The Economic Situation and Prospects in Europe (including Ukraine)

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FOR FORUM OBYWATELSKIEGO ROZWOJU

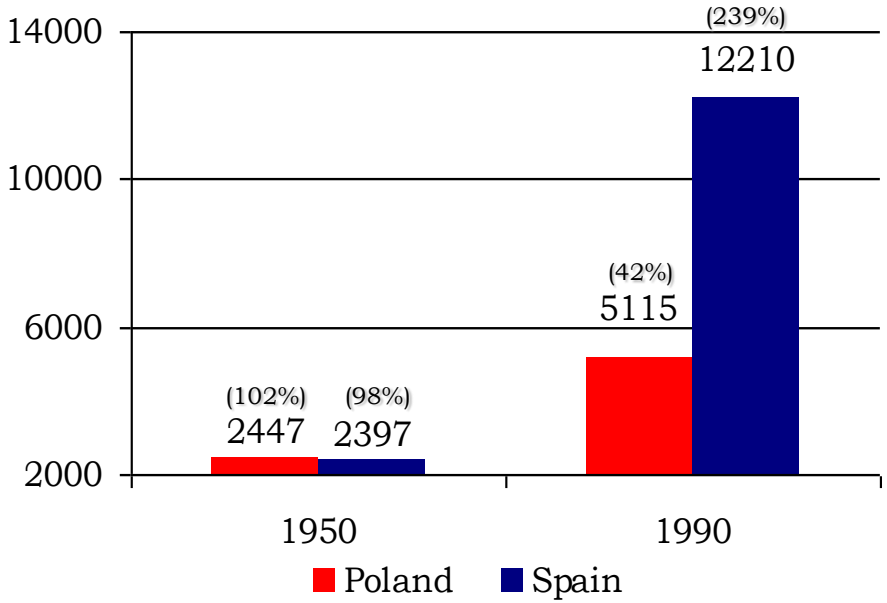
1. **The Economic costs of Socialism**
2. **The Developments after Socialism**
3. **The boom years and the global financial crisis**
4. **The Economic Forecasts for Europe**
5. **The systematic forces versus factors responsible for growth breakdowns**

1. The Economic costs of Socialism

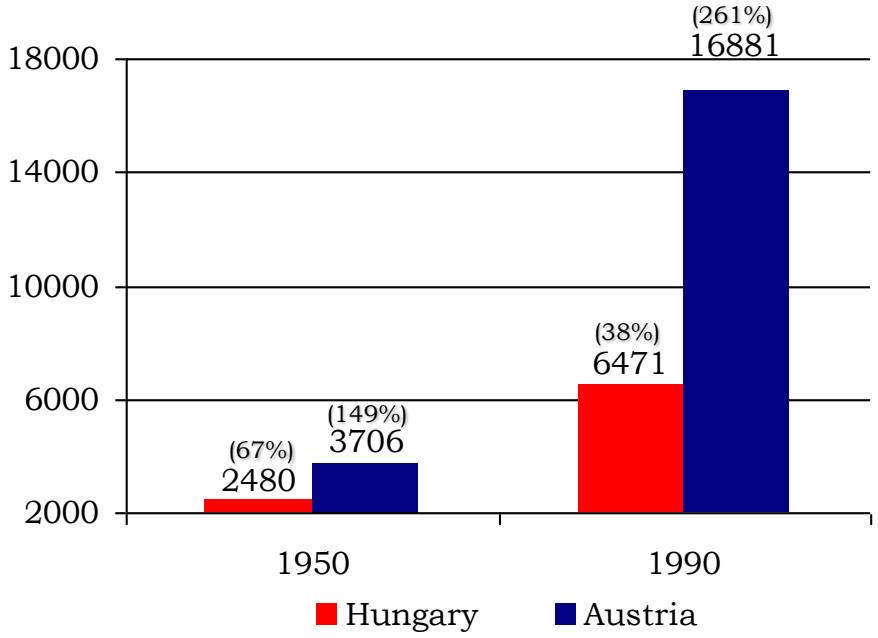
• Countries under socialism lost a lot of distance to Western European economies.

