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The Former Soviet Union after Dis-integration and Transition

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THE FORMER SOVIET UNION AFTER DIS-INTEGRATION AND TRANSITION[1]

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1. Introduction

On 29 December 1922 the representatives of the Russian, Transcaucasian, Ukrainian SFSRs and the Byelorussian (as it was called then) SSR signed the *Treaty of Creation of the USSR* and the accompanying *Declaration*. The two documents were promptly ratified by the 1-st Congress of Soviets of the USSR on 30 December 1922; the Soviet Constitution legitimized the Union further in 1924 . On 1 February 1924 the Union was recognized by the British Empire.

By that time the political system of the Union was already consolidated as a one-Party system, complete with the 1921 prohibition on the formation of factions, the assertion of the "leading role" of the Party and so-called "democratic centralism", in theory the central execution of democratic decisions, in practice totalitarian rule. The party is omnipresent at all levels of the state, economy and society, duplicating and dominating all command structures. Paradoxically, the *Soviets* (Councils) that had christened the Union soon lost their importance almost entirely: Soviet became an adjective simply designating citizenship, as in "German" or "French".

What came to be known as the Soviet-type economic system, instead, took shape later, in the years 1928-1932, with the almost complete dominance of state ownership and enterprise; state monopoly of foreign trade and an inconvertible currency; obligatory central planning, both in physical and financial terms. There were two separate monetary circuits of cash and bank money, respectively for the payment of wages and purchase of consumption goods, and for payments among enterprises, within a monolithic banking system (the Central Bank acting as a *Monobank*), presiding over endemic, permanent repressed inflation. Central administration was partitioned into sectoral Ministries; the principle of one-man management applied to state enterprises; a system of rewards was based on fulfilment and over-fulfilment of physical targets. Trades Unions were supposed to be the "transmission belts" of the will of the Party; full, indeed over-full, employment of labour was achieved simply as a by-product of excess demand (and low productivity of labour).

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From 1922-1940 the USSR went through several enlargements, that raised membership to 15 republics (16 with the addition of the Kareli-Finnish SSR, disbanded in 1956).

After Stalin's death in 1953 there were several, repeated attempts at system reform, both in the Soviet Union and in the countries that had adopted its system after the Second World War (including the Yugoslav "associationist" model, see Uvalic 1992). In the USSR, neither the political nor the economic system were significantly altered until Mikhail Sergieyevich Gorbachev became General Secretary of the Communist Party of the Soviet Union (11 March 1985-24 August 1991; he also became the first and only President of the USSR on 15 March 1990).[3] Gorbachev launched his ambitious projects of *demokratizatsiya, perestroika*, *glasnost'*, *uskorenie* [acceleration], all of which failed leading to his resignation on 25 December 1991. By that time the Central-Eastern European member-states of the socialist bloc had already began their transition from the Soviet-type political and economic model towards pluralist democracy, private ownership and enterprise, and participation in international and national markets. Their transition had began with the Polish elections of 4 June 1989, when the communist government coalition was resoundingly defeated; the fall of the Berlin Wall on 9 November 1989, and the subsequent rapid domino effect throughout the area.

On 9 December 1991, at the hunting lodge of Viskulia-Belovezha near Minsk, the Presidents of Russia, Ukraine and Belarus (respectively Boris Yeltsin, Leonid Kravchuk and Stanislav Shuskievich) decided the dissolution of the Soviet Union, informing the US President by telephone and President Gorbachev by fax. At a meeting in Alma Ata on 21-22 December 1991, the Presidents of 11 Soviet Republics confirmed the dissolution of the USSR and its replacement with a looser Commonwealth of Independent States (CIS, excluding the three Baltics and initially Georgia). The Warsaw Pact military alliance (set up in 1955) had already been dissolved in July 1991. The socialist trading bloc Comecon (Council for Mutual Economic Assistance, founded in 1949) also had been formally dissolved in September 1991 – thus ending the 'transferable rouble' area – but practically Comecon had ceased to function in early 1990, when its European members rejected planned economic integration even at the cost of losing access to cheap Russian oil.

Russia began its own stabilization plan on 2 January 1992, liberalizing prices, the exchange rate and foreign trade, forcing the pace of change in the other republics of the Former Soviet Union (FSU), By June 1992 the Russian Central Bank – that had already cut off the supply of cash

[3] On the Soviet type system and failed attempts at improvements and radical reforms, see Nuti (1988). For an overview of post-socialist transition see Lavigne 1999 and the critical discussion of actual policies and alternatives by Kolodko 2000. Recent up-dates include: Kornai (2005), Svejnar (2006), Nuti (2007).

roubles to all other republics, thus forcing them to issue first their own rouble substitutes – cut off also the supply of bank roubles: the rouble area disintegrated into 15 separate currencies. The Russian Federation became the successor state of the USSR.

2. System collapse: economic causes and predictions

In many respects the Soviet Union was an *above normal* developing country. It achieved rapid industrialization and urbanization, victory in War, won the race to put a man into space, had some 20 Nobel Prize winners, universal free health care and education, low income inequalities and relatively low crime and corruption. "By 1965 Soviet life expectancy had increased to 70 years – only 2 years less that in the US even though per capita income was only 20-25% of the US level." (Popov 2009).

At the same time, in many other respects the Soviet Union was a *sub-normal* country. First, it had endemic shortages, queues and black markets. Prices were administratively fixed at much lower levels than necessary for market-clearing, therefore there was excess money in the hands of both households and firms. The rouble was like a lottery ticket. A shortage economy on that scale was an aberration, responsible for the failure of many attempted reforms.

Second, there was the inability – by an otherwise above-normal country – to identify and satisfy the simplest, most elementary needs of the population, such as convenience food, soft drinks, jeans, shoes, not to speak of local near-famine conditions just before transition (even if these were due mostly to distribution inefficiency, but that is also part of the system). It was not only a question failure to adapt production to changing demand, available technology and international price: invention and innovation were also greatly impeded by the system.

Third, the economy was grossly inefficient. Adam Bergson "estimated the productivity loss of central planning for 1975 – as compared with a market economy at a similar level of economic development – at about a third" (Ofer, 2005). Leonid Kantorovich, a mathematical economist distinguished by the award of both the Nobel and the Lenin prizes, estimated that the Soviet Union wasted on average around 40% of its inputs. As in central-eastern Europe, much of the Soviet industry production had negative value added at international prices: in the 1980s Japan used to buy Soviet machinery for scrap.

The causes of economic collapse of the USSR and the Soviet-type system in central-eastern Europe go beyond the scope of this paper, but by and large three major economic causes should be mentioned.

First, the failure of many repeated attempts to introduce significant market elements in the Soviet-type model, due both to the leadership's fears of losing power, and the permanent endemic excess demand already mentioned. This phenomenon had absolutely nothing to do with the original socialist project; it was the necessary consequence of planners hopelessly attempting to decide both the quantities and prices of goods, at levels which were inconsistent with the equilibrium that, in theory, should have characterized central planning.

Second, the insulation of the economy from the stimuli and opportunities of international trade, particularly at a time when (since about 1970) the globalization process had speeded up economic integration worldwide. This costly insulation was due to state monopoly of foreign trade, exercised through large Foreign Trade Organisations; to quantitative restrictions on both imports and exports; to planned integration within Comecon; to the divergence of domestic from international prices; and to the use of inconvertible currencies and multiple exchange rates (even within Comecon). The elimination of domestic excess demand would have been a precondition also of progress on this front.

Third, the Soviet leadership's reluctance to allow private ownership of land – instead of implementing at least the kind of long-term land lease (*arenda*) pioneered by in Russia in the 1921-1926 New Economic Policy. More generally there was resistance to the formation of new private enterprises; deep-rooted ideological objections were in the way, though in the second half of the 1980s Gorbachev encouraged the establishment of cooperatives, which mushroomed as shells for private enterprises and legal ways of appropriating resources from state enterprises through leasing and sub-contracting.

The contrast with the Chinese experience could not have been greater. Post-1978 China avoided repressed inflation and kept open inflation under control: the peak of Chinese inflation was reached in August 1987 at a yearly rate of 8%. China's participation in the international division of labour, through trade opening, a convertible currency and WTO membership, was a major pillar of the Chinese model. Long-term transferable land leases, precisely like those invented and rejected in the Soviet Union, and the promotion of local authorities' entrepreneurship through Town and Village Enterprises, are among the most important distinguishing features of the Chinese system gradually developed since 1978.

An additional difference between Soviet and Chinese systems is the significant regional decentralization of China, while Soviet regional councils (*sovnarkhozy*) were a minor and short-lived experiment in 1958. Xu (2009) labels China a "regionally decentralized authoritarian system": "The central government has control over personnel, whereas sub-national governments run the bulk of the economy; and they initiate, negotiate, implement, divert and resist reforms, policies, rules and laws. China's reform trajectories have been shaped by regional decentralization. Spectacular performance on the one hand and grave problems on the other hand are all determined by this government structure" (Xu, 2009). It is no accident that the collapse of the Soviet system should take the form of republican dis-integration.

Soviet collapse is one of those events that are rare, extreme, unpredictable until they happen, and perfectly explainable after the event; Taleb (2007) calls them “black swans”. There have been many presumed anticipations of Soviet collapse, but these were no more than “accidental prophecies” (Laqueur, 1996), without scientific foundation, or based on wrong premises. For instance Amalrik (1969) predicted that the USSR would end in the year 1984 of Orwellian memory, but as the result of social and ethnic conflicts and a war with China. Todd (1976) based his forecasts on demographic indicators such as the increase in Soviet infant mortality. Hélène Carrère d’Encausse (1978) announced the coming end of the URSS, but as a result of the higher birthrate of the Muslim republics of central Asia. Levin (1993) boasts of having forecast Soviet collapse in a 1977 article in *The Times*; it is true that he had been exceptionally accurate, having indicated the date of 14 July 1989, only a couple of months before the fall of the Berlin Wall. But it had only been a fortuitous coincidence: he had simply added two full centuries to the start of the French revolution (for a post-mortem on the forecasting failure of Sovietologists, see Rutland 1993).

