

Lessons from the Post-Communist Transition

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American Enterprise Institute
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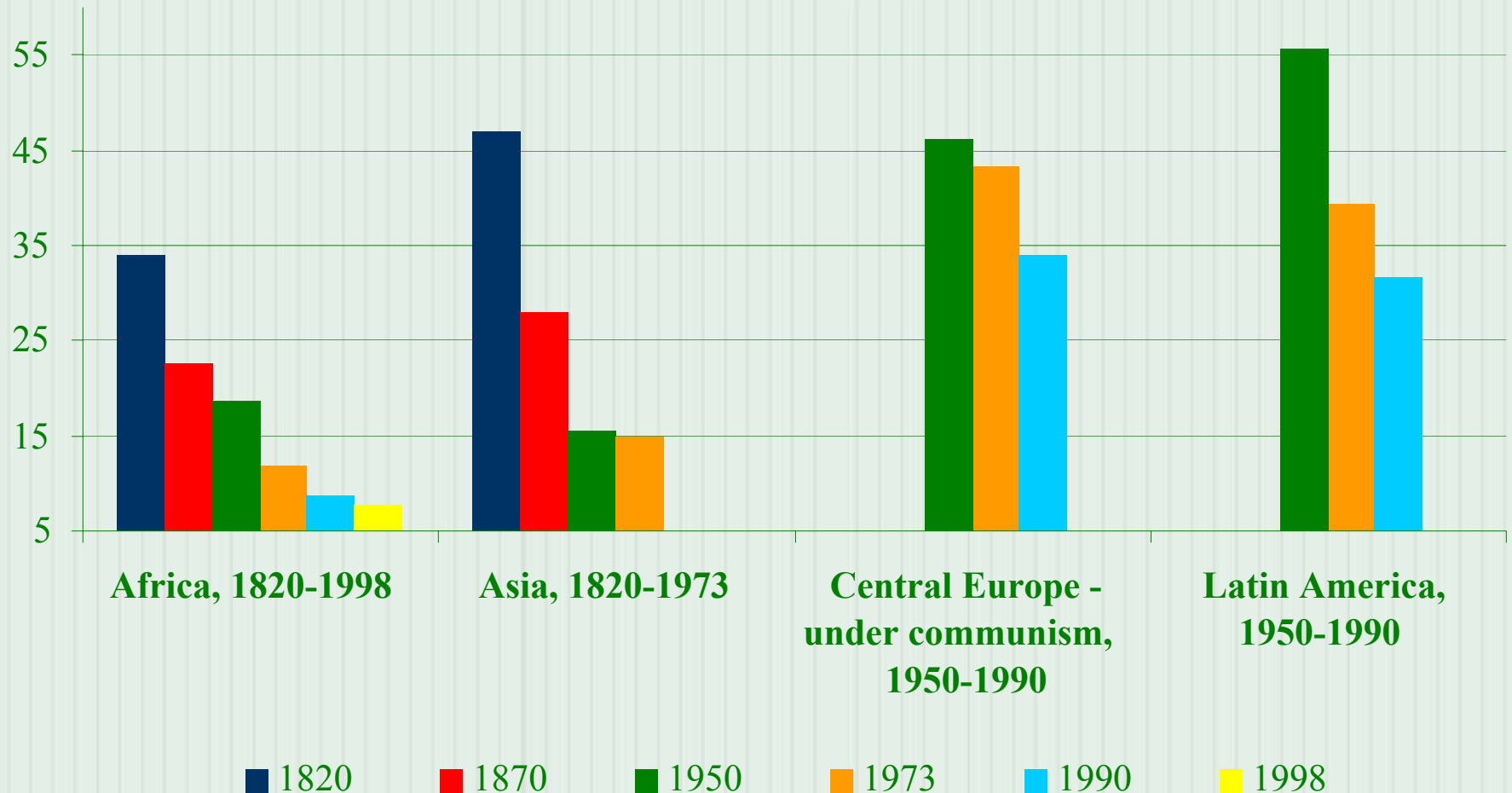
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There are many examples of countries which failed to catch up.

- *all the non-Western world in the 18th-19th centuries, until Meiji in Japan (1868);*
- *most African countries after WW II;*
- *Latin America under the old economic model, until the late 1980s;*
- *all communist countries after WW II;*
- *most post-communist countries after 1990.*

GDP per capita in selected groups of countries

(Western Europe = 100)



Source: Own calculations based on Maddison A., *The World Economy A Millennial Perspective*, OECD, Paris 2001

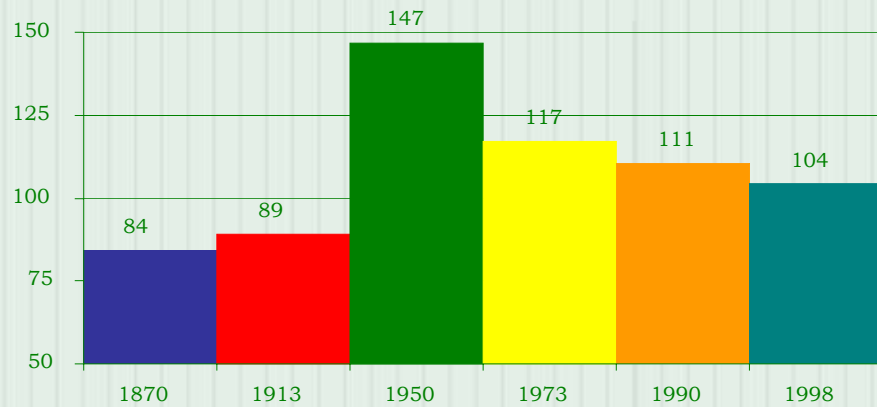
Some countries were successful in converging:

- *Scandinavia, including Sweden before expansion of the Swedish model (the late 19th - the first half of the 20th century);*
- *Japan, post Meiji (1868) until the 1990s;*
- *younger Asian Tigers (South Korea, Taiwan, Thailand, Hong Kong, Singapore);*
- *China since the late 1970s;*
- *Ireland during the last 15 years;*
- *Chile;*
- *a few post-communist countries in Europe in the 1990s.*

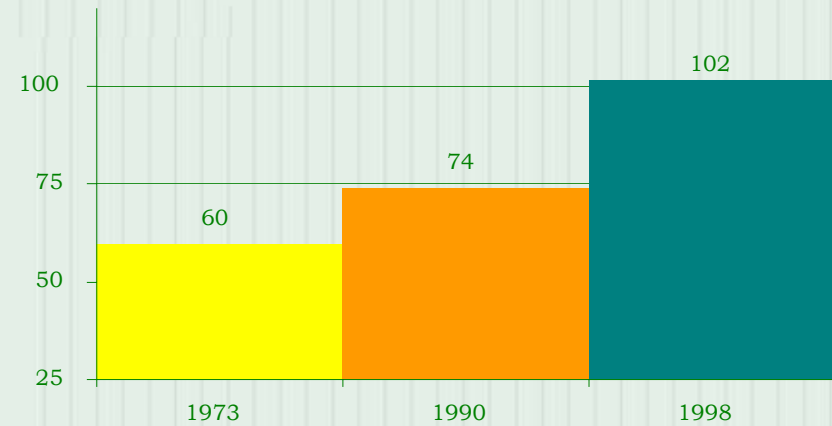
GDP per capita in selected countries

(Western Europe = 100)

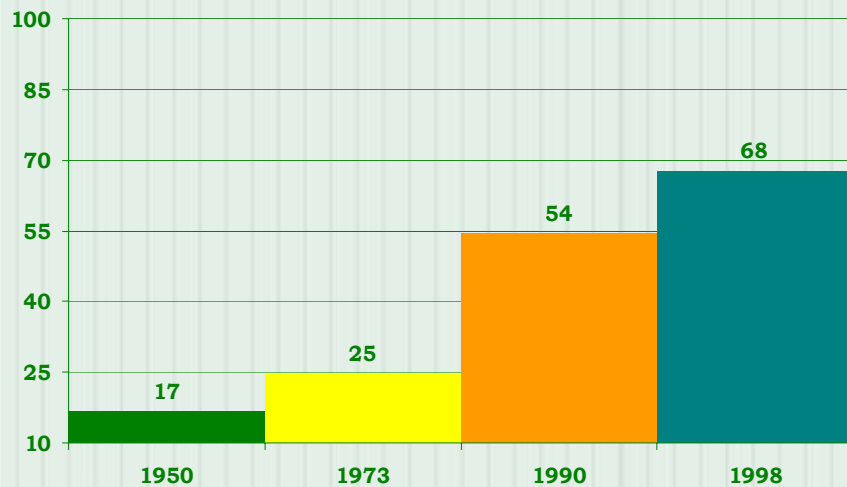
Sweden



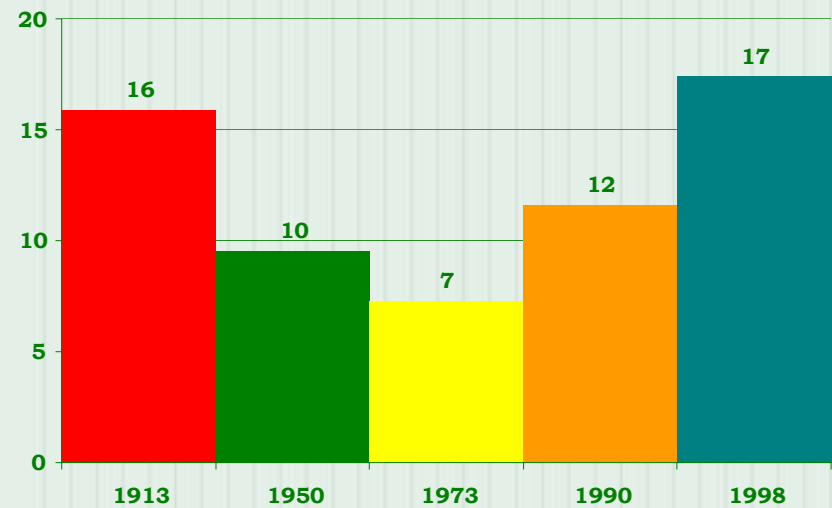
Ireland



South Korea



China



Source: Own calculations based on Maddison A., *The World Economy A Millennial Perspective*, OECD, Paris 2001

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REASONS FOR FAILURES TO CATCH-UP

WARS

DOUBLE STATE FAILURE

STATISM (POPULISM)

FAILURE TO SUPPLY PUBLIC
GOODS (LAW AND ORDER,
PROTECTION OF PROPERTY
RIGHTS, ETC.)

EXCESSIVE PUBLIC
SPENDING AND TAXES

PROTECTIONISM /
CLOSED ECONOMY

MONOPOLISATION

STATE
OWNERSHIP

OVERREGULATION
AND CORRUPTION

LARGE AND SUSTAINED
BUDGET DEFICITS

INFLATION

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WHAT IS BEHIND SUSTAINED SUCCESS WITH CONVERGENCE?

- A RATIONALLY LIMITED STATE, WHICH GIVES RISE TO A FREE MARKET ECONOMY WITHIN THE RULE OF LAW;**
- OR SUCCESSFUL TRANSITION TO SUCH A SYSTEM (REDUCING PUBLIC FAILURES).**

THE MAIN FEATURES OF A SYSTEM CONDUCTIVE TO SUSTAINED AND RAPID ECONOMIC DEVELOPMENT:

- AN OPEN ECONOMY;**
- PRIVATE OWNERSHIP;**
- RULE OF LAW;**
- LOW AND SIMPLE TAXES, HEALTHY PUBLIC FINANCES;**
- STRONG FINANCIAL SYSTEM.**

THE COMMUNIST SYSTEM PRESENTED AN EXTREME CASE OF STATISM (TRANSITION=REDUCING PUBLIC FAILURES)

The nature of the communist economic system - common features of the initial conditions in transition countries:

- central planning (output commands, rationing of inputs and foreign exchange, price controls, directed foreign trade);
- private entrepreneurship banned, monopoly by the state sector;
- the range of financial assets available to enterprises and individuals is extremely limited, as a market-type financial system could not coexist with central planning (no stock exchange, no truly commercial banks);
- large transfers in kind and social protection delivered via SOEs – an overgrown communist welfare state.