Per-capita GDP (in 1990 international dollars) in 1950 and 1990:

Poland vs. Spain



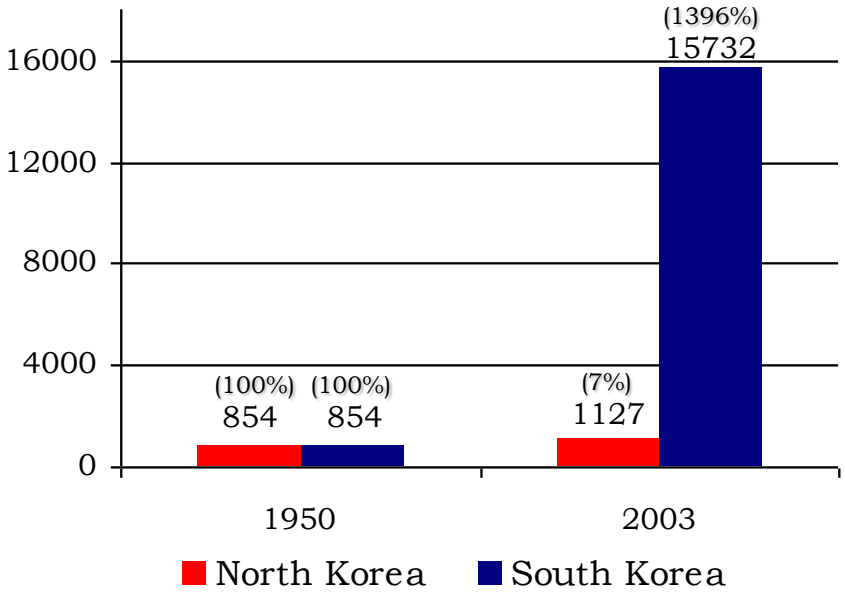
Hungary vs. Austria.



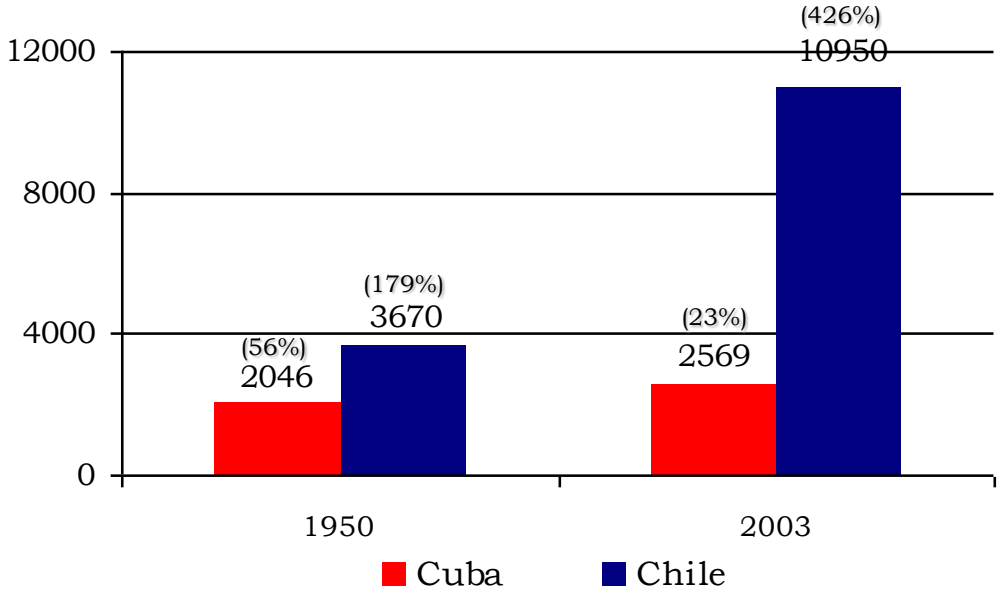
Source: Maddison Database.