3. From the command economy to a market system

The basic Soviet-type economic model, already sketched above, began its transformation in January 1992. Quickly it was split into 15 independent countries transformed into market economies, with dominant private ownership and enterprise (still with the exception of Belarus), open to international trade and investment flows. In principle there were at least three possible alternative target models for the transition:

1) a model of “market socialism”, preserving elements of central political and economic control and a high share of state ownership, within a market economy fairly open to international trade and investment, along the lines of China and Vietnam;

2) the European Social Model, combining private ownership, fully fledged markets and freedom of association and enterprise, with a high level of social protection, collective bargaining, social dialogue and social cohesion, differing from the classical capitalist system in assigning greater weight to “voice” institutions relatively to markets (see Giannetti & Nuti, 2006);

3) a hyper-liberal model along the lines of the US and the Reagan-Thatcher ideology, relying on privatization, de-regulation, low taxation and public expenditure and unrestricted foreign trade and investment.

After the break-up of the Soviet Union, something roughly like the first model emerged in Belarus and Uzbekistan, and to some extent in Turkmenistan and Tajikistan; the European Social Model was not adopted by any FSU country, although it emerged in Slovenia and to some extent in Latvia.

All the other transition economies, both in the FSU and in Eastern Europe – on the rebound, and under political and economic pressure exercised by international financial organizations – followed the hyper-liberal model in a version even exceeding US standards. They also adopted policies of macroeconomic tightening and stabilization, of privatization (including unprecedented mass privatization through the distribution of virtually free vouchers to the population) and international openness. These were the policies recommended by the so-called Washington Consensus (of IMF, World Bank, USA Treasury and business circles), with the acquiescence of the European Union that delegated to the IMF the conditionality to be attached to financial assistance for transition economies (for a criticism see Kolodko and Nuti 1997).

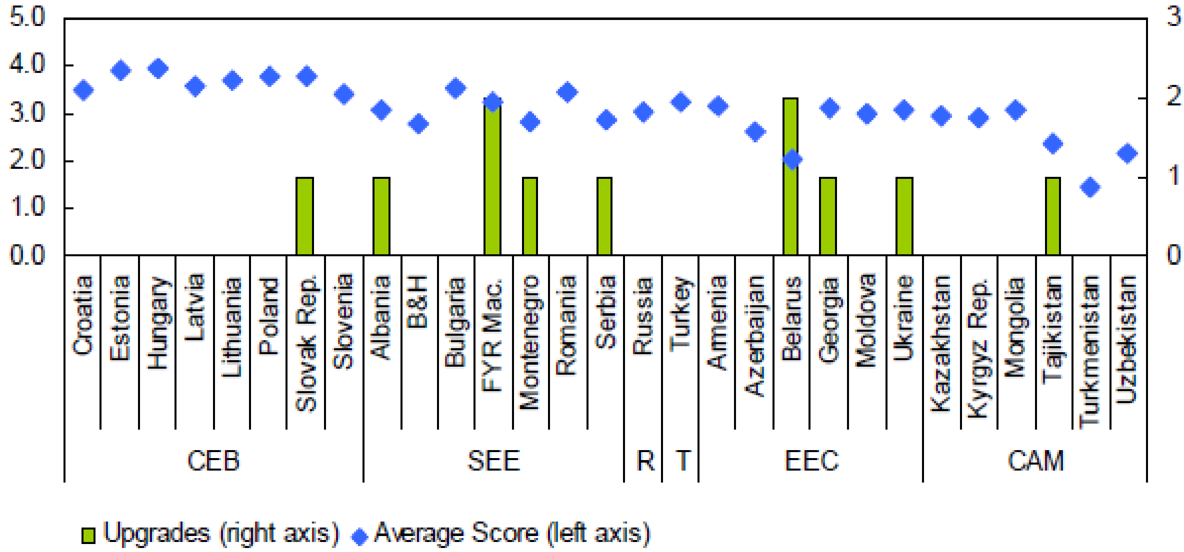
Had the transition taken place today, in the middle of a deep global financial crisis that has discredited the hyper-liberal ideology, with a newly found role for state intervention and the public sector, the target model of a market economy adopted in transition economies might have been different. The same thing might have happened if the transition had taken place ten years earlier than it did, before the victory of the hyper-liberal model, before the foreign debt of transition economies became unbearable, and while the oil price was still high.

Twenty years after the fall of the Berlin Wall, post-socialist countries exhibit the most profound and complex diversity. An authoritative "expert" evaluation, though totally subjective, is provided by the Transition Scoreboard of the EBRD (the European Bank for Reconstruction and Development, set up in 1991 to help finance the transition), in their *Transition Report* published annually since 1994 (and recently back-tracked to 1990).

For each of the EBRD countries of operation, now 29 (since 2008 including Turkey), ten indices are estimated by officials of the Bank's Chief Economist's Office: the share of the private sector in GDP, and nine scores on as many aspects of the transition. These scores are: small, and large scale privatisation; enterprise governance and restructuring; price liberalisation; foreign trade and exchange rate regime; competition; banking reform and interest rate liberalisation; financial markets; infrastructure reform. The scores on these nine aspects range from 1 for little or no change with respect to a fully centralised planned economy to 4+ (considered by the *Report* as numerically equivalent to 4.33) being the standard of advanced and internationally open market economies such as OECD members.

The average of the nine scores obtained by each of the EBRD countries of operation in mid-2009 is given in Figure 1, which is a preview of the *Transition Report* due in November 2009, anticipated by Berglof and Zettelmeyer (2009). It should be noted that in Figure 1 the the scale now begins from zero, while the original scale started from 1; unless the original scores have also been re-scaled accordingly, Figure 1 gives an exaggerated visual impression of transition progress. Changes in the last year are measured on the right hand side.

Figure 1. The EBRD Transition Indicators: Average Scores and Upgrades, 2009



From Berglof and Zettelmeyer, 2009.

The full picture at mid-2008 is reproduced in Table 1, that illustrates in a lucid and immediate fashion both sectors and countries where the transformation has been proceding more slowly. Almost everywhere, these are: company governance, **Table 1.** Transition Indicator Scores, mid-

2008

			Enterprises			Markets and trade			Financial institutions		Infrastructure
Country	Population mid-2008 (million)	Private sector share of GDP mid-2008 (EBRD estimate in per cent)	Large-scale privatisation	Small-scale privatisation	Governance and enterprise restructuring	Price liberalisation	Trade and foreign exchange system	Competition policy	Banking reform and interest rate liberalisation	Securities markets and non-bank financial institutions	Overall infrastructure reform
Albania	3.2	75	3+ ↑	4	2+	4+	4+	2	3 ↑	2–	2+
Armenia	3.2	75	4–	4	2+	4+	4+	2+	3–	2+ ↑	3– ↑
Azerbaijan	8.4	75	2	4–	2	4	4	2	2+	2–	2
Belarus	9.7	30 ↑	2– ↑	2+	2– ↑	3–	2+	2	2	1	1
Bosnia and Herzegovina	3.8	60	3	3	2	4	4 ↑	2	3 ↑	2–	2+
Bulgaria	7.6	75	4	4	3–	4+	4+	3 ↑	4–	3 ↑	3
Croatia	4.4	70	3+	4+	3	4	4+	3–	4	3	3
Estonia	1.3	80	4	4+	4–	4+	4+	4–	4	4–	3+
FYR Macedonia	2.0	70 ↑	3+	4	3–	4+	4+	2+	3 ↑	2+	2+
Georgia	4.5	75	4	4	2+	4+	4+	2	3–	2–	2+
Hungary	10.0	80	4	4+	4–	4+	4+	3+	4	4	4–
Kazakhstan	15.7	70	3	4	2	4	4–	2	3	3–	3–
Kyrgyz Republic	5.1	75	4–	4	2	4+	4+	2	2+	2	2–
Latvia	2.3	70	4–	4+	3	4+	4+	3	4	3	3
Lithuania	3.4	75	4	4+	3	4+	4+	3+	4–	3+	3
Moldova	3.4	65	3	4 ↑	2	4	4+	2+	3	2	2+
Mongolia	2.7	75	3+	4	2	4+	4+	2+	3–	2+ ↑	2+ ↑
Montenegro	0.7	65	3+	4–	2	4	4	2–	3 ↑	2–	2
Poland	38.0	75	3+	4+	4–	4+	4+	3+	4–	4–	3+
Romania	21.7	70	4–	4–	3–	4+	4+	3–	3+	3 ↑	3+
Russia	142.2	65	3	4	2+	4	3+	2+	3–	3	3–
Serbia	9.9	60 ↑	3–	4–	2+	4	4– ↑	2	3 ↑	2	2+ ↑
Slovak Republic	5.4	80	4	4+	4–	4+	4+	3+	4–	3	3
Slovenia	2.0	70	3	4+	3	4	4+	3–	3+	3 ↑	3
Tajikistan	6.8	55	2+	4	2–	4–	3+	2–	2+	1	1
Turkmenistan	6.5	25	1	2+ ↑	1	3–	2 ↑↑	1	1	1	1
Ukraine	46.6	65	3	4	2	4	4+ ↑↑	2+	3	3–	2+
Uzbekistan	26.0	45	3–	3+	2–	3–	2	2–	2–	2	2–

From: EBRD *Transition Report* 2008. Upward arrows indicate progress during the last year.

competition, banking reform and financial markets' development, as well as infrastructure reform, all areas in which the distance between the starting and target models had been greatest. In foreign trade and ownership regimes distance had been equally great but change was surprisingly rapid. Foreign trade liberalisation had benefited from earlier reforms, from pre-existing contacts with western partners, who could take the initiative in identifying and proposing mutually profitable transactions, from the greater facility with which markets could be set up for foreign exchange with respect to other markets for goods and services and for capital.

Privatisation lent itself to being accelerated with the free or subsidised disposal of state capital. In contrast financial markets were missing completely in the old system, where their functions were implemented by re-distribution via the state budget and via credit planning, thus starting from *tabula rasa* rather than capacity restructuring. The greater time required for the construction and re-construction of institutions and behaviour has slowed down the development of financial markets, competition, legality.