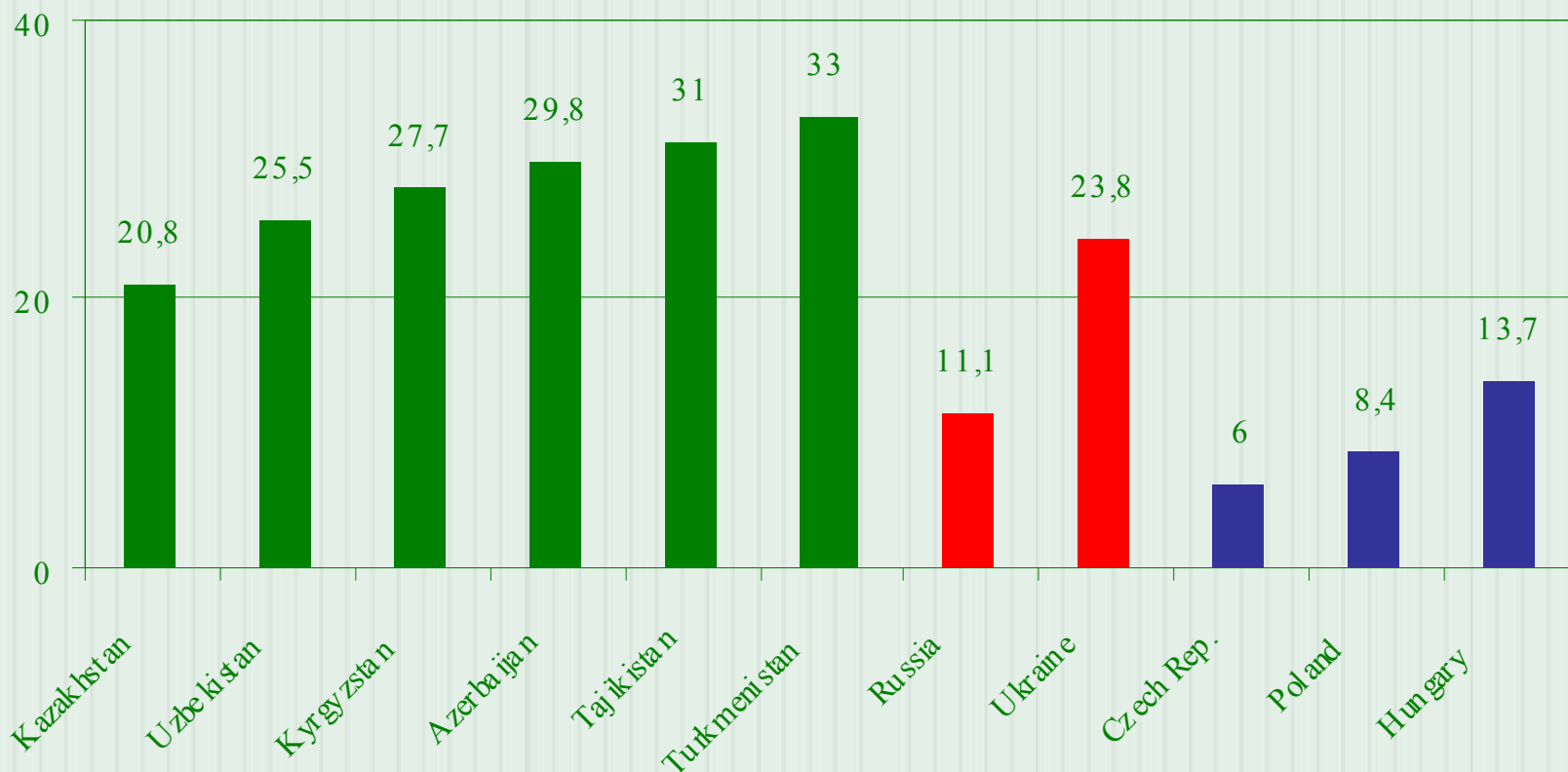
And as a consequence:

- extreme inefficiency, waste;
- high consumption of energy and other inputs causing pollution of the environment;
- lack of innovations and a shortage of goods.

INITIAL CONDITIONS DIFFERED ACROSS THE TRANSITION COUNTRIES, ESPECIALLY WITH RESPECT TO:

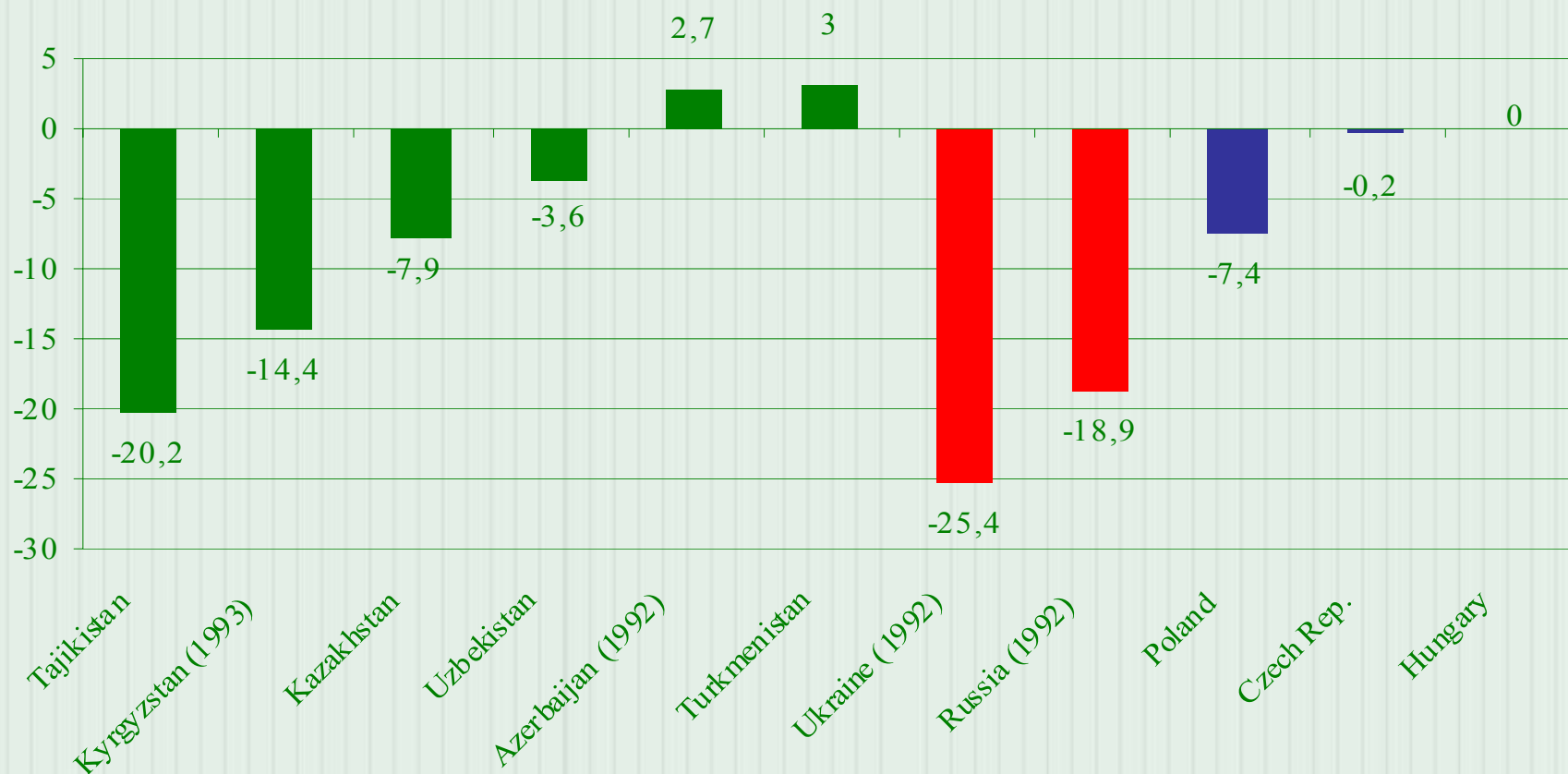
Trade dependence on the Soviet Union and other Comecon countries markets

Trade with Comecon countries 1990 (% GDP).



Level of macroeconomic imbalances

**General government balance (% GDP), the year before transition began
(1989 for Poland, 1990 for the Czech Rep. and Hungary, 1991 for the former Soviet Union countries)**



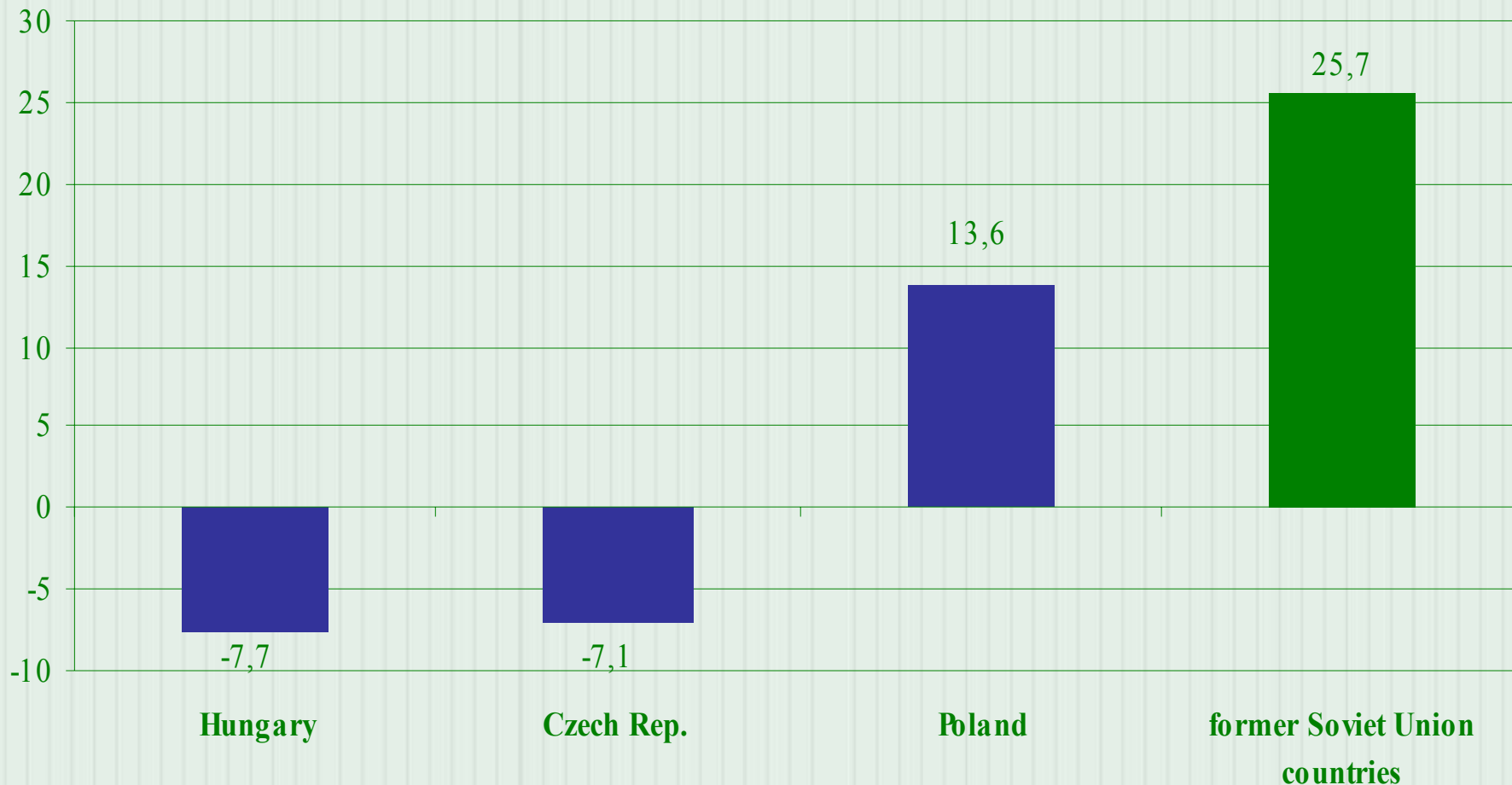
Source: EBRD Transition Report 2001

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“Repressed” inflation 1987-1990

(percent change in the average real wage less the percent change in real GDP over 1987-1990)