Per-capita GDP (in 1990 international dollars) in 1950 and 2003:

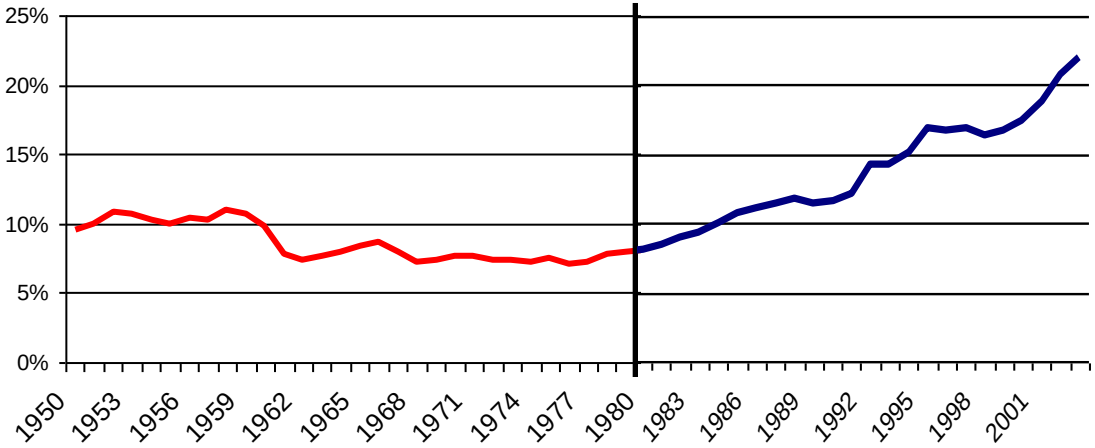
North Korea vs. South Korea



