



Journal of Economics and Business

Vol. V – 2002, No 1 (67 – 87)

Path – Dependence and Initial Conditions in the Transition Process: The Cases of Hungary and Romania

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Abstract

Thirteen years after the fall of the Berlin Wall, initial conditions in 1989-1990, especially the institutional legacy, appear to have been of crucial importance in the determination of ‘vicious’ or ‘virtuous’ national transition trajectories throughout the nineties. To illustrate both cases, the Hungarian and the Romanian paths of transformation are briefly analyzed. Hence this paper discusses the issue of path dependence and initial conditions in transitology and economics, as far as institutional and organizational change are concerned.

KEYWORDS: Transition, Path dependence, Institutions, EU integration, Hungary, Romania.

JEL classification : P2, P52, O49, B25.

Introduction

Thirteen years after the fall of the Berlin Wall, initial conditions in 1989-1990, appear to have been of crucial importance in the determination of 'vicious' or 'virtuous' national transition trajectories throughout the nineties. These starting conditions were themselves outcomes of former historical processes. Among them, the key role of institutions must be pointed out. Nowadays, to claim that 'institutions matter' is not indecent anymore. However this was not the case at the beginning of the nineties, when the prevailing transformation paradigm, in line with mainstream economics, underestimated the role of historical and institutional factors. In this context, it was not surprising that the first transition-cum-stabilization programs paid too little attention to the post-socialist institutional legacy.

It is often argued that the most successful transition economies are those where trade and price were quickly liberalized, where public spendings was rapidly cut and where privatization was speedily implemented. While at the reverse, the countries that are lagging behind are those where the governments were unable to follow the IMF policy, because of a lack of commitment to reform and policy discipline. However, as the UNECE [1999, p.7] underlines, 'the most successful reformers appear to be those where the initial conditions – in terms of both the required scale of restructuring and the institutional capacity to handle it – were most favorable to a faster rate of transition. In other words, governments that were able to implement – and their electorates were willing to tolerate – a faster rate of change than in other transition economies. But this means that the pace of reform is largely determined by the historical legacy and not only by the choice, or the 'political will', of post-socialist governments.' Historical legacy however, does not exclusively refer to the socialist period. Although the immediate past is generally more present in minds and institutions than institutional elements inherited from more remote times, the latter may also play a role.

In countries where the starting conditions were relatively more favorable, mostly in central European and Baltic countries, macroeconomic stabilization programs were relatively 'easier' to implement. Even if these programs generally ignored institutional legacies, the transformational recession in these countries was less severe and then the return to growth faster. International financial aid and foreign direct investments quickly flowed into these countries, while their economic and political relations with the European Union developed rapidly. As a result, they were the first countries to be selected to start pre-accession negotiations with the European Union. This meant

additional financial and technical assistance from the EU, so as to help candidate countries conform their economic and legal systems to EU norms. Consequently, they will be the first post-socialist countries to integrate the European Union. We have here examples - though schematic - of path-dependent transformation trajectories with positive self-reinforcement effects.

Countries with more unfavorable initial conditions than those facing central European countries, i.e. south-east European countries and CIS countries (even if this last group of countries would deserve a specific analysis), all had much greater difficulties; in breaking with their communist past, in establishing the democratic legitimacy of their governments and in getting effective programs of reform and stabilization underway. What more the transformational recession was more severe, economic recovery proved often to be unsustainable, while macroeconomic performances have generally remained poor. As a result, the relations of these countries with international financial organizations were slow to develop and they lagged behind the other transition economies in obtaining more open markets in the western economies and in attracting foreign investment. As the UNECE [1999, p. 57] observed, 'ironically, it is this group of lagging countries, which is most in need of outside assistance for improving the policy making process but which de facto has received less than the leading reformers'. The explanations for this situation generally focus on the conditions required by financial organizations, which are often not met by these countries, and on the slow pace of reform, as well as on western doubts about governments' commitment to both economic and democratic reforms. Moreover, the relations of the less advanced transition economies with the EU have been more erratic. For example, though Bulgaria and Romania signed association agreements with the EU, they have been excluded from the first wave of selected candidates to EU accession in 1997, before being finally entitled to enter pre-accession negotiations in 1999-2000. Moreover, the message from the European Commission in October 2002 was that they would not be included in the first wave of candidate countries to integrate the EU. We have here examples of path-dependent transformation trajectories with negative self-reinforcement effects.