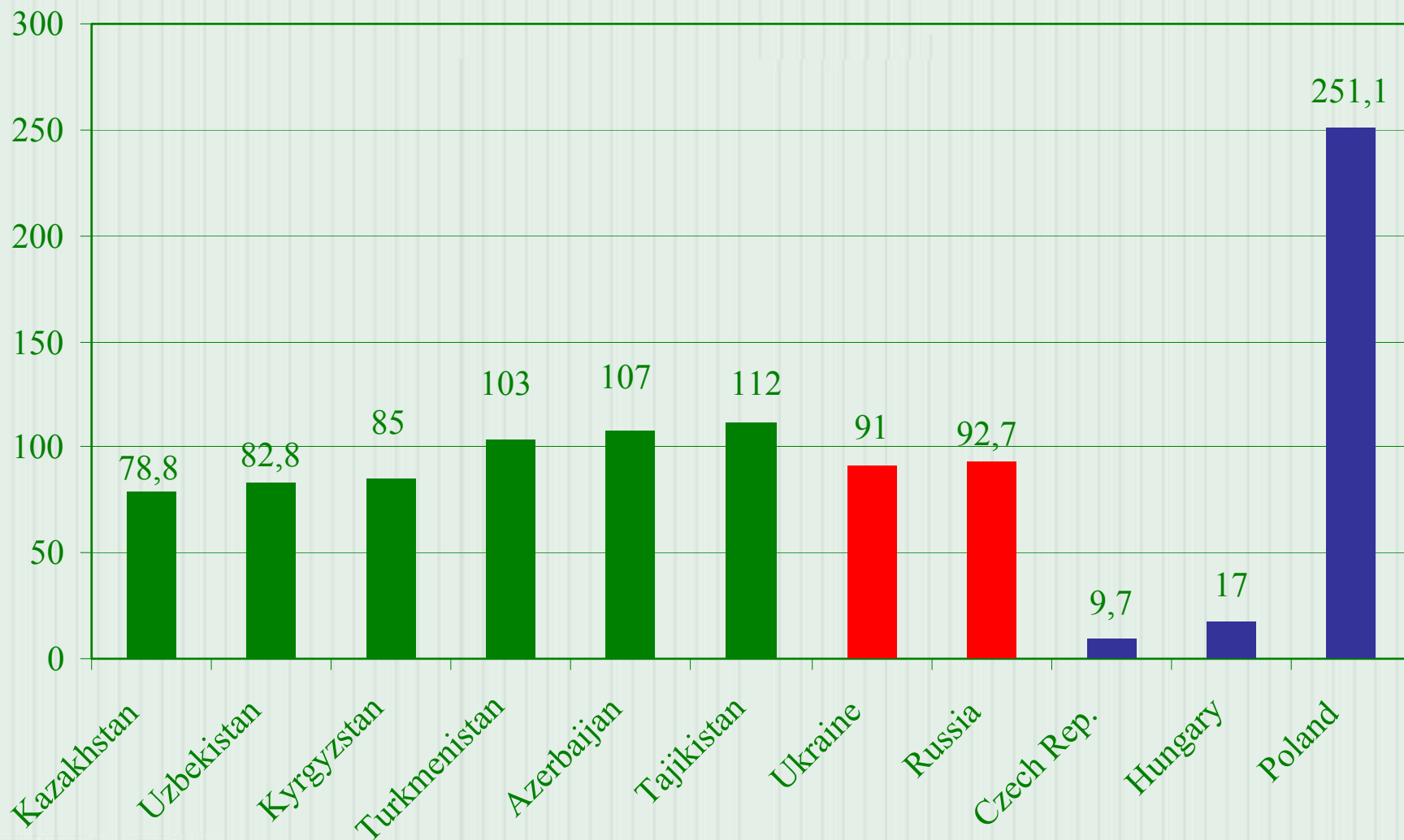


Source: IMF World Economic Outlook, October 2000

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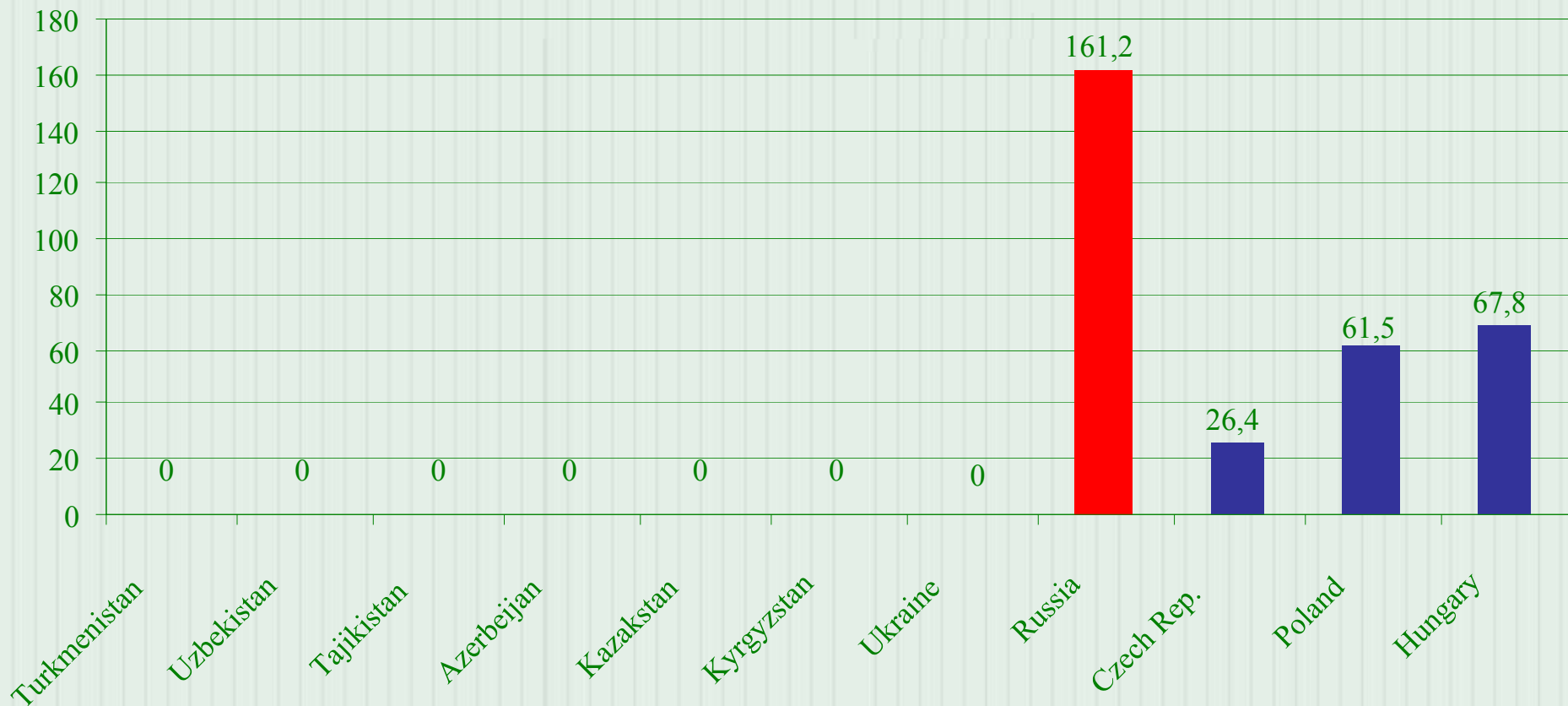
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**Inflation (annual average, in per cent), the year before transition began
(1989 for Poland, Hungary, 1990 for the Czech Rep., 1991 for the former Soviet Union countries)**



Source: EBRD Transition Report 2001

Level of external debt (percentage of GDP) at the beginning of transition (1991).



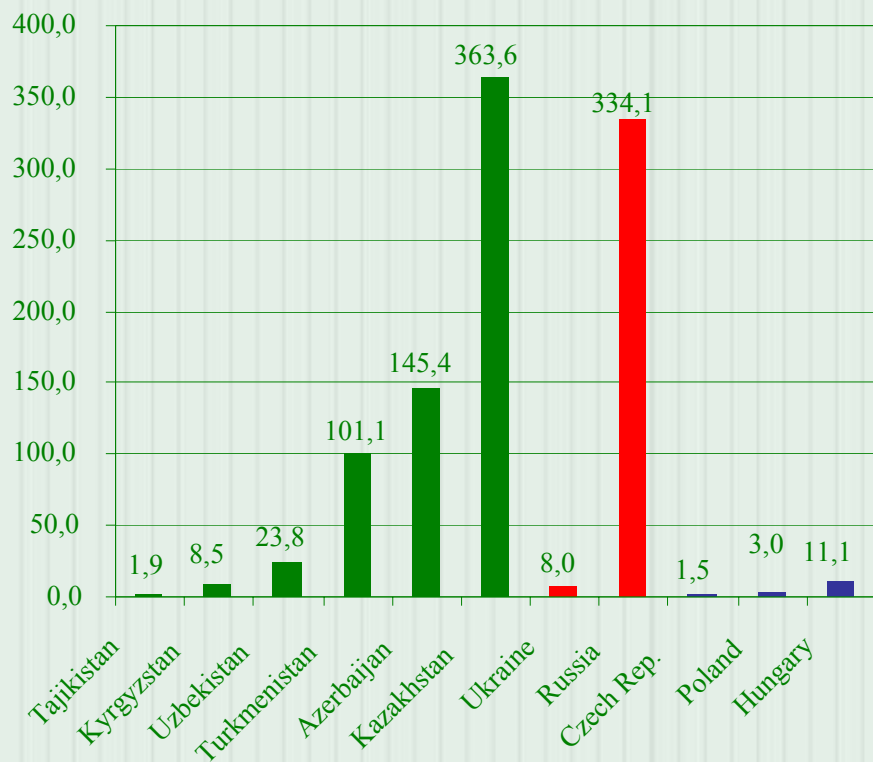
Source: EBRD (1999)

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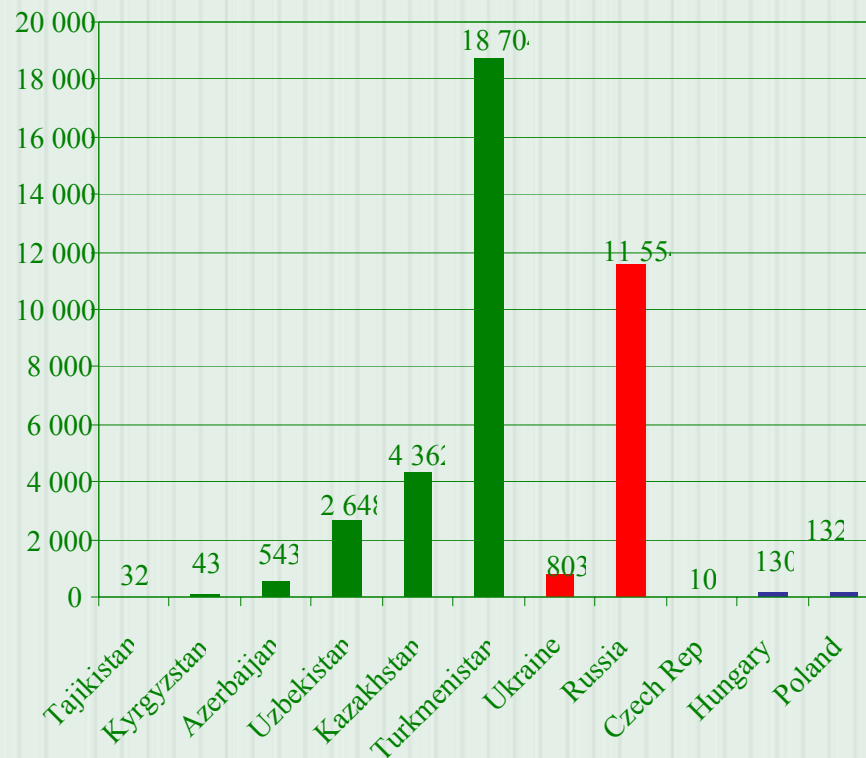
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Resources of oil and gas in transition countries

Crude oil (barrels per capita)

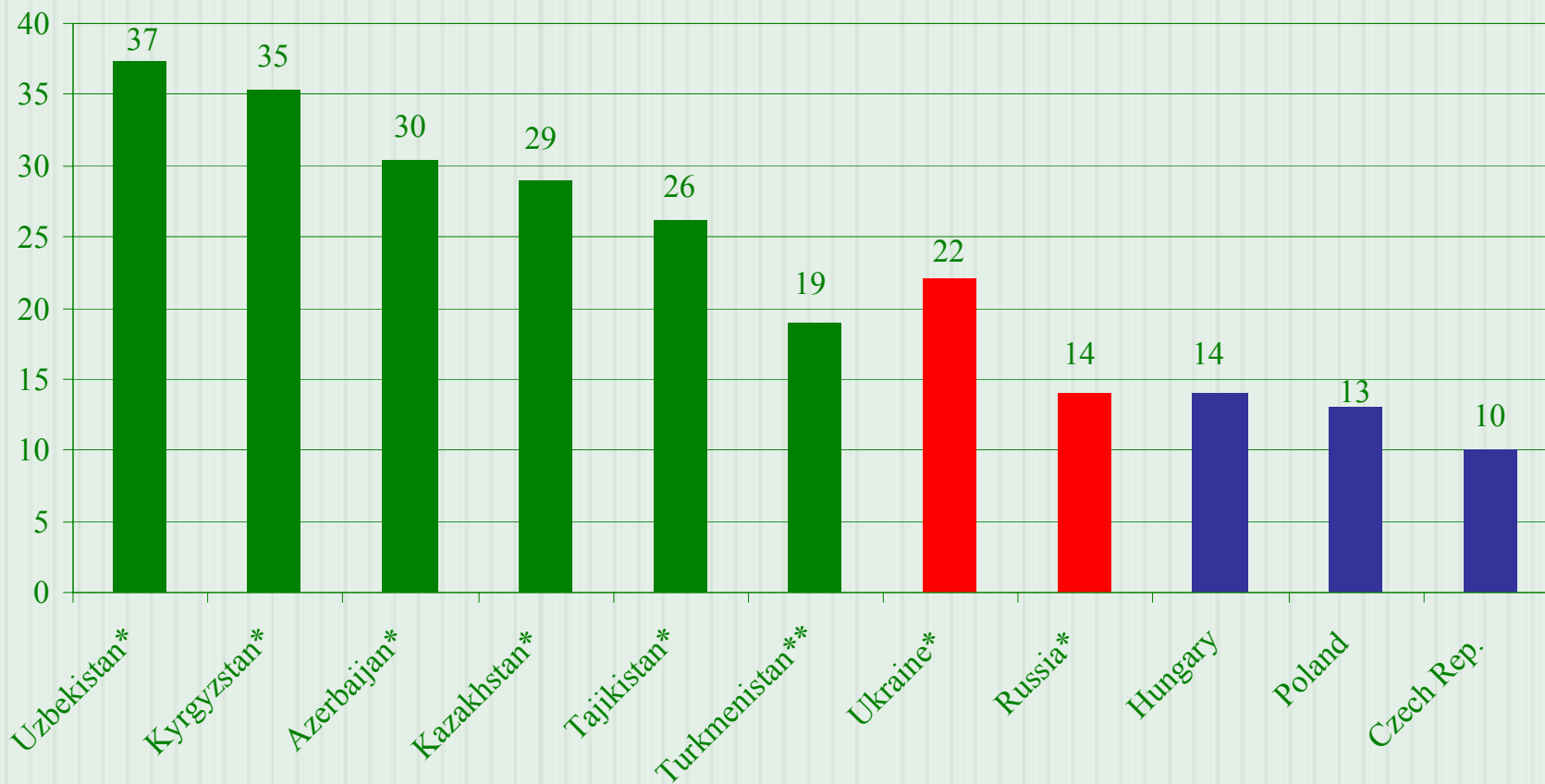


Natural gas (thousand cubic feet per ca)



Source: Energy Information Administration, EBRD.

