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The Two Transitions in Central and Eastern Europe and the Relation between Path Dependent and Politically Implemented Institutional Change

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and Politically Implemented
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HWWA Discussion Paper

The Two Transitions in Central and Eastern Europe and the Relation between Path Dependent and Politically Implemented Institutional Change

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HWWA Discussion Paper 314

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The present paper is an outcome of a research project on the historical and cultural path dependency of the transition processes in Central and Eastern Europe, which is carried out jointly by the *Hamburg Institute of International Economics* (Department European Integration) and the *University of Hamburg* (Institute of Economic Systems, Economic History and the History of Economic Thought). The project is funded by the *VolkswagenStiftung*. The paper has been presented and discussed at the first project workshop that took place in Hamburg at November 27, 2004 and at a Brown Bag Seminar at the *Walter Eucken Institut* at February 16, 2005. We are indebted to the discussants of our presentation at both events as well as to Lena Nievers for language assistance and a number of helpful comments.

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The Two Transitions in Central and Eastern Europe and the Relation between Path Dependent and Politically Implemented Institutional Change

ABSTRACT

The increasing gap between the formerly socialist countries of Central and Eastern Europe (CE & EE) with regard to both their economic and political performance cannot be explained by their different starting conditions after the breakdown of the Soviet Union alone. Rather, it is due to cultural and historical circumstances that shape the particular tradition and societal environment. Taking a cultural approach and referring to the newer literature on the transfer of institutions, we try to improve the understanding of the interrelation between formal and informal institutions. Our central thesis is that the 'reaction rate' of informal institutions depends on their compatibility with imported formal institutions. The transition processes in CE & EE can tell us much about the relation between path dependent and politically implemented institutional change. During the 20th century the countries of CE & EE twice went through rapid institutional change: For centuries they had acculturated to Western Europe, but as a result of the October Revolution 'Eastern' patterns were imposed upon them. Since the breakdown of the SU in the late 1980s they have 'returned to Europe' by (re-)establishing democracy and capitalism. In our opinion, to understand the differences in performance between the transition countries, it is necessary to interpret both transitions as processes of institutional transplantation and ask how the informal institutional settings in the different countries interacted with the imported formal institutions.

Keywords: Cultural Economics, Institutions, Transition, Path Dependence.

JEL-Classification: Z 10, P 51.

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1 Introduction

In the euphoria of the early 1990s the formerly socialist countries of Central and Eastern Europe (in the following: CE & EE) were generally expected to quickly turn into democracies with market economies. The experience of the last 15 years, however, has shown that only some of them (the Baltic States, Poland, Hungary, the Czech Republic, Slovakia and Croatia) have consistently chosen a reform path that aims at establishing Western-type societies. In the cases of Russia, Belarus, Bulgaria, Moldavia, the Ukraine, Romania, and Serbia and Montenegro, by contrast, it is not yet clear where the journey goes. As especially the recent events in the Ukraine have forcefully demonstrated, these countries are – albeit to significantly different degrees – still ideologically divided on the issue of the appropriate reform strategy: Should one try to develop according to Western European and US-American patterns or is this policy doomed to failure because it does not fit the geographical, historical, cultural and economic conditions of these societies?¹

The increasing gap between the two groups of transition countries with regard to both their economic and political orders cannot be explained by their different starting conditions after the breakdown of the Soviet Union alone. Rather, it also has its causes in the cultural and historical circumstances shaping the particular tradition and societal environment. Indeed, the experience of transition has led to a growing awareness of the role of informal institutions in the process of institutional change in institutional and evolutionary economics (see Roland 2002, 47). Although a lot of work has been done on this problem during the last few years, we still do not have a satisfying explanation of the role that informal constraints of human behavior play in institutional change.

To clarify this problem further, the course of our argumentation is as follows: When in institutional and evolutionary economics the idea of historical and cultural path dependence is applied to the problem of CE & EE transition, it is often overlooked that the European nations did never only develop according to the tracks determined by a – however defined – ‘cultural heritage’. Rather, they evolved in close political, military and economic competition with their neighbors, and this competition time and again

¹ In some of the countries mentioned, e.g. Belarus and Russia, clearly the latter approach has taken hold, whereas Bulgaria and Romania have decided to continue the ‘Westernizing’ reforms necessary for accession to the EU.

forced them to adapt to the institutional arrangements of the more successful nations.² This is not to say, however, that the idea of historical and cultural path dependency has to be rejected. For whenever formal institutions are taken over from abroad, in the course of their implementation they mingle with the ‘soil’ of the prevailing informal constraints of human behavior and thought, which are determined by the legacies of the past. This phenomenon can be described as a transplantation of institutions (see Badie [1992] 2000; Polterovich 2001; Djankov et al. 2003, 609-12; Oleinik 2005, forthcoming). According to Vladimir Polterovich’s (2001, 24) definition, institutional transplantation is “the adoption of institutions, that have developed in another institutional environment”. The decisive issue then is, how the informal institutional settings in the different countries interacted with the imported formal settings. In our view, the often made assumption that informal institutions react inertly to changes in the formal institutional settings must be modified. If seen as a transplantation of institutional arrangements, the ‘reaction rate’ of informal institutions depends on their compatibility with imported formal institutions.

We will demonstrate this thesis on the example of the transition processes in CE & EE. Especially in the economic literature it is often overlooked that in the course of the 20th century these countries have gone through two transitions of their political and economic orders. Until World War II, especially the countries of CE had more or less successfully tried to imitate the Western European political and economic development. But as a result of the October Revolution the new Eastern Hegemon forced them to take over the Soviet political and economic formal institutions: The voluntary acculturation to Western Europe (which nevertheless was also partly the result of political, military and economic pressure) was substituted by a forced acculturation to the Soviet Union. Since the breakdown of the Soviet Union in the late 1980s all countries of CE & EE, including the former Soviet Republics, have initially announced the desire to turn into Western-type societies, based on democracy and a market economy. Obviously, the two transitions in CE & EE were caused primarily by political events. And still, we will argue that historical and cultural factors played a decisive role in both transitions, for they determined the degree to which the imported institutions could strike roots in the informal settings prevailing in the receiving countries.

2 A good example for this is that in both Prussia and Russia the abolition of serfdom took place after devastating defeats in wars.

The paper is organized in six sections. After this introduction, the second section will give an overview of how institutional economists deal with the problems mentioned above and indicate how a cultural theory of economics could contribute to their solution. In section three we will specify a theoretical approach that tries to explain the mutual relations between formal and informal institutions. This general theoretical framework is purely structural in the sense that it does not include historical and cultural factors. These factors are included into our analysis in section four, where we apply our framework to the transition processes in Central and Eastern Europe. In section five we will briefly outline some conclusions for economic policy-making. We will finish our paper with a short outlook on the political and theoretical problems before us.

2 A cultural theory of economics as the basis for analyzing the transition problem

The well-known difference between *formal* and *informal* rules emphasizes that within the reality of social order, elements of both planned and unplanned, i.e. spontaneous order are to be found (see Hayek 1964 and 1973; cf. Vanberg 1994, chap.7). Obviously, formal rules and informal constraints are not separate. On the contrary, they work together to form institutions that shape human interaction. A crucial element of economic development and transition lies in the interaction between formal rules and informal constraints. Indeed, with reference to revolutions, North (1990, 91) has already addressed this as one of the major problems of systemic change in CE & EE.

