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September 19, 2007

## **NEW BOOK REVEALS HOW CAPITALISM SUCCEEDED WHILE DEMOCRACY BUILDING FAILED IN FORMER COMMUNIST COUNTRIES**

**Washington**—It had been thought that as former communist countries transformed into market economies, they would naturally become democracies. But this has not been the case. While all but three of the 21 former communist countries have transformed into market economies, less than half have become democracies. In an important new book, *How Capitalism Was Built: The Transformation of Central and Eastern Europe, Russia, and Central Asia*, author Anders Åslund tells the story of this postcommunist transformation between 1989 and 2006 in Central and Eastern Europe, the former Soviet Union, and Central Asia, focusing on why market reform succeeded while democracy building failed.

Postcommunist transformation has been an intense ideological battle. On one side of the barricades stood radical reformers, who wanted to build a normal society. This group consisted of leading Western, primarily American, and Eastern economists, such as Jeffrey Sachs, Lawrence Summers, Stanley Fischer, Yegor Gaidar, and Václav Klaus; politicians such as Mart Laar of Estonia and Einars Repše of Latvia; and international financial institutions such as the World Bank and the International Monetary Fund. Their main opponents were rent seekers, not old communists. This group consisted of rent-seeking state enterprise managers and Soviet officials. The rent seekers' goal was plain: to make as much money as possible on transitional market distortions. Their endeavors led to a great misallocation of resources and slumping output. Their hunger for state subsidies and subsidized credits boosted inflation, disorganizing the whole economy. All their successes skewed income and wealth distribution in their favor.

Despite all hardship, most socialist economies have swiftly become ordinary market economies. Of the 21 countries studied in this book, all but three—Belarus, Turkmenistan, and Uzbekistan—have been successfully transformed. Transactions are monetary, reasonably free, and carried out in markets. In almost all of these countries,

inflation has fallen to single digits, and nearly two-thirds of national output is produced by privately owned enterprises. The international community knew how to build a market economy. It predominantly advocated a radical market economic reform with deregulation, macroeconomic stabilization, privatization, and the creation of a new social safety net. The countries implemented this policy to a reasonable degree, though mostly with delays. Most, but not all, governments made the political choice to build a market economy. The three Commonwealth of Independent States (CIS) nonreformers showed that the success of the market economy was not a given.

The building of democracy and the establishment of the rule of law have been much less successful. There are frequent complaints that too much attention and resources were devoted to economic reform and too little to political and legal reforms. This may be true, but more striking is that in these spheres no viable theory predominated, and the policy advice was often too vague and diverse to be helpful. National leaders had no clear idea or program to follow. As a consequence, only the European Union (EU) accession countries, which adopted all the EU institutions, were successful in building democracy. The promotion of the rule of law has been even more unsatisfactory.

The outcomes of postcommunist transition have been remarkably diverse. The results have depended on early policy choices, which were influenced by the conditions prevailing in each country. The Central Europeans swiftly shifted to normal market economies and privatized. They adopted West European social welfare systems with high taxes, large social transfers, and excessive labor-market regulation, which have impeded their economic dynamism, but they have also become impeccable democracies, and corruption is relatively limited.

Nine CIS reformers also developed market economies, but of a more East Asian type with low taxes, limited social transfers, and liberal labor markets. The low taxes are a major cause of their recent high growth rates. Alas, they are at best semidemocratic and mostly authoritarian states, with pervasive corruption.

The Baltics cleverly chose the best of both of these worlds, adopting full-fledged market economies with limited public sectors and high economic growth. They also enjoy democracy and limited corruption. Southeast Europe straddles a middle ground between the social democratic Central European model and the liberal Baltic model. It is still too early to say what eventual choice it will make. Three CIS countries are completely

nonreformed—Belarus, Turkmenistan, and Uzbekistan. They are true tyrannies and maintain a state-dominated, Soviet-style system.

In terms of economic growth, the postcommunist region has probably achieved sustainable growth. The Russian financial crash turned out to be the catharsis Russia needed to accomplish a full-fledged market economy with a critical mass of markets, macroeconomic stability, and private enterprises. Its impact was felt throughout the post-Soviet region. Growth returned with a boom. It has been driven by sound macroeconomic policies, structural reforms, sharp cuts in public expenditures, low exchange rates, and a commodity boom. Since 2000, the huge former Soviet region from the Baltics to Kazakhstan has recorded an average growth of more than 8 percent a year.

The former Soviet Union has joined the growth belt that started in East Asia a few decades ago and has proliferated through China and India. Will this growth survive the current commodity boom? It probably will in the star performers—the Baltics, Armenia, Azerbaijan, and Kazakhstan because they have undertaken considerable reforms. The main question mark is Russia, which has seriously aggravated its structural policies and reverted to renationalization.

Approaching the European Union, however, this dynamism fades. Central Europe (Poland, the Czech Republic, Slovakia, and Hungary) was limited to a growth rate of only 4 percent a year from 2000 to 2005. That is more than twice the EU rate, but these still-poor countries need much faster growth, and at this rate, they will not converge with the rest of the European Union.

Latin America is a natural yardstick for achievements in the postcommunist region. Both before and after the collapse of communism, their economic level was similar. The postcommunist countries have caught up with Latin America by establishing a market economy and privatization. Latin America has been more successful in democratization, whereas the postcommunist region has achieved much higher growth rates because its structural economic reforms are proceeding. At present, the economic future of Eurasia looks brighter, but the combination of authoritarian rule and the energy curse might take major countries in this region astray.

The book covers 21 countries in the former Soviet bloc in Eurasia, including Poland, the Czech Republic, Slovakia, Hungary, Romania, Bulgaria, and all the 15 former Soviet Republics (Estonia, Latvia, Lithuania, Russia, Belarus, Ukraine, Moldova, Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan),

while excluding all the former Yugoslav republics—Albania, China, Mongolia, and Vietnam. All these 21 countries had much in common: the hierarchical and bureaucratic communist dictatorship, the socialist economic system, and closely connected foreign trade system. Although reforms in Hungary and Poland had altered their systems, the socialist principles remained, whereas the economic and political systems of Yugoslavia and China were profoundly different.

### **About the Author**

**Anders Åslund** is known for making bold predictions, which initially arouse controversy but become common wisdom a few years later. He foresaw the collapse of the Soviet Union in his book *Gorbachev's Struggle for Economic Reform* (1989). After Russia's financial crisis of 1998, Åslund insisted that Russia had no choice but to adjust to the world market (*Building Capitalism*, 2002), although most observers declared the market economic experiment a failure. His new book *How Capitalism Was Built* tells the story of how all but 3 of 21 former communist countries were transformed into market economies from 1989 to 2007, with less than half of them becoming democracies.

Anders Åslund is a leading specialist on postcommunist economic transformation with more than 30 years of experience in the field. The author of seven books, he has also worked as an economic advisor to the Russian government, to the Ukrainian government, and to the President of the Kyrgyz Republic.

Dr. Åslund has been a senior fellow at the Peterson Institute for International Economics since 2006. Before that he was the director of the Russian and Eurasian Program at the Carnegie Endowment for International Peace.

He was born in Sweden and served as a Swedish diplomat. He earned his PhD from Oxford University.

### ***How Capitalism Was Built***

*The Transformation of Central and Eastern Europe, Russia, and Central Asia*

By Anders Åslund

Hardback ISBN-13: 9780521865265

August 2007 \* 384 pp. \* \$70.00

Paperback ISBN-13: 9780521683821

September 2007 \* 384 pp. \* \$25.99