Cuba vs. Chile



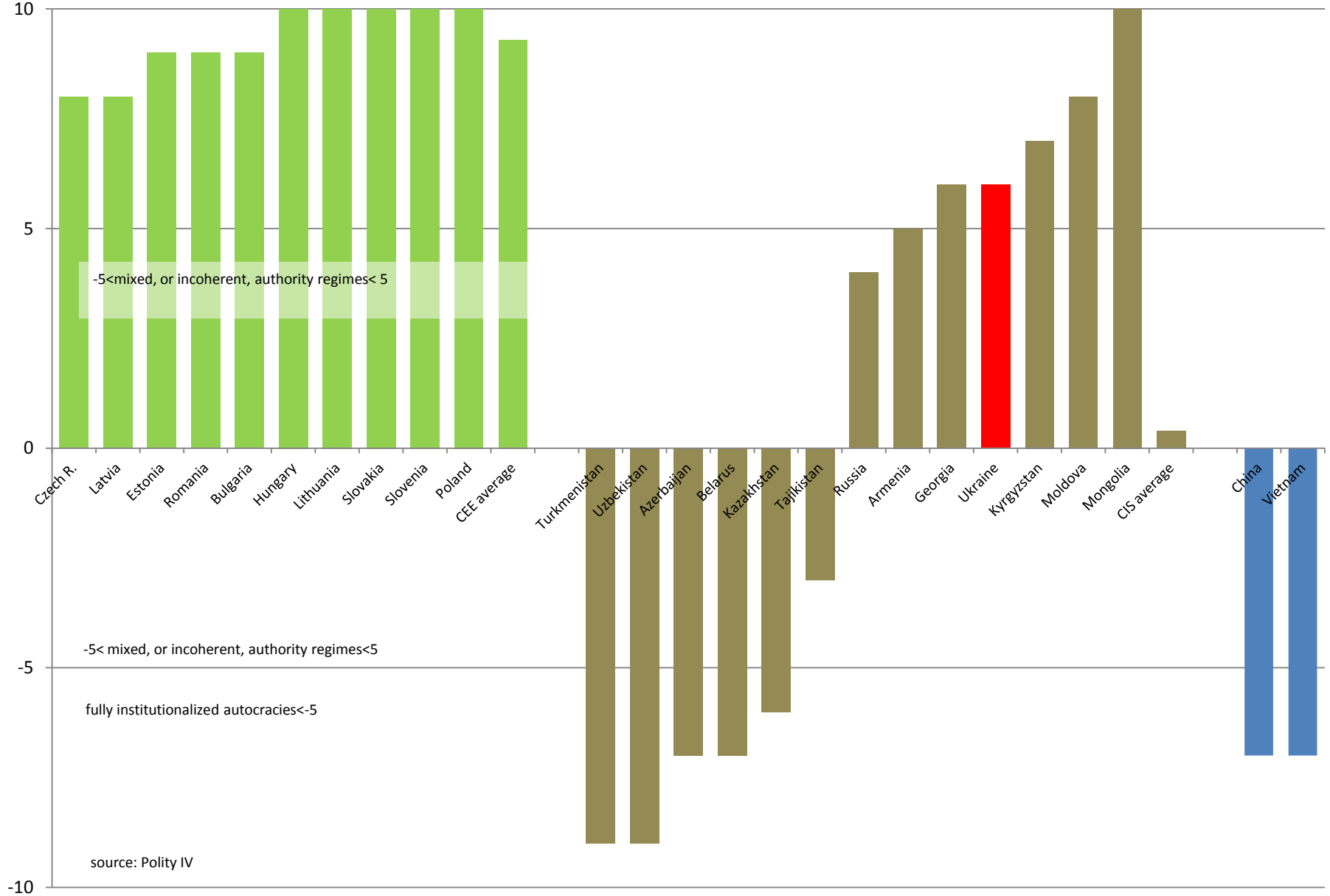
Per-capita GDP (in 1990 international dollars) in China (Western Europe=100).



