T.C.
İstanbul Üniversitesi
Sosyal Bilimler Enstitüsü
İngilizce İktisat Anabilim Dalı

Yüksek Lisans Tezi

THE IMPACT OF INTEGRATION WITH EUROPEAN UNION ON TRANSITION ECONOMIES

Şafak ÖZBAY
2504030002

Tez Danışmanı: Prof. Dr. Nihal TUNCER

İstanbul 2007

TEZ ONAY SAYFASI

ÖZ

80'lerin sonunda, Sovyet siyasi ve iktisadi düzeninin çöküşüyle beraber, Orta ve Doğu Avrupa ülkelerinin pazar ekonomisine kaynaşmaları çok önemli bir konu olarak ortaya çıkmıştır. Bu çalışma Avrupa Birliği ile entegrasyon sürecinde, geçiş ekonomilerinin analizini sunmaktadır. Tezin başında konuyla ilgili temel stratejiler ele alınmaktadır. Küreselleşme ve liberalleşmenin, eski Sovyetler Birliği ülkeleri üzerindeki etkileri incelenerek, uyum sürecinin geleceği ve büyüme oranlarının izleyeceği yola ait tahminler yapılmaktadır. Sonuçlarımız, geçiş sürecinin Batı Avrupa ile daha yakın tarihi, kültürel ve coğrafi ilişki içinde bulunan ülkelerde daha sağlıklı devam ettiğini göstermektedir. Ancak büyüme oranını etkileyen etmenlerin çeşitliliği ve etkilerinin kolay ayırt edilememesi de, sonuç ve geleceğe yönelik tahminler incelenirken göz önünde bulundurulmalıdır. İlaveten her ülke kendi özel şartlarına sahiptir. Şüphesiz, tüm geçiş ekonomileri için geçerli tek bir yargıya varılması mümkün değildir.

ABSTRACT

In the late 80's, with the collapse of Soviet political and economic system, integration with the market economy of Central and Eastern European countries has appeared as a significant issue. This paper presents an analysis of the transition economies in the integration to the European Union process. At the beginning, main strategies have been examined. Some forecasts for the future of adaptation process and the path of growth rates have been made by investigating the impact of globalization and liberalization on former Soviet Union countries. Our results show that the transition process works healthier for the countries which have closer historic, cultural and geographic relations. Nevertheless, the variety factors effect growth rate and undistinguishable influences are also considerable as you study on conclusion and forecasts. In addition, each of the countries has its own specifications. Certainly, it is not possible to have one assessment valid for all transition economies.

PREFACE

The collapse of the Soviet economic (and also politic) system in the late 1980s concluded a significant economic slowdown experienced by the former Soviet Union countries over the foregoing three decades. The transition from central planning to a market economy has been complicated. The presentation of the transition economies has fallen short of expectations for some reasons: advanced western economies did extraordinarily well in the 1990s, which raised the bar for perceptions of economic achievement; the economic problems associated with the transition were widely underestimated; and policymakers made a number of questionable choices. However, progress has been made in a number of dimensions.

Transitional depression in the former Soviet Union and Eastern Europe has lasted much longer than anticipated. It has been the result of both the legacy of the past and policy mistakes. Due to gradual institution-building and structural reforms, the post socialist economies have started to improve, and some leading countries have been able to build up a definite amount of momentum towards rapid growth. There is an option that, within the wider perspective of globalization, some of these emerging market economies are going to be able in a matter of one or two generations to catch up with the more advanced industrial countries.

We find it necessary to study the transition economies for a number of reasons. First of all, the performance of the countries in Eastern and Central Europe is crucial, as they attempt to pass from central planning economy to market system and access the European Union. Secondly, the countries in Eastern and Central Europe are parallel to Turkey that is starting the accession discussions with the European Union. Additionally, Turkey is very closely associated to the development in the transitional economies and stability or instability in the neighbour countries may have a huge effect on economic conditions of Turkey.

I would like to thank my supervisor Professor Nihal Tuncer for her advice, support and help in this study. I also owe thanks to my family for their patience and endless support.

CONTENTS

ÖZ……………………………………………………………………………iii
ABSTRACT…………………………………………………………………iv
PREFACE ……………………………………………………………………v
CONTENTS…………………………………………………………………vii
LIST OF TABLES…………………………………………………………...ix
LIST OF FIGURES ………………………………………………………...x
LIST OF ABBREVIATIONS……………………………………………...xi
INTRODUCTION 1
1. TRANSITION STRATEGIES..3
1.1 Main Strategies 3
1.2 The Effects of Globalization on Post Socialist Transformation 7
2. TRANSITIONAL RECESSION AND THE DEPRESSION OF THE 1990s 12
2.1. First Decade of Post Socialist Transition..19
2.2. Policies without Growth: Absent Components..22
2.3. In the Direction of a New Consensus 30
2.4. The Means and Ends of Economic Policy 35
2.5. Transition as a Process of Systemic Rearrangement 39
2.6. Transition as a Tool of Growth Strategy...43
2.7. Organization Building..45
2.8. The Impact of Washington Consensus 49
2.9. Performance of the Transition Economies in Specific Areas 55
2.9.1. Gross Domestic Product 55
2.9.2. Inflation..59
2.9.3. Exchange Rates and Current Account 60
2.9.4. External Debt and Financial Crises..61
2.9.5. Budget and Taxes...62
2.9.6. Privatization and Creation of New Firms 64
2.9.7. Domestic and Foreign Investment 66
2.9.8. Employment Adjustment, Wage Setting and Unemployment......68

2.9.9. Life Expectancy 73
2.9.10. Fertility....74
2.9.11. Marriage and Divorce Rates 75
2.9.12. Attitudes....76
3. PERFORMANCE THROUGHOUT THE TRANSITION PROCESS 78
3.1. Reforms, Growth and Inflation 83
3.2. Reforms and Structural Change....86
3.3. Economic Growth Potential in the Long Term....90
3.4. Unique Paths of Contraction, Recovery and Growth 97
3.5. Policy Reaction and the Role of Institution-Building....104
3.6. External Impacts and the Reaching Process 108
4. SCENARIOS FOR LONG-TERM GROWTH UNTIL 2050 114
4.1. Active Policies for Catching-Up in the 21st Century 129
4.2. When Will the Transition Be Over? 136
CONCLUSION....138
REFERENCES 146

LIST OF TABLES

Table 1 Average Rate of Growth (NMP) in Centrally Planned Economies 14
Table 2 Recession and Growth in Transition Economies 15
Table 3 Recession and Growth in Transition Economies, 1990-97.......................21
Table 4 Forecast of economic growth in transition economies, 1998-2002 48
Table 5 Current Macroeconomic Indicators 60
Table 6 Income Inequality (Gini Coefficients) 72
Table 7 Life Expectancy and Fertility...74
Table 8 Marriage and Divorce Rates 75
Table 9 Attitudes Toward Transition 77
Table 10 Liberalization and Growth, 1989-95 80
Table 11 Forecasting Long-term Trend Growth 81
Table 12 Fiscal Deficits and Quasi-Fiscal Expenditures for Selected Countries, 1992-94 (as percentage of GDP)..82
Table 13 Sectoral Shifts at Constant Prices, 1989-94 86
Table 14 Registered Unemployment through Transition...89
Table 15 Levels and Change in Revenue, Expenditures and Fiscal Balance, 1989-94...92
Table 16 Money, Interest Rates and Real Balances 95
Table 17 Duration of Recession and Growth in 1990-99 (in number of years).......98
Table 18 Real GDP Index. Forecast for 2003-04...115
Table 19 GDP per capita in 1999 and 2003(4), PPP basis.....................................116
Table 20 Average Rate of GDP Growth in 2000-03(4) 120
Table 21 Catching-up in the Transition Economies in the 21st Century 121
Table 22 The Year of Catching-up with the Developed Countries........................135

LIST OF FIGURES

Figure 1 Real GDP Percentage Change Index 56
Figure 2 Foreign Direct Investment Per Capita..67
Figure 3 Employment Index (1989=Base) 69
Figure 4 Change in share of service sector in GDP..88
Figure 5 Alternative Growth Paths for the Very Long-Term, 2000-2050, Scenario 1A, 1B, 1C 122
Figure 6 Alternative Growth Paths for the Very Long-Term, 2000-2050, Scenario 2A, 2B, 2C 124
Figure 7 Alternative Growth Paths for the Very Long-Term, 2000-2050, Scenario 3A, 3B, 3C 125
Figure 8 Alternative Growth Paths for the Very Long-Term, 2000-2050, Scenario 4A, 4B, 4C 126
Figure 9 How many times the output should rise to catch up with $PPP 30,000 GDP per capita?...133

LIST OF ABBREVIATIONS

ASEAN	: Association of Southeast Asian Nations
CEFTA	: Central European Free Trade Agreement
CIS	: Commonwealth of Independent States
CLI	: Cumulative Liberalization Index
CMEA	: Council for Mutual Economic Assistance
EBRD	: European Bank for Reconstruction and Development
EU	: European Union
FDI	: Foreign Direct Investment
GDP	: Gross Domestic Product
GNP	: Gross National Product
ILO	: International Labour Organization
IMF	: International Monetary Fund
NGO	: Non-Governmental Organization
NMP	: Net Material Product
OECD	: Organisation for Economic Co-operation and Development
UN	: United Nations
WB	: World Bank
WTO	: World Trade Organization

INTRODUCTION

In this study, a general assessment of the strategies and consequences of the first years of the transition have been obtained, as well as an outline of the principal challenges faced by these economies. In introducing examples and data, I focus mainly on comparing the experience of the five central European countries (Czech Republic, Poland, Slovakia, Hungary, and Slovenia) with the experience of Russia. This five countries have a population of approximately 70 million people together and were the first to start the transition process. Russia, the principal country of the former Soviet Union with its population of 145 million, is and now of the Commonwealth of Independent States (CIS), but it has had a very tough experience with transition. I will also make a number of references to three other groups: the three Baltic countries of Estonia, Latvia and Lithuania, with a combined population of 7.5 million, that became part of the Soviet Union only at the outset of World War II and in the 1990s staged a comperatively rapid transition; the Balkan or southeast European countries of Albania, Bulgaria and Romania, combined population 34 million, that have not been affected by war or other conflicts; and Ukraine as the second largest economy of the former Soviet Union and now CIS, with its population of 50 million. I will not discuss except in passing the many smaller countries of the CIS: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, and Uzbekistan. I also will not focus on the countries of the former Yugoslavia, since their formative experiences of the 1990s involve war and civil strife rather than economic transition.

The centrally planned system was comperatively well suited to mobilizing resources for improving existing productive activities during World War II and the postwar reconstruction, even though it also suppressed human rights and imposed great human suffering. The Soviet bloc countries achieved a 4.5 percent annual growth rate in per capita GNP during the 1950s, exceeding the 3.7 percent growth rate of a comparison group of market economies. Nevertheless, the rigidities of the command economy made it much less suitable for invention, innovation and efficient allocation of resources, resulting in a long-term slowdown in the entire Soviet bloc

since about 1960. When the comparison group of market economies averaged rates of growth of GNP per capita of 4.5 percent in the 1960s, 2.8 percent in the 1970s and 2 percent in the 1980s, the growth of per capita GNP of the Soviet bloc countries is estimated to have fallen to 3.6 percent in the 1960s, 2.8 percent in the 1970s, and 0.8 percent in the 1980s.

The collapse of socialism created expectations that the centrally planned economies would generate fast economic growth and gradually catch up with middle income developed countries as they moved to a market system. These expectations were tempered by anxiety over high rates of inflation that were being observed in Poland and in disintegrating Yugoslavia the late 1980s, and by the knowledge that transition would not happen overnight.

1. TRANSITION STRATEGIES

1.1. Main Strategies

The policymakers in the former Soviet bloc formulated transition strategies that focused on macroeconomic stabilization and microeconomic restructuring, along with institutional and political reforms. The functioning of these strategies varied across countries in pace and particulars. A main debate took place about the merits of rapid reform vs. steady reform. But as it turned out, almost all the transition governments plunged ahead in rapid "big bang" style with what will be called Type I reforms. On the other hand, major policy differences ensued in what are termed Type II reforms, which only some governments carried out.[1]

Type I reforms characteristically focused on macro stabilization, price liberalization and dismantling of the institutions of the socialist system. The macroeconomic strategy emphasized restrictive fiscal and monetary policies, wage controls, and in most cases also a rigid exchange rate. The micro strategy was to shift swiftly towards price liberalization, even though a number of key prices like those of energy, housing and basic consumption goods often remained controlled along with wages and exchange rates. The institution governing the Soviet bloc trading area, the Council for Mutual Economic Assistance (CMEA), was abolished and most countries opened up quickly to international trade, therefore inducing a more competent allocation of resources based on world market prices. Most countries also rapidly diminished direct subsidies to trusts and state-owned enterprises, and allowed them to restructure or even break up. They removed barriers to the creation of new firms and banks and carried out small-scale privatizations. Furthermore, early on most governments broke up the "monobank" system, whereby a single state bank (or a system of tightly knit but nominally independent banks) functioned as a country's central bank as well as a nationwide commercial and investment bank, and allowed

[1] Svejnar, Jan (2002). "Transition Economies: Performances and Challenges," *Journal of Economic Perspectives*, Vol.16, No.1, p.3.

the creation of new and independent banks. A final feature was the introduction of some elements of a social safety net. These changes caused a sizable reallocation of labour away from the state-run firms, some of which went to the new private firms and some of which ended up in non-employment. The Type I reforms showed comparatively sustainable and were associated with improving economic performance in central Europe (except the Czech Republic) and in the Baltic countries, while they were much less successful in Russia, the other countries of the Commonwealth of Independent States, and the Balkans.

Type II reforms concerned the advance and enforcement of laws, regulations and institutions that would ensure a successful market-oriented economy. These reforms contain: establishment and enforcement of a market-oriented legal system and accompanying institutions; the privatization of large and medium-sized enterprises; additional in depth development of a viable commercial banking sector and the appropriate regulatory infrastructure; labour market regulations; and institutions related to public unemployment and retirement systems.

The differences in the capacity of transition governments to bring out Type I and Type II reforms seemed to turn on two factors: their ability to collect taxes with which to finance public programs and their ability to reduce corruption and rent-seeking behaviour. Type I reforms usually seek to cut off subsidies and to decrease centrally planned regulation. Since many transition governments had big difficulty in setting up a reliable tax system, cutting off subsidies and dropping the scope of government was roughly forced upon them. Nonetheless, Type II reforms emphasize that transition needs not only the withering away of a ubiquitous dictatorial state, but also a creation of a reliable state apparatus that provides a level playing field for the market economy. Type II reforms require that government have some resources, at least sufficient to enforce market; friendly laws and to avoid being dominated or captured by special interests.

Whilst the full range of differences across countries in Type II reforms are difficult to capture, it is probable to give some sense of the differences across several

areas: privatization, banking reform, labour and social institutions, and a market-oriented legal system.

Outstanding differences subsist across the transition economies in the strategy of privatizing large and medium-sized firms. Slovenia and Poland moved slowly in privatizing state-owned enterprises, relying instead on commercialization, where firms remained state-owned but were run by somewhat independent appointed supervisory boards rather than directly by the state, and on the creation of new private firms. Hungary and Estonia proceeded diligently and unexpectedly efficiently with privatization of individual state-owned enterprises by selling them one-by-one to external owners. This manner of privatization was initially viewed by many strategists as being too slow. Yet it provided much-needed managerial abilities and external funds for investment in the privatized firms, it generated government revenue and efficient corporate governance, and it turned out to be comparatively quick when carried out by determined governments. Ukraine and Russia opted for fast mass privatization and relied mainly on subsidized management-employee buyouts of firms. This method had the advantage of pace, but it has led to poor corporate governance in that existing management usually was not able or willing to improve efficiency. The method also did not produce new investment funds and skills, and it provided little revenue for the government. Ultimately, Lithuania the Czech Republic, and to a lesser extent Slovakia carried out equal-access voucher privatization, whereby a majority of shares of most firms were distributed to citizens at large. While this approach may have been most fair and one of the best in terms of pace, it did not generate new investment funds, nor did it bring revenue to the government. Alternatively, it resulted in dispersed ownership of shares and, together with a weak legal framework; it resulted in poor corporate governance. The poor corporate governance often permitted managers or majority shareholders to appropriate profit or even assets of the firms ("tunnel") at the expense of minority shareholders.

In the improvement of a banking system, virtually all countries swiftly abolished the monobank system as part of Type I reforms. Some countries, such as Russia, allowed impulsive growth of new banks from the bottom up, resulting in the

creation of hundreds of banks almost overnight. In central and eastern Europe, the process was much more government-controlled, but even there dozens of small banks quickly emerged in countries like Poland and Czech Republic. Whilst the banking systems differed in various ways, they shared some dispiriting patterns. Many of the small banks rapidly collapsed. In most countries, large banks started the transition with a sizable portfolio of non-performing enterprise loans and, upon restructuring, they quickly accumulated new non-performing loans. The large banks survived mainly because they were "too large to fail" and governments bailed them out. The requirement for repeated bailouts of banks has in the late 1990s led Czech Republic, Hungary and Poland to privatize virtually all domestic banks to large western banks. Central Europe has therefore become a laboratory for observing some attempts to introduce competitive western banking system with virtually no local banks.

The transition countries differed in the nature and pace of the development of labour and social regulations and institutions. By the end of 1991, all the Central and Eastern European countries developed comparatively well-functioning unemployment compensation and social security benefit schemes, with the originally generous benefits becoming somewhat more modest over time.[2] In Russia and the other countries of the Commonwealth of Independent States, the official benefits were low to start with and declined noticeably in real terms over time; and even the low official benefits were often not paid.

Almost no transition country succeeded in swiftly developing a legal system and institutions that would be highly conducive to the preservation of private property and to the functioning of a market economy, even though some countries did much better than others. This lack of a market-oriented legal structure appears to have been the Achilles heel of the first dozen years of transition. Many policymakers underestimated the significance of a well functioning legal system or believed too

[2] Ham, John, Jan Svejnar and Katherine Terrell (1998). "Unemployment and the Social Safety Net During Transitions to a Market Economy: Evidence from the Czech and Slovak Republics," *American Economic Review*, Vol. 88, No. 5, pp. 1117-1142.

readily that free markets would take care of any foremost problems. In addition, many lately rich individuals and groups in the transition economies (especially those who have contributed to the corruption of public officials) did not desire a powerful legal system. The countries that have made the biggest progress in limiting corruption and establishing a functioning legal structure and institutions are the central European and Baltic countries, with the partial exception of Slovakia and the Czech Republic. In recent years, a significant momentum for carrying out legal and institutional reforms in many of these countries has been the need to develop a system that conforms to that of the European Union as a prerequisite for accession to the EU.

1.2. The Effects of Globalization on Post Socialist Transformation

The vast changes in the world economy have marked the last decade of 20th century. The patterns of economic performance have been changed by the new phases of technological revolution and far going internationalization of capital flows. Wide trade liberalization, accompanying by growing liberalization of financial and capital markets, has brought the new challenges and new prospects. These challenges must be dealt with not only by the governmental and international organizations, but to still growing scope by the private sector and non-governmental organizations (NGOs). Hence, on the eve of the new century, there are not only mounting old and settled structural issues, but also several new problems that must be addressed accurately by theoretical considerations and particularly by sound policy response.

First, the private sector should be not only the main beneficiary of the outcomes of transition and globalization, but must be engaged more than so far in the crisis management. The role of private business is thriving worldwide, both in advanced market economies and in developing and formerly centrally planned economies - in the latter mainly owing to immense privatization. Hence private sector must carry larger responsibility for the results of the crises, when they hit.

Private sector from the improved industrial countries (including various financial intermediaries, investment banks, the hedge funds, and multinational corporations) while getting more involved in business on the global scale, must also be more interested about sharing the costs and the responsibility, when the international capital flow fails to deliver positive results.

Second, the international organizations including institutions dealing with particular aspect of international and global economic activities and regional development banks must coordinate their actions in harmonious way. Despite advancing liberalization, or in some sense just because of it, there are certain interlaced processes monitored by different organizations, yet the latter are not competent to coordinate their policies in a sufficient way. Many problems on the global economic scene, including its post socialist past, go forward just because of lack of that type of coordination. The appropriate example here is risky explanation for unregulated flow of short-term capital, which can help and facilitate economic growth in emerging markets, but it might also make it more difficult. Unfortunately, in the latest years the latter was often the case. If the risk evolving from widespread trade liberalization is augmented by the risk arising from radical financial liberalization, then these risks are crucially escalating, particularly in the economies with weak institutions. This is often the issue of emerging markets, especially among the post socialist countries.

Third, the international Non-Governmental Organizations (NGOs) are going to play much more important role than thus far. The governments and their international organizations must be seen as a strategic partner for private sector. The current case of coordinating the actions regarding the debt reduction for highly indebted poor countries is good example of such work and may turn to be good meaning for the future. If the primary developed countries from the G-7 group as well as the International Monetary Fund and the World Bank practice the challenge of debt burden jointly with NGOs, then the effects are observable. On the one hand, the future will bring definitely more processes of similar characteristic, in particular regarding investment in human capital and natural environment protection, and

counteracting inequality and poverty, on the other. Transition economies will be also increasingly involved in these types of attempts. It will work on the behalf of their ability to develop faster, since these activities are linked to the learning process and to more complimentary participation in the global economic interchange.

Fourth, the systemic transition to market economy has an important meaning for globalization. Some of these countries are clearly on the path towards full-fledged market economy. Some others, while still attempting to reform their existing economic system, e.g. China, will most likely connect this process soon. All three aspects of transition, that is liberalization cum stabilization, institution-building, and the restructuring of industrial capacity, are related to the internationally and thus also globally occurring processes.[3]

Liberalization cum stabilization is linked to the process of opening up formerly relatively closed economies. That is reflected not only in the fact that, due to higher participation in international division of labour, their imports and exports are growing faster (or, during contraction, falling slower) than overall output. It means also free entry to and exit from liberally regulated businesses for both domestic and international entrepreneurs. Moreover, capital flow has been liberalized as well, thus making very rapid the infant capital markets of those countries a part of the global incorporated financial and capital markets. International investors go through particularly the financial and utilities sectors. It is causing not only a progress as far as quality of services provided by these sectors is concerned, but also creates a risk of surfacing a kind of 'dependent capitalism'[4]. Such risk is deriving from the asymmetry between the scope of capital being invested by international corporations and foreign investors in these countries, on the one hand, and the lack of ability of these countries to raise enough capital to invest into foreign markets, since they are even short of capital to meet their own needs, on the other hand.

---

[3] Kolodko, Grzegorz W. (1992). "From Output Collapse to Sustainable Growth in Transition Economies: The Fiscal Implications," Washington, DC: International Monetary Fund, p.13.
[4] Poznanski, Kazimierz (1997). "Comparative Transition Theory: Recession and Recovery in Post-Communist Economies," Conference paper presented at "Transition Strategies, Alternatives, and Outcomes", Helsinki: UNU/WIDER.

This challenge can be overcome only in the long run, assuming that financial stabilization is accomplished, the essentials are sound, and the growth is fast. Institution-building, especially throughout new law and organizations facilitating the market based allocation of recourses is correlated to globalization too. There are several institutional arrangements, which at the same time are a part of international and global institutional order, e.g. regulation in relation to trade liberalization agreed within the framework of World Trade Organization (WTO), or policies and standards aiming at protection of natural environment. Indispensable part of globalization (and not opposition to it) are the processes of various regional integration, e.g. with the European Union (EU) and, after initial disintegration, within the Commonwealth of Independent States (CIS). During globalization the local economies' institutional arrangements are getting more similar to each other and the more similar they become, the easier it is to improve the process of integration and globalization. All these reforms lead to microeconomic reorganization of the existing industrial capacity[5]. To quite large degree it takes place simultaneously with the growing participation of multinational corporations. Thus mounting part of the production and distribution processes in transition economies can be cleanly seen as a division of the global economy. Escalating inward foreign direct investments (FDI) are contributing to this process significantly. Nonetheless, the key meaning for future growth will have higher than achieved so far tendency to save and, as a result, higher capability for domestic capital.[6]

From this outlook, continuous inflow of FDI must be seen only as an addition to strong flow of domestic capital. Owing to globalization it must continue, even after the privatization process attracting so much of the inward FDI expansion in the 1990s, will be done. Hence it should be expected that also in the future the FDI will be targeting at microeconomic restructuring and thus will contribute to rising

[5] Lavigne, Marie (1999). *The Economics of Transition: From Socialist Economy to Market Economy*, (second edition), Chatham, Kent: Macmillan, p. 229.
[6] Kolodko, Grzegorz W. (1999). "Fiscal Policy and Capital Formation in Transition Economies," EMERGO, *Journal of Transforming Economies and Societies*, Vol. 6, No. 3 (Summer), pp. 33-62.

competitiveness in the long run. All these have to to enhance the growth ability in transition economies still further.

2. TRANSITIONAL RECESSION AND THE DEPRESSION OF THE 1990s

Before the historic attempt of transition to a market has been launched, the formerly centrally planned economies were growing. In fact, they were growing fast. Over the four decades preceding the 1990s the annual rate of growth had averaged from 4.8 percent in the former Czechoslovakia to 8.2 percent in Romania. With such rate of growth the national income was doubled in 16 years in the former case, and in less than nine in the latter. However, growth under centrally planned system had many specific features. At least five of them are worth to be mentioned in the context of the way of reasoning related in these considerations.

First, despite stubborn attempts of the governments (or indeed quite often just because of their intervention in economic matters and owing to the bureaucratic allocation of resources) there were specific growth cycles.[7] Although the output was mounting systematically, the medium-term growth rate was fluctuating. There were the periods of accelerated growth, and then the periods of adjustment, during which the growth had slowed down. Later, another development was launched and the sequence, by and large, was repeated. These two features - that is the endogenous mechanism of regular fluctuation and relatively periodical character of these changes - justify the interpretation of those processes as of a cyclical nature.

Second, the growth was of a 'bad quality', since even in relatively better performing economies the shortage syndrome was never eliminated totally. That in turn was causing considerable economic and political stress. Price distortions were leading to additional obstacles to uphold high and stable rate of growth. At the later stage, in some countries the shortages became accompanied by open (i.e. price/wage) inflation. Thus so-called 'shortageflation' syndrome had emerged.[8] Therefore,

---

[7] Bauer, Tamas (1978). "Investment Cycles in Planned Economies," *Acta Economica*, xxi, pp. 243-260.
[8] Kolodko, Grzegorz W. and Walter W. McMahon (1997). "Stagflation and Shortageflation: A Comparative Approach," *Kyklos*, xl, 2, pp. 176-197.

growth was associated with lasting disequilibrium. Under the central planning allocation that was just contradictory to what was accepted by the authorities.

Third, despite high rate of growth the living standard was not improving quickly enough. The socialist model of development was based on expansion of heavy industries and the investment drive, so consumption was rising always slower. Due to the cyclical nature of growth, consumption growth rate did fluctuate too, yet the highest deviation was in relation to investments. Nonetheless, too slow (at least from the people's expectations viewpoint) improvement of standard of living was causing rising social dissatisfaction, what in turn was leading to the further momentum losing. This factor, together with discomfort of shortageflation, explains why the socio-political system was getting out of balance despite not that low rate of overall production growth.

Fourth, there was a 'growth fatigue'.[9] The speed of growth was falling down. Especially at the later stages, after initial rapid growth in the 1950s and 60s, the growth rate significantly decreased. It happened although investments were growing faster than overall production, what shows that the efficiency was shrinking. As the labour productivity was growing still slower, in the late 1980s growth was coming close to stagnation and in 1989 it became indeed slothful. Thus the potential for growth was fading away. Later, unfortunately, together with the beginning of transition, the recession had started and inflation accelerated considerably. Thus these countries, although to different degree and for a different period of time, had shifted from one malaise, that is the shortageflation under dying centrally planned regime, to another, that is the slumpflation under emerging market order.

Fifth, the catching-up process was taking place already under the centrally planned system. Especially in the early years, the countries at relatively lower level of development, e.g. Bulgaria and Romania, were growing much faster than the countries enjoying relatively higher level of production and hence better standard of living, e.g. Hungary and the former Czechoslovakia . The same can be said about the

---

[9] Poznanski, Kazimierz (1996). *Poland's Protracted Transition: Institutional Change and Economic Growth*, Cambridge, UK: Cambridge University Press.

growth pattern within the former Soviet Union, where Caucasus and Central Asian republics were growing significantly faster than the East European republics. Though to a lesser extent similar was situation in the former Yugoslavia republics, where for instance the rate of growth in Macedonia was higher than in Slovenia.

Table 1 Average Rate of Growth (NMP) in Centrally Planned Economies

	1950-89	First Phase of First Cycle	Last Phase of Last Cycle
Romania**	8.2	17.0	5.4
Bulgaria*	6.9	>10.0	5.2
Poland	5.8	9.8	3.9
Soviet Union	6.5	16.0	3.3
GDR	5.9	18.0	3.3
Hungary**	5.0	9.3	1.6
Czechoslovakia	4.8	10.0	2.4

*: Average for 1953-89
**: Average for 1951-89
NMP: Net Material Product

Source: Central Statistical Office (GUS), Warsaw, various years and author's calculations.

And then the transition recession has begun. It lasted from three years in the best case – i.e. Poland since mid-1989 until mid-1992 - to as many as 10 years in the worst case, i.e. in Ukraine from 1990 until 1999. In the former, Gross Domestic Product (GDP) contracted by about 20 percent and then started to recover and grow. In the latter, output fell by over 60 percent and has started to grow only in 2000. While only three countries - additional to Poland in 1996, Slovenia in 1998 and Slovakia in 1999 - have been able to recover the pre-transitional output, at the other end of the spectre there are countries doing even worse than Ukraine. In Georgia and Moldova GDP in 1999 was at about one third of its 1989 level, and in another four former Soviet Union republics it was significantly below a half of that amount. Among the Eastern Europe economies, in six countries GDP was hovering around or below three fourths of the 1989 output.

Table 2 Recession and Growth in Transition Economies

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	Real GDP 1999 1989=100
Poland	0.2	-11.6	-7.0	2.6	3.8	5.2	7.0	6.1	6.9	4.8	3.8	121.6
Slovenia	-1.8	-4.7	-8.9	-5.5	2.8	5.3	4.1	3.5	4.6	3.9	3.5	107.6
Slovakia	1.4	-2.5	-14.6	-6.5	-3.7	4.9	6.9	6.6	6.5	4.4	1.9	101.5
Hungary	0.7	-3.5	-11.9	-3.1	-0.6	2.9	1.5	1.3	4.6	5.1	4.2	99.2
Czech Rep.	1.4	-1.2	-11.5	-3.3	0.6	3.2	6.4	3.8	0.3	-2.3	-0.3	94.7
Albania	9.8	-10	-27.7	-7.2	9.6	9.4	8.9	9.1	-7.0	8.0	7.1	92.5
Uzbekistan	3.7	1.6	-0.5	-11.1	-2.3	-4.2	-0.9	1.6	2.4	3.3	3.0	92.3
Belarus	8.0	-3.0	-1.2	-9.6	-7.6	-12.6	-10.4	2.8	10.4	8.3	1.5	78.2
Croatia	-1.6	-7.1	-21.1	-11.7	-8.0	5.9	6.8	6.0	6.5	2.3	-0.7	77.2
Estonia	-1.1	-8.1	-13.6	-14.2	-9.0	-2.0	4.3	3.9	10.6	4.0	0.0	75.7
Romania	-5.8	-5.6	-12.9	-8.8	1.5	3.9	7.1	4.1	-6.9	-7.3	-4.1	73.0
Macedonia	0.9	-9.9	-7.0	-8.0	-9.1	-1.8	-1.2	0.8	1.5	2.9	0.6	72.0
Bulgaria	0.5	-9.1	-11.7	-7.3	-1.5	1.8	2.1	-10.1	-7.0	3.5	1.4	66.8
Lithuania	1.5	-5.0	-6.2	-21.3	-16.0	-9.5	3.5	4.9	7.4	5.2	0.0	65.4
Kyrgyzstan	4.0	3.0	-5.0	-19.0	-16.0	-20.0	-5.4	7.1	9.9	1.8	0.0	60.4
Kazakhstan	-0.4	-0.4	-13.0	-2.9	-9.2	-12.6	-8.2	0.5	2.0	-2.5	-1.7	60.2
Latvia	6.8	2.9	-10.4	-34.9	-14.9	0.6	-0.8	3.3	8.6	3.6	1.5	60.1
Russia	2.6	-4.0	-5.0	-14.5	-8.7	-12.7	-4.1	-3.5	0.8	-4.6	1.5	56.1
Turkmenistan	-6.9	2.0	-4.7	-5.3	-10.0	-18.8	-8.2	-8.0	-26.1	4.2	17.0	51.2
Azerbaijan	-4.4	-11.7	-0.7	-22.6	-23.1	-19.7	-11.8	1.3	5.8	10.1	3.7	45.2
Tajikistan	-2.9	-1.6	-7.1	-29.0	-11.0	-18.9	-12.5	-4.4	1.7	5.3	5.0	44.1
Armenia	14.2	-7.4	-17.1	-52.6	-14.8	5.4	6.9	5.8	3.1	7.2	4.0	42.5
Ukraine	4.0	-3.4	-11.6	-13.7	-14.2	-23.0	-12.2	-10.0	-3.2	-1.7	-2.5	35.7
Georgia	-4.8	-12.4	-20.6	-44.8	-25.4	-11.4	2.4	10.5	11.0	2.9	3.0	33.8
Moldova	8.5	-2.4	-17.5	-29.1	-1.2	-31.2	-3.0	-8.0	1.3	-8.6	-5.0	30.5
Bosnia-Herz.	na	na	na	na	na	na	-5.7	58.9	50.1	19.4	6.6	x
Yugoslavia	na	na	na	na	na	2.5	6.1	5.8	7.6	1.5	-37.3	x
GDP-weighted average*												
EE-13	-0.2	-6.6	-10.7	-3.6	0.4	3.9	5.5	4.0	3.6	2.4	1.7	99.3
CIS-12	0.6	-3.7	-6.0	-14.2	-9.3	-13.8	-5.2	-3.5	0.9	-3.5	0.3	54.3
EE & FSU-25	0.3	-5.0	-8.1	-9.5	-5.0	-6.0	-0.5	-0.2	2.0	-1.2	1.0	71.3

*: The weights used are the EBRD estimates of nominal dollar-GDP for 1996.

na: data not available.

Source: EBRD, Transition Report, London: European Bank for Reconstruction and Development, 1999.

Of great significance here is the bias stemming from the existence of immense informal, i.e. neither officially registered nor taxed sector. The issue is that informal activities revise upward both output and employment, but not necessary

raise the rate of growth, or lessen the rate of contraction. In another words, it is obvious that in transition economies the factual output and thus GDP is considerably (in the range between 15 and 30 percent) higher than officially acknowledged. However that changes only the basis from which the speed of growth should be counted, but not the rate of growth as such.[10] Accordingly, at present day, the overall GDP as well as the GDP per capita (and consequently the GDP absorption, i.e. private consumption and investment) are higher than it may be suggested by official data. The reason is not faster than officially registered growth, but higher output at the point of departure. Hence these observations might change the understanding and interpretation of the absolute level of output, but not the pace of its expansion. It must be also admitted that in some cases the range of the output fall at the onset of transition was overstated. Part of the factual production did not disappear, but simply was transferred, most often together with assets, from official to informal sector. Later such particular form of privatization (since the official sector used to be state-owned and the unofficial became a private one) resulted in faster officially registered speed of growth than indeed it was actually taking place.

Output, which did exist before, but was not reported, had turned out to be regularly registered and thus counted in the official statistics. Therefore the phenomenon of informal sector is bringing two types of bias to the actual picture of initial contraction and recovery. It could happen that the real scope of contraction was exaggerated, but later the real growth could be exaggerated as well. Interestingly, in many analyses much more attention has been given to the former case than to the latter. The point is that in the longer run - say, in a period of a decade or two - the balance of these two opposing phenomena may be unbiased. There was always a belief that growth will come sooner than it indeed occurred. For instance in Poland, at the beginning of transition, the government assumed that contraction would last just one year and the fall of GDP would not exceed 3.1 percent. Actually it lasted three years and was six times more severe. Stanislaw Gomulka was

[10] Kolodko, Grzegorz W. (2000). "Globalization and Catching-up: From Recession to Growth in Transition Economies," *IMF Working Paper*, p. 9.

predicting the rate of growth for 4.7, 8.7 and 7.9 percent in 1991-93.[11] Whereas it should bring sound expansion of about 22 percent over these three years, actually the economy contracted 12 percent in 1990 and further 7.0 percent in 1991. Only then it grew by 2.6 and 3.8 percent in 1992-93. Assuming better policy response, for Hungary and Poland Borensztein and Montiel foresaw on average 6.5 percent growth in 1991-95 and 3.25 for the former Czecho-Slovakia.[12] Lawrence Summers expected the Polish economy turning around already in 1991 (2.0 percent growth) and thereafter soaring by five to six percent.[13] He had foreseen the positive growth in case of Hungary, Poland, Romania, and Yugoslavia since 1992, and in the case of Bulgaria and Czecho-Slovakia since 1993, with the acceleration of non-weighted mean growth rate for the whole Eastern Europe going up from 0.8 percent in 1992 to about four percent by the end of decade. Contrary, it shrunk by additional 3.6 percent in 1992 (after drop of about 17 percent in 1990-91) and at the end of decade it was expanding by a mere two percent. Not only the individual experts were wrong, but so were the governments and respected international organizations. The International Monetary Fund in its World Economic Outlook 1991 expected the GDP growth for Eastern Europe already since 1992. After predicting contraction of only 1.5 percent in 1991 (contrary to factual collapse by 10.7) the GDP growth was forecast at 2.8 for 1992 and at 4.4 percent for 1993, yet it dropped in the former year by 3.6 and then increased by just 0.4 percent in the subsequent year. Then the pendulum of expectations changed to the other extreme.

