Contents

List of Figures ix
List of Tables x
List of Contributors xiii

Part I. **Introduction and Overview**

1. Structural and Institutional Factors in the Transition to the Market Economy: An Overview 3
   Giovanni Andrea Cornia and Vladimir Popov

Part II. **Lessons from Selected Country Case Studies**

2. Russia: Inconsistent Shock Therapy with Weakening Institutions 29
   Vladimir Popov
3. Reform Paths in Central Asian Transitional Economies 55
   Richard Pomfret
4. The Chinese Road to the Market: Achievements and Long-term Sustainability 78
   Fan Gang
5. Vietnam: Transition as a Socialist Project in East Asia 94
   Manuel F. Montes
6. The Tortuous Road to the Market in North Korea: Problems and Prospects 114
   Keun Lee
7. Cuba: The Stalled Transition 132
   Manuel Pastor Jr

Part III. **Changes in Key Institutions**

8. Economic Performance in Transitional Economies: The Role of Ownership, Incentives, and Restructuring 153
   Derek C. Jones

9. Unorthodox Ownership and Governance Structures in Transitional East Asia 171
Laixiang Sun

10. Transition Approaches, Institutions, and Income Inequality 192
Giovanni Andrea Cornia

11. Informal Institutions, Social Capital, and Economic Transition: Reflections on a Neglected Dimension 218
Martin Raiser

References 240
Index 263

PART I

INTRODUCTION AND OVERVIEW

1

Structural and Institutional Factors in the Transition to the Market Economy: An Overview

GIOVANNI ANDREA CORNIA AND VLADIMIR POPOV

1.1. INTRODUCTION

Despite widespread hopes for a rapid move to political democracy and economic prosperity, the transition to the market economy has brought about a large and abrupt recession and significant increases in unemployment in most countries of Eastern Europe and of the former Soviet Union. In contrast, the reforms introduced since 1978 in China and 1987 in Vietnam were accompanied by a sharp acceleration in the growth of output and rapid improvements in living standards. The move to the market is thus characterized by considerable cross-country variation in policy approaches and outcomes.

With the exception of China and Vietnam, all former socialist economies experienced a severe recession during the initial phase of the transition to a market-type economy. In Eastern and Central Europe the contraction of output lasted for three to four years and ranged from 20 to 30 per cent, while in most CIS countries output continued to fall for seven years in a row and is now less than 50 per cent of the pre-downturn level (Table 1.1). Among the European countries, Poland is that which has registered the most satisfactory performance. The slide of output was stopped already in 1992, and since 1993 GDP grew at a rapid pace while inflation and, to some extent, unemployment were simultaneously reduced, state enterprises started to be restructured, and market institutions built.

Most studies on the impact of the transition have attributed these variations in economic performance to three sets of causes: (i) the policy approaches followed in the field of stabilization, liberalization, and privatization; (ii) differences in initial macroeconomic conditions; and (iii) the availability of external finance. This approach, however, does not explain why apparently different strategies have produced similar results under similar initial conditions (compare, for instance, the cases of gradualism in China and shock therapy in Vietnam), or why better results were achieved under supposedly inferior approaches (compare Uzbekistan and Kyrgyzstan), or why several countries (Moldova is symptomatic of such a situation) which realized important

Table 1.1. *GDP change in transition economies, 1990–1999 (1989 = 100)*

Countries/Years	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Eastern Europe and Baltic countries[(a)]	*93*	*83*	*80*	*81*	*84*	*88*	*92*	*95*	*97*	*99*
Albania	90	65	58	65	72	78	85	79	86	93
Bulgaria	91	80	74	73	74	75	67	63	66	66
Croatia	93	74	66	65	66	67	71	76	78	78
Czech Republic	99	87	84	85	87	93	96	97	94	94
Estonia	92	82	70	65	64	66	69	76	79	79
Hungary	96	86	83	82	85	86	87	91	96	99
Latvia	103	92	60	51	52	51	53	57	59	60
Lithuania	95	89	70	59	53	55	58	62	65	65
FYR Macedonia	90	83	77	70	69	68	69	70	72	72
Poland	88	82	84	88	93	99	106	113	118	123
Romania	94	82	74	75	78	84	87	82	76	73
Slovak Republic	97	83	78	75	79	84	90	95	100	101
Slovenia	95	87	83	85	89	93	96	101	105	108
CIS states[(a)]	*96*	*90*	*78*	*70*	*61*	*57*	*55*	*56*	*54*	*54*
Armenia	93	77	36	31	32	35	36	38	41	42
Azerbaijan	88	87	67	52	42	38	39	41	44	46
Belarus	97	96	86	78	70	63	64	71	78	79
Georgia	88	69	38	29	25	26	29	32	33	34
Kazakhstan	100	87	84	76	67	61	62	63	61	60
Kyrgyzstan	103	98	79	67	53	50	54	59	60	60
Moldova	98	80	57	56	39	38	35	35	32	30
Russia	96	91	78	72	62	60	58	58	55	55
Tajikistan	98	91	65	58	47	41	39	40	42	44
Turkmenistan	102	97	92	83	66	63	58	42	44	52
Ukraine	97	85	74	63	49	43	38	37	37	36
Uzbekistan	102	101	90	88	85	84	85	87	90	93
China	104	112	127	145	162	178	195	213	229	246
Mongolia	98	88	82	81	83	88	90	94	97	—
Vietnam	105	111	120	130	141	155	169	183	193	—

Note: [(a)] Weighted average.
Sources: EBRD (1999); for the Asian non-CIS economies, World Bank (1996*a*) and Asian Development Bank (1999) (Key Indicators).

progress in all three above areas, now have domestic markets dominated by highly protected privatized monopolies little regulated by formal institutional arrangements, limited 'new entries', no growth and extremely high inequality.

While these analyses have served their purpose during the stabilization phase of the transition, their present usefulness is limited. The explanation of the success in containing the transformational recession, restarting growth, and developing appropriate economic structures must, therefore, be sought elsewhere, i.e. in factors which often cut across traditional taxonomies.

This volume attempts to fill—however partially and imperfectly—this gap. It discusses the causes of the observed differences in economic performance and optimal policy responses for the future. Its main conclusions are that differences in output performance are explained by variations in initial 'structural' and 'institutional' conditions and in institutional developments during the transition, i.e. factors that are usually thought to be of secondary importance, such as the preservation of adequate capability of the state, the establishment of competitive markets, the expansion of the new private sector, the introduction of adequate incentives and maintenance of an incentive-compatible distribution of income, and so on. In contrast, factors such as the speed of liberalization do not matter as much, or the evidence on their role is not conclusive.

The volume also tries to fill a second gap in the transition debate. While a considerable literature has appeared on the experience of the transitional economies of Eastern and Central Europe, much less is known about the case of the gradual, late and partial reformers of Asia (including Central Asia) and of the former Soviet Union. With rare exceptions (Kazakhstan and Kyrgyzstan), these countries have followed a transition strategy very different from that of countries of Central Europe. Countries such as China, Vietnam and, to some extent, Uzbekistan—for instance—have been cautious liberalizers and slow privatizers. With the introduction of new forms of ownership, their economies now simultaneously comprise a variety of property rights regimes. In spite of problems met in the initial phases of the reforms, they have been able to sustain the public provision of social services and contain the rise of income concentration within reasonable limits (regional inequality surged in China after 1990).

By managing to preserve the institutional capacity of the state, these countries avoided the institutional collapse which, in most CIS countries, outweighed the positive impact of liberalization. For instance, as Pomfret points out in this volume, Uzbekistan's gradual reform strategy proved superior to that of Kazakhstan which followed a more liberal approach but was unable to create a well-functioning market economy, and is in danger of ending up with a market model in which cronyism and organized crime play a more significant role than the price mechanism.

With the view of filling, if only in part, the 'geographical gap' of the transition literature, our study includes six national case studies which deal mainly with less well analysed nations. Besides the 'classical' models of gradual institutional development (China) and inconsistent shock therapy with weakening institutions (Russia), the volume includes the less studied and understood cases of the Central Asian economies and Vietnam, which, as it turns out, allow the shedding of new light on old transition questions. All case studies focus on the extent to which differences in performance during the transition may be explained by uneven initial structural and institutional conditions and the development of institutions during the transition or should be attributed to other factors.

The two countries that are still operating under central planning—Cuba and North Korea—are also included in this analysis. This provides the opportunity to speculate on what lessons these economies can draw from the transition experience elsewhere, and on how long they can stall a deepening of reforms. As noted by Pastor (this volume), Cuba has already begun a 'transition to somewhere', adjusted to the massive loss of Soviet subsidies, and engineered some output recovery. Yet, there are clear limits to its present minimalist approach to reforms, and it is possible that the country will sooner or later be forced to accelerate policy changes in this area by another economic slowdown. North Korea has also introduced some modest changes in the light industrial sector and agriculture (Lee, this volume). However, the situation is rapidly worsening, and the rationality of this 'extreme gradualism' is getting increasingly difficult to accept.

1.2. NEGLECTED FACTORS IN THE EXPLANATION OF THE TRANSFORMATIONAL RECESSION

The conventional wisdom has probably been best summarized in the 1996 World Development Report *From Plan to Market*, which basically stated that differences in economic performance were associated mostly with 'good and bad' policies, in particular with the progress in liberalization and macroeconomic stabilization: countries that are more successful than others in introducing market reforms and bringing down inflation were believed to have better chances to limit the reduction of output and to quickly recover from the transformational recession. 'Consistent policies, combining liberalization of markets, trade, and new business entry with reasonable price stability, can achieve a great deal even in countries lacking clear property rights and strong market institutions'—was one of the major conclusions of the WDR 1996 (p. 142). Thus, countries that are more successful than others in introducing market reforms and bringing down inflation are believed to have better chances to limit the fall of output and quickly recover from the transformational recession.

While this may well be true as a general theoretical statement, the devil is in the details which often do not fit into the generalizations and make straightforward explanations look trivial. Take the example of Vietnam and China, two countries that shared a lot of similarities in initial conditions and achieved basically the same results (immediate growth without transformational recession) despite different reform strategies. While the Chinese reforms are normally treated as a classical example of gradualism, the Vietnamese reformers introduced a shock therapy in 1989 and still managed to avoid a slump in output (Montes, this volume).

Or, take the example of the differing performance of the states of the former Soviet Union. The champions of liberalization and stabilization in the region are definitely the Baltic states (with a 1995 EBRD cumulative liberalization index ranging between 2.4 and 2.9), whereas Uzbekistan (with an index of 1.1) is commonly perceived to be one of the worst procrastinators. However, in Uzbekistan output fell by only 18 per cent over 1990–5, the economy started to grow again in 1996 and in 1999 was only 7 per cent below its 1989 level, while in the Baltics output fell in the early 1990s by 36–60 per cent and in 1999, five years after bottoming out, was still 21–40 per cent below its 1989 level (Table 1.1).