Perhaps most important of all, the formal rules change, but the informal constraints do not. In consequence, there develops an ongoing tension between informal constraints and the new formal rules, as many are inconsistent with each other. [...] Although a wholesale change in the formal rules may take place, at the same time there will be many informal constraints that have great survival tenacity because they still resolve basic exchange problems among the participants, be they social, political, or economic.

Accordingly, the insight that future developments are tied to historical experience binds (formal) institutional developments to a specific time path, and the developing institutional structure of societies is subject to a “lock-in” or “path dependency”: historical events determine the direction of a development in such a way that the first stages trigger a process that is self-strengthening and very difficult to reverse (cf. Arrow 2000,

Magnusson and Ottosson 1997). The dynamic characteristics of such a development result in the persistence of a few individual, contingent events. The insight that individual action taking place during social and economic development can only be properly understood as being *interdependent*, i.e. as interacting with other individual actions within a specific social environment based on a specific development. Therefore, one can speak of a “socially embedded individual conception” as proposed e.g. by Granovetter (1985). Path dependency does not mean, however, that social development is *determined* by the past development of the society in question. If this was the case, rapid institutional change would be simply impossible. Rather, the theorem of path dependency underlines the significance of historical and social contexts, as well as the necessity to take these contexts into consideration in economic policy-making: As we will argue in section five, it is one of the prerequisites of successful political agenda-setting to be aware of the informal rules that form the soil in which newly established formal rules must strike roots. Specific institutional cultures – and this is to be seen with transition processes – are not necessarily successful when transferred to other social environments. Now, it is clear that path dependencies appear to be due mainly to informal rules. Because informal constraints are created through a long-term process, they provide “fertile ground” for path dependent developments.

Although new institutional economics was successful in shifting the focus away from the neoclassical question of the optimal allocation of specific resources it is left with a residual variable when it comes to why in some places, or periods of time, institutional change (often initiated by the “transfer” of institutions from abroad) adapted very quickly to the challenges of economic growth, and why in other places, or other periods of time, obsolete institutions persisted for a long time and left no place for the successful implementation of new institutions. The genesis of culture and of the set of constraints that are passed down from one generation to the next is hardly taken into consideration in this approach, either. Because of the long-term perspective of cultural phenomena, it is concluded that culture can be externalized and merely viewed as something static. By doing so, new institutional economics is at risk of repeating a mistake found in most empirical and neoclassical-oriented studies on the influence of culture in economic development (cf. Klump 2002): culture appears as an *ad hoc*-variable that is used to explain unusual developments, but a variable that cannot *itself* be explained. There is an insufficient understanding of culture itself. In other words: Culture is not merely a factor which can organize social life in a peaceful and productive – and hence

cooperative – way. Rather, culture’s structural importance for societal and political processes themselves ought to be appreciated.

Friedrich August von Hayek’s evolutionary social philosophy offers a good starting point for an appropriate understanding of “culture”. He stresses that cultural development always implies – contrary to biological evolution – the passing on of acquired characteristics, – “characteristics in the form of rules guiding the mutual relation among individuals which are not innate but learnt“ (Hayek 1988, 25). Referring to Karl Popper (1972) Hayek accordingly views cultural evolution as a process simulating “Lamarckism”, namely handing down acquired characteristics. By doing so, he underlines the uniqueness of cultural processes towards rules of behavior that improve social life. This process of spontaneous development is to be understood as a “decentralized process where, within a society or polity, different individuals or groups of persons experiment with alternative practices” (Vanberg 2001, 80). Thus, “cultural evolution is not the result of human reason consciously building institutions, but a process in which culture and reason developed concurrently It is probably no more justified to claim that thinking man has created his culture than that culture created his reason“ (Hayek, 1979, 155).

With this in mind we can now develop a qualitatively more comprehensive understanding of culture that may be applied to newer developments in social science as well as in evolutionary anthropology. If culture is understood as a dynamic, path dependent and constraining process, as more than just a set of informal rules, then – in Hayek’s perspective – the reception and construction processes of human development will come to the fore. This evolutionary perspective on culture is promising because it can be used to describe a “cumulative cultural evolution”. Evolutionary anthropology speaks of a *ratchet effect* (Tomasello 1999). In contrast to the animal world “human cultural traditions may be most readily distinguished ... precisely by the fact that they accumulate modifications over time, that is to say, they have cultural ,histories””. (Tomasello 1999, 40). The “social genesis of the subject’s structure” (Dux 2003, 252) also helps to better define the behavior of subject and society: “The subject forms in a society under the conditions of this society. Society, however, does not build this process; it is the subject itself that does it” (idem 255). Accordingly, we will understand culture not as a residuum of vague traditions but as the ongoing interplay between formal and informal institutions that emerge in the historical development of every society and must be learned by every individual in the course of his or her socialization.

If economics is understood as the science that deals with the ever-changing world of economic phenomena, then to explain these phenomena we must consider the cultural conditionality under which economic acts (and thought) occur. Because society can only be understood considering the cultural “backdrop”, and because every member of society learns in its ontogeny again and again how to act and think through interaction with society, culture is an integral part of socio-scientific explanation. The ratchet effect of culture forces every individual to reconstruct corresponding structures analogous to the ones of his conspecifics in an act of ‘guided reinvention’ (Lock 1980). Starting with its birth the human organism is subject to the coercion to develop the ability to act in a given social and material context. Without discussing this here in any length, anthropology must be understood as an important ancillary science of economic theory (Goldschmidt and Remmele 2004). Consequently, theoretical reflections on economic phenomena, as well as the possibilities of political economic reforms and company strategies, are always tied to specific social and cultural conditions. A successful theory of economic development can therefore be understood as a cultural theory of economics – in keeping with evolutionary anthropology as an integral part and an endogenous explanatory variable of cumulative cultural evolution.³

What are the consequences for an adequate theory of the transition processes?

- (1) A theory of transition must be an institutional theory. It deals with the systematic analysis of social rules and with the question of how societal conditions are formed.
- (2) A theory of institutional change is concerned with formal and informal institutions, i.e. formal rules and informal constraints. The interplay between these two types of rules is fundamental in understanding economic development.
- (3) The concept of path dependency points to the long-term significance of informal constraints as the “fertile cultural ground” from which economic processes stem.
- (4) Consequently, culture is not viewed as a “residual factor” of economic development, but – in keeping with evolutionary anthropology – is to be understood as

3 Our suggested method is similar to Herrmann-Pillath’s approach of an “economic cultural research agenda on transition” (wirtschaftskulturelle Transformationsforschung). Parallels can be drawn especially to his idea of culture as a constructive as well as communicative process driven by individual action. Furthermore, his assertion that history is an integrative part of culture corresponds to our emphasis on path-dependency. Cf. Herrmann-Pillath (1999) and (2000).

an integral part and an endogenous explanatory variable of cumulative cultural evolution.

- (5) Thus, institutional change is bound to its cultural context as the prevailing informal constraint. To understand transformation processes means understanding the interplay between culture and (establishing new) formal rules. Therefore, the possibilities of political economic reforms are always tied to specific social and cultural conditions.

