Reality Check:
wiiw Economists Reflect on 25 Years of Transition

Vladimir Gligorov, Peter Havlik, Gábor Hunya,
Michael Landesmann, Leon Podkaminer, Sándor Richter and
Hermine Vidovic
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VLADIMIR GLIGOROV
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GÁBOR HUNYA
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SÁNDOR RICHTER
HERMINE VIDOVIC

In the transition from the communist regimes to parliamentary democracies and market economies, there are milestones which are preserved in the collective memory, such as the fall of the Berlin Wall in November 1989 or the failed coup in Moscow in August 1991. But when exactly transition did begin and when it was completed will remain subject to discussion perhaps forever.

In this special issue of the wiw Monthly Report we take the liberty to publish the subjective reflections of wiw senior researchers on the process of transition over the past 25 years. Those of our researchers who were in a position to monitor this process as adult professionals from the very beginning were asked the following questions:

Looking back at transition over the past 25 years:

› Which were the main surprises for you regarding developments?
› Which main tendencies would you expect to mark the next 10 years?

In this special issue of the wiw Monthly Report you will find the answers.
Selected living standard indicators in selected transition countries, 1990*, 2014*

**Motor cars in use, per ten thousand persons**

1990 | 2014 | Absolute change
----|------|----------------
RO  |      |               
CZ  |      |               
SI  |      |               
BG  |      |               
MK  |      |               
RS  |      |               
HU  |      |               
RU  |      |               
HR  |      |               
UA  |      |               
MK  |      |               
PL  |      |               

**Health services, doctors and dentists, per ten thousand persons**

1990 | 2014 | Absolute change
----|------|----------------
RO  |      |               
CZ  |      |               
SI  |      |               
BG  |      |               
MK  |      |               
RS  |      |               
HU  |      |               
RU  |      |               
HR  |      |               
SK  |      |               
UA  |      |               
PL  |      |               

**Educational system: students in tertiary education, per ten thousand persons**

1990 | 2014 | Absolute change
----|------|----------------
PL  |      |               
HR  |      |               
CZ  |      |               
RS  |      |               
HU  |      |               
RO  |      |               
SK  |      |               
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Remark: 1990 or the first available year thereafter, 2014 or the last available year.
Source: wiw Annual Database incorporating national and Eurostat statistics.
Understanding transition

BY VLADIMIR GLIGOROV

It was not hard to understand the basic problem with the socialist system and the key elements of the transition that was to come if you lived in Yugoslavia. The common understanding there, since at least Nikita Khrushchev’s speech in 1956, was that (i) the Soviet socialist system was unsustainable, and that (ii) the socialist system, including the Yugoslav self-management type, was transitory. The reasons were, broadly, three: two economic and one political in nature. On the economic side, there was the issue of efficiency due to distorted prices in a closed, i.e. protected, economy on the one hand, and the state being the exclusive or dominant investor, i.e. the state capitalist system, on the other hand. On the political side, the undemocratic character of the one-party dictatorship stood in the way of political legitimacy and was seen as insecure, unjust, and corrupt. Given that the system was seen as transitory, it needed to be reformed in an obvious way through liberalisation (to improve the price system), privatisation (to enable private investments), and democratisation (to ensure legitimacy).

Legitimacy as key to economic transformation

Until 1968, and not just in Yugoslavia, the strategy of transition was a reformist one, by which was meant something like the Chinese transition after 1989: liberalisation of foreign and domestic trade with investments left to the enterprises, with some limited privatisations. So the strategy of transition was to give attention to the democratisation process only when economic reforms had been successfully implemented. However, with the failure of the reforms in Yugoslavia and Czechoslovakia in 1968, it became clear that the order in the steps of transition needed to be reversed: democratisation first, economic reforms later.

In Yugoslavia, this understanding was almost universal, but was not necessarily favoured by many for political reasons. If one calls this understanding of transition as liberal, the opposite view was the one voiced by the Praxis group of mainly Belgrade and Zagreb intellectuals, mostly seen as dissidents in the West. They were concerned with nationalism, but the contingent in Zagreb feared that democratisation without the socialist system would bring nationalists to power, while the Belgrade group (the more influential members in any case) feared that it would not bring the nationalists to power. The former thought that the economic reforms would give power to the nationalist middle class, while the latter feared that Serbian national interests would be sidestepped by those same economic reforms through decentralisation, while they favoured centralisation.

In 1968, both the liberals and the anti-nationalists lost, while the nationalists advanced both in the Communist Party and in the opposition. So, in Yugoslavia, and to an extent similarly in Czechoslovakia and in the Soviet Union, there was an understanding that the order of transition needed to be the following: constitutional changes, then democratisation, and then economic reforms. The first step,
however, was not seen as necessarily requiring a democratic procedure, which consequently accounted for some of the specific outcomes in these countries after the fall of the Berlin Wall.

My personal involvement was rather intense in 1968. I was working on the secession of the student organisation from the Communist Party and was also cooperating with the Czech students, which gave me the opportunity to observe both the way politics worked in Yugoslavia and in the socialist world too. It was clear to me that without political change, no economic reform would ever succeed. But, in 1968, the liberals in Yugoslavia lost – never to recover to this day. In the brief period before I went to the United States in 1971, I started a bimonthly journal called Ideje (Ideas) in Belgrade, which was completely independent, both ideologically and politically, and participated in the setting-up of a similar journal in Skopje, called Argumenti (Arguments). The latter was banned already in 1971, while the former was taken over by the government in 1975.

The good followed by the bad decade for the socialist world

In the United States, as a graduate student at Columbia University (1971-1973), my interest was in social sciences and not really in communist studies, though I did attend the brown bag meetings ran by Zbigniew Brzezinski at the School for International Affairs every (I think) Tuesday. The dominant figure was Alexander Erlich, whose book on The Soviet Industrialization Debate: 1924-1928 I found to be extremely useful. Also, Stephen Cohen attended from time to time and his biography of Bukharin, which came out around that time, supplemented Erlich’s work marvellously. Perhaps the most consequential was the debate between Jerry Hough and Zbigniew Brzezinski. The former argued that, from a sociological point of view, the Soviet regime would be gradually transformed to something like a democratic-capitalist system due to functional diversification, arising from the need to give more autonomy to e.g. the managers or the apparatchiks in general (that he studied), while the latter believed that totalitarian systems could only collapse with unpredictable consequences. Both did not believe that Russia could be transformed through democratisation.

The 1970s were basically good, in economic terms, for the socialist countries. So after I had returned to Belgrade, my interest in transition was that of understanding, rather than acting, by going back to when it all started, ideologically and revolutionary. That was in part due to the fact that I was earning my living from translation. One side effect of the 1968 uprising in Europe was the increased interest in Marxism, primarily the Western one (e.g. Herbert Marcuse, the authors in the New Left Review, and the dependency school in international trade and investment), but I was able to persuade the editors of a number of journals that the early economic thought was worth looking into. It was not hard to get the books and the newspaper articles, so I put out not just Bukharin’s articles, but also those by Novozhilov (the only one that survived the purges of the 1930s), Yurovsky, Kondratiev and almost everybody, and also by Ota Šik, Kornai, and Kalecki inter alia. While working on those, I got commissioned to write a book on the problem of industrialisation, which was published in 1984: Gledišta i sporovi o industrijalizaciji u socijalizmu (Opinions and Debates about Industrialisation in Socialism) with the main topic being the problem of centralised investment and disequilibrium prices. I also published a book of essays and articles Socijalistički žanr (The Socialist Genre) in 1985 with the main theme being that reforms cannot succeed without democratisation (socialism is a political, not an economic genre). In doing all that, I wrote a critical study of Marx’s economic thought in 1977.
The 1980s were bad for the socialist world, with economic stagnation and in some cases recession, and with the political challenge in Poland from 1981 onwards. Clearly, economic reforms – whenever tried in that period – without liberalisation and privatisation proved ineffective, while those were not possible without democratisation. Support for consumption led to growing foreign debt, which appeared to become increasingly unsustainable. So, European socialist countries had to democratise to secure legitimacy of the economic transformation – which indeed is how things started and why the transition succeeded from 1989 onwards.