At a first glance, there seems to be a positive relationship between liberalization and performance (Fig. 1.1). However, a more careful consideration reveals that the link is

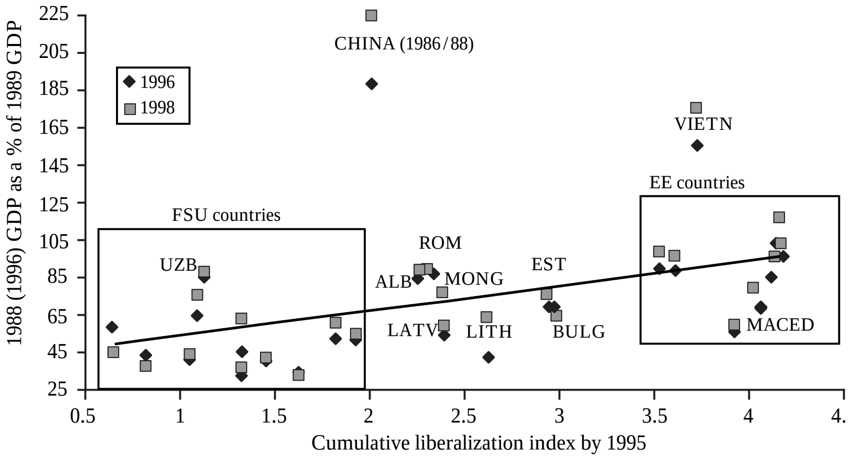

Figure 1.1. *Relation between the extent of liberalization and economic performance in a cross section of economies in transition*

just the result of a sharp difference in the magnitude of the recession in EE countries, as a group, and FSU states, also as a group. Within these groups the correlation, if any, is much weaker, not to speak about China and Vietnam, which are outliers. Similarly, there is no correlation between liberalization index and performance, as measured by changes in industrial output and GDP, for over 80 regions of Russia (Popov 1999*c*).

Overall, attempts to link differences in output changes during transition to the cumulative liberalization index and to macro-stabilization (rates of inflation) have not yielded satisfactory results: dummies, such as membership in the rouble zone (i.e. FSU) and war destruction, have been shown to be much more important explanatory variables than either the liberalization index or inflation (Åslund *et al.* 1996). Other studies that tried to take into account a number of initial conditions (repressed inflation—monetary overhang before deregulation of prices, trade dependence, black market exchange rate premium, number of years under central planning, urbanization, and per capita income) found that in some cases liberalization becomes insignificant as well (De Melo *et al.* 1997, p. 25).

1.2.1. *Initial Structural Conditions*

A substantial portion of the variation in output performance during the transition may be explained by the distortions in the industrial structure and trade patterns inherited from the centrally planned system. The socialist economies differed considerably among each other in terms of the importance of the military sector, extent of over-industrialization, underdevelopment of the service sector, 'under-openness' of the economy, and share of exports to the Soviet republics and among socialist countries. The greater these structural distortions (measured by an aggregate indicator expressed as a percentage of GDP), the more difficult it was to sustain output during restructuring. After accounting for initial structural conditions, the conventional picture of relative significance of various policy-related factors changes considerably.

This explanation—which emphasizes the difficulties faced in restructuring the supply side of the economy—implies that market imperfections hamper the reallocation of resources across sectors, causing in this way a temporary loss of output as the decline in the production of non-competitive industries is not offset immediately by an increase in the production of competitive ones. This asymmetric effect is due to the existence of barriers to capital and labour mobility, poorly developed banking systems and securities markets, uncertain property rights, lack of easily enforceable and commonly accepted bankruptcy and liquidation procedures, the underdevelopment of housing and labour markets, and so on.

In view of this, a low level of economic development (in particular, lower capital/output ratios) may represent a certain advantage, as the resources to be reallocated from the declining to the expanding sector of the economy are substantially smaller. According to this explanation, the Vietnamese and Chinese reformers were therefore less penalized by the legacy of socialism, thanks to the relatively modest weight of the distorted industrial and agricultural structure they inherited from the socialist era. The Chinese communes had little fixed capital stock and proved to be much more amenable to reform than the Soviet and East European state farms which comprised a huge centralized infrastructure poorly suited to family farming.

In contrast to China and Vietnam (and, to some extent, Albania and Mongolia), the East European, Baltic and the CIS states entered the transition with huge accumulated investments in fixed capital stock and were thus doomed to experience a more pronounced transformational recession. Among the countries with modest structural distortions (less than 30 per cent of GDP), one finds Slovenia, Croatia, Macedonia, the Czech and Slovak republics, and Hungary. All these countries, with the exception of war-affected Macedonia, performed better than most other transitional economies (Table 1.1). On the other hand, among countries with aggregate distortions of over 50 per cent of GDP one finds all the former Soviet republics except Russia (where aggregate distortions amounted to 39 per cent of GDP). Taking into account the other two non-policy factors characterizing the initial structural conditions, one finds that about half of the variations in performance may be explained by the level of development, aggregate distortions, and the war dummy variable (Cornia and Popov 1998; Table 1.2, regression 1). Even in China, large state enterprises in heavy industry proved to be a bottleneck to the reform process, as indicated by the negative correlation found between the share of state enterprises in total output and the rates of economic growth by province.

After factoring in the regression equations that explain output performance the initial structural conditions, the addition of the liberalization index and of the rate of inflation increases R^2 only modestly (Table 1.2, regressions 2, 3, and 4). In addition, the coefficient of the liberalization index is not significant and has the wrong sign.

In other words, the differences in performance may be explained in good part by differences in initial structural conditions, and the role of traditional 'good policy'

Table 1.2. *Results of the regression of the log of GDP 1996/GDP 1989*[a] *on non-policy and policy-related factors (all coefficients are significant at the 5 per cent level except those in parentheses)*

Equations	**1**	**2**	**3**	**4**	**5**	**6**
Number of observations	**28**	**28**	**28**	**28**	**17**	**17**
Constant	5.23	4.96	5.55	5.71	5.91	6.07
Distortions, % of GDP[b]	−0.01	−0.01	−0.01	−0.01	−0.001	−0.001
1987 PPP GDP per capita, % of the US level	−0.01	−0.02	−0.01	−0.01	−0.02	−0.01
War dummy[c]	−0.63	−0.58	−0.40	−0.40	0.26[d]	0.27[d]
Decline in government revenues as a % of GDP from 1989–91 to 1993–6	−0.01	−0.01	−0.01	−0.01	—	—
Liberalization index	—	(0.07)	—	(−0.4)	—	(−0.05)
Log inflation (% a year, 1990–5, geometric average)	—	—	−0.12	−0.14	−0.12	−0.14
Shadow economy as a % of GDP in 1994	—	—	—	—	−0.02	−0.02
Adjusted R^2	0.75	0.75	0.85	0.84	0.92	0.91

Notes: [a]For China, all indicators refer to the period 1979–86 or similar. [b]Cumulative measure of distortions as a percentage of GDP equal to the sum of defence expenditure (−3 per cent regarded as the 'normal' level), deviations in industrial structure and trade openness from the 'normal' level, the share of heavily distorted trade (among the FSU republics) and lightly distorted trade (with socialist countries) taken with a 33 per cent weight. [c]Equals 1 for Armenia, Azerbaijan, Croatia, Georgia, Macedonia and Tajikistan, and 0 for all other countries. [d]Significant at the 8 per cent level.

Source: Authors' calculations.

factors is limited. Yet, it would be wrong to conclude that liberalization does not matter at all, since all major explanatory variables (structural distortions, liberalization, and inflation) are correlated with each other. However, controlling for uneven initial structural conditions is a natural step when evaluating the impact of policy measures introduced at a subsequent stage.

There is therefore some, though not very conclusive, evidence that performance depends also on the progress in liberalization. However, even if this impact is real, it is not strong and is overshadowed by other factors. If a lesson is to be derived from this analysis, it is that liberalization by itself does not matter much and works only once the initial structural distortions have been corrected, at least partially, and in a competitive environment with strong state institutions (see later).

1.2.2. *Initial Institutions and the Decline of Institutional Capabilities during the Transition*

In the best of all possible worlds, an efficient state should provide public goods (rules and norms, law and order, contract enforcement, defence, R&D, and so on), goods with large externalities (education and health care), and basic social transfers. The impact of public institutions on development is not necessarily measured by its public expenditure/GDP ratio, since the money could be used to subsidize inefficient industries, or for excessive defence buildup, and so on. The concept of 'ordinary government expenditure' (Naughton 1997) is more suited for the purposes of the current analysis as it excludes defence outlays, investment financing, subsidies, the servicing of the public debt, and social transfers financed from off-budget funds.

The former socialist economies presented considerable variation with respect to initial institutional conditions and their subsequent evolution during the transition. Indeed, accounting for economic performance on the basis of factors discussed above (structural distortions, the level of development, war, inflation, and liberalization) leaves a considerable amount of variance unexplained. This residual appears to be strongly correlated with the efficiency of state institutions. In relation to the predictions of the basic model, China and Vietnam did much better than expected, Central Europe and Baltic states somewhat better than expected, and most CIS states much worse than expected. Exceptions within the CIS prove the rule: Uzbekistan, a country that has adopted a slow approach to the reforms but preserved strong state institutions, performed considerably better than all other CIS countries (Pomfret, this volume).

The decline of the state capacity to implement consistent economic policies has possibly contributed a great deal to the worse than expected economic performance of Russia and most CIS states. In this volume, Popov argues that the collapse of output in the former Soviet Union cannot be attributed to the speed of reform *per se* but to the institutional collapse of the late 1980s/early 1990s. In contrast, it is precisely a strong institutional framework that explains the success of the gradual reforms implemented in China and of the shock therapy adopted in Vietnam (in both cases central planning was not dismantled before new market institutions were created), and for the relative success of the radical reforms in Central Europe, where new market institutions emerged quickly.

The importance of the institutional factor was pointed out more than once for various countries and regions, including transitional economies (Polterovich 1998). Rodrik (1996*b*) found that nearly all variations in the rates of growth in labour productivity in Southeast Asian countries in 1960–94 can be explained by per capita income in 1960, average length of education, and the index of the quality of institutions derived from surveys conducted in the 1980s. Similarly, it was found that 70 per cent of the variations in investment in 69 countries can be explained by only two factors—GDP per capita and institutional capacity index (World Bank 1997). Stiglitz (1998) talks about emerging post-Washington consensus with the greater emphasis on the role of institutions, whereas Holmes (1997) believes that the major lesson to be learned by Western democracies from recent Russian developments is exactly the one about the crucial importance of the state institutions: whereas the Soviet Union proved that the non-market economic system with the strongest state cannot be efficient, Russia today is proving that the market without strong state degrades to the 'exchange of unaccountable power for the untaxable wealth' leading to economic decline.

The efficiency of state and non-state institutions is not easily measurable. In most CIS and Balkan countries, the collapse of the state and the limited development of market institutions is well illustrated by the dramatic spread of the shadow economy and the parallel decline of revenue/GDP ratios; by the inability of the state to deliver basic public goods (e.g. health, education, law and order) and set up an appropriate regulatory framework for the enforcement of property rights, bankruptcies and contracts; by the accumulation of tax, trade, wage, and bank arrears; by the demonetization, dollarization, and barterization of the economy; by the decline of bank financing as a proportion of GDP; by an increase in crime rates; and so on. Most of these phenomena can be defined quantitatively. However, the construction of the aggregate index of institutional capacity is problematic as there is no clear rationale for the selection and weighing of its various components (Campos 1999*b*).

A partial measure of institutional efficiency is offered by the trust placed by businesses and individuals in state institutions. If this approach is followed, the CIS states rank much lower than the Central and Eastern European countries in all polls. In a recent survey of the credibility of state institutions in 69 countries, the CIS states had the lowest score, lower than that of Sub-Saharan Africa (World Bank 1997, pp. 5, 35). Especially striking was the gap between Central and Eastern Europe and the CIS countries.

A synthetic measure of the institutional capacity of the state is the revenue/GDP ratio. Though past analyses rightly emphasized the excessive role of the state (and of the communist party) in the former socialist economies, the downsizing of the state that took place in many CIS states during the recent years has likely gone too far. During the transition, tax/GDP ratio decreased in all former socialist economies. However, the Central European countries and Estonia managed to arrest this decline after only a few years, while Russia (together with Lithuania, Latvia, and several Southeast European and Central Asian states) experienced far greater reductions. In Vietnam the tax/GDP ratio grew by 1.5 times over 1989–93. As planned, the revenue of the Chinese central government as a percentage of GDP fell markedly after the introduction of the fiscal decentralization reform at the end of the 1970s, but this was compensated by an increase in the revenue and quasi-revenue of regional government institutions.