Share of agriculture in GDP (in per cent)

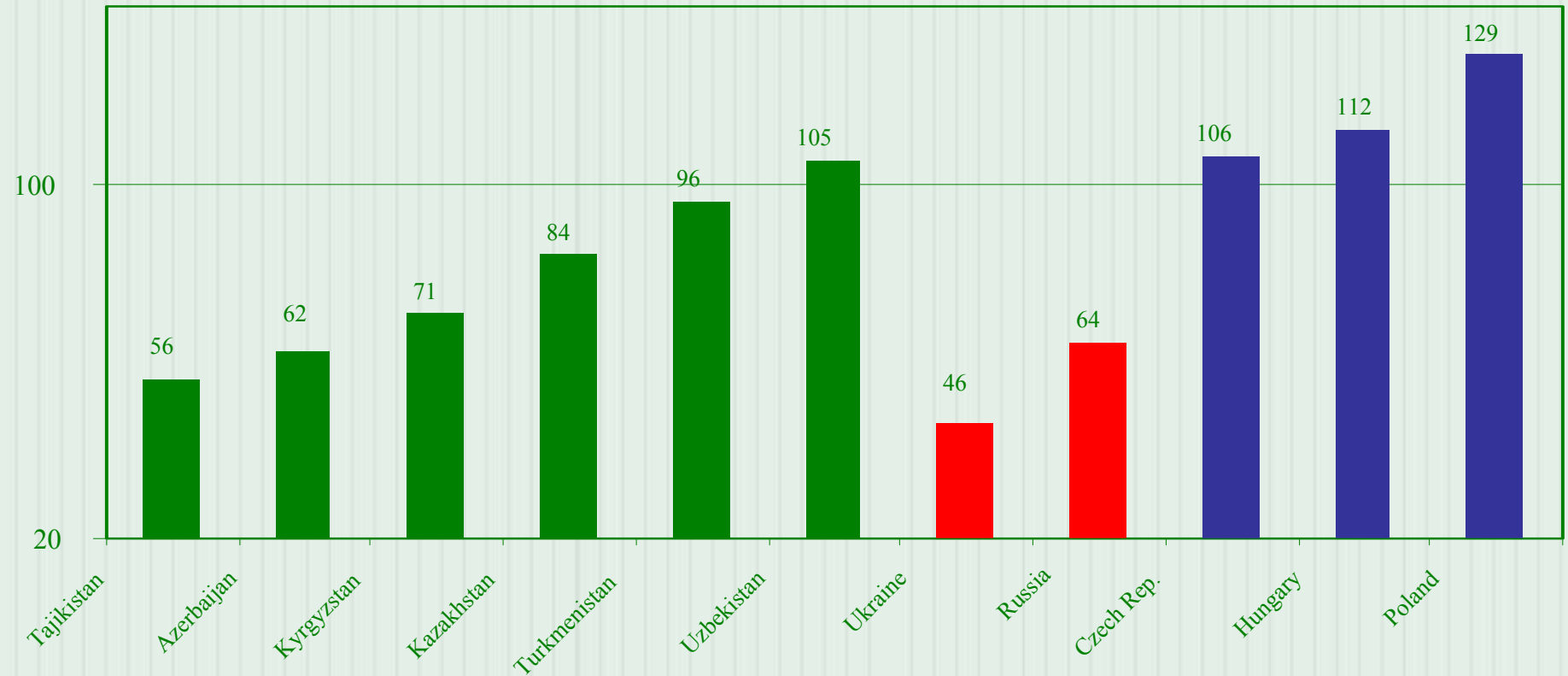


1989 (*1991, **1992)

Source: EBRD Transition Report 1999

Countries in the former Soviet bloc had achieved hugely different economic outcomes just 10-12 years after the collapse of communism.

Real GDP in 2001 (1989=100)

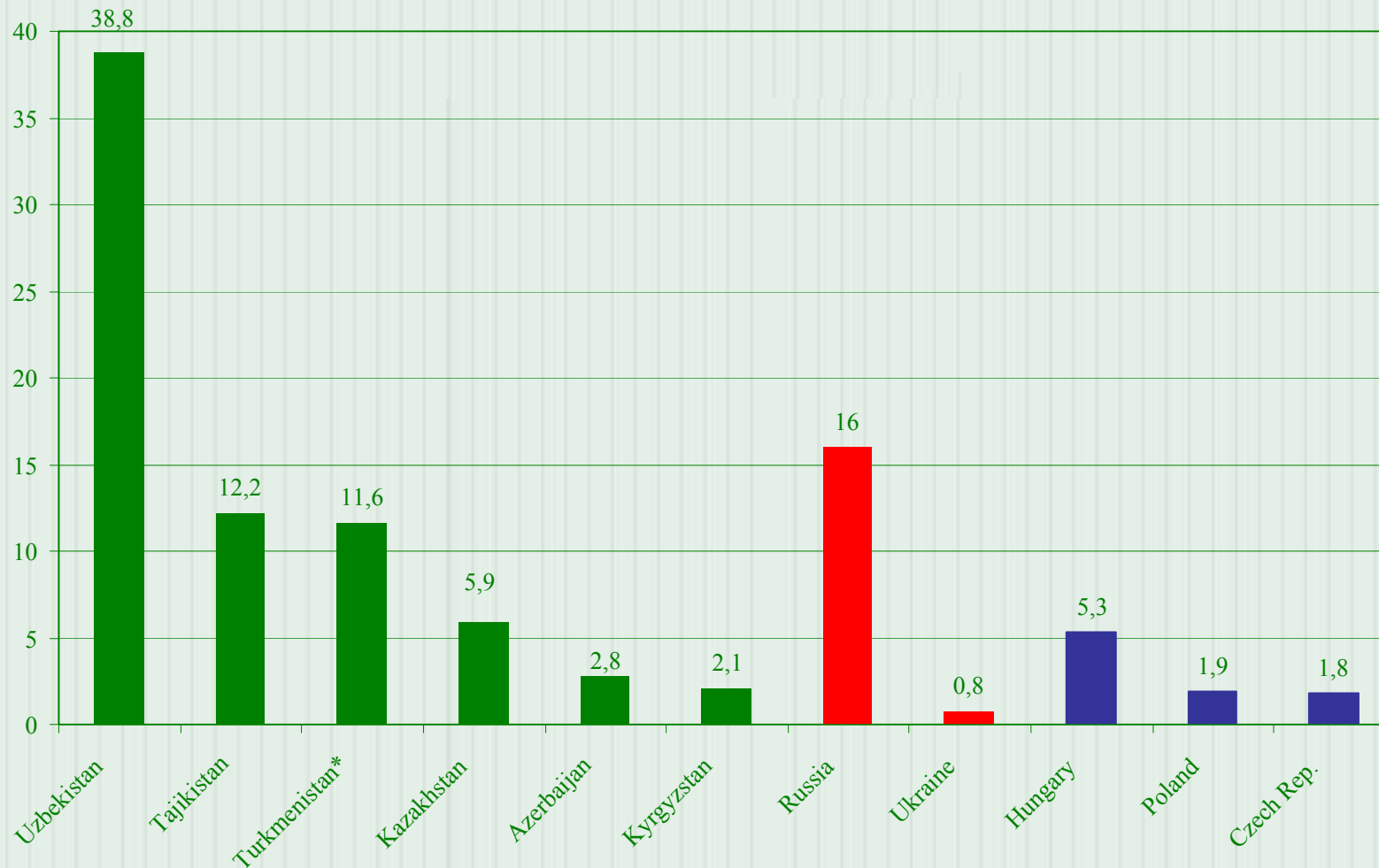


Source: EBRD Transition Report 2002.

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Inflation, 2002 (annual average, in per cent)



