

Course 9823: Transition Meets Development

Stockholm School of Economics

Fall 2006

The experience of countries in transition from centrally planned to market economy has taught the economic profession at least two important lessons. The first lesson is that macroeconomic stability is important for economic growth. The second lesson is that macroeconomic stability is not sufficient for economic growth. A big field that emerged in the recent past is institutional economics, with the primary idea that the rules and traditions created by humans are very important for economic development. This has been pointed out by many economists, for instance, Nobel laureates Douglas North and Ronald Coase. The business community and policy-makers are equally aware of the important role of institutions for growth. The World Bank's Annual *World Development Report 2002*, titled "*Building Institutions for Markets*," discusses how to build laws, courts, enforcement agencies and political institutions supporting markets.

In many countries, not only former socialist economies, achieving macroeconomic stability and building institutions requires large-scale systemic change from one set of (bad) policies and institutions to another set. This is the focus of the field of "transition economics". While the emergence of the field was triggered by the dramatic transformation of centrally-planned economies into market economies, the lessons from this experience has since influenced many other fields of economics and shaped the way economists think about institutional change. Many developing countries now discuss their development challenge in terms of "transition", and development and transition economists are joining forces in the quest to understand institutions and institutional change.

This course uses the transition experience in Central and Eastern Europe, the former Soviet Union and Asia to shed light on these larger issues of economic growth and development. We will concentrate on both issues: how to achieve macroeconomic stability and then how to build appropriate institutional framework. We will investigate the initial conditions facing these countries as they embarked on transition as well as the policies they implemented in the areas of privatization, combating inflation, dealing with balance of payment crises, financial sector reform, corporate governance, labor market and political reform. Why did some countries succeed and others fail? What are the prospects for future reforms and catching-up with Western Europe? In the process of the course the students will acquire a better understanding of how institutions change (or don't change) and how change is brought about (and what hinders change): How do initial conditions affect the outcome of reforms? How are different policies of reform related to each other? What is the role of the state in the reform process?

The course addresses students who want to understand and operate in environments undergoing large-scale institutional change. Different actors, such as foreign companies and banks, national and international organizations play an important role in the transformation of these countries, but this role is changing throughout the transition process. International

financial institutions and bilateral aid agencies have contributed in several ways, but the returns to these efforts differ across countries and policy areas. What are the roles of foreign actors in the long-term economic development of these countries? In particular what role has the possibility of accession to the European Union played?

Requirements and Grades:

Readings should be done in advance of class meetings to facilitate discussion. The course grade will be based on a comprehensive final exam (40 percent), a term project (40 percent), and the quality of class participation (20 percent). The final exam is scheduled for October 13th. The term project will be done in teams of three-five students, who will work together to produce a single paper on a well-defined topic. In principle, any topic within the economics of transition and development can be chosen, but teams are advised to consult with the instructors concerning the feasibility and desirability of chosen topics. The purpose of the project is to permit students to explore areas of particular interest in greater detail than is possible in the regular class meetings. The project has several stages and deadlines:

1. Group membership and provisional topic-title, Prospectus and bibliography (5 points), Sep 15
2. Presentation in class
3. Final version of term paper (35 points), October 10

The prospectus should contain a clear statement of a question that the project will address and of the methods and information to be used in answering it. A list of references should be attached; the list should contain only works that are relevant to the question and that are cited in the prospectus.

Literature:

Students are required to purchase a copy of the book

Shleifer, Andrei and Daniel Treisman, *Without a Map: Political Tactics and Economic Reform in Russia*, Cambridge: MIT Press, 2000.

Other readings will be articles distributed in class or available from the course web page.

Course Schedule:

SESSION ONE, August 29, 10.00-12.00, Room 336

The legacy of socialism and initial conditions at the start of reforms

Issues: Soviet growth model; structure of the economy at the start of transition; reasons for output collapse; mismeasurement of output collapse.