In most CIS states, the reduction of government expenditure proceeded without any coherent plan and did not involve the reassessment of government commitments. Instead of concentrating the limited revenue collected on a few priority programmes, the governments decided for generalized cuts across the board which kept all public activities half-alive, half-financed and barely working. This process has led to a gradual but substantial decay of public education, health care, infrastructure, law and order, R&D, and so on.

Low tax/GDP ratios, and the ensuing weak capacity of the state to regulate and deliver essential programmes, are related to the spread of the shadow economy. To be sure, the expansion of the shadow economy renders revenue collection more complicated. At the same time, weak administration and regulation act by themselves as a potent stimulus to the development of unregulated businesses. Whatever way the causation runs (most probably it runs both ways), there is some evidence that a one percentage point reduction in the share of tax/GDP ratio is accompanied by a similar increase in the share of the shadow economy (Cornia and Popov 1998). In other words, the recent changes in the share of government revenues in GDP are a rather accurate predictor of the ability of the state to enforce rules and regulations.

Institutional capacity is influenced also by the nature of the political system underlying the economy. Using the terminology of political science, it is appropriate to distinguish between strong authoritarian regimes (China, Vietnam, Uzbekistan), strong democratic regimes (Central European countries), and weak democratic regimes (most FSU and Balkan states). The former two are *politically* liberal or liberalizing, i.e. protect individual rights, including those of property and contracts, and create a framework of law and administration, while the latter regimes, though democratic, are not so liberal since they lack strong institutions and the ability to enforce law and order (Zakaria 1997). This gives rise to the phenomenon of 'illiberal democracies'—countries, where competitive elections are introduced before the rule of law is established. While European countries in the nineteenth century and East Asian countries recently moved from first establishing the rule of law to gradually introducing democratic elections (Hong Kong is the most obvious example of the rule of law without democracy), in Latin America, Africa, and now in CIS countries democratic political systems were introduced in societies without the firm rule of law.

Authoritarian regimes (including the communist one), while gradually building property rights and institutions, were filling the vacuum in the rule of law via authoritarian means. After democratization occurred and illiberal democracies emerged, they found themselves deprived of old authoritarian instruments to ensure law and order, but without the newly developed democratic mechanisms needed to guarantee property rights, contracts, and law and order in general. No surprise, this had a devastating impact on investment climate and output. There is a clear relationship between the ratio of the rule of law index on the eve of transition to democratization index, on the one hand, and economic performance during transition, on the other. To put it differently, democratization without strong rule of law, whether one likes it or not, usually leads to the collapse of output. There is a price to pay for early democratization, i.e. introduction of competitive elections of government under the conditions when the major liberal rights (personal freedom and safety, property, contracts, fair trial in court, etc.) are not well established.

As noted, after adding the decline in government revenues variable to the ones that characterize initial conditions (level of development and distortions) and external environment (war dummy variable), the explanatory power of the regression covering the period 1989–96 (1979–86 for China) reaches 75 per cent with satisfactory *t*-statistics (regression 1, Table 1.2). And it is quite remarkable that the inclusion of liberalization variables at this point does not improve regression statistics (regression 2, Table 1.2). Factoring in inflation allows one to improve the explanatory power to 85 per cent (regressions 3 and 4, Table 1.2). The correlation coefficient rises further up to 92 per cent, if other indicators of the institutional capacities, such as the share of shadow economy, are added, though the number of observations in this case is only 17 because of the lack of data (regressions 5 and 6, Table 1.2). Similarly, Campos (1999*a*) found evidence that government expenditures are positively, not negatively, associated with economic growth in transition economies, i.e. lower expenditures contribute to economic decline in transition economies.

Running the same regressions over the period 1989–98 produces similar though somewhat weaker results (Table 1.3). Again, after factoring in distortions and the decline in government revenues, the liberalization coefficient becomes insignificant, although the explanatory power of the regressions does not rise higher than 80 per cent. These results do not support therefore the arguments about the 'threshold' levels of liberalization, i.e. the fact that liberalization starts affecting performance only after a certain time, or about the lagged impact of the liberalization.

To sum up, there is evidence that, after factoring in initial structural conditions and environmental factors, differences in economic performance during the transition depend mostly on the strength of institutions and not so much on the progress in liberalization *per se*. This said, we still have to explain why the results for the period 1989–98 are less satisfactory than the results for the period 1989–96. To solve this puzzle, we rerun several of the regressions in Table 1.2 over the 1994–8 period. The results (Table 1.4) are substantially different from those reported in Tables 1.2 and 1.3: the coefficient of the variable 'initial structural distortions' has the wrong sign, the *t*-statistics of many other variables deteriorate sharply, and about two-thirds of the variations in economic performance over 1994–8 remains unexplained by the variables considered so far.

This suggests that the causal factors at work during the initial five to six years of the transition had become less relevant during the subsequent quinquennium. Indeed, by the mid-late 1990s many countries had started recovering from the transformational recession, and the impact of initial distortions in the industrial structure and trade patterns was being felt less intensely. Although only four years of observations are obviously not enough to draw final conclusions, the regression results of Table 1.4 are consistent with this explanation.

1.2.3. *Changes in Property Rights Regime and Microeconomic Incentives*

One of the comparatively few institutional changes promoted by the dominant approach to the transition is the establishment of a private property rights regime. The theoretical justifications offered for this recommendation generally revolve around the alleged superior incentive structure and access to credit markets that private property exhibits in relation to other forms of property.

The differences in approaches to privatization followed in the economies in transition allow one to verify the validity of these arguments. In fact, despite a comparatively short transition, the former centrally planned economies (CPEs) already exhibit considerable variation in terms of prevailing property rights regimes. On the one side, in Azerbaijan, Belarus, Tajikistan, Turkmenistan, Ukraine, Uzbekistan and—until recently—Romania, the state still controls well over 50 per cent of the industrial companies and practically all the land. This group includes Vietnam which introduced, however, a major commercialization of SOEs in cooperation with several

Table 1.3. *Results of the regression of the log of GDP 1998/GDP 1989 on non-policy and policy-related factors*[a] *(all coefficients are significant at the 5 per cent level except those in parentheses)*

Equations	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**
Number of observations	**28**	**28**	**28**	**28**	**17**	**17**	**17**	**17**
Constant	5.30	4.88	5.68	5.73	5.74	5.43	5.86	6.08
Distortions, % of GDP[b]	−0.01	−0.01	−0.01	−0.01	−0.01	−0.01[d]	(−0.00)	(−0.00)
1987 PPP GDP per capita, % of the US level	−0.01	−0.02	−0.01	−0.01	−0.01	−0.02	−0.01[d]	(−0.01)
War dummy[c]	−0.67	−0.58	−0.38	−0.37				
Decline in government revenues as a % of GDP from 1989–91 to 1993–6	−0.02	−0.01	−0.01	−0.01				
Liberalization index		(0.11)		(−0.01)		(0.11)		(−0.06)
Log inflation (% a year, 1990–5, geometric average)			−0.15	−0.15			−0.13	−0.16
Shadow economy as a % of GDP in 1994					−0.02	−0.02	−0.01	−0.02
Adjusted R^2	0.67	0.69	0.80	0.80	0.72	0.73	0.82	0.81

Notes: See Table 1.2.

Source: Authors' calculations.

Table 1.4. *Results of the regression of the log of GDP 1998/GDP 1994 on non-policy and policy-related factors (all coefficients are significant at the 15 per cent level)*[(a)]

Equations	**1**	**2**	**3**	**4**	**5**
Number of observations	**28**	**28**	**28**	**28**	**28**
Constant	4.51	4.25	4.56	4.32	4.60
Distortions, % of GDP[(b)]		0.004	0.005	0.003	0.003
War dummy[(c)]			0.15		
Decline in government revenues as a % of GDP from 1989–91 to 1993–6				−0.003[(d)]	−0.004
Liberalization index	0.07	0.12	0.09	0.10	0.07
Log inflation (% a year, 1990–5, geometric average)			−0.06		0.04
Adjusted R^2	0.21	0.27	0.37	0.29	0.33

Notes: [(a)]For China, all indicators are for the period 1984–8 or similar. For notes [(b)]and [(c)]see Table 1.2. [(d)]Significant at the 21 per cent level.

Source: Authors' calculations.

multinational corporations. A second group, including China and a few CIS states, has developed a large 'quasi cooperative sector' comprising workers' collectives and town and village enterprises (TVEs) (Sun, this volume). In contrast, in Central Europe and Russia a large chunk of SOEs has been transferred to the private sector, though also in this case there are differences between the insider privatization followed in Russia, the rapid sales of SOEs to foreign companies adopted in Hungary and the slower approach followed in Poland where the marketization of SOEs was given greater priority (EBRD 1999).

The current evidence shows that the attribution of private property rights is, by itself, far from sufficient for engendering adequate incentives and growth. At the macroeconomic level the relation between privatization and economic performance is blurred at best, and is starkly put into question by the comparison between the highly developed but inefficient Russian private sector and the highly successful Chinese TVEs, joint ventures and other firms operating under different types of property rights regimes.

At the microeconomic level, it might be too soon to draw conclusions based on empirical analyses of privatized firms, not least because of the massive scale of the privatization experiment carried out in the former socialist economies. As noted by Suutela (1997), while some 6,800 enterprises were privatized in the non-transition economies of the world between 1980 and 1991, more than 45,300 large and medium-size firms were divested in the transition countries of Central and Eastern Europe and the former Soviet Union by the end of 1994 alone. In addition, actual outcomes of different privatization approaches are still unclear, as secondary and tertiary redistributions of property titles continue, and the time needed for the privatization–restructuring impact to work through is not yet past. Empirical evidence on the relation between privatization and microeconomic efficiency is therefore highly preliminary. Be as it may, these initial analyses cast some doubts on the alleged positive relation between private property and efficiency. To start with, Jones (this volume) shows that the privatization processes in Russia, the Baltic Republics, and other transitional economies have unexpectedly resulted in a substantial amount of employee ownership, but not in worker control. These findings suggest that privatization did not produce fundamental changes in inherited patterns of corporate governance, but that it rather served to strengthen managerial control. While it is often argued (Raiser, this volume) that the range of feasible privatization alternatives was sharply restricted by the initial informal institutions such as the implicit distribution of property rights before the transition, the incentive and efficiency problems caused by insider privatization remain.

Before–after efficiency studies of privatized SOEs are inconclusive, as privatization has not always given rise to restructuring. Most studies confirm what was discussed above, i.e. that TVEs and cooperatives are more efficient than SOEs, whether privatized or not. Finally, a few studies show that auction-privatized firms are generally more efficient than insider-privatized firms, though no one knows whether this is due to causation or self-selection, and that privatization by direct restitution creates disincentives because of the unclear property rights and high litigation costs this approach often entails (World Bank 1996*a*). Indeed, the main message of all these analyses is that the institution of proper incentives for all economic actors involved should take precedence over the establishment—*per se*—of any given property right regime.

1.2.4. *Changes in Asset and Income Inequality*

Another neglected factor in the analysis of the differential performance of the economies in transition is the level of income and asset inequality—and its change during the transition itself. While it can be argued that in the initial years of the transition, growth collapse and large rises in inequality were co-determined by third factors (including differences in the initial structural and institutional distortions), it is equally plausible to argue that, once it did stabilize, inequality affected subsequent growth in a significant manner.

