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**THE PUZZLE OF TRANSIT: THE INSTITUTIONALIST ANSWER  
TO THE DISAPPEARANCE OF THE “SECOND WORLD”**

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The article ponders upon background and outcomes of development strategies chosen by post-Socialist states within the last 25 years, the fundamental limits and opportunities of choices, and evaluation of their progress scaled between traditions and modernity. The problem of development in the former ‘second world’ is being analysed from the viewpoint of, if to generalize, contemporary institutionalist theories in political economy, namely the approaches by Douglas North, Hernando De Soto and the Austrian School, particularly with attention to Joseph Shumpeter’s concept of creative destruction. The political process in the region is colligated through the works of leading Russian political scientists, economists and sociologists.

**Keywords:** development, modernization, transit, tradition, path dependency, OECD, creative destruction, institutionalism.

**ЗАГАДКА ТРАНЗИТА: ИНСТИТУЦИОНАЛЬНЫЙ ПОДХОД  
К ИСЧЕЗНОВЕНИЮ «ВТОРОГО МИРА»**

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Статья посвящена анализу предпосылок и результатов выбора стратегий развития постсоциалистическими государствами на протяжении последних 25 лет, фундаментальным ограничениям и возможностям этого выбора, а также оценке его итогов на шкале между традиционализмом и современностью. Проблема развития и критериев развитости в бывшем «втором мире» рассматривается в контексте институциональных теорий в политической экономии, в частности, подходов разработанных Дугласом Нортон и Эрнандо Де Сото, но, прежде всего, «австрийской школы», а именно концепции «творческого разрушения» Джозефа Шумпетера. Политический процесс в странах региона обобщается изучением междисциплинарных работ ведущих российских политологов, экономистов и социологов.

**Ключевые слова:** развитие, модернизация, транзит, традиция, зависимость от колеи, ОЭСР, креативное разрушение, институционализм.

The discourse of social or societal modernization has been a contradictory research area ever since the assessment of nation-building process in the then post-colonial world has started to trickle into academic publications in the West. It seems to be rather debatable whether the very concept of societal modernization bore any intrinsic flaws in itself – that might depend upon authors' ideological stands. The issue of some inbuilt deficiency is apparently strongly connected to the impact of the Marxian somewhat linear view of history – although, ironically, in the post-WWII period the modernization 'paradigms' have been constructed, to some extent, as an alternative to communist recipes for challenges of development in what came to be called the "third world" [4, с. 219-233]. Currently, the study of modernization embraces a broad array of theories, what makes it easy to 'sink' into detail. Therefore such a study demands a narrowing focus to any treatise in this subject.

Thus, in this article, we are primarily interested to look for answers as to whether the historically most recent post-Communist modernization effort (or transit) (1) could be interpreted as success or failure and why, what direction has it taken (2) and (3) how can its experience be conceptualized within modern theories of social development.

On one hand, a nation's journey from traditional society to a modern one can be perceived as some spontaneous process of change, a quality pertaining to objects like human societies per se. After all there seem to be only a few countries which appear to be frozen or stuck in terms of their progress (such as the Peoples Republic of Korea, or Myanmar for example). Though, even that 'frozenness' might prove to be a superficial illusion. On the other hand, while a precarious exception can be made for the westernmost part of Europe (at which Wallerstein [11] points in his world-system theory) , that spontaneity is rather a product of interplay involving not only internal, but also external factors, which eventually define depth and speed of social change.

A question which immediately arises at fringes of relevant discussions is whether modernization, as a variety of social change actually makes the target nation 'a better place' as politicians tend to put it. There seems to be an answer. Interestingly enough, the updated UN World Happiness Report ranking of 2015 and the IMF country ranking by GDP [12] per capita income (purchase power parity) indicates the same list of countries with some 10-15% change, although in a somewhat different order [13]. Minding that there just might be a methodology problem, rooted in the algorithm of surveying in non-democratic states – for now, these doubts could be discarded.

Accordingly, if we assume that the general goal of modernization is an acknowledged transit from a traditional to a modern society within a 'target nation's' borders, than we can apply certain criteria in order to establish whether such modernization has actually taken place or not. Agreeably then, the final goal of national modernization can be defined as an external recognition of progress taking a visible shape of belonging to a group of similar entities. Before the WW2 such a group could look as a 'concert of European powers' or colonial empires, and afterwards as a 'club' of so-called industrially developed nations.