Source: Maddison Database.

2. The Developments after Socialism

Political Freedom 2010 (Polity IV)



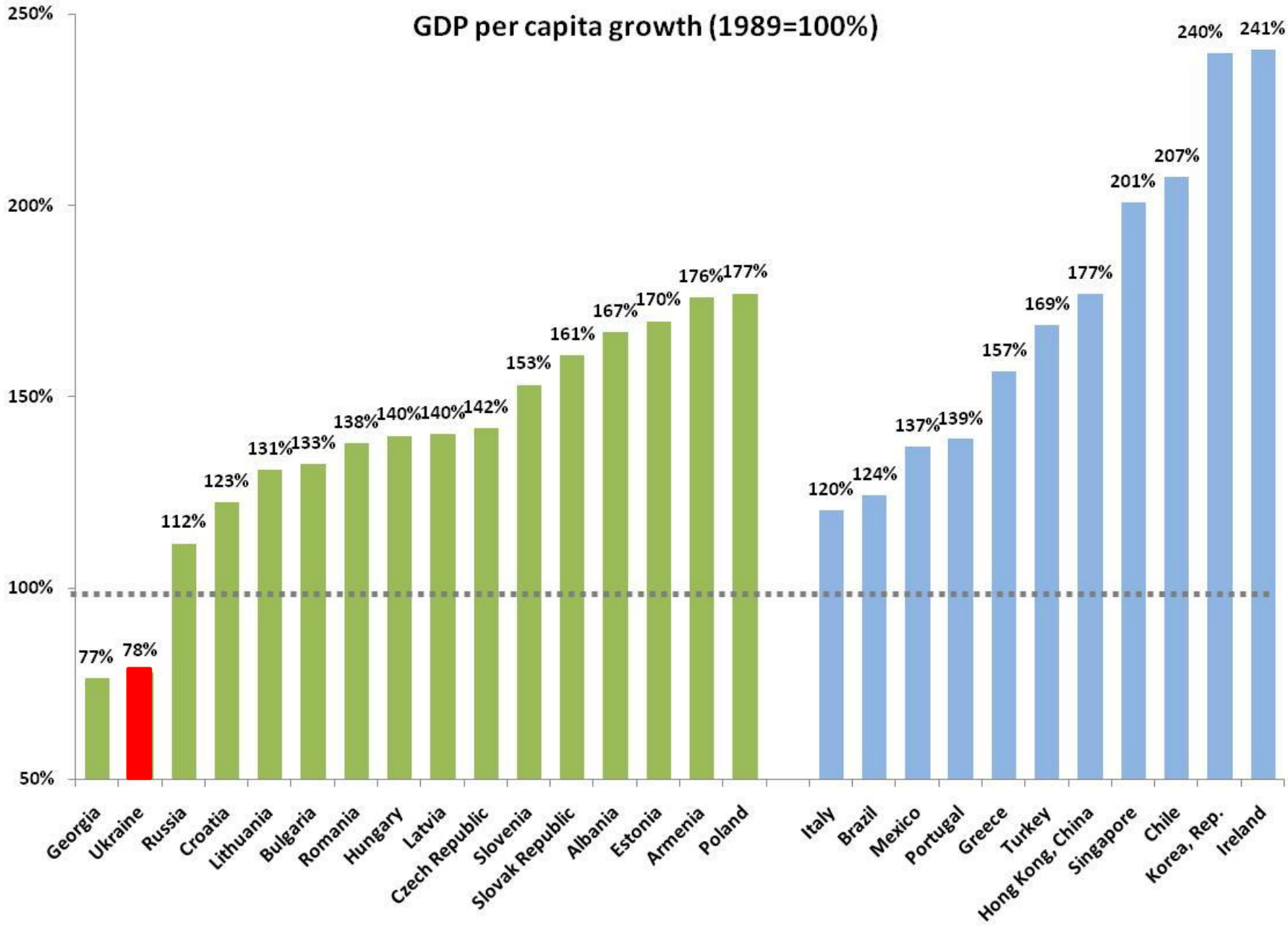
Economic and Political Rights, 1996-2011