3 Holistic and extended orders

In the introduction we said that there are two groups of transition countries: The countries of the first group (the Baltic States, Poland, Hungary, the Czech Republic, Slovakia and Croatia) have been consistent in their implementation of ‘Westernizing’ reforms, whereas the countries of the second group (Russia, Belarus, Bulgaria, Moldavia, the Ukraine, Romania, Serbia and Montenegro) still seem to lack a broadly shared vision on the future outlook of society. If we ask what the countries within these two groups have in common, we will quickly come across the fact in all countries of the first group the ‘Western’ versions of Christianity – Catholicism and Protestantism – dominate, whereas different versions of Eastern Orthodoxy prevail in the countries of the second group. We shall emphasize that we cannot claim originality for the thesis that the divide between ‘Latin’ and Orthodox Christianity is of decisive importance for the process of transition. The issue has been originally raised by historians and social scientists (Huntington 1993; Stark and Bruszt 1998; Wallace and Haerpfer 1998; Goehrke 2000) and in economics it has been highlighted by Stephan Panther (1997, 1998, 2000) in a number of contributions.⁴

4 Since, to our knowledge, Panther was the first economist to deal with this question, we shall briefly summarize his main line of argumentation: His central idea is to apply Robert Putnam’s (1993) concept of civiness to the case of CE & EE. According to Putnam, the key feature of civiness is that it provides values and norms, promoting the development of what is often called “extended trust”: In a non-civic society trust is typically restricted to the members of relatively small personal networks (often between kin). Hence, the individuals treat members of their own personal networks in a different way than those they are not acquainted with personally. Although people still behave differently towards kin and friends than to strangers, they generally treat other people as equals. The resulting extended trust in political terms promotes the participation of the individuals in public affairs, and in economic terms thwarts opportunistic behavior and hence lowers transaction costs. As much as we appreciate Putnam’s approach and Panther’s contributions in applying these ideas to CE & EE, with Eckehard F. Rosenbaum (2001, 893) we see the decisive problem of the chosen approach in that it is unable to explain the historical causes of the emergence and evolution of social capital. For an in-depth critique of Panther see Wagener (2002). Furthermore, it seems not implausible that the “extend

The all-decisive problem of theorizing the historical and cultural dimensions of economic activity is their specificity. Therefore their consideration always raises the question of the possibility or impossibility of general theories in the social sciences.⁵ Without being able to go into the details of this problem: We hold that the historical and cultural dimension of transition can only be properly understood when analyzed on the basis of a well-defined general approach. It is the case of the German Historical School that underlines the necessity of such a general approach: Disregarding theoretical and causal explanation implies the danger of reducing even such phenomena to historical specificity which could be analyzed sufficiently in a general theoretical framework.⁶ Accordingly, we will develop such a theoretical framework that shall hopefully enable us to come closer to an understanding of the interaction between formal rules, informal constraints and culture in the two transitions in CE & EE. This framework is purely structuralist, i.e. it does not include specific factors but provides the background on which the influence of culture and history can be made observable.

Our analysis is based on a comparison between two ideal types of social organization: the holistic and the extended, functionally differentiated order.⁷ A holistic society is characterized by an ideology or religion that claims validity for all spheres of action and thought. Hence, whatever the individual does, he or she will do it in a way that does not violate general binding moral precepts, imposed by a superior authority and learned in the course of socialization. In a society where general binding moral precepts govern men's conduct, there will not be much functional differentiation.⁸ Functional differentiation means that people act according to an economic, i.e. capitalistic logic, when buying and selling things, to a political logic, when searching for solutions to political problems, to a juridical logic when judging a crime and so on. Yet if everything – as in a holistic society – is subordinated to the one and only religious or political rationality, it

trust” of modern societies is more often the result of a sufficient set of institutional rules than an outcome of an unspecific form of “civicness”. However, we cannot discuss this problem here.

5 The issue of historical specificity has been put back on agenda of methodological discourse in economics by Geoffrey Hodgson in his book *How Economics forgot History* (2001).

6 Thus, our approach is based on what Hayek calls “explanations of the principle” and “pattern predictions” (Hayek 1967, 11; 1952/1979, 86; cf. Vanberg 2004a, 166).

7 Note that we use the term “extended order” slightly differently than Hayek. Following Hayek (1988, 6), to “understand our civilization, one must appreciate that the extended order resulted not from human design or intention but spontaneously”. While Hayek stresses the superiority of the extended order (‘capitalism’) due to its capacity to use information, we focus on the functional differentiation of societal processes in such an order. However, it is obvious that these understandings of extended order are closely connected.

8 For an introduction into the paradigm of social differentiation in the social sciences see Alexander (ed.) (1990); Schimank (2000).

follows suit that there cannot emerge different ‘value spheres’ (Max Weber). In an extended order, by contrast, there is no sole generally binding logic according to which the system is organized, but a multitude of competing rationalities. The functioning of an extended order does not rest on “common concrete ends” (Hayek 1988, 64), but on highly formal and abstract rules. Extended societies are composed of different subsystems, functioning according to their own kind of rationality.

The historical path of Western Europe, beginning in the Middle Ages, can ideologically be described as a development from a holistic to an extended order. In the Middle Ages, the religious dogma provided concrete prescripts for every kind of action and thought, and, as Karl Pribram ([1951] 1983, 587) aptly put it, “the firm belief in a hierarchical structure of eternally valid general notions found its counterpart in an equally rigid social and economic organization”.⁹ Now, the more hierarchical a society is the more social relations are personalized. The reason for this is that power as a medium of social control has a much lower coverage than abstract media like money or the general law. Such media are indeed necessary to extend the social order beyond personal acquaintance, whereas where hierarchical power relations are dominant, people are necessarily tied into relatively small groups. Where this is the case and where hence the individual is not used to interact with persons she is not personally acquainted with, she is likely to behave towards them in a much different way than towards the members of the community she lives in: In holistic societies there is to be found a polarity between solidarity among kin and the attitude of hostility towards strangers. Appropriately, Max Weber (1958, 303-4) differentiated in this context between external and internal morals (Binnen- und Außenmoral) as a decisive attribute of pre-modern societies.¹⁰

The post-medieval development of Western Europe was characterized by a sequence of differentiation processes, as a result of which society eventually turned into a system of self-organizing subsystems interacting within the framework of an extended total order.

9 Note that in this quotation nothing is said about a possible causality between ideas and social structures, and nor shall we ourselves make any assertions about this issue.

10 Max Weber’s contribution is mainly a terminological nature, however, for the phenomenon itself it had been widely discussed in German social science during the second half of the 19th century, see e.g. Simmel (1890, 48), Schmoller ([1900] 1920, 65-6). And not only in Germany: Likewise, Alfred Marshall stated in his *Principles* that “a primitive society ... prescribes an attitude of hostility to strangers.” Albeit Marshall emphasizes that in modern society “the ties of family are in many ways stronger than before”, he is convinced that “sympathy with those who are strangers to us is a growing source of a kind of deliberate unselfishness, that never existed before the modern age.” (Marshall 1930, 6).

As what mainly interests us here is the transition from feudalism or socialism¹¹ to capitalism, we shall concentrate on the institutional changes taking place on this threshold. In Western Europe the feudal age came to a close when the ascending bourgeoisie challenged the claim to power of the sovereigns. In doing so it relied on classical liberalism, which demanded an institutional separation between the political and economic spheres of society, a demand that was realized in the first decades of the 19th century in the Western part of Europe. Both democracy and the exchange economy are prime examples of spontaneous, self-organizing systems interacting within the framework of a spontaneous total system (see DiZerega 1989). To us, the decisive question is how the process of social differentiation related to the corresponding informal institutions, which are prerequisite to the functioning of an extended order. Here, we shall concentrate on the economy, but it is worth stressing that the basic principle is the same for all 'value spheres' of modern societies.