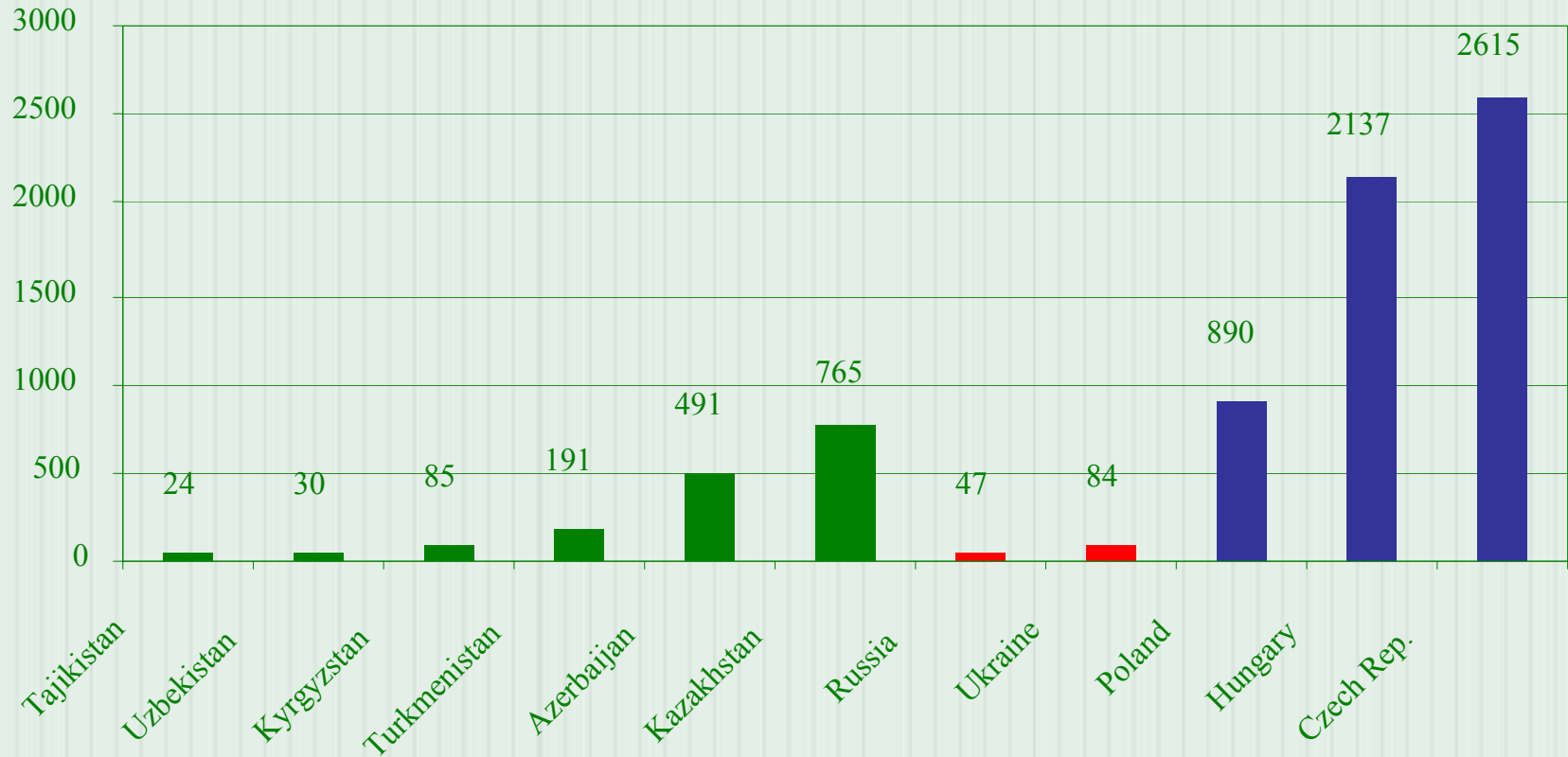
* 2001

Source: EBRD Transition Report 2002, World Economic Outlook, IMF, April 2003

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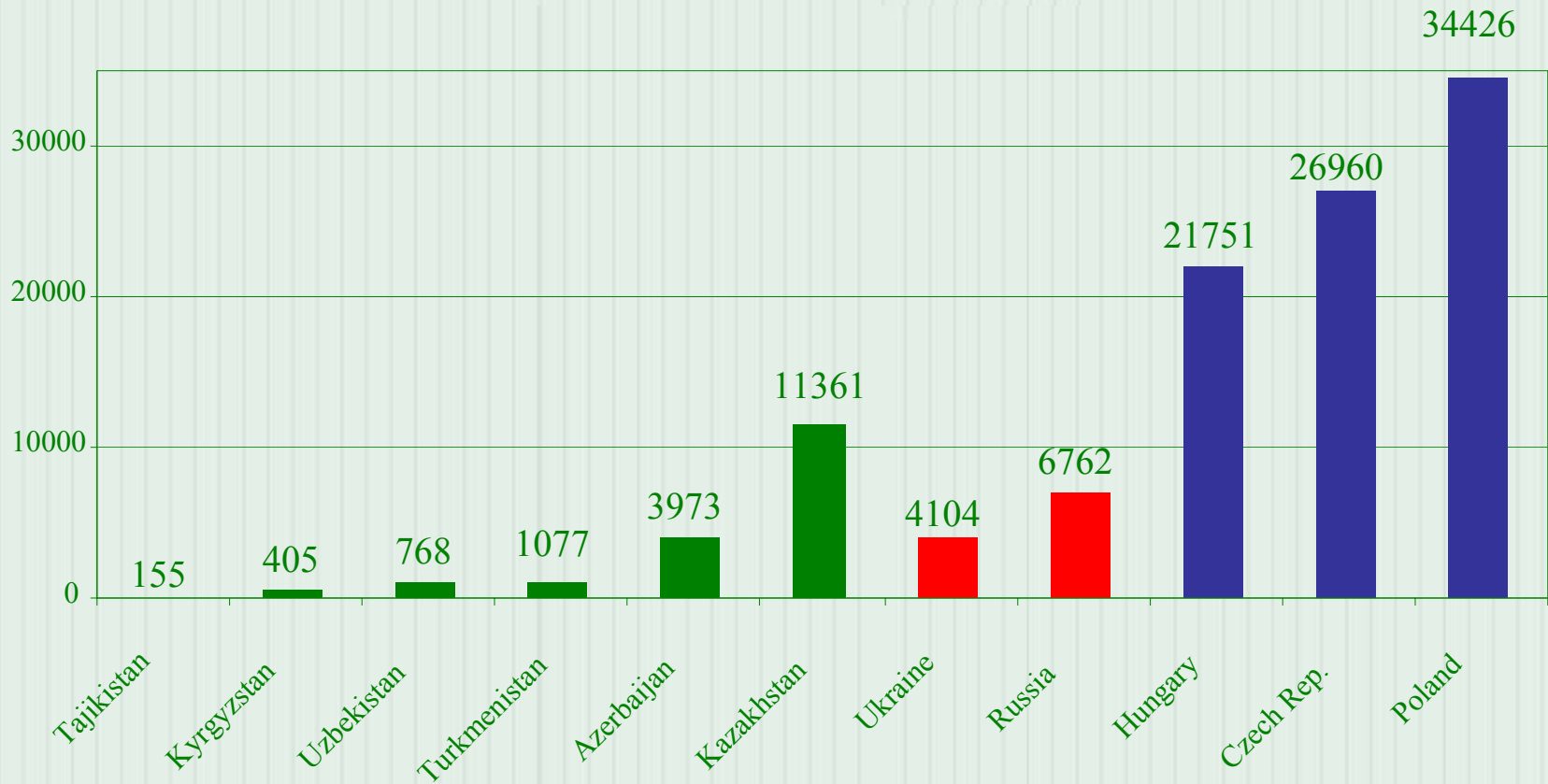
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Cumulative FDI-inflows per capita (in USD), 1989-2001.



Source: EBRD Transition Report 2002.

Cumulative FDI-inflows (in USD mln), 1989-2001.

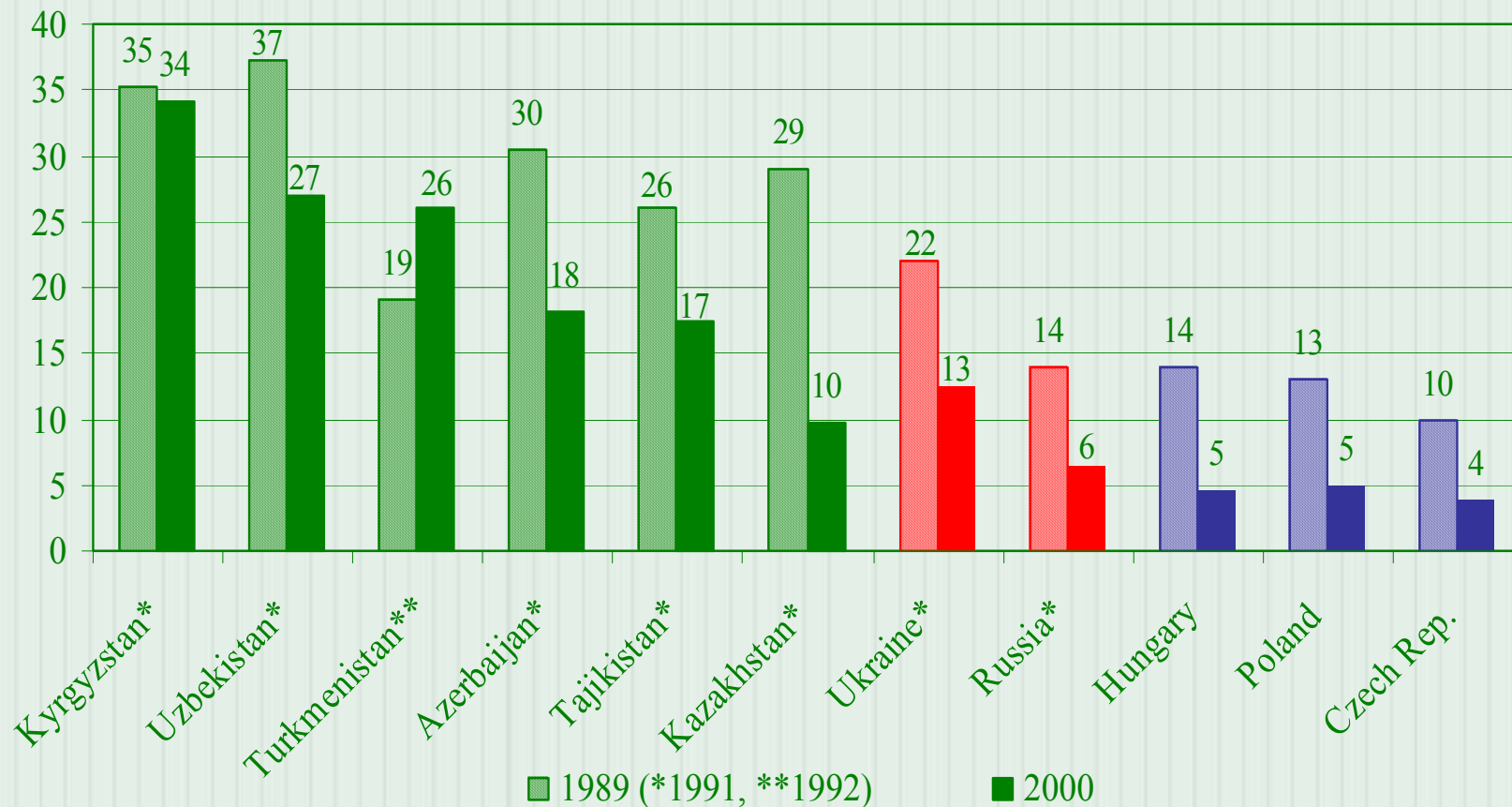


Source: EBRD Transition Report 2002

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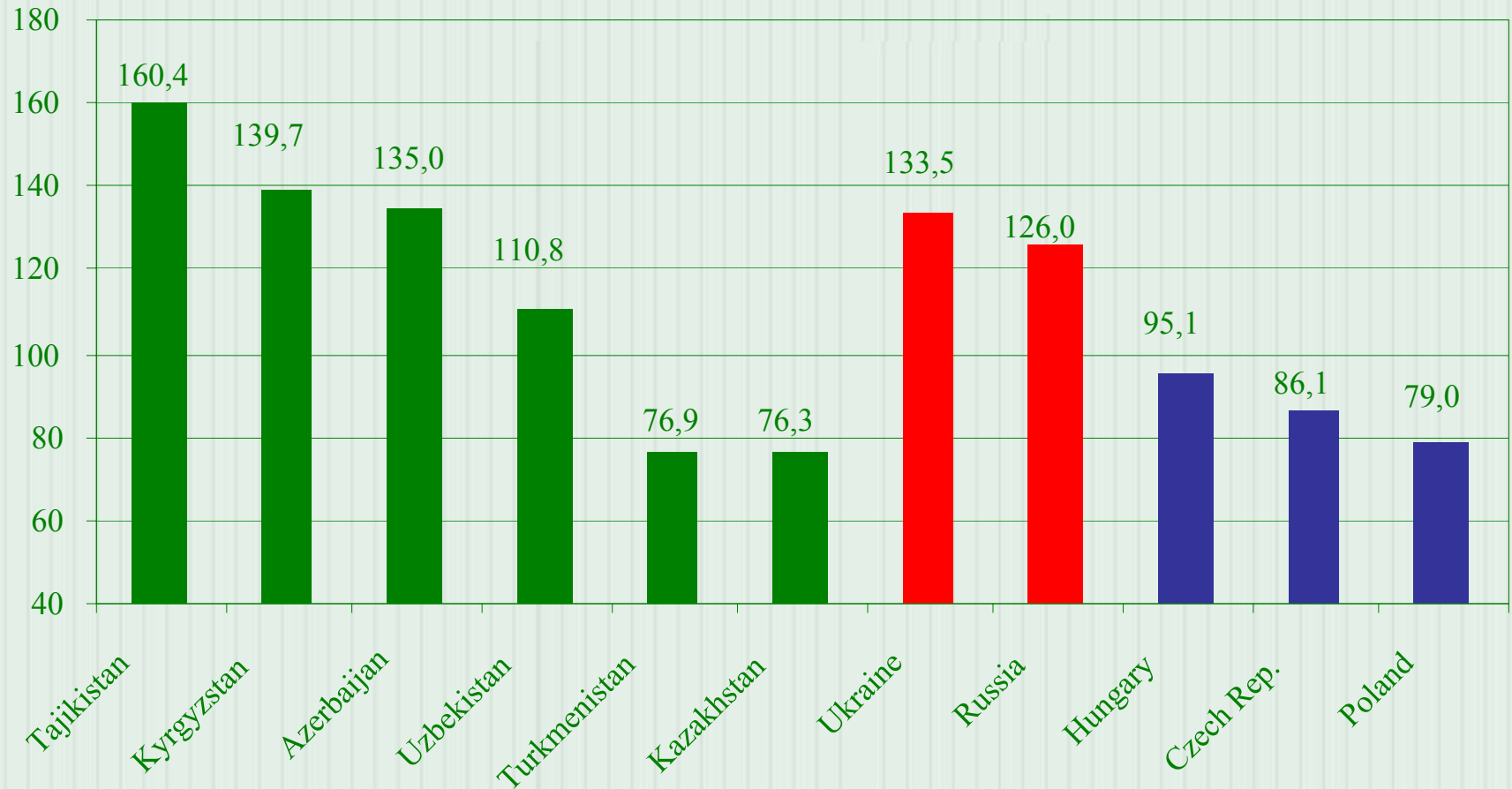
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Share of agriculture in GDP (in per cent)



Source: EBRD Transition Report 1999, 2002

Electricity consumption/GDP in 1998 (1989 = 100).