Transition progress varies not only by sector but also by countries. The frontrunners are those countries that joined the European Union on 1 May 2004 (Hungary, Poland, the Czech Republic, Slovakia, Slovenia, Estonia, Latvia and Lithuania) and on 1 January 2007 (Bulgaria and Romania). The very process of negotiating entry has been a powerful engine of institutional change and of legal and economic convergence with the EU. These are open market economies, with developed financial markets, a solvent banking sector (at least until the recent global crisis, see below), competition and corporate governance.

A second group includes countries that have only begun their negotiations for EU access, like Albania; as well as the more advanced among the CIS republics (i.e. the FSU minus the three Baltic states) headed by Russia, plus the former Yugoslav republics. The countries in this second group leave much to be desired in the areas of financial markets, banking, governance, external opening. A third group includes the least advanced of the CIS republics, such as Belarus, Uzbekistan, Turkmenistan, also in terms of privatisation and price liberalisation; probably in their case we would not speak of transition other than for their optimistic assimilation, by analogy, with countries where the process is more advanced.

Occasionally there have been instances of transition regress. In particular Russia in 2000-2008, especially during President Putin's second mandate, has moved somewhat towards *statism*, reducing the private sector share in GDP from 70% in 2000-2004 to 65% in 2005-2007, raising the state share in the oil industry from below 20% in 2004 to over 50% in 2007 (the Yukos affair etc) and state control in Banks to 38%, not to mention the engineering and defense industries. The nationalisation or "russification" of unspecified strategic sectors, the activities of sovereign wealth funds and the generally discretionary nature of the business environment are all parts of this trend (Hanson 2006, 2007). Ferdinand (2007) notes a Russian shift from free market policies to those associated with a "*developmental state*".

4. The transition depression and recovery 1990-2006

The move from a Soviet-type system notoriously inefficient, inert, imbalanced and cut off from the global market, to an open market economy with all the incentives associated with private ownership and enterprise, was expected to bring rapid benefits in terms of GDP, living standards and growth. Instead of which all transition economies experienced a recession varying from about 20% in Poland to 40% on average in the former USSR, with peaks of about 65% GDP decline in Georgia and Armenia.[4] The picture is clearly summarised in Figure 2, where the 1989 GDP level is given as equal to 100.

By 2005 all the new EU member states from central eastern Europe had exceeded the 1989 GDP level by an average of 33%, except for Bulgaria (94% of 1989 GDP) and Lithuania (98%). South Eastern Europe was still on average at 97% of the 1989 level, the CIS on average at 87% (Russia at 88%), with an overall average for transition economies still below the 1989 level at 97%. The picture was more encouraging if GDP is measured at exchange rates corresponding to the PPP, or purchasing power parity in terms of a common representative consumption basket, reflecting the real appreciation of their exchange rates, starting from a grossly undervalued base at the start of transition. Thus, for instance, from 1990 to 2004 Poland's GDP per head rose from PPP US$ 5,980 to 12974, Hungary's from 9,040 to 16814, Russia's from 8340 to 9902 PPP US$.

Confronted with the disturbing evidence of a "transformation recession", observers' first reaction was one of incredulity: recession – it was argued – is a statistical mirage. In the old system there was a tendency to exaggerate economic achievements in order to obtain bonuses from plan over-fulfilment; all productive units were subjected to compulsory reporting; goods were not available at the official prices, and often involved negative value added. In the new system producers tend to belittle their output and incomes in order to avoid tax; reporting is not compulsory and samples are used instead; a large size "informal" or grey/black sector is neglected; price increases often reflect quality improvements and should not be used to deflate monetary values, and in any case consumers are better off because supplies are now, at last, plentiful at current prices. Even in 2001 Anders Aslund persisted in speaking of the "myth" of post-communist recession.

While, undoubtedly, there is an element of truth in these qualifications, it can be easily exaggerated. The informal sector was already present before the transition and now began to

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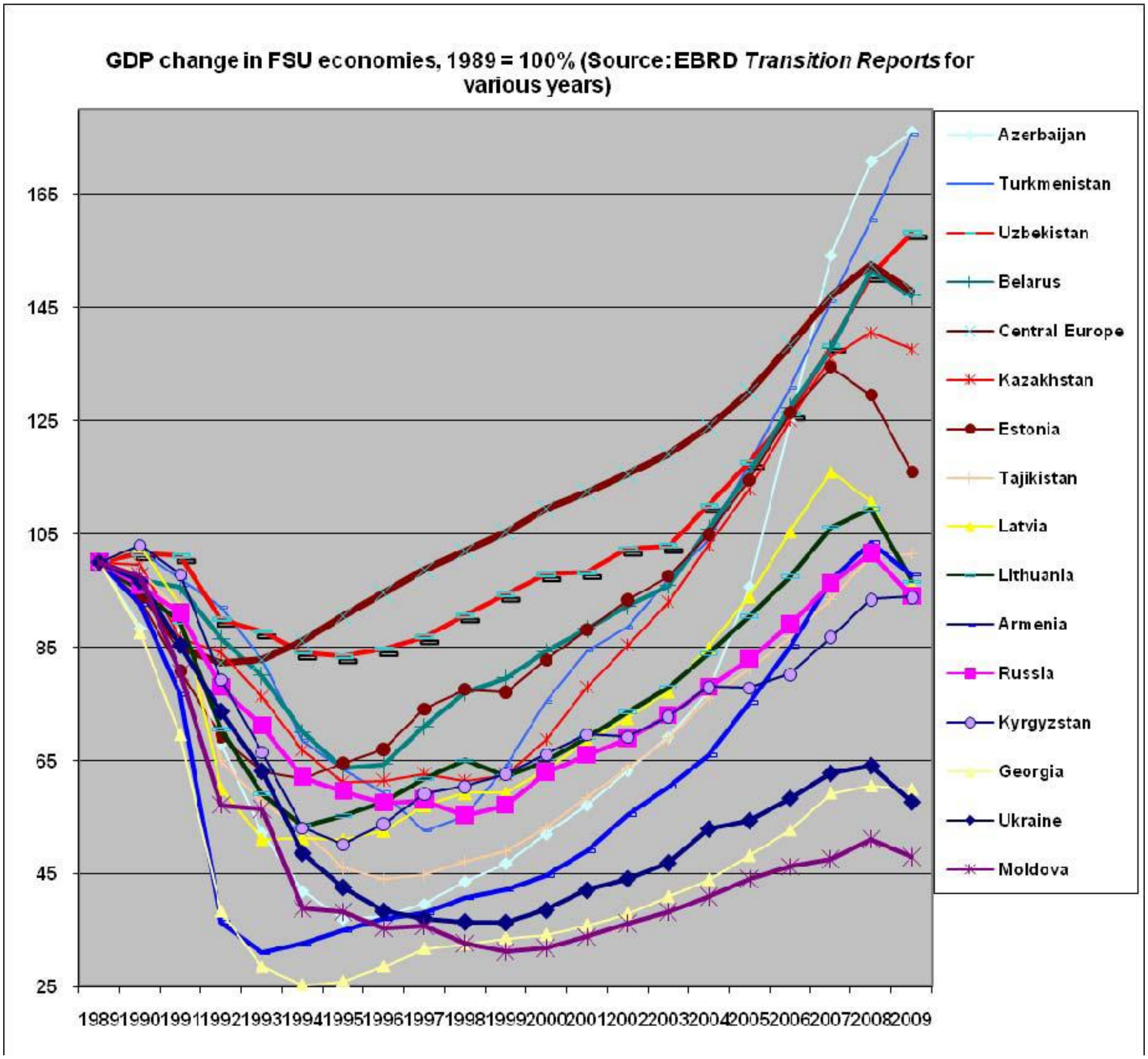
[4] An excellent statistical source on transition economy and society in 1989-2005 is the UNICEF TransMONEE databank, 2006 and 2009.

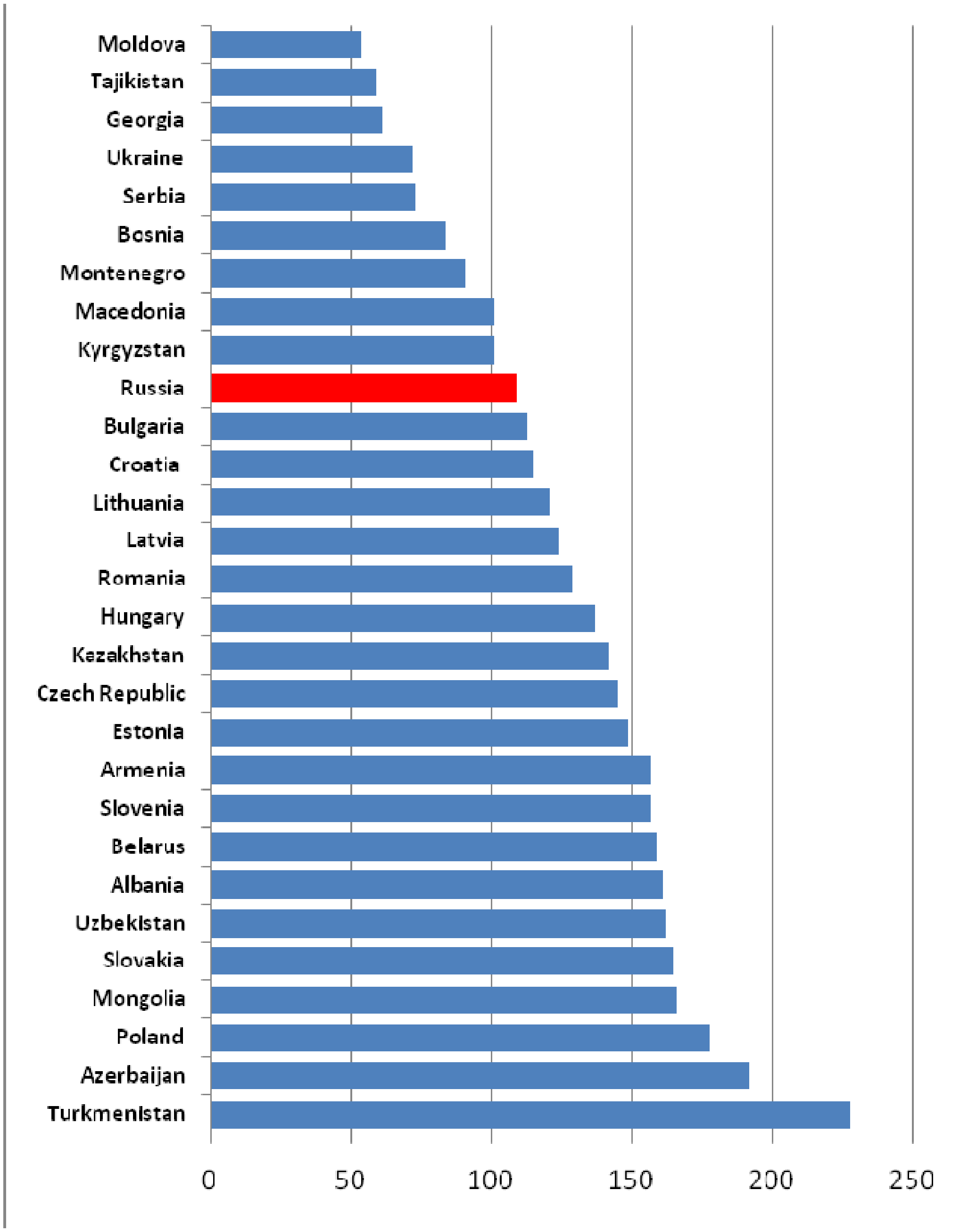
surface, actually boosting official figures instead of depressing them. The reduction of negative-value-added output should have raised GDP instead of reducing it. Not all loss-making enterprises should necessarily have been closed down, as happened often at the beginning of the transition, but only those producing less positive value added than could be obtained in alternative uses. Consumer surplus from goods availability has never been reckoned as part of GDP and there is no reason to start with transition economies. An observer above suspicion, Nobel laureate Bob Mundell (1997), writes that the transformation recession was not only real, but indeed worse than the 1929 worldwide recession and at least as serious as the Black Death recession of the 14th century, with the difference that the plague at least reduced not just output but also population, thus preserving living standards.