Country	Economic Rights[1]	Political Rights[2]
	The Leaders	
Denmark	90	1
Finland	90	1
New Zealand	95	1
Switzerland	90	1
	The Transition Countries	
Bulgaria	50→ 30	2
Czech Republic	70→65	1
Estonia	70 → 90	1
Hungary	70→65	1
Latvia	50	1→ 2
Lithuania	50→60	1
Poland	70 → 60	1
Romania	30→40	2
Slovakia	50	1
Slovenia	50 → 60	1
Belarus	50 → 20	6 → 7
Russia	30 → 25	5 → 6
Ukraine	**30**	**3**
China	30 → 20	6 →7
	Other OECD Comparators	
Greece	70 → 50	2→1
Italy	70 → 50	2→1
Portugal	70	1
Spain	70	1

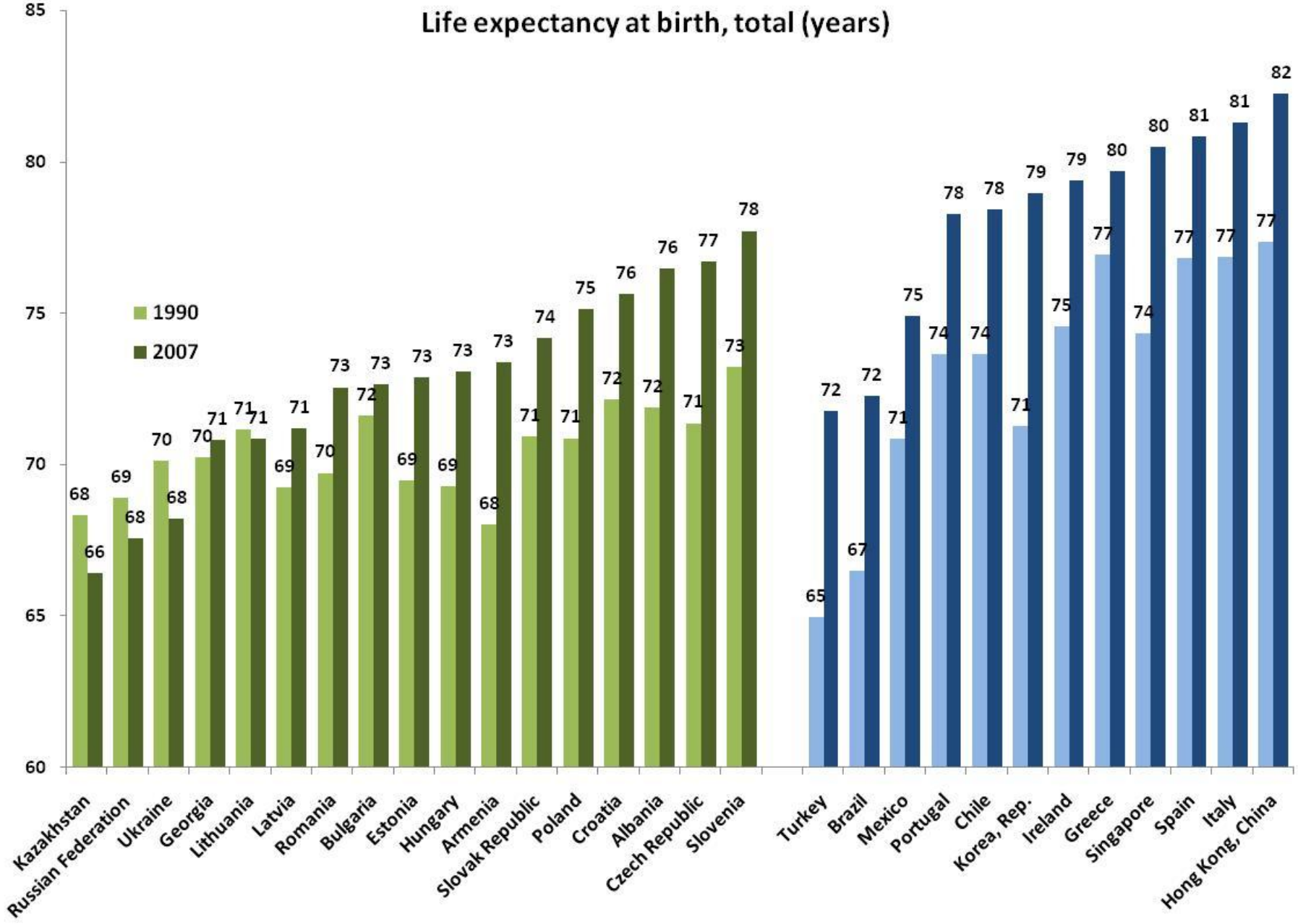
[1] Heritage Foundation, "Index of Economic Freedom", 2011