To illustrate the importance of the starting conditions for the transformation process, the transition trajectories of two countries will be briefly analyzed. Firstly, Hungary will 'represent' the group of central European countries with relatively favorable initial conditions leading to 'virtuous' path-dependent post-socialist trajectories. Then, the case of Romania will exemplify the less advanced countries of southeast Europe with unfavorable initial conditions leading to tortuous path-dependent evolutions after 1990. Hence, the last

section of this paper will return to the theoretical level to draw some lessons from twelve years of transition on the issue of path-dependence and initial conditions in 'transitology' and economics.

The Hungarian 'virtuous' post-socialist trajectory

Among post-socialist countries, Hungary was one of the first to be selected (in 1997) to enter into negotiations for EU accession. Five years later, it is certainly, of the countries knocking at EU's door, the closest to the finishing line. This is the outcome of a 'virtuous' transformation trajectory started in 1990. But this does not mean that the country has not met difficulties of all kinds and that Hungary was destined to succeed. Nor does it mean that the time of painful reforms is behind.

Still, initial conditions were favorable or, more precisely, they were *relatively* more favorable than in other countries. Why? A part of the answer belongs to Hungarian postwar history.

In the socialist period, Hungary was the Eastern European country the most open to the western world. Besides old historical ties with Western Europe¹, the specific socio-political compromise of the Kadar era could also explain this Hungarian specificity. The Hungarians were cruelly hit by the terrible events of the 1956 uprising and the severe repression that followed. Confronted with a general discontent and the fear of another intervention of the soviet army, the Hungarian leaders (under the leadership of Janos Kadar) tried to preserve a kind of socio-political compromise with the population throughout the socialist period. The implicit terms of the agreement were the following: more economic freedom, more openness to Western Europe, better living conditions than in other socialist countries (better balance between consumption and heavy industry, importations of western goods, etc.), in exchange for not contesting the political regime and the one-party system.

¹ *At this point it seems difficult not to refer to the times of Austro-Hungarian Empire, within which Hungary had its political, administrative and cultural autonomy acknowledged and a national territory which was three times larger than today, including large parts of today's Romania, Slovakia and of the former Yugoslavia. It was a time of industrial development and modernization of the country while Budapest, the second capital of the Empire, became a great European city. This experience under the Hapsburg rule testifies of the historical, political and cultural ties that bind Hungary to Western Europe, long before the integration process into the EU. Still, the Treaty of Trianon of 1920 deprived Hungary from two thirds of its territory. It is still considered as a national catastrophe today. A quarter of the Hungarian population is living in neighbouring countries. Public opinion remains very sensitive to the issue of Hungarian minorities abroad. No later than June 2001, a controversial law, aiming to protect and to help Hungarian minorities abroad, has been enacted.*

In this context, the Hungarian government tried to improve the socialist economic system by the way of radical reforms. The story is well known. Hungary abolished the planning system as soon as 1968, hoping to reach a balanced combination between market and plan. From this point of view, Hungary was quite exceptional in the socialist world. And despite the centralizing wind blowing on Eastern Europe in the seventies, Hungary never came back to the traditional soviet model. At the beginning of the eighties, the Hungarian economic reform started again, then accelerated from 1985 onwards. Eventually, between 1985 and 1989, Hungary began to set up most of the institutions - yet in an embryonic state - deemed necessary to the functioning of a market economy.² Moreover, 60% of prices have been freed and the structure of relative prices has been brought closer to world prices. External trade has been in part liberalized and redirected to the West, while the private sector has been more developed and the consumer goods market more balanced than anywhere else in the Eastern bloc. However the external gross debt strongly increased in the eighties.

On the political side, the end of the communist political system has been encouraged by the party itself, by its reformist wing, as soon as 1988³ - another exceptional feature of the Hungarian model.

To what extent did this historical legacy contribute to shape the Hungarian post-socialist path after 1990? A few - yet not exhaustive - points are worth considering.

Twenty years of reforms and institutional change during the communist period as well as the legacy of a relatively favorable macroeconomic situation (except for the external debt) allowed the Hungarian government to chose – with IMF agreement - a ‘gradualist’ strategy of socioeconomic transformation in the first half of the nineties.⁴ Although this strategy did not prevent the country to be hit by the famous ‘transformational recession’ [Kornai, 1994], growth came back rapidly, as soon as 1993.

² For example, a tiny capital market began to emerge in the eighties with the right to issue bonds in 1983 and shares in 1987, a bankruptcy law was enacted in 1986, a two-level banking system was set up in 1987, etc... .

³ J. Kadar had to leave power in 1988. The Party Central Committee itself gave up the doctrine of the ruling role of the Party at the end of that year and finally entitled the multiparty system at the beginning of 1989.

⁴ The ‘gradualist strategy’ was generally opposed to the ‘big bang’ or shock-therapy approach of, for instance, Poland and the former Czechoslovakia.