In that decade, I worked mostly as a private scientist on projects, predominantly microeconomic ones (industrial economics and economics of the firms), but was also commissioned to write a paper on the systemic reasons for the economic crisis of the Yugoslav type of socialism and on the problems with planning, though Yugoslav planning was mostly political rather than technocratic (as at least in theory was that of the Soviet-type systems). So, I produced two long reports, in 1982 and 1983, one on basically sudden stop crises, i.e. abrupt reductions in capital flows into a country, in an economy with negative real interest rates, which is what the Yugoslav economy was in the 1970s, and another on the Arrow-type problems in centralised or decentralised, mandatory or indicative, systems of planning. The papers basically outlined the whole transition agenda with democratisation, liberalisation, and privatisation.

I was also asked to write a policy paper on constitutional and political issues for the internal debates within the Serbian leadership in which I argued that the right thing to do was to go for free elections and then with sufficient legitimacy propose a change of the Yugoslav constitution. The same argument I made on the main TV news programme on the New Year’s Eve in 1985. Thereafter, I was banned from TV until 1989 or thereabout. With the same argument I joined the initiative to form an opposition party in Belgrade at the end of 1988, the Democratic Party. I influenced much of the wording of the initial programmatic statement and I wrote the economic part of the party’s programme. The party eventually came to power, though with a changed programme, when Đindjić became prime minister in the year 2000.

Again, as in 1968, liberal democrats lost in the 1980s and also during the dissolution of Yugoslavia. The reformist government of Ante Marković, formed in 1988, made the mistake of believing that reforms can take precedence over democratisation and that liberalisation and privatisation, which at that moment became possible, would sap the nationalist movements and democratisation would then lead to the ex post legitimisation of the economic transition. That was a mistake, just as it was a mistake that Serbian liberals opted for a nationalist leader instead of for free elections. One reason was the expectation that the Soviet Union or Soviet Russia would preserve the bipolar system with Serbian influence growing within Yugoslavia. I wrote on all that in real time and published the book *Why Do Countries Break Up? The Case of Yugoslavia* in Uppsala where I was a fellow in the early 1990s. Thereafter I studied the consequences of the wars and the regional disintegration as well as the strategies of transition and development, together with state and nation building, in the Balkans. These came out in the book *Neoclassicism in the Balkans and Other Essays*.

**Misunderstandings and mistakes during transition**

My final encounter with transition as an actor came after the regime change in Serbia in 2000. I worked on a survey of Yugoslavia for the OECD and was also asked to consult the Serbian government in the
preparation of the Thessalonica Summit in 2003. On the basis of my work in the early 1980s, I opposed
the policy of the Serbian government that implied a fast increase in foreign debts, which is why my
advice was not really welcomed. I produced a paper for the Peace and Crisis Management Foundation
in Paris, which was presented in Belgrade with no effect in early 2004. As for the Thessalonica Summit,
my paper was adopted by the Serbian government, though informally, even though I argued for a
solution to the Kosovo problem by accepting its independence (it was published independently).
However, after Đindić was assassinated, the successive Serbian governments went in a different
direction and the accession of Serbia to the EU was delayed, mainly because of the issue of the status
of Kosovo, with the process really just starting now.

In the early years of transition I had a number of discussions with Jeffrey Sachs, in Belgrade and in
Helsinki (WIDER Institute), on the policy of stabilisation and on programmes for privatisation. I also took
part in the early discussions at the EBRD on the Russian programme of transition and also in
discussions organised by the Liberty Fund with many prominent reformers in Central Europe, including
Slovenia. At the Stockholm Business School I met people heavily involved in the Baltic transition and in
the Russian one. Out of these numerous high-level discussions a number of my publications came out
(on shock therapy, on justice in privatisation, on the redirection of trade). I was not happy with most of
the privatisation programmes, and I did not find useful the push by most Western advisers, including
Jeffrey Sachs and Anders Aslund, for a semi-autocratic system in Russia. I thought that in part because
of that the country lost the historic chance to democratise sustainably in 1993. It is not terribly important,
but it should be stated for the record that in all those discussions, as well as in most of the publications
that came out at that time e.g. in NBER programmes, the Washington Consensus, later much blamed for
the strategy of transition and for the problems that surfaced, played no role whatsoever. (Sachs for one
was a staunch critic of the IMF at that time and later.)

Taking stock, I think that many of the misunderstandings of and the mistakes during transition came
from the fact that for different reasons, people either opposed liberalisation (part of which was the shock
therapy, i.e. stabilisation of exchange rates and prices) or privatisation, especially when proposed in a
big-bang way. The latter criticism was particularly misplaced. The key to the problems with the socialist
system was the state’s monopoly in investments, based on state ownership of almost everything, and
the planning system that was used for purposes of implementation. Protectionist trade policy and
inconvertible currency were the means that made internal prices susceptible to manipulation. The
outcome, the shortage economy, was well discussed already by Novozhilov and in great detail by
Kornai. So, while the arguments for gradualism, mainly made by Kornai in the case of privatisation,
certainly made sense, primarily because of their realism, the argument for public investments and
employment in order to deal with the transitional recession made little sense. The Keynesian argument
was not applicable because it relies on the private sector being efficient, with government investment
and consumption providing additional support when needed for full employment, while countries in
transition had a collapsing state sector and an emergent private sector. That mostly accounted for the
transitional recession rather than the shortfall of public spending and investment. Protectionism also
made no sense because of the collapsing trade in the former socialist markets and collapsing domestic
demand, so access to the European Union’s market was essential. In addition, sources of domestic
investments and entrepreneurship were limited, so access to foreign investments was vital too and trade
liberalisation helped in that.
The other mistake was made in Russia, but also in Serbia after 2000, where the assumption was that privatisation needed to be done in a clearly corrupt way and, in the case of Serbia, that consumption needed to be boosted in addition, e.g. by an overvalued exchange rate, in order to forestall the danger of reversibility. In part, this was also the justification, as a bribe, for the voucher privatisation system that was used in most countries in transition. These mistakes in countries that democratised convincingly and sustainably did incite dissatisfaction, resulting in frequent changes in government, but without systemic political consequences. By contrast, in countries with deficient democracies these mistakes did not lead to a return to the pre-transition system, but to some combination of oligarchy and authoritarianism, which proved to have long-term consequences especially in Yugoslavia’s successor states and in Russia, Ukraine and some other post-Soviet Union states.

One of the great puzzles in the early literature of transition was the deep initial recession. This is not what happened e.g. in China’s liberalisation and privatisation, but also after the introduction of the New Economic Policy in Soviet Russia in 1921. However, recession was the outcome of the Yugoslav reforms in the mid-1960s (and poor growth prospects of most other reforms in the Soviet post-Stalin socialist systems). This was the consequence of the transfer of investment decisions to the firms and the banks. The efficiency of investment tended to increase, as the Slovenian economist Aleksander Bajt showed in the case of Yugoslavia in the 1960s, but the accompanying restructuring had costs in output and employment. The public did not understand it, and the Communist Party hardliners took the opportunity of the student demonstrations in 1968 to reverse the course, by kicking the liberals out and by borrowing money abroad. One saw then what was going to come, but there was not much that could be done.

Working for transition and failing, while transition eventually succeeded as in Central Europe, is one thing. Failing to convince other students of transition was to be expected, as ideological commitments die hard. But failing altogether as in Yugoslavia and in particular in Belgrade, where one believed everybody thought or could think freely, was an entirely different matter.