Figure 2. Real GDP Index in FSU economies (1989=100)



Source: EBRD Transition Reports, various years (EBRD forecast for 2009, May 2009, http://www.ebrd.com/country/sector/econo/stats/mptgrow.xls). From: Popov 2009.

Figure 3. 2008 GDP as a % of 1989 level



From Popov, 2009. Note: The GDP data for both Figure 1 and Figure 2 are from the EBRD *Transition Reports*. Figure 1 uses chain indices, computed from growth rates reported in *Transition Reports*, whereas Figure 2 uses base indices reported by EBRD. The growth rates are revised all the time and they do not always add up to the base indices, although differences are relatively small.

The unexpected "transformation recession" can be attributed to several causes:

1) trade shocks, i.e. the disintegration of large commercial blocs – Comecon, the USSR, the Czech and Slovak federation, the Yugoslav federation – and the monetary areas associated with them, aggravated by the move to world prices and settlement in convertible currencies (see Mundell 1997);

2) systemic vacuum in the switch from the old system that is no longer there, to a new system not yet fully in position (see Blanchard 1997);

3) gross mistakes in economic policy (see Kolodko-Nuti 1997 and Kolodko 2000), such as the unintended credit shock from targeting monetary variables in nominal terms in the presence of higher inflation than anticipated, or "overshooting" the initial fiscal squeeze (as in Poland in 1990). Moreover, interest rates were raised to higher than usury levels (over 200 per cent in real terms in Russia in 1994) thus depressing employment via low investment and an overvalued currency, and encouraging de-monetization and barter (also caused by not making payments from the state budget, in a misguided attempt to hold down inflation, a form of financial repression similar to the monetary overhang of the old days).

5. Slowdown and the 2008-2009 global crisis

Initially, from mid-2007 to mid-2008 when the current global crisis was only financial, the transition countries of Central Eastern Europe – regardless of EU or EMU membership – seemed to be fairly resilient. The sub-prime loans crisis that hit the United States and global intermediaries did not affect them directly. The 29 transition countries of EBRD operation recorded still impressive, though falling, average growth rates of GDP of 6.9 per cent and 4.2 per cent respectively in 2007 and 2008.

Then, already by the last quarter of 2008, the indirect effects of the growing financial crisis on liquidity and on asset values already began to be felt. A lagged slowdown began to reduce the sustained growth rates experienced until then. The crisis of mid-September 2008 triggered off by the Lehman Brothers bankruptcy began to spread across countries, impacting exchange rates and investment in the corporate sector. By end-2008/mid-2009, when consumption also began to be affected, economic activity in transition economies deteriorated even faster, from slowdown to rapid decline.

In May 2008 the EBRD still forecast, for 2009 in its 29 countries of operation, a resumption of higher growth of GDP at 5.7 per cent. By November 2008 a further slowdown was forecast instead, at 3 per cent. By January 2009 the forecast had been slashed to an imperceptible but still positive growth of 0.1 per cent. On 7 May 2009 the EBRD published their latest forecasts for 2009-2010, anticipating an average 5 per cent *contraction* in real GNP in 2009, followed by a modest recovery of 1.4 per cent in 2010, mostly in the second half of the year. The latest EBRD figures are also – on average but not for Central Europe – worse than the April 2009 growth forecasts by the IMF, in the *World Economic Outlook on Crisis and Recovery*. The European Commission *Spring Forecasts 2009* are much more optimistic about Russia (only -3.8 per cent in 2009) but more pessimistic about Hungary and Poland, and otherwise only marginally different. The forecasts of UN/DESA *Monthly Briefing on the World Economic Situation and Prospects*, published on 7 May 2009, the same day as the EBRD forecasts, are consistently slightly more optimistic. Within these aggregate forecasts given above, the 29 EBRD client countries exhibit very different economic performances (see Table 2).

What the EBRD calls "Eastern Europe and the Caucasus" (meaning the non Asian members of the CIS, not counting Russia) in 2007-2010 exhibit actual and predicted growth (per cent) of 9.9, 5.0, -6.2, 1.3; Ukraine is expected to contract by 10.0 per cent this year and grow at a zero rate next year. Central Asia is the least affected area, with GNP growth rates of 9.2, 5.0, 0.4, and 3.0 in 2007-2010. Finally, Russia is seriously affected: 8.1 and 5.6 in 2007, 2008; - 7.5 in 2009, the result of an even deeper fall in the first quarter and an expected improvement in the rest of the year. The EBRD (7 May 2009) forecasts green shoots of recovery in Russia at a growth rate of 1.0 per cent in 2010. Among the new EU members, in 2009 the sharpest GDP declines are in the Baltic Countries: Latvia -18%, Estonia -5% and Lithuania -13.6%.

In general the current financial crisis confronted all emerging and developing countries – including transition economies – with two shocks: "a 'sudden stop' of capital inflows driven by global de-leveraging, and a collapse in export demand associated with the global slump" (from an IMF Staff Position Note, Ghosh et al., 2009).

Current projections for 2009 indicate for the first time since the last World War a decline in world output (-2 per cent according to the IMF) and a much larger decline in world trade, which fell by 17 per cent between September and December 2008 (FT Editorial, 5 September), thus reducing for the first time since WWII the most common measure of globalisation, the ratio between world exports and world GNP. This "trade destruction" appears to have been much worse than in the corresponding months of 1929-32.

"With net private capital flows to emerging market (and developing) countries projected to decline from an *inflow* of US$600 billion in 2007 to an *outflow* of US$180 billion in 2009, EMEs (Emerging Market Economies) are facing a severe credit crunch. Particularly affected are the countries with large current account deficits – many of which had asset price and credit booms" (Ghosh et al., 2009, p.6.). Transition economies had been able to attract large and growing capital inflows thanks to privatisations at attractive prices, high interest rates net of devaluation cover or even plus revaluations, and production de-localisation thanks to low wages. These attractions have weakened, and the recession has made inflows even less attractive.

Additional factors making the impact of global crisis more serious were: large and diffused external imbalances; a terms of trade shock that in 2009 was almost as large as the trade volume shock; the deterioration of the quality of domestic debt to sub-prime level, due to either devaluation or to recession induced by loss of **Table 2.** Growth in real GDP, 2007-2008 and forecasts 2009-2010