The ‘gradualist’ strategy also characterized the chosen model of privatization. Hungarian leaders decided to put the emphasis on direct sale of assets to strategic, generally foreign, investors. Actually the charge of the inherited external debt did not let much room for manoeuvre (figures 3 and 4 below). Eventually, this privatization strategy proved to be successful thanks to the massive inflows of foreign direct investments, which poured into the country from 1990 onwards (figure 2 below). Besides the geographic proximity with the EU and the historical links with Western Europe, the Hungarian reputation of openness to the West, won during the last twenty years of the socialist regime, as well as the economic relations set up with western firms in this period, have certainly contributed to make this trust emerge. In addition, the exceptional will to settle a high external debt without renegotiations sent a strong signal to foreign investors while strengthening its financial credibility.⁵ In return, foreign direct investments helped the country to pay back a part of its debt and to modernize the productive system in several sectors, which are now sustaining growth and exports.

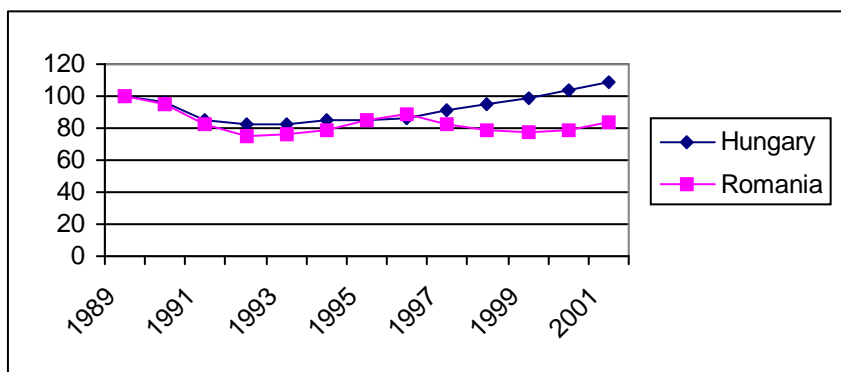
The gradualist strategy also appeared in the political will to preserve, at least in the first half of the nineties, the post-1956 socioeconomic compromise. As a result, the state remained relatively paternalist with firms and households; in terms of financial assistance for enterprises and for banks lending money to troubled companies, and extensive social protection for households. However, protracted state support to economic agents proved to be unsustainable in the long term. This because it led to a steep rise of the budget deficit, in the context of a radical change of the tax regime and high tax evasion, while industrial and financial firms were not induced to restructure and hence to improve their competitiveness. In 1994, when a new government (ruled by the former reformed communists) came to power, the economic situation of the country was worrying. In addition to the double budget and trade deficit, growth remained slow, inflation, unemployment and the external debt; all three reached record levels. And five years after the beginning of the transition process, the Hungarian economy has still not taken off (figure 1 below). As a result of this, the new government in place in 1994 deemed to have no choice but to decide, after a stormy debate, to implement a new macroeconomic stabilization program, which went against its electoral promises. This liberal-type program signed the end of the gradualist and paternalist path and marked a bifurcation of the Hungarian trajectory. The main measures were a cut in public spending, a

⁵ *It has to be remembered that Bulgaria took the opposite side in March 1990 by stopping to settle the service of its huge external debt. As a result, international financial organizations and foreign investors were reluctant to pour money into the country at the beginning of the nineties.*

devaluation of the forint with a special import tax and a fall in real wages. Moreover, the government decided to reform the welfare system and to accelerate the privatization process. Between 1994 and 1997, the bulk of Hungarian large industrial enterprises and banks were sold to foreign investors. In 1998, the private sector accounted for 80% of the GDP. After two years of austerity, Hungary finally took up with impressive macroeconomic performances: inflation, unemployment, the double deficit and the external debt (figure 3 and 4) have all been decreasing since 1997 while economic growth has been sustained around 5%. In 2000 at last, Hungary's GDP exceeded its 1989 level (figure 1). And at the end of 2001, Hungary was ahead (with Slovenia) in the pre-accession negotiations with the EU, with 24 closed chapters.