When describing the social structure of the Middle Ages we argued that abstract media of social interaction are a prerequisite for the emergence of an extended order. Money is the classic example of such a medium. However, although money is undoubtedly one of the central institutions of a market economy, up to the present day even within institutional and evolutionary economics surprisingly little research has been done into the role of money in the process of social and cultural evolution. This is all the more astonishing, because over a hundred years ago the German sociologist Georg Simmel ([1900] 1907) in his *Philosophy of Money* provided a masterly analysis of how the institution of money brings into existence the informal institutions that are basic to the functioning of an extended order.¹² According to Simmel, in the Western societies money has played the decisive role in the "general tendency... of making the individual more and more dependent upon the achievements of the people, but less and less dependent upon the personalities that lie behind them" (Simmel [1900] 2001, 296).¹³ On the one hand it is an

11 It has often been argued that Soviet socialism has much in common with the feudalist state. Both in feudalism and in socialism the process of social differentiation is restricted by the power interests of the absolute sovereign and the socialist nomenklatura respectively, claiming to represent the interests of a collective of people: the nation in the one case, the working class in the other.

12 One of the few appraisals of Georg Simmel by economists is David Laidler's and Nicholas Rowe's remarkable essay "Georg Simmel's 'Philosophy of money' – a review article for economists" (1980). We know only one attempt to apply Simmel's ideas to the problem of transition (Gajo and Rusi 2000), which in our opinion, however, does not fully do justice to the theoretical framework of the *Philosophy of Money*.

13 As this translation is rather imprecise, we will provide the original text: „Die allgemeine Tendenz geht aber zweifellos dahin, das Subjekt zwar von den Leistungen immer mehrer [sic!] [omitted in the English translation!] Menschen abhängig, von den dahinterstehenden Persönlichkeiten als solchen aber immer unabhängiger zu machen“ (Simmel [1900] 1907, 313).

important means to establish – often over great spatial distances – contacts with people whom the individual will never meet personally. The formal institution of money takes over functions that in former times had been provided by family and friends, and therefore it makes the individuals less dependent on these close personal ties. At the same time, the awareness of being dependent on the action of countless people whom one is not personally familiar with, may be seen as the greatest incentive to treat all other persons as equals and hence to overcome the gap between external and internal morals.¹⁴

However, we always have to consider one crucial aspect in analyzing extended orders: In societies based on functional differentiation the degree of possible moral coercion is much lower than in face-to-face communities such as families. This fact leads to two consequences: First, although the need to develop the ability to act in a small and familiar social context in every ontogeny means also to develop moral “skills”, these skills are of less importance for acting in an extended order. Second, because specific formal institutional ties of specific developments change the ontogenetic conditions of construction in their entirety – i.e. that the functional differentiation of society is regarded as a “conventional” fact of society – the difference between the moral dimension learned in face-to-face relations (family) while growing up and the goal-oriented action in the larger society are not perceived as diametrically opposed, because both are learned as integrating social rules.¹⁵ Consequently, there is only a small gap between the perception of social rules in the extended order and those moral rules learned in the face-to-face community. Or, to put it differently: the already mentioned differentiation between ‘internal morals’ and ‘external morals’ as introduced by Max Weber¹⁶ plays

14 The kind of social relations that are brought about by an extended order have already been described by Adam Smith in his *Theory of Moral Sentiments*. It is well known that Smith’s theory was directed against Thomas Hobbes, whose ideas had provided the intellectual background of the absolutist age (see e.g. Perlman and McCann 1998, 35-53). Smith’s central idea and political message was that the individuals’ ability to put themselves into the position of their fellow men, and hence also to see themselves through the eyes of other persons, was sufficient to maintain a stable organization of social relations, so that order did not need to be imposed ‘from above’. For the purpose of our study it is crucial to understand that fellow-feeling with strangers is not, as Smith assumed, an inherent part of human nature. Rather, it is the result of socialization in a functionally differentiated society. As mentioned above, the double process of enhancing weak, impersonal ties between non-familiar people and weakening strong, personal ties with kin and close friends is not restricted to economic relations. Rather, this is the core principle of the type of *Vergesellschaftung* in modern Western societies.

15 This insight should be added to Denzau and North’s concept of shared mental models. While they stress that institutions are “a reflection of the evolving mental models” (Denzau and North 1994, 22) it remains unclear in which way the process of ‘inculturation’ of social rules could be interpreted from an anthropological point of view.

16 Note that the term ‘external morals’ is somewhat misleading. Extended orders are not ruled by moral values (in the sense of taking the interests of others into consideration) but by abstract social rules.

only an subordinate part in the extended order. The formal institutions which justify outside morals are included in the process of socialization.

The opposite is true for holistic societies. If these societies are characterized by an ideology or religion that claims validity for all spheres of action and thought, then there is a sharp distinction between ‘internal morals’ and ‘external morals’, a distinction between ‘us’ and ‘them’. It is based on the perception of mutual respect among the members of the same tribe, religious community or family as well as on the perception of every outsider as an ‘enemy’. Thus, the implementation of new formal institutions (in the process of transformation) is experienced by the member of such societies as a ‘strange’ element and as a large gap between ‘inside morals’ and (underdeveloped) ‘external morals’. This highlights the necessity to perceive the relative autonomy of formal rules and informal constraints and underlines that there could be a conflict between coexisting and competing formal rules and informal constraints – an aspect perhaps underestimated in North’s work (cf. Fiori 2002, 1030 f.).

In this section, we have tried to clarify the connection between the differentiation processes at different levels of the social system: Overcoming the belief in one set of generally binding religious and/or ideological dogmas and functional differentiation of different ‘value spheres’ of society are mutually connected processes. Only functionally differentiated subsystems of society can be organized with the help of highly specialized media of communication, such as money. And these abstract media of exchange, by objectifying personal relations, promote the emergence of extended trust. We are now able to summarize our elaboration on the two ideal types “holistic society” and “extended order” in the following table:

Figure 1: Holistic and extended orders

	Holistic society	Extended order
Type of Ideology	Belief in an orthodox religion or political ideology, claiming absolute and eternal truth for all kinds of action and thought.	Multitude of possible interpretations of social reality.
Degree of functional differentiation, especially relation between polity and economy	No or little functional differentiation between different spheres of society, especially no clear separation between economy and polity.	Clear functional differentiation between the different spheres of society, clear boundary between polity and economy.
Dominant type of social relations	Dominance of personal relations within relatively small personal networks, large gap between internal and external morals.	Dominance of depersonalized relations, weakening of small networks, small gap between internal and external morals.

It is understood that these ideal types were, are and will be realized nowhere in their pure forms. In almost every society there exist some religious or ideological dogmas that are seldom called into question, the boundaries between the different subsystems are never impermeable, and it is hard to imagine a society in which all social relations are fully depersonalized. Nevertheless, these ideal types help us to understand the two processes of transition that have taken place in CE & EE. In a first step we will outline the evolution of these societies in very general terms, leaving aside all differences between the individual countries. In a second step we will broaden the argument by considering the different developmental stages the countries had reached at the eve of socialist transition, and finally we will take into account the role of specific cultural and historical factors.