In October 1992 issue of World Economic Outlook - under the influence of data showing the 1991 severe contraction - the forecast was changed significantly. For the Eastern Europe countries, instead of earlier expectations of 2.8 percent growth in 1992, there was a forecast of 9.7 percent recession. As for the former

---

[11] Gomulka, Stanislaw (1990). "Stabilization and Growth: Poland 1989-2000," Financial Policy - Disequilibrium - Stabilization (II), Warsaw: Research Institute of Finance, pp. 303-321.

[12] Borensztein, Eduardo, and Peter J. Montiel (1991). "Savings, Investment, and Growth in Eastern Europe," in George H. Winckler (ed.), Central and Eastern Europe Roads to Growth, Washington, DC: International Monetary Fund and Austrian National Bank, pp. 153-187.

[13] Summers, Lawrence (1992). "The Next Decade in Central and Eastern Europe," in Christopher Clague and Gordon C. Rausser (eds.), The Emergence of Market Economies in Eastern Europe, Cambridge, Ma. and Oxford, UK: Blackwell, pp. 25-34.

Soviet Union economies, the forecast for that year was minus 18.2 percent, yet actually GDP contracted 'only' 14.2 percent.[14] There were a number of reasons why the early predictions were too optimistic and the expectations were not met. During the early transition the range of uncertainty was certainly very massive, hence it was not difficult to be wrong simply because of the substance of the process. Yet the issue is that the true mistakes had been much more in relation to the policies and their theoretical foundation than about the forecasts. The latter were not accurate because the former were wrong.[15]

Thus what had led to such deep contraction that in so many cases turned to be a decade lasting depression of economic activity at the very low level? It is impossible to explain exclusively the Great Transitional Depression of 1990-99 neither by the legacy of the past, nor by the external shocks.[16] These factors, of course, play significant role, however they are not to be blamed with most of the responsibility for all that misfortune, since a great bad luck indeed it is to lose a half or so GDP over just one decade. The critical role in these events had been played by the policy, which was often incorrect. Among the weakest part of its inappropriateness was the negligence of institutional aspects of building the market system. Emerging market economy performance depends much more on the institutional arrangements than purely on an overall economic liberalization. Hence, the discussion on the platform 'too fast versus too slow' liberalization and privatization has been led along the lines of the wrong alternative.[17] The pragmatic challenge and theoretical question was not about the speed neither liberalization nor privatization, but about the ways these two processes have been designed and coordinated with the institution-building. If the institution-building was not enhancing the previous processes, then there was a lack of compatibility among the elements of multi-track process of transition. In result, instead of growing, the

---

[14] IMF (1991). "World Economic Outlook," Washington, D.C.: International Monetary Fund, p. 45.
[15] Stiglitz, Joseph E. (1998). "More Instruments and Broader Goals: Moving towards the Post-Washington Consensus," WIDER Annual Lectures, 2, Helsinki: UNU/WIDER, p. 9.
[16] Mundell, Robert A. (1997). *The Great Contractions in Transition Economies*, in Blejer, Mario I. and Marko Skreb (eds.), Macroeconomic Stabilization in Transition Economies, London: Cambridge University Press, pp. 73-99.
[17] Stiglitz, Joseph E (1998). **op.cit**, p. 3.

microeconomic efficiency was eroding still further, what in turn had led to output falling for so long and so deep.

2.1. First Decade of Post Socialist Transition

The centrally planned economy has ceased to survive. Even in countries still considered socialist, as China and Vietnam, the method of economic harmonization has altered to a great extent from state intervention to market allocation. Hence, during the 1990s the progression of post socialist transformation has advanced considerably. Approximately 30 countries in Eastern Europe, the former Soviet Union and Asia are involved in immense systemic changes. Unquestionably, these changes are foremost to full-fledged market economies, while the accurate result of transformation is not going to be the same for all countries involved. Whilst, leaders in transition and well-placed geopolitically, are bound to join the EU in the expected future, others, lagging behind in systemic changes, will stay hybrid systems with the remnants of central planning alongside elements of market regulation and a mounting private sector.[18]

Whereas some countries will develop rapidly and catch up with their industrialized neighbours within a generation, others will practice slow economic growth and a comparatively low standard of living. Transition to a market economy is a prolonged process comprised of a variety of spheres of economic activities. New institutional arrangements are of main significance for successful transformation. A market economy requires not only private ownership and liberal regulation, but also sufficient institutions. Because of this, transition can be executed only in a gradual manner, since institution building is a gradual process based upon new organizations, new laws, and the changing behaviour of various economic entities. The principle that a market economy can be introduced by "shock therapy" has been incorrect, and in several cases, when attempted, has caused more trouble than it has solved. Only liberalization and stabilization measures can be introduced in a fundamental manner,

[18] Kolodko, Grzegorz W. (1997). “Ten Years of Postsocialist Transition: the Lessons for Policy Reforms,” *The World Bank Policy Research Working Paper*, No. 2095, p. 3.

and even this is not a requirement. The need for such scheme depends on the scale of financial destabilization and is only feasible under definite political conditions. The major argument in favour of transition was a wish to put the countries in question on the path of sustainable growth. It was supposed that the transfer of property rights from state to private hands and the transfer of allocation instrument from state to free market would soon augment saving rates and capital formation, as well as allocative effectiveness. Therefore it must also have contributed to high-quality growth. Unfortunately, for a number of reasons this has not happened. In all transition economies, before any growth has occurred, there has been harsh tightening, ranging from 20 per cent over three years in Poland, to over 60 per cent in nine years in Ukraine. These unfavourable consequences are the outcome of both the legacy of the previous system and the policies exercised during transition, though it is clear that the latter are of main significance.

These policies were based to a large extent on the so-called "*Washington Consensus*". The set of policies designed along this line has been stressing the substance of liberalization, privatization, and opening of post socialist economies as well as the requirement of sustaining financial discipline. On the other hand, being developed for another set of circumstances, originally this approach was missing decisive elements compulsory for systemic stabilization, overhaul, and growth. These elements included institution building, improvement of corporate governance of the state sector prior to privatization, and the remodel of the role of the state, instead of its vital withdrawal from economic activities. The mistaken assumption that emerging market forces can rapidly substitute the government in its role toward new institutional set up, investment in human capital, and development of infrastructure, have caused strict contraction and mounting social stress. The requirement to supervise the institutional aspects of transition have been recognized and addressed only in later stages. The technical support of the International Monetary Fund (IMF) and the World Bank (WB) with dealing with these problems may contain an even more significant positive influence on the course of transition and growth than their financial involvement. Lending by these organizations is often called 'assistance', in spite of the fact that these are just commercial credits with

strong accompanying terms. They are having the result of enforcing far reaching structural reforms and pushing towards policies that assume to bring sustained growth. Therefore, there is the need to look for a new consensus about policy reforms essential for durable growth.

Table 3 Recession and Growth in Transition Economies, 1990-97

Countries	Years of GDP decline	Did GDP fall after some growth?	Average annual rate of GDP growth			1997 GDP index	Rank
			90-93	94-97	90-97	(1989=100)	
Poland	2	no	-3.1	6.3	1.6	111.8	1
Slovenia	3	no	-3.9	4.0	0.0	99.3	2
Czech Rep.	3	yes*	-4.3	3.6	-0.4	95.8	3
Slovakia	4	no	-6.8	6.3	-0.3	95.6	4
Hungary	4	no	-4.8	2.5	-1.1	90.4	5
Uzbekistan	5	no	-3.1	-0.3	-1.7	86.7	6
Romania	4	yes	-6.4	2.1	-2.2	82.4	7
Albania	4	yes	-8.8	4.9	-2.0	79.1	8
Estonia	5	no	-9.7	4.1	-2.8	77.9	9
Croatia	4	no	-9.9	3.0	-3.4	73.3	10
Belarus	6	no	-5.4	-2.6	-4.0	70.8	11
Bulgaria	6	yes	-7.4	-3.6	-5.5	62.8	12
Kyrgyzstan	5	no	-9.3	-2.4	-5.8	58.7	13
Kazakhstan	6	no	-6.7	-6.0	-6.3	58.1	14
Latvia	4	yes	-13.8	2.2	-5.8	56.8	15
Macedonia	6	no	-12.9	-0.8	-6.9	55.3	16
Russia	7	yes*	-10.1	-5.3	-7.7	52.2	17
Turkmenistan	7	no	-4.5	-12.5	-8.5	48.3	18
Lithuania	5	no	-18.3	0.5	-8.9	42.8	19
Armenia	4	no	-21.4	5.4	-8.0	41.1	20
Azerbaijan	6	no	-14.5	-5.7	-10.1	40.5	21
Tajikistan	7	no	-12.2	-8.4	-10.3	40.0	22
Ukraine	8	no recovery	-10.1	-12.1	-11.1	38.3	23
Moldova	7	yes*	-12.6	-10.2	-11.4	35.1	24
Georgia	5	no	-24.1	2.9	-10.6	34.3	25

*: GDP contracted again in 1998.

Source: Kolodko, Grzegorz W., "**Ten Years of Postsocialist Transition: the Lessons for Policy Reforms**," 1997, p.3.

The East European transition suggests that for recuperation and sustained growth healthy financial fundamentals and liberal, apparent deregulation are not the only influential factors. Sound institutional arrangements, re-regulation of financial

markets and intelligent policy of the governments are also necessary. Against the current experience with the crises of some emerging markets, the outline of a new consensus can be drawn. It points not only to the need for liberal markets and open economies, but stresses the new role of the state, the primary implication of market organizations and the institutional links between them, and the need for more equitable growth. After losing over a quarter of GDP between 1990-98 majorities of the post socialist transition economies are gaining impetus. If this is not yet valid in the two biggest, i.e. Russia and Ukraine, they also have the possibility to turn into growing economies. In the approaching years, the post socialist emerging markets will become not only swiftly growing economies, but the fastest growing region in the world. Yet how fast this development is going to be, depends on policy reforms implemented in particular countries. The direction of these reforms will also depend on cooperation with international organizations and their technical advisory and financial support, which are provisionally linked to execution of market-friendly policies and implementation of sound structural reforms. Therefore these organizations' influence upon the course of reforms and chosen policies is much more powerful than their actual financial engagement and undertaken risk.

2.2. Policies without Growth: Absent Components

From the beginning of 1990s, Washington Consensus has been received as widespread wisdom on policies for progress from stabilization to growth. It was assumed that rough financial policy accompanied by deregulation and trade liberalization would be adequate to overcome stagnation and begin economic growth, particularly in the less developed countries toward which the Washington Consensus was addressed. Although the truth that the policy reforms advised by this line of consideration were at that time mainly applicable to the Latin American practice, they were applied to structural crisis problems in other regions, including transition economies. Afterwards, there was an interaction between the theories and the practice, a process of learning by doing. On one hand, the orientation of these policy reforms has had a significant authority upon the course of post socialist transition.

On the other hand, the transition process has had an impact on policy as well. A synopsis of the 1989 Washington Consensus was given by John Williamson, which classified the projected set of policies, stressing the significance of the organizations involved.[19] He enumerated 10 points that at the time seemed to be agreed upon by influential financial organizations, political bodies, and professional economists:

- *Fiscal Discipline*: Budget deficit ought to be undersized sufficient to be financed without recourse to the inflation tax.

- *Public Expenditure Priorities*: Spending must be redirected from politically receptive areas toward deserted fields with high economic returns and the potential to advance income distribution.
- *Tax Reform*: Tax reform involves enlarging the tax base and cutting marginal tax rates. The plan is to sharpen incentives and improve horizontal equity without lowering realized progressivism.

- *Financial Liberalization*: The crucial purpose of financial liberalization is market-determined interest rates, but the practice has exposed that, under conditions of a persistent lack of confidence, market-determined rates can be so high as to pressurize the financial solvency of productive enterprise and government.

- *Exchange Rates*: Countries need a unified exchange rate set at a level adequately competitive to encourage a swift growth in non-traditional exports and managed so as to ensure exporters that this competitiveness will be maintained in the future.

- *Trade Liberalization*: Quantitative trade boundaries should be quickly replaced by tariffs, and these should be progressively reduced until a uniform low tariff in the range of 10 percent (or at most around 20 percent) is accomplished.

---

[19] Williamson, John (1997). "The Washington Consensus Revisited," In Louis Emmerij (ed.), Economic and Social Development into the XXI Century. Washington, DC: Inter-American Development Bank, p. 56.

- *Foreign Direct Investment*: Barriers impeding the entry of foreign firms must be abolished; foreign and domestic firms should be authorized to compete on equal terms.

- *Privatization*: State enterprises should be privatized.

- *Deregulation*: Governments should abolish regulations that impede the entry of new firms or that restricts competition, and then must guarantee that all regulations are justified by such criteria as safety, environmental protection, or prudential supervision of financial institutions.

- *Property Rights*: The legal system should supply protected property rights without unnecessary costs and ought to make such rights accessible to the informal sector.[20]

Afterwards, mostly under the influence of experience with overhauling the Latin American economies over the first half of 1990s and taking into concern the lessons learned from Eastern Europe and the former Soviet Union, the new agenda was obtainable. While it includes clear points from earlier opinions, there are definite new concerns and accents. Once more, 10 points were raised:

- Increase saving by maintaining fiscal discipline
- Reorient public expenditure toward well-directed social expenditure
- Reform the tax system by introducing an eco-sensitive land tax
- Strengthen banking supervision
- Maintain a competitive exchange rate, abounding both floating and the use of the exchange rate as a nominal anchor
- Pursue intra-regional trade liberalization
- Build a competitive market economy by privatizing and deregulating (including the labour market)
- Make well-defined property rights available to all

[20] **Ibid.**, pp. 60-61.

- Build key institutions such as independent central banks, strong budget offices, independent and incorruptible judiciaries, and agencies to sponsor productivity missions
- Increase educational spending and redirect it toward primary and secondary school.[21]

The new stuff on this agenda accurately addresses the matters of institution building, investment in education and environmental protection yet they are still missing some points of immense significance which are particularly pertinent to transition economies.

First of all, dealing with corporate governance reform in the state sector before privatization is not mentioned, nor is the behavioural feature of institution building. Moreover the requirement of equitable growth is still overlooked. The shortest point on the agenda of the early Washington consensus is “Privatization”; and this is in actuality a long-term policy challenge. Even if there is a sound commitment to privatize rapidly and widely it is not practicable, for both technical and political reasons. There are also the problems of sequencing, pace, distribution of costs and benefits, and the capable implement of corporate governance. As for the institutional aspect of reform, in post socialist transition economies, unlike in distorted developing market economies, it is not adequate simply to found organizations, for example, an independent central bank or widespread tax administration. Cultural changes are also required to assist effectiveness and growth, changes in behaviour within organizations and changes in the interactions between them.

The early Washington consensus was in fact purposing at countries that had already market economy, and were not just in a transition to such a system. Joseph Stiglitz, while stressing the significance of governments as a balance to markets points out that the consensus achieved in the late 1980s and early 1990s between the

[21] **Ibid.**, p. 58.

United States Treasury, the IMF, and the WB, as well as some dominant think tanks, was catalyzed by the experience of Latin America in the 1980s. Stiglitz claims that for this reason, countries facing diverse challenges have never found acceptable answers to their most pressing questions in the Washington consensus. Its basic interpretation in relation to the post socialist economies implied that it would be enough to fix the appropriate financial essentials and privatize the bulk of state assets. Afterwards, growth must start and persist for the long term. Because this has not happened as presumed, the Washington consensus should be reconsidered. There has always been a problem as to the current subsistence of a Washington consensus.[22]

Was a consensus accomplished, or was the effort just an intention and well-motivated attempt? In fact, the latter is the case. There is no model terminology for these sets of doctrines, and a variety of practitioners supported these doctrines with altering degrees of subtlety and emphasis. The set of views is usually shortened as the "Washington consensus", although to be sure, there never was a consensus even in Washington on the suitability of these policies.[23] The partial collapse of the Washington consensus with regard to transition economies must be linked with the neglect of the importance of institution building for the start of growth, even if economic essentials are by and large in order. Such mistake explains why so many Western scholars initially did not correctly recognize the real dilemma. Institutions vary extremely gradually, but they have a powerful influence on economic performance.

As the 1993 Nobel Laureate in Economics states, since Western neo-classical economic theory is devoid of institutions, it is of little help in analyzing the underlying sources of economic performance. It would be little exaggeration to say that, while neo-classical theory is focused on the operation of efficient factor and product markets, few Western economists understand the institutional requirements

---

[22] Stiglitz, Joseph E. (1998). "Economic Science, Economic Policy, and Economic Advice," Conference paper, Annual Bank Conference on Development Economics on Knowledge for Development, Washington D.C.: The World Bank, April 20 and 21, p. 57.
[23] **Ibid.**, p. 58.

essential to the creation of such markets since they simply take them for granted. A set of political and economic institutions that provides low-cost transacting and credible commitment makes possible the efficient factor and product markets underlying economic growth.[24]

Prospect of growth were based on the assumption that market institutions, if they had not yet appeared routinely, would someway increase up soon after liberalization and stabilization measures were executed. It was believed that if policies were put in place to safe the improvement of stabilization and develop sound fundamentals, the economy should return to momentum and begin to develop rapidly. Nonetheless, what really happened was much more depressing. Because of a vacuum with both plan and market system, productive capacity was utilized even less than formerly, savings and investments began to decrease, and instead of rapid growth there was profound recession. A lack of institutional development turned out to be the missing element in transition policies based on the Washington consensus. Instead of continuous growth, liberalization and privatization without a well-organized market structure led to extended contraction. This was not only the legacy of a socialist past, but also the consequence of contemporary policies. Under some conditions, although not in every case, the manner of reasoning characteristic of the Washington consensus may be applicable to the challenges faced by distorted less industrialized market economies.

Dissimilar to the evidence of post socialist economies, in these cases definite market organizations have always been in place. In post socialist countries, though, organizations fundamental to a market economy were either distorted or did not exist, so the economy could not enlarge. Some institutions have to be developed from scratch, since they did not exist under the centrally planned regime. Thus, even with progress in liberalization and radical privatization, there was still no positive supply answer. Misallocation of resources and investments has continued, even though this

[24] North, Douglass C. (1997). "The Contribution of the New Institutional Economics to an Understanding of the Transition Problem," WIDER Annual Lectures 1, Helsinki: United Nations University World Institute for Development Economics Research, p. 2.

time for diverse reasons. At the beginning of transition the only comparatively developed part of a market infrastructure was a commodities trading network, but even this was operating under persistent shortages. A capital market structure was missing. The lack of financial intermediaries disheartened accumulation and worsened allocation of savings. Hence, instantly after the collapse of socialism, the lack of appropriate regulation of the emerging capital market and the dearth of such main organizations as investment banks, mutual funds, a stock exchange, and a security control commission, etc, caused distortions that could not be offset by liberalization and privatization.

All these organizations and institutional links have to be developed gradually. Considering the point of departure, this also calls for a progression of retraining many professionals to enable them to work in the market environment. This takes years, and thus it would be much more intelligent to supervise the processes of liberalization and privatization at a speed compatible with the pace of human capital development. Or else, loosed market forces will not be able to figure economic structures and processes and raise competitiveness and capacity for growth. A disagreement between liberalization measures and institution building has actually occurred in a number of countries that took a bit more fundamental approach toward transition. In these cases, “creative destruction” failed to deliver, because there was too much destruction and not sufficient creation. Socialist countries were full employment economies, i.e. economies with labour shortages. As a result a social security system protecting against unemployment did not exist, because it was not necessary. All countries in this region ought to develop such a security net from scratch. In the meantime, before such systems could be implemented, in addition to the misallocation of capital, there has been the misallocation of labour. As the mid 1990s, the Bretton Woods organizations have started to pay more attention to the way market structures are organized as well as to the behavioural aspects of market performance. A number of less developed and transition economies have learned rapidly that there is no continuous growth without sound fundamentals. Afterwards, it was learned and accentuated too, that the market and growth need both: the liberalization and the organization.

Now, due to the experience of transitional contraction and because of conclusions drawn from the East Asian crisis, we learn that even with sound fundamentals, i.e. a balanced budget and current account, low inflation, a stable currency, liberalized trade, and an immense private sector, there will not be sustained growth if these favourable features are not supported by an suitable institutional setup. Truly, without such a set up, the fundamentals themselves will become unsustainable and unsound, what time and again is proved by the actual developments, for instance in the Czech Republic or lately in Brazil. There seems to be a mounting agreement that the early Washington consensus has to be reconsidered and revised toward contemporary challenges and recent conditions. If it is going to work, elements so far absent must be included. These elements are linked with institutional arrangements, while they are not universal. Several other elements were missing regarding the overhauling of the Latin American debt crisis, some others in the case of counteracting the Eastern Asia's contagion, and still others in fighting the Eastern European transitional depression. In the latter, eight elements are of key importance:

- The lack of organizational infrastructure for a liberal market economy.
- Weak financial intermediaries unable to allocate efficiently privatized assets.
- A lack of commercialization of state enterprises prior to privatization.
- Unqualified management unable to execute sound corporate governance under the conditions of a deregulated economy.
- A lack of institutional infrastructure for competition policy.
- A weak legal framework and judiciary system, and a consequent inability to enforce tax code and business contracts.
- Poor local government unprepared to tackle the issues of regional development.
- A lack of non-governmental organizations (NGOs) supporting the functioning of the emerging market economy and civil society.

Therefore, policies that under other circumstances may have worked were not efficient in overcoming the crisis in the post socialist economies. Even if the targets

and instruments as such were well defined, they might not be reached and used as envisaged, since they were put into use within a systemic vacuum.

2.3. In the Direction of a New Consensus

Rather than an eternal agreement between principal partners, the progression of developing new consensus must involve a steady investigation for such agreement as well as a quest for new partners. These characteristics are vital for its eventual accomplishment. From time to time, when the conditions change and our knowledge about it evolves, new documents and programs, accentuating additional points of concern and examining old points in a diverse light, come to the fore. A good example of such progress is the World Bank's 1996 Annual Development Report, dedicated entirely to the transition from plan to market, and the September 1996 IMF Interim Committee Declaration on a Partnership for Sustainable Global Growth.[25]

The latter statement may be seen as an adapted version of the early Washington consensus. Among eleven points, six are of particular importance to the circumstances of transition economies. Point one stresses that monetary, fiscal, and structural policies are opposite and reinforce each other. Point three claims that there is the requirement to generate a positive environment for private savings. Point seven accentuates that budgetary policies ought to plan at medium-term balance and a decrease in public debt, while point nine says that structural reforms should be supplemented with special attention paid to the labour markets. Point ten stresses the significance of superior corporate governance, and point eleven cautions against corruption in the public sector and money laundering in the banks, warning that their monitoring and management must be strengthened. Other points, also significant for sustainable development, address the problems of disinflation, exchange rate solidity, progress toward increased freedom of capital movement, resisting protectionist pressure and fiscal adjustment by reducing unproductive expenditure whereas ensuring sufficient investment in infrastructure. Nevertheless, the Washington

[25] IMF (1996). “Partnership for Sustainable Global Growth, Interim Committee Declaration,” Washington, D.C.: International Monetary Fund.

consensus is not a representative position taken by any particular organization or institution. It is rather a gathering of policy options being agreed upon by vital partners to such an extent that the agreement may be considered a consensus. However there is still an exploration for agreement between the organizations as well as between the policymakers, policy-oriented researchers and advisors.

This time, psychological and political rather than economic and financial opinions are given as influential factors favouring the fundamental set of policies undertaken at the opening of the 1990s. Nevertheless, it seems that we still differ as for the evaluation of the scope and costs of that overload. Was it only 'a little bit' of otherwise required measures, as one may still believe, or was it a serious excess of redundant extremism, as it seems to be proved elsewhere?[26] When ideas and strategies involving more regular change and the dynamic involvement of the state in institutional redesign in post socialist transition economies were expounded first time, and when they were later implemented in Poland, they were controversial and unorthodox, with respect to the Washington consensus. In detail, these new ideas did not so much support more gradual change, but recognized that the essential changes would be time-consuming by their very nature.

In 1997 and 1998, on the other hand, even in official international circles, there have been extensive signs that a new consensus is emerging, and that it is, to a definite extent, based on the ideas implemented in Poland in 1994-1997. Poland is now recognized to have avoided the unfavourable experience of other transition economies. The new ideas and policies, developed under 'Strategy for Poland', were to some extent elaborated against the mainstream of the early Washington consensus and now have contributed significantly to its revision. In the outcome of the Southeast Asian crisis, as it has extend beyond anybody's expectation, the train of thought has also begun to alter track among the most dominant opinion leaders in the international financial community. This has been accompanied by a much belated start of doubt rising regarding the accuracy of the recipe proposed for post socialist

[26] Hausner, Jerzy (1997). "The Political Economy of the Socialism's Transformation," Conference paper, UNU/WIDER Project Meeting: Transition Strategies, Alternatives and Outcomes, Helsinki.

emerging markets, especially for the most essential, i.e. Russia. A consensus has not yet been agreed upon, but lessons are gradually being learned. It is now admitted that,

The benefits brought by short-term international lenders are dubious: they do not provide new technology, they do not develop the management of domestic institutions; and they do not present reliable finance of current account deficit. In countries with high savings rates, they also raise already excessive investment rates. To supervise the inflows, borrowers may have to accumulate massive reserves. The Asian saga proves, once again, that liberalization of insufficiently regulated and capitalized financial system is a recipe for disaster.[27]

All the while, the Bretton Woods organizations were insisting upon, and determining their financial involvement based on harsh fiscal and monetary policy. If it was a period of 10 per cent GDP decrease, or a period of 10 percent expansion, there was always pressure to bring the fiscal gap down and keep the real interest rate up. Even while the budget deficit was lesser than that of industrial countries and the real interest rate was so high that it was not probable to hold the deficit further due to soaring costs of servicing the public debt, there was an enduring necessity on continuing fiscal and monetary tightness. High real interest rate facilitates fine the portfolio investors through the interest rate differentials, but at the costs of both budget, i.e. taxpayers and the business sector owing to crowding out effect.

The significance of a change in corporate governance is now being recognized even by early intense followers of fast, mass privatization. There is no clear confirmation that the privatized enterprises perform better than state enterprises just in the consequences of privatization. Nicholas Stern and Joseph Stiglitz point to the process of restructuring, which itself will be a foremost and primary task

[27] Kolodko, Grzegorz W. (1997). "Ten Years of Postsocialist Transition: the Lessons for Policy Reforms," p. 11.

involving investment, tough decisions and dislocation.[28] It will be much less painful if economic growth, efficient corporate governance and well-functioning safety nets are established. Hence good corporate governance of the public enterprises and sound competition policy are at least as necessary for recovery as privatization and liberalization. After the laissez-faire of the early transition, values of co-operation and solidarity are being rediscovered. Even billionaire financier George Soros has not hesitated to admit that, "*although I have made a fortune in the financial markets, I now fear that the untrammelled intensification of laissez-faire capitalism and the spread of market values into all areas of life is endangering our open and democratic society*".[29] Too much competition and too little cooperation can cause intolerable inequities and instability. Yet it must be clear from the beginning that transition based upon a sort of laissez-faire should bring 'intolerable inequities and instability', it is still not acknowledged broadly enough and such an apparent conclusion is still challenged.

However the World Bank 1996 World Development Report emphasizes strongly the requirement for social consensus, although it was very difficult to reach a considering diminishing production and increasing inequality in transition economies.[30] Establishing a social consensus will be decisive for the long-term success of transition cross-country analyses suggest that societies that are very unequal in terms of income or assets tend to be politically and socially less stable and to have lower rates of investment and growth. It is now rather accepted that in economies still affected by structural rigidities, such as formal and informal indexation and sluggish supply response, once inflation has fallen well below a threshold of about 20 percent, attempts at speeding up disinflation would have had important, possibly intolerable costs surely higher than the moderate, but stable falling inflation actually experienced by some countries leading in transition and

[28] Stern, Nicholas and Joseph E. Stiglitz (1997). "A framework for a development strategy in a market economy: objectives, scope, institutions and instruments," EBRD Working paper 20, London: European Bank for Reconstruction and Development, p. 19.
[29] Soros, George (1997). "The Capitalist Threat," *The Atlantic Monthly*, Vol.279, No:2, p. 47.
[30] World Bank (1996). *World Development Report 1996; From Plan to Market*, World Bank Publication, p. 12.

those recently following Poland's path. What counts is that inflation must continue to fall gradually and obviously, without ever accelerating again.

Such a process of disinflation contributes not only to mounting credibility of the government and monetary authorities, but secures the predictability of economic developments and creates a better business environment and confidence on the international scene. The prerequisite for an improved savings ratio, i.e. sooner than income increases, is a growth of real income, stabilization, and optimistic expectations. Only against such background can the propensity to save steadily increase. The 1996 EBRD Transition Report, which is devoted to infrastructure and savings, stresses the equal role of rising government savings, particularly throughout the repair of social security and pension systems, and more broadly based taxation at lower rates, and the development of contractual savings and life insurance. From this standpoint, the pressure for high and positive real interest rates has been grossly misplaced. The fiscal and quasi-fiscal activities of central banks, remarkably in the emerging economies and especially in post socialist countries, have attracted substantial attention.[31] In particular, the costs of sterilization policies, which are the consequence of excessive interest rate differentials and/or of undervalued currencies, have come to the fore, e.g. the OECD country study of the Czech Republic. It turns out that for a significant time, the central banks of both the Czech Republic and Poland have wasted about 1 per cent of GDP in their unfortunate sterilization policies.[32]

There is yet one more main characteristic of the emerging consensus. This time, along with the continuous leading role of the Washington-based organizations, especially the IMF and the WB, it must include more partners. Other international organizations, like the UN, OECD, WTO, ILO, and EBRD, have to play a greater role than they have thus far. Also, regional organizations, like ASEAN in Asia, CEFTA in central Europe, or the CIS in the former Soviet Union, should be better

---

[31] Fry, Maxwell (1993). "The Fiscal Abuse of Central Banks," *IMF Working Paper 93/58*, Washington DC.: International Monetary Fund, p. 23.

[32] Nuti, Mario (1996). "Exchange Rate and Monetary Policy in Poland 1994-96, or the Case for Privitising the National Bank of Poland," Conference paper, Helsinki: UNU/WIDER Project Meeting: Transition Strategies, Alternatives and Outcomes, p. 9.

organized to present their purpose in the global forum and try to influence the process of changing the international financial and economic order. Some international NGOs ought to be more influential too. Hence the search for the new consensus must rely not only on the quest for new policies agreed in Washington, but also on the policies agreed between Washington and other essential places in diverse parts of the global economy. There are many hints that such process is on the way, but there is much more yet to be achieved.

2.4. The Means and Ends of Economic Policy

The lack of accomplishment of policies based on the early Washington consensus is also due to the confusion of the means of the policies with their ends. A sound fiscal stance, low inflation, a steady exchange rate, and overall financial stabilization are only the means of economic policy, while sustained growth and healthier standard of living are its ends. However after several years of exercising these policies, neither growth nor a higher standard of living has been achieved in transition countries. Significant changes like privatization and liberalization are simply instruments, not main objectives. So it is strange that so often these instrumental processes are offered as a core of economic policy. Too much attention is focused on the means that hypothetically must lead to enhancement of competitiveness and efficiency, instead of concentration on the result of these exercises. Such bias leads to policy's distortion and the tools become the goals themselves, without adequate concern about their impact on the real economy. In economic policy sometimes it happens that intellectual oversimplification assumes that, from a definite point and under certain conditions, the things have to run themselves, so there is no need to think about how to supervise them.

An extreme example of such thought is the supposition that ‘the best policy is no policy’. But, considering the distinction between ends and means, it must be apparent to all those involved in economic research, advice, and policy, that such confusion cannot be explained simply by the laziness of economists and politicians.

The intellectual misunderstandings result from political antagonism, and the difference is more about conflicts of interests than about alternative theoretical concepts and scientific explanations. Of course, it does occur that policy mistakes happen due to a lack of practice and appropriate knowledge, but more often this confusion stems from obedience to a special group of interests, or to 'theoretical schools', that happen to be ideological and political lobbies too.

That is why there are no rightist or leftist doctors or engineers, but there are rightist and leftist economists and policymakers. John Williamson points to 'political' and 'technocratic' Washington, stressing their diverse priorities and policy options. Nonetheless, there are significant divisions not only between the 'political' and 'technocratic' parts of Washington, but also within them.[33] What makes the image still more complicated, is the fact that some of the actors on the so called 'technocratic' side of the scene do play, even if unintentionally, political roles as well. This is also true with regard to the Bretton Wood organizations, especially the IMF. Their influence and the results of their policies basically have such severe implications for particular countries and regions, if not the entire global economy, that sometimes they have much more to say than what may be seen as merely 'technocratic' concerns. The place of the IMF towards such big countries in transition as Russia and Ukraine are the best points in case here. But the problem is even more composite than that, because, aside from intellectual controversies and different normative values, there are also diverse political, economic, and financial interests involved. Or else it would be unfeasible to interpret why erroneous policies had continued, in many cases, even after it was clear that they were mistaken.

These were the cases, for example, with early liberalization and stabilization policy in Poland in 1989-1992, the neglect of corporate governance in the Czech Republic in 1993-1996, the Russian privatization of 1994-1998, executed with the active involvement of politically connected informal institutions, and with fraudulent

[33] Williamson, John (1990). "What Washington Means by Policy Reform," In John Williamson, editor, Latin American Adjustment: How Much Has Happened? Washington, D.C.: Institute for International Economics, p. 33.

Albanian financial intermediaries in 1995-1997, which were tolerated until the whole economy ultimately collapsed. Such events serve only as examples of the confusion of economic policy's targets with its instruments. Economic policy is not to be judged by the speed of privatization, but by its effectiveness, measured first by the raise of competitiveness and budgetary proceeds, and then by the increase in contribution to national income. The powerful insistence for privatization's acceleration coming from some lobbies and their political allies is purely a means to sell the assets cheaper. Hence there are entities that are able to buy these assets not more rapidly, as is publicly suggested through political connections and dependent news media, but to obtain them cheaper than under a more rationally paced procedure. The ones, who sell fast, sell cheap; and the ones, who buy fast, buy cheap as well. There have been warnings, criticisms, and intellectual and political opposition against all these unwise policies, but still they have gotten through.

It has happened not due to a lack of good economic ideas or a deficit of sound policy programs, but because of pressure from strong lobbies and interest groups. Hence, in designing good policy, it is essential not only to be right but also to be able to enforce the favoured policies. Often it happens that the strongest lobby is not there where are the truth and the logic, but where are the power and the money. Hence, true reforms, those that facilitate the public interests of many as opposed to the particular interests of a few, must always be thought of as a means to long-term targets, i.e. sustained growth. Otherwise, there will be fictitious 'progress' reflected in a simulated development of situation. If the share of private sector, the scope of trade liberalization, or the deregulation of capital transfers are greater than it would be without these policies, but at the same time economic contraction is deeper or growth slower and the standard of living is declining, then the overall situation is worse, not better. However, often, economic status is judged from the outlook of a particular group of interests and this perspective is presented as an image of the common economic situation. So, while evaluating the actual standing of an economy and policy, one ought to consider not only what is examined, and by what means it is scrutinized, but also who is carrying out such an evaluation. With this in mind, it is apparent that, for example, the evaluations of Moody's rating agency and the Russian

trade unions must be as diverse as the interests of the Morgan Stanley investment bank and the Siberian miners. Thus, the objectives of development policy are more widespread and their interpretation is changing as well among those who subscribed to the Washington consensus, mainly the World Bank. Not only should a balanced economy and sustained growth be of severe policy concern, but also standard of living improvement, the environment, distribution of income, and, last but not least, democracy itself.[34]

Our perceptive of the instruments to support well-functioning markets has also enhanced, and we have broadened the objectives of development to contain other goals, such as sustainable development, egalitarian development, and democratic development. The World Bank always was more inclined toward social problems and development of human capital than other international financial institutions, dissimilar any other bank. Typically banks look to profits, not to the human development index as an indicator of their success. It must be acknowledged that the World Bank has become involved in a number of projects, not only in transition economies, that serve to raise standards of living and diminish poverty. Yet now even the IMF is trying to join the club and claim that it too would like to plan a more fair distribution of the benefits of growth, if only the advised policies would deliver some.