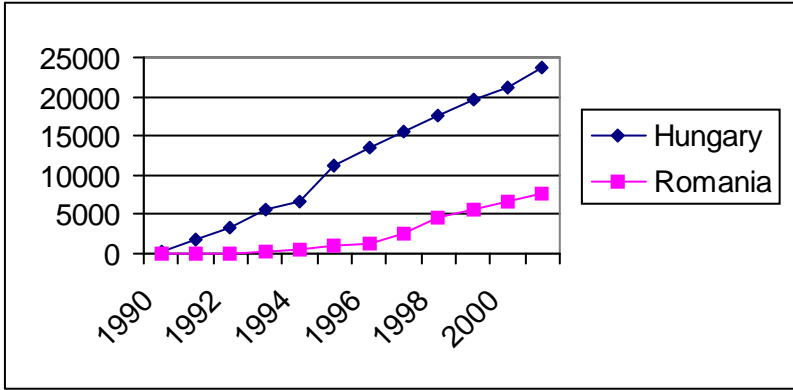
However, Hungary is still facing serious problems of sectorial, regional and social disparities. The major part of these disparities has been inherited from the socialist period, such as the development gap between the eastern and the western part of the country or the Roma situation. Yet, the transition process has also tended to make things worse, as far as social inequalities are concerned, and widen the gap between large firms with foreign capital and small and medium-sized local enterprises. Since 2000, the Hungarian government has decided to take on the problem, with EU assistance, and is probably more likely to succeed now than in 1990.

Figure 1: Hungarian and Romanian growth trajectories, 1989-2001
(Real GDP, indices, 1989 = 100)



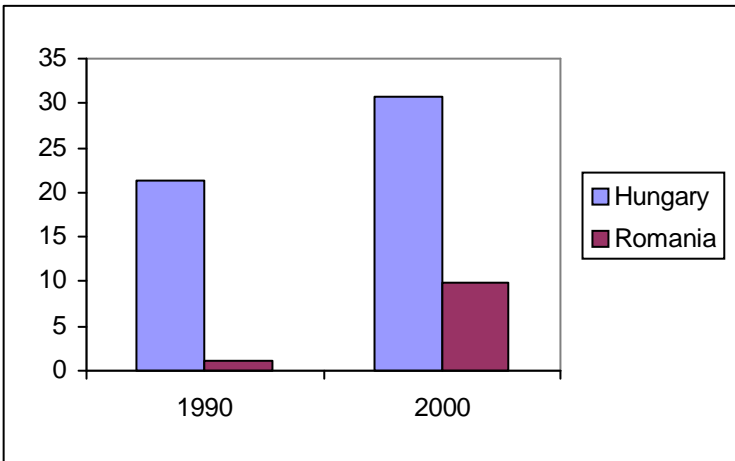
Source: UNECE (2002)

Figure 2: *Inflows of foreign direct investment in Hungary and Romania, 1990-2001 (cumulative, million dollars)*



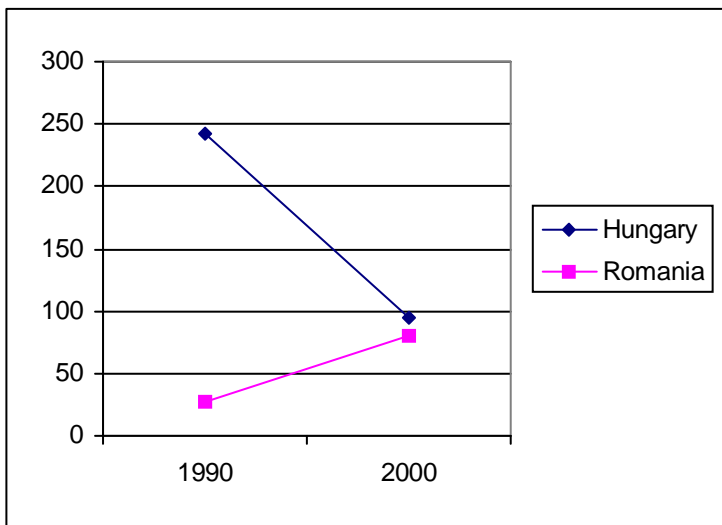
Source: UNECE (2002)

Figure 3: *External gross debt (million dollars)*



Source: UNECE (1997; 2001)

Figure 4: *Gross debt/exports (per cent)*



Source: UNECE (1997; 2001)

The Romanian ‘perverse’ post-socialist trajectory

While the Hungarian trajectory has been relatively favorable, the Romanian path has been more tortuous. Initial conditions proved again to be of crucial importance. As the UNECE [1999, p.71] observes, ‘Romania started the transition process at a disadvantage, with significantly worse initial conditions than those prevailing in the leading reform countries’. And the nineties did not allow the country to fill the gap with its neighbours.

