77,9	79,3	81,9	73,4	74,3		74,3	
Czech Republic	28,2	28,1	29,5	36,0	48,3	57,1	50,5	50,1	50,5	50,1
Hungary	48,3	43,8	41,6	44,6	44,0	41,8	40,1	34,7	40,1	34,7
Poland	39,1	37,9	37,5	32,9	37,9	43,1	49,9	49,5	49,9	49,5
Slovakia	51,6	50,3	50,7	46,9	53,9	57,9	60,0	64,4	60,0	64,4
Slovenia ¹⁾	52,2	56,7	57,7	57,7	62,4	61,9	57,7	56,5	57,7	56,5
Bulgaria ¹⁾	.	60,4	59,1	56,8	58,2	62,2	66,2	65,3	66,2	65,3
Romania ¹⁾	51,3	47,7	41,9	44,3	51,5	49,5	53,1	60,7	53,1	60,7

Notes: 1) More than 11 months.

Source: EUROSTAT, national LFS statistics for respective countries.

Note: NMS = new member states; SEES = Southeast European states; LFS = labor force survey.

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