4 The countries of CE & EE between the holistic and the extended order

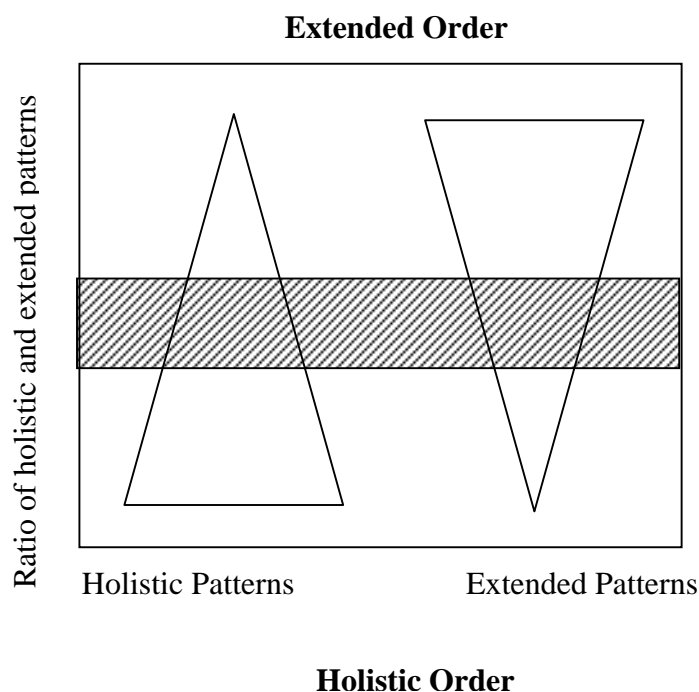
Compared to Western Europe, all the CE countries went through catch-up development. Before they were re-organized according to socialist principles in the aftermath of World War II, they all had – to a greater or lesser degree – participated in Western Europe’s development from a holistic to an extended order. Yet as historical latecomers they had not fully arrived at modernity when the Second World War brought this development to an abrupt halt. In the inter-war period, any generally binding religion or political ideology previously prevalent in these countries had been replaced by a multitude of possible interpretations of social reality. In most of them, however, there were strong nationalist movements, demanding to subordinate all action and thought to the interests of the national state (in detail, see Sugar and Lederer (eds.) 1994; Banac and Verdery (eds.) 1995). The connection between political and economic nationalism was extremely tight in the CE societies, so that they are often even regarded as prime examples of economic nationalism (see e.g. Kofman 1997; Berend 2000).

Neither the economic nor the political systems that existed in the CE countries on the eve of socialist reconstruction can be characterized as extended. It is true that after World War I in all of them democratic systems had been established, but these were not to last long. With the exception of Czechoslovakia, in all countries of CE the young democracies had been replaced by autocratic systems by the early 1930s (see Crampton [1994] 1997, 33).¹⁷ If our presumption is correct that there is a mutual dependency of social differentiation or ‘extendedness’ of society at its different levels, we can assume that personal relations in these societies were also of a less extended type than in Western Europe. Small, personal networks and a significant gap between internal and external morals are likely to have still prevailed.

¹⁷ Of course, this development must be seen before the background of the overall autocratic tendencies in Europe at that time, and we simply do not know how things would have developed without the October Revolution and World War II. However, from a scientific perspective, there is no reason to idealize the pre-Soviet history of the Central European nations. If today intellectuals in these countries tend to do so, however, this fulfils an important function in the process of defining a new political identity.

Now it would be a severe mistake to assume that these societies each as a whole were characterized by a structure that lies somewhere between our two ideal types. Rather, countries passing through catch-up development are typically distinguished by a co-existence of the old and the new, and often there emerges a tension between these poles: While the well-educated urban population comes into close contact with the culture of the more advanced countries, little changes in the life and thought of the not so well-educated rural population which tends to oppose the structural changes. The social tension usually finds its expression in fierce ideological clashes between advocates and opponents of the modernization processes. The conflict of opposed patterns of life and thought makes catch-up development an extremely volatile path of social development, for the risk of a counter-revolution against modernity is always given (see also Zwey- nert 2004). When the co-existence of the two patterns is taken into account, a rough approximation of the developmental path from the holistic society to the extended order can be illustrated in figure 2.

Figure 2: The potential conflict between holistic and extended patterns



This very simple graph illustrates that in the course of the development from the holistic to the extended order (bottom-up movement) holistic and extended patterns of action

and thought co-exist but change their relative positions. Leaving external shocks, such as wars and economic crises, aside for the moment, we can assume that the clashes between holistic and extended patterns will reach their peak in the marked field, where the ratio between holistic and extended patterns is close to 1. It is beyond the scope of this paper to decide to what degree each of the countries of CE had already passed the ‘critical zone’. And it makes little sense to speculate about the likelihood of the establishment of totalitarian regimes in any of them without the October Revolution and World War II. In fact, at the very same time that the countries of CE introduced democratic systems for the first time in their history, an anti-modern counter-revolution happened in Russia, a country in which there was a sharp tension between holistic and extended patterns when it got roped into the First World War.¹⁸ In the aftermath of World War II the Soviet Union managed to impose her formal institutions on the countries of CE & EE. The people in these societies now were forced to acculturate to the Soviet Union.¹⁹ In the foregoing section we have briefly explained what we think are the decisive features of Western European social evolution. In order to understand the forced acculturation of the countries of CE to the Soviet Union, we now have to look into the basic features of Russian social and economic development before the revolution.

Most experts on Russian history agree that it was the Orthodox tradition that set the country apart from the developmental path of Western Europe. It has often been argued that the differentiation processes that in Western Europe were initiated by the competition between the religious and the secular powers, were blocked in the Orthodox East by the far-reaching amalgamation between the two within the framework of the patrimonial state (see Müller-Armack [1945] 1951, 350; Pipes [1971] 1992, chap. 9; Buss 2003, chap. 2). Therefore, in Russia the whole chain of differentiation processes, formative for the evolution of Western Europe, did not occur – at least not endogenously.²⁰ In view of its impact on Russia’s acculturation to Western modernity the decisive feature of the Russian Orthodox religious tradition is its extreme holism.²¹ The world view of the

18 World War I as an external political shock played a decisive role in the development of CE & EE. But while in Russia it led to the political de-stabilization of an extremely volatile society, it helped the CE countries to establish democratic systems.

19 For a concise overview over the “Different Roads to Socialism” in CE see Swain and Swain ([1993] 2003, 31-54); in detail, see Berend (1996).

20 The ‘borderlessness’ within the patrimonial state was certainly partly a reflection of material factors, such as the country’s lack of any natural borders, the shortness of the agrarian season and others. Yet as we are concerned here mainly with the impact of cultural factors on transition, we shall concentrate on the role of the Russian Orthodox legacy on the evolution of Russian society.

21 “Orthodox thinking is based on representation of things in their wholeness, which means that each individual incident falls into a much wider category” (“Some thoughts regarding the preparation of

Russian Orthodox Church was holistic not only in the sense that it claimed validity for every kind of social action or thought, as was typical also of the medieval Catholic Church. More than that, it saw in the wholesomeness of society an end in itself, the final aim of history. The contradiction between the Russian Orthodox ideal of a homogenous, undifferentiated society and the rationalistic ‘fragmentation’ of Western culture was discussed as a central issue by Russia’s Church authorities up to the 18th century.²² The idea that there might be a difference between religious and political truth, and that a person could act as a merchant in one way and as a believer in another, ran counter to the Orthodox religious dogma that also strongly influenced Russian secular culture (see Berdyaev [1937] 1990, 19; Buss 2003, 167).