The country was – and still is – one of the poorest of Eastern Europe. Geographically speaking, Romania is remote from Western European markets. Moreover, Romania inherited from the communist period a productive system more difficult than others to restructure and to adjust to world demand. Firstly, adding to a classical socialist industrial structure biased towards heavy industry, ambitious projects of public investment and production concentration in gigantic units, Romania had an autarkic development. Secondly, agriculture accounted for an important part of economic activity, situation that was not to make economic exchanges with Western European countries easier. But worst, during the eighties, the Romanian government imposed a sharp reduction of imports so as to pay back the external debt quickly (figure 3 and 4 above). As

the UNECE [1999, p.72] points out, 'this forced reduction of the external debt in the 1980s (actually a *sui generis* shock-therapy), accentuated the decline in the competitiveness of the economy, exacerbated imbalances among sectors, increased shortages, and generally lowered the welfare of the people'. Last but not least, the Ceaucescu political regime was especially authoritarian and absolutely not inclined to follow the eighties wave of economic reforms in Eastern Europe launched by Gorbachev's perestroika.

Quite understandably, these unfavorable starting conditions had a negative impact on the post-socialist Romanian trajectory.

Firstly, the political exit of the communist system turned into a violent revolution in circumstances which are still unclear and contested but led to the end of the Ceaucescu rule and to the disappearance of the communist party - but not of the communist networks. Most members of the former communist party joined the new social democratic forces of Ion Iliescu. Secondly, after the sacrifices of the eighties, Romanian people were not ready for a new shock-therapy, what more, the social situation was strained in the aftermath of the revolution in which workers' demonstrations played an important part. Thirdly, in the first half of the nineties, post-communist political leaders were most often members of the old elite, much less prepared to democracy and to reformist ideas than their Hungarian counterparts. Finally, habits and routines developed by economic actors in the context of an unreformed planned economy proved to be particularly persistent after the system change.

In this troubled context, political leaders had not much room for manoeuvre and, as governments followed one another, were unable to find a clear way towards a well-functioning market economy or to carry out consistent structural reforms. Therefore, between 1990 and 1996, under the Iliescu presidency, Romania followed a gradualist path of transformation. But, whereas the Hungarian gradualist approach was logically chosen because Hungary was the most reformed country of the Eastern bloc, the Romanian gradualist strategy of transformation was on the contrary an outcome of the lack of reforms during the communist era and of the severe above-mentioned initial constraints. Therefore, different results were expectable. In the first half of the nineties, Romanian gradualism meant the following: a partial liberalization of prices, exchange rate and external trade, and a limited reduction of state support to public enterprises, hence the persistence of a relatively soft budget constraint. Moreover the privatization process slowly progressed during this period despite a mass privatization program. The private sector accounted for about 60% of GDP in 1997, and foreign direct investments remained low (figure 2 above).

However, some institutional changes did take place during those years; such as massive land privatization, the emergence of a private sector from below, the redirection of trade towards Western countries and the rapid adjustment of Romanian legal framework to conform to that of a market economy. After a severe transformational recession (a 30% fall of GDP in three years), growth came back as soon as 1993 and even reached 7% in 1995 (figure 1 above). However, growth proved to be unsustainable because of the lack of structural reforms, such as the limited restructuring of large industrial and financial firms due to their protracted soft budget constraints. All economic indicators deteriorated again in 1996 while the IMF and the World Bank decided to suspend their financial support. In this situation of growing economic imbalances and destabilization, opposition parties won the 1996 parliamentary and presidential elections, putting an end to seven years under the rule of the members of the old political elite.

Facing a Bulgarian-type economic crisis [UNECE, 1997], the new Romanian government declared to have no choice but to implement a shock-therapy with the renewed support of the IMF and the World Bank. As a result, the country was hit again by three years of severe recession, between 1997 and 1999, while inflation remained desperately high. Thus, this new government only succeeded in losing the confidence of the population. The delusion was terrible and proportional to the hope it brought about. The immature behaviour of political leaders within the ruling coalition and their unceasing quarrels accentuated this feeling [Lhomel, 2000], while spectacular bankruptcies of large financial institutions worried the population and increased uncertainty. Confronted with growing unemployment, falling real wages and living conditions, deteriorating education and health services, increasing corruption and criminality, more and more Romanians regretted the « golden age » before 1989. And the few positive achievements of the government were unable to reverse the trend. Among them are worth pointing out, the significant improvement of the banking sector soundness, the acceleration of privatization, the opening of pre-accession negotiations with the EU and the return to growth in the year 2000 (figure 1). In a situation of growing poverty, the informal economy (estimated between 20% and 40% of GDP) and the agricultural sector helped to soften the shock of the transition by supplying employment, income and means of subsistence for a large part of the population.⁶ However, starved of capital, the Romanian agricultural potential tended to become locked in a logic of self-consumption on tiny plots [Lhomel, 2000; Simon, Amblard, Colin, 2002]. The

⁶ *This desperate comeback to land for survival can be considered as an unexpected de-modernizing evolution of Romanian economy and society.*

2000 parliamentary and presidential elections saw the comeback of Ion Iliescu and his political party at the head of the country, as well as the success of the extremist party which gained a high number of parliamentary seats [Lhomel, 2001].

