17. Transition

Transition

- not a _______ of the existing system, but a _____________ of the current system with a new system
- involves virtually all aspects of the economy: micro-, macro-economics, property rights, legal institutions, trade, social safety net, financial sector,...
- vast differences among transition countries (@ 30) –
- similarities –

Dimensions of transition

- Microeconomic
  - market creation and price liberalization
  - firm restructuring and privatization
  - property rights and the legal system
- Macroeconomic
  - Stabilization (hyperinflation, output, employment)
  - budgetary finances
  - financial sector reform
  - international trade
  - social safety net
Output in transition countries

Changes in Real Output, 1990-2001

<table>
<thead>
<tr>
<th>Country</th>
<th>Consecutive years output decline</th>
<th>Cumulative output decline (%)</th>
<th>Real GDP, 2000 (1990=100)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hungary</td>
<td>4</td>
<td>15</td>
<td>109</td>
</tr>
<tr>
<td>Poland</td>
<td>2</td>
<td>6</td>
<td>112</td>
</tr>
<tr>
<td>Romania</td>
<td>3</td>
<td>21</td>
<td>144</td>
</tr>
<tr>
<td>Armenia</td>
<td>4</td>
<td>63</td>
<td>67</td>
</tr>
<tr>
<td>Georgia</td>
<td>5</td>
<td>78</td>
<td>29</td>
</tr>
<tr>
<td>Russian Federation</td>
<td>7</td>
<td>40</td>
<td>64</td>
</tr>
</tbody>
</table>

Output decline during the Great Depression (1930-34)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Slovenia</td>
<td>4.16</td>
<td>0.82</td>
<td>26</td>
<td>3.0</td>
<td>84</td>
</tr>
<tr>
<td>Poland</td>
<td>4.14</td>
<td>0.84</td>
<td>34</td>
<td>4.2</td>
<td>88</td>
</tr>
<tr>
<td>Hungary</td>
<td>4.11</td>
<td>0.84</td>
<td>21</td>
<td>0.0</td>
<td>81</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>3.61</td>
<td>0.60</td>
<td>16</td>
<td>0.8</td>
<td>81</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>3.47</td>
<td>0.66</td>
<td>19</td>
<td>0.4</td>
<td>79</td>
</tr>
<tr>
<td>Average</td>
<td>3.90</td>
<td>0.63</td>
<td>23</td>
<td>1.7</td>
<td>83</td>
</tr>
</tbody>
</table>

Advanced reformers

Uzbekistan | 1.11 | 0.37 | 640 | 2.5 | 89 | 88 |
Belarus    | 1.07 | 0.35 | 1,694 | 1.6 | 73 | 64 |
Ukraine   | 0.80 | 0.20 | 2,789 | 2.5 | 56 | 46 |
Turkmenistan | 0.63 | 0.19 | 2,731 | 3.0 | 69 | 62 |
Average    | 0.90 | 0.37 | 1,964 | 2.3 | 72 | 66 |
Privatization

Types of privatization and their main characteristics

<table>
<thead>
<tr>
<th>Governance</th>
<th>Revenue</th>
<th>Speed</th>
<th>Fairness</th>
</tr>
</thead>
<tbody>
<tr>
<td>IPO</td>
<td>+</td>
<td>+/-</td>
<td>+/-</td>
</tr>
<tr>
<td>Strategic foreign investor</td>
<td>++</td>
<td>++</td>
<td>-</td>
</tr>
<tr>
<td>Voucher</td>
<td>-</td>
<td>-/+</td>
<td>+++</td>
</tr>
<tr>
<td>Management-led</td>
<td>-/+</td>
<td>-/+</td>
<td>+</td>
</tr>
</tbody>
</table>

Results: - negative; +/- mixed; ++ good; +++ very good; ++++ excellent.

Speed of transition

- Big push
  - all at once and painful
    - all prices liberalized at once
    - rapid privatization
  - change the system as fast as possible and so it cannot (before it can) be undone
  - the Washington Consensus
    - 10 "simple" policy prescriptions
    - very controversial
  - Poland, some other CEE countries

- Gradualism
  - it takes time to change institutions and laws
  - realization that transition is complex
  - sequencing and complementarities
  - experimentation might be warranted
  - could be reversed (political commitment issues)
  - Hungary, China
The end of the Soviet Union

- Gorbachev’s _______ (restructuring) aimed at reforming the central planning system and not replacing it with the market system
- Boris Yeltsin was supporting a rapid shift toward a market system
- ____ : Transition to Market
  - replacement of the centrally planned system with private property and liberalized market prices
- 1991: the SU broke apart → Commonwealth of Independent States (CIS)

Gaidar reforms (shock therapy)

The five pillars:
1. Rehabilitation of the Ruble
2. Market liberalization
   - decontrolling prices (except energy), free entry into all economic activity, reforming the legal system
3. Privatization
4. Constructing social security net
5. Converting the defense sector
Institutional Reforms in Russia

- Privatization (mass privatization)
  - management led
  - voucher privatization *(Anatoly Chubais)*
  - privatization for cash (from 1995)
  - financial-industrial groups (FIGs) – bank-led
- the tax system
  - needed to be started from scratch → too complex
- financial sector
  - a large number of private small banks
  - many banks failed in 1998 (financial crisis)
  - securities market not well developed

Evaluation

- rampant corruption *(kleptocracy)*
- worsened income distribution
- heavily reliant on natural resources (exports)
  - high oil prices helped Russia pay off its debt to foreign creditors
- issues with concentration of political power
  - President Vladimir Putin
  - curtailed power of the oligarchs to a degree
  - regional issues with Chechnya