(In percent; EBRD forecasts as of May 7, 2009)	GDP Growth (year over year percent change)						Memorandum item: GDP Growth within year (Q4 over Q4 percent change)			
			Current forecast		Forecast Jan. 2009				Forecast	
	2007	2008	2009	2010	2009	Change May-Jan	2007	2008	2009	2010
Central Europe and the Baltic states										
Croatia	5.5	2.4	-3.0	-0.2	0.0	-3.0	3.5	0.2	-3.0	1.9
Czech Republic	6.0	3.2	-3.5 [2]	0.1 [2]	0.0	-3.5	...	...	...	...
Estonia	6.3	-3.6	-10.5	-0.2	-3.5	-7.0	4.4	-9.7	-5.9	2.9
Hungary	1.1	0.5	-5.0	0.0	-2.0	-3.0	0.8	-2.3	-3.7	0.4
Latvia	10.0	-4.6	-13.2	-4.1	-5.0	-8.2	10.0	-10.3	-8.7	-1.3
Lithuania	8.9	3.0	-11.8	-2.0	-2.5	-9.3	8.8	-2.2	-10.6	-0.4
Poland	6.7	4.9	0.0	0.8	1.5	-1.5	7.2	2.5	-1.0	1.9
Slovak Republic	10.4	6.4	-3.5	0.8	2.5	-6.0	14.3	2.5	-4.9	2.2
Slovenia	6.8	3.5	-4.0	0.5	1.5	-5.5	5.4	-0.8	-2.1	2.0
Average [1]	***6.2***	***3.4***	***-2.9***	***0.2***	***0.4***	***-3.3***				
South-eastern Europe										
Albania	6.2	6.9	1.2	1.8	4.0	-2.8	7.0	5.8	-0.3	3.5
Bosnia and Herzegovina	6.8	6.0	-1.0	1.0	1.5	-2.5	...	...	...	...
Bulgaria	6.2	6.0	-3.0	-1.0	2.0	-5.0	6.9	3.5	-4.3	1.2
FYR Macedonia	5.9	5.0	-1.3	0.8	3.0	-4.3	7.3	2.1	-1.4	1.6
Montenegro	10.3	7.0	-1.0	-0.3	3.0	-4.0	...	...	...	...
Romania	6.0	7.1	-4.0	0.4	1.0	-5.0	6.6	2.9	-4.0	3.0
Serbia	6.9	5.4	-3.0	1.0	2.0	-5.0	5.8	2.8	-3.4	3.2
Average [1]	***6.3***	***6.6***	***-3.2***	***0.4***	***1.5***	***-4.7***				
Eastern Europe and the Caucasus										
Armenia	13.8	6.8	-5.5	1.0	5.5	-11.0	13.8	6.8	-4.5	1.1
Azerbaijan	23.4	10.8	3.0	6.0	8.0	-5.0	23.4	10.8	3.4	6.6
Belarus	8.2	10.0	-3.0	1.4	2.0	-5.0	7.1	7.5	-3.6	2.8
Georgia	12.4	2.1	-1.0	2.0	3.0	-4.0	11.7	-2.5	0.4	3.4
Moldova	3.0	7.2	-6.0	1.5	1.7	-7.7	2.3	6.2	-6.7	2.7
Ukraine	7.6	2.1	-10.0	0.0	-5.0	-5.0	7.4	-8.0	-2.6	0.0
Average [1]	***9.9***	***5.0***	***-6.2***	***1.3***	***-0.8***	***-5.4***				
Turkey	4.7	1.1	-5.5	1.0	-3.0	-2.5	4.2	-6.2	-0.1	1.0
Russia	8.1	5.6	-7.5 [3]	2.5	1.0	-8.5	9.0	1.2	-4.7 [3]	1.0
Central Asia										
Kazakhstan	8.9	3.2	-2.0	1.4	0.5	-2.5	6.5	1.3	-1.1	1.0
Kyrgyz Republic	8.2	7.6	0.5	3.5	3.9	-3.4	...	...	...	...
Mongolia	9.9	8.9	2.7	5.0	6.0	-3.3	...	...	...	...
Tajikistan	7.8	7.9	0.5	2.0	5.0	-4.5	...	...	...	...
Turkmenistan	11.6	9.8	9.5	9.0	10.5	-1.0	...	...	...	...
Uzbekistan	9.5	9.0	5.0	6.0	5.0	0.0	...	...	...	...
Average [1]	***9.2***	***5.0***	***0.4***	***3.0***	***2.3***	***-1.9***	...	...	...	...
All transition countries										
Average [1]	***6.9***	***4.2***	***-5.2***	***1.4***	***0.1***	***-5.3***				

1. Weighted average. The weights used for the growth rates are EBRD estimates of nominal dollar-GDP lagged by one year. 2. IMF projections. EBRD no longer produces a forecast for the Czech Republic. 3. Based on first quarter GDP growth estimates of the Ministry of Economy of the Russian Federation of – 9.5 per cent year on year. Source: *EBRD Forecasts*, 7 May 2009.

competitiveness at fixed exchange rates; the withdrawal of funds by foreign banks Transition economies have benefited from the large-scale fiscal stimulus, the low interest rates and the monetary expansion that on this occasion – unlike what happened during the transition recession of the early 1990s – have characterized the global response to the crisis (For a fuller discussion of the impact of the global crisis on transition economies, see Nuti, 2009).

6. Demography

In the FSU republics the transition brought about remarkable demographic changes: a general fall in birth rates – as in all other transition economies – and a unique increase in mortality rates, especially in the early 1990s, the opposite of what happened in Eastern Europe. Both trends have caused a population decline in the FSU, except for the Asian republics (see Brainerd 2009).

In the old system marriage and childbearing were early and near-universal. Rates of childlessness were near the biological limit of about 5 per cent; in 1965-1989 the Soviet fertility rate had stabilized at about the replacement level of 2.1 children per woman. Abortion rates were high.

Virtually all East European and FSU countries experienced a sharp decline in fertility beginning in the late 1980s or early 1990s. Age at first marriage increased, approaching that of Western Europe. There was a rapid shift towards later childbearing throughout Eastern Europe, gradually followed in the FSU. These changes were slower in the transition laggards like Belarus. The share of extramarital births increased across the region beginning in the early-to-mid-1990s; in Estonia it reached nearly 60% of all births, close to the share typical of Scandinavian countries.

The explanation is probably the income and employment uncertainty surrounding the transition; the decrease in child-care facilities provided by the state and by enterprises; the increase in the rate of return on education, leading to higher enrolment by women; the decrease in the number of middle-aged men due to higher mortality rates.

Mortality trends diverged sharply in the FSU and in Eastern Europe. After a rise in life expectancy in the late 1980s, undoubtedly due to Gorbachev's anti-alcohol campaign, "between 1990 and 1994 the death rate among working age men in Russia increased by 70 percent …. Male life expectancy at birth fell from 63.7 years to 57.4 years during that period, while female life expectancy at birth fell from 74.3 years to 71.1 years. A similar increase in mortality rates occurred in many other countries of the former Soviet Union in the early 1990s, in particular in Belarus, Ukraine, and the three Baltic countries" (Brainerd 2009). The mortality crisis affected primarily middle-aged men. “In Estonia and Russia (and many other former Soviet countries), the increase in death rates for men age 25 to 54 between 1989 and 1994 was astonishing.” These trends were reversed in the late 1990s but their size and large and erratic swings are unprecedented in European countries in peace time and the absence of famines or epidemics.

In Eastern Europe, on the contrary, “mortality rates fell and life expectancy rose throughout the region”, in spite of similar – though milder and less protracted – trends in GDP losses and unemployment that accompanied the transition.

The mortality crisis among middle-aged men in the FSU republics was primarily due to a tremendous increase in deaths due to circulatory diseases (heart disease and strokes, which on the contrary decreased in Eastern Europe except for Bulgaria and Romania in 1989-94) and due to external causes, including suicide and homicide. After the mid-nineties these death rates declined but remained at least as high as before the transition. “Most analysts believe that alcohol consumption is one of the major causes of the large swings in mortality in the western former Soviet Union in the 1990s” (Brainerd 2009, Popov 2009). The price of alcohol rose dramatically less than the price of food in the early years of transition in Russia. The impact of alcohol was increased by “binge” drinking and the consumption of “surrogate” alcohol. [5]

Falling fertility, plus mortality rising above fertility, leads inexorably to a falling population, and indeed in the last two decades there were significant population decreases in most FSU countries. In Russia the population fell from 147 million in 1989 to 142 million by 2008. The loss, of 3.4 per cent, is much more dramatic if one excludes the substantial migration inflows of over 6 million (net) immigrants into Russia, between 1989 and 2008 – a fall of 11 million in the native Russian population. Russia’s population decline is much smaller than that of other FSU countries: 20 percent in Moldova and Georgia, nearly 15 percent in Estonia and Latvia, 4 to 10 percent in Kazakhstan, Armenia, Lithuania and Ukraine. Similar declines occurred in Bulgaria and Romania. In the same period populations grew in the Central Asian republics (except Kazakhstan), Azerbaijan and Hungary.

“Population declines are likely to continue in many countries due to the much smaller cohorts of women entering their childbearing years” in spite of Putin’s fertility ‘bonus’. Increasing life expectancy and higher immigration may make a more significant contribution. But it is no accident that Goskomstat forecasts the Russian population to decrease from 142 million in 2008 to 137.5 million in 2025.

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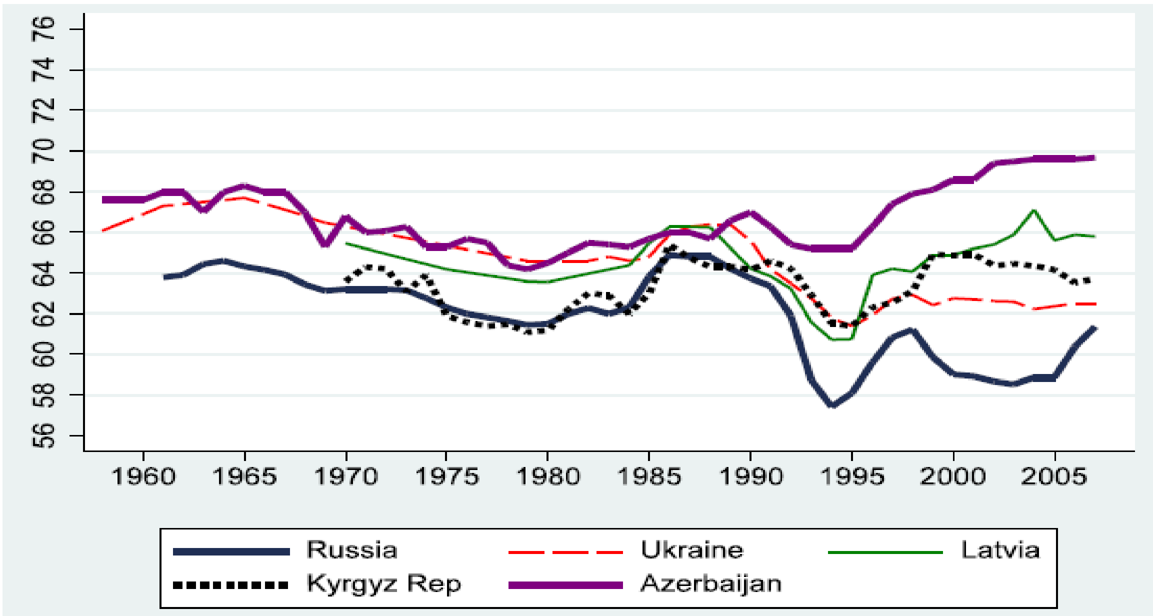
[5] Surrogates, all untaxed and cheaper than vodka in alcoholic content, include homemade alcohol (*samogon*), and “non-beverage” alcohol, such as after-shave, anti-freeze and lighter fluid, all characterized by high content of ethanol and other toxic ingredients.