Last but not least, the difficulty of the Romanian transition did not ease its relations with the EU. Brussels experts generally considered that the country had repeatedly failed to come to grip with serious reforms. Therefore, Romania was not selected in 1997 to belong to the first wave of candidate countries to enter into accession negotiations. After what, the EU canceled the distinction between a first wave and a second wave of candidate countries. Finally, the negotiations for the accession of Romania began in early 2000, two years after Hungary. Though Romania is certainly seen as the laggard in the EU race, it seems clear now that the EU will not leave it outside the enlargement process but only postpone its integration. This could be the main opportunity for Romania to escape from this ‘perverse’ post-socialist trajectory and path-dependence, for it binds any government to the economic and institutional pre-accession program and allows the country to receive a large volume of resources to implement it.

Path-dependence and initial conditions: short lessons from twelve long years of transition

The post-socialist transformation has given social sciences in general and economics in particular the opportunity to discuss the issue of path-dependence, as far as institutional and organizational change is concerned. As the Hungarian and Romanian transition trajectories have testified, the starting conditions have been of crucial importance for the success of economic and socio-political transformations. Post-socialist countries with relatively favorable initial conditions did better in terms of structural reform progress, macroeconomic performances and growth sustainability, than those with relatively unfavorable starting conditions, some of which are still struggling against considerable difficulties. However, this assertion should be qualified in two ways.

First, it is obvious that initial conditions are never totally favorable. All ex-communist countries inherited some unfavorable starting conditions such as structural deficiencies and macroeconomic imbalances. Initial conditions are therefore favorable only in relative terms. And favorable does not mean rosy. There has been no easy transition. Transition trajectories have never been entirely ‘virtuous’ or completely ‘perverse’. That is why quotation marks are required. Reforms have often been difficult to implement and imposed

sacrifices on national populations in all countries. Macroeconomic stabilization was not gained easily either, even for the ‘successful’ Hungary. Until 1995, Hungary seemed to follow an unsustainable path inducing poor macroeconomic performances. Hence a second stabilization program was necessary to escape from this ‘inefficient’ trajectory. Only in 2000 did Hungary exceed its 1989 GDP level. As for the Czech Republic, considered as the leading reformer until 1996, it was hit by a severe crisis in 1997 and also compelled to adopt austerity measures again. However, because of their relatively favorable initial conditions, governments in these countries were more capable to impose harsh measures, people more capable to tolerate them, making these measures more likely to succeed.⁷ Conversely, Romania is not doomed to fail despite its worse starting conditions. It has made slow but real progress on the way towards a market economy. What more, Romania’s initial conditions could be deemed more favorable than those facing some CIS countries. Moreover Romania, unlike most of its Balkan and CIS neighbours, has at least started the process leading to EU accession. Even if it is a long way off, this means – in the better case – stabilization of economic actors’ expectations, financial and technical assistance, enforced institutional change and policy discipline. We can conclude Romanian trajectory is now anchored to the accession process.⁸

Secondly, even within groups of ‘similar’ countries (in terms of reform progress), initial conditions widely varied and therefore determined various national paths of transition. Hungary and Poland, for instance, reformed their economy long before 1990, while it was not the case of the former Czechoslovakia. But the Czech Republic was a relatively developed market economy in the period between the two world wars. If Hungary and the former Czechoslovakia benefited from relatively balanced macroeconomic situations in 1989, Polish leaders had lost control of the economy at that time. And while a relative social peace characterized Hungary during the communist period, social unrest marked Poland trajectory throughout the seventies and eighties...

Among initial conditions, the strain of the socio-political constraint proved to play a significant part in the success of transition. The socio-political constraint does not here refer to the literature analyzing socio-political aspects in terms of winners and losers from the reform process, but to the nature of the political regime and the degree of people reform fatigue. In all post-socialist countries, the process of democratization and political stabilization – grounded on a true multiparty system with a regular change in the party in power – is taking a

⁷ Still, parties in power generally lost the elections following a period of painful reforms.

