

PART II.
TRANSITION

1. TASKS OF TRANSITION.

- Liberalization, development of markets and allocative shifts
- Stabilize macroeconomy if preexisting aggregate imbalance (reformed socialism)
- Privatize (change incentives toward profit maximization).
- Introduce new institutions (fiscal administration, legal code and court system, central bank, financial system,

Constraints:

- uncertainty of outcomes. No preexisting transition theory.

Outcome could be close to West German miracle ...

... or Weimar republic

...or Yugoslav scenario

Initial controversies on this but reality has shown huge aggregate difference in outcomes.

- Complementarities between reforms.

Ex: incentive changes and liberalization.

Complementarities: argument for big bang approach.

- Political constraints.

Winners and losers even if aggregate gain.

2. STYLIZED FACTS OF TRANSITION.

1. Difference in reform paths and strategies.

Main difference: gradualism in China vs big bang in Central and Eastern Europe.

Liberalization usually big bang (with exception of Hungary and Slovenia)

Restructuring gradual and late in reform process.

Two waves in Eastern Europe:

- 1) 1990: Poland, Hungary, Czechoslovakia, Romania
- 2) 1992: Former Soviet Union.

Late starters had greater difficulties.

Poland (39 million inhabitants).



Initial situation:

Poland became independent again after WWI. Agrarian (and catholic) country.

1956 uprising. Agriculture remained private.

1970 disturbances. Heavy indebtment and investment in the 80's.

1980. Solidarity created (became legal!).

Transition start.

June 1989 elections. Solidarity won all the free seats.

Mazowiecki government August 24: mainly non communist coalition. Balcerowicz finance minister.



Shock therapy.

1. Stabilization policy.

- Budget deficit from 8% of GDP to -.5 % in 1990. Subsidies reduced from 16% of GDP to 7%.
- Zloty devalued to black market rate.
- Inflation reduced from 250% in 1989 to 585% in 1990 and 70.3% in 1991.
- Wage freeze: popiwiek (prohibitive tax on wage increases).

2. Liberalization. January 1990.

3. Privatization. Bill passed in July 1990. Liquidation plus joint stock company status plus mass privatization plan (vouchers for mutual funds owning enterprises with 20% blockholder). In practice, mass privatization delayed for years and implemented at a smaller scale. Gradual privatization ensued.

4. Tax reform only in 1993. Problem of tax collection.
5. Banking reform in 1993. Consolidation program with debt-equity swap for bad loans.

Political evolution in Poland.

Mazowiecki government did not survive the 1990 election campaign. Walesa promised acceleration of privatization.

1991: Bielecki government with bold mass privatization plan. Government instability between 1991 and 1993.

1993-97: left wing coalition with brake on privatization program and also good growth performance.

1997-2001: right wing coalitions. Left won in 2001.

Hungary (10 million):



Initial situation:

1956 uprising.

1968 reform under Kadar: “Gulash communism”.

Transition start:

- important liberalization and entry before 1989. “Market socialism”. Tradition of FDI.
- tax reform in 1987 establishing income tax.
- April 1990 elections: nationalist coalition (Antall) plus small freeholder party). Lasted until 1994. Far-reaching liberalization plus gradual privatization and radical bankruptcy reform (harakiri clause) in 1992 (lasted only 1 year). Repeated bank bailouts.
- 1994-98: former communist plus liberals. Achieved stabilization.

Czech republic (10 million):



Initial conditions:

Czechoslovakia created in 1918.

Invaded by Nazis in 1938. Income per capita 75% that of France and 10% higher than Austria.

Communist regime in 1948.

Prague spring in 1968 (Dubcek). Soviet tanks in August 1968.

Important dissident movement in 70's (intellectuals: Havel).



Transition start.

Velvet revolution. Communists resigned.

December 28: Dubcek leader of Parliament and
Havel president of the republic.

June 1990 elections. Klaus finance minister.

Liberalization: January 1991 with
compensation transfers.



Mass privatization via voucher scheme. Implemented in 1992.

Klaus won 1992 elections and became prime minister.

Split of Czechoslovakia decided in 1992.

Bankruptcy reform only in 1993.

1996-97: devaluation and austerity package. Poor banking sector.

Slovakia (5.4 million):



Disagreements in Czechoslovak Parliament. Slovakia had heavy arms industry producing for USSR. => Heavy restructuring burden expected.

Meciar.

Split in 1993.

Brake put on privatization program. Issues of democracy, minority rights...

Elections of 2002 seem to show that democracy is consolidating.

Slovenia (2 million)



Initially part of Yugoslavia. Had been part of Austro-Hungarian empire (like Croatia). Independent since 1991.

Example of gradual strategy to capitalism based on entry, cautious privatization and liberalization. (ex: capital account restrictions)

Corporatist style institutions with minimum wages and high taxation but moderate wage growth.

Estonia (1.4 million)



Independent from Russia in 1918 but only until 1941.
Broke away from USSR in August 1991.

Big bang approach to reform.

Liberalization, drastic stabilization (currency board),
fast privatization via auctions to outsiders, politics dominated
by right-wing since beginning of transition

Entered the first wave of applicants to EU (with Poland, Hungary,
Czech republic, Slovenia)

Bulgaria (7.7 million)



Was part of Ottoman empire until 1878. Big Turkish minority.

Political instability. Communists in government mostly except 1992 and since 1997.

Reforms started later and more half-heartedly.

Liberalization in 1991 but privatization started only in 1994.

Bankruptcy reform and banking reform only in 1994 and 1997 respectively.

Strong reversal of liberalization in 1994-97.

Romania (22 million)



Belonged to Ottoman empire until mid 19th century

Ceausescu ousted by Iliescu and national Salvation Front.

Prices partly liberalized in November 1990 (together with large devaluation of currency like in Poland)but chaotic movement of protests, price freezing and liberalization between 1991 and 1993.

Mass privatization announced in 1991 but delayed endlessly like in Poland.

Little progress in banking reform and soft budget constraints of banks and enterprises.

Russia (146 million):



Young nation. Invaded by Tatars for centuries (until 16th and Ivan the Terrible), Russian expansion started in 18th century.

Serfdom until most of 19th century.

Tsarist regime collapsed in February 1917. Bolchevik revolution in October.

USSR until 1991.

Gorbachev reforms: 1985-91.

Failed coup in August 1991.

Collapse of Soviet Union.

Eltsin takes command of Russia.



Price liberalization in January 1992 and failed stabilization (until 1995).

Mass privatization initiated by Chubais in 1993. Achieved end of 1994.

Strong communist opposition to reforms (especially in “red belt” regions).

Deteriorating economic performance.

August 1998 crisis. Sharp devaluation of Ruble, financial crisis.

Improvement of macroeconomic situation since 1999 with oil price increase, devaluation and Putin presidency (2000)



Ukraine (49 million):



Belonged to Russia for several centuries (Kiev capital of Rus')

Transition never really started in the Ukraine.

Kravchuk: nationalist communist president.

Liberalization only late 1994 with Kuchma presidency.

Slow start of privatization only in 1995.

Reforms stalled in 1998 with communist victory in elections.