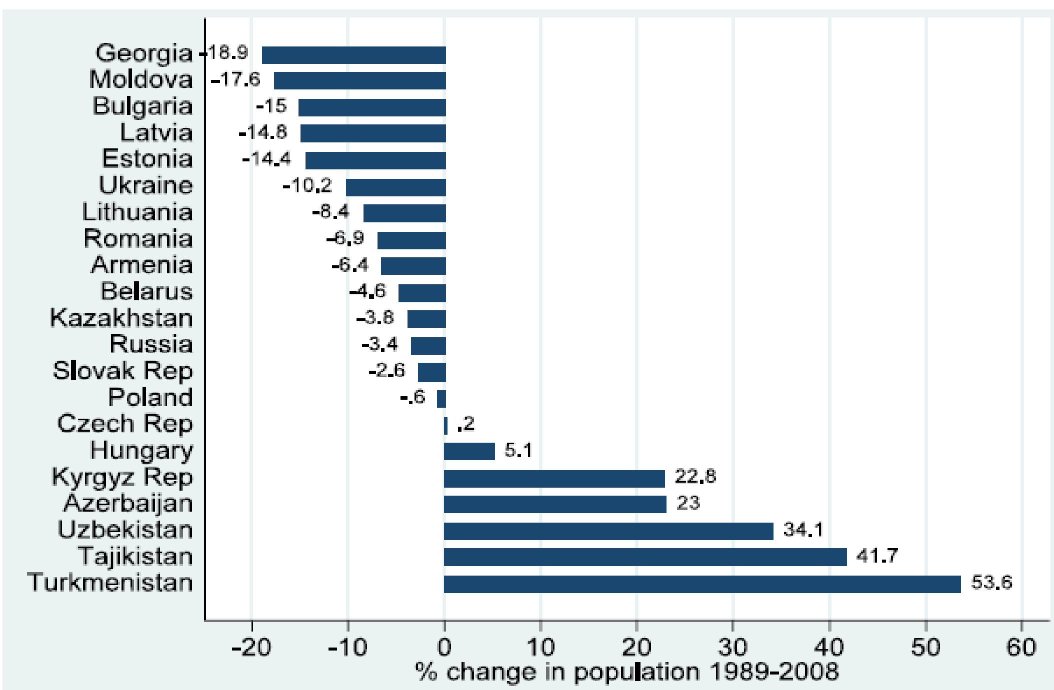
Naturally there are adverse implication of population decline for economic growth. Higher capital per man is more likely to result in unused capacity than in higher labour productivity, due to low ex-post factor substitutability; growth will suffer because of the accompanying population ageing, and the destruction of human capital.

Figure 4. Male life expectancy at birth: Former Soviet Union, selected countries



From Brainerd, 2009

Figure 5. Population change 1989-2008



TransMONEE database (2009 version). From Brainerd, 2009

7. Unemployment

Typically the Soviet-type system was characterized by full employment, indeed by *over-full* employment i.e. excess demand for labour at the prevailing wage rate. While full employment of labour was obviously desired, it was the by-product of excess demand for labour and not the result of a specific policy; and of course there was nothing positive about *over-full* employment which was only a cause of high labour turnover and inflationary wage drift, which in turn contributed to the perpetuation of a state of excess demand for goods.

Conversely, the initial prolonged stage of the transition has been accompanied by shrinking employment and the rapid emergence of labour unemployment, converging to similar average values and dispersion typical of European Union countries. The many queues for goods typical of the old system have been replaced by a single but much longer queue for jobs. In the CIS, however, there were lower rates of job loss and limited job creation, leading to an increase in under-employment and reductions in real wages (UNICEF, 2009).

Table 3 provides data for unemployment rates and employment ratios for 1998–2006. While unemployment remained high in Central and Eastern Europe, it tended to decrease in the rest of the area. Employment ratios did not have a clear trend, with several countries remaining under 60% and only a few being close to the Lisbon target of 70% for the EU member states. Employment rates tended to be higher in the CIS countries than in CEE countries, but this partly reflect higher under-employment and lower unemployment benefits.

The global economic crisis of 2008–2009 has already raised unemployment and reduced demand for migrant labour.

Table 3. Unemployment rates and employment ratios in CEE/CIS

	Unemployment rate (percentage of the labour force)					Employment ratio (number of employed as percentage of population aged 15–64)				
	1998	1999	2004	2005	2006	1998	1999	2004	2005	2006
Czech Republic	6	9	8	8	7	68	67	65	66	66
Hungary	8	7	6	7	7	53	55	56	56	57
Poland	11	15	18	17	12	59	55	53	54	55
Slovakia	13	16	18	16	13	60	58	57	58	59
Slovenia	8	7	6	6	6	66	64	67	67	69
Estonia	10	12	10	8	6	66	63	65	66	–
Latvia	14	14	10	9	7	62	61	64	66	–
Lithuania	13	15	11	8	6	64	63	62	64	–
Bulgaria	14	16	12	10	9	54	52	55	56	58
Romania	6	7	8	7	7	–	–	61	61	62
Albania	17	–	–	–	–	52	51	46	45	45
Croatia	12	15	14	12	11	54	50	52	53	54
Montenegro	–	–	–	30	30	–	–	–	43	43
Serbia	–	–	19	21	21	55	47	59	55	53
TFYR Macedonia	34	32	37	37	36	40	40	37	39	40
Belarus	–	–	–	–	–	66	66	63	64	64
Republic of Moldova	13	11	8	7	7	61	62	52	51	49
Russian Federation	13	13	8	7	7	58	62	66	67	68
Ukraine	11	12	9	7	7	68	59	62	64	64
Armenia	–	–	–	–	–	54	51	50	50	49
Azerbaijan	–	–	–	–	–	75	74	68	67	68
Georgia	15	14	13	14	14	58	59	62	60	59
Kazakhstan	–	–	8	8	8	63	63	71	70	–
Kyrgyzstan	–	14	9	8	8	61	62	59	60	64
Tajikistan	–	–	7	–	–	57	54	54	53	52
Turkmenistan	–	5	–	–	–	–	–	–	–	–
Uzbekistan	–	–	–	–	–	65	64	62	62	62

Source: TransMONEE database 2008.
Note: Results from national Labour Force Surveys, except for Albania, Belarus, Armenia, Azerbaijan, Kazakhstan (2004 and 2005), Kyrgyzstan, Tajikistan and Uzbekistan, which are official data. The different sources may use different criteria, for example for registering unemployment, working activities in the informal sectors, temporary jobs.

8. Inequality and Poverty

In the Soviet-type system wealth was almost entirely in public hands; the little that remained private was a source of direct satisfaction rather than income. By itself, this made distribution of income among the population tendentially more equal than in a market economy where income is derived also from private wealth (always more unequally distributed than labour incomes). Labour full employment and centrally-set wage norms also made for greater equality than in a market economy. There were also factors making for greater equality across republics and countries within the bloc: the emphasis on industrial development in every country, regardless of efficiency considerations; the socialization of enterprise profits and their re-distribution via the state budget; large scale subsidies via the All-Union Soviet budget, and via the under-pricing of raw materials and oil within the USSR and Comecon (Cornia 2009).

Egalitarian ideals associated with socialist ideology should not be exaggerated. First, there was significant residual real inequality due not so much to monetary income differentials but to privileged access to goods for the Party *nomenklatura*: this was no small matter, as it affected access to housing, automobiles, holiday facilities, health and education, foreign travel, imported and luxury goods as well as simple items of daily consumption which were in scarce supply for the ordinary citizen. Second, in 1931 Josef Stalin in person had condemned the “leftist leveling of wages” (*uravnilovka*), and urged the introduction of sharp wages differentials between skilled and unskilled and difficult and easy jobs. And there were prizes for managers for plan-fulfilment and over-fulfilment, discretionary prizes for workers, money to be made by mediators (*tolkach*) in the informal semi-legal exchange of materials among enterprises, in the black and grey markets among consumers, the reliance on "pull" (*blat’*) through "acquaintances" (*znakomstvo*) to obtain scarce goods and services; a few legal markets, such as *kolkhosian* food markets and flea markets (*barakholki*). Bribes and large gifts (*prinoshenie*) were also common. All these factors distorted the significance of the degree of inequality as measured through official monetary incomes.

Subject to these qualifications, pre-transition measures of inequality, such as the Gini coefficient (=0 for absolute equality; 1 for absolute inequality, a situation in which one subject takes all) were impressively low in the Soviet Union and Central Eastern Europe, and from 1989 to 2004 have increased significantly nearly everywhere in the transition, from about 0.25-0.30 to around 0.35-0.40. Indeed, in many countries especially in the CIS they soon surpassed the degree of income inequality normally found in western market economies. The exceptions are the Czech Republic, where the Gini coefficient was and is lower, but still has risen from 0.198 to 0.235; Belarus, with a similar trend; and Slovenia where it has fallen slightly from 0.265 to 0.243 from 1991 to 2004 (see UNICEF 2006; for alternative measures of inequality see Milanovic 2009).

“In recent years inequality has either increased at a much slower rate, or – in some cases – even declined. For example, in those CIS countries, where levels shot up in the mid-to-late 1990s, there have been signs of reductions; while in the Central European countries, where levels increased less dramatically in the 1990s, rates of increase have continued to be slow but steady. However, in most of the region, levels of inequality have remained high in the period of economic recovery, suggesting that growth has not always been inclusive in nature” (UNICEF, 2009).