⁸ On the importance of external anchors for the Bulgarian trajectory, see Ialazov (2002).

longer time than experts initially imagined. The political legacy of the communist period is one of the decisive factors in the speed of the process. In countries where the political regime before 1990 was relatively more authoritarian, and/or opposition movement more embryonic and/or the communist party less reformist, the political extrication path appeared to be more difficult and sometimes degenerated into violent uprising. In these cases, the post-socialist democratization process has been more tortuous and political maturity even slower to get than in other young democracies of Eastern Europe. This context accounts for policy decisions often been taken in an ad hoc manner, without a coherent and consistent framework for policy and long term objectives, as well as the absence of any public debate about the policy, 'with the consequent failure to gain public support for difficult but necessary reforms' [UNECE 1999, p.57]. As far as the degree of reform fatigue is concerned, it is now acknowledged that, beyond a certain threshold, imposing harsh measures could generate perverse outcomes and resistance to reforms. No reform can succeed without public support. Furthermore, besides the concept of sustainable development, the concept of 'sustainable policy' should also be emphasized. A 'sustainable policy' could be defined as the capacity of a policy package to be implemented the time necessary to reach its objectives without being rejected by the population, even if the efficiency and consistency of the policy are to be reduced. A perfectly consistent textbook shock-therapy leading to massive social unrest does not help much. Argentina is a perfect example of this.

The idea that historical and institutional legacy matters, that transition trajectories and institutional change are path-dependent, were not widely shared among experts and 'transitologists' at the beginning of the 1990's. There were few exceptions to that, like D. Stark [1992] and institutionalist authors in general [Chavance, 1990; North, 1994; Chavance and Magnin, 1995]. Yet, as P. David [2001, p.15] observes, 'a decade after it began to be trendy among economists to say that 'history matters''. We could add in the same line, that to claim nowadays that institutions and initial conditions matter is also 'trendy'. Eventually, the transition process appears ex post to be a 'validation', on various points, of North's theoretical approach [North, 1990, 1991, 1994].⁹

Firstly, North explains the diversity of national trajectories and macroeconomic performances, as well as the persistence of inefficient paths, by the path-dependent character of institutional change. Once a development path is set, it becomes more and more difficult to escape from this path because of self-

⁹ The Nobel prize was awarded to Douglass North in 1993.

reinforcement mechanisms and increasing returns. North borrowed the concept of path-dependence (and lock-in) to David [1985] and Arthur's [1989, 1990] works on technological change. Both put the emphasis on the starting conditions and 'historical' random events in the determination of technological trajectories. Arthur shows that small differences in the starting conditions lead to growing divergent trajectories. This observation is in line with endogenous growth theory in which different initial conditions (e.g. the stock of growth-inducing factors) lead to diverging growth paths [Romer, 1986; Lucas, 1988]. In both cases, initial gaps or even small differences are difficult to narrow. That is why, as far as the post-socialist transition is concerned, policy prescriptions made in the very beginning were particularly important - aside from institutional legacy - because they could generate a positive - or negative - cumulative process.¹⁰ To get positive results from the start could ease the next stage of economic reform. Had this first phase been more successful, the next phase could have been easier and the population involved could have been more prone to accept painful reforms further on. That is why, external assistance in this phase is decisive in order to put national economies on sustainable trajectories. Yet, external assistance was quite limited at that time for the current group of lagging countries. What more, it was the responsibility of the EU, the local leading power, and of international financial organizations and their experts, at the beginning of the nineties, to make sure the transition process was well under way.

Secondly, North operates a useful distinction between formal rules and informal constraints and was one of the firsts to explain that 'while the (formal) rules may be changed overnight, the informal norms usually change only gradually... And economies that adopt the formal rules of another economy will have very different performance characteristics than the first economy, because of different informal norms and enforcement. The implication is that transferring the formal political and economic rules of successful Western market economies to third-world and Eastern European economies is not a sufficient condition for good economic performance. Privatization is not a panacea for solving poor economic performance.' [North 1994, p. 366]. In transition countries, in fact, formal rules were rapidly changed but inherited informal habits tended to persist, especially in less-reformed socialist countries such as Romania. Last but not least, North puts the emphasis on rule enforcement, which proved to be of crucial importance for the success of the

¹⁰ *However, in the early nineties, policy makers underestimated the role of historical and institutional legacy and neglected the problem of the sustainability of economic or structural reforms.*

transition process and whose role is now widely acknowledged, even among 'mainstream' economists [Sachs and Pistor, 1997; World Bank, 2002].