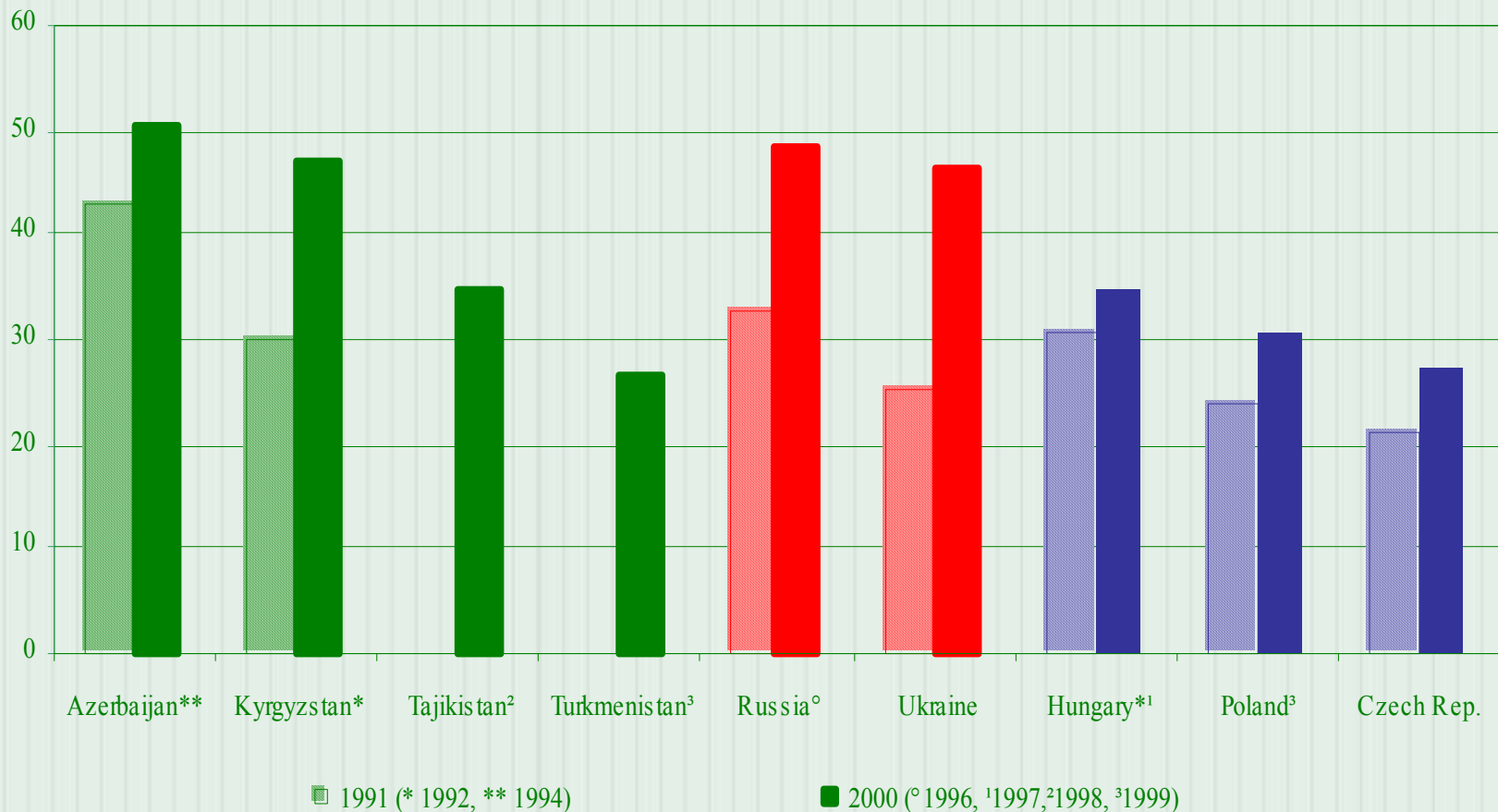


Source: EBRD Transition Report 2001.

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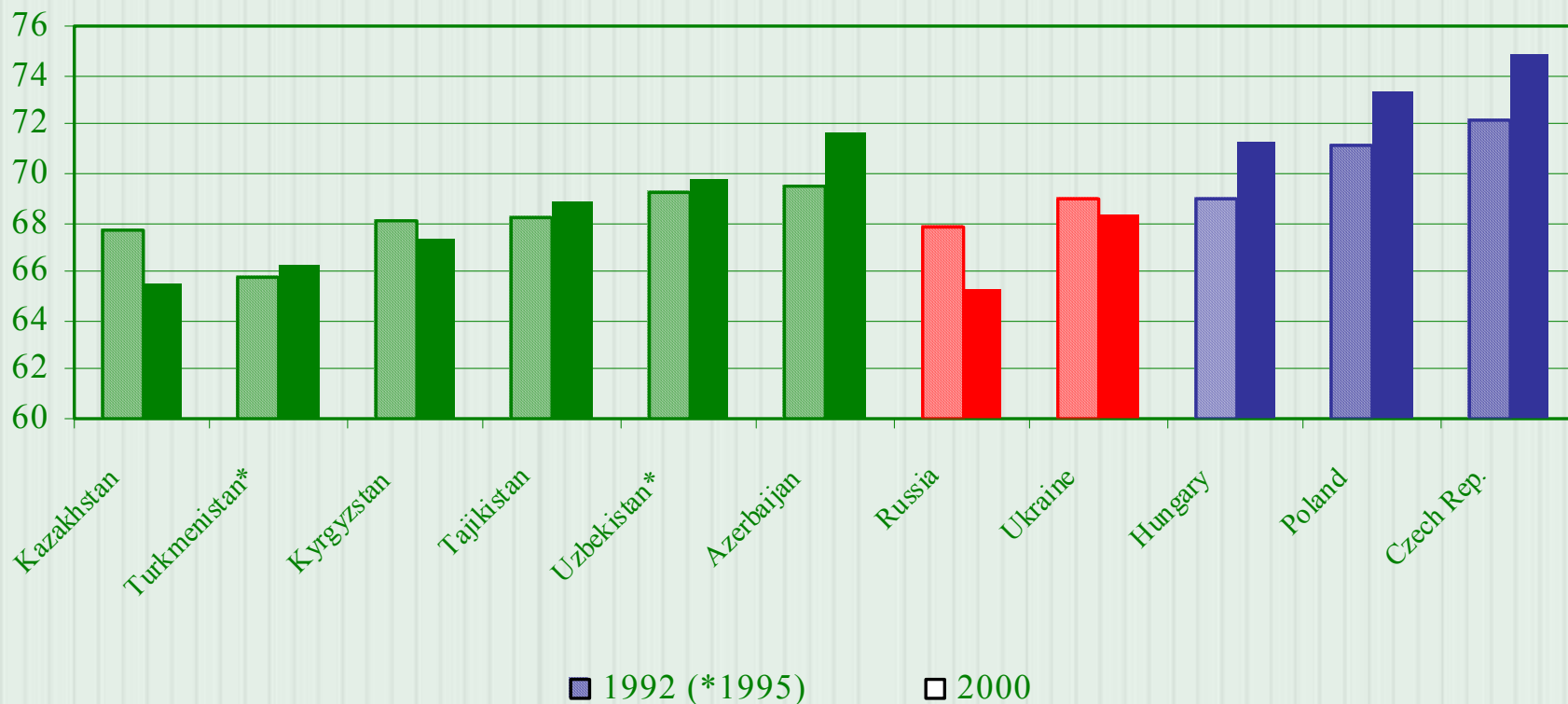
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Earnings inequality in transition countries (as measured by the GINI coefficient) increased the quickest and to the highest levels in countries which lagged behind in reforms and obtained relatively poor economic results.



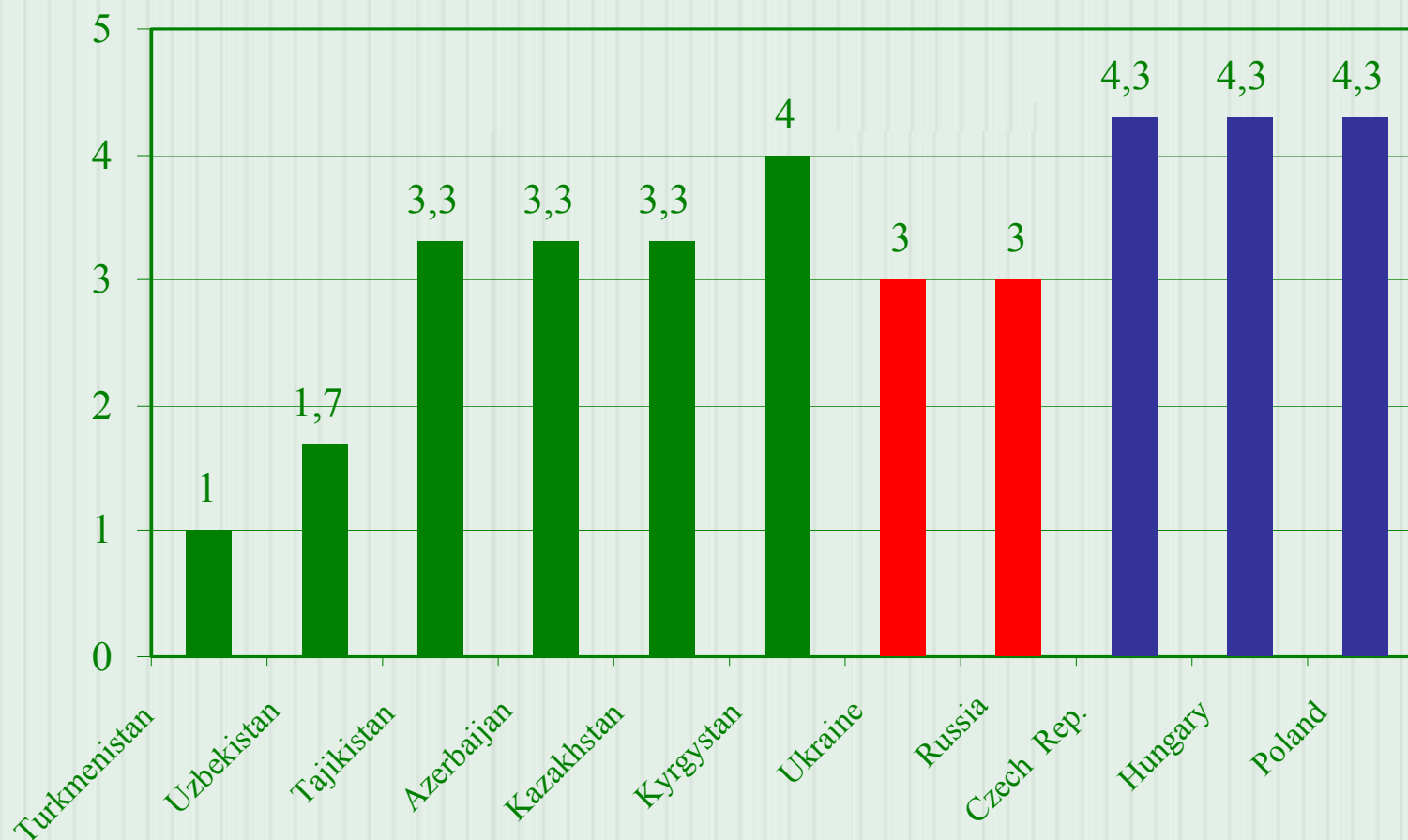
Countries with relatively better economic outcomes also displayed more favorable developments in health.

Life expectancy at birth (years)



Source: EBRD Transition Report 2002

EBRD Index of foreign exchange and trade liberalisation (2001)



1 - Illiberal

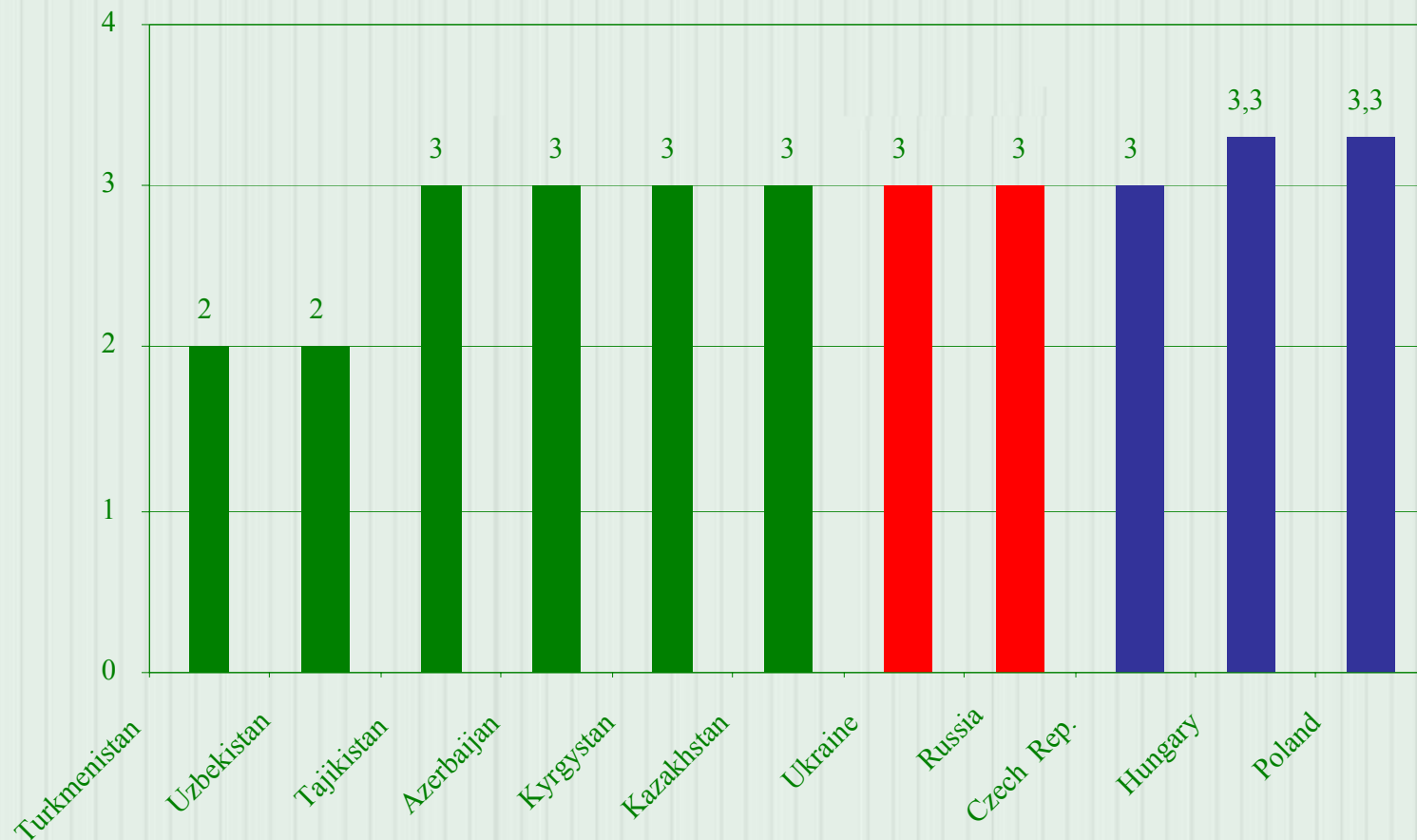
4,3 - Liberal, standards of advanced industrial economies, membership in the WTO