What is then a developed country? Which criteria are to be used and which countries can be classified as being developed are still subjects of debate. However, at first, let's approach that query in a more simplistic manner. A developed country, industrialized country, or "more economically developed country" (MEDC), is a sovereign state that has a highly developed economy and advanced technological infrastructure relative to other less industrialized nations [5]. Most commonly, the criteria for evaluating the degree of economic development are gross domestic product (GDP), gross national product (GNP), the per capita income, level of industrialization, amount of widespread infrastructure and general standard of living. Some argue that only developed countries have post-industrial economies, meaning the service sector provides more wealth than the industrial sector. They are contrasted with 'developing' countries, which are in the process of industrialization, or undeveloped countries, which are pre-industrial and almost entirely agrarian.

Although, this view looks somewhat outdated because the service sector has come to dominate the economic structure of most economies, that's why it is hardly any confident criteria anymore. Economists such as Jeffrey Sachs, however, have claimed that the current divide between the developed and developing world is largely a phenomenon of the 20th century [9]. But we cannot agree with vagueness like that – it tends to question the very concept of human progress. Thus, we might accept that a 'quality stamp' on whether a country is developed or developing is issued by, as mentioned above, a group or club identity. The Organization for Economic Co-operation and Development (OECD) is probably best suited to serve as such identity, as it has followed the expansion of the post-WW2 international order as a certain marker of, first, post-war reconstruction and, second, parallel political modernization of Germany and Italy. It is a forum of countries describing themselves as committed to democracy and the market economy, providing a platform to compare policy experiences, seeking answers to common problems, identify good practices and coordinate domestic and international policies of its members.

In 1948, the OECD originated as the Organization for European Economic Co-operation (OEEC) to help administer the Marshall Plan (which was rejected by the Soviet Union and its satellite states [11]). This would be achieved by allocating American financial aid and implementing economic programs for the reconstruction of Europe after World War II. (Similar reconstruction aid was sent to the war-torn Republic of China and post-war Korea, but not under the name "Marshall Plan") In 1961, the OEEC was reformed into the Organization for Economic Co-operation and Development by the Convention on the Organization for Economic Co-operation and Development and membership was extended to non-European states [7]. Most OECD members are high-income economies with a very high Human Development Index (HDI) and are regarded as developed countries.

There are currently 34 members of the OECD. The list includes 21 of the 28 European Union member states. The EU states not in the OECD are Bulgaria, Croatia, Cyprus, Latvia, Lithuania, Malta, and Romania.

During the Cold War nations like Turkey, New Zealand, and Japan acquired membership.

In 1989, after the Revolutions of 1989, the OECD started to assist countries in Central Europe (especially the Visegrád Group) to prepare market economy reforms. In 1990, the Centre for Co-operation with European Economies in Transition (now succeeded by the Centre for Cooperation with Non-Members) was established [6], and in 1991, the Program "Partners in Transition" was launched for the benefit of Czechoslovakia, Hungary, and Poland. This program also included a membership option for these countries. As a result of this, Poland, Hungary, the Czech Republic, and Slovakia, as well as Mexico and South Korea became members of the OECD between 1994 and 2000. Finally, Chile, Estonia, Israel and Slovenia have been invited and joined the OECD in 2010.

In 2013 the OECD has initiated negotiations with Latvia and in May 2016 the country was officially welcomed to become the 35th member. The same year accession procedures were launched with regards to Colombia. On April 9, 2015, the OECD decided to open accession negotiations with Costa Rica. Also, the OECD decided to open accession negotiations with Lithuania. It is worth notice, that in May 2007, the OECD decided to open accession negotiations with Russia, but they were halted in March 2014.

Therefore, the developed nations club will soon amount to 40 members and there are two peculiar features which seem to be intrinsic to it – apparently, it is not enough to dispose of industrialized market economy. In order to be accepted, the nation has also to be a recognized sovereign state (that's why we do not observe Taiwan as part of the OECD) and a working democracy (that's why Singapore and China are still absent).

There is a certain feeling that the doors of the 'golden billion' are closing in 2016 – in the future it potentially could still include the remaining 'Europe 2' and the new 'Europe 3' (EaP pending Association countries) and nations like Malaysia [3]. There exist obvious political obstacles to pave way for China and Russia – whatever

their economic development results are, disregarding the nowadays sluggishness of their performance (although driven by different reasons).