Stanley Fischer, the IMF First Deputy Managing Director, himself concerned about equitable growth for a long time, has raised the question; why do equity considerations matter for the Fund? And then has answered that: First, as an issue of social justice, all members of society should share in the fruits of economic growth. And even though there are many significant arguments about accurately what constitutes a reasonable distribution of income, we accept the vision that poverty in the midst of plenty is not socially acceptable. But, second, there is also an instrumental argument for equity: modification programs that are equitable and growth that is equitable are more likely to be sustainable. These are good enough reasons for the IMF to be concerned about equity considerations - whether it is

[34] **Ibid.**, p. 34.

poverty lessening or concerns about income distribution in the programs the IMF maintain.[35] Unquestionably, the practice of transformation has contributed considerably to these changes. We still have to deal with difficult road from contraction to growth in post socialist economies, but we have also experienced rapid growth in Asian reformed socialist economies, which (unlike the Eastern European and the former Soviet Union transition economies) did not chase many early Washington consensus suggestions.

Now these experiences, together with the consequences of the Southeast Asian crisis and its contagion, are working as a catalyst for the emergence of ‘the post-Washington consensus’ the same way that the Latin American debt crisis of the 1980s ignited the formation of its predecessor. Nonetheless, there is still a long distance to journey from the emerging intellectual consensus to a real political agreement about proper policy reforms and actions. And, of course, even if intellectual consensus is closer than before, controversies concerning diverse normative principles and conflicting interests do remain.

2.5. Transition as a Process of Systemic Rearrangement

The single opportunity for the eventual success of transformation is to intend suitable institutions, which usually must be developed from the start. This design is harder in post-Soviet republics than in Eastern Europe, because in the former there was a lack of even such fundamental institutions as an independent central bank or national currency, and private property of the means of production was virtually none existing. In Asian reformed socialist economies the process is going at much slower speed and yet it also is directed at further liberalization and opening up. As for post socialist countries, some have taken a course of gradual, perhaps even too slow liberalization and privatization. Although that was followed by relatively milder contraction, it caused a postponement of decisive structural reforms as well. Nonetheless, if the given time is used for proper institution building, it can pay off

[35] Fischer, Stanley (1998). “Opening Remarks,” Presented to the conference on Economic Policy and Equity, Washington, D.C.: The International Monetary Fund pp. 7-9.

later. If, on the other hand, the time of gradual liberalization is wasted from the viewpoint of institutional reforms, than the opportunity for a long term expansion is indeed fragile.

Some countries follow a path of swift change. Even though under these circumstances contraction was harsher in early stages, later, institution building is often more advanced. In the long-run, after learning the bitter lesson that market economies do not expand without an intelligent government-led development policy and well designed institutions, both types of economies, i.e. European and former Soviet economies in transition as well as the reformed economies of China and Vietnam, have an opportunity to succeed in their market activities. The government involvement in the process of inclusive institution building is of crucial significance. Truly, this, as much as the liberalization, is the essence of transition. In other words, without taking sufficient care of institutional arrangements, exclusively liberalization and privatization is unable to deliver what the nations suppose from their economies. Hence, if the state fails to design an appropriate institutional set up, then market failures prevail and informal institutionalization takes over. Instead of a sound market, in the words of the leader economists of the World Bank and the European Bank of Reconstruction and Development, 'bandit capitalism' does emerge.

It is simple to identify institutional arrangements that work well: each partner does what it is supposed to do, there is good coordination, slight conflict and the economy grows smoothly and fast. We can also recognise ill-functioning institutional arrangements: change is inhibited by bureaucratic needs or there is "bandit capitalism" with persistent corruption and deceit.[36] Such institutional pathologies could occur as a result of transition-by-chance, as opposed to transition-by-design. In some cases incorrect transition policy has led to such difficulty. A system where 'only the stupid pay taxes', the contracts are not executed as agreed, or the payments are not made on time, is almost not a market economy. It is rather chaos stemming from institutional disintegration. Without the knowledge of how a new system works,

[36] Stern, Nicholas and Joseph E. Stiglitz (1997), **op. cit.**, p. 20.

and without a vision of how to get to that system, there is no way to achieve to target on time and in superior shape. Transition becomes protracted: costs are higher than necessary, while results are not as good as they could be under an alternative scenario, and the whole process lasts longer than would otherwise be essential. And, as was stressed by the advocates of transition-by-design opposing to the supporters of transition-by-chance, the recession lasts longer, recovery comes later, and production expands more slowly. Hence the appropriate institutional design is a supreme task during the time of transition. At the same time, its achievement is more difficult than elsewhere, because of institutional discontinuity.

The old set up, for example, central price regulation or the investment's allocation and branch ministries, does not work anymore, the new one, such as, investment banking, or stock exchange, is not yet in place. Thus the systemic vacuum prevails. A foundation for market capitalism requires the domination of private property, but also a competitive enterprise sector, functioning markets, and respect for the rules of market allocation. Well-performing financial intermediaries are required to facilitate trade transactions and investment deals, as well as to promote savings. But the market, its introduction notwithstanding, also needs an appropriate legal environment, one that is able to carry execution of market rules, enforcement of contracts, and the proper behaviour of economic agents (firms, households, organizations, and the government). For these reason transition calls not for a dismissal of government, but for its reorganization and tuning to the new conditions. The World Bank, unlike the advocates of market fundamentalism, admits that:

> *The state makes a vital contribution to economic development when its role matches its institutional capability. But capability is not destiny. It can and must be improved if governments are to promote further improvements in economic and social welfare. Three interrelated sets of institutional mechanisms can help create incentives that will strengthen the state's capability. These mechanisms aim to:*
>
> *- Enforce rules and restraints in society as well as within the state*

- Promote competitive pressures from outside and from within the state, and

- Facilitate voice and partnership both outside and within the state.[37]

This is accurate for all economic systems, countries with differing scopes of economic activity, different GDP levels, and odd institutional advancement, so it is even truer for transition economies. In countries where the rules were beforehand essentially different from existing post socialist regulations, the introduction of new behaviours and the enforcement of new regulations for economic entities calls for even harder and more determined state effort than elsewhere. Unfortunately, the state's ability to attack the matter of law enforcement is much weaker during transition than it was under state socialism. It is also weaker than under the governments of traditional market economies, with mature civil societies and well-working institutions. Post socialist states have been intentionally weakened by neo-liberal policies, often led with the official support of the governments of leading industrial countries and the international organizations.

For instance, the Russian government is weak and unable to collect due taxes not because of the legacy from the communist period, but owing to ill-advised liberal approach and incorrect deregulation and privatization. Now it is difficult to carry things under the independence of the new state, because they have been allowed to get out of control of the old state, primarily because of mismanaged liberalization and the manner the institutional redesign occurred. As for new partnerships between market players, that is accurately what gradual institution building is about. In the long-term, such partnerships advance the environment for growth, but at the initial stages in progress changes can destabilize active links between partners involved in economic activities. The old relationships cease to exist, while the new ones are only in statu nascendi. Hence the active state participation is required, since market relations are often associated with unsuitable events owing to activities of a variety of lobbies and informal organizations, including the organized crime.

[37] World Bank (1996), **op.cit.**, pp. 13-14.

2.6. Transition as a Tool of Growth Strategy

The new institutional set up must be founded on the basis of new organizations that did not exist, because they were not necessary, under the centrally planned state economy. Transition calls not only for a new legal system, but also for learning a new type of behaviour. Enterprises, banks, the civil service and state bureaucracy, even households; all of them must swiftly learn how to act under the conditions of new reality, i.e. emerging market system. Political leaders in post socialist countries do not have, many years to turn their people around. To speed up this process and cut the costs of institutional and cultural adjustment need special training and education efforts by political and intellectual elites, and non-governmental organizations (NGOs). The Bretton Woods institutions are contributing to this acceleration. After seeing that sometimes providing new skills and knowledge is more significant than just lending money, they have started to pay much more attention to technical assistance and professional training. In countries that enjoyed a comparatively liberal system under socialism, the progression of learning goes much more rapidly. If there was already a private sector and decentralized management of state companies, learning new methods of corporate governance is smoother. If there was already a two-tier banking system, learning sound commercial banking is easier. If there was already an anti-trust body, this formerly rather useless organization (because of the shortages) now ought to regulate well-supplied markets to make them really competitive.

In countries, which had traditional centrally planned regimes until the late 1980s, learning is slower. This factor explains the differences in the economic performance of such neighbours as Hungary and Romania. The sooner is the process of institution building; the better is the environment for business activity and so for growth. Government guidance and intervention can speed up the whole process, as it was done in Poland in the 1990s, but (if mismanaged, as it was over the same period of time in Russia) can spoil it too. Nevertheless, such a risk cannot be a reason for state withdrawal from these activities. The risk calls for intelligent guidance and reasonable intervention. In the very long term, the transition has to be seen as a

foremost instrument of development policy. Systemic changes that do not lead toward sustained growth and development do not make sense. Though, there are ideologically motivated efforts at change, which are made without deep concern about their practical implications for society. Such motivation should not be ignored since it can be very powerful, particularly during a period of revolutionary change. And the post socialist transformations are of such a nature, despite of their speed. Yet the situation is more complicated, because behind political motivations there are always some exacting interest groups.[38]

To offset these interests with lobbies oriented toward long-range progress and development is not easy, since such a group would require resisting strong pressures coming from interest groups. In other words, if there are lobbies that struggle with any and all means for their own current interests, there are no lobbies fighting with such determination and force in favour of long term development and distant policy targets. In point of fact, the only observable and somehow efficient lobby of the latter type is the environmental lobby. On the other hand obvious it is that systemic transition is not the target but simply the path to a more significant objective, there is still some confusion on this point. This confusion is first about the inter-dependence of institutional changes and real economy expansion. Can the system be faultless while growth is not satisfactory, or can it be praised at a time when capacity to expand is pathetic? Of course it must not, yet unusually, it often is. It is clear in professional discourse that reforms are appreciated for their own sake, without paying enough notice to their real conclusion.

Hence the massive contraction in Eastern Europe and the former Soviet Union has been a consequence of, on one hand, deficiencies of development policy and exaggeration of the importance of transition as such and, on the other, a confusion of transition with liberalization and privatization. Policies have focused primarily on stabilization measures, trade liberalization, and privatization, without paying enough attention to events in the real economy, i.e. production, investment, consumption, unemployment, etc. This approach changed the initial conditions

---

[38] **Ibid**., p. 15.

(though not always for better) and caused contraction instead of growth. From a very long-term perspective, the system's design plays an active role for expansion and development. As one generation passes away, the next takes its place. When one set of solutions has ceased to serve the purpose, another ought to replace it and take over. Thus, the system must be elastic enough to meet the challenge of changing state of affairs. It adjusted numerous times in the past and will change again many more times in the future, given its serving, i.e. supporting for development role and new, often erratic circumstances. As a result, the whole transformation should be seen only as a historical episode, albeit a very significant one, which may serve development requirements well, if policies are supervised in a proper way.

Opposite to this practice, attention to development policy and treatment of market oriented reforms as the means for successful development have contributed considerably to the high rate of growth in China and Vietnam. This is indeed interesting, because there is not yet any such promising in terms of durable growth example in post socialist economies of Eastern Europe and the former Soviet Union. The reforms of the socialist system were unsuccessful in Europe, still work in Asia. In the latter, it was possible to differentiate between system design and policy guidance; that is, to take advantage of the system and adjust it as essential to new challenges for the sake of extra growth. This is the capacity to use the system and its adjustment as a means of expansion, and not as a target. Therefore, within each political system there is a space for some dissimilarity, for separate policies and exercises. The system itself cannot serve as an alternative for good policy. In history we can see most repeatedly that it is adequate to advance policies, without overhauling an entire system. Of course, during transition there is also room for better or worse economic policy, for wise or not-so-wise government action, and for diverse forms of involvement of the international community.

2.7. Organization Building

Following the failure of ‘shock therapy’, since it did failed, due to the systemic vacuum and profound recession, the process of post socialist change has been managed in a more logical way, by deliberate measures at a somehow slower

speed. By the very nature of this long-term and complicated process, it can not be carried forward in a fundamental way. It takes time and is costly in both financial and economic senses. It is risky and can expose the country to social and political tensions. Only part of the multi-layer transition process, namely liberalization linked with stabilization, can be executed (if political conditions permit) in a major manner. Even this is not an imperative, but a policy choice depending on the scale of monetary and fiscal disequilibria, and on the range of social acceptance.

As for structural adjustment, institutional reform, and behavioural change, they will take a long time under any circumstances. For instance, in Eastern Europe it is approximately 77 percent of computer software are pirated, while in the United States such misconduct stands at about 20 percent. This is still not unimportant, but four times less common in the US than in transition economies. Such a difference cannot be explained exclusively on the basis of more well-organized law enforcement and better marketing. The more significant difference is that between a weak market culture and an established one. Yet even in mature markets the process of behavioural change ought to continue if, although the sophistication of market institutions and established market culture, as much as a fifth of computer software is still basically stolen.

Certainly, from the perspective of the societies concerned and their political elites, it must seem that this will be a very long process, but in reality it has to be seen as a very short historical incident, considering the mighty and inclusive changes that are taking place. Establishing the traditional market economies, although achieved under different circumstances, did take much more time than the present transformations in socialist and post socialist countries. Ten years is really a very short time to turn an economy around. So, the post socialist transition, even though the hardship it has brought, should be seen as relatively fast process of complicated changes of structures, institutions, and behaviours. The difficulties have not derived, on the other hand, from a lack of knowledge of how the market works, but from a difficulty in knowing how to get to a market system from the specific situation of the late socialist economies.

The most challenging problem is not finding an objective design for new organizations and institutions, but the process of transition leading toward those targets. The most difficult question to be answered, hence, is not how it ought to look and work at the very end, but how to get from here to there. Simultaneously, a process of learning by doing is taking place. Both in the East and West preceding theoretical explanations and pragmatic approaches have evolved considerably. Professionals from transition countries have gained knowledge of market performance. Great political and intellectual debates, training at home and abroad, and simple experience of the process, have brought tremendous progress in relation to the qualifications of researchers, entrepreneurs, and political elites.

Professionals from developed countries, together with government representatives dealing with transition, experts of international organizations, and the business community has learned about the specific conditions of transition. They have been able to absorb knowledge on a variety of features of post socialist realities, and have understood that one should attack the challenges in a someway different, rather unorthodox way. Main lessons about the importance of institution building for sustained growth have been learned at last, and the appropriate policy conclusions seem to have been drawn. Unfortunately, the process of learning by doing has been very costly for the Eastern European and post-Soviet nations. To be sure, future growth should not be counted as compensation for the past fall. It was anticipated and predicts already several times that the production over the whole region will grow, yet in some cases it has happened not to be a reality so far. Worse, there are still the post socialist economies, where production is shrinking and even further contraction, at least in the year 2000, is foreseen.

As for the first 10 years of transition, GDP in post socialist economies contracted more than at the time of the Great Depression in 1929-33. This was not necessary and could have been declined, if actually existing knowledge about the probable alternative methods of transformation had not been ignored, and the adjustment of Western economic consideration and policy advice to actual challenges had been quicker. Later, there were better-orchestrated attempts aimed at

gradual, but steady institution building. By institutions we mean not only organizations and the links between them, but also correct behaviour of actors on the economic stage. Hence, with much better coordinated international assistance, transition policies have shifted in a number of countries in the right direction. Market organizations have been created, new law has been drafted and adopted, and new skills have been taught. Indeed in the late 1990s Eastern Europe, and to a lesser degree the former Soviet Union, look differently than they did in the early 1990s. Yet there is still long road to travel.

Table 4 Forecast of economic growth in transition economies, 1998-2002

	GDP index 1997	Growth Rate					1998-	Average	GDP index 2002	
	1989=100	1998**	1999	2000	2001	2002	2002	Ranking*	1997=100	1989=100
Poland	111.8	4.8	4.5	5.0	5.4	5.7	5.6	9	128.4	**143.2**
Slovenia	99.3	4.3	3.7	4.3	4.4	4.8	4.7	15	123.4	**122.6**
Slovakia	95.6	5.3	2.2	4.0	5.6	6.9	5.3	10	126.3	**120.8**
Hungary	90.4	5.2	4.3	4.1	4.0	4.1	4.7	13	123.7	**111.8**
Albania	79.1	4.3	6.2	8.9	8.0	4.4	7.2	4	136.0	**107.6**
Uzbekistan	86.7	4.5	4.5	4.3	3.8	4.2	4.6	16	123.2	**106.8**
Czech Rep.	95.8	-2.5	0.5	3.3	3.9	5.2	2.1	23	110.6	**106.0**
Estonia	77.9	6.4	6.1	5.9	6.9	5.9	7.1	5	135.3	**105.4**
Romania	82.4	-4.7	2.2	4.9	4.8	5.1	2.5	22	112.5	**92.7**
Croatia	73.3	4.2	2.9	4.3	4.1	4.3	4.3	19	121.4	**89.0**
Bulgaria	62.8	3.5	2.7	4.6	5.2	5.2	4.6	17	123.0	**77.3**
Yugoslavia	62.7	5.4	1.3	3.9	4.7	5.5	4.5	18	122.5	**76.8**
Latvia	56.8	6.6	5.4	4.4	3.9	5.4	5.7	8	128.5	**73.0**
Kyrgyzstan	58.7	3.0	3.0	4.7	5.2	5.7	4.7	14	123.5	**72.5**
Turkmenistan	48.3	4.7	12.1	16.0	3.5	4.2	9.4	2	146.8	**70.9**
Kazakhstan	58.1	1.4	0.6	3.0	5.5	8.3	4.0	20	120.0	**69.7**
Macedonia	55.3	5.3	4.7	4.6	4.1	4.1	5.0	12	125.0	**69.1**
Belarus	70.8	4.2	-9.3	-5.8	1.5	2.9	-1.4	26	93.0	**65.8**
Azerbaijan	40.5	7.9	7.9	9.0	9.9	10.7	10.9	1	154.4	**62.5**
Lithuania	42.8	7.4	4.5	3.7	3.8	4.1	5.2	11	125.8	**53.8**
Armenia	41.1	5.7	4.4	5.0	5.7	6.1	6.0	6	129.9	**53.4**
Tajikistan	40.0	4.3	4.3	5.8	5.5	5.9	5.7	7	128.6	**51.4**
Russia	52.2	-4.7	-5.3	-2.6	3.9	4.1	-1.0	25	95.1	**49.6**
Georgia	34.3	7.2	5.1	7.9	9.4	8.0	8.7	3	143.6	**49.3**
Moldova	35.1	-2.2	0.7	4.1	5.2	6.2	2.9	21	114.5	**40.2**
Ukraine	38.3	-2.0	-5.2	-1.1	4.0	4.6	0.0	24	100.0	**38.3**

*: Ranking is according to the 2002 GDP index (1997=100) and 1998-2002 average rate of growth.

**: Preliminary evaluation

Source: PlanEcon, "**Review and Outlook for the Former Soviet Union,**" Washington, D.C.: PlanEcon, Inc. December 1998.

2.8. The Impact of Washington Consensus

It is correct that the course of procedures in post socialist economies has been under great influence from policies based upon the Washington consensus. But it is also true that the transformation to a market economy and occurrences associated this process have had important influence upon the modification of these policies. On the one hand, the line of thinking typical for the Washington consensus has had major meaning for the directions of systemic reform and policy attempts in Eastern Europe and the former Soviet Union. On the other hand, the fact that suggested and executed policies did not carry the anticipated consequences led to a search for alternative policy means. In fact, the range of problems upon which there is consensus among the foremost partners on the global financial, economic, and political scene has expanded over the years.

The post socialist transformation has contributed to this evolution of attitudes. New issues and problems have emerged together with the emerging post socialist markets, and thus there are new concerns, toward which views differ and are far from being agreed upon. Nonetheless, there are many symptoms of a vital necessitate for a new consensus. Additionally some new elements should be emphasized in what has been agreed upon in the past. There are twelve key policy conclusions:

1. The major policy conclusion, and the key implication of the post-Washington consensus, is that the institutional arrangements are the most significant factor for progress toward sustained growth. What is taken for granted in some market economies, i.e. an institutional set up adequate for far going liberalization and free market performance, should be created, often from beginning, in countries moving from statist, centrally planned economies. If there is a choice between developing these institutional arrangements spontaneously (by chance) or in a way directed by the government (by design), then the latter option is more appropriate in the case of post socialist countries. Yet the governments of industrial countries and international organizations should assist some governments in these attempts. Those countries which, due to powerful government commitments, were able to take care of

such design are doing much better. Recovery has come sooner, growth is robust and there is the outlook of durable development. Those which have tried to trust that main institutional overhaul can occur by itself or have not been able to lead this complicated process sufficiently, are lagging behind in both transition advancement and speed of growth.

2. The size of the government is less significant than the quality of its policy and the method of the changes of government size. In transition economies the subject is not just downsizing the government, but a profound restructuring of the public finance system and change of the policy targets and means. Essentially, fiscal transfers should be redirected from non-competitive sectors toward institution building (including behavioural and cultural changes), investment in human capital, and solid infrastructure. Attempts to downsize the government through cuts of budgetary expenditure can cause more damage than good for launching recuperation and growth. Even if small government is sometimes better than a larger one, the problem is that usually it can not be downsized without causing contraction and standard of living worsening. It must be considered that creative downsizing should occur only when the economy is on the rise, though most often the strongest attempt to do so is undertaken over a period of deep contraction. Hence, the general problem lies in restructuring expenditures rather than cutting them for an illusion of concurrent, albeit unsustainable fiscal prudence.

3. Dissimilar exact liberalization measures, institution building by its nature must be a gradual process. So feedback between specific ‘inputs’ to this process and its ‘output’ must be monitored regularly and the policies must be adjusted and corrected. In post socialist transition there are many uncharted waters where one should not rely on unwise analogies with experience from distorted market economies. One must regard as the specific features of that type of emerging market. Consequently it is essential to coordinate some institution building innovation in a way beforehand unseen in other places. This is valid first regarding privatization and development of capital markets.

4. If institutional arrangement is ignored and left to the spontaneous processes and unleashed forces of liberalized markets, then informal institutionalization fills the systemic vacuum. The ignorance of government in organizing market infrastructure with active policy is causing a position in which informal organizations and institutional links among them are taking over. Excessive cases here are immense corruption and organized crime. These are the two major maladies in countries after liberalization and privatization under weak governments. Sometimes governments are too weak because they are too large, but because they were forced to become smaller too early, that is before the infant market was able to substitute for the state. Prematurely or too extensively downsized government is not strong enough and then the market expands in the informal sector (shadow economy), while difficulties climb in the official economy. Then profits accrue to the informal sector, but the revenues fall in the official sector, with all the negative results for the budget and social policy. Hence the market works in a way where profits are privatized, but the loss is socialized in a politically unsustainable way.

5. In transition economies the policies have to renovate and streamline the judiciary system to serve the requirements of market economy. This is a huge challenge, because the old system of contract execution under planned allocation has ceased to exist, but a new system of contract implementation under market rules and culture has not yet matured. The establishment and development of new law, e.g. trade and tax code, capital market regulation, property rights protection, competition and anti-trust rules, banking supervision, consumer protection, and environmental protection are even more significant and have to be addressed before privatization of state assets. Creation and advancement of a legal structure for the market economy should be much higher on the agenda of international financial organizations. It must be put in front, as a more vital and central concern than liberalization and privatization, since the latter can contribute to sound growth only if the former is secured.

6. A move of capability and power from the central government to local governments is essential for deregulation of the post socialist economy. Such a shift

means moving the public finance system toward decentralization, and streamlining local governments by giving them larger fiscal autonomy. Or else, the process of weakening the central government is not matched by enhancing local governments. The joint position of both levels of government must be seen as an integrated entity required for the sake of gradual institution building. If local governments are not enhanced while at the same time the central government is weakening too much, and market forces are not yet supported by new institutional arrangements, than liberalization and privatization will not necessarily improve capital allocation and will not increase effectiveness.

7. There is a vital requirement to speed up the development of non-government organizations. Next to the private sector and the state, this is the third crucial pillar of a current market economy and civic society. With a lack of a range of NGOs, which are supposed to take care of various aspects of public life, there is a continued tension between the state and society, and the expanding private sector does not provide adequate or suitable solution to this matter. There are spheres within the public area that ought to depend neither on the state, nor on the profit-oriented private sector. A mounting part of international technical, financial, and political assistance must be channelled into enhancing the NGOs. Otherwise the infant market economy and democracy in post socialist countries will not evolve rapid enough and the transition will be unfinished. The postponement of institutional infrastructure provided by the NGOs becomes a growing hurdle for successful systemic changes and high-quality growth.

8. During transition income policy and government concern for equitable growth has a huge meaning. While rising inequity is inevitable during the initial years of transition, the state must play an active role, throughout fiscal and social policies, in controlling income dispersion. There is a limit of disparity beyond which further expansion of overall economic activity becomes constrained and growth starts to slow or recovery is postponed. If disparity growth is tolerated for a number of years during contraction, when the standard of living is increasing for a few and decreasing for many, then the political support for required reforms will evaporate.

Consequently, large inequities turn against crucial institutional and structural reforms.

9. Post socialist transition to the market is taking place at a time of worldwide globalization, thus opening and integration with the world economy is an obligatory part of the whole attempt. Yet these processes must be managed carefully with extraordinary attention to short-term capital flow liberalization. It must be monitored and controlled by the countries' fiscal and monetary authorities with the support of international financial institutions, e.g. the IMF and Bank for International Settlements (BIS). It is better to liberalize capital markets later than earlier. First the institution building ought to be advanced enough, and stabilization must be consolidated into stability. Only then should financial markets be liberalized in a gradual manner. Or else, the societies of young emerging markets and democracies are not going to be supportive of market mechanism's introduction or integration with the world economy, and they may even become hostile toward such changes.

10. International organizations should not only sustain, but also insist on further regional integration and co-operation. If growth is anticipated to be sustained and rapid, it needs export expansion, which will depend on powerful regional links. Hence it calls for institutional support, as export-import banks, commodity exchanges, credit insurance agencies, and suchlike. This must be the major institution building concern of the EBRD, supported by directed lending from this bank and by its technical assistance. This type of market infrastructure is still underdeveloped in transition economies, so regional trade and cross-country foreign direct investment is lagging behind overall changes. What should be one of the driving forces of sustainable growth is actually one of its main obstacles.

11. The Bretton Woods organizations must review their policies toward transition economies. If the IMF mostly takes care of currency convertibility, financial liquidity, fiscal prudence and monetary stabilization, the World Bank ought to further focus attention primarily on circumstances for equitable growth and sustainable development. For apparent reasons these two kinds of economic policy

aims, or rather the means in the former case and the ends in the latter, are often contradictory. There is an inclination to confuse the ends with the means of the policy, to subordinate long-term development policy to short-term stabilization policy. Yet the record of transition so far has obviously proved that there is neither much development, nor stability. Thus, in the future fiscal and monetary policies must be subordinated to development policy, not the other way around. There is a necessitate for the World Bank performance criteria describing socio-economic development as much as there is such a need for the traditional IMF fiscal and monetary criteria. The new set of criteria should always stress the implication of advised financial policies for growth, capital allocation, income distribution, and the social safety net. The World Bank should not accept and support policy reforms and actions that, while aiming at financial stabilization, may lead to social destabilization resulting from lack of growth, spreading poverty, mounting inequality, and divestment in human capital.

12. These interactive processes of learning-by-monitoring and learning-by-doing continue and will last for some years. After all, even if there is (as indeed it seems to be) a rising chance for some kind of the post-Washington consensus, this ought to be seen as a progression, and not as an act. Such an emerging consensus must be accomplished indeed among many more partners than just the significant organizations based in Washington. Or else, the policies agreed in Washington will not be able to deliver what they assume elsewhere. This is also a vital policy conclusion that should be noticeable in the era of globalization. Moreover, what may be agreed upon presently must be revised often if conditions and challenges alter, as they have done recently and undoubtedly will do again and again in the future. Consequently the quest for a comprehensive and applicable consensus on policies facilitating sustainable growth must persist.

2.9. Performance of the Transition Economies in Specific Areas

The transition economies have not performed as well as many had anticipated. Economic performance has also varied broadly across the transition countries, with the central European countries of Poland, Hungary, Slovenia, Slovakia, and the Czech Republic generally performing better than the Baltic states of Estonia, Latvia and Lithuania and the Balkan state of Bulgaria and Romania, which in turn performed better than Russia, Ukraine, and other countries in the Commonwealth of Independent States.

2.9.1. Gross Domestic Product

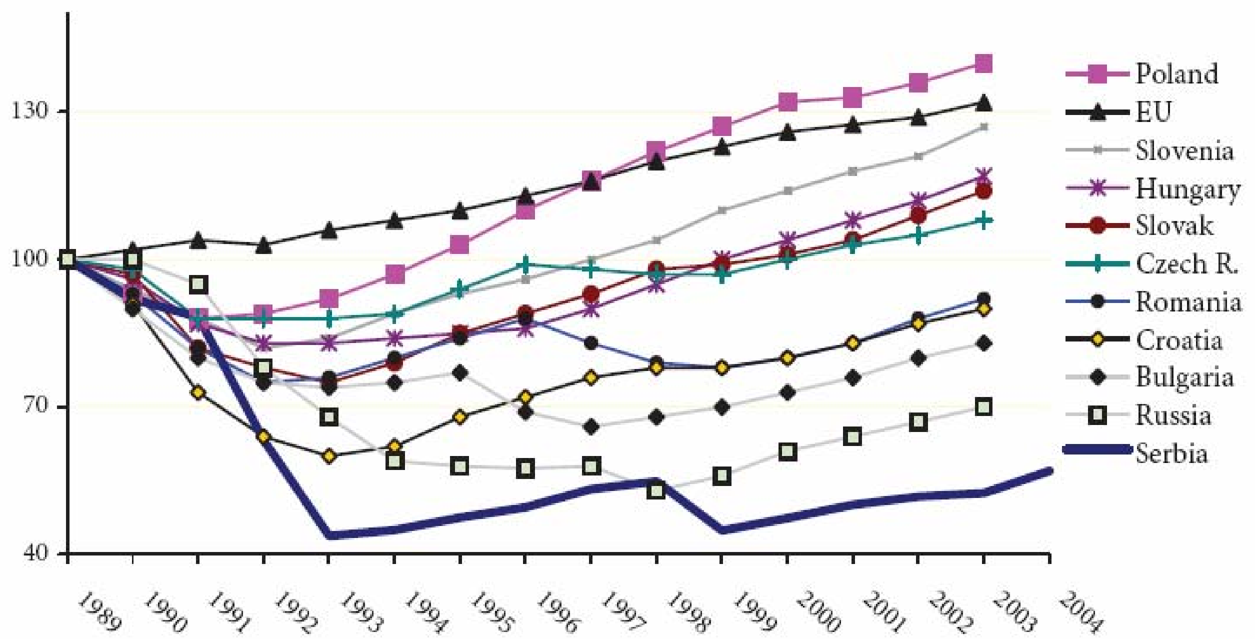
Calculating the evolution of GDP is difficult in the transition economies. Instead of GDP, the socialist countries used "gross material product" to measure the range of their economies, a measure which neglected the production of services. Furthermore, the socialist economies were considered by prices that did not reflect scarcity and consumer demand, so making market valuations complicated. The remarkable growth in the number of small firms during the transition was not well captured in the official statistics; to say nothing of the course of the underground economy in these countries both before and during the transition.[39] National statistical offices and the international institutions have devoted important resources to estimating GDP for the late 1980s, and tracing out GDP correctly afterwards, but the early data apparently have to be interpreted with caution.[40]

With the above caveats in mind, one may interpret the growth performance since 1989 as having been kindly to considerably unsatisfactory in central Europe and poor to disastrous in Eastern Europe and the Commonwealth of Independent States. Figure 1 provides GDP data for an illustrative set of countries. All of the transition economies experienced large decreases in production at the start of the transition. The decline varied from 13 to 25 percent in central European and Eastern

[39] Filer, Randall K. and Jan Hanousek (2000). "Output changes and inflationary bias in transition," Economic Systems, 24(3), pp. 285-294.
[40] Brada, Josef C., Arthur E. King and Ali M. Kutan (2000). "Inflation bias and productivity shocks in transition economies: The case of the Czech Republic," Economic Systems, 24(2), pp. 119-138.

Europe; over 40 percent in the Baltic countries; and as much as 45 percent or more in Russia and even more in many of the other nations of the CIS, like the fall of approximately 65 percent in Ukraine. Whereas the Central and Eastern European countries reversed the decrease after 3-4 years, in Russia and most of the CIS no turnaround was observable through most of the 1990s. Russia, for instance, suffered a permanent decline in GDP until 1996, showed signs of growth in 1997, but then went into another 5 percent decline during its 1998 financial crisis.

Figure 1 Real GDP Percentage Change Index



Source: William Davidson Institute based on OECD Economic Outlook Vol. 69 July 2001, EBRD Transition Report 2001 Update, and Davidson Institute staff calculations.

All central European countries apart from the Czech Republic have generated durable economic growth since the early to mid-1990s. Though, only in Poland has the growth rate been adequate to start closing the relative income gap with the advanced OECD economies back towards its primary 1989 level. By 2004, every transition economy had an even larger relative income gap with the advanced economies than had existed in 1989.

What is the importance of the income gap? At 1999 exchange rates, GDP per capita ranged from $620 in Ukraine to $1,250 in Russia, $4,070 in Poland, $5,200 in the Czech Republic, and $10,000 in Slovenia.[41] Comparable figures for the United States, the 15 European Union countries and Japan were $33,900, $22,560 and $32,600, respectively. The gap between the poor and rich countries is of course declined when calculated in terms of purchasing power parity, but nonetheless, for most transition economies the massive absolute and relative income gaps will take decades to close. Note that since these figures refer to roughly one decade after price liberalization, they do not suffer from mis-measurement of inflation, as may have been the case in the early transition.

The length and depth of the early transition depression was unpredicted. A number of explanations have been offered: tight macroeconomic policies[42]; a credit crunch stemming from the reduction of state subsidies to firms and rise in real interest rates[43]; disorganization among suppliers, producers and consumers associated with the collapse of central planning; a switch from a controlled to uncontrolled monopolistic structure in these economies[44]; difficulties of sectoral shifts in the presence of labour market imperfections[45]; and the dissolution in 1990 of the Council for Mutual Economic Assistance (CMEA), which governed trade relations across the Soviet-bloc nations. Whereas each explanation contains a small piece of reality, none is in itself totally convincing. All countries have gone through the decrease; yet cross-country differences in initial conditions and the nature of reform are considerable enough to make one question the universal applicability of any single explanation. No explanation has strong empirical support across the board.

---

[41] EBRD (2000). Transition Report, London: European Bank for Reconstruction and Development, pp. 8-9.
[42] Bhaduri, A., K. Kaski and F. Levcik (1993). "Transition from the Command to the Market System: What Went Wrong and What to do for Now?," *Vienna Institute for Comparative Economic Studies*, pp. 9-11.
[43] Calvo, Guilermo A. and Fabrizio Coricelli (1992). "Capital Market Imperfections and Output Response in Previously Centrally Planned Economies," in Caprio G., Folkerts-Landau D. and Lane T. (Eds.) Building Sound Finance in Emerging Market Economies, Washington, D.C., IMF, pp. 13-15.
[44] Li, Wei (1999). "A Tale of Two Reforms," *RAND Journal of Economics*, Vol. 30 (1), pp. 120-136.
[45] Atkeson, A. and P.J. Kehoe (1995). "Social Insurance and Transition," *International Economic Review*, Vol. 37, pp. 377-402.

What factors account for the unrelenting growth in Hungary, Poland, Slovakia, and Slovenia since the early to mid-1990s, as compared to the recession experienced in the second half of the 1990s by the Czech Republic, Bulgaria and Romania, and the incessant fall in Russia and the other CIS countries? Again, no single explanation suffices. Geography alone does not explain the consequences as the western-most country, Czech Republic, did much worse in the second half of the 1990s than countries further east such as Poland, Hungary and Slovakia. In fact, the evolution of Czech GDP in the second half of the 1990s resembles that of Bulgaria and Romania.

The extent to which countries pursued a combination of key Type II reforms provides some explanatory power. The four leading transition economies shown in Figure 1 (Slovenia, Poland, Hungary, and Slovakia) have pursued a comparatively complete set of reforms, including maintaining relatively obvious property rights and corporate governance. For instance, Hungary and to a lesser extent Slovakia privatized most state-owned enterprises in a way that assigned clear property rights to the new owners. Slovenia and Poland proceeded slower with privatization, but both countries exposed the state-owned enterprises to competition and a risk of financial collapse. In all four economies there was also extensive creation of new private firms that contributed to growth.

Other countries have carried out much more limited Type II reforms. The Czech Republic is remarkable because it was comparable to the four leading economies but it grossly ignored the requirement to establish a functioning legal framework and corporate governance of firms and banks. The privatization experience of the Czech Republic, Russia and Ukraine also suggests that mass privatization in the non-existence of a functioning legal system has strong negative effects on performance. The circumstances in Russia and other CIS economies have been further aggravated by the political and economic disintegration of the Soviet Union, including attempted coups, a greater presence of organized crime, and the spread of aggressive rent seeking and corruption.