Source: EBRD Transition Report 2002

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EBRD Index of price liberalisation (2001)



1 - Most prices formally controlled

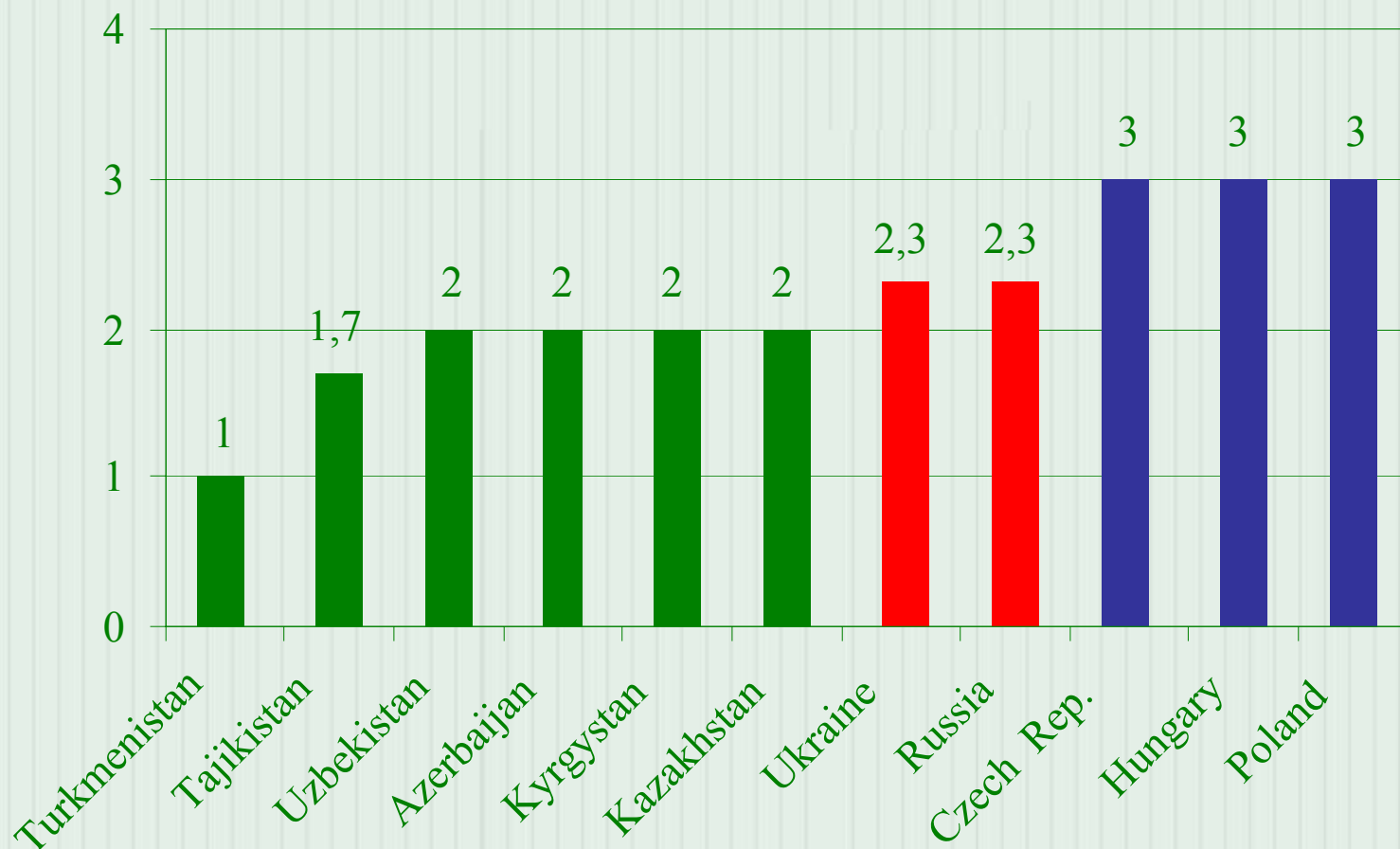
4,3 - Standards of advanced industrial economies

Source: EBRD Transition Report 2002

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EBRD Index of competition policy (2001)



1 - No competition in legislation and institutions

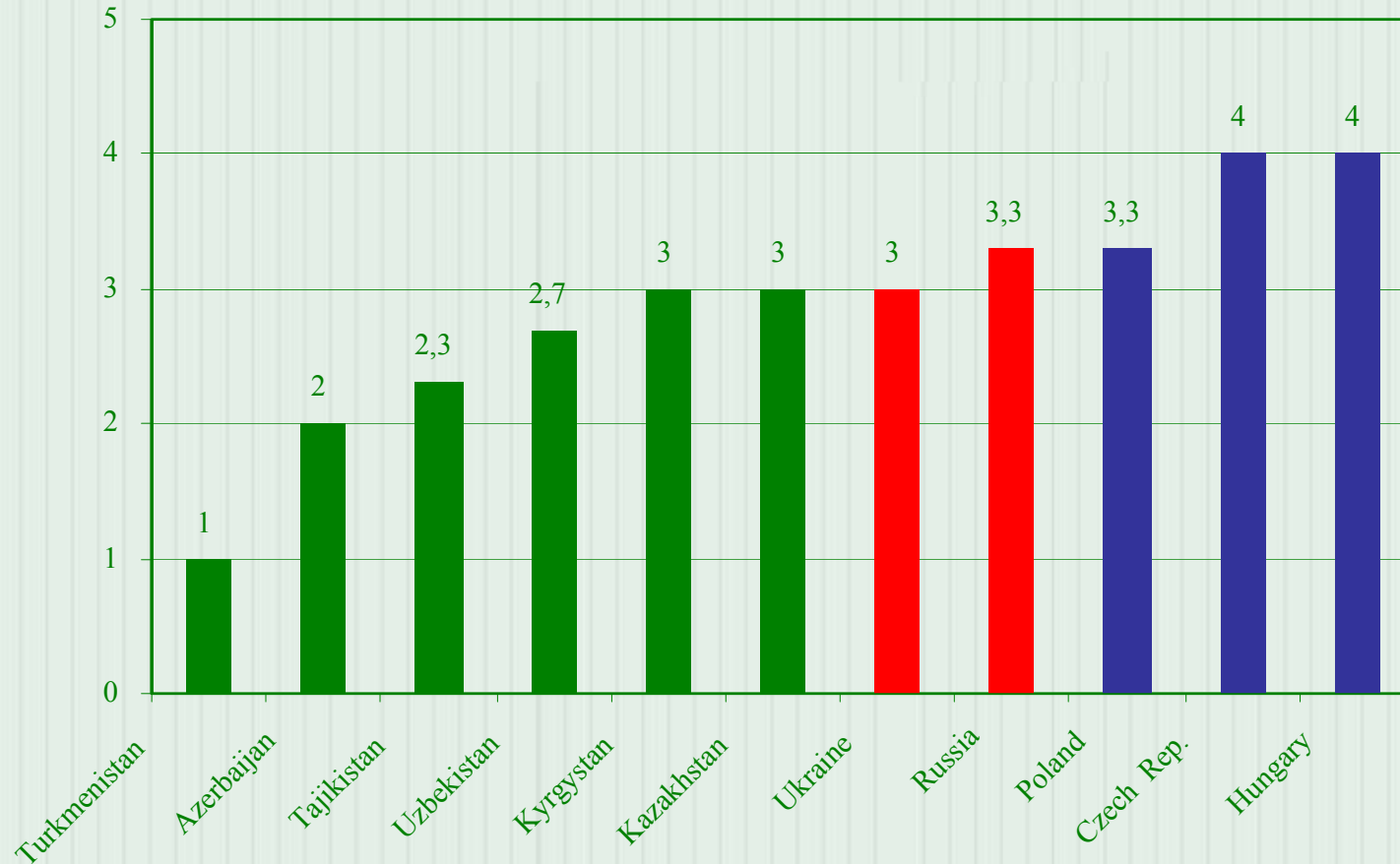
4,3 - Standards of advanced industrial economies

Source: EBRD Transition Report 2002

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EBRD Index of large-scale privatisation (2001)



1 – Small extent of private ownership

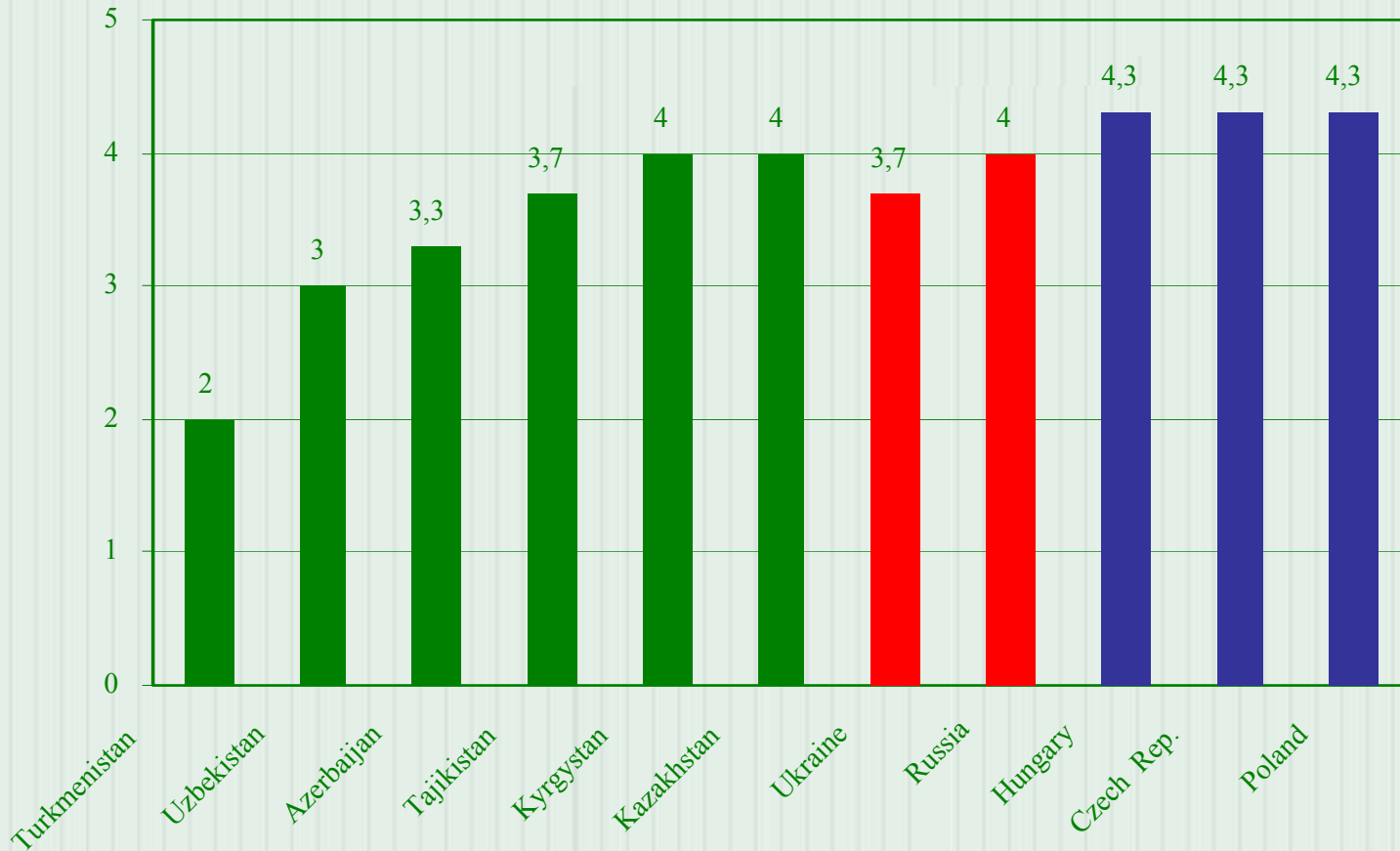
4,3 - Standards of advanced industrial economies