Do the above necessarily mean that a 30-year transit of the “second world”, which has started under Gorbachev, has been somehow flawed? If you look into the demographic dimension, you can find a different answer – over 76 million inhabitants of the former ‘second world’ in 4 original, 3 restored and 3 new countries have joined the first world within these three decades and another 120 million in 2 original and 8 new countries – which pose no external threats and progress in competitive democracy, although their economic development can be evaluated as slow or unstable – secure a chance of being accepted in next 20 years or so. Is this a mixed and emotionally complicated result? Definitely, a mass of almost 240 million people in 9 new countries of the former Soviet Union (or 54.7% in terms of demographics and 31% in terms of sovereign states) stay outside the whirlpool of wealth and freedom, locked into a historical deadlock. However, when observed from some distance and bringing some of other relevant interdisciplinary research into the game, that outcome looks as being far from obsessive.

The institutionalist theory in both economics and political science seems to have provided a different perspective and evaluation to the consequences of post-Communist transit. Firstly, it’s the fundamental Angus Maddison’s work in the field of the construction of national accounts, where a country’s accounts are calculated back in periods of several decades all the way to the year 1. To this end he combined modern research techniques with his own extensive knowledge of economic history and in particular countries’ performances in the field of GDP per capita. Maddison’s studies resulted in a deep new understanding of the reasons why some countries have become rich whereas others have remained poor (or have succumbed to poverty). In his ‘The World Economy: Historical Statistics’, a book published in 2004 by the OECD Development Centre, it has shown the growth of populations and economies across the centuries: not just the world economy as it is now, but how it was in the past. Henceforth, a derivation made by institutional economists from Maddison’s statistical data can be the following: it’s the movement of formal and informal

institutions in the society what really matters with regard to the speed and substance of its development and modernization.

In 2010 and 2011 Alexander Auzan, the leading Russian economist, currently the dean of the College of Economics in Moscow State University has adapted institutionalist discoveries to the general public in a series of articles for the *Snob Magazine* [1]. Within their logic, revolutions play a role of explosion with long-term unpredictable consequences, as Douglas North has demonstrated in his analysis of Russia's October Revolution. It showed that the wave of negative consequences of the violent revolution can stretch across the entire century. However, the tension between the poles of formal and informal institutions is growing, and this leads to a bilateral restructuring: informal rules begin to slowly catch up, to adapt to the changing vector of life, and the formal rules roll back to more familiar forms. At some point, these two lines intersect, and the country enters a period of economic prosperity, followed by political reaction. In Russia this phenomenon was reflected in the 'New economic policy' epoch. But later formal and informal rules continue to move apart and a certain restoration of previous order with its inefficient institutions becomes a sad reality. What blocks changes? It is so-called path dependence, institutional inertia that keeps the country in a certain trajectory. The idea of these paths has been generated by Angus Maddison. Maddison took major indicators of all nations which have controlled the globe for centuries – their gross domestic product, population, and, accordingly, the level of gross domestic product per capita – and brought all this data in a single table valid for the last 200 years. It became apparent that most of the world is divided into three groups, and this division is very clear.

The first group is on a high trajectory and stably shows high economic results.

In the former 'Second world' this group corresponds with the ten countries which have joined the OECD.

Second group is as stable at a low trajectory. It includes traditional societies that simply do not set the goal to achieve any high economic results, and focus on other values, like family and religion.

That category reminds of Central Asia, although it should be underlined, that Kazakhstan and Kyrgyzstan, both in their unique manner, demonstrate peculiar features of modernity, while Belarus evades being archaic through its industrial policies and Russia can only be evaluated as turning into this direction, it still does not fully fit in.

And there is a third, the most volatile a group of countries, which are constantly trying to go from the second group to the first. They emerged from tradition, but cannot complete modernization. Examples of such transitions are extremely rare. Members of the third group they jump, they hit the ceiling and then slide down.

This group to a large extent relates to the few EU member-states, which do not belong to the OECD, also to three EaP EU Association countries, and partially to other three countries, formally belonging to EaP, but effectively two of them are members of the “Eurasian Economic Union”. Russia has seemed to be a part of this category until recently, when a new-old set of values has been declared by its elite and the economy has shrunk drastically. This is even more disappointing, once you recall that in 2012 Russia was defined by the World Bank as a high-income economy, although it never has had a top HDI position.