References


Looking back a quarter of a century to December 1990, to the very beginning of transition, and reflecting on my personally expected outcomes and the actual current situation, I ventured to consult a compendium of papers which I edited in 1990 under the title *Dismantling the Command Economy in Eastern Europe*.\(^1\) With few existing peers looking closely at the region of Central and Eastern Europe at that time, wiiw was in an exclusive position to analyse the transition-related challenges as it enjoyed the advantage of both being in the vicinity and possessing intimate knowledge of these economies and societies. The above-quoted compendium of papers included chapters on ‘Transition from Command to Market Economies’ (co-authored by former wiiw Director Kazimierz Laski, who discussed the pros and cons of the ‘shock therapy versus gradualism’ while convincingly arguing against the feasibility of a ‘third road’ yet still recognising the plurality of ‘market economies’), on monetary and exchange rate policies, on East-West economic relations in view of the changes in the CMEA (the then still existing Council for Mutual Economic Assistance), on East-West energy prospects, and on unemployment and social security, as well as seven country case studies, including ones on East Germany, Czechoslovakia, Yugoslavia and the Soviet Union. These entities do no longer exist as states: there are now 24 new independent states in their place while East Germany merged with West Germany. For me, this was probably one of the least expected transition outcomes, as was in particular the subsequent extremely violent nature of the Yugoslav disintegration. Nor had I expected, on the other hand, the speed and the depth of the process of integration starting in the region soon thereafter, especially the fact that parts of the former Soviet Union would join the European Community, not to mention NATO membership – although a ‘return to Europe’ was high on the agenda in most post-communist countries in Central and Eastern Europe from the very beginning.\(^2\)

Regarding other personal expectations confronted with the transition outcomes, let me continue with a few additional quotes from my introduction to the above-mentioned volume: ‘historic traditions and starting conditions for a successful transition differ widely’ (Havlik, 2015, p. 1). This explicit recognition of diversity (which wiiw has been continuously stressing in contrast to the then prevailing ‘Washington Consensus’)\(^3\) implied not only the need for diverse transition strategies (not ultimate transition targets, these were ‘the establishment of a market economy and democratic political institutions’ – Havlik, 1991), but also the possibility of diverse outcomes, the latter implying that there was no guarantee for either a speedy and smooth transition or for its success. Using another quote from this book, I was convinced

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1. At that time, wiiw was still called The Vienna Institute for Comparative Economic Studies. The papers collected in the volume were drafted in 1990, but in the pre-internet era published only in 1991 – see Havlik (1991).
2. In the economic context this was largely understood as an ‘opening to trade and more economic contacts with the West’ – see Havlik (1991), p. 1.
3. For a recent overview see D. Rodrik (2015), in particular Chapter 5, pp. 159-167.
that ‘a return to communist dictatorship of the old sort is rather unlikely in the countries of Eastern Europe contrary to the disintegrating Soviet Union, where future developments in individual republics may go virtually in any direction’ (Havlik, 1991, pp. 1-2). Indeed, the spectrum of transition varieties which emerged in the region ranges from the more ‘successful’ transitions in the Czech Republic, Slovakia, Estonia and Poland to the more or less ‘failed transitions’ such as Bosnia and Herzegovina, Kosovo, Belarus, Turkmenistan, Ukraine and Uzbekistan. The latter group unfortunately confirms the expected variety of transition outcomes.

The next bundle of my personal expectations related to the challenges how ‘to cope effectively with the difficult legacy of the past and with adverse consequences of transition’ (Havlik, 1991, p. 2). I was also aware of the dangers associated with ‘the newly emergent nationalism, combined with a vacuum of functioning institutions’. Indeed, the establishment of ‘institutions and market mechanisms that are often granted in the West, but which either do not exist or were discredited in the East’ and the high social costs associated with the transition ‘endangering the maintenance of a necessary social consensus in the new and fragile democracies’ (Havlik, 1991) turned out to be even more challenging than I had expected. A quarter of a century ago, I certainly did not imagine that politicians like Kaczyński, Orbán, Zeman and Putin would be among the leaders winning democratic popular vote, that a unified Germany would be led by two East Germans (Federal President Joachim Gauck and Chancellor Angela Merkel), and that the daughter of an Evangelic pastor from the German Democratic Republic and a former KGB agent who operated in the same country in the 1980s would be the two currently mightiest and in their respective countries (still) most popular politicians in Europe.4

Finally, the ‘decisive importance of Western support for the success of transition in the East’ (Havlik, 1991, p. 3) was also recognised. In the economic sphere this meant the abolishment of remaining trade barriers and providing financial aid including ‘at least a partial remission of existing debts’ (the latter was at that time particularly relevant for Hungary, Poland and the Soviet Union). The importance of Western technical assistance through the transfer of technology and management know-how via both technology imports and foreign direct investments was also underlined. Indeed, also the necessity to engage a ‘massive involvement of Western capital’ (Havlik, 1991) was recognised already at the outset. Last but not least, perhaps ominously, the book issued an early warning that ‘the social net in Eastern Europe might easily collapse and the West would be forced to erect new walls’ (sic!). Unfortunately, these fears seem now to be partly materialising – be it in the chaotic response to migration flows or Ukraine’s and Western conflicts with Russia. The latter in particular – de facto a return to a sort of Cold War after nearly three decades of ‘climate improvements’ – came to me as totally unexpected, perhaps even more so than the power of destructive forces of nationalism, populism and xenophobia in the region (and not only there). That the frozen conflicts in Abkhazia, South Ossetia, Nagorno-Karabakh and Transdniestria would last until this day, and that new conflicts such as the one in Ukraine could flare up with such intensity, I certainly did not expect either.

Closing my personal ex-post reflections on the transition in Central, East and Southeast Europe, I may add some comments on selected economic outcomes, focusing on three areas: catching-up processes in economic development levels, labour market developments and trends in social cohesion

4 Angela Merkel has been named ‘Person of the Year 2015’ by the TIME Magazine (see http://time.com/time-person-of-the-year-2015-angela-merkel/). Vladimir Putin got this title in 2007.
EXPECTATIONS OF TRANSITION AND REAL OUTCOMES IN RETROSPECT

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(inequality).\(^5\) Table 1 shows the evolution of development levels (defined as GDP per capita at current purchasing power parities).\(^6\) As expected, the processes of catching-up have been uneven: they have been most impressive in Poland, Slovakia and Estonia (with a more than 30 percentage points reduction of the gap to the EU-28 average). But they have been disappointing in a number of other countries such as Croatia, Macedonia, not to mention Ukraine. And compared to some expectations (not mine, but those of many colleague economists from Eastern Europe), the actual pace of catch-up remained much behind (for instance, in terms of per capita GDP, the Czech Republic still remains one third below the Austrian level, Slovakia two fifths below, and Hungary reaches just 55% of that level).

The persistence of stubbornly high unemployment (not the emergence – there was in fact substantial hidden unemployment in socialist economies) is particularly disturbing. The social exclusion of certain minorities (especially Roma) particularly in some Western Balkan countries and peaking youth unemployment rates represent a ticking bomb which may become even more dangerous than the homegrown terrorism in Belgium, France, Norway or the United Kingdom. Despite some remarkable successes (Slovakia and the Baltic states come to my mind), my personal quarter-century balance of transition is predominantly sober and mixed with a slight tilt to the negative, perhaps affected by the current developments in Europe, or by the foggy autumn weather.

**Table 1 / GDP per capita at current PPPs (EU-28 = 100)**

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<td>Austria</td>
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Source: wiiw Database, own estimates.

\(^5\) See e.g. H. Vidovic (2013), Holzner and Leitner (2012); economic inequality is by no means confined to transition countries – see e.g. Piketty (2014).

\(^6\) For more analysis of catching-up processes see, for instance, Dobrinsky and Havlik (2014):
References


Remembering transition

BY GÁBOR HUNYA

The author has been staff economist at wiiw since 1991 and was 37 years old in 1990.

What transition meant for me

Reflections on the past are typically influenced by present circumstances. My current life takes place on the Austria-Hungary-Romania axis which is not much different from that of 25 years ago. Based in Hungary in the 1980s, I wrote on economic development issues in Romania and other East-Central European countries. I was aware of the deepening crisis of the centralised ‘planned’ economic systems. Also the results of the – mostly half-hearted – market reforms disappointed me. Still it was a lot more pleasant to live in Hungary than in most of its Eastern and Northern neighbours. I had ample opportunity to travel and experience the functioning of the Western system. By the late 1980s I became an enthusiastic supporter of deep systemic reforms which aimed at introducing market coordination in the economy and democratic institutions in politics. This was what transition meant to me: adopting the internationally dominating system of liberal capitalism and democracy.

On speed and sequencing

As to sequencing, I shared the overwhelming opinion among Hungarian economists that the liberalisation of market forces based on private property required a fast and coordinated change in the legal and institutional systems. But the various aspects of market reforms required different amounts of time, giving rise to transitory mixed systems. It took at least half a decade to set up the main institutions and make private property the dominant form of ownership. By all indicators, transition was faster and better implemented in Hungary, which essentially became a market economy by the mid-1990s, than in Romania with its gradualist policy and half-transformed state-owned enterprises (SOEs).