*Ofer, Gur, "[Soviet Economic Growth: 1928-1985](#)," *Journal of Economic Literature*, December 1987

*Sachs, Jeffrey, "[Reforms in Eastern Europe and the Former Soviet Union in Light of the East Asian Experience](#)," *Journal of the Japanese and International Economies*, December 1995, v. 9, iss. 4, pp. 454-85 (a prior version exists as NBER WP 5404).

Kornai, Janos, 1992, *The Socialist System: The Political Economy of Communism*. Princeton University Press. Chapters 3, 4, 5, 6, 7, 8, 9 (copies available from Lilia Kouzmina, room 931).

SESSION TWO, August 31, 10.00 – 12.00, Room 336
Towards macroeconomic stability

Issues: Sources of chronic inflation in developing world; sources of high inflation in early years of transition; methods and results of inflation stabilization programs in developing world; comparison to Russian experience

*Shleifer and Treisman, Chapter 3

*Calvo, Guillermo A., and Carlos A. Végh, "Inflation Stabilization and BOP Crises in Developing Countries," in John Taylor and Michael Woodford, *Handbook of Macroeconomics* (Volume C; North Holland, 1999), pp. 1531-1614. (A prior version exists as [NBER WP 6925](#)). **Only sections 1-3 need to be read.**

SESSION THREE, September 5, 10.00 – 12.00, Room 336
Financial crisis and the conquest of inflation

Issues: First generation model of currency crises; unpleasant monetarists arithmetic and relevance to Russia; second and third generation models of currency crises; additional political reasons of the Russian 1998 crisis; experience of Central European countries with inflation stabilization; inflation targeting in Poland, Czech Republic, and Hungary.

*Kharas, Homi; Pinto, Brian; Ulatov, Sergei, "[An Analysis of Russia's 1998 Meltdown: Fundamentals and Market Signals](#)," *Brookings Papers on Economic Activity*, 2001, v. 0, iss. 1, pp. 1-50

*Berglöf, Erik and Patrick Bolton, 2002, "The Great Divide – Financial Architecture in Transition," *Journal of Economic Perspectives*, Vol.16, No.1, Winter 2002, pp.77-100.

Jonas, Jiri; Mishkin, Frederic S., "[Inflation Targeting in Transition Countries: Experience and Prospects](#)," 2003, NBER Working Papers: 9667.

SESSION FOUR, September 7, 10.00 – 12.00, Room 194
From stabilization to economic growth: the role of institutions

Issues: Sources of economic growth; introduction to institutional economics; evidence on the link of institutions and growth; instrumental variable techniques to establish causality.

*Acemoglu, D., S. Johnson, and J. Robinson, 2004, "[Institutions as the Fundamental Cause of Long-Term Growth](#)," forthcoming in the Handbook of Economic Growth

*Glaeser, E., R. La Porta F. Lopez-de-Silanes, and A. Shleifer, 2004 "Do Institutions Cause Growth?", *Journal of Economic Growth*, 9 (previous version as [NBER WP 10568](#)).

Rodrik, D., A. Subramanian, and F. Trebbi, 2004, "[Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development](#)," *Journal of Economic Growth*.

Easterly, William, [The Elusive Quest for Growth: Economists' Adventures and Misadventures in the Tropics](#), MIT Press, 2001

SESSION FIVE, September 12, 10.00 –12.00, Room 328
The political economy of reforms: big-bang versus gradualism

Issues: Political impediments on the way of reforms; arguments in favor of a big-bang versus gradualist approach; rent-seeking.

*Roland, Gerard, 2002, "The Political Economy of Transition," *Journal of Economic Perspectives* 16(1), Winter, 29-50.

*Shleifer and Treisman, Chapter 1,2,4

Hellman, Joel, 1998, "Winners Take All: The Politics of Partial Reform in Post-communist Transitions," *World Politics*, 50: 203-34.

SESSION SIX, September 14, 10.00 – 12.00, Room 194
Privatization and corporate governance.