John Rawls claims that "a person's good is determined by what is for him the most rational long-term plan of life given reasonably favorable circumstances. A man is happy when he is more or less successfully in the way of carrying out this plan" [8, p. 395] Therefore, a country that cannot implement a modernization plan – is ‘unhappy’. What could be the reason for cyclic failure?

The most pessimist explanation is provided by the Neo- Schumpeterian (Austrian) school. They keep to the theory of "creative destruction" formulated by the Austrian-American economist Joseph Schumpeter to explain technology development. According to this theory [10], what we usually perceive as development is nothing else than the recombination of elements: their shuffle gives semblance of a new picture, but they all lie within the same paradigm. The paradigm



itself changes rarely – applied to nations it is the national identity, which sets very rigid development limits.

Neoshumpeterians infer, that in order to make this leap to the first world, the country should sacrifice its national identity to adopt successful blueprints, like Japan has done. To some extent we can observe such phenomena when we look at the transit experience of those post-Communist countries which have joined or plan to join the OECD. Nevertheless, old institutions like church and folk traditions are still quite strong – what also can mean that those countries went back to their pre-Communist national identity and it did not interfere with their transit (while specific recent processes in Poland and Hungary are still under assessment)

Douglas North has decided to apply this idea more widely to the development as a whole. He suggested that countries that are trying in vain to reach high trajectory of development, have made the initial error in their institutional choice. He proves this by the example of England and Spain. By XVI century, these countries were at absolutely equal starting positions. Both were about equal in population and employment structure and both carried out foreign expansion. Any macroeconomist would have said that they will be at close levels in distant future. But by the XIX century England has transformed into a major world power, while Spain has degraded into of the most backward countries in Europe. What's the matter? North has shown that what happened was an ‘accident’. The taxation distribution in England was handed to the parliament and in Spain it was entrusted to monarchs, who’ve blown its colonial riches away to wage wars and produce luxury. Wrong institutional choice – such as strong presidential models of the early 1990s, later hurriedly changed for mixed or parliamentary ones, constitutional, but unfunded ‘social orientation’ of the government or such far-reaching solutions as serfdom – is genuinely identifiable in the less successful post-Communist countries. The question is whether they are able to succeed at all.

Finally, a different (“how”) approach was taken by famous Peruvian economist Hernando De Soto [5]. De Soto has asked why developing countries do not actually develop. He looked at the problem both from within the developed world, and from

some distance. It turned out that all of the deficiencies that occur in developing countries have plagued the advanced countries, only much earlier. In XVII century England the city tried to introduce residence permits. Two centuries ago virtually no one recognized property rights in the United States; the American values were painfully born in an infinite series of lawsuits and legislative decisions by states. However, the living generations in developed countries have already forgotten how to solve these problems, and that's why solutions they offer to developing countries often don't work. According to De Soto, the underdevelopment is about the gap between the formal and informal institutions, followed by the struggle of dominant groups seeking to preserve a status quo favorable for themselves. The conflict of formal and informal institutions is the basic reason underlying social turmoil in all of the three EU EaP Association countries within last 15 years.

Despite the fact, that in the beginning of this paper we have already established that statistical data indicate correlation between modernization and happiness, what if nation's progress isn't worth the pain it is accompanied with?

A recent article by Russian sociologist and economist Vladislav Inozemtsev generalizes in some depth to compare effectiveness of tradition and modernity with respect to quality of human life and government sustainability [2].

China, the most powerful economically power of the medieval world (32% of global GDP at the beginning of the XVII century, according to Maddison), which has been mysteriously lured by autarky at the peak of the Ming Empire, eventually de-linked its relationship with the outer world for more than three hundred years. The outcome was a tragic defeat in the war against Western powers, 'opium colonialism' and dependence on Japan, subsequently – a communist dictatorship. Eventually, China's share in the global economy has declined to 1.7%. In only forty years since its comeback to the modern world the country has regained the rank of the largest economy in the world and has acquired the unprecedented status of a second global superpower.

The above is quite some evidence to argue that traditionalism poses a direct long-term threat to government's effectiveness and national security.

In another part of the world "conservative" Islamic states, first the Arab countries, and then the Ottoman Empire have consistently rejected progress, what has resulted in their virtual deterioration by the middle of the XIX. It took the Ataturk revolution in Turkey and the (failed) liberal reforms in Iran, to start bringing these countries closer to modernity. Today, the price of "tradition" is even higher. Obviously, the United Arab Emirates, Qatar and Kuwait, where the lifestyle is almost indistinguishable from the West are among the richest countries in the world, whereas Afghanistan or Somalia continues to rank among the poorest.