Romania muddled through the 1990s without having established a functioning market economy. Transformation was guided by foreign consultants with little success of transferring and embedding knowledge. Rent-seeking produced more destruction in public assets than what could be expected from straightforward privatisation. Hesitant transition promoted cronyism and legal uncertainty. Only after 2000, when EU accession was put on the agenda, did Romania implement the most important reforms. The privatisation of what had remained of the large SOEs was carried out. The country soon underwent a spectacular economic recovery. But cutting back corruption and improving the functioning of public institutions has been put on the agenda only in recent years. One may now have some hope in progress seeing the efforts of the current technocratic government and the anti-corruption agencies. I did not expect a decade ago to get more optimistic about Romania’s future than Hungary’s.
On privatisation and FDI

The privatisation of SOEs was in the focus of my research and publication activity in the 1990s. I argued for the sale of SOEs to strategic owners which had the knowledge and capital to restructure the companies, invest in technological upgrading and ensure access to new markets. Based on social (often populist) arguments in the early phase of transition, mass privatisation by coupons was widely introduced in several countries, giving away shares to the population at large. As expected, corporate governance was not established by this method and the concentration of ownership followed via the secondary market making the social argument obsolete.

Whatever way of privatisation was taken in the transition countries, most of the former state-owned enterprises did not prove viable. They lacked proper management, lost their former markets and were short of capital. Many former SOEs went out of business and their assets were taken over by new firms. In the whole privatisation process, foreign investors had an advantage over domestic ones in terms of market knowledge, management skills and access to capital. Those technologies which were relevant for growth were mainly in the possession of multinational corporations and could be accessed only through becoming subsidiaries. The sale of industries and banks to foreign investors proved successful in most cases, giving rise to a strong export sector and accessible banking services.

In retrospect, there was too much attention given to the privatisation of large enterprises in the 1990s and too little to the support of entrepreneurship. Small ventures mushroomed often as an escape from unemployment. They seldom grew beyond arm’s length. Domestic private capital thrived mainly in protected segments of the economy where connections to the authorities, favouritism and corruption supported the accumulation of fairly large fortunes. A partly different way of privatisation was pursued in Poland where the stock exchange mobilised capital for hundreds of domestic companies. As a result, the domestic private sector there has become larger and more competitive than in Hungary and in other countries of the region.

After privatisation had by and large been completed, my research interest turned to the study of greenfield FDI and its impact on economic development. Research has confirmed the expected positive effects of FDI on economic growth, but also problems were identified. The spill-over effects to the domestic economy were very limited, mainly because the domestic companies did not develop sufficiently to become attractive partners for foreign multinationals.

The access of foreign investors to former public monopolies and oligopoly markets resulted not only in better services to customers but also in relatively high prices and lack of competition. The authorities proved weak in building and safeguarding competition. Unfortunately, the debate on the role of the state went into the wrong direction, focusing on the size of public involvement in the economy instead of on its quality. The failures of some privatisations should not have resulted in questioning the idea itself but in stimulating the transformation of public institutions. The new roles of the state in shaping and guarding competition, providing framework conditions, regulation and public goods evolved too slowly and were often blurred by group interest and allowed for discretionary intervention.
On post-transition in Hungary

The newly gained freedom in 1990 and the relatively smooth political transition gave ground for optimism regarding Hungary’s political future as a democratic state. To my surprise, democratic values have not become deeply rooted in the society. Some were opportunistic, giving up ideals for personal benefits, while for the majority of people making both ends meet remained the main concern.Democratic control over the government diminished over time. The Fidesz party learned the use of the manipulating power of the media and has relied on populist slogans to gain a comfortable majority and re-write the democratic constitution.

To my disappointment, etatism has not lost its popular attractiveness and the idea of national control over large market segments has re-emerged. The Orbán regime has brought back some of the institutional solutions of the communist era in the form of state monopolies over utilities, or the standardised curricula in public education. What I had expected even less was the revival of the pre-WWII national conservative ideology and practices at the government level. I had been aware of the strong nationalist undercurrent in Hungarian popular thinking which contrasted with my liberal ideals. But I thought a compromise for progress was possible and did not expect that the nationalists would expand their control over the state and the society in the way they have done since 2010.

Arguably, the historical period called ‘transition’ came to an end at about the time when the respective countries joined the European Union under the condition of having a ‘functioning market economy’ and democratic institutions. Whatever changes the development path of a country has taken since then comes under the heading of ‘varieties of capitalism’. The current Hungarian variety moves away from the ideals of transition as illiberal political and economic solutions have come to the forefront. Poland has embarked on a similar road recently. Right-wing populism as well as its leftist counterparts has gained ground also in the rest of Europe. The trust in common European institutions has been shaken, partly due to their cumbersome operation and inability to provide common solution to pressing issues such as migration. Options for more and for less integration are both open now. While my preference is for more and smoother integration, I am worried about where we are heading to.
The author has been research director of wiiw since 1996 and was 38 years old in 1990.

Let me start with some personal notes: I got involved in transition issues while I was still at the University of Cambridge (UK) during the eventful year 1989. During the 1980s I worked with a research team led by Professor Sir Richard Stone on multi-sectoral structural modelling of the European economy. With my background as a Central European, the events of 1989 were too exciting to miss. Along with some political scientists (John Dunne, István Hont) and the Polish Oxford economist Włodzimierz Brus we organised a two-year-long seminar series on the transition process at King’s College/Cambridge. Further, I became involved in projects coordinated by the Centre for Policy Research (CEPR) on developments in Central and Eastern Europe as well as in a series of projects for the European Commission. Finally, to this period also dates back my first contact with the Vienna Institute for Comparative Economic Studies (now, Vienna institute for International Economic Studies, wiiw) where I participated in a project led by its then Scientific Director Professor Kazimierz Laski for which I wrote a paper on industrial policy.

The transition which was unfolding in Central and Eastern Europe (CEE) included many aspects: economic, political, social, and cultural ones. There were many things which I learnt from observing and analysing the transition processes in the CEE region and its impact on overall European integration. As an economist with an expertise on international economic integration and on longer-term structural change I shall focus on a sub-set of issues which led to certain research lines.

International integration and catching-up

One of the intriguing issues was to analyse the particular circumstances of a dramatic process of international integration between two groups of economies which were hardly integrated at all before but rather separated through the ‘Iron Curtain’. The additional features of this integration were, firstly, that the integration process proceeded very rapidly, i.e. with a ‘Big Bang’ of trade liberalisation and, in due course, financial markets integration. Secondly, it took place between groups of economies which differed strongly from each other in terms of overall productivity levels, historically grown economic structures (such as the relative neglect of the services sector in the previously socialist economies) and in other aspects as well (such as institutional, legal and behavioural features). Hence it meant to observe and analyse a rapid integration process amongst very ‘heterogeneous’ economies. The obvious way to analyse the integration processes was an application of bits of growth and trade theory. Growth theory has proposed models of ‘convergence’ and international trade theory models of international trade (and production) specialisation. Combining the two, we projected at a relatively early stage three likely features in the development of East-West European integration processes: (i) that we might see instances of very rapid ‘convergence’ processes (due to rapid market integration which would facilitate technology transfer and productivity catching-up); (ii) that EU accession prospects would play an
important role in institutional and political-economic anchorage; and (iii) that there might be a lot of
country differentiation as ‘convergence’ does not just depend on the ‘potential’ for catching-up but also
on domestic institutional, behavioural and political adjustment processes facilitating or hindering the
exploitation of such a potential.

Labour market implications of ‘structural catching-up’

The dramatic process of ‘de-industrialisation’ in the first phase of transition combined with rapid
productivity catching-up was likely to take a strong toll on employment in transition economies. The deep
‘transformational recession’ (a term coined by the Hungarian economist János Kornai) was the result of
a very rapid systemic change in mechanisms of resource allocation combined with a very quick process
of international opening-up (shifting demand initially strongly in the direction of imported goods and
services), but there was also a sectoral adjustment process linked with it. The sectoral adjustment
proceeded with an initial dramatic contraction of an ‘over-sized’ industrial sector combined with strong
productivity catching-up; this led to strong contraction of employment and, when recovery from the
transitional recession set in, to a phase of ‘jobless growth’. As the initially underdeveloped services
sector grew, resources and employment shifted into that – relatively – labour-intensive sector and hence
aggregate employment followed in most countries a ‘U-shaped’ pattern.