2.9.2. Inflation

A number of the transition economies practised high or hyperinflation as the socialist system disintegrated. Slovenia, Poland, Bulgaria, Albania and Romania all experienced at least one year from 1990 to 1993 when consumer price inflation exceeded 200 percent; Latvia, Estonia and Lithuania all had one year with inflation around 1000 percent; and Russia, Ukraine, and Kazakhstan experienced at least one year when inflation was above 2000 percent. Sometimes these bouts of inflation arose after lifting price controls; in other cases, the inflation grew out of financial sector crises. Though, by the later part of the 1990s, Type I reforms had shown that they could reduce inflation rates with pace and effectiveness.

First column of Table 5 shows inflation rates for a selected group of transition countries. The first group of countries are in Central Europe; the second set stand for the Southern part of Eastern Europe (Balkan countries); the third set stand for the Northern part of Eastern Europe (Baltic countries), the fourth set stand for Russia and other countries in the Commonwealth of Independent States; and the final panel offers some comparisons from the Western European economies and the United States. By 2001, inflation rates in many transition economies were in single digits. Even countries that practised very high rates of inflation during the 1990s (Russia, Ukraine, Kazakhstan, and Bulgaria, for instance) had inflation rates in the range of 9 to 35 percent by 2001[46]. This conclusion is significant because annual inflation of 40 percent or less does not seem to have a foremost negative impact on economic growth and consumer welfare.[47]

[46] Bruno, Michael and William Easterly (1995). "Inflation Crises and Long-Run Growth," NBER Working Paper No. 5209, Vol. 41, No:1, pp. 7-9.
[47] Fischer, Stanley, Ratna Sahay and Carlos Vegh (1996). "Stabilization and Growth in Transition Economies; The Early Experience," *Journal of Economic Perspectives*, 10(2), pp. 45-66.

Table 5 Current Macroeconomic Indicators

Countries	Consumer Price Inflation 2001[a]	Current Account Balance 2001[b]	External Debt 2000[b]	Government Budget Balance 2001[b]	Private Sector Share of GDP 2000[c]	Unemployment 2000[d]
Czech Rep.	4.6	-5.1		-9.2	80	8.9
Hungary	9.4	-5.4	67.8	-3.5	80	6.5
Poland	6.6	-6.0	42.8	-3.0	70	16.1
Slovakia	7.1	-3.8	53.5	-4.0	75	18.6
Slovenia	7.7	-3.0	33.4	-1.3	55	7.0
Estonia	6.2	-7.7	63.0	-0.5	75	13.7
Latvia	3.3	-7.1	66.2	-2.0	65	14.3
Lithuania	2.0	-6.4	43.8	-1.4	70	16.1
Albania	4.0	-6.3	29.1	-9.2	75	17.1
Bulgaria	8.0	-5.2	86.0	-1.5	70	16.2
Romania	35.0	-3.9	27.8	-4.0	60	7.2
Kazakhstan	8.7	2.0	67.6	-1.5	60	6.3
Russia	22.4	10.2	62.0	0.0	70	10.0
Ukraine	16.0	1.4	33.2	-3.0	60	4.2
EU	1.8	-0.4	na	-0.2	na	8.2
United States	2.6	-4.2	na	1.5	na	4.0

a: Annual percentage change.

b: As % of GDP.

c: In percent, mid-year.

d: Percent

Sources: William Davidson Institute based on EBRD Transition Report various issues, IMF World Economic Outlook May 2001, OECD Economic Outlook Vol. 69 July 2001, UN Transition At A Glance 2001, World Bank World Development Indicators 2001.

2.9.3. Exchange Rates and Current Account

Most transition economies devalued their currency as a means of export promotion and adopted a fixed exchange rate as part of macroeconomic stabilization. They also drastically reoriented their foreign trade away from the old CMEA arrangements and toward market economies. Nonetheless, as domestic inflation exceeded world inflation in the 1990s, the fixed exchange rates often became overvalued, leading in some cases to substantial current account deficits. For example, Russia, Kazakhstan, Albania and Bulgaria all had at least one year between 1990 and 1993 when the current account deficit was -10 percent or higher. Most countries responded by devaluing their currencies once more and adopting more

flexible exchange rate regimes, although Bulgaria, Estonia and Lithuania have fixed their exchange rate through currency boards as a means of long-term economic stabilization. The second column of Table 5 shows that central and Eastern Europe now have current account deficits of moderate size, which would be anticipated for countries that are seeking to attract a net inflow of foreign investment capital. On the other hand, Russia and the other economies of the Commonwealth of Independent States are often major exporters of natural resources and are experiencing a net outflow of investment funds, as shown by their current account surpluses.

2.9.4. External Debt and Financial Crises

A number of transition countries started the 1990s with high foreign indebtedness. In Bulgaria, Hungary, and Poland, external debt exceeded 50 percent of GDP in 1990. In Russia, external debt in 1990 was a gigantic 148 percent of GDP. Other transition economies, such as Romania, Slovenia, Czech Republic, and Slovakia, had traditionalist regimes where foreign debt was less than 20 percent of GDP in 1990. These diverse initial conditions deeply affected the following performance of these countries. For example, high-debt Poland succeeded in renegotiating its debt, while high-debt Hungary serviced its debt in full. The Hungarian approach imposed a serious fiscal burden and induced a number of policies, including the revenue-oriented form of large-scale privatization. By the mid-1990s, most of the highly indebted countries diminished their debt relative to GDP, while a number of the less indebted countries raised theirs. But since about 1996, foreign indebtedness appears to have risen in the comparatively more indebted countries, particularly Russia and Hungary. Certainly, Russia defaulted on its independent debt in 1998. Interestingly, whereas the Russian financial crisis had a key influence on the CIS countries that still have close trading relations with Russia; it had relatively little impact on the countries of Central and Eastern Europe or on the Baltic nations, which had already reoriented most of their trade and commercial relations to Western Europe. The third column of Table 5 shows external debt as a share of GDP in 2000. All the countries in the table have external debt in excess of 25 percent of GDP, but leaving aside Bulgaria, none have external debt higher than

70 percent of GDP. This is in line with a number of other developing and some developed countries. Unless accompanied by other destabilizing factors, such as a high proportion of short-term debt that may rapidly not be refinanced as investor sentiment shifts (as was the case in Russia), this level of debt is not especially alarming.

2.9.5. Budget and Taxes

Since under socialism the government owned nearly everything, taxes and expenditures were transfers among centrally determined activities. The principal taxes were a tax on turnover (inputs plus output), along with other taxes on enterprises and payroll taxes. Tax rates changed often; indeed in some countries, tax liabilities seemed more an issue of negotiation than an obligation.[48] Because most taxes were collected at the enterprise level, many citizens were ignorant of the heavy tax burden in the communist economies and therefore have resented the explicit taxes that have been introduced during the transition. As the transition unfolded, governments had to develop new fiscal institutions for collecting taxes. This institutional development was one of the hardest Type II reforms to attain. Whereas tax collection has been relatively efficient Central and Eastern Europe, Russia and some other countries of the Commonwealth of Independent States have faced important decreases in tax revenue as many producers have been operating through barter and accumulating tax arrears. At the same time, the governments have been facing much public expenditure, including infrastructure and the new social safety net.

The relative inability of Russia and the CIS nations to collect taxes is one reason why their social safety nets have been much weaker than those in Central and Eastern Europe. Many the transition economies, particularly those in Central and Eastern Europe, have higher tax rates than other countries at a similar level of GDP per capita. The highest tax burdens (35 to 42 percent of GDP) are found in Central Europe among the most advanced economic reformers, who rely mainly on the

[48] Tanzi, Vito and George Tsiboures (2000). "Fiscal Reform over Ten Years of Transition," IMF Working Paper WP/00/113, pp. 17-18.

payroll tax, value-added tax and personal income tax to finance government programs. The comparatively high ratios of taxes to GDP in transition economies have not prohibited governments of many of these countries from running budget deficits. Hence, Russia, Bulgaria, Czech Republic, Albania, Hungary, Lithuania, Kazakhstan, Slovakia, and Ukraine have in a number of years had annual budget deficits in excess of 5 percent of GDP. The fourth column of Table 5 shows government budget balance as a share of GDP in 2001. The patterns in public revenues and expenditures reflect local factors as well as the mixed advice that the transition economies received from western countries and institutions.

The International Monetary Fund and the World Bank have generally advised the transition economies to intend for balanced government budgets, or to run only small budget deficits, while growing the size of the private sector and decreasing the role of the government. The European Union also placed emphasis on low budget deficits and imposed a 3 percent upper bound on the size of the deficit relative to GDP as a precondition for entry into the Union. Though, the European Union also needs that countries applying for EU membership adopt a number of relatively costly social programs and structural measures, which places upward pressure on government expenditures. A particularly problematic characteristic of the public finances in many transition economies is the mounting strain from the pension system. The countries of Central and Eastern Europe entered the transition with publicly-funded pension systems, roughly universal coverage of the population, low retirement ages (on average 60 for men and 55 for women)[49], a high and growing ratio of retirees to workers, high payroll tax contribution levels, and high levels of promised benefits relative to recently earned pre-retirement wages. Furthermore, most of these systems exercise a perverse redistribution of benefits from lower-income workers to higher-income workers.[50]

---

[49] World Bank (1994). "Averting the Old Age Crisis," New York: Oxford University Press, p. 14.

[50] Svejnar, Jan (1996). "Pensions in the Former Soviet Bloc: Problems and Solutions," in Council on Foreign Relations, The Coming Global Pension Crisis, New York, pp. 33-35.

The promises of these systems, which are mainly pay-as-you-go, are not sustainable. Several countries, including Hungary, Latvia, Poland and Kazakhstan, have already moved to rise the retirement age and to supplement the public retirement system by a multi-pillar public/private retirement system with a funded component. Russia and other CIS countries face less of a public sector burden with regard to retirement costs, because the stage of government-promised retirement benefits is lower. Given the fiscal pressure under which most of the transition economies operate, it is interesting to note that their governments have collected very little revenue from privatization. The average in Central and Eastern Europe, as well as in the former Soviet Union, was only about 5 percent of GDP. Hungary, which was most revenue-oriented in its privatization, generated a total of about 14 percent of GDP, which is still an unpretentious figure when spread over several years.

2.9.6. Privatization and Creation of New Firms

In the early 1990s, most transition economies quickly privatized small enterprises as part of their Type I reforms. This small-scale privatization was done mainly through local auctions. It was instrumental in creating small and medium-sized enterprises in countries where most firms were, by ideological and practical design, either large or very large. Casual evidence suggests that this move in ownership improved efficiency and quality of production. Parallel developments were the break-ups of state-owned enterprises (which contributed to the growth in the number of firms), restructuring of firms and management, and increased competition. Break-ups of small, average and somehow above-average size appear to have increased efficiency of both the remaining master enterprises and the spun-off units.[51] Some of the broken up firms were then privatized. A large number of new, mostly small, firms were founded. These firms filled niches in demand and started to compete with existing state-owned enterprises and with imports.

The growth of new firms has varied across countries. In general, it proceeded more rapidly and smoother in Central Europe than in Eastern Europe and the

---

[51] Lizal, Lubomir, Miroslav Singer and Jan Svejnar (2001). "Enterprise Break-ups and Performance During the Transition From Plan to Market," *The Review of Economics and Statistics*, Vol. 83 (1), pp. 92-99.

Commonwealth of Independent States. In the end, in most countries, the majority of private assets were generated through large-scale privatization, which differed in its method across countries. What is outstanding, though, is how rapidly most countries generated private ownership, irrespective of the particular privatization methods used. The private sector had approximately 20-25 percent of GDP in Poland and Hungary, but characteristically only 5-10 percent of GDP in other transition economies in 1990. But these figures improved very rapidly. As early as 1994, the private sector was more than 30 percent of GDP in all of the transition economies and represented half or more of GDP in many countries, including Russia. The fifth column of Table 5 shows that by 2000 the private sector share of GDP was at or above 60 percent in all of the transition economies except Slovenia and in most of them it constituted 70-80 percent. The effect of privatization on economic performance is unexpectedly tough to determine.

At the country level, some of the fastest growing economies (Poland, Slovenia, and also China) have been among the slowest to privatize. In a cross-country econometric study, privatization does not by itself increase GDP growth, but they find a positive effect when privatization is accompanied by in-depth institutional reforms.[52] Four recent surveys make assessments that range from finding no methodically important effect of privatization on performance[53], to concluding carefully that privatization improves firm performance[54], to being fairly confident that privatization tends to advance performance[55]. Obviously, the consequences are not yet definite. Many of the micro econometric studies suffer from severe problems: small and unrepresentative samples of firms; misreported or mismeasured data; limited controls for other main shocks that occurred at the same time as privatization;

[52] Sachs, Jeffrey, Clifford Zinnes and Yair Eilat (2001). "The Gains from Privatization in Transition Economies: Is Change of Ownership Enough?," CAER II Discussion Paper 63, Harvard Institute for International Development, Cambridge, MA, IMF Staff Papers, Vol. 48, p. 147.
[53] Bevan, Alan, Saul Estrin and Mark Schaffer (1999). "Determinants of Enterprise Performance during Transition," Centre for Economic Reform and Transformation (CERT) Working Paper 99/03, pp. 20-26.
[54] Megginson, William and Jeffrey Netter (2001). "From State to Market: A Survey of Empirical Studies on Privatization," *Journal of Economic Literature*, Vol. 39, No. 2, pp. 1-3.
[55] Shirley, Mary and Patrick Walsh (2000). "Public versus Private Ownership: The Current State of the Debate," The World Bank, Washington, DC., pp. 10-11.

a short period of observations after privatization; and above all, not controlling sufficiently for selectivity bias. Selectivity bias is likely to be a mainly serious problem since better performing firms tend to be privatized first.[56]

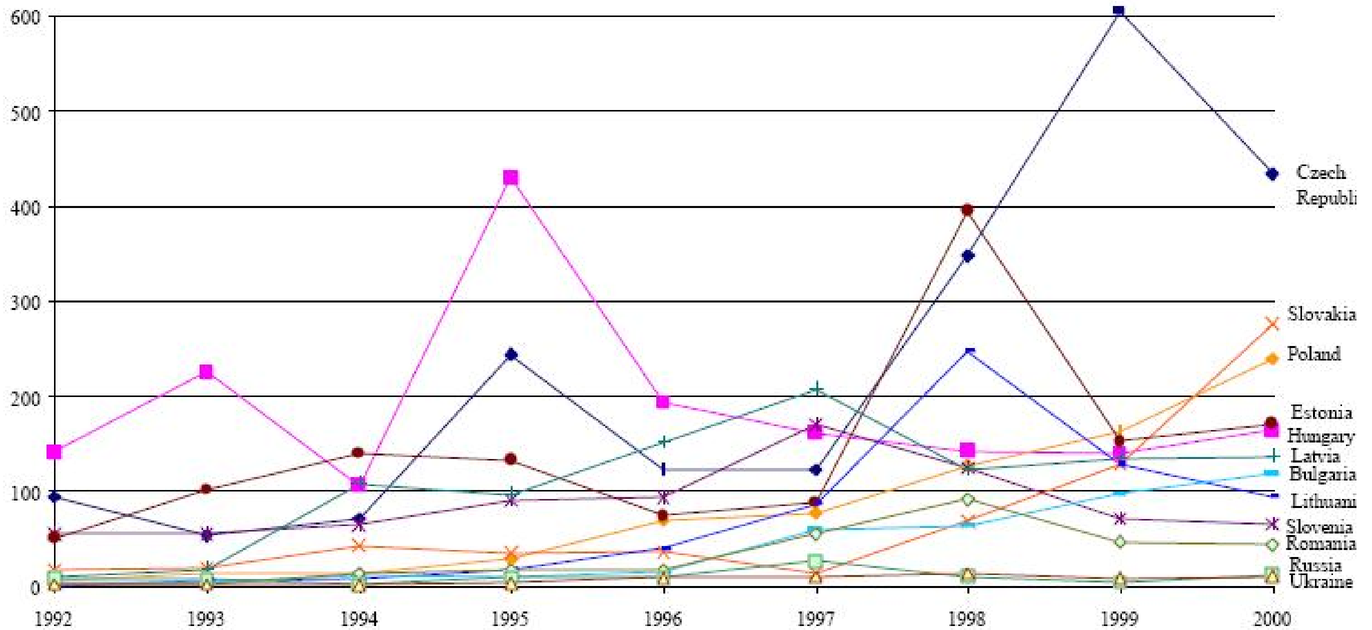
Hence, comparing the post-privatization performance of privatized firms to the performance of the remaining state-owned firms without controlling for selectivity bias, as many studies do, will mistakenly attribute the greater performance of the privatized firms to privatization.

2.9.7. Domestic and Foreign Investment

The socialist countries, like the East Asian tigers, were known for high investment rates, often exceeding 30 percent of GDP. The rates of investment slowed down to about 30 percent in the 1980s in a number of countries as governments yielded to public pressure for more consumer goods. The investment rates decreased further to about 20 percent of GDP in the 1990s in a number of transition economies[57], even though countries such as the Czech and Slovak Republics maintained relatively high levels of investment. Unfortunately, much of this investment appears to have been allocated inefficiently; by the monobank system through the 1980s and by the inexperienced and often politicized or corrupt commercial banks in the 1990s.[58] In fact, trends in foreign direct investment may supply a better measure of the attractiveness of investment in the transition economies than domestic investment figures.

[56] Gupta, Nandini, John Ham and Jan Svejnar (2000). “Priorities and Sequencing in Privatization: Theory and Evidence from the Czech Republic,” Working Paper No. 323, The William Davidson Institute, revised September 2001, pp. 8-12.
[57] EBRD (1996). “Transition Report,” London: European Bank for Reconstruction and Development.
[58] Lizal, Lubomir and Jan Svejnar (2002). “Investment, Credit Rationing and the Soft Budget Constraint: Evidence from Czech Panel Data,” *The Review of Economics and Statistics*, Vol. 184, pp. 360-363.

Figure 2 Foreign Direct Investment Per Capita



Sources: William Davidson Institute based on EBRD Transition Report 2001 Update, World Bank Development Indicators 2001.

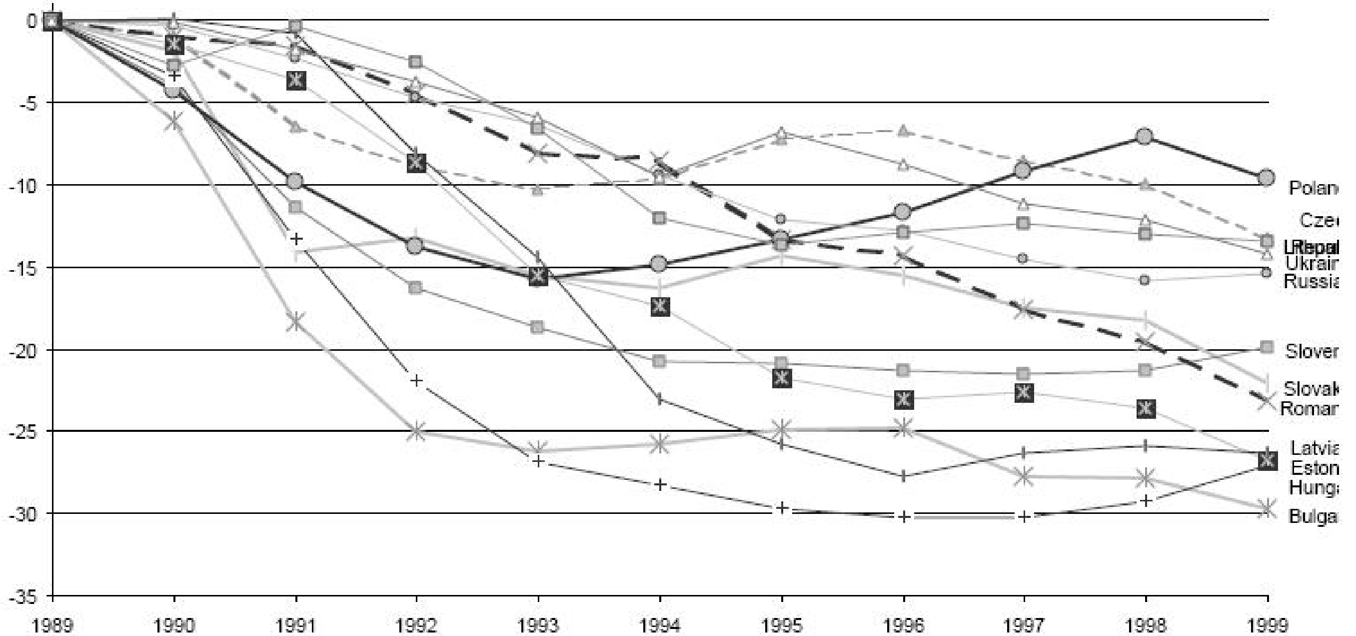
As Figure 2 shows, until 1997 Hungary was the only transition economy receiving an important flow of foreign direct investment. Analysts usually attribute this success to the fact that Hungary was more hospitable to and had well-defined rules and regulations for foreign direct investment since the early 1980s. But starting in 1998, foremost foreign investments went to Poland, the Czech Republic and Slovakia. On the other hand, many countries of Eastern Europe remain, along with Russia, rather unattractive to foreign direct investment. The foreign direct investment rate appears to rise with several factors: the proximity of the perceived date of accession of a given country to the European Union; the desirability of the country's political, economic and legal environment; and the availability of attractive privatization projects in the country.

2.9.8. Employment Adjustment, Wage Setting and Unemployment

State-owned enterprises in all the transition economies quickly declined employment and/or real wages in the early 1990s. In Central Europe, the greatest initial reduction in industrial employment occurred in Hungary (over 20 percent), followed by Slovakia (over 13 percent), Poland (over 10 percent), and the Czech Republic (9 percent). The downward adjustment in industrial wages proceeded in reverse order and amounted to 24 percent in the Czech Republic, 21 percent in Slovakia and 1 percent in Poland. Real wages in industry essentially rose by 17 percent in Hungary.[59] In Russia and the rest of CIS, the modification carried a mixture of wage and employment adjustment and the wage decrease was more pronounced than in Central and Eastern Europe.[60] Demand for labour elasticities with respect to production and wages were important in the more marketized pre-transition economies, and they rose swiftly in central Europe as transition was launched. Depending on the institutional setting in a given country, the jagged decline in production at the beginning of the transition was therefore absorbed more by employment or wage declines.

[59] Basu, Swati, Saul Estrin and Jan Svejnar (2000). "Employment and Wages in Enterprises under Communism and in Transition: Evidence from Central Europe and Russia," The William Davidson Institute Working Papers, No.114b, p. 5.
[60] Desai, Padma and Todd Idson (2000). "Work without Wages: Russia's Nonpayment Crisis," Cambridge, MA: MIT Press; pp. 467-469.

Figure 3 Employment Index (1989=Base)



Source: William Davidson Institute based on UN Economic Commission for Europe, Statistical Division.

Figure 3 shows that in most transition economies, the employment decrease reached 15-30 percent in the 1990s. A constant decline is observed in Russia, Slovakia and Romania; an L-shape pattern detected in Bulgaria, Hungary and Slovenia; a U-shape pattern in Poland; and a sideways S-shape pattern in the Czech Republic. When combined with the GDP data in Figure 1, the employment data suggest that restructuring in the transition economies involved an initial decline in labour productivity as output fell quicker than employment and a subsequent increase in productivity as output and labour stopped declining. But a note of caution is in order here. With production shifting from large to small firms, the decline in employment (and output) may be less marked than suggested by the official data, since small firms are harder to capture in official statistics. Unemployment was unknown before the transition, but it emerged quickly in central and east European countries, except for the Czech Republic. Within two years after the start of the transition, the unemployment rate rose into double digits in most economies of

Central and Eastern Europe. By 1993, for instance, the unemployment rate reached 16 percent in Bulgaria and Poland, 12 percent in Hungary and Slovakia, 10 percent in Romania, 9 percent in Slovenia, but only 3.5 percent in the Czech Republic.

The high unemployment rates reflected high rates of inflow into unemployment as firms laid off workers, and relatively low outflow rates as the unemployed found it hard to find new jobs. The Czech labour market was an ideal model of a transition labour market, considered by high inflows as well as outflows, with unemployment representing a transitory state between old and new jobs.[61] Unemployment rose more gradually in the Commonwealth of Independent States and the Baltic countries, as firms were slower to lay off employees and used wage decreases and arrears as devices to hold on to workers. In 1993, for instance, unemployment in Estonia and Russia still hovered near 6 percent. Over time, the patterns of unemployment have shown significant differentiation. The Czech Republic was the only Central European country to enter recession in the second half of the 1990s and its unemployment rate respectively rose to 8 percent. The rapid-growing economies of Poland, Slovenia, Hungary, and to a lesser extent Slovakia managed to diminish their unemployment rates in the late 1990s.

In opposition, the Commonwealth of Independent States and the Baltic countries practised steady rises in unemployment as their transition proceeded. By 1997, unemployment rates in Russia and Estonia were near 10 percent. By 1999-2000, the unemployment rate rose again in Bulgaria, the Czech Republic, Poland, Slovakia and Slovenia. It stabilized in countries such as Hungary, Romania and Russia. As may be seen in column 6 of Table 5, with the exception of Hungary, Slovenia and Romania, transition economies in 2000 had comparatively high unemployment rates that are at least as high, and often considerably exceed, those observed in the European Union. Whereas real wages in Central and Eastern Europe have increased by about 15-20 percent after their initial 25 percent decline in the 1989-91 period, in Russia and a number of other CIS countries real wages declined

[61] Boeri, Tito (2000). “Structural Change, Welfare Systems and Labor Allocation,” Oxford: Oxford University Press, p. 7.

until 1993 and stagnated or increased only reasonably afterwards. The trajectory of real incomes has therefore been very dissimilar in the more and less advanced transition economies. The reduction in employment in the old state-owned firms, rise in unemployment and establishment of new firms has brought about substantial destruction and creation of jobs, as well as mobility of labour. Contrary to the main models of the transition process, job creation in new firms is not necessarily tightly linked to job destruction in the old firms since many new jobs have been created even in economies (such as the Czech Republic) that experienced low rates of job destruction.[62] Much of the labour mobility consisted of occupational rather than geographic change, with individuals moving from one occupation to another within regions, as jobs in old occupations were destroyed and opportunities in new occupations were created.[63]

Compared to the U.S. labour market, where individuals move more geographically than occupationally, the transition has led to more occupational rather than geographic mobility. Data on income distribution, expressed in the form of Gini coefficients, are summarized in Table 6. The socialist countries had highly egalitarian income distributions. In central and east Europe, the Gini coefficients ranged from 20 in Czechoslovakia and Slovenia to 25 in Poland in the late 1980s. The 1988 Ukrainian Gini coefficient of 23 (based on survey data) and the 1991 Russian coefficient of 26 based on the registry wage data of the Russian Statistical Office (Goskomstat) suggest that income distribution was comparatively egalitarian in the former Soviet Union as well. Nonetheless, inequality rose during the 1990s, with the Gini coefficient reaching 26-34 in central and east Europe, 30 in Ukraine and 40 in Russia.

[62] Jurajda, Stepan and Katherine Terrell (2001). "Optimal Speed of Transition: Micro Evidence from the Czech Republic and Estonia," Working Paper No. 355, William Davidson Institute, p. 9.
[63] Sabirianova, Klara (2000). "The Great Human Capital Reallocation: An Empirical Analysis of Occupational Mobility in Transitional Russia," Working Paper No. 309, The William Davidson Institute, p. 47.

Table 6 Income Inequality (Gini Coefficients)

	Late 1980s		Early 1990s		Late 1990s	
	Year	**Gini**	**Year**	**Gini**	**Year**	**Gini**
Czech Rep.	1988	20.0	1992	23.0	1996	26.0
Hungary	1987	24.4	1992	26.0	1998	25.3
Poland	1987	25.0	1993	29.8	1998	32.7
Slovakia	1988	19.5	1993	21.5	1996	26.3
Slovenia	1987	19.8	1993	24.1	1996	26.1
Estonia	1987-90	0.2	1993-94	0.4	1996-99	0.4
Latvia	1987-90	0.2	1995	0.3	1996-99	0.3
Lithuania	1987-90	0.2	1993-94	0.3	1996-99	0.3
Bulgaria	1989	21.7	1993	33.3	1997	34.1
Romania	1989	23.3	1994	28.6	1997	30.5
Russia[a]	1991	26.0	1993	39.8	2000	39.9
Russia[b]	1992	54.3	1994	45.5	1996	51.8
Ukraine[a]	...	na	1996	33.4	1999	30.0
Ukraine[b]	1988	23.3	1995	47.0	...	na

a: Based on Goskomstat data.

b: Based on survey data.

Source: William Davidson Institute based on various sources and Davidson Institute staff calculations.

These coefficients carry inequality in the transition economies into the range spanned by capitalist economies from the relatively egalitarian Sweden to the relatively inegalitarian United States, and in line with developing countries such as India. On the other hand, while the central and east European data seem to reflect reality, the Russian and Ukrainian data may well understate the extent of inequality. In particular, the Goskomstat data are based on salaries that firms are supposed to be paying to workers, but many Russian firms have not been paying contractual wages. In Table 6, a second row for Russia and Ukraine shows inequality based on survey data from the Russian Longitudinal Monitoring of households. These data suggest that income inequality in Russia and Ukraine has reached much higher levels (a Gini coefficient of 47-50) which resemble the level of inequality found in developing economies with the most inegalitarian distribution of income, like Brazil. The comparatively egalitarian structure of income distribution in Central and Eastern

European countries has been brought about by their social safety nets, which rolled back inequality that would have been brought about by market forces alone.[64] In opposition, the Russian social safety net has been regressive; it has made the distribution of income more unequal than it would have been without it.[65]

2.9.9. Life Expectancy

A number of social indicators suggest that average living standards improved during the transition in Central Europe, enhanced slightly in the Baltic countries, remained about the same or decreased slightly in the Balkan countries not involved in wars, and fell in the CIS. The data on life expectancy presented in Table 7 show this pattern. For comparison, between 1989 and 1999, life expectancy at birth increased by about two years from 75 to 76.9 years in the United States and from 76.5 to 78.5 years in France. During the same period, life expectancy increased by one to three years in most Central European countries; improved faintly in the Baltic countries; decreased slightly in Albania, Bulgaria and Romania; and declined by 2.5 years in Russia, over three years in Ukraine and almost four years in Kazakhstan. The decline in life expectancy in Russia, Ukraine and Kazakhstan during the transition thus represents a main break from mounting life expectancies in the past. Disaggregated data point out that the decrease in life expectancy in the CIS countries is mostly due to the early deaths of middle aged males, who are most probably more exposed to stress and resort to heavy alcohol consumption.

---

[64] Garner, Thesia and Katherine Terrell (1998). "A Gini Decompositon Analysis of Inequality in the Czech and Slovak Republics During the Transition," *The Economics of Transition*, Vol. 6, No. 1, pp. 23-46.

[65] Commander, Simon, Andrei Tolstopiatenko and Ruslan Yemtsov (1999). "Channels of redistribution: Inequality and poverty in the Russian transition," *The Economics of Transition*, Vol. 7, No: 1, pp. 411-465.

Table 7 Life Expectancy and Fertility

	Life Expectancy at Birth (total years)			Fertility Rate (total births per woman)		
	1980	**1989**	**1999**	**1980**	**1989**	**1999**
Czech Rep.	70.3	71.7	74.6	2.1	1.9	1.2
Hungary	69.5	69.5	70.6	1.9	1.8	1.3
Poland	70.1	71.0	73.2	2.3	2.1	1.4
Slovakia	70.4	71.0	72.7	2.3	2.1	1.4
Slovenia	70.3	72.7	75.1	2.1	1.5	1.2
Estonia	69.1	70.1	70.6	2.0	2.2	1.2
Latvia	69.1	70.1	69.8	2.0	2.1	1.1
Lithuania	70.7	71.5	72.1	2.0	2.0	1.4
Albania	69.3	72.5	72.1	3.6	3.0	2.4
Bulgaria	71.4	71.8	71.1	2.1	1.9	1.1
Romania	69.1	69.5	69.5	2.4	2.2	1.3
Kazakhstan	66.6	68.3	64.8	2.9	2.8	2.0
Russia	67.1	69.3	65.8	1.9	2.0	1.3
Ukraine	69.2	70.5	67.3	2.0	2.0	1.3
France	74.3	76.5	78.5	2.0	1.8	1.8
Germany	72.6	...	77.0	1.4	1.4	1.4
United Kingdom	73.8	...	77.2	1.9	1.8	1.7
United States	73.7	75.0	76.9	1.8	2.0	2.1

Sources: William Davidson Institute based on the World Bank World Development Indicators 2001, and the Global Market Information Database.

2.9.10.Fertility

In Table 7, fertility point towards the number of births per woman decreased noticeably in virtually all the transition economies in the 1990s, as compared to the counterpart numbers in western countries and to the trend in the 1980s. As of 1989, the transition and western countries had similar ranges of fertility rates, from 1.5 in Slovenia to 2.2 in Romania among the transition countries, and from 1.4 in Germany to 2.0 in the United States. In the 1990s, fertility rates fall moderately in Western Europe and increase slightly in the United States. In contrast, in Russia and Ukraine the fertility rates plummeted from about 2 to 1.3. The rate of decline is substantial in all the other transition economies.

2.9.11.Marriage and Divorce Rates

As may be seen from Table 8, marriage rates have been decreasing over time in most western as well as transition economies. Furthermore, marriage rates in continental European countries have traditionally been lower than in the United Kingdom and United States. But the rate of decline in marriage rates accelerated in most transition economies. In 1989, marriage rates in the Soviet republics and the Czech part of Czechoslovakia were in a range of 8 to 10 percent. By 2000, these transition economies recorded marriage rates of 3.3 to 6 percent.

Table 8 Marriage and Divorce Rates

	Marriage Rates (per '000 inhabitants)			Divorce Rate (per '000 inhabitants)		
	1980	**1989**	**2000**	**1980**	**1989**	**2000**
Czech Rep.	7.6	8.6	4.3	2.6	3.0	3.1
Hungary	7.5	6.3	4.6	2.6	2.4	2.6
Poland	8.6	6.8	3.6	1.1	1.2	1.2
Slovakia	7.9	7.6	5.0	1.3	1.6	1.6
Slovenia	6.5	4.9	3.7	1.2	1.1	1.1
Estonia	8.8	8.1	3.5	4.1	3.8	3.2
Latvia	9.8	9.0	3.3	5.0	4.2	2.5
Lithuania	9.2	9.4	5.0	3.2	3.3	3.3
Albania	…	…	…	…	…	…
Bulgaria	7.9	7.0	4.0	1.5	1.4	1.2
Romania	8.2	7.7	5.9	1.5	1.6	1.9
Kazakhstan	…	10.0	6.0	…	2.8	2.2
Russia	10.6	9.4	5.0	4.2	4.0	3.1
Ukraine	9.3	9.5	6.0	…	3.7	3.5
France	6.2	5.0	4.9	1.5	1.9	2.0
Germany	6.3	…	5.4	1.8	2.0	2.4
United Kingdom	14.8	14.0	10.6	2.8	2.9	3.2
United States	10.5	9.7	8.5	5.2	4.7	4.6

Sources: William Davidson Institute based on the World Bank World Development Indicators 2001, and the Global Market Information Database.

On the contrary, the data in Table 8 point to the propensity to divorce does not seem to have been much affected by the transition. In fact, while divorce rates

rise in western European countries in the 1990s, they declined in many transition economies, including Bulgaria, Estonia, Latvia, Kazakhstan, Russia, and Ukraine. Thus, while one might expect that the psychological stress and economic hardship of the transition would result in increased break-ups of families, on the whole this has not been the case. The transition appears to have had a powerful negative effect on marriage formation and fertility, but it has not destroyed existing marriages.

2.9.12. Attitudes

People's attitudes toward the transition provide interesting information that complements the evidence on behaviour. Table 9 presents several key findings from a 1999 study carried out by Public Opinion Research Center on national random samples of 1,018 individuals in the Czech Republic, 1,523 individuals in Hungary and 1,111 individuals in Poland.[66] These three countries are the most advanced transition economies. They have succeeded in joining OECD and North Atlantic Treaty Organisation (NATO), and are among the five front-runners for admission to the European Union. Yet, the findings reflect rather negative attitudes toward the benefits of the transition during the 1989-99 decade.

In all three countries the majority of individuals feel that it was worthwhile to change the political and economic system, with the largest majority (67 percent) being found in Poland where the political revolts in the 1980s were the most powerful and the GDP growth in the 1990s the fastest. However, in each country many more people believed that the losses from transition exceeded the gains than the reverse. Likewise, in each country more respondents feel that their "material conditions of living are now a little worse" than the reverse. The attitudinal survey so provides a sobering assessment of how people in the most advanced transition economies feel about the benefits and costs of the transition. It is likely that the sentiment in the more poorly performing countries is even more pessimistic.