You might think of similarities between these examples by Inozemtsev and differences between former 'second world' and now the developing nations in Central Asia. On one hand, we observe the experience of Kazakhstan and Kyrgyzstan, very different in terms of living standards but forging their ability to adapt to, in the first case, up-to-date capitalism and vibrant competitive democracy in the second case. On the other hand, there is sad experience of isolation and backwardness by three other former Soviet republics in the region.

Further, all the different kinds of authoritarian and totalitarian regimes in history, which in all cases were meticulous about moral principles of ideological purity and dominance of the state over the public and individuals – have never held a leading position globally or regionally for more than a couple of decades.

In Europe, Spain, which has disposed of a per capita GDP of circa 65% compared to the UK, has shrunk three times by the end of Franco's rule.

In the 1920s Argentina was the most prosperous country in Latin America, while by early 1980s, after a series of military dictatorships, its per capita GDP has slid to the fifth place in the region.

Many other examples show that rejection of modernity and human progress can easily lead any nation to devastation and hunger, break-up and loss of sovereignty.

The commitment of to tradition is also dangerous because such country neighbors usually follow a different path. France, for example, has slugged in military reform and suffered painful defeats in the 1871 and 1940. Russia was forced

to recover modernization after half of century traditionalist apathy after being defeated in the war of 1855 and then speed reform up again in 1905 after its unfortunate Far East adventure. It is clear today, that autarky is unable to create a modern defense industry.

Russia is sometimes referred to as a playground for harsh and eloquent social experiments in the area of development studies – the struggle of its conservatives and progressives drags on for many ages and is very instructive. In the XVI century Moscow has conquered primitively organized states on Volga basin and Siberia, but lost to a Western coalition in the Baltic – that knocked the country over into flawed institutional choice, such as serfdom, civil war and protracted decay. Much of the same has repeated and Nicholas the First and Alexander the Third, both well-meaning conservatives – what has essentially determined Russia's muddling-through and hitting the ceiling development pattern and the horrors of the Bolshevik revolution and war. Russia's complicated experience with modernization corresponds with findings made by Joseph Schumpeter in the area of paradigm resistance, path dependence studies and institutional change research by Douglas North.

Finally, traditional nations' (and conservative areas, such as the Bible Belt in the US) indicators in terms of social ills, health and crime are times worse than data characteristic of progressive countries and territories. It seems that superficial religious identity reflected through different forms of collective dictate does not actually deliver on its own promises – the elusive moral purity is unable somehow to transform into social health and wealth all by itself. The above does not necessarily mean that parish communities and family values foredoom certain countries to spend centuries in backwardness – they very well can serve as a useful segment to cluster phenomena, assisting national development. But as official state ideology, traditionalism can surely be regarded as an impediment to country's ability to transit from low-income and poor living standard strata into a higher one, be it in the former 'second world' or elsewhere.

In contrast, smart use of unique historical chances for creative destruction followed by long-term stability afterwards with elites' attention paid to bringing

formal and informal institutions closer together into certain harmony, reflected through rule of law and law enforcement, vivacious market economy and competitive political system

*Conclusions:*

Firstly, when analyzed from a distance of 25 or 30 years, the post-Communist transit can be evaluated as a relative success – especially when taking into account long-term development patterns discovered by Angus Maddison. Large groups of nations within the former ‘second world’ have made their choice between modernization and traditional way of life and this choice has determined their political processes and integration reference points for decades in the future.

Secondly, a number of post-Communist countries, many of them newborn – have withdrawn from traditionalist social organization but their results are somewhat contradictory. That phenomenon can be interpreted through Austrian school theoretical contribution and interdisciplinary institutionalist research, focusing at drama of path dependency and instruments of stabilizing complex processes of social change.

Thirdly, historical defeats of modernization that we can observe, to some degree of credibility in large countries of North and Eastern Eurasia (partially also belonging to the battlefield of Marxist experiments in the past), in the Middle East and in Latin America – can translate into deficient institutional effects which prove to be very difficult to overcome outside rare opportunities of social implosion. Such implosions, however, could not serve as a sole guarantee and background of sustainable social progress.

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