Balance-of-payments constrained growth (BOPCG)

The integration process was also one in which John Thirwall’s theory of BOPCG could be well applied.
Catching-up economies which grow on a higher growth path than their more advanced trading partners
are likely to run deficits in their trade balances. This would be true even if (income) trade elasticities on
exports and imports were the same. But since the demand for higher-quality consumer goods and
technology-intensive intermediates and capital goods was high in catching-up economies, income
elasticities for imports were particularly high in CEE economies. Furthermore, real exchange rates were
propped up by capital inflows based on an expectation of sustained higher income growth in CEE
economies compared to the more mature Western European economies. Hence one could expect high
deficits in the trade accounts in the early phase of transition. Again, differentiation across CEE
economies could be observed. In the Central European economies (such as the Czech Republic,
Slovakia, Hungary) this period of high current account deficits was used to utilise capital inflows in the
form of FDI to build up export capacities and upgrade these rather successfully. In other economies
(such as those in the Balkans), capital inflows mostly went into ‘non-tradable’ activities (such as real
estate, retail trade, etc.), high net import dependence continued and this led to a chronic deficit situation
in the current accounts.

The role of exchange rate regimes

Exchange rate policies and exchange rate regimes mattered and the CEE region almost represented an
experimental field in which a wide range of such policies were executed and regimes were in place at
different times. The choice amongst exchange rate regimes amounted in many instances to a ‘between
Scylla and Charybdis’ situation. Choosing a flexible exchange rate regime meant that a country was
exposed to the volatility of capital inflows which could lead to bouts of currency appreciation followed by
depreciation, not necessarily driven by fundamentals, but often by volatile expectations, at times mistrust
of national monetary policy authorities, and external developments (ECB policy etc.). Choosing a fixed
exchange rate regime, on the other hand, could lead to a trend appreciation of the real exchange rate as exchange rate risks were perceived as non-existent, and this could make the economy uncompetitive, accentuating a long-term balance-of-payments vulnerability. Very often a period in which the country stuck stubbornly to a fixed exchange rate ‘anchor’ was followed by an exchange rate crisis which interrupted the growth process.

**Regionalist vs. global international production networks**

An interesting aspect of transition was the development of a ‘Central European Manufacturing Core’ (see Stehrer and Stöllinger, 2014) which was characterised by a situation in which a sub-group of CEE economies which had previously faced the problem of ‘de-industrialisation’ now belongs to those economies in Europe with the highest share of manufacturing in GDP. The reason for this has been the development of strong cross-border production linkages (especially in automobile manufacturing, but also in other industries). This was an expression of the advantage of ‘vertical specialisation’, i.e. where countries or regions with different production characteristics (e.g. productivity and wage differentials, differences in skill endowments, in infrastructural characteristics) combined with rather good transport and logistics linkages can lead to firm strategies which ‘split up production chains’ into ‘tasks’ and execute these in different locations. The group of Central European economies greatly benefited from these cross-border production linkages and a principal worry in other lower- and medium-income regions currently is that such international production networks would not extend beyond the Central Manufacturing Core. Such persistent agglomeration contributes to sustained regional imbalances which also get reflected in macroeconomic external imbalances and a precarious position of ‘Europe’s periphery’.

Which main tendencies do we expect to mark the next ten years? I would single out the following:

(i) **Differentiation in country and regional developments will continue:** from an economic point of view, the more advanced of the CEE economies have attained relative economic stability and are well anchored in European trade and production integration. There is still the aftermath of the financial crisis which has hit the banking system and there are lingering debt problems. Further problems arise with respect to political developments and attitudes towards European integration (on this below). However, the much bigger economic challenges arise in countries in Southeast Europe (the Balkans) as well as countries which make up the ‘buffer zone’ between the EU and Russia. Here the accession perspective is not settled (regarding the timing of accession for the countries in the Western Balkans, and for the other countries – Ukraine, Moldova, Georgia, etc. – there might not be an accession perspective at all). It has taken a long time for EU policy-makers to recognise the persistence of strong heterogeneity amongst its Member States as a major structural challenge for the EU and the EMU and we are still far from having developed the institutional and policy tool-kit to appropriately confront this issue.

(ii) **EU-Russia relations and the future of EU neighbourhood policy:** The European integration process proceeded along rather idealistic and technocratic lines after 1989. It failed to take account of the fact that outside the EU, big (and at times regional) power politics still shaped (and will continue to shape) the bulk of international relations. This has become very obvious over the past years in the escalating conflict situation with Russia over the destiny of Ukraine and before that of other ‘buffer’ states such as Georgia and Moldova. The recent refugee crisis is another instance of the impact of power-political interventions in the Middle East and Northern Africa which has had significant spillover
effects on Europe. It has become evident (especially after the failure of the ‘Arab Spring’) that the EU has failed miserably as a development engine for the part of its neighbourhood which has no accession perspective. It is still a little understood issue why being in the neighbourhood of a very large, rich entity such as the EU has had so little development spillover effects on the neighbourhood where the instances of collapsed economies and of failed (or fully disintegrating) states have multiplied. It is clear that the EU has to put a major effort into rethinking and reshaping its neighbourhood and development policies, on the one hand, and also to become a more serious (at least regional) player in international relations, on the other hand.

(iii) Nationalism and the danger of European disintegration: Then there is the major challenge of a slump in popular belief in the capacity of the European integration process to contribute positively to economic and social security. There might be a temporary element in this as the drawn-out impact of the financial and economic crisis and its inefficient handling by European policy-makers is one of the reasons for this gloom. However, there is also a longer-run structural issue which is unlikely to be resolved in the near future: deep down it is the difficulty to shift a system of economic stabilisation, of social security and of distributional policies, which is well accepted at the national levels to some degree, to the European level. This – I would argue – lies behind the very incomplete policy-making and institutional structure of the EMU and the EU as a whole. One has to face the fact that such a shift will be required to put the European integration process on a stable basis. However, it would also be unrealistic to expect that this will be anything else than a drawn-out process. This also means that the integration process will suffer reverses – as we are witnessing now with developments in Hungary and Poland and in a series of electoral results and forthcoming electoral challenges in member and candidate countries of the EU. It is our responsibility as social scientists and economists to provide the appropriate political-economic analysis and suggest realistic policy steps which prevent a ‘tipping’ process towards regionalist disintegration in Europe.

Reference

Illusions lost ... ?

The author has been staff economist at wiiw since 1994 and was 45 years old in 1990.

Throughout much of the 1980s my research interests were on the measurement of disequilibria in Poland’s consumer markets. It may be remembered that the problem of such disequilibria – and of the ways of dealing with them – was of paramount importance as the repeated attempts to restore equilibrium through ‘price reforms’ stipulating rising relative prices of food met with violent workers’ revolts (in 1970, 1976, 1980, 1988). My research, first reported in 1982¹, concluded that the past ‘price reforms’ were totally counterproductive. An economically correct policy would have stipulated falling relative prices of food. At that time I believed that restoring equilibrium – through the moves proposed – would make the system much more efficient – without necessarily destroying it (which then seemed a sheer impossibility anyway). But my message was accepted by neither the fellow economists (both at home and abroad) nor the Polish ‘decision-makers’.

From 1985 through 1991 I was an economic advisor to the Trade Unions’ Association (OPZZ) which was allowed to fill the place vacated by the Solidarity Trade Union (the latter was outlawed under the Martial Law in 1982). In that capacity I instigated OPZZ opposition to the Party’s and governmental economic and social policies – with rather limited success. Unlike my fellow (opposition) economists who mostly believed that the ‘whole system’ could not be repaired and had to be scrapped to pave the way for an unconstrained ‘market economy’, I still believed in a ‘third way’. I thought that the management and regulation of the economy through competent fiscal, monetary, trade, industrial, incomes etc. policies were to stay. There was no place in my vision for any wholesale privatisation. Employees of the state-owned firms were to become ‘genuine’ stake-holders in ‘their’ firms.

As a participant, in early 1989, in the Round Table Talks which were to clear the way for the transition from the old regime to a free-market democracy I observed – with some unease – a convergence of views, held by the representatives of the old regime and the democratic opposition, on the general features of the future system.