Now of course Russia did not develop in isolation from the rest of the world. The key to understanding her history is that the country was under permanent political, military and economic pressure to imitate the more successful Western European institutional settings. By the end of the 17th century it had finally become clear that Russia had desperately fallen behind the other European nations, and with the reign of Peter the Great began Russia’s forced acculturation to the West (see e.g. Hughes (ed.) 2001; Cracraft 2004). It would definitely be a mistake to overemphasize – in the style of the Russian Slavophiles – the peculiarities of the country’s social evolution. Certainly Russian catch-up development was ‘normal’ in the sense that also in other countries economic modernization processes were politically implemented in an authoritarian style. And although the social and ideological tensions that arose as a result of the modernization process might have been rather stronger in Russia than in other countries, they were not a specific phenomenon, but could also be observed in Germany, for instance (see also Zweynert 2004). There was one specific – and crucial – difference, however. The settings imported from the West had developed as a result of the process of social differentiation which was in conflict with the holistic legacy of the Orthodox dogma. This is the main reason why economic reforms, aiming at the implementation of an exchange economy, met with especially fierce resistance in both the broader strata and the educated classes of the Russian population, and why the transfer of Western institutions often led to the emergence of strange hybrids between extended and holistic patterns.

the CCPD/WCC Orthodox Consultation on ‘An Orthodox Contribution to the Search for Justice’’, quoted in Harakas 1999, 2).

22 An outstanding elaboration of “Eastern Orthodox Anti-Westernism” has been recently provided by Vasilios N. Makrides and Dirk Uffelmann (2003). It is especially commendable that the authors (*ibid.*, 87) do not confine their analysis to the intellectual aspects of the issue, but emphasize that “the forms of anti-Western attitudes can be observed at the level of statements and expressions as well as at the level of behavior and actions”.

This is best illustrated by the heated debates about the fate of the Russian rural commune, the so-called *obshchina*.²³ Indeed, the fact that this collectivist institution was maintained even after the abolition of serfdom in 1861 and until as late as 1908 must be seen as one of the decisive reasons why the thorough modernization of Russian society failed.²⁴

On the eve of the Bolsheviks' putsch, however, Russia did not only have the highest economic growth rates in Europe, she had also entered into an extremely intense and fruitful intellectual exchange with Western Europe. Very much speaks in favor of the thesis that under luckier historical circumstances Russia could have become a 'normal' European nation in the early 20th century. At the same time, the Soviet reconstruction of Russian society definitely had something to do with cultural patterns which in the 'Silver Age' of Russian culture had more and more taken a back seat. As the Russian historian Boris N. Mironov (2000, vol. 2, 333-4) has shown, the Russian Revolution can be seen as an attempt to modernize the country on the basis of the pre-modern patterns of social organization. In a society that since the 1890s had already significantly approached the Western world, an all-embracing ideology was implemented yet again. This ideology tied in with the traditional creed for the wholesome society: By means of violence social differentiation was more or less abolished and the priority of the social collective over the individual was revived. Society was pushed from the path towards the extended order to that towards the holistic society.

23 In the second half of the 1850s a heated debate was started in the Russian journals on the issue whether in the course of the imminent abolition of serfdom (realized in 1861) the rural commune should be dissolved or whether this institution should be maintained (in more detail see Zweynert 2002, 206-10). Only a small group of liberals favored the former alternative, arguing that because of its collectivist character the commune formed a major obstacle to both the economic and the political development of the country. However, the *obshchina* was vigorously defended by a coalition between socialists and romanticists. For both camps the idea that the individual can and should exist without being bound into a social collective ran counter to the core of their ideological convictions that were – and this is the decisive point – shaped by the same holistic tradition.

24 In his remarkable paper "A Model of Network Capitalism: Basic Ideas and post-Soviet Evidence" Anton Oleinik (2004a) has put forth the thesis that the peculiar features of today's Russian network capitalism can partly be explained by the patterns of social interaction shaped by the institution of the *obshchina*. It is beyond the scope of this paper to deal with this controversial issue, see the debate between Barnett (2004) and Oleinik (2004b).

5 The two transitions in CE & EE and the transfer of institutions

In the aftermath of the Second World War the Stalinist model of a wholesome society, a strange hybrid of modern and pre-modern patterns, was imposed upon the countries of CE & EE (in detail, see Part II of Ramet (ed.) 1998). The implementation of the formal institutions of Soviet society pushed all these countries from one developmental path to another. If for centuries they had slowly and gradually approached the West, they were now forced to acculturate to the East.

In all countries concerned, the implementation of socialist institutions led to a deep-going de-modernization of social relations at all levels of society:²⁵ The multitude of competing interpretations of reality was replaced by the rule of a generally binding ideology. Functional differentiation of society was drastically reduced because all social subsystems were subordinated to and made a function of the political system. Not as obvious is the question of how social relations (that is, the micro-level of our ideal-type comparison) were affected by socialist reconstruction. We again restrict our analysis to the economic sphere. In the third section we have argued that the institution of money played a decisive role in extending social relations beyond the limits of personal ties. In order to understand the impact of the planned economy it is important to be aware that the socialist shortage economies were only apparently monetized barter systems (Kornai 1980, vol. 2, 544). The permanent shortage of goods of all kind forced the individuals – both in the spheres of production and consumption – to build personal redistribution networks. Within these networks, the factor that decided over success or failure of a transaction was the personal relation to the people able to supply the demanded good (Srubar 1991, 422). Yet the shortage economy did not only lead to a re-personalization of economic relations. More than that the only possibility to redirect resources into one's own network of personal ties was to detract them from the official economy. Consequently, opportunistic behavior towards 'big' society and solidarity with family and close friends was a central element in the economic socialization of the individual in a planned economy. In other words: Under the conditions of the shortage economy the gap between internal and external morals was revived, or, formulated in other terms: Social differentiation, one of the most important prerequisites of a functioning market economy, was yet again replaced with personalized trust.

25 At the same time, Soviet modernization brought about technical progress, which in the medium and long run also led to urbanization and other forms of modernization. Nevertheless, as far as the structure of social relations is concerned, we can speak of de-modernization processes.

At this point we must conclude the structural explanation and ask what the specific historical and cultural patterns were that determined the degree to which the different countries moved towards the holistic society. Both the unsolicited acculturation to Western Europe and the forced acculturation to the Soviet Union can be described as transfers of institutions. As outlined in the introduction, the decisive problem of institutional transfer is the compatibility between imported formal rules and the informal institutions prevailing in the receiving country. In the case of full compatibility, the adaptation to the imported formal rules will be relatively quick and smooth. In the case of partial or full incompatibility, the adaptation to new formal institutions will take much more time and in the worst case there will emerge a gap between formal rules and real behavior, resulting in disorder and welfare losses. But then, the imported market institutions' intended legal and economic incentives have either no effect or they might even provoke practices that counteract the intentions of the original institutional design. The ensuing uncertainty about the behaviour of transaction partners and the missing certainty of the law lead to a personalization of economic relations, to corruption and the creation of criminal network structures, all of which produce least a minimum degree of social stability, however in a very sub-optimal way. In his important paper on "Institutional traps" (2001b) Viktor M. Polterovich has explained a whole range of dysfunctions in/of the Russian economy, such as barter, arrears, tax evasion and corruption with the gap between imported formal institutional settings and the informal constraints that govern economic behavior.