The transition was expected to bring about a closer relation between human capital, effort, and monetary rewards than during the socialist era. But in many countries it brought about much larger increases in inequality than expected (i.e. Gini coefficients of the distribution of disposable income equal to or greater than 35–40). These surges in inequality proved to be detrimental to long-term growth. There are three sets of theoretical arguments supporting this contention. To start with, high inequality (particularly when it arises from undeserved accumulation of assets and opportunities, the erosion of labour institutions, rent seeking and predatory activities) erodes microeconomic incentives, reduces work effort, and increases labour shirking and the cost of monitoring and supervising labour performance. Second, high levels of income inequality create socio-political instability and social tensions which reduce the savings ratio (Venieris and Gupta 1986) by driving away domestic and foreign investment, erode the security of property rights, augment the threat of expropriation, and increase the cost of business security and contract enforcement (Benabou 1996). Finally, the political economy of high inequality may also lead to slow growth: for instance, under democratic rule, countries characterized by a high degree of asset and income inequality are expected to grow less rapidly than more egalitarian countries as high inequality leads to the election of governments which favour redistribution through high marginal tax rates which, in turn, depress private investment and growth (Alesina and Rodrik 1994; Alesina and Perotti 1996). In a sense, redistributive policies of this kind were implemented in the democracies of Central Europe, but not in 'illiberal democracies' such as Russia. In this class of models, high income inequality reduces also progress in education and human capital accumulation, as financial markets are incomplete and governments are unwilling or unable to tax the wealthy to expand public education.

Even a cursory look at the data shows that the recent trends in income and asset inequality tend to correlate with economic performance (Milanovic 1998; Cornia, this volume). On the one side, the better performing economies of Central Europe have caught up with the level of inequality observed in the Western European market economies. These countries contained the cuts in the tax/GDP ratio, and were thus able to maintain a fairly comprehensive welfare state. Even more important, in these countries earnings inequality rose only moderately despite a full liberalization of the labour market.

On the other hand, in the collapsed economies of the former USSR and South Eastern Europe Gini coefficients rose by 10–20 points (despite large under-registration of high incomes), i.e. two to three times faster than in Central Europe. In these countries, the transitional recession, fall in the wage share, and rise in earnings inequality were very pronounced, the volume of social transfers collapsed and their composition and targeting deteriorated (Milanovic 1995), and privatization was much less egalitarian than in Central Europe (Honkkila 1997).

Though inequality rose also in Vietnam and China, such a rise followed a different pattern less likely to affect incentives and social cohesion. In China, inequality rose imperceptibly (from very low levels) during the years of rapid agricultural growth of 1978–84. Overall income concentration rose somewhat faster between 1985 and 1990, and much faster after 1990. The rise in income disparity which began in 1985–90 can be traced to the rapid expansion of industrial and commercial activities in the urban centres and coastal regions, which exacerbated regional inequality and the urban–rural income gap (Ping 1997; Cornia, this volume). Fiscal decentralization and an industrial policy favouring explicitly urban areas and coastal provinces accentuated markedly this disequalizing trend. While the public policy of the last two years is trying to address this imbalance, it is noteworthy that the surge of inter-regional inequality of the 1990s did not affect growth. In fact, the rise in inter-regional inequality was accompanied by much less pronounced increases in intra-regional inequality. A lower local-level inequality, and continued control of domestic migration, have thus affected little local-level work incentives and social cohesion.

1.3. KEY POLICY CHOICES: POSSIBLE ELEMENTS OF AN INSTITUTIONS-FOCUSED TRANSITION STRATEGY

Mainstream economics argues that the optimal policy approach to the transition should include immediate price and trade liberalization, subsidies removal, unified and competitive exchange rate, rapid privatization of SOEs, elimination of barriers to FDI and portfolio investments, a 'small state', development of the financial sector, and reform of the social sector and taxation. The evidence included in this volume indicates that these measures are not sufficient to ensure a good performance, and that other factors necessary for a successful transition have been neglected. In addition, the mainstream approach does not spell out an explicit 'transition strategy' (in terms of engine of growth, incentives, leading sectors, key actors, role of the state, and so on). It focuses on some necessary conditions (as in the case stabilization) but does not say much about other necessary and sufficient conditions. In addition, it overemphasizes the macroeconomy, while ignoring microeconomic and structural reforms, equity and sectoral policies, and the institutional aspects of the transition. Some of the key ingredients of an alternative 'post-Washington strategy' to the transition are reviewed hereafter.

1.3.1. *Macroeconomic Approach*

1.3.1.1. *Macroeconomic Stabilization and Inflation Control*

Even a cursory review of the literature indicates that high inflation affects adversely economic performance. However, there is no evidence that inflation rates below 40 per cent a year damage growth, while it has been suggested that inflation rates below 20 per cent may even be beneficial to economic activity (Bruno and Easterly 1995; Bruno 1995; Stiglitz 1998). Though this chapter does not explicitly try to identify the 'threshold' below which inflation is not detrimental to growth, it may be argued that in transitional economies such a threshold is actually higher than in other emerging markets because of the numerous structural rigidities inherited from the socialist era. In Uzbekistan, one of the most successful reformers, inflation never fell below 20 per cent a year during the first five years of transition, while in China, the rate of inflation exceeded 20 per cent a year in 1988–9 and in 1993–5 without only modest effects on growth (see Chapters 2, 4, and 5 in this volume).

1.3.1.2. *Exchange Rate Policy*

There is a long-standing debate among economists about what kind of exchange rate policy is most suitable to the economies in transition. The conventional shock therapy approach to stabilization recommends fixing the nominal exchange rate, which operates as a nominal anchor. Others claim that it is the real exchange rate that should be kept stable so as to ensure that the actual rate remains below the PPP rate needed to stimulate export and growth. The Czech Republic, Estonia, Latvia, Mongolia during 1991–4 and, more recently, Russia tried to maintain a stable nominal exchange rate despite persistent high inflation, thus allowing the real exchange rate to appreciate. In contrast, in Poland, Romania, Slovakia, Slovenia, Ukraine, and Belarus the real exchange rate was more or less stable during the same period while the nominal exchange rate depreciated considerably.

Each of these two approaches has its own advantages. The first may be useful in reducing rapidly high inflation (wherever it is possible) during the initial stages of macroeconomic stabilization, while the second may be better suited for overcoming transformational recession and promoting economic recovery by facilitating the transfer of resources from domestic demand to exports. With an appropriate monetary policy (such as the partial sterilization of increases in the money supply caused by foreign exchange reserves buildup) the inflationary pressures arising from this policy can be controlled, as proven by the example of many emerging market economies. Though several economists favour exchange-rate-based stabilization (Bofinger *et al.* 1997), others find that money-based stabilization was successful in quite a number of countries (Albania, Slovenia, Croatia, FYR Macedonia) and there is no evidence that this is an inferior strategy to pegging the nominal exchange rate (Zettermeyer and Citrin 1995).

However, the exchange rate is far too important a tool to be used only for fighting inflation. Indeed, a policy of managed real exchange rate, aiming at the stability of the real rate at a parity substantially below the PPP rate, is better suited for promoting economic recovery and exports. And the desirability of continuing a strong currency policy after macroeconomic stabilization is achieved is highly questionable because of the adverse effects it produces in terms of exports, interest rates, and foreign debt. In particular, such a policy tends to push up domestic interest rates at a time when exactly the opposite is needed.

1.3.1.3. *Government Revenues and Expenditure*

Maintaining the share of government revenues in GDP at an adequate level is essential for output growth. As argued in Section 2 of this chapter, an excessive reduction of public expenditure on 'ordinary government' activities undermines the provision of public goods, social cohesion, capital productivity and growth, and in some instances may lead to the paralysis of the state machinery. The example of Russia—where inadequate tax collection led to the near collapse of the state, the erosion of an already weak social protection system, the massive buildup of government arrears and a large domestic and international debt, and the instability of the rouble—offers a vivid illustration of the perils implicit in such policy. The Russian pattern of institutional decay proved to be extremely detrimental for investment, and, most important, to capital productivity and growth. It must be underscored that the fulfilment of the obligations of 'ordinary government' still leaves considerable room to reduce the inefficient public expenditures (in the field of defence, production and consumption subsidies, and some public investment) inherited from the socialist era.

The objective of sustaining basic public expenditure at adequate levels has been achieved both under authoritarian and democratic regimes, and under a variety of administrative arrangements. For instance, in China while the expenditure on 'ordinary government' of the central administration as a percentage of GDP was much lower than in Russia and Poland, it was sufficient to preserve the functioning of public institutions since the financing of social safety nets by the central government was traditionally low, and since local authorities were transferred some of the functions of the centre after 1978. Besides, due to the fast rise of GDP, during the first seven years of the reforms the absolute level of expenditure for 'ordinary government' doubled. In Russia, in contrast, though such expenditure did not look much lower than in Poland, its pace of decline during the transition exceeded that of GDP. To put it differently, while in Poland 'ordinary government' financing in real terms grew by about one-third over 1989–95/6, in Russia it fell by about three times.

1.3.2. *Microeconomic, Institutional and Industrial Policies*

1.3.2.1. *Establishing Competitive Markets*

The first and foremost task of market reforms is the creation of effective competition in each market, regardless of the property rights regime prevailing in such markets. Establishing a competitive environment and avoiding monopolistic, oligopolistic, or free-riding behaviour should thus take precedence over any other policy objective, including privatization. In the absence of competition, de-monopolization and anti-trust legislation, privatization can lead to worse economic outcomes than during socialism, mainly because of lack of control and coordination failures. In a sense, the emphasis on competition and on market environment is consistent with the emerging 'post-Washington consensus'. China managed to sustain double-digit growth by extending the scope of competition, without privatizing state-owned enterprises (Stiglitz 1998). In Vietnam, privatization was not necessary to create competitive markets and install incentives for reorienting the supply side of the economy and increasing output (Montes, this volume).

One way to achieve competition is allowing free trade. But, as noted by Stiglitz (1994, p. 256) 'there might be cases where there is sufficient internal competition and where, apart from political economic concern, . . . a convincing "infant industry" case for protection can be made. Thus . . . this needs to be taken into account in the process of privatization or reorganising of state enterprises, as well as in the laws allowing the formation of firms, co-operatives and partnership. The government must take action to minimise barriers to *entry* (emphasis added).' Another way to create a competitive market environment is to allow for *exit* through bankruptcy, liquidation, and consolidation of non-performing enterprises. This approach can be staggered over a fixed schedule, so as to give the 'ageing industry' the time to adjust. Finally, competition requires the creation of efficient asset, credit, and insurance markets, to avoid that only those with cash can bid in the markets for privatization or retrading, to allocate assets to the most efficient producers and to reduce risk aversion. Under these conditions (which are difficult to achieve), the creation of markets where to re-trade land, assets, securities and housing would improve efficiency substantially.

1.3.2.2. *Export Orientation*

Since the inception of the transition, considerable divergence has developed in this area. Countries such as Turkmenistan, Belarus, and Ukraine have adopted autarkic trade regimes characterized by the exclusion of competing imports and overvalued exchange rates. A watered-down version of this approach is observable in Russia where average tariffs are low (15 per cent), but where, at 70 per cent of its PPP level in 1995–8 (before the August 1998 crisis), the exchange rate is comparatively overvalued in relation to the 50 per cent level prevailing in Central Europe, and where declining sectors such as machinery and agriculture receive public subsidies. This import-substituting-industrialization (ISI)-like approach is sustained by the export of gas, oil, and other primary commodities which account for 75 per cent of Russia's export basket. However, the long-term impact of this approach is unlikely to be positive. Indeed, the literature indicates that while focusing on primary commodity exports hampers long-term growth and diversification of exports, in the presence of skilled labour, an open trade regime and a neutral industrial policy favour the diversification of exports and promote growth (Mayer 1997).