The new system born in late 1989 and early 1990 embodied an extreme version of the Washington Consensus. Apart from provoking a deep recession (through misadvised and unnecessarily harsh macroeconomic stabilisation policies constituting the so-called ‘shock therapy’) it dumped the ideas of social solidarity and employees’ active involvement in managing ‘their’ firms in history’s wastebasket. The ‘entrepreneur’ (not infrequently a former apparatchik pillaging the state assets) became the hero of the brave new world – dethroning the ‘worker’ and the ‘intellectual’. Needless to say, the new system had nothing in common with the system I had advocated².

² My views on that subject were presented at a conference held in Vienna at mid-1989. Much later they were reproduced (under the title ‘Macroeconomic Policy for the Transitional Reforms in the Centrally-Planned Economies’) in a book edited by J. Kovacs and M. Tardos (Reform and Transformation in Eastern Europe, Routledge, 1992).
The ‘shock therapy’ was allowed to reign for almost two years during which the deterioration of the economic and social conditions (precipitous fall in output combined with run-away inflation and massive unemployment) assumed catastrophic dimensions. When the ‘shock therapists’ were finally voted out of power, a period of ‘therapy without shock’ followed. Pragmatic policies allowed a gradual improvement of the economic and social conditions. That lasted until 1997. Of course the overall socio-economic system did not change much: the progress achieved within the ‘integrative economic model’ (akin to the Washington Consensus) was based on an attempted emulation of the ‘best foreign (i.e. Western) practices’ and the expectation of being admitted into the European Union.

While retaining my fundamental reservations about that model, I was of course favouring, though not uncritically, some of the policies of that period – and also of the years 2002-2005 (and, with rising reservations, of the years 2007-2015). But I strongly (and loudly!) objected to the policies of the years 1998-2001. (At that time a ‘shock therapy mark II’ was instituted – with very bad economic and social effects again.)

On balance, the 25 years of Poland’s transition are generally deemed a success – or even unprecedented success. That is a fair judgement. I do not intend to deny this – even if on many counts the picture is not really impressive. (Here I mean the massive exodus of the young and skilled, the persistence of quite high unemployment, extensive areas of poverty, high inequality, inadequacy of public health services etc.).

Despite the undeniable (past) achievements I remain sceptical about the longer-term prospects of the economy of Poland (and of the remaining Central European new Member States of the European Union). In my opinion the ‘integrative economic model’ embraced by these countries dooms them to their traditional role of the relatively underdeveloped hinterland of the West. Indeed, these countries’ affluence vs. the West is very likely to stagnate in the future at (relative) levels not much different from those achieved 100 or more years ago. As such these countries are very likely to experience paroxysms of discontent (as already observed in Hungary and Poland). These outbreaks are unlikely to overcome the economic and social retardation at all – but may otherwise have nasty political, and eventually economic, consequences.

Has there been an alternative path of transition? Or does the TINA principle apply: ‘There Is No Alternative’? It may be another illusion of mine, but I still believe a ‘third way’ could have been a possibility – as it actually has been in East Asia. Whether a ‘third way’ of some sort still waits to be invented I do not know. Possibly not anymore. In any case, it is no longer the task of the representatives of my generation to propose – and try – such new ways.

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3 However, the equilibration of the consumer market (i.e. elimination of shortages) was achieved within days of the start of the ‘shock therapy’. I derived some (bitter) satisfaction from the fact that the equilibrium stipulated a strong fall in the relative prices of foodstuffs. On this issue see J. Bell and J. Rostowski, ‘A note on the confirmation of Podkaminer’s hypothesis in post-liberalisation Poland’, *Europe-Asia Studies*, No. 3/1995.

4 On this I elaborate in more detail in the paper ‘Central and Eastern Europe: Trapped in Integration?’, which is forthcoming in *Acta Oeconomica* (Budapest). See also ‘Development patterns of Central and East European countries (in the course of transition and following EU accession)’, *wiiw Research Reports*, No. 388/2013.
The early transition through the ‘reformer’s glasses’

BY SÁNDOR RICHTER

The author has been staff economist at wiwi since 1990 and was 37 years old in 1990.

For someone like me who lived in Hungary in the pre-transition years, the transition to a market economy was a lengthy, gradual process. My perception at the beginning of the transformation was that it was more or less a broadening of the economic reforms which had already been initiated in different waves in pre-transition Hungary: in 1953, 1968 and in the early 1980s. These reforms had a common denominator: they represented a departure from the classic model of the centrally planned economy, which survived without significant changes in peer countries such as the GDR, Czechoslovakia, Bulgaria, Romania and, most importantly in this respect, the Soviet Union. These waves of reforms introduced changes which lasted for shorter or longer periods of time before they were fully or partially withdrawn. The reforms of the early 1980s were not withdrawn, they went more or less seamlessly over into the introductory phase of the transition process. The latter started in Hungary as early as 1987, with the re-establishment of the two-tier banking system, and evolved with a market-economy-compatible transformation of the legal forms of entrepreneurship and the modernisation of the taxation system, among other measures.

Each economic reform in the pre-transition era brought about spectacular improvement in the supply of goods in the shops, in the standard of living and in the efficiency of enterprises involved. This unambiguous turn to the better, once reforms had been introduced, was a fundamental experience for my generation of economists in Hungary. It seemed to be granted that any deviation from the classical centrally planned economy would sooner or later exert its beneficial effect, and accordingly the mind-set of economists was programmed for welcoming transition as a sort of ‘super reform’, with an expected stepped-up positive impact.

Only at the beginning of the discussion on the ways and speed of privatisation it became clear to me that what I was witnessing not a ‘super reform’ under a flexible but principally irremovable one-party communist regime, but a step-by-step return to mainstream market economy or capitalism, coupled with the political end of the communist regime and, consequently, the rebirth of Western-type parliamentary democracy. What had been started was something completely different from a greatly extended version of the earlier reforms. Nevertheless, my attitude, characterised by highly optimistic expectations concerning the outcome of the process, remained the same as before. It took time and necessitated also a change of perspective before I was ready to put down my rose-coloured ‘reformer’s glasses’.
What surprised me

What surprised me first was the pace and depth of the collapse of intra-CEE trade. I had reckoned with an unavoidable shrinkage, but had not expected how quickly liberalised imports from the West would knock out imports from the Comecon\(^1\) region. Though quality aspects must have played an important role in this phenomenon, a psychological factor, namely the aversion felt by the citizens of all CEE countries towards practically everything imported from other CEE countries (or produced domestically) was certainly of utmost importance.

As transition began, the historically established large weight of West European countries in CEE exports was restored, while intra-regional trade shrank to very low levels. What surprised me was how that intra-regional trade gained significance again along with the forthcoming EU accession of the CEE countries and right after EU accession. That phenomenon was important in the light of the discussion in the initial stage of transition about the future position of the CEE countries vis-à-vis one another and the EU, respectively. Western politicians urged the establishment of a regional integration group for the CEE countries: first these countries should prove their ability for (regional) integration, and only conditional on the success achieved in that respect their accession to the Western European integration blocs should progress. CEE experts, including myself, warned that the underdeveloped CEE countries with their very similar supply of mostly uncompetitive products could not establish successful regional integration in their state of economy at that time and the precondition of successful regional integration for becoming members of the European Union might therefore postpone these countries’ EU accession to a considerable extent. Finally, the CEE countries established their regional cooperation agreement, CEFTA, in 1992, one year after the first Association Agreements with the EU had been signed. The low level of mutual trade of the CEFTA members registered in the first years of its operation eventually justified the reservations towards a prioritisation of regional integration over integration with the EU.

A disappointment: the ‘Hungarian model’

Another surprise, a negative one and simultaneously a main source of disappointment about transition for many Hungarian economists, including myself, was the failure of the ‘Hungarian model’. In the 1980s, the ‘hero of the day’ in Hungary was the small entrepreneur who established his/her one-person firm to sell a product or service, or the employee who worked eight hours a day at a state-owned company or in an office of the central or local government and afterwards drove a taxi or taught English language (or was engaged in thousand other activities) in the next three, four hours of that day. Others (family members, friends or colleagues) together established small cooperatives. The number of small cooperatives mushroomed in this period, based on creative ideas and the exploitation of one’s own body and mind. A large part of the population was burning in an optimistic ‘Gründerzeit’ fever. It was believed at that time that Hungary enjoyed an unsurmountable advantage in this respect compared to other CEE countries, because these small firms seemed to serve as a superb training room for a fully-fledged market economy. What was not clear to me then was the extent to which these ventures were actually linked to the state-owned enterprises, and further how much they profited from the mistakes, shortages and bad management prevailing in the public sector.