Source: EBRD Transition Report 2002

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EBRD Index of small-scale privatisation (2001)



1 - Small extent of private ownership

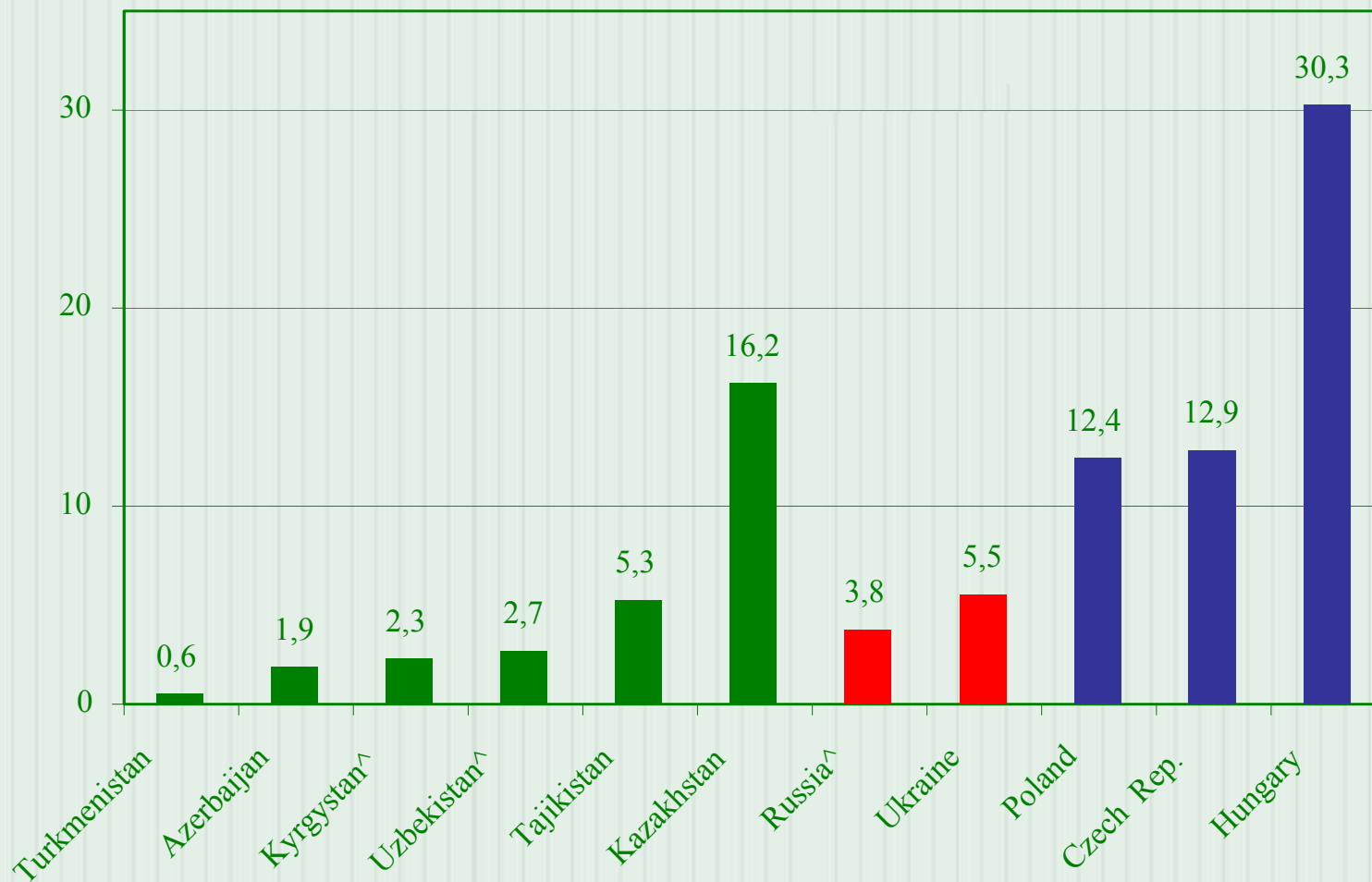
4,3 - Standards of advanced industrial economies

Source: EBRD Transition Report 2002

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Privatisation revenues (cumulative up to 2001, as a % of GDP)



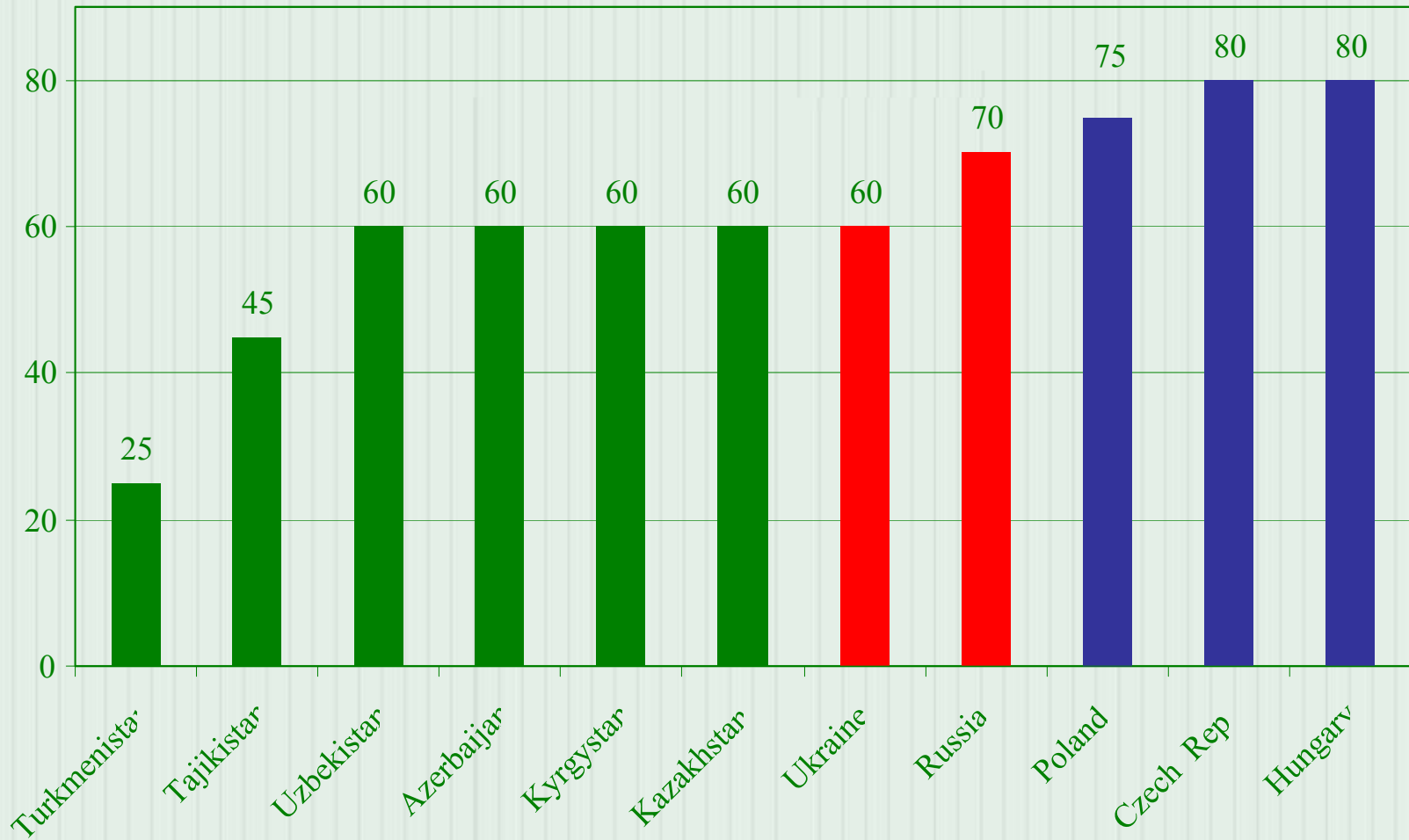
Source: EBRD Transition Report 2002

^ Year 2000

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Private sector share in GDP (in per cent, 2001)

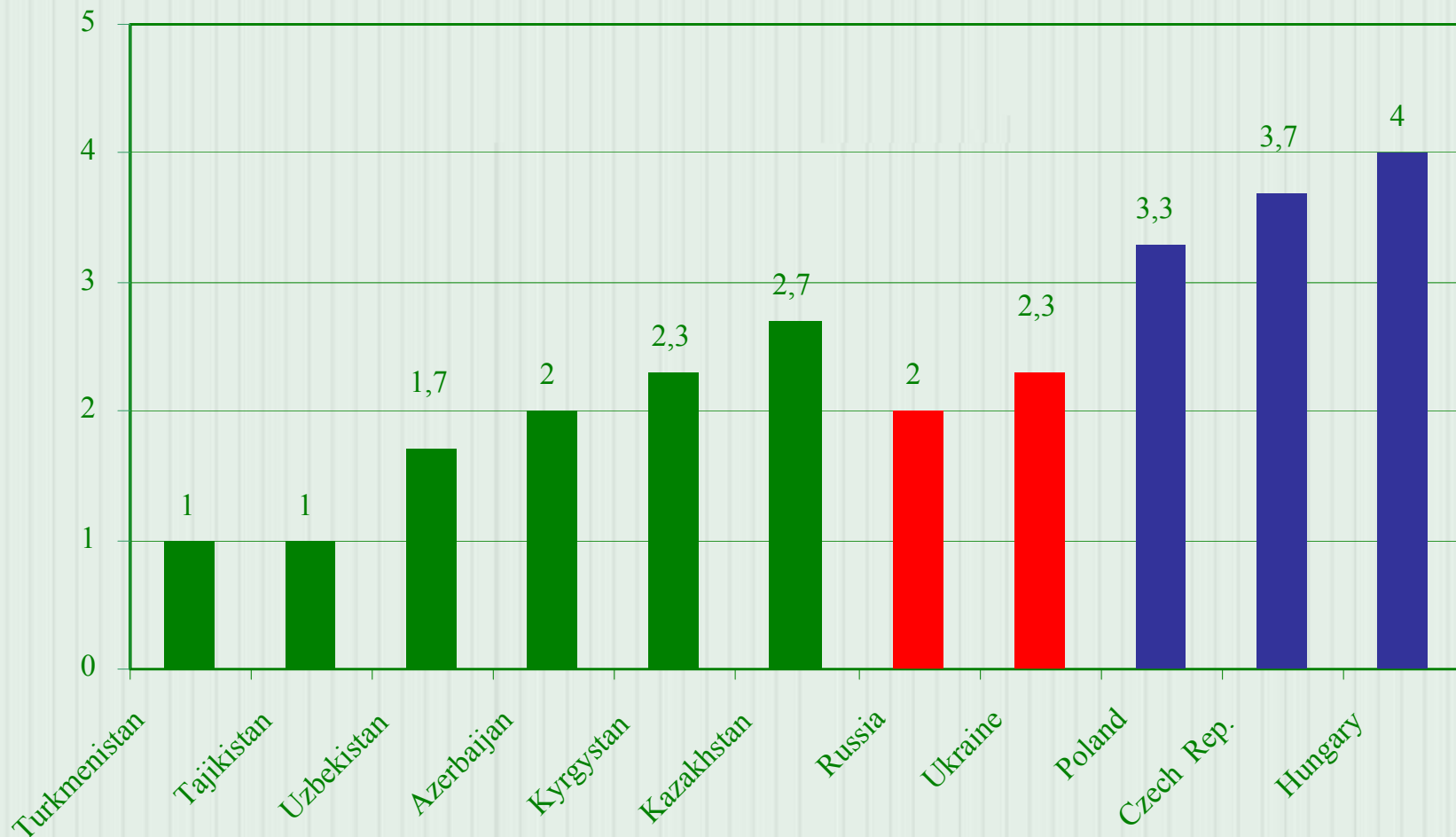


Source: EBRD Transition Report 2002

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EBRD Index of banking sector reform



1 - Little progress beyond the establishment of a two-tier system

4,3 - Standards of advanced industrial economies

Source: EBRD Transition Report 2002

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