[66] Public Opinion Research Center (1999). "Was it Worthwhile? The Czechs, Hungarians and Poles on the Changes of the Last Decade," Warsaw, Poland, p. 2.

Table 9 Attitudes Toward Transition

Question	Country	Responses			
From a temporal perspective, do you think that it was worthwhile to change the political and economic system?		Yes	No	Difficult to say	
	Czech Rep.	55%	32%	13%	
	Hungary	46%	40%	14%	
	Poland	67%	24%	12%	
Have the changes taking place in your country since 1989 brought people more losses than gains?		More gains than losses	The Same	More losses than gains	Difficult to say
	Czech Rep.	23%	42%	31%	4%
	Hungary	15%	28%	45%	12%
	Poland	24%	30%	37%	8%
Please compare your present situation with the situation before 1989 and say whether:		A little better	Neither better nor worse	A little worse	Difficult to say
The opportunities of having an impact on the political life in the country are now:	Czech Rep.	20%	37%	20%	23%
	Hungary	41%	29%	14%	16%
	Poland	30%	44%	14%	12%
Material conditions of living are now:	Czech Rep.	30%	29%	33%	8%
	Hungary	12%	16%	66%	6%
	Poland	25%	19%	46%	10%
Your life is now generally:	Czech Rep.	35%	30%	29%	6%
	Hungary	18%	27%	49%	6%
	Poland	28%	23%	40%	9%

Source: Public Opinion Research Center, "**Was it Worthwhile? The Czechs, Hungarians and Poles on the Changes of the Last Decade**," Warsaw, Poland, November 1999.

3. PERFORMANCE THROUGHOUT THE TRANSITION PROCESS

This section provides a reconsideration of major macroeconomic aggregates, GDP growth and inflation rates in the Eastern Europe and former Soviet Union up to 1996. The data organized according to the Cumulative Liberalization Index (CLI). The CLI is annual and covers the period between 1989 and 1995. It is composed of three sub-indices and each fluctuate between zero, representing a centrally planned economy and one, representing a reformed, market based economy. These are internal or domestic price liberalization and competition (I); foreign trade liberalization and current and capital account convertibility (E) and privatization, new entry regulations and small and large enterprise development (P). Using these three sub-indices and assigning them weights (0.3, 0.3, and 0.4 respectively) CLI has created for the same time period. In this approach, the CLI contains both the duration of reforms and intensity. Following this exercise, the countries are classified by reform categories. Countries that were affected by regional tensions or civil wars are shown independently. The groupings are arranged by the following values of the CLI:[67]

Group 1: advanced reformers, CLI>4
Group 2: (high) intermediate reformers, 2.7<CLI<4
Group 3: (low) intermediate reformers, 1.7<CLI<2.7
Group 4: slow reformers, CLI<1.7

As shown in Table 10, when transition started out, 1989 in Eastern Europe and late 1991 in former Soviet Union, there was a recession in all countries.[68] This was anticipated and many analysts pointed this out early in the transition. What was not anticipated, however, was the harshness of the decreases in production. Initial years of transition saw massive diminishes in reported GDP, which reached to an

---

[67] Denizer, Cevdet (1997). "Stabilization, Adjustment and Growth Prospects in Transition Economies," *World Bank Policy Research Working Paper No: 1855*, p. 5.
[68] Fischer, Stanley and Alan Gelb (1991). "The Process of Economic Transformation," *Journal of Economic Perspectives*, Vol. 5, No: 1, pp. 14-16.

average of 41 percent of GDP by 1995. In the case of former Soviet Union, productivity collapse started in 1992 even though in most countries production has been falling since 1989. This was mostly due to the breakdown of the Council of Mutual Economic Assistance (CMEA) trading system, and given the interlinked nature of production structure in the former Soviet Union, production decreases were merely unavoidable early on in the process. Inflation has also risen swiftly initially. This mainly reflected the effects of price liberalization and therefore it was a required level modification towards international prices. On the other hand, sustained raise in prices after the original spurt largely reflected the effects of monetary financing of deficits.

Simply three countries in Europe (Czech Republic) managed to contain inflation in double digits throughout. In the former Soviet Union inflation first increased in 1991 from previous low levels. Starting in 1992, price increases reached record levels, with Armenia and Ukraine recording inflation rates of 10,000 percent in the year of maximum inflation. Every country in former Soviet Union, except the Baltics, at one point practised inflation rates of more than 1000 percent. Starting in 1992 growth was turned positive in Poland and by 1994 all advanced reformers were mounting powerfully which continued in 1995 and initial estimates of production imply this tendency has continued in 1996. As shown Table 10, the cumulative output drop, at about 20 percent between 1989 and 1994, was the lowest in this group relative to all other countries included in this study.[69]

The next group, high intermediate reformers also started to grow in 1994 but this group, on average, registered a cumulative output fall of 35 percent in the same period. However, with the exclusion of the Kyrgyz Republic, low intermediate reformers were still registering negative growth in 1995. Furthermore, these countries lost half of their production. Slow reformers seem to have suffered less in terms of productivity drop but growth was still negative in 1995, and 1996 according to early estimates of GDP in those countries. Not unexpectedly, countries affected by regional conflicts or internal conflicts lost more than half of their production

[69] Denizer, Cevdet (1997), **op. cit.**, p. 6.

although some attained relatively high CLI values. Inflation data, more or less monitors the paths of growth with one main difference. That is, in every county where growth curved positive, this was preceded by a sharp fall in inflation rates, or stabilization. Actually, data shows that growth returned in Eastern Europe about two years after inflation stabilization was accomplished. In former Soviet Union and Mongolia resumption of growth took longer, about 3 years after stabilization which is a year longer than the Eastern Europe countries.

Table 10 Liberalization and Growth, 1989-95

Group	Countries	CLI 1995	Annual Output Growth 1989	1990	1991	1992	1993	1994	1995	Av. Growth 93/94	93/94 GDP /89 GDP	Lowest level of GDP/89 GDP
Advanced	Slovenia	5.01	-2.70	-4.70	-8.10	-5.40	1.30	5.50	4.00	3.00	84	81
Reformers	Poland	5.03	0.20	-11.60	-7.00	2.60	3.80	6.00	6.50	4.20	88	82
	Hungary	5.04	0.70	-3.50	-11.90	-3.00	-0.80	2.90	1.70	0.00	81	80
	Czech Rep.	4.54	1.40	-1.20	-14.20	-6.40	-0.90	2.60	4.80	0.80	81	80
	Slovakia	4.39	4.50	-0.40	-15.90	-6.70	-4.70	4.80	7.40	0.40	79	77
	Averages	**4.80**	**0.82**	**-4.28**	**-11.42**	**-3.78**	**-0.26**	**4.36**	**4.88**	**1.70**	**83**	**80**
High	Bulgaria	3.57	-0.50	-9.10	-11.70	-7.30	-2.40	1.40	2.50	-1.40	73	73
Intermediate	Estonia	3.86	-1.10	-3.60	-11.90	-21.60	-8.40	3.00	4.00	0.90	69	67
Reformers	Lithuania	3.58	1.50	-5.00	-13.40	0.00	-18.40	1.00	3.50	-7.30	44	44
	Latvia	3.26	3.00	-2.30	-11.10	-35.20	-14.80	2.00	0.40	-4.40	60	59
	Romania	3.00	-5.80	-7.40	-12.90	-8.80	1.30	3.90	6.90	2.20	69	67
	Albania	3.04	9.80	-10.00	-28.00	-7.20	9.60	9.40	8.60	9.50	74	65
	Mongolia	2.94	4.20	-2.00	-9.20	-9.50	-3.00	2.10	6.30	0.60	84	83
	Averages	**3.32**	**1.59**	**-5.63**	**-14.03**	**-12.80**	**-5.16**	**3.26**	**4.60**	**0.03**	**68**	**65**
Low	Russia	2.61	3.00	-2.00	-12.90	-19.00	-12.00	-15.00	-4.00	-13.50	57	52
Intermediate	Kyrgyzstan	2.63	3.00	4.00	-5.00	-19.30	-16.10	-26.20	1.30	-13.20	61	57
Reformers	Moldova	2.30	8.80	-1.50	-18.00	-29.10	-1.20	-31.20	-3.10	-17.00	53	46
	Kazakhstan	1.88	-0.40	-0.40	-18.80	-13.90	-12.00	-25.00	-8.90	-18.50	57	49
	Averages	**2.36**	**3.60**	**0.03**	**-13.68**	**-20.33**	**-10.33**	**-24.35**	**-3.68**	**-15.60**	**57**	**51**
Slow	Uzbekistan	1.64	3.70	4.30	-0.90	-11.00	-2.40	-3.50	-1.20	-2.50	89	88
Reformers	Belarus	1.55	7.90	-3.20	-1.20	-9.60	-10.70	-19.10	-10.20	-16.60	73	64
	Ukraine	1.31	4.10	-3.60	-11.90	-17.00	-13.00	-21.80	-11.40	-18.60	56	48
	Turkmenistan	0.85	-7.00	-2.30	-4.80	-5.30	-10.20	-20.00	-13.90	-15.00	69	62
	Averages	**1.34**	**2.18**	**-1.20**	**-4.70**	**-10.73**	**-9.08**	**-16.10**	**-9.18**	**-13.20**	**72**	**66**
Affected	Croatia	4.83	-1.50	-8.50	-20.90	-9.70	-3.70	0.80	-1.50	-0.70	69	68
by War	Macedonia	4.70	0.90	-9.70	-10.70	-21.10	-8.40	-8.20	-3.00	-10.70	57	55
	Armenia	2.02	14.20	-7.20	-11.80	-52.30	-14.80	5.30	5.00	-7.40	38	38
	Georgia	1.81	-4.80	-12.40	-20.60	-44.80	-25.40	-11.30	-5.00	-24.60	24	23
	Azerbaijan	1.47	-4.40	-11.70	-0.70	-22.10	-23.10	-21.10	-13.20	-17.70	50	44
	Tajikistan	1.34	-2.90	-1.60	-7.10	-29.00	-11.00	-21.50	-12.50	-26.30	35	30
	Averages	**2.70**	**0.25**	**-8.52**	**-11.97**	**-29.83**	**-14.40**	**-9.33**	**-5.03**	**-14.50**	**45**	**34**
East	Vietnam	4.07								8.5	145	100
Asia	China	3.67								11.7	157	100
	Averages	**3.87**								**10.10**	**151**	**100**

Source: de Melo, Martha, Cevdet Denizer, and Alan Gelb, "**From Plan To Market: Patterns of Transition**," Policy Research Department, World Bank, April 1996(revised).

These patterns are also observable if fiscal deficits and base money data are arranged by the CLI, which are presented in tables 11 and 12. As can be seen, there was almost one to one relationship between fiscal deficits and base money growth. In the advanced reformers deficits are much smaller and the monetary policy is not under pressure to contain the deficits. In the second and third group deficits are larger but base money growth was still under control as domestic and foreign financing were available which in turn depended upon reforms. The slow reforming group seem to have lesser deficits than the second and third group but this hides subsidized central bank lending.

Table 11 Forecasting Long-term Trend Growth

		Population Growth Rate	Secondary School Enrollment	Gross Capital Formation	Per Capita Income in US Dollar[a]	Forecasted Per Capita Growth Rate	Forecasted Growth Rate
1	Albania	1.19	0.79	0.17	495	4.08	5.27
2	Azerbaijan	1.28	0.83	0.24	1,720	4.83	6.10
3	Bulgaria	-0.35	0.71	0.12	4,280	2.16	1.80
4	Croatia	0.06	0.80	0.10	3,872	1.99	2.06
5	Czech Rep.	-0.06	0.89	0.31	7,940	4.66	4.60
6	Estonia	-0.31	0.92	0.30	6,634	5.18	4.86
7	Hungary	-0.53	0.81	0.23	7,010	3.51	2.98
8	Latvia	-0.53	0.92	0.18	5,170	3.63	3.10
9	Macedonia	1.12	0.80	0.38	1,604	7.28	8.40
10	Moldova	0.41	0.81	0.12	2,270	2.94	3.35
11	Poland	0.20	0.83	0.16	5,480	2.59	2.79
12	Romania	0.19	0.80	0.30	2,950	5.80	5.99
13	Russia	0.55	0.92	0.26	4,510	4.83	5.38
14	Slovakia	0.35	0.96	0.22	6,730	3.63	3.98
15	Slovenia	0.41	0.80	0.25	5,982	3.78	4.19
16	Armenia	1.40	0.85	0.10	2,204	2.31	3.74
17	Belarus	0.20	0.92	0.35	4,830	6.44	6.66
18	Georgia	-0.20	0.82	0.32	1,354	6.97	6.76
19	Kazakhstan	0.10	0.90	0.24	2,946	5.15	5.26
20	Kyrgyz Rep.	0.40	0.88	0.30	2,358	6.23	6.66
21	Lithuania	0.00	0.78	0.18	3,551	3.55	3.55
22	Tajikistan	2.00	0.73	0.22	993	4.28	6.36
23	Turkmenistan	4.60	0.70	0.46	2,939	6.66	11.57
24	Ukraine	0.00	0.80	0.35	3,149	6.79	6.79
25	Uzbekistan	2.20	0.94	0.23	2,293	4.54	6.84
26	Mongolia	1.90	0.78	0.21	2,090	3.86	5.84
27	China	1.20	0.55	0.42	2,510	6.93	8.21
28	Vietnam	2.10	0.35	0.24	1,040	3.32	5.49
	Average	**0.26**	**0.84**	**0.22**	**4,443**	**4.06**	**4.32**

a: Purchasing Power Parity (PPP) based.
Source: World Bank, World Development Report: From Plan to Market, Washington, D.C.,1996.

Table 12 Fiscal Deficits and Quasi-Fiscal Expenditures for Selected Countries, 1992-94 (as percentage of GDP)

	Fiscal Deficits			CB Implicit Subsidy[a]			Total		
Advanced Reformers	**1992**	**1993**	**1994**	**1992**	**1993**	**1994**	**1992**	**1993**	**1994**
Poland	6.8	2.9	2.9	0.0	0.0	0.0	6.8	2.9	2.9
Hungary	5.7	7.0	6.5	0.0	0.0	0.0	5.7	7.0	6.5
Czech Rep.[b]	0.5	-0.6	-0.5	0.3	0.8	0.1	0.8	0.2	-0.4
Slovakia[b]	13.1	7.6	2.5	0.3	1.7	0.0	13.4	9.3	2.5
Intermediate Reformers									
Bulgaria	5.0	11.1	6.1	1.3	0.8	0.7	6.3	11.9	6.8
Estonia[c]	-0.5	1.4	0.0	-	0.2	0.3	-	1.6	0.3
Romania	5.5	1.0	3.0	5.9	3.9	0.0	11.4	4.9	3.0
Russia[c]	3.4	8.1	8.8	11.3	1.7	0.0	14.7	9.8	8.8
Kazakhstan	7.3	1.2	4.5	32.7		2.6	40.0		7.1
Slow Reformers									
Belarus[c]	6.4	9.4	1.5	26.5	9.3	3.4	32.9	18.7	4.9
Turkmenistan[c]	10.1	3.6	1.1	12.5	21.2	6.4	22.6	24.8	7.5
Uzbekistan[c]	10.2	8.4	2.0	13.1	18.5	19.0	23.3	26.9	21.0

a: Implicit subsidy from the Central Bank to commercial banks and economy due to difference between the Central Bank refinancing rate and inflation. Annual figures are averages of monthly (quarterly) figures

b: For 1992 the nominal federation subsidy is divided 2 to 1 in favor of the Czech Republic.

c: Calculations done on quarterly basis.

Source: de Melo, Martha, Cevdet Denizer, and Alan Gelb, "**From Plan To Market: Patterns of Transition**," Policy Research Department, World Bank, April 1996(revised).

3.1. Reforms, Growth and Inflation

What lies at the basis of this differential reform, production and inflation performance across countries? It is observable that one source is the economic policies implemented by governments. To explore the relationship between policies and consequences, a cross country regression analysis is accepted. In this model inflation and growth equations are estimated as functions of the CLI and some other control variables. Because the other cause of cross country variation could be due to initial conditions (ICs), this framework extends the study including proxies for ICs into the regression equations. The other variables integrated in the regression analysis are the following. In the first equation, the dependent variable is the GDP growth rate (GR). The CLI is the key variable. A positive relationship would be a signal of the favourable effects of economic policies or reforms on growth. Since over industrialization was one of the characters of centrally planned economies, the share of industry in GDP (IS) was included in the equations.

The rationale is that the more industrialized a country, the disruption of trade and financial flows due to the collapse of planning would be larger and decrease growth rate during the transition period. In this way the effects of trade dependence are also captured. There are two initial condition proxies integrated in the equations. The first is a dummy variable for institutional factors (IF). It is given a value of one for the countries which were market oriented and independent states before becoming socialist countries. The idea is to recognize the significance of market memory and administrative capacity during the transition. As emphasized already, most former Soviet Union countries, except the Baltics, were never sovereign states in their history and this could be an essential determinant of their aptitude to reform. The second factor considered is the distance, (DM) from markets. For this intention, the distance (in miles) from Vienna is used. The goal is to understand the importance of geographical distance from rich markets on growth performance. Regional tensions are also captured with a dummy variable (RT).[70]

[70] Murrell, Peter (1996). "How Far Has the Transition Progressed?," *The Journal of Economic Perspectives*, Vol. 10, No: 2, pp. 25-44.

The following equation is estimated with t ratios in parenthesis:[71]

$$GR = \underset{(-2.8)}{-3.2} + \underset{(3.1)}{1.9CLI} - \underset{(-2.2)}{1.2IS} - \underset{(-4.2)}{4.7DM} + \underset{(1.9)}{3.9IF} - \underset{(-3.7)}{9.1RT} \quad (1)$$

Adjusted R2: 0.57

A unique specification is projected for inflation. In addition to the CLI, fiscal deficits (FD) and repressed inflation (RI) are added. Fiscal deficits are consolidated budget deficits of each country. Subdued inflation is considered by change in wages less change in GDP. Since just wage payments were made in cash under central planning, wage increases beyond GDP growth would mean the accumulation of financial assets by households given shortages of goods. This is also known as monetary overhang. Thus, the larger the repressed inflation, the larger the price raises would be. The estimated equation is:[72]

$$LogINF = \underset{(2.9)}{3.7} - \underset{(-2.4)}{4.2CLI} + \underset{(4.33)}{1.2FD} + \underset{(1.8)}{2.9RINF} + \underset{(2.5)}{9RT} \quad (2)$$

Adjusted R2: 0.63

According to the results in the first equation, CLI was positively related to growth. The coefficient of industry verifies our anticipation that more industrialized countries would face larger falls in their growth rates. Both preliminary condition variables enter with the expected sign. This suggests that countries that were not sovereign states in their history and far from rich markets suffered more during the transition. This is a significant finding as it proposes that initial conditions matter in the transition period and this may have implications for long run growth potential of the countries in question. Regional tension variable enters with a negative sign as predictable. While the estimated coefficient needs to be interpreted with caution as

[71] Denizer, Cevdet (1997), **op. cit.**, p. 8.
[72] **Ibid.**, p. 9.

they only capture broad relationships between the variables used, the large coefficient of regional tension variable is suggestive of how much it could add to the decrease in the growth rate in addition to other factors. Results of the inflation equation are also in line with our a priori prospect.

Detailed and continuous reform efforts were negatively related to inflation rates. Smaller fiscal deficits also diminish inflation even though it is importance intensity is lower than the CLI coefficient. This is anticipated because reforms decrease subsidies which in turn decrease fiscal deficits. Repressed inflation enters with a positive sign which suggests that this variable as expected. Regional tension (RT) variable has a positive coefficient as ordinary and highly important. Regressions were also run with the individual components of the index. The outcome shows that this does not alter the qualitative conclusions and thus they are not presented. In each case they are significant and enter with the expected sign. There is a change in the coefficients but this is relatively small in importance.

Table 13 Sectoral Shifts at Constant Prices, 1989-94

Group	Countries	Liberalization Index	Change in Share (% of GDP)		
			Industry	Agriculture	Services
Advanced Reformers	Slovenia	5.01	-23.30	-3.80	27.10
	Poland	5.03	-21.40	-2.00	23.40
	Hungary	5.04	-0.20	-1.70	1.90
	Czech Rep.	4.54	-10.50	-0.50	11.00
	Slovakia	4.39	-14.80	0.20	14.60
	Averages	**4.80**	**-14.00**	**-1.60**	**15.60**
High Intermediate Reformers	Bulgaria	3.57	-10.30	4.30	6.00
	Estonia	3.86	-12.70	-10.10	22.80
	Lithuania	3.58	-11.50	2.60	8.90
	Latvia	3.26	-18.80	1.90	16.90
	Romania	3.00	-6.50	6.20	0.30
	Albania	3.04	-20.10	14.80	5.30
	Mongolia	2.94	3.00	4.30	-7.30
	Averages	**3.30**	**-11.00**	**3.40**	**7.60**
Low Intermediate Reformers	Russia	2.61	3.50	6.50	-10.00
	Kyrgyz Rep.	2.63	-7.80	7.20	0.60
	Moldova	2.30	3.50	6.50	-10.00
	Kazakhstan	1.88	-6.30	17.50	-11.20
	Averages	**2.40**	**-1.80**	**9.40**	**-7.70**
Slow Reformers	Uzbekistan	1.64	-7.60	12.70	-5.10
	Belarus	1.55	5.80	-2.80	-3.00
	Ukraine	1.31	-11.20	10.00	1.20
	Turkmenistan	0.85	-4.50	0.10	4.40
	Averages	**1.30**	**-4.40**	**5.00**	**-0.60**
Affected by War	Croatia	4.83	-4.00	0.80	3.20
	Macedonia	4.70	9.10	-6.00	-3.10
	Armenia	2.02	-6.40	0.00	6.40
	Georgia	1.81	-8.70	18.30	-9.60
	Azerbaijan	1.47	-14.80	0.20	14.60
	Tajikistan	1.34	n.a.	n.a.	n.a.
	Averages	**3.00**	**-5.00**	**2.70**	**2.30**
East Asia	Vietnam	4.07	-1.10	-6.00	7.10
	China	3.67	18.60	-6.10	-12.50
	Averages	**3.90**	**8.80**	**-6.10**	**-2.70**

Source: de Melo, Martha, Cevdet Denizer, and Alan Gelb (1996), *Op. cit.*, p. 22.

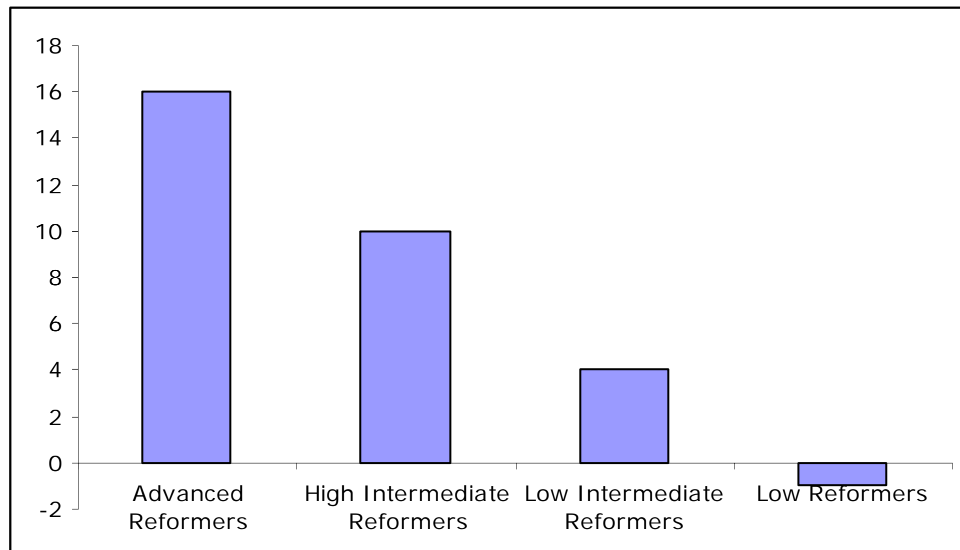
3.2. Reforms and Structural Change

The influences of the strength and length of reforms on economic structure can be analyzed by examining three indicators. The first one is the share of services. Beforehand, this was a repressed sector, and with the liberalization of the economy,

it was anticipated that services would enlarge quickly. As shown in Table 13, this was realized and swiftly reforming economies recording the major raises as a percentage in their GDPs. In fact, given the fall in the shares of industry and agriculture, it seems that the link between growth and reforms were mostly driven by the growth of the services sector. The other indicator of structural change is the change in the share of private sector in GDP. It goes without saying that private sector's share was small under socialism.

Nonetheless, once more there were differences across countries. In Eastern Europe, Poland, for instance, had a sizable agricultural sector and private sector accounted for between 30-40 percent in Eastern Europe before transition began. In former Soviet Union, the share was relatively low averaging about 15-20 percent of GDP at the most. By 1994, about 3 years after reforms private sector surpassed 50 percent mark in all advanced reformers and by 1996 this percentage was up by as much as 75 percent in Czech Republic and Albania, in Figure 4. In former Soviet Union, this process has been slower and three years after the collapse of the former Soviet Union, or in 1995, private sector share totally remained relatively low, about 37 percent on average. Only Russian Federation had a outsized share of private sector than the public sector as of mid-1996. The Kyrgyz Republic was the second after Russia with 50 percent. Alteration in employment is also an indication of restructuring and adjustment. Whilst the data on employment in former Soviet Union is mainly problematic, the broad trends can be observed and compared to the Easter Europe countries.

Figure 4 Change in share of service sector in GDP



Source: Denizer, Cevdet, "**Stabilization, Adjustment and Growth Prospects in Transition Economies,**" World Bank Working Paper, World Bank, February 1997, pp. 28-29.

As shown in Table 14, advanced reformers and high intermediate reformers differ fundamentally on this measure. Measured unemployment rose progressively between in Eastern Europe and the Baltics while it remained at negligible levels in the former Soviet Union countries. Whereas unofficial data suggests employment is much higher in former Soviet Union as well, the registered unemployment data does not demonstrate this. Since enterprise labour shedding has been much slower in former Soviet Union, this could be normal. On the other hand, it is evident that reallocation of labour has been occurring at a faster rate in Eastern Europe than former Soviet Union. Taken together these patterns suggest the following. First, since service sector growth led the recuperation and this was due to the de novo entry by small and medium firms through new start ups and not privatization, it seems that growth came from reallocation of resources and hence increased efficiency.

Table 14 Registered Unemployment through Transition (as percentage of labor force, end of year)

Group	Country	CLI	1989	1990	1991	1992	1993	1994
Advanced Reformers	Slovenia	5.01	2.90	4.70	8.20	11.10	14.50	14.50
	Poland	5.03	0.10	6.10	11.80	13.60	16.40	16.00
	Hungary	5.04	0.30	2.50	8.00	12.30	12.10	10.90
	Czech Rep.	4.54	0.00	0.80	4.10	2.60	3.50	3.20
	Slovakia	4.39	0.00	1.50	11.80	10.40	14.40	14.80
	Averages	**4.80**	**0.70**	**3.10**	**8.80**	**10.00**	**12.20**	**11.90**
High Intermediate Reformers	Bulgaria	3.57	0.00	1.50	11.10	15.30	16.40	12.80
	Estonia	3.86	0.00	0.00	0.10	4.80	8.80	8.10
	Lithuania	3.58	0.00	0.00	0.30	1.30	4.40	3.80
	Latvia	3.26	0.00	0.00	0.10	2.10	5.30	6.50
	Romania	3.00	0.00	0.00	3.00	8.40	10.20	10.90
	Albania	3.04	1.90	7.70	8.60	26.90	28.90	19.50
	Averages	**3.40**	**0.30**	**1.50**	**3.90**	**9.80**	**12.30**	**10.30**
Low Intermediate Reformers	Russia	2.61	0.00	0.00	0.10	0.80	1.10	2.20
	Kyrgyzstan	2.63	0.00	0.00	0.00	0.10	0.20	0.70
	Moldova	2.30	0.00	0.00	0.00	0.70	0.80	1.20
	Kazakhstan	1.88	0.00	0.00	0.10	0.50	0.60	1.00
	Averages	**2.36**	**0.00**	**0.00**	**0.10**	**0.50**	**0.70**	**1.30**
Slow Reformers	Uzbekistan	1.64	0.00	0.00	0.00	0.10	0.20	0.30
	Belarus	1.55	1.00	1.00	1.00	0.50	1.50	2.10
	Ukraine	1.31	0.00	0.00	0.00	0.30	0.40	0.40
	Turkmenistan	0.85	0.00	0.00	0.00	0.00	0.00	n.a.
	Averages	**1.34**	**0.30**	**0.30**	**0.30**	**0.20**	**0.50**	**0.90**
Affected by War	Croatia	4.83	0.00	9.30	15.50	17.80	17.50	18.00
	Macedonia	4.70	n.a.	n.a.	18.00	19.00	19.00	19.00
	Armenia	2.02	1.00	1.00	3.50	3.50	6.20	5.60
	Georgia	1.81	0.00	0.00	0.00	5.40	8.40	n.a.
	Azerbaijan	1.47	0.00	0.00	0.10	0.20	0.70	0.90
	Tajikistan	1.34	0.00	0.00	0.00	0.30	1.10	1.70
	Averages	**2.70**	**0.20**	**1.70**	**6.20**	**7.70**	**8.80**	**9.00**
East Asia	Vietnam	4.07	n/a	n/a	n/a	n/a	n/a	n/a
	China	3.67	2.60	2.50	2.30	2.30	2.60	2.80
	Averages	**3.87**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**

Source: de Melo, Martha, Cevdet Denizer, and Alan Gelb (1996), *Op. cit.*, p. 23.

Changes in investment ratios point to the same inference. Investment ratios fell from around 36 percent on average under socialism to about 20-25 percent ranges over the course of transition. The fact that many transition countries are now developing for the last couple of years with these lower investment rates is a clear signal that investment efficiency is much upper now than before. The link to reforms seems rationally straightforward. In reforming countries liberalizing the economy

forced sectors that suffered form structural demand reallocate due to collapse of communism to correct. At the same, since this involved the elimination of subsidies and hard budget constraints, it permitted new and growing sectors to acquire resources. This in turn supported growth in new and productive sectors and moderated the decrease in GDP. Thus, reforming transition economies required simultaneous implementation of macro and micro policies. Furthermore, as the empirical evidence shows, this did not involve a trade off between growth and stabilization.[73]

What policy choices affected was the time profile of production decreases, not their cumulative decline since the structural demand shift was a lasting event. Given this situation, status quo, or non-reform was not a policy choice. This also implied that postponing reforms would not recover productivity and it is in this sense swift reforms are desirable. Obviously and with the benefit of hindsight, the issue was not fast reform versus gradual reform for growth performance and inflation performance but one of trade-off between reforms and growth and inflation.

3.3. Economic Growth Potential in the Long Term

Section 3.1 studied over the determinants of growth during the transition period using cross country regression equations. The consequences are symptomatic of this period and they are accurately transitory conclusions. Additionally, as economies progress along, the explanatory power of independent variables used in equation 1 will be decreased. Thus, a longer run growth potential analysis would need standard growth determinants sort of analysis. Nonetheless, adequate time has not passed yet to forecast meaningful long term growth equations for transition economies.

The main approach is to use coefficients estimated by Levine and Renelt (LR) and forecast growth rates for transition economies as a function of preliminary

[73] Easterly, William (1995). "When Is Stabilization Expansionary?," Working Paper, Policy Research Department, World Bank, Washington, D.C., pp. 7-8.

conditions and control variables that condition the long run growth process in the neo-classical models of growth.[74] The analysis draws on LR because it includes variables that are shown to be robust in various specifications of the growth equation. The long run growth determinants for the 26 Eastern Europe and former Soviet Union countries under study are presented in Table 15.

Statistical sources are given under each variable heading in the same table. The equation used to estimate future growth rates takes the following form:[75]

$$gp(t) = f(Y(0), SSE(0), IN(t), PGR(t))$$

In this formulation gp(t) is the growth rate of per capita income. Y(0) is the initial per capita income, SSE(0) is the secondary school enrolment ratio measured as a percentage of the total secondary school aged population, IN(t) is the ratio of physical investment to GDP, and PGR(t) is the population growth rate. It is accepted that the per capita growth rate, gp, would have a negative relationship to (Y0). This is due to the neoclassical convergence hypothesis which posits that poorer countries should grow more rapidly than the richer countries holding everything else constant. SSE is included to capture human capital's impact on growth and it is expected that this variable would have a positive relationship to gp. Higher investment rates tend to raise growth rates though the efficiency of investment is significant as well. PGR is anticipated to have a negative relationship with gp.

As shown in Table 15, there are big differences across countries in terms of per capita income. This is also valid for the former Soviet Union countries which show the former Union was not successful in diminishing gp differences among its constituents. It is obvious that the Eastern Europe countries and the Baltics are nearer to middle income counties than most of the former Soviet Union countries. Investment levels fell from previous highs and as of 1994 averaged around 25

[74] Barro, Robert J. (1991). "Economic Growth in a Cross Section of Countries," Quarterly Journal of Economics," Vol. 6, May, pp. 407-443.
[75] Denizer, Cevdet (1997), **op. cit.**, p. 13.

percent of GDP which seems rational. It is yet relatively low in Albania, Bulgaria, Croatia, Macedonia, and Poland.

Table 15 Levels and Change in Revenue, Expenditures and Fiscal Balance, 1989-94

		Lib.	**Change in (% of GDP)**			**Levels, 1994 (% of GDP)**		
Group	**Countries**	**Index**	**Revenue**	**Expenditure**	**Balance**	**Revenue**	**Expenditure**	**Balance**
Advanced Reformers	Slovenia	4.16	4.60	5.80	-1.20	46.60	47.50	-0.90
	Poland	4.14	6.50	1.50	5.00	47.90	50.40	-2.50
	Hungary	4.11	-6.80	-1.70	-5.10	52.30	58.80	-6.50
	Czech Rep.	3.61	-10.90	-13.80	2.90	51.20	50.70	0.50
	Slovakia	3.53	-11.60	-11.50	-0.10	50.50	53.00	-2.50
	Averages	**3.91**	**-3.60**	**-3.90**	**0.30**	**49.70**	**52.10**	**-2.40**
High Intermediate Reformers	Bulgaria	2.96	-21.90	-17.30	-4.60	38.00	44.10	-6.10
	Estonia	2.93	-8.00	-7.50	-0.50	35.00	35.00	0.00
	Lithuania	2.62	-25.20	-17.10	-8.10	25.10	30.40	-5.30
	Latvia	2.39	-15.10	-12.30	-2.80	36.70	38.70	-2.00
	Romania	2.35	-18.50	-7.10	-11.40	32.60	35.60	-3.00
	Albania	2.30	-20.30	-16.00	-4.30	27.70	41.00	-13.30
	Mongolia	2.27	-12.40	-17.30	5.00	36.20	48.00	-11.80
	Averages	**2.55**	**-17.30**	**-13.50**	**-3.80**	**33.00**	**39.00**	**-5.90**
Low Intermediate Reformers	Russia	1.90	-4.50	-4.40	-0.10	36.30	45.10	-8.80
	Kyrgyz Rep.	1.81	-14.20	-3.70	-10.40	24.30	32.70	-8.40
	Moldova	1.62	-18.20	-7.80	-7.10	17.10	25.90	-8.80
	Kazakhstan	1.31	-21.70	-15.70	-6.00	19.00	23.50	-4.50
	Averages	**1.66**	**-14.60**	**-7.90**	**-5.90**	**24.20**	**31.80**	**-7.60**
Slow Reformers	Uzbekistan	1.11	7.80	9.20	-1.40	43.00	45.00	-2.00
	Belarus	1.07	-1.60	3.40	-1.50	36.60	38.10	-1.50
	Ukraine	0.80	15.90	25.70	-8.40	42.30	51.40	-9.10
	Turkmenistan	0.63	-26.20	-23.90	-2.30	6.20	7.30	-1.10
	Averages	**0.90**	**-1.00**	**3.60**	**-3.40**	**32.00**	**35.50**	**-3.40**
Affected by War	Croatia	4.02	12.30	8.10	4.10	27.20	27.60	-0.40
	Macedonia	3.92	6.60	5.60	1.10	42.80	45.40	-2.60
	Armenia	1.44	-15.20	11.20	-21.60	37.00	61.00	-24.00
	Georgia	1.32	-16.50	-6.60	-8.10	15.00	24.00	-9.00
	Azerbaijan	1.03	10.20	24.70	-11.50	36.00	49.00	-13.00
	Tajikistan	0.95	-4.90	-0.50	-1.00	35.40	38.10	-2.70
	Averages	**2.11**	**-1.20**	**7.10**	**-6.20**	**32.20**	**40.90**	**-8.60**
East Asia	Vietnam	3.42	8.70	-3.20	5.50	24.70	25.20	-0.50
	China	3.08	-5.10	-4.70	-0.40	11.40	13.30	-1.90
	Averages	**3.25**	**1.80**	**-2.20**	**2.50**	**18.10**	**19.30**	**-1.20**

Source: de Melo, Martha, Cevdet Denizer, and Alan Gelb (1996), *Op. cit.*, p. 25.