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\(^1\) Comecon, or CMEA, stands for Council for Mutual Economic Assistance, the Eastern version of the West European economic integration in 1949-1991.
Once this environment had changed along with the progress of privatisation and the opening-up to world market competition, making a living from the environment’s shortcomings was no longer a successful business strategy and only relatively few of the earlier entrepreneurs managed to adapt to the new situation. A certain rent-seeker mentality survived and even gained momentum in a broad circle of entrepreneurs, persisting until today. For these entrepreneurs tax evasion, cronyism, fraudulent bankruptcy and corruption-infected public procurement (including that financed from EU grants) are more important than forward-looking and innovative business plans. Integration into the meanwhile very important foreign-owned sector through subcontracting has remained far below the expected intensity. Moving from a small enterprise to a medium-sized enterprise status is much less frequent and successful than I had hoped to see at the beginning of transition.

Finally, I have to mention the strong increase in income inequality in Hungary. I had certainly reckoned with the emergence of a new wealthy layer of society as a natural consequence of a fully developed market economy, but I did not expect the pauperisation of wide strata of the population, the lack of solidarity with the poor, and the political passivity of the impoverished citizens.
Personal reflections on the case of Slovenia

BY HERMINE VIDOVIC

The author has been staff economist at wiiw since 1983 and was 34 years old in 1990.

Unlike many of my colleagues at wiiw, I did not live in a socialist country prior to transition; thus I observed the whole process before, during and after transition from the outside. From the early 1980s up until its break-up I followed Yugoslavia’s economic development, in a period which was characterised by no or low growth, rising unemployment, growing current account deficits, rising foreign debt and finally hyperinflation. In response to the economic turbulences a series of reform/stabilisation programmes were launched and half-way implemented, but eventually failed. These developments went along with the country’s disintegration. What came as a shock, and completely unexpectedly to me, was the violent dissolution of Yugoslavia – and the helpless European response to that.

The role of trade, privatisation and the tolar

After the break-up of Yugoslavia, Slovenia, the most developed among the six republics of the former country, became – at least from the outside – the most interesting successor state from an economic point of view. Transition was twofold: first, from a socialist to a market economy and, second, from a regional to a national economy (see Mencinger, 2004). Thus it is difficult to distinguish the effects of economic transition and those of the dissolution of the former country. Remembering the years 1990/91, the most frequently asked question was whether Slovenia was viable as an independent state due to its small size and the loss of the Yugoslav and parts of the CMEA markets. In 1990, the majority of foreign trade (58%) was conducted with the other Yugoslav republics. However, compared to other socialist countries, Slovenia was already a rather open economy at that time and its firms had well-established trade links with Western Europe.

After heavy and controversial discussions, Slovenia opted for a gradualist approach in transforming its economy to a market economy, which helped to avoid major shocks at least at the beginning of the transition. One of the key issues disputed in this respect was the method of privatisation, which finally ended up in a compromise approach. The model chosen resulted in a high remaining share of direct or indirect state ownership in banks, insurance companies and enterprises, thus the government still exerted strong influence on the management. The share of foreign ownership continued to be small. Foreign investors were practically excluded from privatisation at the beginning of the transition due to the complicated privatisation scheme. This was quite in contrast to the privatisation schemes applied in other transition economies, where the involvement of foreigners played a major role in privatisation. In view of the almost balanced budget and the low public debt, the sale of state-owned property was not necessary – as opposed to the case of, e.g., Hungary at that time.

1 With the exception of Macedonia, the economies of all other successor states of former Yugoslavia were directly or indirectly affected by the war.

An important step towards Slovenia’s economic independence was the introduction of a new currency, the Slovenian tolar, in October 1991, at a time when the country was facing numerous problems such as double-digit inflation, lack of international reserves, high share of non-performing loans in the banking sector and generally no confidence in the central bank. Price stability was the main goal of the national bank, which should be achieved by using a monetary anchor while keeping the exchange rate flexible. I was rather sceptical whether the country would be successful in introducing its own currency without an austerity programme of the IMF. However, contrary to my expectations, inflation was down to one-digit levels already in 1995, the current account was balanced and foreign currency reserves had increased. The latter was made possible among other things through the sale of socially owned apartments to the current tenants by using foreign currency of Slovenian citizens either deposited abroad or under their mattresses.

What surprised me was the fast economic recovery: after only two years of recession, Slovenia’s economy returned to robust and steady GDP growth rates at about 4% p.a., the current account and the budget were balanced, the latter slipped only slightly into negative territory by the end of the 1990s, unemployment was among the lowest and the employment rate high compared to other transition countries. In 2008 Slovenia’s GDP per capita reached 91% of the EU average, outperforming all other transition countries in this respect. Also politically the country was very stable compared to others – but with the old elites remaining in power. Overall, the country was considered a success story or even an economic miracle.

Recently uncovered weaknesses

Based on the above-mentioned facts, I had not expected the deep economic downturn Slovenia had slipped into during the last financial and economic crisis. Being a frontrunner prior to the crisis, Slovenia’s economy was among those hit hardest and on the verge of collapse, and soon became one of the ‘usual suspects’ of the euro area such as Greece, Portugal, Spain and Ireland. My expectations that the stimulus packages would mitigate the consequences of the crisis hitting in 2008 and 2009 – at a time when both fiscal deficits and public debt were low – did not materialise. On the contrary, public debt rose sharply due to state interventions in/recapitalisations of the banking sector, low tax revenues and rising social expenditures. Slovenia only narrowly escaped an international bailout of its majority state-owned banking sector. The crisis revealed serious weaknesses: banks had raised easy and cheap credits for an unsustainable investment boom and leveraged management buyouts, with the resulting high indebtedness making banks and enterprises vulnerable to changes in market conditions (OECD, 2015, p. 7). The close relationship between the large state-owned banks and enterprises on the one hand and politics on the other hand further aggravated the situation. Thus, the launched austerity programmes had to make up for some of the apparent failures of transition: for instance, apart from fiscal tightening, the government approved the privatisation of 15 state-owned enterprises and of the country’s two largest banks. In an additional step all state-owned enterprises have been opened to private capital.3

The economic crisis had also translated into a political crisis. Traditional parties disappeared and new parties were formed. The years 2012-2013 witnessed a series of demonstrations against corruption of the country’s political elite. Since 2008 none of the governments elected has served for the full term,

creating a climate of political instability. It is yet to be seen whether the current government, in office since September 2014 and headed by Miro Cerar, a political newcomer, can restore public confidence in the country’s politicians.

To sum up, Slovenia was one of the best performers during the transition, but lost this position and also its credibility within a short period of time. The way back is stony and difficult once the confidence of creditors, foreign investors and, last but not least, the country’s citizens has been lost.

References


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* wiwi publications issued after 1999 are available online at [http://wiiw.ac.at/publications.html](http://wiiw.ac.at/publications.html). Recommended readings issued earlier are available in print version in the wiwi library, Rahlgasse 3, 1060 Vienna, 2nd floor. Our librarian Marlene Klug is happy to answer questions on the accessibility of wiwi publications [contact: klug@wiiw.ac.at, +43 (1) 533 66 10-29].
The monthly and quarterly statistics cover 20 countries of the CESEE region. The graphical form of presenting statistical data is intended to facilitate the analysis of short-term macroeconomic developments. The set of indicators captures tendencies in the real sector, pictures the situation in the labour market and inflation, reflects fiscal and monetary policy changes, and depicts external sector development.

Baseline data and a variety of other monthly and quarterly statistics, country-specific definitions of indicators and methodological information on particular time series are available in the wiiw Monthly Database under: http://data.wiiw.ac.at/monthly-database.html. Users regularly interested in a certain set of indicators may create a personalised query which can then be quickly downloaded for updates each month.

NEW: Starting from January 2016, the wiiw Monthly Database covers the following additional time series: quarterly data on GDP, current account in per cent of GDP, and general government budget (revenues, expenditures and balance) in per cent of GDP. The corresponding graphs have been adjusted accordingly: data on budget balance are now presented in per cent of GDP instead of EUR million.