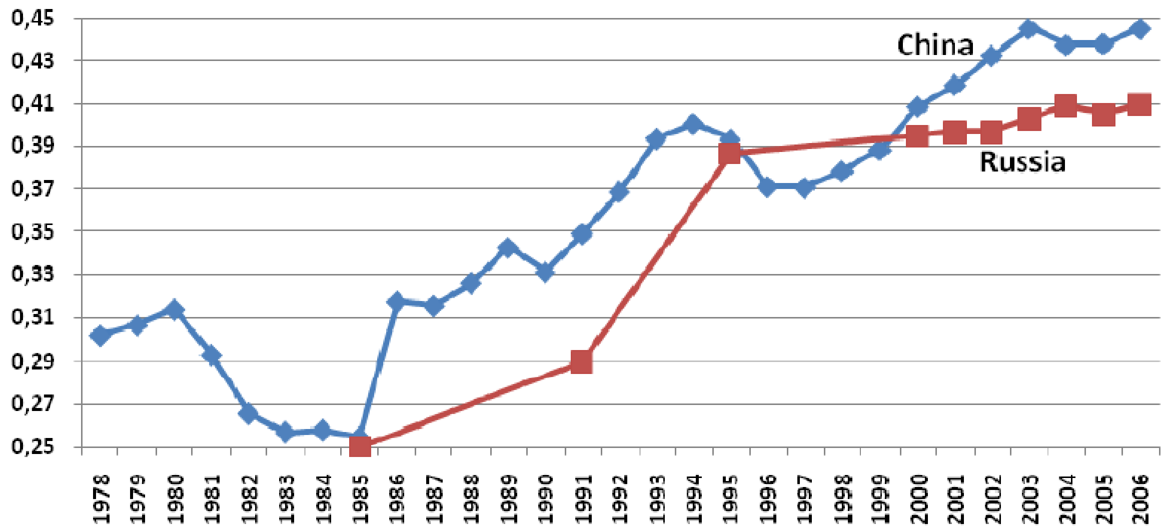
Table 3. Trends in disposable income inequality, selected countries, 1989-2006

	Gini 1989	Max Gini (year)	Latest Gini (year)	Difference max–1989	Difference latest–1989
CEE and the Baltic States					
Czech Republic	0.20	0.26 ('05)	0.24 ('06)	0.06	0.04
Hungary	0.23	0.28 ('05)	0.26 ('06)	0.05	0.03
Poland	0.28	0.37 ('05)	0.37 ('05)	0.09	0.09
Slovakia	0.20	0.30 ('03)	0.24 ('06)	0.10	0.04
Slovenia	-	0.27 ('91)	0.24 ('05)	-	-
Estonia	0.28	0.40 ('03)	0.36 ('05)	0.12	0.08
Latvia	0.26	0.39 ('04)	0.39 ('04)	0.13	0.13
Lithuania	0.26	0.36 ('02)	0.31 ('04)	0.10	0.05
Bulgaria	0.23	0.38 ('95)	0.31 ('06)	0.15	0.08
Romania	0.24	0.36 ('06)	0.36 ('06)	0.12	0.12
Serbia	-	-	0.39 ('06)	-	-
TFYR Macedonia	-	-	0.39 ('06)	-	-
CIS					
Republic of Moldova	0.25	0.46 ('97)	0.39 ('06)	0.21	0.14
Russian Federation	0.24	0.50 ('96)	0.42 ('01)	0.26	0.18
Ukraine	0.23	0.47 ('95)	0.33 ('02)	0.24	0.10
Armenia	0.25	0.48 ('03)	0.40 ('06)	0.23	0.15
Georgia	0.28	0.50 ('98)	0.45 ('02)	0.22	0.17
Kyrgyzstan	0.27	0.47 ('97)	0.40 ('06)	0.20	0.13

Source: TransMONEE database 2008 and Milanovic (1998). Data based on national household surveys.

Note: The 1989 Gini coefficients for Slovakia, Estonia, Latvia, Bulgaria, Republic of Moldova, the Russian Federation, Armenia, Georgia and Kyrgyzstan are calculated on the basis of gross income data. The 1989 Ginis for Slovakia and the Russian Federation refer to 1988. During the pre-transition period personal income taxes were small, therefore the differences in Ginis calculated on gross income data and on disposable income data can be assumed to be small.

Figure 6. Gini coefficient of income distribution in China and Russia, 1978-2006



From: Popov 2009

Post-socialist transition, by itself and together with the associated deep and protracted recession, brought about a drastic increase in poverty. By 1998 it was estimated that, in the transition countries of Europe and Central Asia, one out of every five people survived on less than $2.15 per day (at 1996 Purchasing Power Parity exchange rates), whereas a decade earlier "fewer than one out of twenty-five lived in such absolute poverty" (World Bank, 2000). "There is little doubt that poverty has increased dramatically in the region. Moreover, the increase in poverty is much larger and more persistent than many would have expected at the start of the process." By 1998 the people living in poverty had reached 20%. Poverty began to fall after 1998, with the generalized resumption of economic growth; by 2003 the poor represented only 12% of the population. (Alam et al., 2005).

With respect to the predicament of the poor in developing countries, the material hardship associated with poverty in the transition was made much worse by the drop from earlier achieved levels and expectations, and the loss of security. Sudden large scale unemployment, prolonged nonpayment of salaries, unpaid or decimated pensions, hyperinflation and loss of savings, the loss of free or subsidized social services "made people feel unusually vulnerable, powerless, and unable to plan for the future." For most of the new poor, transition brought "the destruction of "normal" life and accustomed social patterns." (World Bank 2000).

"The highest levels of absolute poverty are in poor countries of Central Asia": Tajikistan (70 percent), and the South Caucasus (with Georgia with a poverty rate of 50 percent in 2003). "Yet most of the poor and vulnerable in the transition countries of the Region are in large middle-income countries such as Kazakhstan, Poland, Russia, and Ukraine.” Those most at risk are “the young, residents in rural areas and in secondary cities. The unemployed, people with little education, and those belonging to underprivileged minorities, such as the Roma are also at great risk. Most of the poor are working poor”. (Alam et al., 2005).

Conversely, in the early 2000s Russia saw a spectacular increase in the number of dollar billionaires. In the Soviet era there might have been, at most, a dozen dollar-millionaires in the shadow economy. In 1995 there were no billionaires in Russia. In 2007, according to *Forbes*, Russia had 53 dollar-billionaires, in third place after the US (415) and Germany (55), but in second place in terms of their wealth, which in Russia totaled $282 billion ($37 billion more than Germany’s billionaires). In 2008 the number of billionaires in Russia increased to 86, with a total wealth of over $500 billion, corresponding to one third of a year’s GDP.

In a recession such as that of 2008-2009 it is plausible to conjecture that inequality falls – because the rich probably lose proportionally more than those who have less to lose – and poverty rises because the poor cannot afford to lose what they have (viceversa in a boom), at least initially. This is probably what happened in transition economies, though it is too early to tell. If the crisis lasts, losses among the poor – for instance through unemployment – become more substantial, and inequality as well as poverty may increase.

9. Is the transition over?

Blanchard (1997) argues that the beginning of transition can be identified by the accompanying onset of recession. This begs the question of whether recession is a necessary and unavoidable connotation of transition; this approach dates Russian transition from 1988 instead of 1992 and it implies that transition has not yet begun in China. Undoubtedly the post-socialist transition began in 1990-91 in Central-Eastern Europe and in 1992 in the FSU; its precise timing in the Balkans may be arguable, but roughly everywhere it started with price liberalisation and stabilisation plans. What is not clear is whether, where and when transition has come to an end.

In most of the post-socialist economies that have joined the European Union in 2004 and 2007 the transition process can be deemed to have been completed thanks to the implementation of European standards, the harmonization of legislation and the verification of economic convergence, sanctioned by their *acquis communautaire* and by all the policy constraints imposed by EU membership. Slovenia and Slovakia are already members of the euro-zone.

The politically correct view is that transition has been successfully completed also in nearly all other transition countries, and notably Russia. The question has been debated in terms of whether or not transition countries have reached a degree of “normality” as democratic, market economies. Thus Shleifer and Treisman (2004) claim that "compared to other countries at a similar level of economic and political development, Russia looks more and more the norm than the exception" (Shleifer and Treisman, 2004; also Shleifer, 2005).

Such a statement does not amount to much: "compared to other countries at a similar level of economic and political development" by definition *any* country will look like the norm, for otherwise it would not be comparable. Indeed, if one takes the Shleifer-Treisman approach, why stop there. One can equally correctly and equally meaninglessly say that Russia is the best country of its own quality, or the richest country of its income category however defined – and the diametrically opposite statement would be equally correct. The questions remain open of whether standards of economic and political development can be regarded as satisfactory.

A spirited rebuttal of the "normality" thesis is found in Rosefelde (2005) who boldly states that "Russia is an abnormal country": "A nation that has no independent judiciary, no independent parliament, no parliamentary control over the secret services, no politically important independent media and a public sector ruled by the state … cannot be democratic, no matter how closely it approximates other development norms. Likewise, a country where a rent-granting autocrat creates and manipulates economic agents with market power for his own purposes, in the name of lofty social purposes, cannot be workably consumer sovereign. Outcomes necessarily violate the western requirements that it is the people's preferences which completely govern supply, not those of the authorities" (Rosefelde 2005, p.13).

Hanson (2007) argues that Russia is a normal large emerging economy, but his criterion is based primarily on the role of enterprises and markets in resource allocation, which is a definition of normality much easier to satisfy than Rosefelde's standards. Popov (2009) argues that Russia has indeed become a normal "emerging" country, although he regards this as a demotion from its earlier, above-normal achievements.

Havrylyshyn (2009) lays out criteria for verifying the end of transition that are both too strict and too lax. His definition of a completed transition requires not only systemic transformation but also the implementation of capacity and trade restructuring, something that can be seen as the mirror image of Olivier Blanchard's criteria for the beginning of transition, for both authors confuse cause and effect at the two ends of the transition. Recession is often, but also may not be, the necessary consequence of beginning transition, just as capacity and trade restructuring is often, but also may not be, the necessary consequence of a completed transition. At the same time, Havrylyshyn gives some credit also for the partial completion of systemic changes, some of which are easy and can be completed at a stroke (convertibility, trade liberalisation, mass privatisation): regardless of whether partial transition has reached a broad-based, critical mass, without which there can be no transition at all.

Keren and Ofer (2007) follow a method introduced by Kutznets and look for regularities between the development level of various countries and the attributes of the state and of the institutional basis, like the governance indices of the World Bank, and the corruption indices of Transparency International. The deviations of transition countries – and particularly of Russia and Ukraine, from the institutional growth path characterized by Kutznets leads them to conclude firmly that these are not normal countries. Ofer (2009) developed this approach to include other rankings (like the component indices of the Economic Forum Global Competitiveness Index); the title of his paper clearly states his conclusion: "Twenty years later: the Socialist heritage is still kicking – The case of Russia".

On this thorny issue, three observations are in order. First, an apparently similar degree of income inequality – Russia in 2007 had a Gini coefficient of 42%, i.e. a more equal income distribution than China's 47% – can conceal a profound diversity. In China, and in "normal" capitalism, income inequality depends mostly on entrepreneurial success and is the price to be paid for efficiency; in Russia it depends primarily on the pillage of national resources during the transition (through privileged access to natural resources at prices lower than in the world market, to subsidized credit and to privatized assets also on privileged terms) and therefore it is a form of inefficient inequality.