On the other hand they are idealistically high in Belarus and Turkmenistan which is probably due to measurement problems. The most interesting feature of this table is the high secondary school enrolment ratios. This reflects the importance attached to education under socialism and should be supposed as a possible source for growth. Whereas that is so, what is important is to comprehend that there will be dissimilar skill requests under a market based system and all transition economies will go on to need to invest in human capital. Population growth rates illustrate an important degree of variation across countries. The Eastern Europe and Baltics have small growth rates while some parts of the former Soviet Union, mostly Central Asian countries, have rates. This suggests higher growth rates for the Eastern Europe and Baltics and lower for the Central Asian states. Using this data and the coefficients of the Levine and Renelt equation, given below, per capita growth rates might be predicted.[76]

$$gp = -0.83 - 0.35Y(1960) - 0.38POP + 3.17SEC + 17.5INV$$

where Y(1960) refers to the preliminary level of real per capita income at international prices, POP is the growth rate of the population, SEC is the secondary school enrolment rate, and INV is the share of investment in GDP. The results are also presented in Table 15.

There are again important variations among the countries but on average the predicted growth rate seems to be around 5 percent. The consequences are mainly in line with our expectations. Countries with higher investment in human capital and physical capital are estimated to grow more rapidly. Using these consequences, it is not difficult to forecast the number of years it would take these countries to reach present OECD levels of income per capita. While this exercise maybe more applicable for the Eastern Europe and the Baltics, it however provides some idea how long it may take the former Soviet Union countries if their purpose is to enjoy per capita income levels comparable to the OECD.

[76] **Ibid.**, p. 14.

The results are presented in Table 16. It is comprehensible that it would take most Eastern Europe and Baltic countries between 20 and 25 years. Russia and Belarus also fall in this range. However, given preliminary circumstances and economic policies it would take most other former Soviet Union longer, on average about 45 years. Given the parameter values in the Levine and Renelt growth equation various simulation exercises could be performed by changing the variables (levels or growth rates) included in the study. On the other hand, what would be the impact of raising growth to 30 percent of GDP from its present levels? The consequence, also presented in Table 16, show considerable change in long term growth rates, which is normal. In some cases, the differences are radical. For example, Armenia's per capita growth rate jumps to 5.8 percent from 2.3 percent which in turn diminishes the number of years to converge to OECD levels by 55. This implies the sensitivity of growth rates to changes in investment and is a clear indication that transition countries should plan to save more and invest more.

Consequently, reforms in transition economies were successful in dropping inflation and establishing sustained growth. Important as they are, these findings, however, can not explain the transition experience. The question was how to react to the advent of transition and this is where most countries in Eastern Europe differed from the former Soviet Union, with the exception of Baltics. As explained before, the Eastern Europe countries quickly moved with reforms whereas the Former Soviet Union countries were in general, late in developing reform programs and implementing them. The vital difference which mainly determined economic policy choices or reform strategies was the political change. It is no secret that about all Eastern Europe countries and the Baltics desired to break away from communism and former Soviet Union domination, and transition there in was first categorized by political change. Communists were discredited and removed from control which gave increase to a “period of extraordinary politics” which provided the window opportunity for reforms.

Table 16 Money, Interest Rates and Real Balances

Group	Countries	Lib. Index	Broad Money Growth	Real Money Balances 1991=100			Discount Rate in Real Terms, percentage	
				92	93	94	92-94	end-94
Advanced Reformers	Slovenia	4.16	5	92.00	127.00	164.00	-3.00	-1.00
	Poland	4.14	3	98.00	101.00	104.00	1.00	3.00
	Hungary	4.11	2	105.00	106.00	102.00	0.00	1.00
	Czech Rep.	3.61	1	106.00	104.00	111.00	-1.00	-1.00
	Slovakia	3.53	1	95.00	84.00	86.00	-1.00	-1.00
	Averages	**3.91**	**2**	**99.00**	**104.00**	**113.00**	**-1.00**	**0.00**
High Intermediate Reformers	Bulgaria	2.96	4	91.00	76.00	68.00	-3.00	0.00
	Estonia	2.93	7	25.00	20.00	21.00	n/a	-3.00
	Lithuania	2.62	9	30.00	17.00	20.00	n/a	n/a
	Latvia	2.39	6	29.00	28.00	34.00	-8.00	0.00
	Romania	2.35	7	63.00	43.00	41.00	-8.00	12.00
	Albania	2.30	5	82.00	89.00	105.00	-4.00	2.00
	Mongolia	2.27	6	56.00	36.00	40.00	-16.00	-8.00
	Averages	**2.55**	**6**	**54.00**	**44.00**	**47.00**	**-8.00**	**1.00**
Low Intermediate Reformers	Russia	1.92	15	32.00	23.00	16.00	-17.00	-2.00
	Kyrgyz Rep.	1.81	11	36.00	16.00	8.00	-19.00	9.00
	Moldova	1.62	13	23.00	9.00	3.00	-18.00	0.00
	Kazakhstan	1.31	19	21.00	14.00	8.00	-31.00	4.00
	Averages	**1.67**	**15**	**28.00**	**16.00**	**9.00**	**-21.00**	**3.00**
Slow Reformers	Uzbekistan	1.11	19	45.00	53.00	71.00	-35.00	-12.00
	Belarus	1.07	20	35.00	33.00	17.00	-34.00	-5.00
	Ukraine	0.80	22	40.00	26.00	13.00	-29.00	-40.00
	Turkmenistan	0.63	23	63.00	73.00	9.00	-45.00	-48.00
	Averages	**0.90**	**21**	**46.00**	**46.00**	**28.00**	**-36.00**	**-26.00**
Affected by War	Croatia	4.02	16	68.00	60.00	76.00	-9.00	2.00
	Macedonia	3.92	19	89.00	91.00	89.00	-1.00	1.00
	Armenia	1.44	24	22.00	7.00	2.00	-33.00	-26.00
	Georgia	1.32	29	29.00	24.00	6.00	n/a	n/a
	Azerbaijan	1.03	17	40.00	40.00	19.00	-40.00	-52.00
	Tajikistan	0.95	19	39.00	30.00	n/a	-30.00	-16.00
	Averages	**2.11**	**21**	**48.00**	**42.00**	**39.00**	**-23.00**	**-18.00**
East Asia	Vietnam	3.42	n/a	97.00	107.00	n/a	1.00	0.60
	China	3.08	2	123.00	141.00	168.00	-5.00	-5.00
	Averages	**3.25**	**n/a**	**110.00**	**124.00**	**n/a**	**-2.00**	**-2.20**

Source: de Melo, Martha, Cevdet Denizer, and Alan Gelb (1996), *Op. cit.*, p. 26.

The collapse of the former Soviet Union, on the other hand, was different. While there were indications of unhappiness with the Union, with the exception of the Baltics, these were not as powerful as in the Eastern Europe countries and there were explicit demands for sovereignty. More significantly, when the Union

collapsed, this did not lead to a political change in most former Soviet Union states. Given this, rather than reforming rapidly, the previous communists hoped that CIS, which was established after the collapse of the Union, would evolve into a loose federation so that trade and financial links would not vanish. Until the Russian Federation issued new Roubles and forced out other countries out of the Rouble zone in late 1993 many countries did not want apply policies that were too dissimilar than Russia's. What political leaders did not comprehend at the time, on the other hand, was the permanent nature of the change which needed modification. In short, the reform choices were seriously conditioned by the countries' politics and their aspirations and perceptions.

Most apparent evidence is the behaviours of Baltics. Sharing very parallel production structure with other former Soviet Union states they left the Union early in the process. Following this, they adopted their currencies and were successful in stabilizing their economies. All Rouble zone countries had the option of moving out of it but did not do so until late 1993. In fact, there is a hastening of pace of reforms after the collapse of the Rouble zone in the former Soviet Union. As this experience show, knowing where to go has been an essential determinant of reforms. The Eastern Europe and Baltics, wanting to join the EU and encouraged by it, first initiated political change which in turn led to reforms. Most former Soviet Union countries, not completely knowing whom to align themselves with initially saw no other country other than the Russian Federation, which in turn closely influenced their reforms.

Once reforms are launched, the consequences are pretty alike. Growth starts about two full years after stabilization although the former Soviet Union took about a year longer. This suggests, initial conditions, which are shown to be vital in this study are related factors in the process of transition. Longer term forecasts seem more encouraging for the Eastern Europe and the Baltics in the short to medium term. Nonetheless, they still have a catching up to do with the OECD countries as statistics proved. On the other hand, if they are admitted to the EU, they may reach high growth rates even in the longer term. The former Soviet Union countries have

even more catching up to do than the Eastern Europe countries. In the short to medium term countries with slower population growth rates and powerful reform efforts could be anticipated to enjoy swift growth rates per capita. The Central Asian countries have relatively high population rates and this is likely to affect their per capita growth rates negatively in the short to medium term. What this suggests is that they need high economic growth rates, exceeding their population growth rates, an apparent indication that there is not much space for slowing reforms. Furthermore, given the benefits of integration, there is a strong case for Central Asian countries to push for an economic union, which would also facilitate the restructuring of their economies.

3.4. Unique Paths of Contraction, Recovery and Growth

Although not direct, there is one further dispute proving that of crucial importance for recession and growth is not the legacy from the past, or bad or good lack, but actually executed policies. The legacy sometime could help, but in the post socialist economies more often it hinders. Yet whatever is such legacy, the policies decide. The argument is that, despite many cultural, institutional, geopolitical, and structural similarities between these countries, they have been moving along quite different paths over the first decade of transition.[77] These paths have been shaped more by the policies than by any other factor. That is the major cause that in certain countries transitional recession lasted just three to five years, but in some others it sustained over the entire 1990s. Therefore the existing level of output is a function of two occurrences.

First, it is the consequence of the significance of output fall during particular years of recession. Second, it is the result of the numbers of such years. In some countries, the contraction lasted for relatively shorter period, yet it was altogether deeper owing to harsher fall of output during that time. In some others, the recession lasted for a longer period, yet it was milder because production dropped to a lesser

[77] Blejer, Mario I., and Marko Skreb (eds.) (2000). “Transition. The First Decade,” MIT Press, Cambridge, pp. 153-174.

degree in those years. In Moldova and Georgia -two countries mostly affected by the Great Transitional Depression - in 1999 GDP stood at about one third of the pre-transition level. Whereas it is the outcome of eight years of contraction and two years of growth in the former case, in the latter it is the result of six years of contraction and four years of growth. Whereas there are countries, like Armenia, suffering recession only for a period of four years, yet that was enough to bring their national income down to about 40 percent of pre-transition level, there are also countries like Romania, where the output had been falling for seven years, nevertheless in 1999 it was at 76 percent of the 1989 amount.

Table 17 Duration of Recession and Growth in 1990-99 (in number of years)

Countries	Transitional Recession	Recovery	Second Generation Contraction	Growth	Total Number of Years of Contraction	Total Number of Years of Growth
Albania	3	4	1	2	4	6
Armenia	4			6	4	6
Azerbaijan	6			4	6	4
Belarus	6			4	6	4
Bulgaria	4	2	2	2	6	4
Croatia	4	5	1		5	5
Czech Rep.	3	5	2		5	5
Estonia	5			5	5	5
Macedonia	6			4	6	4
Georgia	5			5	5	5
Hungary	4			6	4	6
Kazakhstan	6	2	2		8	2
Kyrgyzstan*	5			4	5	5
Latvia*	3	1	1	4	4	6
Lithuania	5			5	5	5
Moldova	7	1	2		9	1
Poland	2			8	2	8
Romania	3	4	3		6	4
Russia	7	1	1	1	8	2
Slovakia	4			6	4	6
Slovenia	3			7	3	7
Tajikistan	7			3	7	3
Turkmenistan*	7			2	7	3
Ukraine	10				10	0
Uzbekistan*	5			4	5	5

*: There was growth until 1990 and recession started only in 1991.
Source: Kolodko, Grzegorz W. (1997), *Op. cit.*, p. 12.

Transition is a unique process by its very nature and substance, so even more is the transitional recession, depression and recovery. There are excessive examples of annual drop of GDP in excess of 50 percent (Armenia in 1992), and of growth of about 17 percent (Turkmenistan in 1999). It is possible to mark to enormous differences between the highest rates of contraction and growth for the same year. In the most extreme case such gap exceeded 55 percentage points and that was in 1992. Even in the tenth years of transition, i.e. in 1999, this difference was still larger than 20 percentage points. Altogether there are as many as 57 cases of the years with two-digit rate of contraction, but not unexpectedly only seven cases of the years with two-digit growth rate. After the initial collapse of output, later the more the transition process had been advanced, the lower had been the fluctuation of these growth rates.

The worst of all those years was 1992. Then only Poland, due to recovery which took off already in the middle of that year, had modest (2.6 percent) growth rate. All other countries were suffering contraction within the range from 2.9 in Kazakhstan and 3.1 percent in Hungary to as much as ruinous 44.8 in Georgia and 52.6 percent in Azerbaijan. For the entire group of countries the recession at that year was quite deep and accounted for 9.5 percent. That occurred when the transition was going serenely and only in certain minor regions were local military conflicts. Of course, in the latter case the explanation of such remarkable contraction is obvious, since those conflicts did contribute to further distortions, thus to the output still reducing further.

So far the best year was 1997, when the early fruits of structural reforms had started to ripe, but still before the East Asian contagion and the fallout from the Russia's financial crisis were making their negative impact upon the region's economic activity.[78] In that year the production fell only in five countries (including unusual for this stage of transition drop of 26.1 percent in Turkmenistan), whereas it was rising in remaining 20. The highest growth rate was recorded in Georgia and Estonia. The rate is 11.0 and 10.6 percent, respectively. On average, for the entire

[78] Montes, Manuel, and Vladimir Popov (1999). "The Asian Crisis Turns Global," Singapore: Institute of Southeast Asian Studies, p. 14.

region, the rate of growth of weighted GDP was 2.0 percent. And then, in 1998, it fell again by 1.2 percent. It is possible and even most likely that that was the last year when contraction was reported for the whole region of both the Eastern Europe and the former Soviet Union economies.

There is not any clear outline of the sequence of contraction, recovery and growth in transition economies. The first decade of this attempt must be seen as incredibly untypical period, which neither has similar to anything in the past, nor should be expected to be repeated in the future. Number of specific factors has been influencing the developments with these regards.

First, the moment the production begun to fall was different in particular countries. In a few of them, e.g. in Latvia and Uzbekistan, it was possible to delay the beginning of transition contraction until the end of 1991 and beginning of 1992 through postponement of liberalization. However for the same reasons, that is due to the postponed structural reforms, production started to fall already in 1989 in countries like Turkmenistan, in Croatia, or in Romania. Thus the initial impulse triggering off the contraction was not identical in each of transition economy. In some of them it happened because transition was just initiated, whereas in certain others it happened because it was not launched yet.

Second, the depth of recession was different owing to initial distortions associated with centrally planned economy, on the one hand, and to the applied policies, on the other. The harsher were those distortions - e.g. the burden of non-performing foreign debt, rate of open inflation and shortages, range of price subsides, and array of inefficient state companies, etc. - the deeper was the following contraction. But, during the early years, the range of contraction was also larger in the countries that tried to exercise too radical liberalization policy. If both these occurrences had taken place simultaneously - and that was precisely the case in e.g. Poland in 1989-90 and Russia in 1992- 93 - the early contraction was relatively deeper.

The reverse example, that is the case without distortions typical for reformed statist economy and with steady shift towards liberalization, does not exist. However the Chinese and Vietnamese experiences of the 1990s show that, if there is not too much of the first characteristic and not too little of the second, the growth can be rapid and, at least for the time being, sustained.

Third, the duration of transitional contraction was shorter in these countries, which were able to reform their economies under the previous system. The more the economic and financial mechanism of centrally planned economy was reformed, the shorter was the introduction of crucial mass of new arrangements. Accordingly, it had taken less time to recover allocative efficiency and hence to return to the growth path. This is clearly the case of Hungary and Poland as well as Slovenia. This claim is also supported by the experience of Estonia, where certain market-oriented reforms were also executed relatively earlier, if compared with other former Soviet Union republics.

Such observation is not contradictory with conclusion that those inadequate reforms did contribute to growing financial destabilization too.[79] Such mixed conclusion was causing also mixed impact upon first contraction and then expansion. Again, the best examples here are Hungary and particularly Poland. In this country, on the one hand, the inconclusive reforms of the 1980s led to fiscal and monetary instability. Yet on the other hand - and that in the longer run has been proved to be of much greater importance - these changes contributed to higher flexibility and better ability to adjust. Thus the derivative of these contradictory tendencies for the future growth turned to be positive: the growth was faster and the recovery came sooner.

Fourth, even when there is recovery following the period of contraction, it does not mean that transitional depression is over. During the decade of 1990s there were at least 10 cases of returning contraction after the economy had already bottomed up. So far, six cases of such 'second generation transitional contraction'

[79] Kornai, Janos (1986). "The Hungarian Reform Process: Visions, Hopes, and Reality," *Journal of Economic Literature*, Vol. 24, No: 4, pp. 687-737.

have lasted for more that just one year. These events are not caused only by the external shocks, but are happening too due to the lack of both sound essentials and strong institutions that supposed to uphold growth when it ultimately comes. In other words, in transition economies, even more than in the established markets, the growth never is given just because it has already taken place. It must be maintained by good policy, and also that might not be enough, if good institutions do not support good policy. Unquestionably just for that simple reason it must be expected that also the future will bring the instances of falling productivity. Some of them will result from the policies' failures; some form the business cycle mechanism. However, as far as the cases of the 'second generation transitional contraction' are concerned, they have been mainly the results of wrong policies or negative external shocks, or the concurrence of both. The business cycle mechanism in post socialist countries has not yet been set fully in motion, since it is a function of the strength of market mechanism, which is just being introduced.

Fifth, it must be remembered that if the national income was lost in the past due to the policies' failures, its current and future growth is not a compensation for such loss. Only in the instances when the later growth is coming because of the preceding fall in output caused by structural reforms, such contraction can be seen as a specific 'institutional investment'. If not, recession and depression basically mean the unrecoverable lose of welfare.[80]

The first decade of transition came to the end with the aggregate GDP for the whole region matching barely about 70 percent of the pre-transition level. With this evaluation in mind always particular countries are compared from an angle of their current productivity in relation to their productivity at the onset of transition and, of course, to the other countries' relative production. However, it may be very helpful to take a look at their aggregated output over the whole decade of 1990s. If certain country has accomplished to recover pre-transition level of production and another country has not been able to do so, most often it is interpreted that the former is

[80] Nuti, Domenico M. (1992). "Lessons from Stabilization and Reform in Central Eastern Europe," CEC Working Papers, 92, Brussels: Council of the European Community (May), p. 23.

doing better than the latter; at least as far as the growth process is concerned. But it may happen that in the latter case the productivity, in relative terms, was higher over the entire period of 10 years than it was in the former country.

Consider the hypothetical sequence of four years of recession, recovery and growth in two countries. In first of them, production fell by 10 percent during second year of that sequence. And then, during the third, returned to the previous level. In the fourth year it was still growing, but only by 2.0 percent and hence was overcoming pre-transitional level by this amount. Thus the sum of output over a period of four years is equal to 392 units. In the second country the production contracted only by one percent and then again by one percent, and then again by one percent. So, at the end of that period it stood at 97.03 percent of the level of starting year. The sum of output over period of four years is 394.03. It means that, despite that currently, i.e. at the end of the whole sequence of contraction-recovery-growth, the production (one year flow) is larger in the first country (i.e. 102 units), the total aggregated production for the whole time span is larger in the second country, where the current production (again one year flow) stands at about 97 units. In the latter, with current output smaller by five units (102 minus 97), the sum of the total four years output is by two units larger (394 minus 392).

For instance this was the case of Slovakia and Uzbekistan. The index of 1999 GDP, while compared with 1989, is equal to 101.5 and 92.3 percent, respectively. However, in the former the GDP combined for the whole decade is equal to 883 percent of the 1989 GDP, whereas in the latter to 901 percent of the output from that year. The illustration of relevant sums of the GDP combined over the period of entire decade 1990-99 for 25 transition countries.

The message is mixed again. In certain instances, while the relative aggregate GDP counted for the whole decade is larger, simultaneously the current relative level of GDP is smaller. So, who consequently is better of? Is it the country with higher current level of GDP compared against the pre-transition output, though the sum of GDP for the entire transition period is relatively lower than in an alternative case? Or

is it the country where the GDP combined over the entire transition decade is relatively larger than otherwise, though the current production is still relatively lower if compared to the alternative case? It depends. The issue is that from the formal point of view (leaving aside important structural changes), the same category of GDP is concerned. Although from another perspective somehow already changed society is taken into consideration. Once again today's higher income is not always a compensation of yesterday's loss. This is so, because some other people lost and some other had gained. Such result may cause social pressure and political tensions, making the economic policy and facilitating it structural reforms still more complicated. Thus, what is important with this regard is the fluctuation of the rates of contraction and growth. It seems that more favourable for long-term fast growth and the nations welfare is less frantic and volatile fluctuation of these rates and thus the smoother process of quantitative changes in respect of productivity.

Totally over the period of last decade the whole group of 25 post socialist transition economies produced barely 7.6-fold what they were able to produce in 1989. The corresponding index for the CIS stands at 673 and for the Eastern Europe at 895 percent. It means that in Eastern Europe it takes as many as 11 years to produce the GDP matching the 11-fold 1989 GDP. From the statistical viewpoint it is the same as if there would not be recession, but simply stagnation lasting 11 subsequent years - from 1990 until 2000.

3.5. Policy Reaction and the Role of Institution-Building

At present stage of transition the post socialist countries have much more in common with other emerging markets than it was the case just a few years ago. Then it was too often believed that these countries supposed to tackle parallel structural problems as other regions with deformed economy. That was neither true then nor is now, despite growing similarities between different challenges all these countries are facing. So why considering the policy options from the perspective of future growth, the specific features of post socialist economies still must be taken into consideration very critically. Of crucial importance here is the process of institution-building. From economic outlook the statist centrally planned system had collapsed because of lack

of capability to adjust. The changing environment of the world economy became more requiring and thus rigid, inflexible system, enmeshed in several distortions, proved to be unable to advance its competitiveness. Whereas on the one hand globalization brought a threat for countries unable to adjust, on the other hand it brought also a chance to repair the unproductive economic system.

In addition to growing internationalization of economic links and immense political changes, the technological progress happened to be a crucial channel deciding that the time for comprehensive transition arrived. Otherwise it would be difficult, if at all possible, to regulate to growing development challenges and take advantage of forecasts for long-term expansion. Here two problems have emerged. First, initially the policies must tackle the new challenges within the framework of inherited old institutions. The institutions, i.e. the organizations and the rules, always matter during transition.[81] But, within the wider conception of the meaning of institutions, also the market culture and behavioural aspects of market economy must be seen. Thus in transition countries (even if the law regulating the rules of emerging market economy has been already adopted and even if the organizations support the observance of this law have been established) there still stay the challenge of relatively lagging behind market culture and behaviour. Second, as the time is elapsing, these very institutions must be transformed for the purpose of policies' facilitation. It means that while in the long run quality of institutions is a matter of policy, in the short-term the institutions are given.

Hence the policies carried out must be performed within the limits imposed by the existing institutional arrangements. In other words, there were, and to a degree still are, the policies that cannot be implemented in transition economies because of institutional weak spot. This claim, so clear at the end of the first decade of post socialist transition, was not a common wisdom at the onset. Not surprisingly, weak institutions - either earlier tailored for the requirements of the outgoing statist system marked by the domination of government sector and immense bureaucratic control or

[81] North, Douglass C. (1997), **op. cit.**, p. 9.

later only emerging from a naught - were weakening the efficiency of policy. Considering such institutional weak spot there were various reactions that should be expected, yet often they were not anticipated, exactly because of the negligence of institutional arrangements. The most important with this respect was the lack of early positive supply response. Many policymakers and their advisors (including international organizations) in fact expected that production should start to grow soon after liberalization took place and if only certain critical mass of privatization was executed.

Conversely; despite quite rapid and far going privatization for a prolonged period of time there was not an enhancement of allocative efficiency, or it even deteriorated. It would be opaque to assume that it was happening because private assets are less productive than owned by the government, though there was such coincidence that privatization was followed by contraction. If for that purpose sometimes transitional recession and depression are associated with ongoing privatization, it is a mistake, since it must be linked to the institutional weakness. Emerging private sector to prove its dominance needs a rudimentary institutional streamlining. Another significant observation is that within the same or similar institutional arrangements alternative sorts of policies might be implemented. It means that, regardless the existing at given moment of time institutional arrangements, the policies can be better or worse. The policy response can be more suitable to tackle the issues in one country, or less appropriate in another. Therefore though the institutions do not differ, the different policy responses are delivering fluctuating outcomes. It is also possible that even within the framework of weaker institutions the results are better than they might be in other places enjoying stronger institutions. And that is accurately the result of better policies. Thus the institutions do matter, but so do the policies. It may happen that economic performance is healthier in a country with better or worse institutions, or in a country with better of worse policies. To some extent these are opposite matters, to some extent they may substitute each other.

As far as economic growth is concerned this explains why some countries, ceteris paribus, are doing better than definite others. It also explains why in some of them the performance is more extraordinary over one period and worse during another, even though the fact that in the meantime the institutional arrangements have been upgraded and improved. Fine example of this inter-relation can be the Polish economy. In this country, due to steady yet committed institution-building and because of sound policy, following the recovery that started in mid-1992 the growth had accelerated profoundly after 1993. However later, since after 1997, the pace of growth did slow down considerably. It had occurred although ongoing advancement of institution-building over all those years. To modest extent it was motivated by external shocks, but mainly was provoked by the deterioration of policy. The analyses pointing just to the external shocks fall short to explain the drop of the rate of GDP growth from as much as 6.7 percent in 1995-97 to only about 4.5 percent in subsequent three years, i.e. 1998-2000. The quality of policy deterioration does explain it. Of course, the best combination is to have sound policies and good institutions. And, no doubt, the worst one is to have the opposite, i.e. weak institutions and bad policies.

From this standpoint, unfortunately, in transition economies the latter alliance has happened more often than the former. Not surprisingly the transitional recession transformed into the Great Transitional Depression. At the early stages of transition there is not any obvious rule with the respect to the combination of quality of institutions and policies. Later, presumably, they start to facilitate strongly each other. Before that occurs it might happen that relatively better institutions can demobilize the policymakers from taking care of further structural reforms and commitment to progressing institution-building, since it is never easy. These are ever-lasting processes, not just an episode. Or it may happen to go the other way around. Then the tensions, crises, difficulties, distortions, etc. are pushing the governments to restructure the institutional orders still further. Yet of great economic implications, this question too is of great political nature. The answer depends on capacity of the elite to formulate long-term development vision and is powerfully involved in a feedback with simultaneously going process of political liberalization,

i.e. democratization. Thus the problems are quite complex. It is excellent when the progress with institution building is resulting merely from the wisdom of the people and determination of their leaders. It happens. But the experience shows that pretty often the institution-building is getting momentum only if the problems are mounting, so 'the worse, the better'. Then strong pressure appears and the requirement for structural reforms, especially from business sector, but also from outside, does increase. International organizations, while providing methodological advice and financial assistance based upon conditionality stressing proper policies and reforms, contribute to such processes too.

3.6. External Impacts and the Reaching Process

Widespread opinion that a push towards market economy in post socialist countries must bring better allocative efficiency and higher competitiveness is strong argument behind the rationale to do so. Thus in due time it must carry, too, the rising productivity and better standard of living. Yet to achieve such aim not only the pre-transition level of production must be recovered, but the return to path of quick and sustained growth must be accomplished. Only then there will be the possibility for catching-up, what means gradual and lasting process of declining the development gap between transition economies and wealthier industrial countries. While looking into the future, there is always temptation to assume that it will be fine. Such optimism may seem rational from the policymakers' point of view, especially since they always believe that they do know well what has to be done and that unfavourable external shocks, making their ambitious plans impossible, will not happen. Unfortunately, quite often these assumptions do not hold.

Consequently, the future seldom looks as bright as envisaged just couple of years earlier. Although such experiences, too optimistic prospect is tended to be repeated time and again. Post socialist economies and their leaders are not any exception from this rule. It might be added that international organizations have been following this model of behaviour too, or at least they were doing so for several

years.[82] Moreover, at least at the outset of transition they have made a huge impact on such excessive optimism in transition countries. There is nothing wrong with optimistic expectations, if they are only based on knowledge and sound commitment to structural policies, on the one hand, and represent the right conclusions from the historical practice, on the other. Otherwise too much of optimism becomes too much of ignorance, what always acts against growth and its sustainability. Therefore the considerations about catching up in transition economies should draw from these countries own experiences as well as from the characteristic of growth processes occurring elsewhere.

As for the experience it must be obviously understood why some countries produce in 1999-2000 more that they did in 1989-90 and many of them are still not able to do so. Or, in another words, there is a question to what extent the growth rate in the future will differ between particular emerging markets in the Eastern Europe and former Soviet Union region? Can it differ as considerably as it did over the last decade? That is hardly imaginable, because there were some distinctive reasons for such diversification and is very unlikely that they will resurface again. First, there had been local military conflicts. Countries affected by such misfortunes have clearly lost important part of their production. Especially Armenia, Azerbaijan, Georgia, Moldova and Tajikistan in the former Soviet Union region, and several Balkan countries in the Eastern Europe region, have been harmed by heavy loses owing to military operations. It is a tragedy to lose during just one year as much as 21.1 percent of GDP in Croatia in 1991, 52.6 in Armenia in 1992, 18.9 in Tajikistan in 1994, or 37.3 in Yugoslavia in 1999.

In some countries the situation remains unstable and unpredictable. As for the future, all further predictions are presuming that there will not be such type of conflicts. If, however, transition process during next decades will evolve serenely - and all necessary attempts to secure such course must be undertaken - it is reasonable to suppose extra growth just for this cause. In the 1990s production started to rise

[82] World Bank (1997). "Global Economic Prospects and the Developing Countries," Washington, DC: World Bank, p. 14.

quickly in certain countries immediately after military conflicts ceased. But if regional conflicts will continue then slow economic performance and depression will last for several more years. Second, they were external shocks causing additional difficulties. Among them, the shock following collapse of the former Soviet Union was extraordinary. Only for this reason the transitional recession was much deeper in the former Soviet Union economies than in the Eastern European countries. The break of the former Yugoslavia became a large shock, too. Meaningful, though with milder implications, was dissolution of the Council for Mutual Economic Assistance (Comecon), i.e. the trade bloc of socialist countries. More recently, the contagion following the 1998-99 Russian financial crisis has shown that especially the former Soviet Union republics are vulnerable for crises occurring in these economies among them, with which the others maintain strong links. Nevertheless, owing to diversification of trade partners and directions where capital is flowing from, there is likelihood that this weakness will decline. Yet all the time there will remain the risk of external shocks, what can reduce the growth prospect. Hence a shield against negative external shocks has to be created.

Third, certain events are the good and the bad news at the same time. There are the economies, mainly among the former Soviet Union countries, that rely to large extent on specific good prices. Natural gas and oil for Turkmenistan, cotton and gold for Uzbekistan, crude ore for Ukraine, oil for Azerbaijan, etc., are of big meaning for these countries' income. So, of course, is the oil for Russia. Without taking a closer look into the fluctuation of these prices, it is not possible to explain such shifts of growth rate as from minus 11.8 to plus 5.8 percent between 1995 and 1997 in Azerbaijan, or from minus 26.1 to plus 17 percent between 1998 and 2000 in Turkmenistan. When the prices of oil and gas were plummeting to the lowest level since 25 years, it was negative shock for countries, which revenues depend on export of these products. But for the same incident it was positive shock for the importers, including majority of the Eastern European economies. Through influence upon their terms of trade such price fluctuations affects their growth rates in a positive way. Fourth, in the post socialist countries not only the market economy is emerging, but also democracy rises. It is a value by itself, though at the same time is inter-linked in

composite manner with the process of economic growth. Neither there is an obvious relation between market and democracy, nor there is between marketization, i.e. the process of transition to a market system, and democratization, i.e. the process of transition to democracy. There are the examples of economies growing rapidly and durable without much of democracy and of lasting depression under authoritarian regimes.

There are plenty of cases of rapid growth under democracy as if bumpy process of democratization in definite transition countries did not help economic growth instantly; it does so in the longer run. In such outlook, democracy assists growth, because it corrects the policy excesses. Of course, democracy works better if the market performs well.

Fifth, in certain cases extraordinary productivity fall was also due to the lack of wise macroeconomic policies. The best examples here are the failure of fraudulent financial pyramids in Albania and the Russian financial crisis, but there were many misguided policies and incorrect decisions in other economies too. As for the future, in result of increasing maturity of both market and democracy institutions, it seems rational to expect more responsible policies. Further institutional advancement will contribute to relatively higher growth rate.

Whereas all these five opinions are based on lessons from the past, there are definite others, pointing to contemporaneous processes going in global economy, which can be promising for the prospects of rapid and sustained growth.[83] Against this background, it is reasonable to expect that the process of catching-up with industrial countries indeed will take place. Here in turn, the first opinion is that the course of catching-up with technological progress is taking momentum on the global scope. Transfer of new technologies from industrial economies to catching-up countries considerably contributes to rising competitiveness of all emerging markets. If macroeconomic essentials are sound and financial stabilization is achieved, and if

[83] Fischer, Stanley, Ratna Sahay and Carlos Vegh (1996), **op. cit.**, pp. 39-41.

only political institutions perform well, then technology transfer carries major acceleration of growth rate.

On this precise field the catching-up process is going to be most visible and most effective. It makes sense to assume that, ceteris paribus, in the long-term in transitional economies at least one additional percentage point of growth can be obtained only due to this factor. Technology transfer is causing more rapidly rise of the labour skills than its costs, i.e. wages are increasing. For this reason production placed by developed in less developed countries will raise faster than the global average. It is also true for transition economies. Such mechanism of catching-up has been set in motion already, however it is difficult to mark it within the complication of changes influencing the contraction-recovery-growth sequence. If not the present phase of global technological revolution and transfer of know-how, the transitional recession could be even deeper and last longer, the recuperation would be weaker, and the growth slower. Such spill over effect, i.e. spreading out new technologies and know-how, upgrades the qualifications of labour. Unfortunately, simultaneously there is destructive process of brain drain, what diminishes the capability to compete and expand. That threat must be counteracted by better compensation for and larger investment in the human capital. Particularly the inward Foreign Direct Investment (FDI) works against the flight of human capital. In countries absorbing most of them, e.g. Hungary and Poland, there is already net inflow of skilled labour, what means that more competent people are coming into these countries than leaving them. This is good for future growth.

The second argument is related to the process of integration with global economy. Transition is not only essential part of globalization, but post socialist economies have a chance to be one of the main beneficiaries of this multi-track process. However, the picture is mixed here and this time the geopolitical situation does matter more. In best situation are the Eastern European countries negotiating their access to the EU. First the Czech Republic, Estonia, Hungary, Poland and Slovenia, and later Bulgaria, Latvia, Lithuania, Slovakia and Romania, followed soon by Croatia, will get a strong boost for their growth ability because of this

integration. These countries upgrade rapid institutional arrangements along the line of the policies observed in the EU, what facilitates growth ability in the long run. They can also calculate for relatively larger inflow of FDI.

Indeed, outlook for their future membership in the EU have attracted already significant inward FDI. Net transfer of resources from Western to Eastern Europe works as catalyst of growth and hence the process of integration with the EU should speed up long-term rate of growth, maybe for another percentage point or so. The third argument is linked to movement of wisdom on economic and financial issues. Yet not appreciated in a similar way as technological revolution, this progress too contributes to catching up, because macro and microeconomic management is more composite challenge currently than it used to be in the past.[84] Experience suggests that there is certain lag in relation to adopting such knowledge owing to both cultural and political reasons, yet learning by doing is already very well on the way. Although not possible to measure, by all means this factor enhances speed of growth, too. And the fourth argument is that the advancement of institution-building contributes to getting rid of systemic bottlenecks and structural distortions both, inherited from the past as well as created at the early stages of transition. This, in turn, boosts labour productivity and overall economic efficiency. So there is a argument to assume that transition economies will grow more rapidly than the global economy and developed industrial countries, and in due time they might catch up with the latter group. Yet the completion of catching-up theory needs support.

Various cultural, political and institutional factors must come into existence and definite conditions must be met to set an instrument of catching-up fully in motion. In several countries, after first decade of transition, these factors and conditions seem to be at least to exact extent established. Against such background, it seems possible to outline alternative scenarios of catching-up and the policy recommendations facilitating implementation of the optimistic scenarios.

---

[84] Kozminski, Andrzej K. (1993). "Catching Up? Organizational and Management Change in The Ex-Socialist Block," Albany, N.Y.: State University of New York Press, pp. 23-25.