[2] Freedom House, "Freedom in the World" , 2011

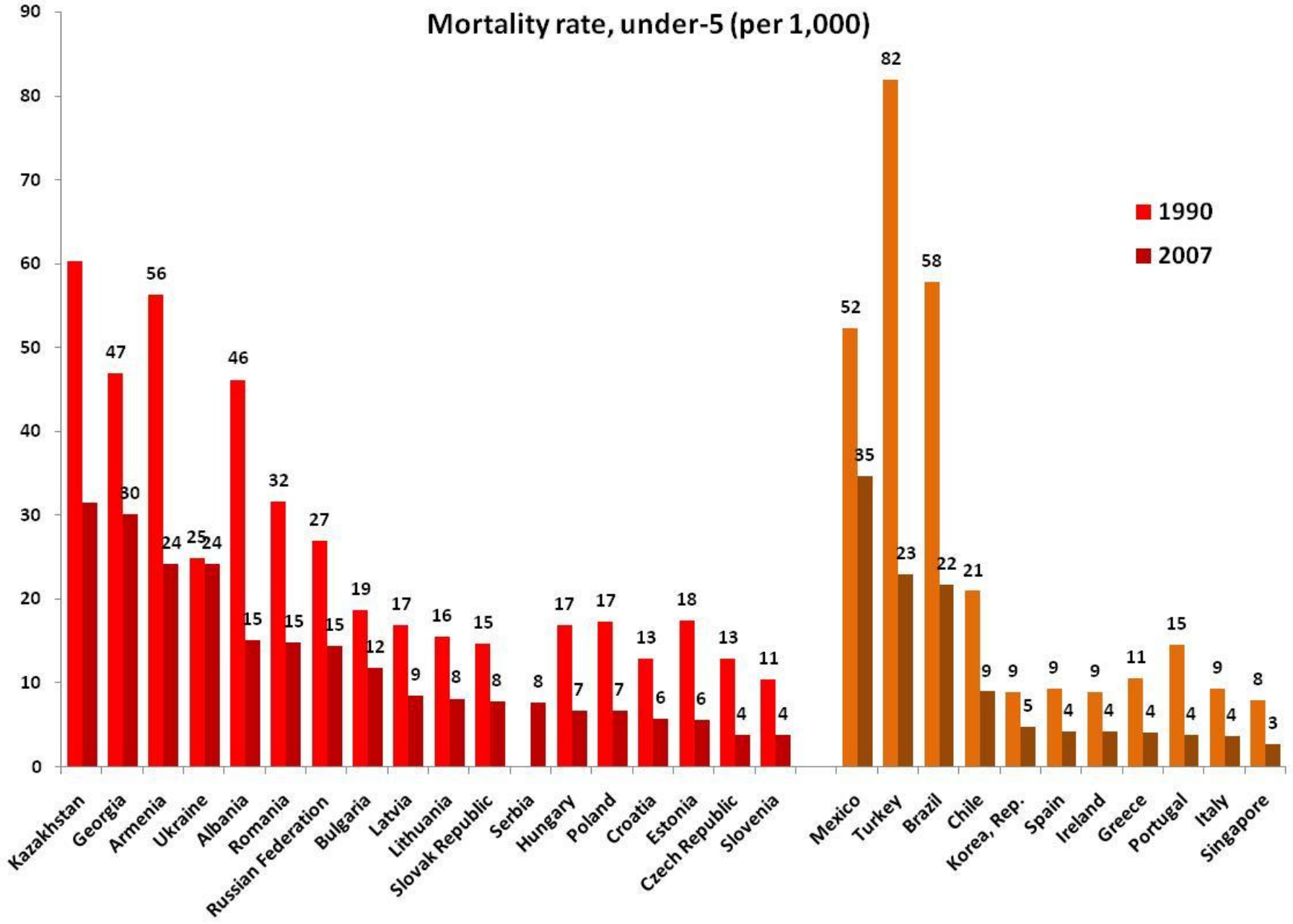
Source: Leszek Balcerowicz Institutional Change after Socialism and the Rule of Law, Hague Journal on the Rule of Law, 1: 215–240, 2009



Source: EBRD Transition Report 2008; WB WDI, IMF WEO



Source: WB World Development Indicators



Source: WB World Development Indicators

Explaining the differences in economic outcomes

The principal factors explaining differences in growth rates are:

- **initial conditions,**
- **external developments (e.g. the Russian crisis) including:**
  - **access to markets,**
- **location,**
- **extent of market reforms and the nature of macroeconomic policies: most important in the long run**

- **These findings are strongly supported by substantial empirical literature reviewing the experience of countries in transition.**