The export promotion strategy followed by the Asian transition economies (for instance, by maintaining a strongly undervalued exchange rate) exhibits features more akin to that of the 'Asian tigers' (Rodrik 1996*a*) than of the countries of Eastern and Central Europe. Export promotion was not accompanied by simultaneous import and capital account liberalization. Montes (this volume) argues that Vietnam (and the other economies in this group) is likely to follow an Asian model of development, in which the trade policy is at the service of industrialization, and focuses on the protection and subsidization of sectors with growth potential, export promotion, and invitation of foreign investment to raise resources and obtain technology for industrialization.

In transitional economies, the argument in favour of export-oriented growth is particularly compelling. The long isolation of these economies from the world market led to the emergence of a perverted industrial structure doomed to collapse once exposed to international competition. The convertibility of national currencies and lowering of trade barriers made it impossible to rely on the previous model of collective import substitution. In addition, the promotion of exports has been rendered necessary by the depressed state of domestic demand. Thus, the only hope to outweigh the decline of the traditional domestic sector is by rapid export expansion. Policies to support non-competitive industries at the expense of competitive ones do not pay off.

The empirical evidence supports this viewpoint. Indeed, in all fast-growing transitional economies the export sector was a main contributor to growth (Fig. 1.2). Countries with an industrial policy designed to favour export-oriented industries (China and Vietnam) were more successful than those which did not adopt an explicit industrial policy (the Central European and Baltic countries), and far more successful than those (the CIS countries) that continued subsidizing non-competitive industries.

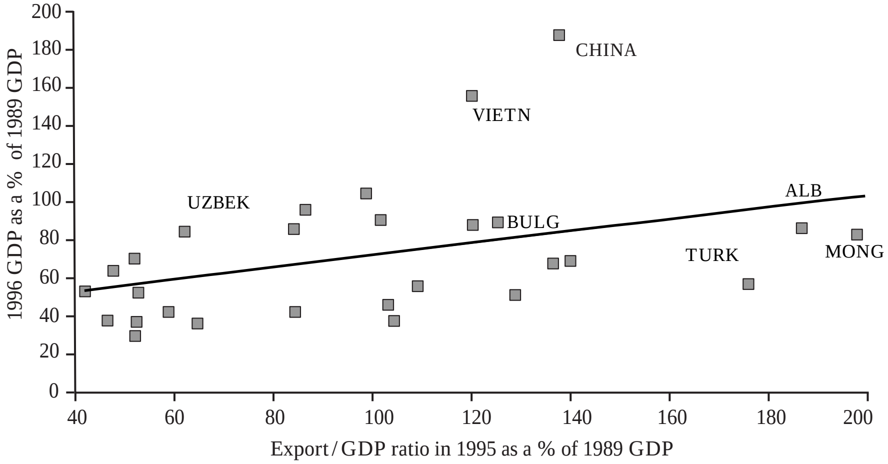

Figure 1.2. *Relation between the extent of export orientation and economic performance in a cross section of economies in transition*

1.3.2.3. *The Development of the New Private Sector*

Much of the discussion about the privatization of the economy has focused on privatizing the old SOEs. Yet, it now appears that effective privatization, an equitable distribution of assets, and growth may require an expansion of a new private sector (NPS). A preliminary comparison between the successful transitional economies (China in Asia, and Poland in Central Europe) and Russia provides empirical support to this view, but needs to be tested more rigorously.

Theoretically, the new private sector presents a series of advantages in relation to the SOEs and privatized SOEs. First of all, NPS firms generally exhibit better incentive structures for both managers and workers. In addition, supervision costs are lower than in other types of firms, there is no 'path dependence' vis-à-vis old work habits (which are more difficult to eradicate in state-owned enterprises, even after they have been privatized), and the risk of adverse selection of management and governance problems are lower. In many cases, managers and owners are the same people. In others, the small size of NPS firms better allows the owner to persuade the managers to act in the best interest of the firm, to monitor their performance, and to remove them if necessary. Third, some of these advantages (lower cost of supervision and greater incentives) are further strengthened by the smaller size of the NPS in relation to that of the privatized SOEs. The risk of monopolistic behaviour is therefore smaller and the inclination to compete (rather than seek rents) higher. Fourth, NPS firms have generally higher total factor productivity and lower capital/worker ratios than the SOEs and privatized SOEs. Their expansion might thus improve the allocative efficiency of the scarce investible funds available. As the development literature shows, however, these small new enterprises may face greater costs or tighter rationing in some input markets (credit), and greater difficulties in the penetration of export markets (Stewart 1987). However, experience from several developing economies, and mounting evidence about a few transitional economies (such as the Czech Republic; see Nesporova 1997) show that successful policy responses to these problems are possible.

While the development of the new enterprises across countries is not yet well understood, it is clear that without an increase in their number it might be difficult to privatize–restructure the SOEs. An increase in the number of NPS firms can indeed facilitate the absorption of labour and assets shed by the restructuring of privatized SOEs. Failure to absorb workers made redundant by the restructuring SOEs will either slow down the restructuring process, or increase the volume of transfer payments on account of unemployment benefits of early retirement schemes (possibly crowding out public investment and employment creation over the long term), or generate large political costs which may be politically destabilizing.

1.3.2.4. *Microeconomic Incentives and Governance Issues*

Governance and incentives issues are themes which theorists in comparative economics have long pointed to as being of crucial importance in influencing economic performance. Lack of incentives was certainly one of the major problems faced in the socialist enterprises. A current belief is that privatization will automatically take care of this problem. This volume argues, however, that microeconomic efficiency crucially depends on the explicit introduction of adequate incentives/sanctions for all stakeholders (managers, local authorities, national government, owners, and workers). As several studies now show (see, among others, the chapters by Jones and Sun in this volume), the imposition of a hard budget constraint, the genuine threat of bankruptcy and adequate microeconomic incentives prove to be more important for restructuring and performance than changes in the form of ownership. The excellent performance of the Chinese TVEs, for instance, may be attributed to the compatibility of incentives among community members, township and village governments and the TVE management, and to the fact that community governments are effectively monitored by assemblies of community members. The evidence also indicates that efficiency improves with the introduction of schemes which provide for earnings related to firm performance. Jones (this volume) shows that in both China and Bulgaria there is a link between the pay of the senior management and firm productivity.

At the enterprises level, careful attention must thus be paid to the design of compensation packages, whether wage based, piece rate based, or enterprise performance based, to the participation to profits and bonuses by managers and workers, to the rules on the dismissal of management and labour. As noted, these measures maximize reward to effort, minimize labour shirking and free riding, maintain the cost of supervision within acceptable limits, and reduce the agency problems between management and ownership. Improvements in incentives and governance require also the establishment of clear and certain property rights (of whatever nature they are) so as to keep transaction and enforcement costs low, and, in the case of SOEs, to establish transparent corporate governance structures. SOEs and TVEs necessitate the introduction of the hard budget constraint and the removal of subsidies (including ‘hidden subsidies' such as tax and inter-enterprise arrears). This imposes restructuring and acceptance of enterprise risk.

1.3.2.5. *Privatization Approaches, Property Rights Regimes, and Efficiency*

Do efficiency and growth depend on privatization? From a theoretical perspective, this is not the case whenever the markets for credit, insurance and assets, as well as regulatory institutions, are weak or absent. It can also be argued that efficiency depends on the pattern of privatization: for instance, insider privatization (by which assets are obtained by ascription and asymmetric access to information) leads to adverse selection, and to a dilution of the incentives to make assets fructify which were acquired at no cost. Indeed this approach may even encourage firm cannibalism and asset stripping. In turn, the sale of SOEs to foreign investors (who allegedly have the ability to restructure/supervise/modernize) may face political difficulties (as this approach would create a brand of dependent capitalism), and would entail large social transfers needed to support the labour shed by the new foreign-owned companies. Third, the efficiency of privatization varies considerably depending on the scale and structure of the enterprises considered: for instance, strong incentives and lower monitoring costs are more typical of the small-scale sector than of large enterprises which tend to suffer from governance, agency, and incentive problems. Fourth, cooperatives can be more efficient than private companies.

Rapid, mass privatization has become widely applauded. Yet, the analyses in this volume suggest that quick privatization is generally inferior to a more cautious approach, both in terms of raising economic efficiency and containing the surge in inequality and poverty. Fast give-away privatization is now perceived as less efficient as it provides little revenue, and can create negative incentives and governance problems, which can be very costly over the long term. Direct sales through auctions may provide revenue to the state budget but limited domestic savings reduce local buying ability, while a glut on the asset market may reduce privatization proceeds. So the form and pace of privatization matters, while privatization *per se* (or at any cost) does not. The idea that any privatization is better than no privatization should thus be rejected. In many cases marketization and the institution of appropriate incentives are more essential.

1.3.3. *Political-economic and Institutional Factors*

1.3.3.1. *Stable Leadership and Institutional Continuity*

In democratic and authoritarian regimes alike, good performance appears to be related to stable leadership, institutional continuity, and the capacity of the state to guide the transition process over the medium term. Such capacity ensures policy stability and predictability, the prioritization of reform measures, the optimization of choices over a longer time horizon and, as a result of all this, greater policy credibility. The latter is key to attract FDI and access international financial markets at rates incorporating low country risk premia.

Thus, the most essential feature of a policy approach is not the speed of implementation of the reforms but the fact that these will not be reversed and will be sustained in the foreseeable future. The state administrative, regulatory, and policy-making capacity must therefore be strengthened, for instance through the reform of the civil service, to achieve the goals of policy stability and efficient policy implementation. And so must its ability to initiate new investment in infrastructure and to preserve and retrain the human capital inherited from the socialist regimes.

Interestingly, the sustainability of reforms has often proven to be greater when these avoided radical shocks. Fan Gang (this volume) notes that China started its economic reforms because of widespread dissatisfaction about the shortage of consumer goods and the inefficiency of state enterprises. However, a radical change was never contemplated, and never seemed necessary as the economy kept growing fast, particularly after the introduction of the initial reform package.

Commitment to reform and policy continuity (for instance in the area of social protection, preservation of human capital, and equity) can be observed in countries with different political regimes and reform approaches—the Czech Republic and Hungary on the one side, and Uzbekistan on the other. The same can be said for lack of commitment, which is observed in both democratic and autocratic regimes. An area in which policy commitment is key is that of equity and social cohesion. Excessive inequality is likely to reduce incentives, increase the demand for public transfers, erode support for the reforms and, possibly, lead to an increase in crimes motivated by material reasons.

1.3.3.2. *Formal and Informal Institutions*

Over the last few years the transition debate has increasingly emphasized the role of the legal, administrative and regulatory framework in the development of the former socialist countries (EBRD 1995). Ever more frequently, attention is also being paid to the problems connected to the enforcement of such rules. Less attention has been placed, however, on the relation between enforcement of formal rules and informal institutions, and on the long-term impact on economic efficiency of the evolution of informal institutions (North 1990). Theoretical, historical, and cross-country evidence suggests that relations of trust and cooperation are essential to keep transaction costs low, facilitate economic exchange, support self-enforcing rules of the game, and foster trust in third-party enforcement through the state. Analytically, it is therefore essential to look at the state of and recent changes in informal institutions, and to their relation to microeconomic efficiency and implementation of formal rules.