When acculturating to Western Europe, the CE & EE countries imported social institutions that were a result of and reflected the key feature of the Western European developmental path: social differentiation. In order to catch up with the advanced nations, all of these countries had to pass much quicker through the different developmental stages than the Western European countries. Hence, there was much less time to cope with the tensions caused by the modernization process, and this made the political development somewhat volatile. The decisive specific difference within the group of countries of CE & EE was that the 'Latin' nations had participated to a higher extent in the cultural developments that formed an inseparable part of the Western European path towards the extended order. For centuries they had not only imported the 'hardware' of formal institutions, but had also participated – at least partly – in the differentiation process that formed the 'software' of the institutional settings. This is not to say, however, that in the Orthodox countries the attempt to import Western European institutions was doomed to failure. As formal and informal institutions are mutually connected, the imported formal

institutions clearly stimulated the development of 'fitting' informal institutional arrangements. But as the original setting of informal institutions in the Orthodox countries was significantly less compatible with the imported Western institutions than it was in the 'Latin' ones, the process of acculturation took more time, and the tensions between formal and informal settings as well as the division of society into advocates and opponents of the modernization process were significantly stronger.

If this thesis is correct, it follows suit that the opposite was true for the acculturation to the East, when the Soviet Union imposed her institutional settings upon the countries of CE & EE. The formal institutions imported from Soviet Russia were quite incompatible with the informal institutional settings prevailing in the 'Latin' countries. Perhaps it was especially the feeling among the people of these countries that they belonged to Western Europe which prevented the growing together of native and imported institutions.²⁶ In the Orthodox countries the informal institutions were more compatible with the imported formal Soviet institutions, because the de-differentiation process was in accordance with the holistic legacy of Orthodoxy. The different degree of cultural compatibility explains why the implementation of Soviet institutions had a qualitatively different impact on the countries concerned: All of them experienced de-modernization processes and developed in direction of a holistic society, but in the Orthodox countries due to the higher degree of compatibility between the externally imposed formal settings and the internal informal institutions this movement went significantly further than in the 'Latin' countries. Therefore, it can be expected that Soviet socialism widened the cultural gap between the Orthodox and the 'Latin' countries.

In the first half of the 1990s, this gap was concealed by the overall hey-day of political and economic liberalism, when all countries of CE & EE expressed the desire to turn into societies of the Western European type. In the meanwhile, however, it has become obvious that these ideas have gained a much more stubborn foothold in the 'Latin' than in the Orthodox countries.²⁷ A typical feature of the Orthodox countries is that freedom

26 Nevertheless, the case of Eastern Germany clearly shows that less than 50 years of Soviet socialism were enough to establish 'fitting' informal institutions. And the fact that today, 15 years after the fall of the Berlin Wall, there still exist significant differences between Eastern and Western Germany in key attitudes towards the economy and politics clearly indicates that the impact of politically imposed formal institutions on informal behavioral constraints should not be underrated (see Lehmann-Waffenschmidt and Böhmer 2004).

27 At the present moment there are roughly two and a half times more liberal deputies in the parliaments of the 'Latin' countries than in those of the Orthodox ones, where the number of Communist parliamentarians is four times higher than in the 'Latin' countries (the authors' own calculations on the ba-

of opinion is suppressed. As we have argued above, belief in the absolute and eternal truth of a religious or political dogma is a key feature of a holistic society. The compatibility between Soviet ideological patterns and the Orthodox tradition may explain why freedom of expression in the Orthodox countries is much more difficult to realize than in the 'Latin' ones. It is particularly telling that this is not only true for the former Soviet Republics, but also, as the European Commission stresses in its recent monitoring reports on these countries, for Bulgaria (see Commission of the European Communities 2004 a, 22) and Romania (see Commission of the European Communities 2004 b, 26). The fact that socialist dictatorship did not last longer in Romania and Bulgaria than in the other formerly socialist countries clearly speaks for the importance of the Orthodox legacy as the predominant cultural factor.

The borderline between the polity and the economy is much more blurred in the Orthodox than in the 'Latin' countries. This clearly emanates from the 2004 annual report "Economic Freedom in the World" provided by the Fraser Institute²⁸ and the Transparency International 2004 annual report.²⁹ Not only in Belarus, but also in Russia the political elite clearly tries to regain power over big business. The startling case of Lukoil and its director Chordokovskii has drawn the attention of a broader public to the Kremlin's attempts to gain control of the key positions in the Russian economy (see Mommsen 2003). As cited above (in footnote 14), Adam Smith held that it was not necessary to impose order from above, because fellow-feeling provided stable social relations. In the history of the social sciences there has been much debate on the issue whether this assumption on human nature – or more precisely: the nature of social relations – is valid in all places and at all times. The transition experience suggests that it is not. When Western institutions are imposed upon a society in which there is a gap between internal and external morals, there is a high risk that the individuals will use the

sis of the website "Parties and Elections in Europe" [www.parties-and-elections.de] by Wolfram Nordsieck.

28 On average, the 'Latin' countries reached position 47 out of 123, whereas the average rating of the Orthodox countries was position 105. Again, the recent monitoring reports of the European Commission provide evidence that this problem is by no means restricted to the former Soviet Republics but forms a decisive obstacle to Bulgaria's (Commission for the European Communities 2004 a, 19) and Romania's (Commission for the European Communities 2004 b, 21-23) accession to the EU. Similarly, Pejovich analyzes the influence of culture on economic transition processes using the "Index of Economic Freedom" by the *Heritage Foundation*. His conclusion, that a conflict of the formal rules with the prevailing informal rules will raise transaction costs and reduce the production of wealth in the community, tallies with our findings. Cf. Pejovich (2003).

29 While the 'Latin' transition countries reach averagely position 45 out of 133 monitored countries, the Orthodox countries are on average at position 86.

freedom an extended order offers to opportunistic behavior towards ‘big’ society in order to benefit their own personal network(s).

The problems at the three levels of society are mutually dependent: Where liberal ideas are weak and not deeply rooted in the minds of the political and scientific elite, market reforms are unlikely to be put through rigorously. If the resulting weakness of the formal institutions is reinforced by informal institutional settings contradicting the market order, the emerging order may even combine ‘the worst of two worlds’. This can lead to the political demand to abandon all attempts to follow an ‘alien’ developmental path that allegedly does not fit the domestic traditions, and to return to a national model of social development. The Orthodox countries, which during the last years have increasingly restored elements of the old order, seem to be excellent examples of the path dependency of institutional change: The political changes of the early 1990s initially led to attempts to radically change the formal political and economic institutions. But when the informal settings in these societies did not keep up with the speed of development, there emerged a gap between formal and informal institutions. The resulting disorder and welfare losses then seem to have induced a re-adaptation of the formal institutions to the informal settings, so that hybrid structures between the old and the new have now emerged. As much as this experience gives evidence of the persistence and power of past developments: The ‘orange revolution’ in the Ukraine has clearly shown that the turning away from the principles of an extended order observed in Belarus and increasingly also in Russia is not the pre-determined result of the Orthodox heritage. Consideration of the cultural dimension of systemic change in CE & EE should not lead to cultural fatalism. Quite on the contrary, it should help us not only to reach a better understanding of transition, but also to develop political strategies that take into account its cultural dimension.

6 Implications for economic policy-making

The theorem of path dependency in institutional economics implicitly emanates from the assumption that national cultures are to a high degree homogenous, so that certain ‘cultural constants’ determine the trajectory of institutional change. On the one hand, our central thesis that the transition processes in CE & EE have been decisively influenced by the ‘Latin’ and the Orthodox versions of Christianity, is fully in line with this assumption. On the other hand, we have called into question the assumption of cultural homogeneity by arguing that the process of catch-up development can also be described

as a transfer of institutions (in analogy to our understanding of culture as a dynamic, evolutionary process): In the case of CE & EE the different religious traditions seem to have had an important impact on the relative strength of holistic and extended patterns of behavior and thought. The acculturation to the West was more difficult in the Orthodox countries, because the legacy of the Orthodox belief was in potential conflict with the imported Western institutions. This strengthened the anti-modernist sentiments, and hence the cultural and ideological division was stronger in these countries.