Djankov, Simeon and Peter Murrell (2002), "Enterprise Restructuring in Transition:

A Quantitative Survey", Journal of Economic Literature, Vol. XL (September 2002) pp. 739792.

*Gerard Roland, Transition and Economics, Chapter 10 (Comparing Policies of Privatization and Restructuring), pp229 - 264

Estrin, Saul (2002),
"Competition and Corporate Governance in Transition"
Journal of Economic Perspectives, Winter 2002, 101-124

SESSION SEVEN, September 19, 10.00 – 12.00, Room 336
Fiscal federalism structure: Russia vs. China

Issues: Determinants of the size of nations; optimal degree of centralization in a federate state; incentives for local governments; state capture at the local and federal level.

*Blanchard, Olivier and Shleifer, Andrei, "[Federalism with and without Political Centralization: China versus Russia](#)," IMF Staff Papers, Special Issue 2001, v. 48, iss. 0, pp. 171-79

*Shleifer and Treisman, Chapter 6

Desai, Raj M.; Freinkman, Lev M.; Goldberg, Itzhak, Fiscal Federalism and Regional Growth: Evidence from the Russian Federation in the 1990s, 2003, The World Bank, Policy Research Working Paper Series: 3138

Decentralization of Governance and Development; By *Bardhan*, Pranab; Journal of Economic Perspectives, Fall 2002, v. 16, iss. 4, pp. 185-205

SESSION EIGHT, September 21, 13.00 – 15.00, Room 336
Labor markets in transition.

*Boeri, Tito, and Katherine Terrell, "Institutional development of Labor Reallocation in Transition," *JEP* 16(1), 2002, 51-76.

SESSION NINE, September 26, 10.00 – 15.00, Room 336
Outcomes: Internal Accountability

Issues: Internal forces that drive reforms in Russia; detailed look at the mood of entrepreneurs in 2000s

*Shleifer, Andrei, and Daniel Triesman, 2005, "[A Normal Country: Russia After Communism](http://post.economics.harvard.edu/faculty/shleifer/papers/normal_country_jep.pdf)", *Journal of Economic Perspectives*, 2005
(http://post.economics.harvard.edu/faculty/shleifer/papers/normal_country_jep.pdf)

*Case study: The CEFIR monitoring of administrative barriers to small business development, reports available at [CEFIR website](http://www.cefir.ru/). Read the fifth round report only.

SESSION TEN, September 28, 10.00 – 12.00, Room 336

Outcomes: External Accountability - The Case of EU Enlargement

Issues: External forces that drive reforms in Eastern Europe; the influence of the EU on reforms in accession countries.

*Roland, Gérard, 2004, After Enlargement: Institutional Achievements and Prospects in the New Member States, mimeo, European Central Bank.
(will be shortly available for download from course website)

Baldwin, Richard, Joseph François and Richard Portes, 1997, “The Costs and Benefits of Eastern Enlargement: The Impact on the EU and Central Europe,” *Economic Policy*, April, pp. 125-170.
(will be shortly available for download from course website)

Berglöf, Erik and Gerard Roland, 2001, “From ‘Regatta’ to ‘Big Bang?’—The Impact of the EU Accession Strategy on Reforms in Central and Eastern Europe,” IMF Working Paper.
(will be shortly available for download from course website)

Botero, J., S. Djankov, R. La Porta, F. Lopez-de-Silanes, and A. Shleifer, 2004, “The Regulation of Labor” , *Quarterly Journal of Economics*, November (downloadable http://post.economics.harvard.edu/faculty/shleifer/papers/labor_June04.pdf)

SESSION ELEVEN, October 3, 9.00 – 12.00, Room 542

Presentation of Group Projects

SESSION TWELVE, October 5, 9.00 - 12.00, Room 328

Presentation of Group Projects

SESSION THIRTEEN, October 10, 9.00 - 12.00, Room 328

Presentation of Group Projects

October 13th : Written examination