Conventional signs and abbreviations used

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<td>%</td>
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<tr>
<td>GDP</td>
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<td>HiCP</td>
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<td>PPI</td>
<td>Producer Price Index</td>
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<tr>
<td>M1</td>
<td>Currency outside banks + demand deposits / narrow money (ECB definition)</td>
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<td>M1 + quasi-money / intermediate money (ECB definition)</td>
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<td>p.a.</td>
<td>per annum</td>
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<tr>
<td>mn</td>
<td>million (10^6)</td>
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<tr>
<td>bn</td>
<td>billion (10^9)</td>
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<td>Bosnian convertible mark</td>
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<td>HRK</td>
<td>Croatian kuna</td>
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<td>EUR</td>
<td>Euro – national currency for Montenegro and for the euro-area countries Estonia (from January 2011, euro-fixed before), Latvia (from January 2014, euro-fixed before), Lithuania (from January 2015, euro-fixed before), Slovakia (from January 2009, euro-fixed before) and Slovenia (from January 2007, euro-fixed before).</td>
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<td>Hungarian forint</td>
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<td>Polish zloty</td>
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<td>TRY</td>
<td>Turkish lira</td>
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<tr>
<td>UAH</td>
<td>Ukrainian hryvnia</td>
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Sources of statistical data: Eurostat, National Statistical Offices, Central Banks and Public Employment Services; wiiw estimates.
Online database access

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You may access the databases here: [http://data.wiwi.ac.at](http://data.wiwi.ac.at).

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Starting from January 2014, we offer an additional service package that allows you to access all databases – a Premium Membership, at a price of € 2,300 (instead of € 2,000 as for the Basic Membership). Your usual package will, of course, remain available as well.

For more information on database access for Members and on Membership conditions, please contract Ms. Gabriele Stanek (stanek@wiwi.ac.at), phone: (+43-1) 533 66 10-10.
Albania

Real sector development
annual growth rate in %
- Industry
- Employed persons (LFS)
- Construction

Unit labour costs in industry
annual growth rate in %
- Wages nominal, gross
- Productivity*
- Exchange rate
- Unit labour costs

Inflation and unemployment
in %
- Consumer prices
- Producer prices in industry
- Unemployment rate (LFS)

Fiscal and monetary policy
in %
- General gov. budget balance, cumulated, in % of GDP
- M2, annual growth rate
- Central bank policy rate (p.a.)
- Central bank policy rate (p.a.), real, defl. with annual PPI

External sector development
annual growth rate in %
- Exports total, 3-month moving average (EUR based)
- Imports total, 3-month moving average (EUR based)
- Real exchange rate EUR/ALL, PPI deflated

External finance
EUR bn
- Gross reserves of NB excl. gold
- Gross external debt
- Current account

*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

Source: wiw Monthly Database incorporating Eurostat and national statistics.
Baseline data, country-specific definitions and methodological breaks in time series are available under:
http://data.wiiw.ac.at/monthly-database.html
Bosnia and Herzegovina

Real sector development
annual growth rate in %

Unit labour costs in industry
annual growth rate in %

Inflation and unemployment
in %

Fiscal and monetary policy
in %

External sector development
annual growth rate in %

External finance
EUR bn

*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

Source: wiiw Monthly Database incorporating Eurostat and national statistics.
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Bulgaria

**Real sector development**
annual growth rate in%
- Industry, 3-month moving average
- Construction, 3-month moving average
- Employed persons (LFS)

**Unit labour costs in industry**
annual growth rate in %
- Wages nominal, gross
- Productivity
- Unit labour costs

**Inflation and unemployment**
in %
- Left scale:
  - Consumer prices (HICP)
  - Producer prices in industry
- Right scale:
  - Unemployment rate (LFS)

**Fiscal and monetary policy**
in %
- Left scale:
  - General gov. budget balance, cumulated, in % of GDP
- Right scale:
  - Broad money, annual growth rate
  - Central bank policy rate (p.a.), real, defl. with annual PPI

**External sector development**
annual growth rate in %
- Exports total, 3-month moving average (EUR based)
- Imports total, 3-month moving average (EUR based)
- Real exchange rate EUR/BGN, PPI deflated

**External finance**
EUR bn
- Left scale:
  - Gross reserves of NB excl. gold
  - Gross external debt
- Right scale:
  - Current account

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Source: wiw Monthly Database incorporating Eurostat and national statistics.
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Croatia

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Czech Republic

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Estonia

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Latvia

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Lithuania

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Macedonia

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Baseline data, country-specific definitions and methodological breaks in time series are available under:
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Montenegro

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Source: wiiw Monthly Database incorporating Eurostat and national statistics.
Baseline data, country-specific definitions and methodological breaks in time series are available under:
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Poland

Real sector development
annual growth rate in %

Inflation and unemployment
in %

Unit labour costs in industry
annual growth rate in %

Fiscal and monetary policy
in %

External sector development
annual growth rate in %

External finance
EUR bn

*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

Source: wiiw Monthly Database incorporating Eurostat and national statistics.
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Romania

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Source: wiw Monthly Database incorporating Eurostat and national statistics.
Baseline data, country-specific definitions and methodological breaks in time series are available under:
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Russia

Real sector development
annual growth rate in %
- Industry, 3-month moving average
- Construction, 3-month moving average
- Employed persons (LFS)

Unit labour costs in industry
annual growth rate in %
- Wages nominal, manuf., gross
- Productivity*
- Exchange rate
- Unit labour costs

Inflation and unemployment
in %
- Left scale:
  - Consumer prices
  - Producer prices in industry
  - Unemployment rate (LFS)

Fiscal and monetary policy
in %
- Left scale:
  - General gov. budget balance, cumulated, in % of GDP
  - M2, annual growth rate
- Right scale:
  - Central bank policy rate (p.a.)
  - Central bank policy rate (p.a.), real, defl. with annual PPI

External sector development
annual growth rate in %
- Exports total, 3-month moving average (EUR based)
- Imports total, 3-month moving average (EUR based)
- Real exchange rate EUR/RUB, PPI deflated

External finance
EUR bn
- Left scale:
  - Gross reserves of NB excl. gold
  - Gross external debt
- Right scale:
  - Current account

*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

Source: wiwi Monthly Database incorporating Eurostat and national statistics.
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Serbia

*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

Source: wiw Monthly Database incorporating Eurostat and national statistics.
Baseline data, country-specific definitions and methodological breaks in time series are available under:
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Slovakia

Real sector development
annual growth rate in %

Industry, 3-month moving average
Construction, 3-month moving average
Employed persons (LFS)

Unit labour costs in industry
annual growth rate in %

Wages nominal, gross
Productivity*
Unit labour costs

Inflation and unemployment
in %

Consumer prices (HICP)
Producer prices in industry
Unemployment rate (LFS)

Fiscal and monetary policy
in %

General gov. budget balance, cumulated, in % of GDP
Broad money, annual growth rate
Central bank policy rate (p.a.)
Central bank policy rate (p.a.), real, defl. with annual PPI

External sector development
annual growth rate in %

Exports total, 3-month moving average (EUR based)
Imports total, 3-month moving average (EUR based)
Real exchange rate EUR/EUR, PPI deflated

External finance
EUR bn

Gross external debt
Current account

*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

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Slovenia

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Turkey

Real sector development
annual growth rate in %

- Industry, 3-month moving average
- Construction, 3-month moving average
- Employed persons (LFS)

Unit labour costs in industry
annual growth rate in %

- Wages nominal, gross
- Productivity*
- Exchange rate
- Unit labour costs

Inflation and unemployment
in %

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- Producer prices in industry
- Unemployment rate (LFS)

Fiscal and monetary policy
in %

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External sector development
annual growth rate in %

- Exports total, 3-month moving average (EUR based)
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- Real exchange rate EUR/TRY, PPI deflated

External finance
EUR bn

- Gross reserves of NB excl. gold
- Gross external debt
- Current account

*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

Source: wiwi Monthly Database incorporating Eurostat and national statistics.
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Ukraine

Real sector development
annual growth rate in %

Unit labour costs in industry
annual growth rate in %

Inflation and unemployment
in %

Fiscal and monetary policy
in %

External sector development
annual growth rate in %

External finance
EUR bn

*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

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