It is sometimes argued that the path-dependency approach is exclusively focused on historical legacy and the influence of the past on the present, forgetting the expectation dimension or the influence of an anticipated future on the present [Federowicz, 2000]. Still the argument seems of little relevance, for a few reasons. First, path-dependency theorists never claimed that both visions were mutually exclusive. The assertion 'history matters' cannot seriously be understood as 'expectations do not matter'. Of course expectations matter and are perfectly compatible with the path-dependency approach. The main point rather is a question of balance between both perspectives, related to the object studied. As far as the post-socialist transformation is concerned, the very specific institutional and organizational legacy of former socialist countries explains the relevance of path-dependency analyses. Yet, in the beginning of the nineties, most specialists focused on the future objective, the market economy, neglecting the effects of the past on post-socialist evolution. However, if Hungary today proves to be more successful than Romania, it is not because 'the vision of a new system' was more 'powerful' in the former case than in the latter [Federowicz, 2000, p.92]. In 1989-1990, the vision of the future system was actually blurred or at best simplistic for both countries. Expectations were not stabilized, because of the high degree of uncertainty and instability of the period. For instance, it was feared that the process could be reversible. Initial conditions were then decisive in the selection of national trajectories and hence in the progressive stabilization and clearing up - or not - of expectations. Then, if expectations become gradually fulfilled, for better or for worse, they tend to self-reinforce. In that sense, expectations are themselves path-dependent. Of course, the growing credibility of EU accession has been a powerful driving force for the transition process and institutional change in candidate countries. In the second half of the nineties, the prospect of future integration has probably overcome the influence of initial conditions. Still, this also is a path-dependent outcome and it remains nevertheless true that present developments and policies are likely to determine future evolutions.

Along the same line of argument, emphasizing initial conditions and path-dependency is often criticized as a determinist point of view. This is a common misunderstanding. This brings me to point out that path dependence does not exclusively deal with initial conditions. The latter mark the selection of a path (the 'determinist' influence of the past on the present) but other bifurcations are likely to happen in the future evolution of the system through endogenous process or exogenous random events. That is why the final outcome is

unpredictable and why 'it is not possible to explain a state of the world without analyzing the process that tends to lead to that state'. [Garrouste and Ioannides, 2001]. However, as sheer determinism is out of question, absolute indeterminism is probably excessive too, because path-dependence reduces the range of probable solutions or trajectories. As North explains, «at every step along the way there are choices – political and economic – that provide real alternatives. Path dependence is a way to narrow the choice. It is not a story of inevitability in which the past neatly predicts the future» [North, 1990, p.98]. Actually, there is a dialogue between determinism and indeterminism inherent to the concept of path dependence.¹¹ In 1990, forecasters, to the question of which country would experience a successful transition, would have probably answered Hungary but certainly not Romania. This shows that some evolutions are more probable than others.

Finally, how can a national economy escape from an 'inefficient' path-dependent trajectory or an uncomfortable lock-in? There is no straightforward answer to that. A significant inflow of resources seems required to pass a threshold, to leave a chreod [Hodgson, 1994] or to break protracted vicious circles. As far as the post-socialist experience is concerned, resources mean financial and technical assistance, especially to set up an efficient control and sanctions system, so as to impede the survival of bad habits in a context of weak institutions and to make sure institutional change is effective and law enforced. It seems that EU accession process meets these requirements, since it results in additional resources, strict control and expectations stabilization, hence it may prevent candidate countries to follow 'inefficient' trajectories.¹²

Conclusion

Among the various lessons, which can be drawn from twelve years of transformation in Eastern Europe, the present paper emphasizes on the crucial importance of the starting conditions in the determination of diversified transition trajectories. The post-socialist experiences of Hungary and Romania make North's works on the path-dependent nature of institutional change still more relevant. Beyond the post-socialist transformation, the role of initial

¹¹ *This dialogue is missing in Federowicz [2000] but the contradiction is not. On the one hand, he points out that the 'weakest point of such an explanation is in the deterministic ingredient' (p. 94) and, on the other hand, he explains that 'the proper path-dependency explanation... is always a post factum explanation' (p.93). First, if path-dependence is a determinist approach, ante factum explanations or predictions are possible. Second, post-factum explanations are the logical result of the impossibility of predicting the final outcome, i.e. of a non-determinist approach.*

¹² *That is why it is so important for Bulgaria and Romania not to be excluded from EU enlargement.*

conditions, the concepts of path-dependence and lock-in are now widely acknowledged in economics, both in heterodox and mainstream economics (endogenous growth theory, evolutionism and technical change, old and new institutionalisms). Remember it was not the case at the beginning of the nineties. However, one conclusion shared by many authors from the various aforementioned schools of thought is the following: initial gaps or differences are difficult to fill and lock-in difficult to escape from, because it is a costly process and resources are scarce. Even if difficult does not mean impossible, as economic history has shown, national trajectories are likely to keep on diverging for long, despite globalization. We find here again another explanation of Kaldor's [1961] famous stylized fact stating that growth rates differ among nations and, beyond, of the variety of national models of capitalism [Crouch and Streeck, 1996; Magnin, 1999b]. At the beginning of the third millennium, many economists seem eventually more pessimistic about the possibility of economic and technological catching-up in a complex world.

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