In this regard, Raiser (this volume) shows that the transition process has largely been influenced by the inherited informal institutions. In most centrally planned economies, and particularly in the former Soviet Union, the communist regime had weakened the relations of solidarity within the family and society, instilled a strong sense of dependence on the state, suppressed entrepreneurship, and eroded the relations of trust and cooperation among microeconomic agents. Recent work (Poznanski 1996) underscores, however, that there were considerable differences in this regard among the former socialist countries. If his analysis is correct, the comparatively superior performance of Poland can be explained by the better 'initial institutional conditions', in particular by the ability of her citizens to play the market, take risks, maintain a cooperative behaviour, and so on. Similarly, the case of the Chinese TVEs has shown that relations of trust and cooperation among economic agents are key to the successful development of a sophisticated system of incentives linking managers, workers, and government officials. And the stability-cohesiveness of the extended family (as in the Caucasus or rural China) and the strength of the organizations of civil society such as trade unions, neighbourhood associations, churches, etc., have been shown to affect favourably economic performance and welfare.

The implications of the institutional analysis for the future of the transition economies are that the Central European nations, firmly rooted in informal institutions supportive of market behaviour and social solidarity, may rapidly return among the group of advanced industrial nations. Further East, the prospects look much bleaker as state capacity has been eroded and institutional power at times has been taken over by criminal organizations. These countries are in danger to revert to an archaic situation of institutional competition among 'roving bandits' (Borner *et al.* 1995, cited in Raiser, this volume) which is likely to drive the economy underground for a considerable period of time.

All this implies that there cannot be one optimal strategy for institutional reform, and that the strength and legitimacy of the state, and the state of informal institutions have to be taken into account in designing policies for institutional reform. Raiser (this volume) argues that trust and cooperative behaviour will grow out of an articulated civil society and depends positively on the existence of a universal morality at the level of the nation state. While governments cannot directly influence trust in public institutions, they can do so indirectly through reforms that limit the scope for predatory behaviour by public officials, improve political and economic performance, and favour the development of the organizations of civil society.

Index

A-firms 188, 190
accountability 116
accounting wages 201
'advantages of backwardness' 32
aerospace 41, 52
after-tax income 185
aggregate distortions 8
Aghion, P. 154, 221
agrarian reform 65
agriculture 39–40, 60, 67, 85, 97, 117, 127
Agroprombank 54
aid 129, 134
Akmola 62
Albania 8, 160, 164–5
Alesina, A. 17, 216
Alfa Bank 50
alienation right 176
Almaty 62
Alvarez, E. C. 143
Andreff, V. 116
Aoki, Masahiko 154
Aral Sea 55–6
arrears 201, 203, 227
Ashgabat airport 76
'Asian crisis' 97
Asian Development Bank (ADB) 129
'Asian tigers' 21, 129
'Asian-type responsibility' 48
Åslund, A. 7, 33, 35
asset(s) 47
  distribution 48
  inequality 16–17, 36, 216
  leasing 172
  stripping 24, 209
associated enterprise 116
  model 116
Atkinson, T. 193
attenuation 176
auction-privatized firms 16
'auctioning property for money' 46
'auctioning property for vouchers' 46
'August Third Campaign' (1984) 118
Aukutsionek 157
autarchy 52, 76
autarkic trade regimes 21
authoritarian regimes 20, 24, 29, 37, 44–5
autonomy 116, 127, 166, 177, 181–2
Azerbaijan 45
Bach Ho oilfield 104
Bai, Chong-En 172
balance-of-payments crisis 44
Balcerowicz, L. 218
Banister, J. 123
banking and finance 48
bankruptcies 112, 203
banks 62, 64, 156
barriers to entry 195, 197
barter trade 56
'barterization' 33
base wage 156
BAT 60
Belarus 21, 45
Ben-Ner 154
Benabou, R. 17, 216
benefits rights 173
benefits 185, 197
Berezovsky, B. 53
Bevan, A. 160
'big bang' theorists 35
Bim, A. S. 154
birth rates 66
black market exchange rates 33
black market 135–6, 229, 231–2
'black plots' 122
Blair, M. 190
Blanchard, O. 154
Blasi, J. R. 47, 159
Bofinger, P. 19
Boltho, A. 193
bombings 143
Bonin, J. 155
bonuses 110
book-to-market ratio 47
Borner, S. 231
Borys, B. 174
Bosnia-Herzegovina 45
Boswell, J. 223
Bourdet, Y. 178
Boycko, M. 154
Brada, J. C. 172
Braithwaite, J. D. 196
Brenner, M. 206
Breton, P. 33
Brezhnev era 57
bribes 231–2
Bruno, M. 18

Buchanan, J. M. 174
Bulgaria 48, 159, 163, 166
bundle of rights 175
business ethics 48
business performance 160
Byrd, W. 226

Cambodia 172
Campbell, J. L. 176
Campos, J. E. 223
Campos, N. F. 11
capital 97
  flows 137
  incomes 207
  inflows 85
  markets 45
  productivity 19, 30, 39
  stock 32
  transfers 100, 183
capital–labour ratio(s) 53, 123, 185
capital/output ratio(s) 8, 32
capitalism 47–52
capitalist economies 194
Cardoso, E. 135
Carlin, W. 160
Carroll, G. R. 175
Castañeda, R. 145
Castro, Fidel 133, 139
Castro, Raúl 139
cement 105
Central Asian Republics (CARs) 55
Central European countries, *see* countries by name
central planning 10, 32, 37, 73, 90, 116, 174, 178
Central Statistical Offices 200
central–local coordination 91
centrally planned economies (CPEs) 13, 25, 30, 115, 154
'champion of isolationism' 52
Chernobyl disaster 56
China
  agriculture 32, 195, 226
  GDP 11, 52
  gradualism in 3, 6, 10, 29, 78, 224
  health care/education in 79
  income inequality in 17, 194, 205–6
  property rights reform in 178
  reforms in 3, 8, 78–92, 142, 149, 198, 225–7
  SOEs 172, 176, 197
  township and village enterprises (TVEs) 23, 26, 32, 85, 166, 173, 183–6, 225
Chinese strategy 45
Chubais 156
Chun, Hong-Tack 123
Chung, J. S. 115
Ciolko, M. 34
CIS 3, 5, 10–11, 41, 235
  see also countries by name
Citrin, D. A. 19, 42
civil institutions 234
civil unrest 135
CMEA 103, 106, 134
cobalt 150
Coleman, J. 220
collapse 115, 122, 131, 150
collective(s) 188
  farms 117, 226
  ownership 183, 195
Comecon 56
Commander, S. 159
commitment 25
commodity-exchange business 48
communist(s) 42
  regime 25, 114, 132
compensation 155–6, 165–7
  packages 23
competition 20, 107, 150, 172, 188, 191, 226
competitive markets 20
concentration coefficient 206
construction 104
consumer goods 118
  sector 128
consumer(s) 44, 195
  subsidies 41
consumption 41, 44, 196
contract responsibility system 175, 179
contracts 186
control 154–5, 158–60, 162
  right(s) 154, 173, 175
  rights in 184
cooperation 25–6, 220
cooperative(s) 60, 65, 102, 110, 136, 144
  equilibrium 220
  shareholding (CSH) 93
  shareholding corporations 88
Cornia, G. A. 66, 95
corporate financing and control 49–50
corporate governance 162
corporatization 87
corruption 48, 57, 229
cotton 56, 58, 70, 74
credibility 36, 229, 233, 235
crime 5, 26, 67
  rate 48
criminals 26, 230–1
Croatia 8
cronyism 5
Cuba 5, 132–47
Cultural Revolution 78
currency collapse 43
current account deficits 99

Czech Republic 25, 164, 236
Czechoslovakia 150, 193

Daewoo 60
Dang, Duc Dam 98
data quality 201
De Melo, M. 7, 33–4, 126
de Vylder, S. 103, 178
de-collectivization 226
death rates 66
debt 142
  financing 44
debt–asset ratio 87
debt–service payments 44
decentralization 81, 86, 91, 101, 115, 130, 225, 229
'Decisions on Economic Reform' 93
defence expenditure 31, 148
'deliberation councils' 223
democratic regimes 20, 24, 44–5
  see also strong and weak democratic regimes
Democratic Republic of Vietnam (1954–75) 177
democratization 12, 35
demonetization 33, 36
Demsetz, H. 175
depoliticization 157
deregulation 33
Desai, P. 42, 44
desert 56
devaluation 98, 196
development 95–7
  level 8, 79
direct foreign investment (DFI) 60, 72
direct subsidies 41
discounted bills of exchange 227
disincentives 16, 183, 215
distortions 32
distribution rights 175
distrust 229
dividends 185, 195
DIW 227
Dmitriyev, M. 49
Dodsworth, John R. 100, 172
Doi Moi reform process 98–103
Dollar, D. 98–9, 182
dollarization 33, 99, 141
dollars 136, 149
domestic 44
  prices 31, 43, 71
'domestic multinationals' 83
dong 98
Dong, Xiao-Yuan 185
Dornbush, R. 43
downsizing 156
dual-track pricing system 179
dual-track transition 78, 82–8, 173
Earle J. S. 45, 154
East Asian (growth) model 114, 128–9
East Asian model 111
East Germany 227
Easterly, W. 18
Eastern European countries, *see* countries by name
Eberstadt, N. 123
EBRD 25, 41, 229
economic and technological development areas (ETDAs) 86
economic development 8, 32, 90, 115, 219–20
economic efficiency 117
economic growth 79, 97
economic liberalization 35
economic performance 6, 10, 13, 65–7, 95, 114, 118–19, 153–69, 233–5
economic sanctions 129
economic structure 83–8
education 60, 62
Edwards, S. 43
efficiency 16, 24, 127, 190
elections 35
electric energy 39
Elster, J. 219
embezzlement 112
emigration 67, 135
employee(s) 154, 158–9
  influence 170
  ownership 153–4, 156, 163
  participation 153, 155–6
employers 36
employment 40, 45, 108, 123, 172
energy 41
engineering 31
'enterprise localism' 116
enterprise(s) 85, 98, 116, 144, 184, 186, 203
  rationalization 142
  sector 45–6, 203
environmental degradation 56, 108
environmental factors 12
equality 141, 146
equipment 39
equitized firms 108
equity 25, 146
Estonia 11, 158, 162, 165
Estrin, S. 154, 158
ethnic composition 35, 77
ethnic groups 67, 77
ethnic tensions 122
European Union (EU) 47, 215
'European-type responsibility' 48
Evans, G. 178
Everleny Perez, O. 149
ex-communist parties 35
excess wage tax 211
exchange controls 69

exchange rate(s) 19, 59
  policy 18
exchange-rate-based stabilization 19, 42, 44
executive compensation 156, 167
exogenous shocks 223, 238
explanatory power 12
export(s) 32, 43, 107, 128, 133–4, 137, 184
  orientation 21
  promotion 21
  quotas 40
  sector(s) 36, 107
  tariffs 40
  taxes 40
export-oriented growth 52
export-oriented manufacturing firms 37
export-oriented oligarchy 37
exporters 44
extended family 226
extent of liberalization 34
external borrowing 44
external finance 3
external shock(s) 133–5, 181
external trade 48

family allowances 45, 195, 212
family businesses 226
'family' restaurants 139, 150
famine 119–22, 180
Fan, G. 223
farmers 37, 60, 82, 85, 136, 226
farmers' markets 148
Feinsilver, J. M. 135
'fence breaking' 180
Fergana Valley 56
fertilizers 106
Fforde, A. 103, 178
Fifteenth Party Congress 180
Filatotchev, I. 157
financial institutions 50
financial sector reform 64
financing 44
firm cannibalism 24
firms 108, 111, 127, 142, 145
fiscal decentralization 17, 197, 206, 225
fiscal deficit(s) 99, 135
Fish, M. S. 35
Fitzgerald, F. T. 149
fixed assets 32
fixed-term leasing 183
Flemming, J. 200
flexibility 57, 81
floods 119
food 106, 119, 135
  crisis 119
foreign debt 120, 125
foreign direct investment (FDI) 24, 83, 128, 197
foreign exchange 59, 132, 134, 142
foreign investment 42, 85, 97, 128, 132, 135 137, 148, 182, 216
foreign investors 24, 60, 72, 81, 127, 142–3, 190
foreign joint venture(s) 85, 104, 127
foreign ownership 163
foreign trade 61, 82, 120, 125
formal institutions 25–6, 219, 221
former Soviet Union (FSU) 29, 202–5
free riding 23, 215
free trade zone (FTZ) 128
Freedom House political freedom index 34
Friedman, E. 223
frontier approach 163
Frydman, R. 161, 172
Frye, T. 49, 232
'FSU effect' 33
fuel 39, 104
Funck, B. 178
Fyodorov, B. 42