4. SCENARIOS FOR LONG-TERM GROWTH UNTIL 2050

Transition can be seen as a specific attempt shifting part of global economy from one development model to another. Before recent recession, though their early expansion went along the growth pattern cycles unique for centrally planned system, all these economies were growing up. Until they had lost momentum in the late 1980s, they were catching-up with more developed regions. Now, as assuming that the Great Transitional Depression has come to the finish, there will be the growth along the pattern of business cycles characteristic for market system. In further considerations, there is a contained assumption that long-term growth will evolve around a tendency derived from business cycle fluctuations. Thus the post socialist economies are going through progression of shifting the substance of their cyclical growth. They do not move from system, where there was not growth to a system, where the growth will resumes per se and routinely will be of a 'better character'. That must still happen. There are various forecasts for forthcoming years. Actually nobody foresees further decline of productivity for any of transition economies. There are just a couple of cases where drop of production is expected and only for a single year. Of course, presuming that the developments will go serenely and severe external shocks will be avoided. Yet the misfortunes cannot be ruled out a priori. In 2003-04 the GDP index will look less miserable than now, though not as much impressive as one would like to see it.

In 2004 only in seven or eight out of 27 countries the output will overcome GDP of 1989. At the other end of the list, in another eight countries it will still stay below two thirds of that standard. That will be altogether after 15 years of transition.

Table 18 Real GDP Index. Forecast for 2003-04 (1989=100 and 1999=100)

Countries	Index 1999 1989=100	2000	Growth Rate 2001	2002	2003	2004	Index 2003(4)* 1999=100	1989=100
Poland	121.6	4.8	5.1	5.5	5.8	4.9	129.0	156.8
Slovakia	101.5	3.8	4.6	6.4	6.0	6.9	130.9	132.9
Slovenia	107.6	4.0	3.9	4.2	4.1	4.8	122.8	132.2
Albania	92.5	7.0	6.7	8.3	6.9	6.5	140.8	130.2
Hungary	99.2	5.3	5.2	5.4	5.1	5.5	129.5	128.4
Czech Rep.	94.7	2.6	3.6	4.8	4.7	4.4	121.8	115.3
Uzbekistan	92.3	3.8	-1.0	2.2	3.8		109.0	100.6
Croatia	77.2	2.6	3.5	4.4	4.8	4.7	121.6	93.9
Romania	73.0	5.3	5.4	5.3	5.0	4.6	128.4	93.7
Estonia	75.7	5.5	5.5	5.1	4.5		122.2	92.5
Macedonia	72.0	4.8	5.5	5.0	4.5	3.6	125.7	90.5
Bulgaria	66.8	4.1	5.0	5.2	4.7	4.4	125.7	84.0
Lithuania	65.4	5.3	5.3	5.7	5.2		123.3	80.6
Belarus	78.2	-8.1	1.7	3.1	5.7		101.9	79.6
Latvia	60.1	4.9	4.8	5.5	5.3		122.1	73.4
Kazakhstan	60.2	3.3	4.5	5.9	6.1		121.3	73.0
Kyrgyzstan	60.4	4.5	4.1	4.2	4.4		118.3	71.5
Azerbaijan	45.2	7.3	9.1	9.7	9.0		140.0	63.3
Turkmenistan	51.2	5.3	5.1	5.0	6.1		123.3	63.1
Russia	56.1	2.2	2.7	2.0	3.4		110.7	62.1
Armenia	42.5	6.2	6.9	7.1	7.2		130.3	55.4
Tajikistan	44.1	5.0	5.1	5.0	5.9		122.7	54.1
Georgia	33.8	8.0	7.8	7.8	7.5		134.9	45.6
Ukraine	35.7	0.2	3.3	3.9	4.6		112.5	40.2
Moldova	30.5	3.7	4.7	5.6	6.1		121.6	37.1
Bosnia-Herz.	*na*	*6.1*	*4.6*	*3.8*	*3.1*	*3.7*	*123.2*	*na*
Yugoslavia	*na*	*15.4*	*13.2*	*10.9*	*8.1*	*5.9*	*165.8*	*na*

*: 2003 for the FSU and 2004 for the EE countries.

na: Data not available

Source: PlanEcon, "**Review and Outlook for the Former Soviet Republics**," Washington, D.C.: PlanEcon, Inc., 1999.

Sometimes, owing to market exchange rate instability, the change of relative value of national currency may suggest the fall of GDP measured in dollars whereas actually it is growing. For that reason it is justified to take closer look at the evaluation of GDP per capita on the basis of Purchasing Power Parity (PPP). This indicator ought to be regarded as point of departure into catching-up process.

Table 19 GDP per capita in 1999 and 2003(4), PPP basis*

Countries	1999	2003(4)	Growth (in PPP$)	Growth (in%)
Slovenia	14,267	17,344	3,077	21.6
Estonia	9,096	16,048	6,952	76.4
Czech Rep.	9,472	11,442	1,970	20.8
Slovakia	8,395	10,954	2,559	30.5
Hungary	8,063	10,648	2,585	32.1
Croatia	8,284	9,528	1,244	15.0
Poland	7,232	9,255	2,023	28.0
Latvia	6,341	7,877	1,536	24.2
Belarus	5,722	5,737	15	0.3
Russia	4,539	5,087	548	12.1
Bulgaria	3,758	4,796	1,038	27.6
Lithuania	3,680	4,520	840	22.8
Romania	2,962	3,837	875	29.5
Armenia	2,842	3,662	820	28.9
Macedonia	2,897	3,423	526	18.2
Turkmenistan	2,891	3,376	485	16.8
Kazakhstan	2,482	3,028	546	22.0
Yugoslavia	1,828	3,027	1,199	65.6
Uzbekistan	2,612	2,721	109	4.2
Azerbaijan	1,970	2,689	719	36.5
Ukraine	2,348	2,641	293	12.5
Georgia	1,950	2,570	620	31.8
Kyrgyzstan	2,211	2,472	261	11.8
Moldova	1,745	2,104	359	20.6
Albania	1,474	2,025	551	37.4
Tajikistan	748	848	100	13.4

*: 2003 for the FSU and 2004 for the EE countries.

Source: PlanEcon, "**Review and Outlook for the Former Soviet Republics,**" Washington, D.C.: PlanEcon, Inc., 1999.

Remarkable phenomena here, unlike in the EU and other developed market economies, is that in transition economies there is a large gap between the GDP counted at current, i.e. the market exchange rate, and its evaluation on the basis of PPP. The progress of opening up and integration of transition countries with the world economy is deteriorating this gap, yet it still remains. For this reason, there is

going to be long-lasting process of real appreciation of transition economies currencies. Indeed, it already is well under way. If from time to time the currencies of transition economies do depreciate, it is not dissimilar with such long trend. These data better reflects current level of development and living standard. Hence this is the point where these societies and economies are at the time, and not the GDP per capita measured at current exchange rate. If the latter is taken into account for instance in Russia, than - with her GDP per capita according to market exchange rate at around 1,500 dollars - it stands in 2000 at only 13 percent of the Slovenian GDP.

With all drawbacks Russia is not that much behind. In the future, following progress in respect of financial stabilization, such gap subsequently will decrease along the line of the real Rouble appreciation and, most likely, also faster rate of growth in Russia than in more advanced post socialist countries. So where all these post socialist countries can be in a time of generation or two? From the outlook of their long-term growth ability, and thus the ability to catch up with advanced industrial countries, four separate groups of post socialist economies can be specified. First can be called ‘the gainers’ and will consist of economies able to sustain over the very long-term the rate of GDP growth at least two times higher than in advanced market economies. As a yardstick the recent growth rate in the EU can be used. Despite the fact that the future growth is not a sure figure in this case too, it seems rational to assume that, by and large, it will sustain around the level accomplished in 1997-2000, i.e. 2.5 percent. This implies that over the coming decades annual growth rate will be about five percent, oscillating mainly between four and six.

Second group, ‘the even-runners’, will be able to sustain the growth pace alike or slightly only higher than the EU, so it will oscillate around three percent on average, jumping between two and four. Consequently these countries will not be catching-up with most advanced part of the European economy, or if doing so it will occur very slowly. In result, the relative distance between these two groups will change only very diffidently, yet given different bases, the absolute distance will

increase still further. Also the growth gap between this group and the gainers will rise.

Third group; let us call them 'the laggards' due to the lack of ability to take transition to their own advantage will rise over the long term even less than the EU economies. Their long-term growth will not exceed two percent or even can stay below such low level. Thus in the future their relative income, while compared with other groups of transition economies, will lag behind even more than at the turn of the millennium. There are many opinions that all post socialist region will be the growing economies, yet it would not be wise to assume that, owing to coincidence of unfavourable conditions and policies, the worst among them will not be driven from time to time into another recession. Therefore, their long-term growth can happen to be very inadequate.

And there is fourth group, or at least there an option that such will appear - 'the frontrunners'. These countries, under a fortunate coincidence of favourable circumstances and superior policies, will enjoy average growth rate around three times higher than the EU, i.e. 7.5 percent. Whereas running between six and nine percent annually, they will approach the EU standard, while at the same time will distance themselves from all other post socialist economies. These are definite general reflections in respect of alternative pace of growth. It does not mean, of course, that each country growing more rapidly will enjoy higher productivity and, consequently, better standard of living than a country growing at lower rate. In the longer run, that must ultimately happen. However, for several years it can be just to the opposing, because of the very logic of catching-up mechanism. It means that countries departing from lower level of output in 2000, like Azerbaijan in the former Soviet Union region, or Albania in the EE region, though they will report faster growth than, say, Estonia and Slovenia, for a number of years will still have relatively lower income. In Azerbaijan the GDP per capita at PPP basis was estimated in 1999 at about 1,970 dollars, while in Estonia at 9,096 - almost five times more.

Against this background it is assumed that while in the former the GDP will increase on average between 2000 and 2003 by 7.0 percent, in the latter it will grow only by 4.1 percent per year, yet the absolute production will remain much larger. As for Albania and Slovenia, the relevant GDP per capita on PPP basis is 1,474 and 14,267 dollars, whereas expected growth rates are 7.1 and 4.2 percent. Therefore, while sticking with above categorization, not unexpectedly Albania and Azerbaijan can be found among the frontrunners, whereas more developed Estonia and Slovenia among the gainers, and amongst them only at the extremely end of the league. These forecasts have to be seen as passive scenarios based on the extrapolation of recent trends and certain assumptions in respect of future policy reforms. The recent predictions are often less optimistic than only couple of years ago. Such alteration of the mood results, from negative external shocks, which have influenced not only the real economy, but even more the ways of thinking and expectations. For this reason it can happen that this time, dissimilar to the early 1990, there is extreme pessimism.

Yet it is true that the Russian 'crisis within the crisis' and its 1998 financial climax has affected not only several former Soviet Union republics, but, owing to large exposition for trade with Russia, also some other economies, including previously more rapidly growing Slovakia and Estonia. In other countries, e.g. Poland and Slovenia, deceleration of growth had occurred more as the consequence of policy mistakes. As far as active policies are concerned, they can possibly bring back the pace of growth in all those countries close to already achieved seven percent. Maintaining it at that level for many years will keep these economies among the frontrunners. That is possible and that is likely. As a result, definite scenarios would change soon in more optimistic direction. The predictions depend mostly on the policies - not the other way around. Accordingly, there can be four paths of long-term growth: for laggards, even-runners, gainers and frontrunners. Thus where particular country can arrive, if it would stay the course of specific pace of growth for a given period of time during the next 50 years?

Table 20 Average Rate of GDP Growth in 2000-03(4)*

Frontrunners	
Yugoslavia	10.7
Albania	7.1
Azerbaijan	7.0
Georgia	6.2
Gainers	
Slovakia	5.5
Armenia	5.5
Hungary	5.3
Poland	5.2
Romania	5.1
Macedonia	4.7
Bulgaria	4.7
Lithuania	4.3
Turkmenistan	4.3
Bosnia-Herzegovina	4.3
Slovenia	4.2
Tajikistan	4.2
Estonia	4.1
Latvia	4.1
Even-runners	
Czech Rep.	4.0
Moldova	4.0
Croatia	4.0
Kazakhstan	4.0
Kyrgyzstan	3.4
Ukraine	2.4
Russia	2.1
Laggards	
Uzbekistan	1.8
Belarus	0.5

*: 2003 for the FSU and 2004 for the EE countries.

Source: PlanEcon, "**Review and Outlook for the Former Soviet Republics**," Washington, D.C.: PlanEcon, Inc., 1999.

Within such four hypothetical scenarios there are three sub-scenarios, i.e. the core scenario A, the minimum scenario B, and the maximum scenario C. The extreme sub-scenarios are based on calculation that over whole half century the rate

of growth is either at the minimum or at the maximum end of the band, the centre of which is given by the core scenario.

Table 21 Catching-up in the Transition Economies in the 21st Century

	1A	1B	1C	2A	2B	2C	3A	3B	3C	4A	4B	4C
Year	**L-5 ER-5 G-10 ER-30**	**Min**	**Max**	**ER-15 L-10 ER-15 L-10**	**Min**	**Max**	**G-10 F-10 G-5 ER-25**	**Min**	**Max**	**F-10 G-5 ER-35**	**Min**	**Max**
2000	100	100	100	100	100	100	100	100	100	100	100	100
2005	110	105	110	116	110	122	128	122	134	144	134	154
2010	128	116	134	134	122	148	163	148	179	206	179	237
2015	163	141	180	156	135	180	234	198	276	263	218	317
2020	208	172	241	172	141	199	336	265	424	305	241	385
2025	242	190	293	192	149	220	428	323	567	354	266	469
2030	280	209	356	222	164	267	497	356	690	410	293	571
2035	325	231	433	258	181	325	576	393	840	475	324	694
2040	377	255	527	296	200	395	668	434	1022	551	357	845
2045	437	282	641	327	210	437	774	479	1243	638	395	1028
2050	506	311	780	361	221	482	897	529	1512	740	436	1250

L: Laggards.

ER: Even-runners.

G: Gainers.

F: Frontrunners

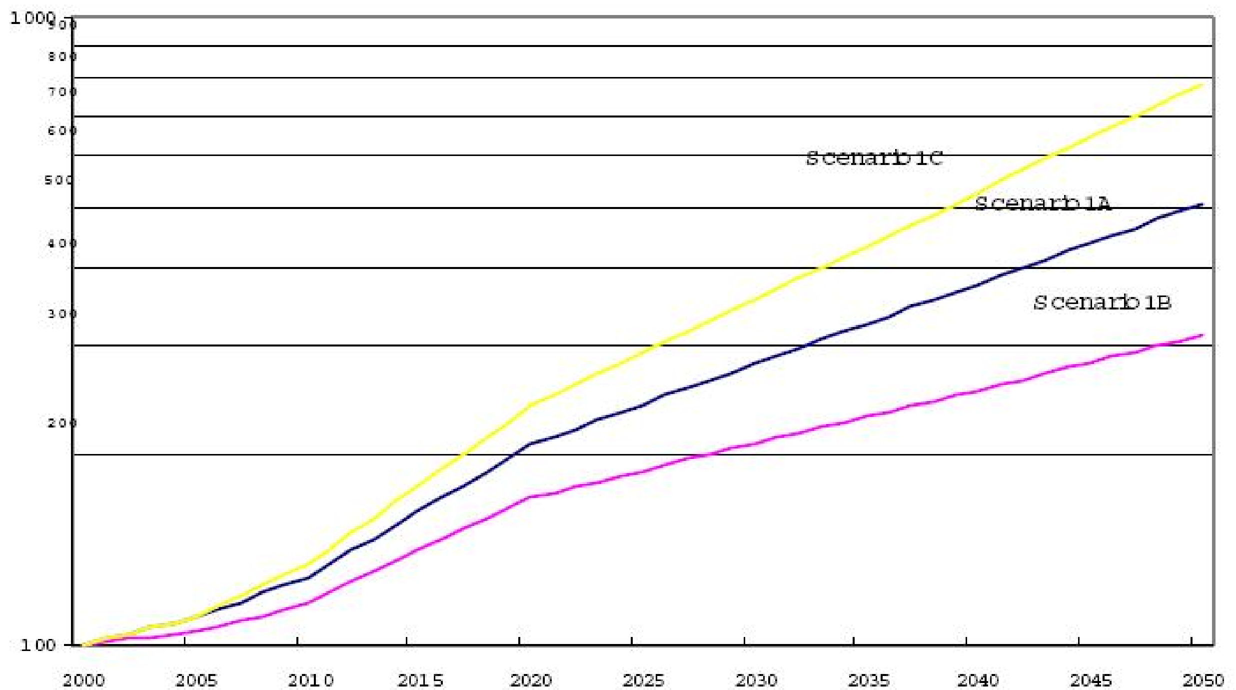
Source: Kolodko, Grzegorz W., "**Globalization and Catching-up: From Recession to Growth in Transition Economies**," IMF Working Paper, June 2000, p.30.

First situation mainly presumes medium-term (five years) period of slow growth due to unstable essentials, weak institutions, insufficient policy response, and negative external shocks. Then the growth accelerates for succeeding five years due to continuing institution-building and policy reforms as well as more favourable external factors, e.g. an end of regional conflicts. Later, over a decade, acceleration is getting momentum owing to institutional enhancement and better policies stemming from learning by doing, experience and knowledge. Thus these economies advance to the gainers group, what means that their growth rate rises to the range of four to six percent. Afterwards, for the long-term of three decades, the growth decreases, yet only to the pace of even-runners, i.e. three percent. Thus in a matter of one

generation it lifts national income almost twofold and over the two generations time, by 2050, it might increase it about five times.

Considering the range of rates of growth, in sub-scenarios 1B and 1C the cumulative growth can be much smaller or significantly larger than in the core scenario 1A.

Figure 5 Alternative Growth Paths for the Very Long-Term , 2000-2050, Scenario 1A, 1B, 1C.



Source: Kolodko, Grzegorz W., "**Globalization and Catching-up: From Recession to Growth in Transition Economies**", IMF Working Paper, June 2000, p.29.

Such sort of scenarios is likely for countries that have weak essentials, poor institutions, postponed structural reforms, contradictory development policies, relatively less favourable geopolitical position, and in certain cases might be directly or indirectly affected by local tensions and conflicts. For instance, countries like Tajikistan in the former Soviet Union or Romania in the Eastern Europe region fit to certain degree in these scenarios. The future will carry a lot of fluctuations that will

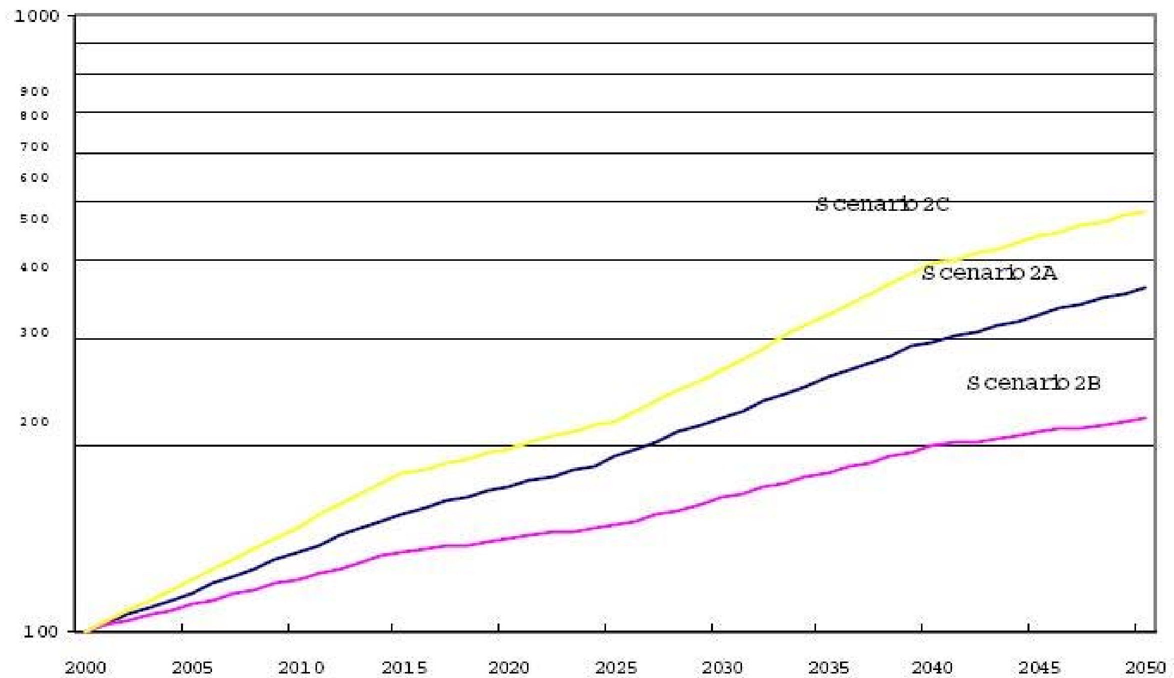
make the real picture even more colourful. However, these countries can accelerate their growth rate later too, if only through correct policies they will be able to get rid of various structural and institutional bottlenecks keeping thus far their growth potential in check. Second scenario is for countries, which will take only restricted benefit of the chances brought by introduction of market economy. For this reason they will develop even slower than under centrally planned system.

Furthermore, a lethargic growth will be accompanied by further mounting inequality.[85] For the first, say, 15 years, they will grow at about three percent annually and then even slower. Then, during a period of second generation, such sequence of 15 years as the even-runners and 10 years as the laggards can be repeated. All these are possible for the countries that are still muddling through contradictory structural reforms and burdened by the institutional vacuum. Old institutions have been already dismantled, but the new ones are not yet in place. Such hybrid system purely contributes to making the growth more complex and averts the opportunity to catch up in just fantasy. If even the geopolitical situation helps and the human capital is comparatively well, the weak essentials and unsteady political situation can discourage domestic capital formation and hinder absorption of flow of foreign savings. Thus such group can be in 2025 and 2050 as far behind the average global income as in 2000, because it will rise only by about 260 percent over the very long-term.

What countries may belong to this group, which is left for them to make a decision, as according to the logic of reasoning presented thus far none is doomed a priori for such meagre growth.

[85] Milanovic, Branko (1998). "Income, Inequality, and Poverty during the Transition from Planned to Market Economy," Washington, DC: World Bank, pp. 121-125.

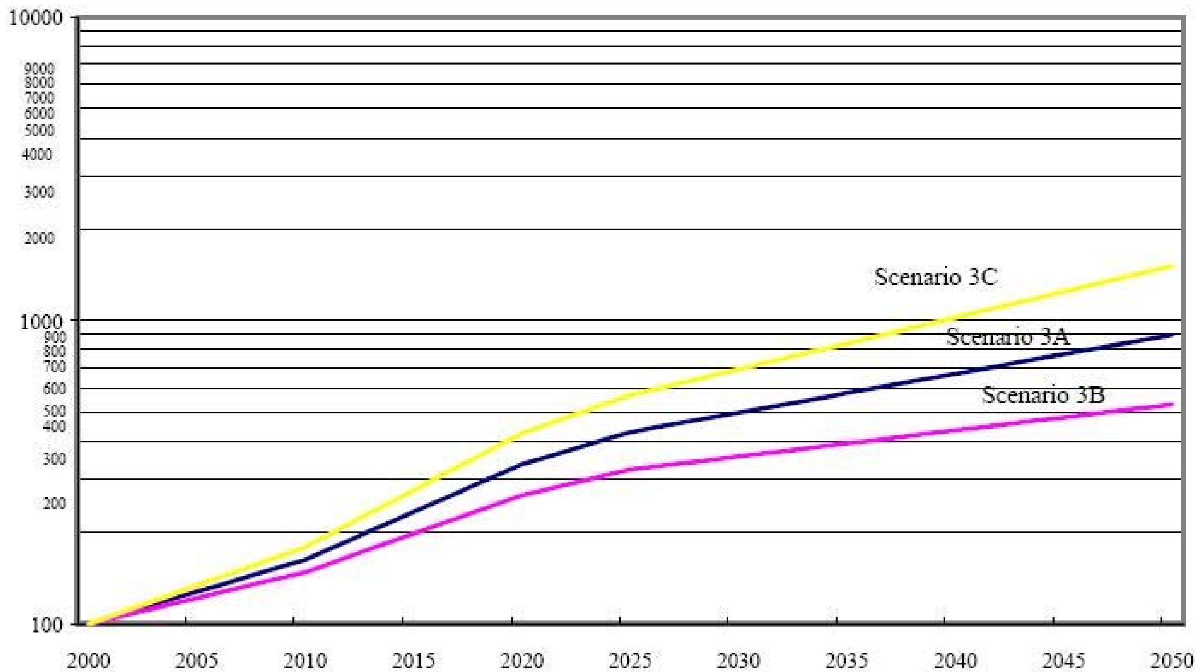
Figure 6 Alternative Growth Paths for the Very Long-Term, 2000-2050, Scenario 2A, 2B, 2C.



Source: Kolodko, Grzegorz W., "**Globalization and Catching-up: From Recession to Growth in Transition Economies**," IMF Working Paper, June 2000, p.29.

Third scenario reflects condition while over 10 years or so the average growth rate remains at five percent, whereas oscillating between four and six. That may be logical for the gainers with strong institutions and improving essentials as well as rational policy response and advanced structural reforms. For the period of following decade the growth could even jump to 7.5 percent and then cease one more time to five percent for a medium-term. After time span of one generation it will slow down to the pace of the even-runners, where it can be maintained for another 25 five years. That would be certainly enormously successful. In such case the catching-up would be complete, since at the end of the journey along such lines the income would be on the par with the standard of developed industrial countries. With fortune it may happen, possibly, for the best performers among countries joining soon the EU. It is hardly imaginable that all of them will take such path, yet the best seem to have a chance.

Figure 7 Alternative Growth Paths for the Very Long-Term, 2000-2050, Scenario 3A, 3B, 3C.

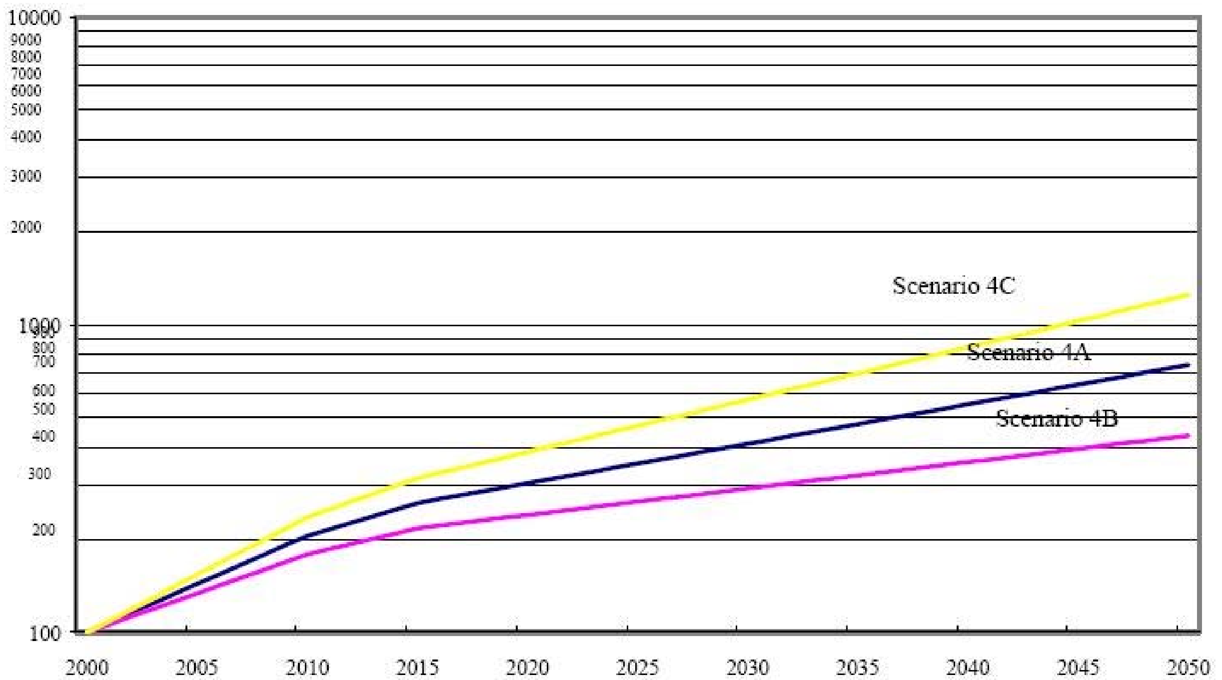


Source: Kolodko, Grzegorz W., "**Globalization and Catching-up: From Recession to Growth in Transition Economies**," IMF Working Paper, June 2000, p.29.

If so, pragmatically looking they should fit close to minimum sub scenario 3B, because the maximum one, i.e. 3A, is rather on the edge of post socialist miracle. Of course, it would help, the problem however is that the miracles do not happen neither in Eastern Asia, nor in Eastern Europe. Fourth scenario is very optimistic as well. Over sevenfold increase of real income during half century did not happen that often in the course of history.[86]

[86] Cohen Daniel (1998). "The Wealth of the World and the Poverty of Nations," Cambridge: Massachussets Institute of Technology, pp. 145-153.

Figure 8 Alternative Growth Paths for the Very Long-Term, 2000-2050, Scenario 4A, 4B, 4C.



Source: Kolodko, Grzegorz W., "**Globalization and Catching-up: From Recession to Growth in Transition Economies**," IMF Working Paper, June 2000, p.29.

In fact, it had occurred very seldom. Nevertheless, under definite conditions that may be fulfilled in the case of leading transition economies, on the one hand, and some post socialist countries that are underdeveloped, on the other. To this first group can aspire economies with strong essentials and matured institutions, say, the members of Organisation for Economic Co-operation and Development (OECD). They ought to simultaneously deal with sound policies and take firm advantage of their integration with the EU as well as attract continuously large inflow of FDI. For instance, for Hungary or Poland among the Eastern Europe emerging markets, or for Estonia within the former Soviet Union region this scenario is imaginable. Their favourable geopolitical position and quality of human capital can help too. Yet decisive is going to be the policy, particularly enhancing entrepreneurship. Open product markets, flexible labour markets, and well-developed capital markets make it easier for entrepreneurs to start new firms. This kind of 'venture privatization' and grass-root entrepreneurship has a crucial importance for sustaining high-speed

growth.[87] In the first decade of 21st century these types of economies would grow as the frontrunners having average growth rate at about 7.5 percent. In such case GDP would double over 10 years, that is two times sooner than under the first scenario. Later, when catching-up will be superior, the growth rate would decrease to five or so percent and then would fall to the EU level. But this scenario might fit also feature of another type of economies, which are starting from very low income. Even though weak institutions and unstable essentials, despite lagging structural reforms and often not the most rational policy response, they can take off towards this kind of catching-up too. That is because of coincidence of two specific factors that, at the top of many other features facilitating rapid growth, do subject for catching-up.

On one hand, the nascent consequences of transition as such, i.e. liberalization and privatization, are contributing to rapid growth in countries at extremely low point of beginning because of capital inflow and its better allocation. On the other hand, precious natural resources will attract firm FDI flow boosting for several years very strong growth. For example, Azerbaijan suits this category fine and, to a lesser extent, Tajikistan. Their rank of development obtains them greater opportunity to grow fast, since they are starting from GDP per capita, at PPP basis, at only 1,970 and 750 dollars, respectively. If only other conditions are met, mainly if there will be decisive end of regional conflicts, then they can really take off towards rapid growth. Later, these two different groups of post socialist economies, after raise their development level outstandingly over the next 15 years or so, will expand at different speed. The advanced ones should slow down to the pace of even-runners for following 35 years. Probably then they are going to be nearer to the lower limit within the band of two to four percent of annual growth. The less developed countries will be closer to the upper limit, which is to four percent, or even can match higher rate of growth feature for the gainers. In this scenario, alike in scenario two and three, the critical catching-up happens at the opening and middle years of the whole period, while closer towards its end the growth rate supposed to be essentially on the par with more advanced countries and only for the countries starting presently

[87] Lavigne, Marie (1999), **op.cit**, p. 230.

from very low level it can sustain higher. Yet it can occur that the whole process of catching-up will be unsuccessful, if structural reforms and institution building will not be performed deeply. It can fall short, if political situation switch to adverse. It may be deferred, if globalization will get off course and instead of streamlining transition will hamper it.

The factual future of post socialist economies will be much more complex than that outlined in these hypothetical scenarios. It is extremely unlikely that any country will remain the constant course for the long run. Countries may switch often from one path of growth to another. They will do so in both directions, that means up and down, depending on the changing local and global situation. Some will be not able to stay away from a danger of recession, when they will get hit by external shocks or by their own policies' excesses. Many of these changes are totally erratic at the moment. Many others will be an issue of political decisions that may be taken or may be not. That in turn will depend on the institutional aspects of development and the democracy performance. Of course, the latter is also unpredictable, especially in the nations with relatively immature democratic regime, as indeed all post socialist countries are. Whereas for some countries worldwide the future development game will be about sustaining the path of growth they have been able to take earlier, for some others the struggle will focus on getting to the path of faster move forward.[88]

The prospect of post socialist economies depends on taking a constructive path of economic growth and their capability to sustain for the longest possible time on the required route. A bulk of scenarios of further development is feasible. In the hypothetical occurrence of the extreme cases certain post socialist economy could expand for the entire period of half century as the frontrunner or can drag as a laggard. That will happen, because neither there are arguments that we should expect any country running on average at 7.5 percent until 2050, nor we ought to be that pessimistic that there will be a country growing its productivity by very low margin, say just one percent per year, if at all. It should be expected that these economies will

[88] Lucas, Robert E. (2000). "Some Macroeconomics for the 21st Century," *The Journal of Economic Perspectives*, Vol. 14, No:1, p. 160.

belong to neither of such extreme groups, but rather to the central one, that is to the gainers and the even-runners. It implies that they will manage to stay on the course of rate of growth relevant for these two groups, that is between two and six percent. However, within this very wide band one can expect that most often the growth rate will fluctuate between three and five percent.

4.1. Active Policies for Catching-Up in the 21st Century

Whereas looking into the future, it is essential to discriminate between passive scenarios and active strategies. Along what path a travel towards the future will go, it depends on many variables. Some of them are given and so we can only try to predict them more or less accurately and obviously. On the other hand, the critical mass of the growth process is contingent to selected policies and political capability to follow the lead. Once again the geopolitical position, inherited culture, quality of human capital and skilled labour, number of population and thus the scope of products and service markets, stock of natural resources, the beauty of country and its tourist attractiveness - all these given factors do matter for the growth prospect. Some of them are given forever; some can be changed only over long time and only under the conditions of growing economy. But what does matter most, which is the policy.

Without a sound one even comparative advantage given by other factors will not serve the purpose of development well. Countries with better geopolitical position, having advantage of localization nearer to the immense markets, as Estonia to Scandinavia, the Czech Republic to Germany, Bulgaria to Turkey, or even Azerbaijan to Turkey or Kyrgyzstan to China, are founding themselves in relatively superior situation to grow more rapidly. Still more do so the countries attempting at integration with the European Union. Countries that with true promise are taking care of steady institution-building, as for instance Hungary and Poland, will take advantage from this strong foundation in the years to come more than other emerging markets. Combination of these two factors, that is constructive geopolitical position in Eastern Europe and substantial progress in relation to institution-building, are

already boosting growth of the candidates for accession to the EU. These countries, even if developed relatively more, as the Czech Republic, Estonia or Slovakia, will grow more rapidly than other countries in the region. That whole group can be foreseen in the next decade or two among the gainers. Some of them, under mistaken policies or harsh external shocks, might be downgraded to the lower league. Yet before they will catch up with Western Europe - or at least with relatively less industrialized southern part of the continent - they should not remain there for too long. It means that even if from period to period they will not succeed to sustain the growth rate at about five percent annually, they can be back on such path soon afterwards. As for the countries advancing infrequently to the upper league, they will be coming from two different groups.

The first will include the true leaders of transition, which are able to unite sound development strategy with comprehensive structural reforms. These are two different, yet strongly inter-related matters. Healthy institutions brought up by the structural reforms and improving market culture are not the substitutes for good policy and logical development strategy. They are just opposite. In transition economies there is not straightforward causing relationship between structural reforms and development. At least there is an obvious message from the record of the first decade of transition, which for sure not such relation has been set in motion yet. Since this relationship does not work mechanically, it must become a candid concern of the government policy.

So far there have been only three cases of high-speed growth, which deserve to be counted as the frontrunners. On the other hand, it was that way only for a while. Estonia in 1995-1997 and Poland in 1994-1997 were growing at average rate of 6.3 percent. Slovakia was able to follow the suit at the latter period of time with 6.2 percent rate. All these three countries, as well as other working out their way to the EU, have an opportunity to repeat such accomplishments in the future. It calls for good coordination of monetary and fiscal management, well-designed industrial and trade policies, and subordination of structural reforms to pro-growth policy. The main issue is that across the region of both the former Soviet Union and Eastern

Europe the governments tend to neglect this latter aspect of long-term growth. It is so because often they are advised (and they tend to follow such guidance eagerly) that just additional reforms, mostly full liberalization and privatization, will do the job. Later, when the latter unfortunately is not done, the delay of structural reforms is blamed for 'unpredicted' underperformance. And if there is no approach to speed up those reforms still further owing to political and social constraints, than external shocks are called as an excuse for the failures in respect of growth policy. From this point of view the Russian financial crisis in 1998-2000 has come to the save to many governments in transition countries, as well as their foreign institutional and individual advisors, because it serves the rationale of a scapegoat enormously well.