This, as we are convinced, more feasible view of the connection between cultural patterns and economic development does not call into question the historical and cultural specificity of countries or cultural areas, but it challenges the unrealistic assumption that societies develop in isolation from each other. Just now, in the so-called 'age of globalization' it should be clear that, as Carsten Hermann-Pillath (1999, 48) aptly puts it, one should speak of "transculturality" rather than of national cultures: If the process of catch-up development is interpreted as a transfer of institutions, it does indeed become clear that the decisive problem is not the (economic) culture of the receiving country as such, but rather its interaction with the imported formal institutions. Our analysis implies that in threshold countries there already exist – more or less – extended patterns, so that an important task of developmental policy is to be seen in strengthening these patterns. In our opinion, two dimensions of this problem can be distinguished: One problem refers to the adaptation of the imported formal institutions to the informal institutions prevailing in the receiving country. Politics in a country which is characterized by a strong division between modernists and traditionalists is likely to waver between the extremes, and the introduction of painful economic reforms can all too easily lead to a counter movement that abandons the road towards the extended order. Therefore, as a second problem the question arises how this development may be stabilized.

To begin with the first problem: According to our analysis, the Orthodox countries face the dilemma that the Orthodox legacy is potentially in conflict with an extended order. This potential contradiction causes problems both at the level of thought (ideology) and at the level of action. At the level of action much speaks in favor of the thesis that Western political and economic institutions could not simply be transferred to the Orthodox countries. Experience has shown that the gap between the informal constraints prevailing in the Orthodox countries and the imported (formal) market institutions was so wide that the gap often caused the emergence of institutional traps in the form of durable institutional hybrids of holistic and extended patterns. David Stark's statement that

in the course of transition the actors reconstruct organizations and institutions “not on the ruins but with the ruins of communism as they redeploy available resources in response to their immediate practical dilemmas” (Stark 1996, 995; cf. Stark and Bruszt 2001, 1130) is particularly true for the interplay between (traditional) informal constraints and (imported) formal rules.

Formulated in general terms: if a country imports formal institutions from abroad, the compatibility with the prevailing informal constraints must be carefully analyzed. If such an analysis leads to the conclusion that there are severe incompatibilities, it must be examined how the imported settings can be modified in order to avoid the emergence of institutional traps. In case of full incompatibility, however, “second-best solutions” (from a neoclassical point of view) are to be preferred to an import of unfitting institutional arrangements (see Oleinik 1998, 27; Goldschmidt 2004b).

At the ideological level it must always be taken into account that in societies where the intellectual traditions were shaped by holistic traditions³⁰ the understanding and backing of liberal ideas will be weak. In such a situation it is the task of the politician to guide society not only by adapting reform programs to the prevailing attitudes but also by developing marketing strategies that help to ‘sell’ the political vision to a broader public.³¹ This view is fully compatible with the main insight of constitutional economics: The actual implementation of a specific social arrangement will be especially credible if it is approved of by the parties involved.³² Thus, constitutional economics analyses whether reforms are compatible with the existing legal-institutional framework as well as whether these reform proposals can be integrated within the existing, socially acceptable set of rules based on informal constraints. In consequence, constitutional reforms should be implemented gradually and on the basis of previous experience, because people’s trust in reforms is increased if the reform plans correspond to familiar principles and ideas (cf. Goldschmidt 2004c). This way, what legitimizes the policy is the citizens’ involvement in the familiar social environment, and not some sort of ‘objective’ economic efficiency (see e.g. Vanberg 2004b).

30 As we have shown in another paper, this was also the case in Germany, the intellectual history of which strongly resembles that of Russia (Zweynert 2004).

31 The implementation of the German ‘Social Market Economy’ after World War II is a good example of such a strategy. Yet as we have already dealt with that issue in other publications (Zweynert 2004, Goldschmidt 2004a), we shall not go into the details here.

32 Very much in line with this basic idea of constitutional economics, North, Summerhill and Weingast (2000, 27) speak of “credible commitments”: “Establishing credible commitments requires the creation of political institutions that alter the incentives of political officials so that it becomes in their interests to protect the relevant citizen rights”.

Let us now turn to the second problem mentioned: After decades of Soviet de-modernization that have weakened the ‘Western’, modernist branch and strengthened the ‘Eastern’ anti-modern one, the Orthodox countries are torn between holistic and extended patterns at all the three levels described in our ideal types. There is ideological dissent between adherents and opponents of modernization. Hence, there is also no consensus on whether society should continue with its attempts to import the formal institutional settings of Western Europe and the USA. Under the conditions of the resulting uncertainty, for the economic agents it is absolutely rational to behave in a ‘hybrid’ way that ensures survival until it is clear where the journey will go in the end: Many of the red directors in Belarus, whose companies survived the early 1990s through inter-enterprise indebtedness, have now safely returned into the custody of the state. Overall uncertainty, resulting from the tension between conflicting patterns of thought and action, can easily lead to a call for a strong leader who re-establishes an authoritarian style of rulership – this is exactly what one can observe in Belarus and in Russia, as well as in other former Soviet Republics.

History shows that this problem is not restricted to the Orthodox countries, for – as mentioned above – with the exception of Czechoslovakia on the eve of the Second World War all countries of CE had already left the road towards an extended order by implementing more or less authoritarian regimes. Also around the middle of the 1990s one could observe how as a result of what Janos Kornai called “transformational recession” (1994) post-communist parties were remarkably successful in the elections in almost all CE countries. In this situation, political pressure from without seems to have been a decisive stabilizing factor: The prospect of EU membership, which is bound to clearly defined conditions, has favored the choice of the ‘Western’ path of development both economically and politically. It has to be underlined that this prospect offers not only clear economic incentives but also the decisive advantage that the provision of painful reforms can be justified with reference to the constraints imposed by the EU authorities. It is understood that not all countries of the ‘Orthodox block’ can be offered to become EU members. But still, the Western European countries can be blamed for having done too little to promote the feeling of ‘belonging to the West’ in the former Soviet Republics by offering a least the prospect of what is now often called ‘privileged partnership’.

7 Outlook

By announcing the intention to integrate Bulgaria and Romania into the EU in December 1997 the European Council has made a historical decision, the momentousness of which is seldom recognized in public debates. Making these countries members of the EU means nothing else than attempting to push the centuries-old boundary between the 'Latin' and the Orthodox part of Europe further east. Interestingly, albeit both countries still lag much behind their 'Latin' neighbors, since the late 1990s both Bulgaria and Romania have made significant progress in political and economic reforms and are now already positioned somewhere between the two groups in most ratings. At the same time, however, the European Commission's recent reports on "progress towards accession" in these countries make clear that at the present time they still share the problems of the other Orthodox countries in transition. The next few years will provide new insights into the relation between path dependent (endogenous) and (external) politically induced institutional change: Will the pressure of the benevolent dictator EU manage to set the Orthodox countries on the path to an extended order, or will the Orthodox legacy prevent a full 'Westernization' of these countries?³³

33 The framework developed here allows to derive empirically testable hypotheses. This paper forms part of a research project in which a so-called "extended order index" has been developed. With the help of representative surveys this instrument will provide insights into the prevailing attitude towards the extended order. In summer and autumn of 2004 surveys have been conducted in Latvia, Poland and Russia the results of which are soon to be published.

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