Gaidar, Y. 42
game theory 220
Gazprom 40, 52
GDP 30, 65, 135, 137, 140, 172
  per capita 10, 32, 149
German big bang model 131, 138
German invasion (1941) 56
German Monetary Union 227
Germans 77
Gerschenkron 32
Gini coefficients 16–17, 193, 200–1, 206, 214
'giving property to work collectives' 46
global interests 116
GNP 120
  per capita 140
gold 59, 74, 99
Gomulka, S. 127
Gonzalez, E. 149
goods 9, 95, 106, 175
Gorbachev era 57, 157, 193
Gorbachev reforms 30, 36
governance features 188
governance issues 23
governance structures 24, 171, 183–6
government(s) 34, 43, 50, 70, 73, 89, 136, 223
  expenditure 11, 19, 36, 51, 62
  revenues 12–13, 19, 34, 36, 79
  spending 60
  type 35
Grabher, G. 228
gradualism 10, 29–30, 58, 138, 144, 224
grain 58, 71
Granick, D. 176, 226
Greenlagh, S. 226
Greif, A. 231
Griffin, K. 57

gross earnings 208–12
gross national expenditure (GNE) 57
group activities 155
group-based incentive schemes 155
Groves, T. 166
growth 16, 19, 43, 80, 85, 94, 97, 106, 145
  equations 161–2
  rate(s) 30, 144, 185
Gui, S. 180
Gupta, D. 17, 216
Gurkov, I. 172

Haerpfer, C. 233
Hainan 86
hard budget constraint 133, 226
hard currency 126, 134, 142
  shortages 128
'hard landing scenario' 131
Harrold, P. 197
Hart, O. 190
Havrylyshyn, O. 172
health 60, 62
heavy industry 8, 118, 123
Heinrich, R. 236
Heleniak, T. E. 196
Helms–Burton legislation 139, 142
Helwege, A. 135
Hernandez-Cata, E. 35
Heybey, B. 34
high-technology industries 41, 52
'hire-purchased' 183
Holmes, S. 10
home repairs 110, 150
honesty 220
Hong Kong Stock Exchange 184
Honkkila, J. 17, 207
horizontal integration 116
household budget surveys (HBS) 200–1
household enterprises 186
household responsibility system 65, 82, 194, 226
Howitt, P. 221
human capital 108, 132–3, 141
human development (HD) 161
Hungary 8, 25, 34, 45, 49, 150, 164, 193, 195, 201
Hussain, P. 194
hybrid governance structures 174
hyperinflation 65, 69
Hyun, Myung-Han 117

Ickes, B. 34, 114
ideology 89, 221
IED–GDP ratio 87
Illarionov, A. 42
'illiberal democracies' 12
IMF 58, 65, 68, 70, 129, 172
immigration 135
import(s) 107, 134, 137
  capacity 134
  substitution policy 41
import-substituting industrialization 21
'in-household work teams' 118
incentives 146
  microeconomic 13–16, 23
income distribution 48, 65, 149, 193–206
income inequality 16–17, 36, 67, 92, 145, 201–6, 215
  see also income distribution
income redistribution 37, 44
incomes 172, 212
inconsistent gradualism 77
'inconsistent shock therapy' 77
indirect subsidies 41
'individual business family' policy 188
industrial policy 91, 103–8, 206
industrial restructuring 127
industrial strategy 39–41
industrial structure 51, 124
industrialization 79, 91
industry 31, 74, 76, 102, 133, 140
inflation 6–7, 36, 41–4, 197, 201
  control 18
  rates 98
  tax 44
informal economy, *see* second economy
informal institutions 25–6, 122, 219–37
informalization 141, 207
infrastructure 129, 133, 186
initial conditions 55–7, 78–82, 114
  institutional 5, 9–13, 232
  structural 5, 7–9, 113
input 95, 117
insider ownership 153–5, 157–8
insider privatization 24, 235
insider-privatized firms 16
'insiders' 47, 75, 87, 156, 235–6
institutional capacity 149
  of the state 5, 11–12, 24, 30, 34, 36, 45, 111, 224, 238
  index 10
institutional change 223
institutional collapse 10, 29, 33, 36
institutional continuity 24, 226
institutional decline 36–9
institutional economies 24–6
institutional efficiency 11
institutional factors 24
institutional investors 49
institutional reforms 224–9
institutional transition 90
institutions
  formal rules (legal system) 25, 220–1, 223
  informal rules (social norms) 219–24

inter-enterprise debt (IED) 87
inter-regional inequality 17, 215
inter-republican trade 32
interest rate(s) 59, 98
international specialization 51–2
intra-regional inequality 17, 215
investment(s) 17, 30, 80, 128, 143
  rate 97, 100
Iraq 125
Irvin, G. 182

J-firms 188, 190
Jansen, K. 111
Japan 129
Jefferson, G. H. 166, 178
Jemison, D. B. 174
Jiang, Zemin 180
Johnson, S. 223
joint ownership 183
joint ventures 182–3, 190
Joint-Venture Law (1984) 128
Jorge, D. 147

Kakwani, N. 206
Kandel, E. 231
Kang, Myoung-Kyu 115
Karimov (President) 70
Kato, T. 156, 166
Kaufman, R. R. 36, 44
Kaufmann, D. 230
Kazakhstan 5, 55–77
Kazaks 67, 77
Kim Il-Sung 115, 130
  era 123
Kim Jong Il 118, 122, 130
Kim Chul-Sik 116
Kim Hyung-Ki 154
Kim, S. 128
Kim, W. 117
kiosks 77
'kitchen plot' 117
Klugman, J. 60
Koen, V. 42
kolkhozni 200
Kolodko, G. W. 196, 232
Kombinaten 116
konzertierte Aktion 223
Kornai, J. 156, 174, 196, 218
Krueger, A. O. 111
Kruger, G. 34
KUB 118
Kumtor gold project 72
Kwon, Oh-Yun 118
Kyrgyzstan 3, 55–77

labour 95, 110
  force 78, 82, 91, 127
  market 108–11, 215
  mobility 48
  productivity 39, 53, 153, 161
  shedding 142
  shirking 16, 23, 215
Lahiri, A. K. 42
Laky, T. 174
Landesmann, M. 160
Lao People's Democratic Republic 178
Laos 172, 182–3
Latvia 11, 158, 164
law and order 36, 48, 61, 74
layoffs 142–3, 145, 182, 203, 210
leases 82
leasing 183
  contracts 190
Lee, Hy-Sang 115
Lee, Pong S. 115
Leff, N. H. 188
legal norms 219
'legal person socialism' 113
legislation 157, 181
Lehmann, H. 209
Li, D. D. 158, 173
liability 188
liberalization 3, 6, 34–6, 114, 127
  indices 35
  domestic prices 82, 99
  of foreign trade 61
  of labour markets 94, 126, 197, 214
light industry 117, 123, 127
Lin, J. Y. 114, 176
Lin, N. 186
Lindberg, L. N. 176
Lipton, D. 224
liquidation 236
Lithuania 11, 158, 164
Liu, Yia-Ling 188
living standards 65
Ljunggren, B. 98
loan rates 98
loans 129
local government property rights 176
local interests 116
Logovaz 54
losses 112, 181

Macedonia 8
machinery 39
macro-level distortions 32
macroeconomics
  approach 18–20
  conditions 3
  policy 41–4
  populism 43–4
  stability 113
mahalla 61, 69, 74
mainstream approach 18

majority ownership 165
malnutrition 148
management contracts 190
managers 22, 60, 87, 112, 117, 156–7, 166, 179, 235
manat 64
Marcincin, A. 236
market 174
  forces 133
  imperfections 8
  information 186
  liberalization 82
  models 73–6
  reform(s) 6, 20, 144, 194
  transition as 174
market-type reforms 30
marketization 81, 94, 117–18, 127
Marrese, M. 42
mass privatization 236–7
Mayer, G. 21
McAuley, A. 200
McCarty, A. 181
McGettigan, D. 172
McKinley, T. 206
'median voter theory' 216
Menatep 50
Mercedes Benz 60
Merrill, J. 117
Mesa-Lago, Carmelo 135
Miami 143
Micklewright, J. 193, 214
micro-level distortions 32
migration 18, 67, 92, 215
Milanovic, B. 17, 203
Milgrom, P. 175, 190
militarization 30, 32
modernization 81, 127
Moldova 3, 45
monetary overhang 7, 81, 136, 144, 149
money-based stabilization 19
Mongolia 8, 57
Montes, M. 43
moral norms 219, 221–2
morality 220–2, 232
'muddling-through' scenario 143–4
multiple exchange rates 33
multiplier effects 128
Mummert, U. 227
Murrell, P. 34, 114
Mygind, N. 158

nationalism 42, 76, 122
Naufor 49
Naughton, B. 10, 34, 112, 172, 227
Nazarbayev (President) 70–1
Nee, V. 175
Nelson, J. 223
Nesporova, A. 23
New Democracies Barometer 233
New Economic Policy 51
new market institutions 30
new private sector (NPS) 22–3, 127, 145, 198, 236, 239
Nguyen, Thi Hien 98
nominal exchange rate 18
non-ferrous metals 39
non-policy-related factors 30–4
non-priority goods 115
non-resource sector 43
non-state enterprises 62, 112
non-state institutions 10, 33
non-state sectors 80, 83–6, 91, 102
non-tradable sector 133
non-tradables 95, 97
North Korea 5, 114–31, 129
North Vietnam 103
North, Douglass 25, 218
Nuti, D. M. 232

O'Brien, K. J. 185
'objective' factors 35
OECD 49, 201, 235
Oi, J. K. 177
oil 104, 106
oil and gas industry 40, 44
'one factory–two systems' method 127
open-door policy 128–30
optimal policy approach 18
'ordinary government expenditure' 10
organizations 154
Otani, I. 173
output 42, 65, 95, 106, 134, 164, 172
  loss 140
  performance 5, 7–9
  quotas 181
output–labour ratios 185
outsider ownership 154, 157
'outsiders' 47
over-industrialization 30, 32, 140
overvalued exchange rate 43–4
owner(s) 22, 87, 154, 173, 184
ownership 154, 156–8, 162, 171, 175–6, 183–6
  right 175
  structure(s) 83, 87–8, 108, 190