Second, to a great extent Russia's degree of normality is an increasing function of the price of its oil, gas and other primary exports.

Finally, we can use the EBRD "expert" assessments already mentioned; we have seen that Figure 1 indicates the distance between an average measure of country indicators of transition progress in mid 2009, and the maximum score of 4.33. Figure 7 visualizes the same distance, but over time, for three country groups (Central Europe and the Baltics, South Eastern Europe and the CIS +Mongolia) and three areas of progressively harder systemic change: three different groups of indicators: 1) small privatization, liberalization of trade and prices, 2) large privatization and financial development, 3) governance, competition and infrastructure. Even the CEB frontrunners, not to speak of the CIS laggards, still have on average a great deal of ground to cover, especially in the second and third group of indicators.

Figure 7. Reform progress over time: three reform stages in three country groups.

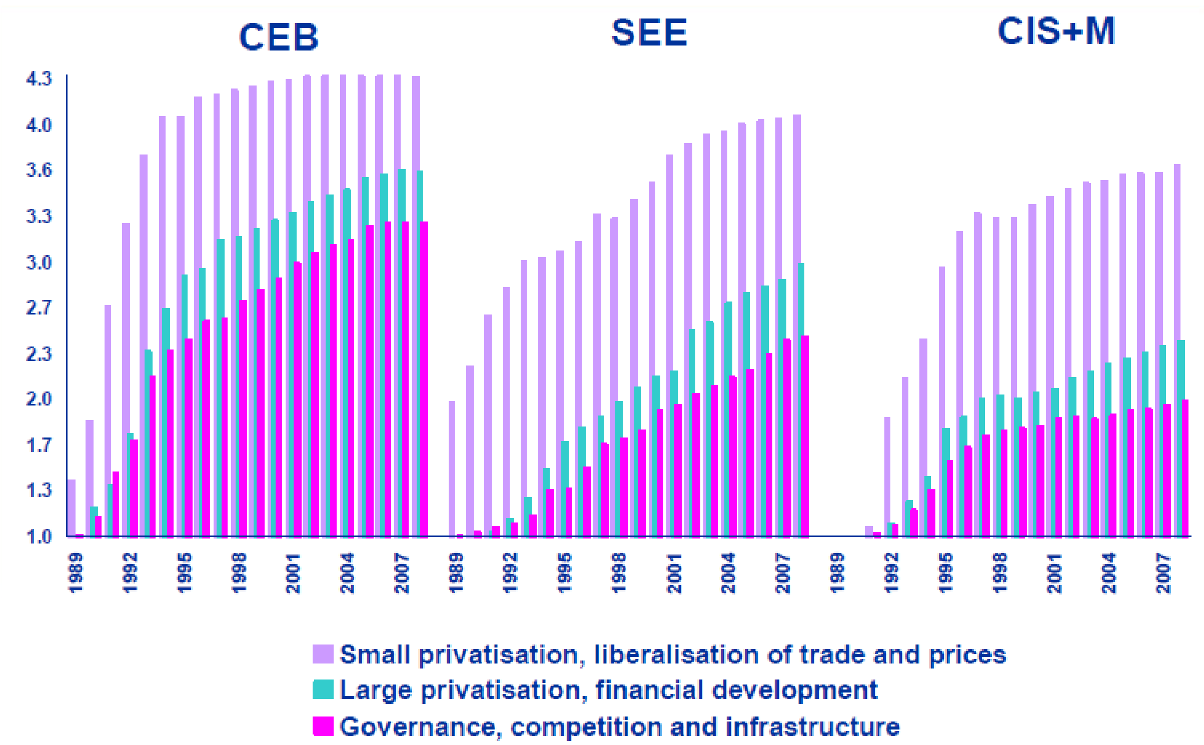
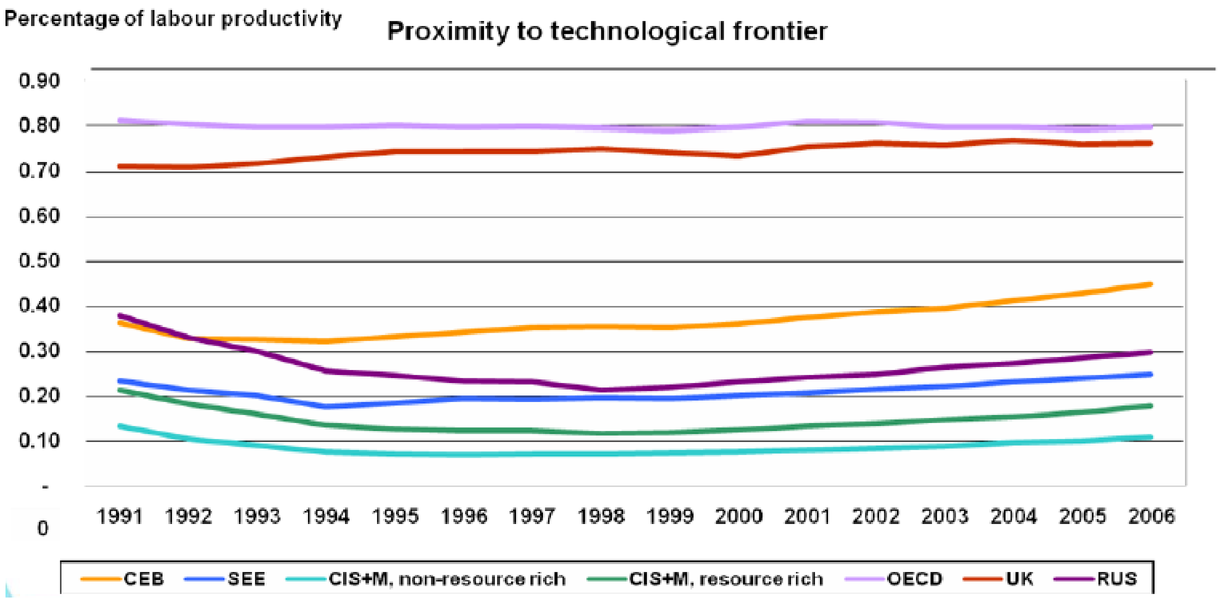


Figure 8, finally, shows the persistent and large gap between the average productivity of the same three country groups and the United States and the UK, which is still higher in 2006 than in 1991 except for the CEB group, and in any case has been closing excruciatingly slowly. The resource-rich CIS subgroup is performing only marginally better than the rest of the subgroup.

Figure 8. Labour productivity gap with the United States (1991-2006)



From Berglof (2008)

Finally, the global crisis of 2008-2009 has set in motion a new transition in advanced market economies, towards a reconsideration and revaluation of the role of the state, of active fiscal and monetary policy – right down to zero and even negative nominal interest rates, in place of the previous dogma of positive real rates – and government regulation and control especially of financial markets. Post-socialist economies will have to adjust their transition course towards these new, moving targets, often undoing some institutional developments that had been regarded as important transition achievements. Countries that by the old standards had achieved the transition to the market economy will now have to reconsider where they are and where to go next.

10. Conclusions

a) The lack of regional de-centralisation was one of the causes of Soviet collapse, together with the other causes common to all the countries in the bloc: a permanent, endemic state of excess demand (repressed inflation), involving shortages, queues and black markets, and preventing the functioning of market reforms (see Kornai, 1980; Nuti 1986). Second, there was the planners' inability to identify and satisfy the simplest, most elementary needs of the population; to innovate and to exercise entreneurship, because the system lacked the information and incentives normally provided by a market mechanism. Third, the economy was grossly inefficient. The insulation of the economy from the stimuli and opportunities of international trade, particularly at a time when (from about 1970) the globalization process had speeded up economic integration worldwide, greatly damaged all the Soviet bloc countries. The contrast with China is stunning.

b) The transition was accompanied almost everywhere by a deep and protracted recession. This was a real phenomenon and not a mere statistical delusion. It was due to the trade shocks of economic and monetary dis-integration, to systemic vacuum in the move from a system that was partially no longer there to a system that was not yet in position, and to the adoption of a hyper-liberal model of the market economy.

c) The transition took place at the height of Thatcher-Reagan hyper-liberalism, under the supervision and the inducements (conditionality of loans and aid) provided by the Bretton Woods institutions and the European Union. The model was characterized by: early full convertibility on both current and capital account, unilateral trade liberalization, reliance on foreign capital in the privatisation and foundation of banks and other financial institutions, strict monetary discipline under exceptionally independent Central Banks, with high interest rates combined with stable and often appreciating nominal exchange rates, lack of social safety nets. That model generated a considerable vulnerability, both in the transition recession of the early 1990s, and in the recession due to the impact of the global crisis of 2008-09. On the positive side, the same factors have facilitated and will facilitate a recovery.

d) The transition was accompanied by remarkable demographic changes: a general fall in birth rates – as in all other transition economies – and a unique increase in mortality rates, especially in the early 1990s, the opposite of what happened in Eastern Europe. Both trends have caused a population decline in the FSU, except for the Asian republics. It is notable and disconcerting to see how much our lives are influenced by the policies and institutions of the economic system in which we live, and how rapidly we can adapt to the transition from one system to another.

e) The transition was accompanied by a number of other large scale adverse developments: the rise and persistence of unemployment, the rise of inequality and of poverty. These phenomena were particularly serious because they meant a drastic reversal of earlier conditions of full (over-full) employment, greater equality and low poverty incidence. Moreover higher inequality could not be justified as the reward for efficiency, as in normal market economies, but was the result of unrestrained pillage by privileged operators.

f) In most of the post-socialist economies that have joined the European Union in 2004 and 2007 the transition process can be deemed to have been completed. However. even the central-eastern Europeans and Baltic frontrunners still have a great deal of ground to cover, especially in large-scale privatization and financial development; in governance, competition and infrastructure.

g) The global crisis of 2008-2009 has moved the goal posts. There has been a sudden revaluation of the role of the state, of active fiscal and monetary policy, of government regulation and control, especially of financial markets. Post-socialist economies will have to adjust their transition course towards these new, moving targets, often undoing some of the institutional developments that had been regarded as important transition achievements.

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