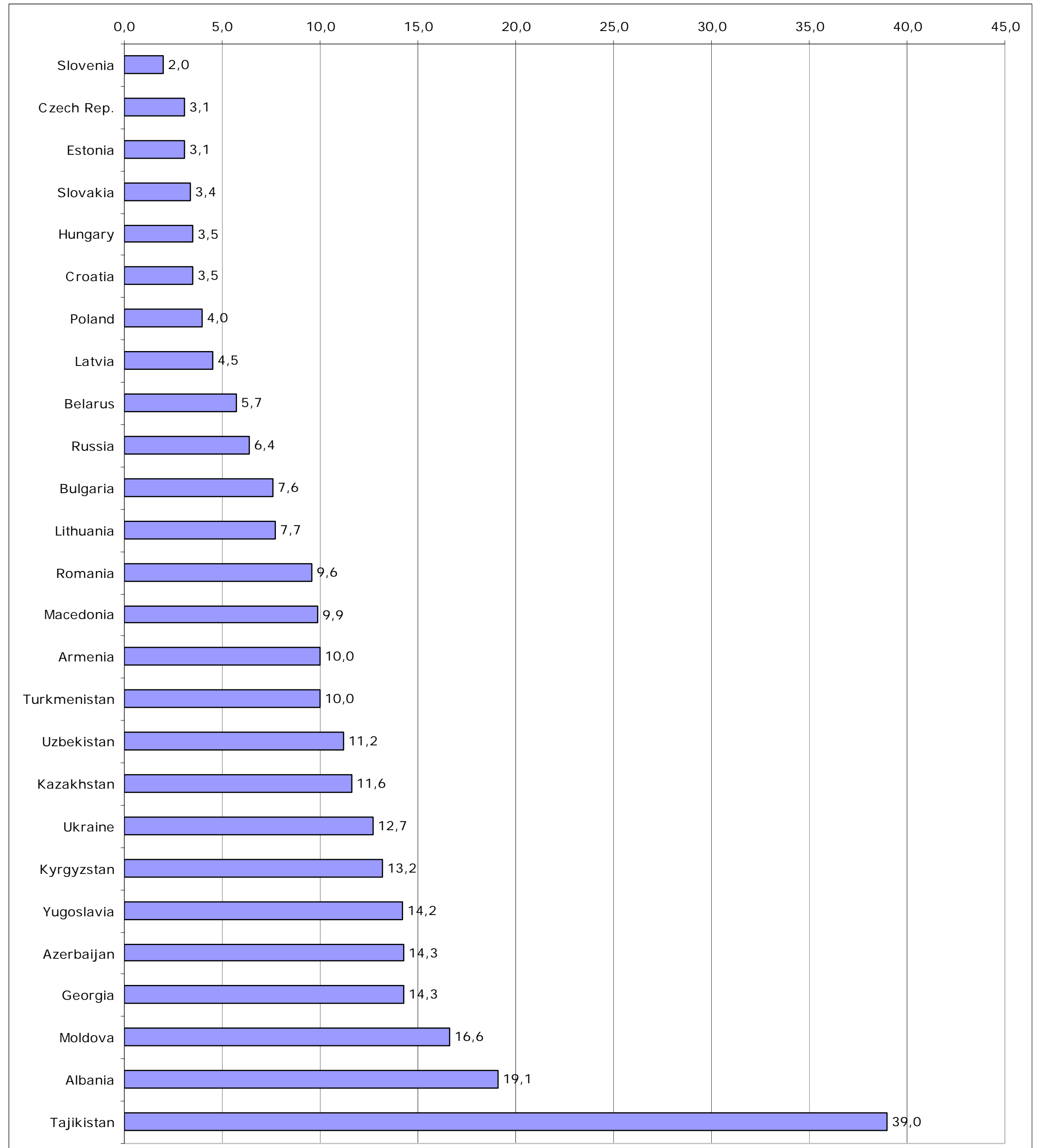
The second group advancing cyclically to the frontrunners is going to surface from the less developed post socialist economies, accurately catching-up with their more advanced neighbours. If moreover these countries will obtain good benefit of foreign support, which in some cases (e.g. in Albania and Bosnia-Herzegovina) is not insignificant, they can run forward indeed fast. It did happen incidentally during the first decade of transition, but it will happen more often over the next decades. Bosnia-Herzegovina had remarkable, soaring growth rate of over 40 percent, on average, in 1996-98, but it was due to the post-war recuperation completely financed from external sources, mostly grants. Albania in 1993-96 had the average growth rate of 9.2 percent. In Georgia in 1996-97 GDP was rising by 10.2 percent annually. Similarly in Azerbaijan soon later, in 1997-98, the average growth rate was 7.9 percent. However, all these processes became unsustainable in the face of too weak essentials, poor institutions, contradictory policies and negative external shocks. Hopefully that is going to alter again, this time to the right direction. Already, and not without good cause, for the latter three countries very high growth rates are forecasted for the early 2000s. All of them might turn into the frontrunners for some period of time.

Yet if that will occur, one more time it will not mean that rapid growth will be definite for very long. It requires that the active policies, coordinating appropriately the structural reforms with development strategy, must be carried out. For simple,

computation reason small differences in relation to growth rate become big in the very long-term. When considering next half of century only one point difference between three and four percent annual growth rates makes as much as 272 percentage points on the cumulative basis. That is enough to catch up and close quite large gap. For instance, if country like Hungary starts from existing GDP (on the market exchange basis) of about 5,500 dollars and would be able to maintain for next 50 years four percent growth rate, it would bring GDP up to as much as 39,000 dollars. That is more than today's GDP of the United States. If it would raise only by three percent over the next five decades, then in 2050 it will make 'only' about 24,000 dollars. Hardly enough to catch up with moving all the time up the EU average, because then it will firmly exceed 50,000 dollars - even if over next 50 years it would grow by a mere two percent annually.

And the higher rates of plausible growth are taken into account, the larger such difference becomes. What particular country's GDP per capita will be in the future, depends on its value at the point of departure in 2000 and the pace of growth over the next decades. Assuming that the GDP per capita, on PPP basis, in the most advanced industrial countries is approximately 30,000 dollars, how many times the present level of GDP in transition economies must raise to match it? The spectre of the multiplying factor with this regard is quite immense: from about two times in the case of the most advanced post socialist economy, that is Slovenia with GDP per capita at around 14,800 dollars, to about as many as 39 times in the case of the most underdeveloped country, that is Tajikistan with GDP per capita at about 770 dollars. While only for eight countries such ratio is not bigger than five to one, in 12 cases it is believed to be no less than 10 to one.

Figure 9 How many times the output should rise to catch up with $PPP 30,000 GDP per capita?



Source: Kolodko, Grzegorz W., "**Globalization and Catching-up: From Recession to Growth in Transition Economies**," IMF Working Paper, June 2000, p.36.

In fact, many post socialist countries are not that far behind the countries with the highest GDP per capita as the data on GDP suggest. Gross domestic product is

just a flow of present production and does not reflect other important aspects of standard of living. In transition economies there is high, on the par with the OECD countries, life expectancy.

The rate of literacy is very high; secondary school enrolment is similar as in advanced industrial societies, etc. It has important implications for the future not only because it reflects that quality of human capital and so the growth potential is relatively higher. It also shows that if growth in terms of quantity supplied can be considered as a linear process, it is not so with socioeconomic development. In future the model of development will alter, so the measures of development are going to evolve too. They will take more into account the standard of natural environment, quality of human capital, access to culture and nature, density of urban areas and other matters that are omitted in the GDP index. Some of the items that thus far are counted in it, and hence suppose to increase the standard of living, in due time can be considered as an obstacle to this end. Therefore, the catching-up may take a shorter time than it can be seen through the prism of catching-up with the level of productivity. It would be more rational for the point of catching-up to maintain stable yet relatively high growth rate for the very long period of time, than to endeavour at its maximization over certain time, which comes to its limits sooner than expected. In such case, owing to involved risks and likeliness that the economy may get out of balance and as a result slow down, even if only for a couple of years, the consequence may be less remarkable. In other words, it is better strategy to be the gainer all the time than to be for a while the frontrunner, but at the price that later one becomes even-runner, if not yet the laggard.

As the consequence of all these conditions, particular post socialist countries can catch up with the level of production of the developed world in very different years. Of course, the latter countries are the growing economies too, so actually the catching-up must be seen as a running towards target moving forward. Yet just to get only to the current level of production of the world leaders would be quite an achievement. In what year it might happen? It depends on a path of growth: is one

going to be more like a frontrunner or rather like an even-runner? The laggards, of course, do not count.

Table 22 The Year of Catching-up with the Developed Countries

Countries	GDP per capita in 2000 (in 1995 $PPP)	The year of catcihng-up with the GDP per capita of 30,000 $PPP		
		Frontrunners	Gainer	Even-runner
Albania	1,569	2041	2060	2100
Armenia	3,009	2032	2047	2078
Azerbaijan	2,101	2037	2055	2090
Belarus	5,238	2024	2036	2059
Bulgaria	3,930	2028	2042	2069
Croatia	8,484	2017	2026	2042
Czech Rep.	9,699	2016	2023	2038
Estonia	9,606	2016	2023	2038
Macedonia	3,017	2032	2047	2077
Georgia	2,099	2037	2055	2090
Hungary	8,525	2017	2026	2042
Kazakhstan	2,576	2034	2050	2083
Kyrgyzstan	2,279	2036	2053	2087
Latvia	6,681	2021	2031	2051
Lithuania	3,872	2028	2042	2069
Moldova	1,805	2039	2058	2095
Poland	7,575	2019	2028	2047
Romania	3,124	2031	2046	2076
Russia	4,654	2026	2038	2063
Slovakia	8,707	2017	2025	2041
Slovenia	14,802	2010	2014	2024
Tajikistan	770	2051	2075	2124
Turkmenistan	3,004	2032	2047	2078
Ukraine	2,357	2035	2052	2086
Uzbekistan	2,681	2034	2048	2082
Yugoslavia	2,108	2037	2055	2090

Source: PlanEcon, "**Review and Outlook for the Former Soviet Republics**," Washington, D.C.: PlanEcon, Inc., 1999.

All these paths show how long is the distance to be triumph over the sake of catching-up and closing the development gap. This gap had risen not only during the

times gone by long ago, but unfortunately deepened even more during just the last decade of the last century. It might happen that in certain cases not a half, but some centuries will be needed to liquidate it utterly. If at all, because the catching-up of transition economies with advanced industrial countries does not mean that it is an essential. It is only an alternative and possibility, which can be taken or can be lost - as it happened so many times in the history of mankind. The post socialist countries ought to try to find their path of growth that will enable them to advance in the catching-up process as much as feasible. Only this will make sense of the whole transition and can turn it in its ultimate success. Such success is contingent on patience, good policies and years of hard work.

4.2. When Will the Transition Be Over?

Because transition is a process, it is natural to ask when it is possible to be completed. The answer depends on how one defines the terminal point. A number of analysts are on record on this issue and their definitions differ considerably. Janos Kornai views the end of transition as a condition in which the socialist parties have lost monopoly political power, the private sector accounts for the majority of GDP, and the market is the dominant coordinator of economic activities.[89] According to this rational definition, rooted in a fundamental shift in political power and a radical structural change in the economy, the transition is in most countries over; and has been so for the last five years. From a different point of view, Alan Gelb sees the end of transition as a position when the issues and the policy matters confronted by today's "transition countries" resemble those faced by other countries at similar levels of growth.[90] This definition relies on notions of economic improvement and also makes good sense. Based on this definition, one may also argue that the transition is over. But whatever the logic of this opinion, most citizens of the transition countries do not feel that they have reached the transition. This is because most have been completely equating the transition with a process that will make them partners with

---

[89] Kornai, Janos. (1999). “Reforming the Welfare State in Postsocialist Economies,” Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, pp. 130-132.
[90] Gelb, Alan. (1999). “The End of Transition?,” Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, pp. 34-37.

the relatively advanced countries in the world in general and with Western Europe in particular. Taking this aspect into account, the end of transition may be defined as a state when these economies replace central planning by a functioning market system and when they generate fast and sustainable rates of economic growth that enable them to interact with the more advanced market economies without foremost forms of protection. Czech Republic, Estonia, Poland, Hungary, Slovenia, and possibly Slovakia will presumably reach this stage in a few years when they fully enter the European Union. Others have a much longer way to go.

CONCLUSION

The Eastern Europe and Baltics, wanting to join European Union and encouraged by it, first intiated political change which in turn led to reforms. Most FSU countries, not fully knowing whom to align themselves with initially saw no other country other than Russian Federation, which in turn heavily influenced their reforms. Growth starts about two full years after stabilization although the FSU took about a year longer. Longer term prospects seem more favourable for the Eastern Europe and the Baltics in the short to medium term.

Reforms in transition economies were successful in reducing inflation and restoring growth. The Eastern European countries rapidly moved with reforms while Former Soviet Union countries were in general, late in developing reform programs and implementing them. The most significant difference was the political change. On the other hand, discontent with the Union were not as strong as in the Eastern European countries and there were explicit demands for independence.

When the FSU collapsed, this did not lead to a political change in most FSU states. Given this, the former communists hoped that the CIS would evolve into a loose federation so that trade and financial links would not disappear.

The economic performance of the former Soviet bloc economies during the first twelve years of the transition has been deficient. Whereas many significant structural transformations have taken place, the relative gap in per capita income between these countries and the advanced economies has widened. A foremost issue for the transition economies was obviously the preliminary recession that set them back relative to the advanced economies. In Russia, Ukraine and other CIS countries, this depression lasted almost a decade. Transition countries further east have on average performed worse than their more western counterparts, which suggests that geography-related initial conditions have been significant in the transition process. The Central European countries, located most to the west among the transition

economies, have historically shared the same alphabet and religions, had similar educational and bureaucratic systems, and intensively traded and otherwise interacted with countries in Western Europe. They, together with the Balkan countries, were under the Soviet system for only four decades, as compared to five decades in the case of the Baltic countries and seven decades in the countries of the Commonwealth of Independent States.

Ultimately, the countries of Central Europe were the first to aspire and be encouraged to prepare for entry to the European Union. The physical closeness and historical belongingness to Europe thus seems to have provided a significant advantage for the "western" transition economies in moving from the socialist system to a democratic and market-oriented system. Though, the fact that the western- most transition economy, Czech Republic, has performed worse than others since the mid 1990s indicates that geography does not provide a complete explanation and that policies do matter. Interestingly, the original conditions had little impact on whether the countries carried out Type I reforms (macroeconomic stabilization, price liberalization, break-ups of trusts, reduction of direct subsidies, carrying out small-scale privatization, state-owned enterprises and the monobank system, removal of barriers to the creation of new firms, and introduction of a social safety net) which all transition economies carried out rapidly.

On the other hand, they did affect Type II reforms: large-scale privatization, further (in depth) development of a commercial banking sector and effective tax system, labour market regulations and institutions related to the social safety net, and establishment and enforcement of a market-oriented legal system and accompanying institutions. The reform of greatest significance seems to be that countries that placed emphasis on the improvement of a functioning legal framework and corporate governance of firms, like Hungary, Poland and Slovenia, have performed better than those that did not, like the Czech Republic, Russia and Ukraine. On a related note, evidence suggests that large scale privatization can be handled in a variety of ways, or even delayed, as long as the state-owned firms face the discipline of needing to

earn their way without government bailouts and as long as new firms appear through new creation, break-ups of old firms, and foreign investment.

It is time to ask one more essential question: are all these analyses and inferences acceptable, and particularly are the predictions rational, if they happened to be mistaken so many times in the recent post socialist past? The answer consists of three parts. First, there were many forecasts and warnings that precisely were pointing to the risks and to the future unpleasant occurrences, yet they were not taken adequately into account by the policymakers, including international organizations. Second, theoretical assumptions that the transition countries can become rapid growing economies are right; however the conditions for such take off were not fulfilled earlier, also due to the policy failures. And third, now there is a time to suppose reasonably that such conditions can be met, so the growth can increase speed. Yet there are the risks and there are the differences.

One difference between then and now is that now we assume to know much better than then what works in post socialist economies and why, and what does not work and why. Even though there remain the risk that the incorrect assumption suggesting that unleashed market forces will itself do the development job can still take over, we already should know that they will not. For this basis the governments' sound development strategies and sensible involvement of the international community, including official and non-government organizations, have to support the market forces. A second difference between then and now is that at the onset of new century all transition economies are already growing. So the question is not any more how to stop recession and depression, but how to speed up the growth rate and carry on it at the highest probable stage for the longest possible period. All the time there is a challenge how to do it within the framework of specific institutional and political environment of nascent post socialist market and democracy. A negligence of this specificity creates the second risk.

Policies exercised during the first decade of transition to large extent have been derived from so-called Washington consensus; nonetheless this set of structural

reforms was designed for another challenge. Yet while applied towards post socialist economies, these policies have greatly influenced the direction of systemic reforms and the course of changes. However, the transition has also had a significant counter-impact. The policies have not generated the anticipated results, and this has led to a search for alternative measures. As the post socialist markets have emerged, so have fresh issues, problems, and concerns. The reactions to these have differed, and new approaches have been evolved. Following a number of policy options and conclusions formulated so far, another ten major policy conclusions must be put forward here. First, institutional arrangements are the most significant factor in the accomplishment of rapid and sustained growth. They should be established throughout a process directed by government rather than spontaneously.

In those nations in which government has been committed to this approach, recovery has come earlier, growth has been healthier, and there are more forecasts for sustainable development. Those countries in which government has relied on the spontaneous appearance of new institutions have not been able to supervise this complicated process sufficiently and are lagging behind both in respect of systemic transition and the growth of the real economy. Institution building must be a gradual process. The effects of specific inputs in this process must be regularly monitored, and policies must be constantly corrected and adjusted. One should not depend on the experiences in distorted market economies, but should understand the special character of the emerging post socialist markets. This is especially true in privatization and the development of capital markets.

Second, the size of government is less important than the quality of government policies and the manner in which the changes are implemented. In transition economies an insightful restructuring of the public finance system is more significant than is the downsizing government. Fiscal transfers should be redirected from non-competitive sectors towards institution-building (including behavioural and cultural reforms) and investments in solid infrastructure and human capital. Attempts to scale down government through spending cuts can do more harms than good in terms of recovery from transitional recession and the achievement of continuous and

rapid growth. Even if one believes that undersized government is better than full-size government, to downsize may lead to economic narrowing and worsening in standards of living. Expenditures should not be cut for the sake of the fantasy of fiscal prudence, but should be restructured.

Third, if institutional arrangements are neglected and left to natural processes and liberalized market forces, then there will be a systemic vacuum and 'informal institutionalization' will happen. Organized crime and spreading corruption are significant examples of informal institutionalization. These are the two principal diseases in countries in which liberalization and privatization have taken place under feeble government. Governments may sometimes be too weak because they are too big, but in transition economies they are often too weak because they have been downsized too soon, before the emerging market and the NGOs were able to take over relevant functions of the state. Even if the purpose of the downsizing is to decrease the scale of fiscal redistribution so as to support capital formation and hence investment and growth, one must not ignore the fact that the fight against informal institutions is also costly in fiscal terms. A prematurely or too thoroughly downsized government may not be strong enough to guide in this fight, and the market may swiftly expand within the informal sector, while the difficulties are increasing in the official economy. Thus, profits accumulate to the informal sector, while revenues drop in the official sector. Profits are thereby 'privatized', while loses are 'socialized' in a politically unsustainable process full of negative consequences for the budget and for social policy.

Fourth, in transition economies policies must plan transforming and streamlining the legal system so that it can serve the market economy. The organization and development of new laws - trade and tax codes, banking supervision, capital market regulations, consumer protection, the protection of property rights, antitrust regulations, and environmental protection - are tremendously significant and must be addressed before state assets are fully privatized. The establishment of a legal framework, which is suitable for the market economy, ought to be higher on the agenda of international financial organizations. It

has to be a more crucial concern than trade liberalization and assets privatization, since these latter can contribute to sound growth only if the former has been assured.

Fifth, alter in functions from the central government to local governments is required for deregulation in the post socialist economy. That means that some decentralization must be undertaken in the public finance system and that local governments must be given more fiscal autonomy. The process of taking functions away from the central government must be harmonized by reinforcing local governments. Both levels of government must be seen as two parts of a single entity, which is indispensable for gradual institution-building. If local governments are not empowered as the central government is reduced, then healthy market forces cannot be supported by new institutional arrangements, and liberalization and privatization are less likely to develop capital allocation and elevate efficiency.

Sixth, the development of non-governmental organizations must be accelerated. More important international technical and financial assistance must be channelled into the effort to strengthened non-governmental organizations. Along with the private sector and the state, these organizations are an essential third pillar of the current market economy and society. A broad range of non-governmental organizations active in a variety of areas of public life is needed to ease the steady tension between the state and society. The growing private sector alone cannot sufficiently fill this gap. Definite areas of public life can rely neither on the state, nor on the business oriented private sector. Without the institutional infrastructure supplied by non-governmental organizations, successful systemic change and premium growth become more problematic, the infant market economy and democracy in post socialist nations cannot evolve correctly, and the transition will remain imperfect.

Seventh, income policy and fair growth are very important for the growth sustainability and thus the eventual accomplishment of the transition. Because mounting inequity is inevitable during the initial years of transition, the state has to play an active role in managing income dispersion through fiscal and social policies.

Beyond a certain limit, income disparities inhibit the expansion of economic activity, postpone recovery, and slow down economic growth. Substantial inequities hamper key institutional and structural reform.

Eighth, the post socialist transition to the market is taking place in a perspective of worldwide globalization. Thus integration with the world economy is an obligatory part of the process. This must be supervised cautiously. Extraordinary attention must be paid to short-term capital liberalization, which must be monitored and controlled by fiscal and monetary authorities and supported by international financial institutions. It is better to liberalize capital markets later rather than sooner. Institution-building must first be adequately advanced, and stabilization ought already to be consolidated into stability. Only then should financial markets be liberalized in a gradual manner. Or else the populations in the immature and emerging democracies will not back the introduction of market mechanisms or integration with the world economy and may even become antagonistic to these steps.

Ninth, international organizations should not only carry globalization, but must encourage regional integration and cooperation. Rapid and sustained growth needs export expansion, which depends on powerful regional linkages. In turn, this calls for institutional support through import-export banks, commodity exchanges, credit insurance agencies, and so on. This should be the major focus of the institution-building effort of The European Bank for Reconstruction and Development (EBRD) through its direct lending and technical assistance. This sort of market infrastructure is now underdeveloped in transition economies and regional trade and direct cross-country investment are lagging behind in the process of changes. What should be a driving force behind durable growth is actually now a key obstacle.

Tenth, the Bretton Woods institutions must review their policy approach towards transition economies. While the IMF should underline currency convertibility, financial liquidity, and fiscal and monetary stabilization, the World

Bank should focus primarily on supporting equitable growth and sustainable development. These two areas of economic policy are commonly at odds. There is a trend to confuse the means and the ends of policy, to favour short-term stabilization over long-term growth and development. Decision makers should not rely only on stabilization policies, but should search for an appropriate balance between stabilization policies and medium and long term development strategies.

Fiscal and monetary policies must be subordinated to development policy - not the other way around. The World Bank performance criteria for socioeconomic development are required as much as are the IMF fiscal and monetary criteria. There should always be an eye on the impact of financial policies in terms of growth, income distribution, capital allocation, and the social safety net. As conditions change and challenges appear, policies must be revised in the future too. As a result, the quest for a possible and comprehensive policy consensus, which facilitates sustained and rapid growth, ought to be ongoing. Such possibility must not be missing.

REFERENCES

Atkeson, A. and P.J. Kehoe (1995). "Social Insurance and Transition," *International Economic Review*, Vol. 37, pp. 377-402.

Barro, Robert J. (1991). "Economic Growth in a Cross Section of Countries," Quarterly Journal of Economics," Vol. 6, May, pp. 407-443.

Basu, Swati, Saul Estrin and Jan Svejnar (2000). "Employment and Wages in Enterprises under Communism and in Transition: Evidence from Central Europe and Russia," The William Davidson Institute Working Papers, No.114b, p. 5.

Bauer, Tamas (1978). "Investment Cycles in Planned Economies," *Acta Economica*, xxi, pp. 243-260.

Bevan, Alan, Saul Estrin and Mark Schaffer (1999). "Determinants of Enterprise Performance during Transition," Centre for Economic Reform and Transformation (CERT) Working Paper 99/03, pp. 20-26.

Bhaduri, A., K. Kaski and F. Levcik (1993). "Transition from the Command to the Market System: What Went Wrong and What to do for Now?," *Vienna Institute for Comparative Economic Studies*, pp. 9-11.

Blejer, Mario I., and Marko Skreb (eds.) (2000). "Transition. The First Decade," MIT Press, Cambridge, pp. 153-174.

Boeri, Tito (2000). "Structural Change, Welfare Systems and Labor Allocation," Oxford: Oxford University Press, p. 7.

Borensztein, Eduardo, and Peter J. Montiel (1991). "Savings, Investment, and Growth in Eastern Europe," in George H. Winckler (ed.), Central and Eastern Europe Roads to Growth, Washington, DC: International Monetary Fund and Austrian National Bank, pp. 153-187.

Brada, Josef C., Arthur E. King and Ali M. Kutan (2000). "Inflation bias and productivity shocks in transition economies: The case of the Czech Republic," Economic Systems, 24(2), pp. 119-138.

Bruno, Michael and William Easterly (1995). "Inflation Crises and Long-Run Growth," NBER Working Paper No. 5209, Vol. 41, No:1, pp. 7-9.

Calvo, Guilermo A. and Fabrizio Coricelli (1992). "Capital Market Imperfections and Output Response in Previously Centrally Planned Economies," in Caprio G., Folkerts-Landau D. and Lane T. (Eds.) Building Sound Finance in Emerging Market Economies, Washington, D.C., IMF, pp. 13-15.

Cohen Daniel (1998). "The Wealth of the World and the Poverty of Nations," Cambridge: Massachussets Institute of Technology, pp. 145-153.

Commander, Simon, Andrei Tolstopiatenko and Ruslan Yemtsov (1999). "Channels of redistribution: Inequality and poverty in the Russian transition," *The Economics of Transition*, Vol. 7, No: 1, pp. 411-465.

Denizer, Cevdet (1997). "Stabilization, Adjustment and Growth Prospects in Transition Economies," *World Bank Policy Research Working Paper No: 1855*, pp. 5-14.

Desai, Padma and Todd Idson (2000). "Work without Wages: Russia's Nonpayment Crisis," Cambridge, MA: MIT Press; pp. 467-469.

Easterly, William (1995). “When Is Stabilization Expansionary?,” Working Paper, Policy Research Department, World Bank, Washington, D.C., pp. 7-8.

EBRD (1996). “Transition Report,” London: European Bank for Reconstruction and Development.

EBRD (2000). Transition Report, London: European Bank for Reconstruction and Development, pp. 8-9.

Filer, Randall K. and Jan Hanousek (2000). “Output changes and inflationary bias in transition,” Economic Systems, 24(3), pp. 285-294.

Fischer, Stanley (1998). “Opening Remarks,” Presented to the conference on Economic Policy and Equity, Washington, D.C.: The International Monetary Fund pp. 7-9.

Fischer, Stanley and Alan Gelb (1991). “The Process of Economic Transformation,” *Journal of Economic Perspectives*, Vol. 5, No: 1, pp. 14-16.

Fischer, Stanley, Ratna Sahay and Carlos Vegh (1996). “Stabilization and Growth in Transition Economies; The Early Experience,” *Journal of Economic Perspectives*, 10(2), pp. 39-66.

Fry, Maxwell (1993). “The Fiscal Abuse of Central Banks,” *IMF Working Paper 93/58*, Washington DC.: International Monetary Fund, p. 23.

Garner, Thesia and Katherine Terrell (1998). “A Gini Decompositon Analysis of Inequality in the Czech and Slovak Republics During the Transition,” *The Economics of Transition*, Vol. 6, No. 1, pp. 23-46.

Gelb, Alan. (1999). “The End of Transition?,” Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, pp. 34-37.

Gomulka, Stanislaw (1990). “Stabilization and Growth: Poland 1989-2000,” Financial Policy - Disequilibrium - Stabilization (II), Warsaw: Research Institute of Finance, pp. 303-321.

Gupta, Nandini, John Ham and Jan Svejnar (2000). “Priorities and Sequencing in Privatization: Theory and Evidence from the Czech Republic,” Working Paper No. 323, The William Davidson Institute, revised September 2001, pp. 8-12.

Ham, John, Jan Svejnar and Katherine Terrell (1998). “Unemployment and the Social Safety Net During Transitions to a Market Economy: Evidence from the Czech and Slovak Republics,” *American Economic Review*, Vol. 88, No. 5, pp. 1117-1142.

Hausner, Jerzy (1997). “The Political Economy of the Socialism's Transformation,” Conference paper, UNU/WIDER Project Meeting: Transition Strategies, Alternatives and Outcomes, Helsinki.

IMF (1991). “World Economic Outlook,” Washington, D.C.: International Monetary Fund, p. 45.

IMF (1996). “Partnership for Sustainable Global Growth, Interim Committee Declaration,” Washington, D.C.: International Monetary Fund.

Jurajda, Stepan and Katherine Terrell (2001). “Optimal Speed of Transition: Micro Evidence from the Czech Republic and Estonia,” Working Paper No. 355, William Davidson Institute, p. 9.

Kolodko, Grzegorz W. (1992). “From Output Collapse to Sustainable Growth in Transition Economies: The Fiscal Implications,” Washington, DC: International Monetary Fund, p.13.

Kolodko, Grzegorz W. (1997). "Ten Years of Postsocialist Transition: the Lessons for Policy Reforms," *The World Bank Policy Research Working Paper*, No. 2095, pp. 2-11.

Kolodko, Grzegorz W. (1999). "Fiscal Policy and Capital Formation in Transition Economies," EMERGO, *Journal of Transforming Economies and S*ocieties, Vol. 6, No. 3 (Summer), pp. 33-62.

Kolodko, Grzegorz W. (2000). "Globalization and Catching-up: From Recession to Growth in Transition Economies," *IMF Working Paper*, p. 9.

Kolodko, Grzegorz W. and Walter W. McMahon (1997). "Stagflation and Shortageflation: A Comparative Approach," *Kyklos*, xl, 2, pp. 176-197.

Kornai, Janos (1986). "The Hungarian Reform Process: Visions, Hopes, and Reality," *Journal of Economic Literature*, Vol. 24, No: 4, pp. 687-737.

Kornai, Janos. (1999). "Reforming the Welfare State in Postsocialist Economies," Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, pp. 130-132.

Kozminski, Andrzej K. (1993). "Catching Up? Organizational and Management Change in The Ex-Socialist Block," Albany, N.Y.: State University of New York Press, pp. 23-25.

Lavigne, Marie (1999). *The Economics of Transition: From Socialist Economy to Market Economy*, (second edition), Chatham, Kent: Macmillan, pp. 229-230.

Li, Wei (1999). "A Tale of Two Reforms," *RAND Journal of Economics*, Vol. 30 (1), pp. 120-136.

Lizal, Lubomir and Jan Svejnar (2002). "Investment, Credit Rationing and the Soft Budget Constraint: Evidence from Czech Panel Data," *The Review of Economics and Statistics*, Vol. 184, pp. 360-363.

Lizal, Lubomir, Miroslav Singer and Jan Svejnar (2001). "Enterprise Break-ups and Performance During the Transition From Plan to Market," *The Review of Economics and Statistics*, Vol. 83 (1), pp. 92-99.

Lucas, Robert E. (2000). "Some Macroeconomics for the 21st Century," *The Journal of Economic Perspectives*, Vol. 14, No:1, p. 160.

Megginson, William and Jeffrey Netter (2001). "From State to Market: A Survey of Empirical Studies on Privatization," *Journal of Economic Literature*, Vol. 39, No. 2, pp. 1-3.

Milanovic, Branko (1998). "Income, Inequality, and Poverty during the Transition from Planned to Market Economy," Washington, DC: World Bank, pp. 121-125.

Montes, Manuel, and Vladimir Popov (1999). "The Asian Crisis Turns Global," Singapore: Institute of Southeast Asian Studies, p. 14.

Mundell, Robert A. (1997). *The Great Contractions in Transition Economies*, in Blejer, Mario I. and Marko Skreb (eds.), Macroeconomic Stabilization in Transition Economies, London: Cambridge University Press, pp. 73-99.

Murrell, Peter (1996). "How Far Has the Transition Progressed?," *The Journal of Economic Perspectives*, Vol. 10, No: 2, pp. 25-44.

North, Douglass C. (1997). "The Contribution of the New Institutional Economics to an Understanding of the Transition Problem," WIDER Annual Lectures 1, Helsinki: United Nations University World Institute for Development Economics Research, pp. 2-9.

Nuti, Domenico M. (1992). "Lessons from Stabilization and Reform in Central Eastern Europe," CEC Working Papers, 92, Brussels: Council of the European Community (May), p. 23.

Nuti, Mario (1996). "Exchange Rate and Monetary Policy in Poland 1994-96, or the Case for Privitising the National Bank of Poland," Conference paper, Helsinki: UNU/WIDER Project Meeting: Transition Strategies, Alternatives and Outcomes, p. 9.

Poznanski, Kazimierz (1996). *Poland's Protracted Transition: Institutional Change and Economic Growth*, Cambridge, UK: Cambridge University Press.

Poznanski, Kazimierz (1997). "Comparative Transition Theory: Recession and Recovery in Post-Communist Economies," Conference paper presented at "Transition Strategies, Alternatives, and Outcomes", Helsinki: UNU/WIDER.

Public Opinion Research Center (1999). "Was it Worthwhile? The Czechs, Hungarians and Poles on the Changes of the Last Decade," Warsaw, Poland, p. 2.

Sabirianova, Klara (2000). "The Great Human Capital Reallocation: An Empirical Analysis of Occupational Mobility in Transitional Russia," Working Paper No. 309, The William Davidson Institute, p. 47.

Sachs, Jeffrey, Clifford Zinnes and Yair Eilat (2001). "The Gains from Privatization in Transition Economies: Is Change of Ownership Enough?," CAER II Discussion Paper 63, Harvard Institute for International Development, Cambridge, MA, IMF Staff Papers, Vol. 48, p. 147.

Shirley, Mary and Patrick Walsh (2000). "Public versus Private Ownership: The Current State of the Debate," The World Bank, Washington, DC., pp. 10-11.

Soros, George (1997). “The Capitalist Threat,” *The Atlantic Monthly*, Vol.279, No:2, p. 47.

Stern, Nicholas and Joseph E. Stiglitz (1997). “A framework for a development strategy in a market economy: objectives, scope, institutions and instruments,” EBRD Working paper 20, London: European Bank for Reconstruction and Development, p. 19-20.

Stiglitz, Joseph E. (1998). “More Instruments and Broader Goals: Moving towards the Post-Washington Consensus,” WIDER Annual Lectures, 2, Helsinki: UNU/WIDER, pp. 3-9.

Stiglitz, Joseph E. (1998). “Economic Science, Economic Policy, and Economic Advice,” Conference paper, Annual Bank Conference on Development Economics on Knowledge for Development, Washington D.C.: The World Bank, April 20 and 21, pp. 57-58.

Summers, Lawrence (1992). “The Next Decade in Central and Eastern Europe,” in Christopher Clague and Gordon C. Rausser (eds.), The Emergence of Market Economies in Eastern Europe, Cambridge, Ma. and Oxford, UK: Blackwell, pp. 25-34.

Svejnar, Jan (1996). “Pensions in the Former Soviet Bloc: Problems and Solutions,” in Council on Foreign Relations, The Coming Global Pension Crisis, New York, pp. 33-35.

Svejnar, Jan (2002). “Transition Economies: Performances and Challenges,” *Journal of Economic Perspectives*, Vol.16, No.1, p.3.

Tanzi, Vito and George Tsiboures (2000). “Fiscal Reform over Ten Years of Transition,” IMF Working Paper WP/00/113, pp. 17-18.

Williamson, John (1990). “What Washington Means by Policy Reform,” In John Williamson, editor, Latin American Adjustment: How Much Has Happened? Washington, D.C.: Institute for International Economics, pp. 33-34.

Williamson, John (1997). “The Washington Consensus Revisited,” In Louis Emmerij (ed.), Economic and Social Development into the XXI Century. Washington, DC: Inter-American Development Bank, pp. 56-61.

World Bank (1994). “Averting the Old Age Crisis,” New York: Oxford University Press, p. 14.

World Bank (1996). *World Development Report 1996; From Plan to Market*, World Bank Publication, pp. 12-15.

World Bank (1997). “Global Economic Prospects and the Developing Countries,” Washington, DC: World Bank, p. 14.