Paniccà, R. 66
Pérez-López, J. F. 148
parallel markets 150
Parris, K. 188
paternal role 74
path dependence 22, 174, 238
patron–client ties 188
Paufor 49
payroll taxes 196
peasant associations 65

peasant markets 117
peasants 110, 117, 226
Pejovich, A. 175
pensions 45, 195, 199
performance 6, 24, 30, 45, 65–7, 108, 155, 161, 170
performance-based pay 156
perks 195
Perotti, E. 184
Perotti, R. 17, 216
peso 141
'petty plots' 117
Pham, Chi do 173
Phelps-Brown, H. 194
Ping, Z. 17
Pinto, B. 166, 236
planners 51
planning 51
Platteau, Jean-Phillipe 220
Pliskin, J. 155
Pohl, G. 160
Poland
  (transition) performance of 3, 25
  income inequality in 193, 201
  private sector 195, 232
  privatization in 45, 164, 236
  stock market in 49
policies 20–6, 57–65, 127
policy choices 18–26
policy options 34–47
policy-related factors 30–4
political credibility index 235
political elites 239
political freedom, *see* democratization
political institutions 234
political revolution 232
political tensions 81, 122, 139
political uncertainty 129
politico-economic factors 24–6
Polterovich, V. 10
Popov, V. 42, 43, 71
population(s) 66, 108, 123
populist model 76
populist policies 43–4, 216
post-communist economies 47
'post-Washington' consensus 20
poverty 65, 67, 149
power groups 139
Poznanski, K. 25
predatory activities 16
price(s) 59, 61, 97–8
  control(s) 43, 45, 58, 69, 98
  deregulation 40
  liberalization 61
  mechanism 5
  reform(s) 57–8, 63, 75, 113
  subsidies 41
primary industry 123
primary producers 56
Prior, R. 231
private enterprises 108, 173, 186–8
private farms 60
private investors 97
private ownership 24, 133, 144, 153, 165, 183
private plot 117
private sector(s) 91, 111–12, 142, 146
privatization 3, 15, 20, 24, 45, 57, 61, 63, 65, 78, 94, 101, 112, 117–18, 144–6, 154–5, 157, 171, 235–7
privatized SOEs 22–3
Probert, J. 177
producers 44
production 195
  functions 163
  possibilities frontier diagram 95
  possibility frontier curve(s) 95
'production team contract system' 117
productivity 95, 117, 155–6, 160, 170, 185
  gap 31, 39
profit(s) 181, 195
  targets 179
profit-sharing 165
profitability 160, 167
property 145–6
  claims 145
  registers 150
  rights 116, 146, 150, 171, 175, 178–83
  rights reform 174
property rights regimes 24
  orthodox 13–16, 171
  unorthodox (new ownership forms) 171–91
Pryor, F. L. 193
public goods 9, 19, 36, 50
public ownership 89
Putterman, L. 185
pyong 117
Pyongyang 117

Qian, Y. 225
Qingsong, L. 226
'quasi cooperative sector' 15

radical reform(s) 78, 127, 130, 179
radical reform parties 35
Rajin 128
Rana, P. B. 182
raw materials 97
  industries 39
Rawski, T. G. 166, 185
real exchange rate 18, 43–4
recession 29, 203
redistribution 195
redistributive policies 36
redundant employment 186
reform(s) 35–6, 115, 138–40

paths 55–77
strategies 224
regional differences 92
regression(s) 12–13, 33–4, 160
equations 8
relative prices 31, 40, 71
religion 35
remittances 132, 137, 141–2, 150
remuneration 110
rent(s) 43, 52, 75, 195, 230
redistribution 43
seeking 16
repressed inflation 7
resource(s) 96
endowment 68
sector 39–40, 43, 52
resource-based industries 31, 52
restructuring 32, 39, 43, 80, 127, 164
return right(s) 154, 175
reunification 103, 224
revenue/GDP ratio 11, 38
rice 98, 106
rights 154
riots 73, 135
urban 67
Riskin, C. 226
Robert, J. 175, 190
Roca, S. 149
Rockel, M. 156
Rodriguez, J. L. 139
Rodrik, D. 10, 17, 21, 216
Roland, G. 225
role of the state 94, 111, 145, 224–9
Root, H. 223
Rose, R. 233
Rose-Ackerman, S. 223
Rosevear, A. 158
Rostowski, J. 42
rouble 19, 40, 43, 57
rouble zone membership 7, 58
Roxborough, I. W. 212
'rule of law' 12, 81
rural collectives 82
rural industrialization 186
rural private enterprises 187
rural reform 82
rural–urban balance 133
Russia
(inconsistent) shock therapy in 5
economic performance of 10, 30–4
exchange rate(s) in 19, 21, 42–4
GDP 8, 11
income inequality/redistribution in 17, 43–4, 48, 193
institutional decline in 19, 36–9
privatization in 45–7, 162, 172
resource sector 39–40
shock therapy (inconsistent) 29–53
stock market in 49
wage dispersion in 210
Russian Longitudinal Monitoring Study 200, 209
Russians 77
Rutkowski, J. 209
Ryterman, R. 114

Sabel, C. 174
Sachs, J. D. 32, 43, 98, 223
'safety valve' 43
Sanguinetty, J. 150
savings 41, 44
ratio 17
Schieber, G. 60
'second economy' 174, 193
secondary industry 123
secondary manufacturing 31, 39
industries 52
security firms 231
Seilschaften 229
Selden, M. 103
self-employment 136, 144–5
separation allowances 109
serfdom 226
service sector 31
severance scheme 109
shadow economy 11, 36, 48, 229
Shandong 88
Shanghai 87, 179
Shapiro, J. C. 212
shareholding corporations 91, 113, 127
'shares for loans' auctions 49
Shenzhen 85, 87, 179
Sherritt 143
Shleifer, A. 232
Shmeler, N. 31
shock therapy 18, 30, 33, 42, 98–9, 224, 227–9
see also inconsistent shock therapy
'shortageflation' 196
Sinn, G. 225
Sinn, H. W. 225
Sipos, S. 195
Slavs 77
Slovenia 8, 164
slow-reform parties 35
Smith, S. 163
smuggling 107
social burdens 186
social capital 173–4, 220, 223–4, 229–35
social cohesion 19, 25, 215
social mobility 226
social norms 219, 221
social policies 45
social sector reforms 108–11
social security 60, 91
social services 48, 133, 186

social spending 133
social tensions 17, 216
social transfers 9, 50, 195, 197, 215
social trust 187, 233–5
socialism 8, 113, 226
socialist economies 7, 10, 80, 95, 115, 117, 125, 132, 194
socio-political instability 17, 216
SOE reforms 83–8, 116
soft budget constraint 117, 134, 171
'soft landing scenario' 130
solidarity 222
South Korea 114, 129
South Vietnam 103
Soviet-type economies (STEs) 155
special economic zones (SEZs) 86, 128, 197, 206
speed of liberalization 5, 33–4
speed of reform 29
shareholding 87
stabilization 3
  macroeconomic 18, 42, 59, 62–3, 196
stable leadership 24
stagnation 115, 122
Stallings, B. 36, 44
Standing, G. 161, 211
Stark, D. 172, 228
starvation 135
state enterprises 8, 60, 86–7, 91, 98, 100, 108, 110, 112, 116, 127, 142
state farms 60, 63, 65, 136, 146
state firms 108, 143
state institutions 33
state ownership 89, 165
state sector(s) 78–9, 102, 173
State Statistical Bureau (SSB) 172
state-owned enterprises (SOEs) 13, 22–3, 78, 87, 94, 171–2, 176, 226
Stewart, F. 23
Stiglitz, J. 10, 18, 20
stock exchanges 87, 154, 179, 184
Stolychniy Bank 54
'stop and go' approach 42, 132, 178
strong authoritarian regimes 12
strong democratic regimes 12, 30, 46
structural adjustment 133–5
structural change 39
structural distortions 7, 29, 33
structural reforms 196–8
subcontracts 186
subsidiaries 127
subsidies 38, 41, 58, 87, 111, 134, 142, 182, 195
subsidization 38, 41
Suchlicki, J. 140
sugar 133, 143
Sugden, R. 219
Sun, L. 108
Sunbong 128
supervision costs 22
support 173
'surrogate' financing 38
Suutela, P. 15
Svejnar, J. 185

Taiwan 114
Tajikistan 45, 55
'tariff jumping' 83
Tarr, D. 68
Tashkent 56
tax(es) 40, 139, 144–5, 181, 196, 198, 230
  evasion 198
  reform 94
  revenue 112
tax/GDP ratio 11
Tengiz oilfield 68, 71
textiles 97, 106
Thailand 108
Than, Mya 114
Thanh, Ngo Kim 181
'the red directors' 46
three-plan system 181
threshold levels of liberalization 13
Thuyet, Pham van 108
time wages 155
tourism 132, 135, 137, 141–3
town and village enterprises (TVEs) 15, 23, 85, 183–6, 190, 225
tradable sector 133
tradables 95, 134
trade 30, 56, 91, 118, 126, 133
  deficits 32, 137, 140
  dependency ratio 125
  embargo 132, 135, 142
  flows 32
  issues 103–8
  openness 84
  policy 111
  protection 111
  'under-openness' 140
traditional property rights theory 184
transaction costs 25, 219–20, 226–7
transfers 57, 195, 212
transformational recession 6, 30, 103, 140
transition 94–7, 140–7, 150
  strategies 18–26
'transitional democracies' 44
trust 25–6, 34, 155, 220, 222, 233–5
Tumen river 128
Turkic Central Asians 77
Turkmenistan 21, 45, 55
Turley 103
TVE sector 173
two-tier banking system 98

Ukraine 21
underdevelopment 30, 96, 111
undervalued exchange rate 43
UNDP 60, 65, 128
unemployment 67, 110
UNICEF 197
UNIDO 123
unification 33, 131, 227–9
unions 142
urban private enterprises 186
urbanization 79, 91, 186
  ratio 123
use-rights 57
user fees 111
utilization right 175
Uzbekistan 3, 5, 10, 25, 45, 55–77
Uzbeks 67

value-maximization principle 190
Van Arkadie, B. 99
Vaughan-Whitehead, D. 160, 211
'VAZ' autoplant 54
Vecernik, J. 209
Velvet Revolution (1989) 237
Venieris, Y. 17, 216
Vietnam's Company Law (1991) 108
Vietnam
  GDP 11, 99
  health care/education in 111
  property rights reform in 180–2
  reforms in 3, 8, 33, 98–103
  shock therapy in 6, 10, 29, 98–9
  SOEs 172, 177, 197
  trade policy in 21, 107–8
voting shares 157
voucher privatization (scheme) 156, 236
voucher privatization method 237

wage flexibility 96
wages 156, 194, 197
Walder, A. G. 176
Wallis, J. 220
Wank, D. L. 187
war destruction 7, 8, 12
Warner, A. 35, 44
Washington consensus 95
Watson, A. 226
weak democratic regimes 12, 37
weak institutions 47–52
Weisskopf, T. 159
Weitzman, M. L. 158, 184
welfare 196
  state 17, 36
West Germany 227
Whyte, M. K. 226
Wijnbergen, S. van 236
Williamson, O. E. 174
Wong, C. 177
Wong, J. 184
Woo, Wing Thye 32, 86, 98, 185, 223
Woodward 164
work collectives 46–7
work ethics 48
worker cooperatives 146
workers 22, 36, 40, 46, 67, 87, 98, 110, 136, 155, 157, 165, 210, 235
workers' collectives 15
World Bank 10, 16, 46, 64, 68, 70, 98, 109, 129, 173, 209, 235
World Development Report 6, 108
world prices 31, 40, 58, 71
WTO 91

Xiamen 85
Xiaoping, D. 179
Xu, C. 158, 184

Yeltsin, B. 157
Yeltsin reforms 30
Yi, G. 177
Young, S. 177
Young, S. 187

Zakaria, F. 12
Zamfir, C. 210
Zettermeyer, J. 19, 43
Zhang, W. 177
Zimbalist, A. 145
Zou, L. 175