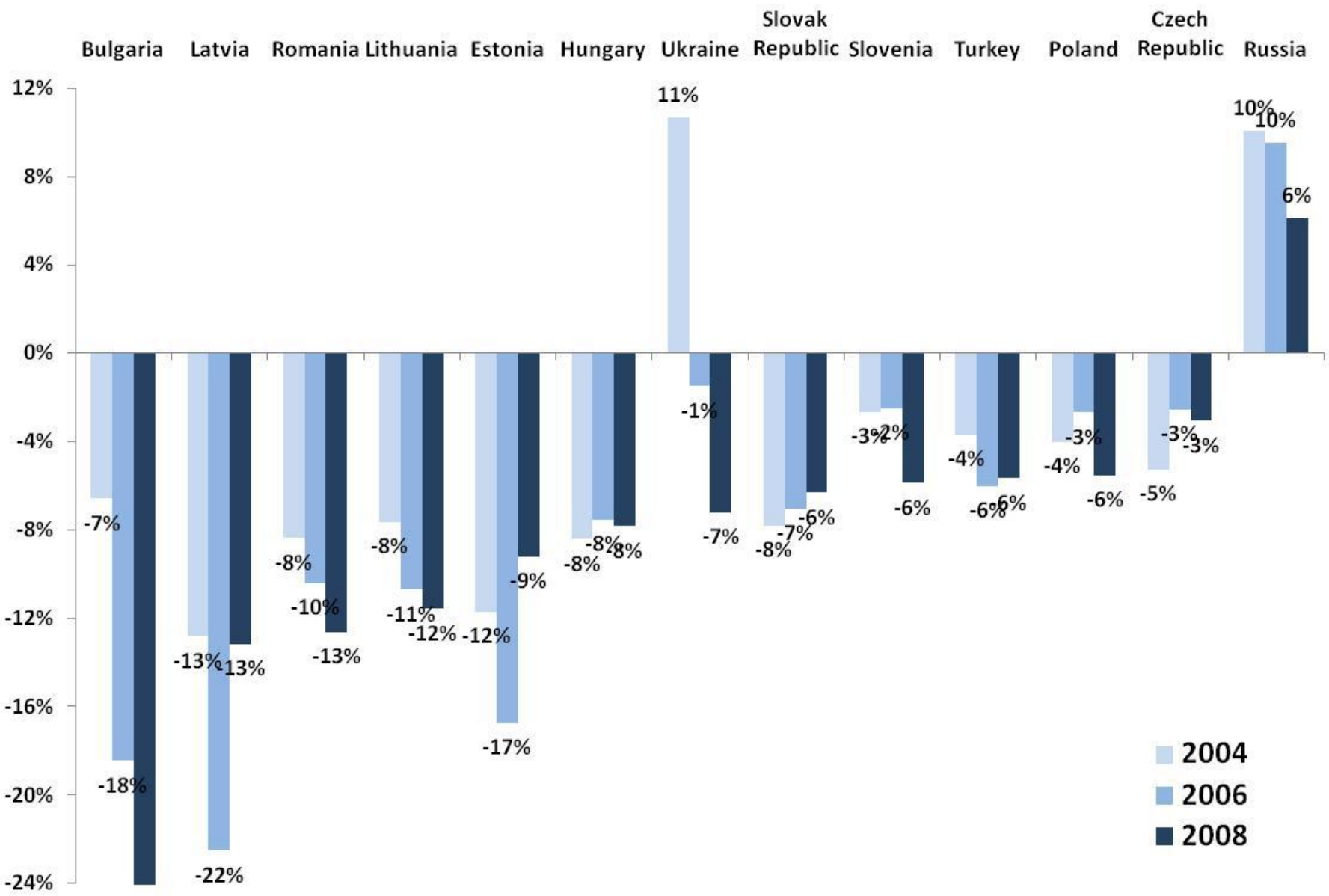
Polanec, Saŝo (2004)	*”(…) we find that in later stages of transition, measures of economic reforms matter for productivity growth, although with a lag, which is in our exercise equal to four years. This result confirms importance of reform efforts in enhancing the potential for growth.”*
Krueger, Anne O. (2004)	*”(…) it is worth noting that those transition countries that experienced the most rapid structural reforms have, by and large, experienced more rapid growth. This is true, for example, of the Baltic States. In recent years, Russia has also seen higher rates of growth – a result, in large measure, of reforms that were implemented in the 1990s.”*
Fischer, Stanley; Sahay, Ratna (2004)	*”The general conclusion was that the effect of initial conditions, while strong at the start of transition, wears off over time (…). Moreover, the importance of the fiscal policy variable (the budget balance) increases with the longer period data set. The coefficients on the reform indices (…) are significant throughout the period, irrespective of the time period considered.”*
Falcetti, Elisabetta; Lysenko, Tatiana; Sanfey, Peter (2006)	*”During transition, a positive correlation between progress in market-oriented reforms and cumulative growth is observed for most countries. This is reassuring to those who have promoted the virtues of reforms; is also serves as a warning of the dangers that arise when ‘reform fatigue’ set in, as it appears to have done in parts of some region (…) We find that the importance of initial conditions as a determinant of growth has declined over time, but that fiscal surpluses remain positively associated with higher growth.”*

Why better economic results go hand in hand with better non-economic indicators (health, environment, etc.)?

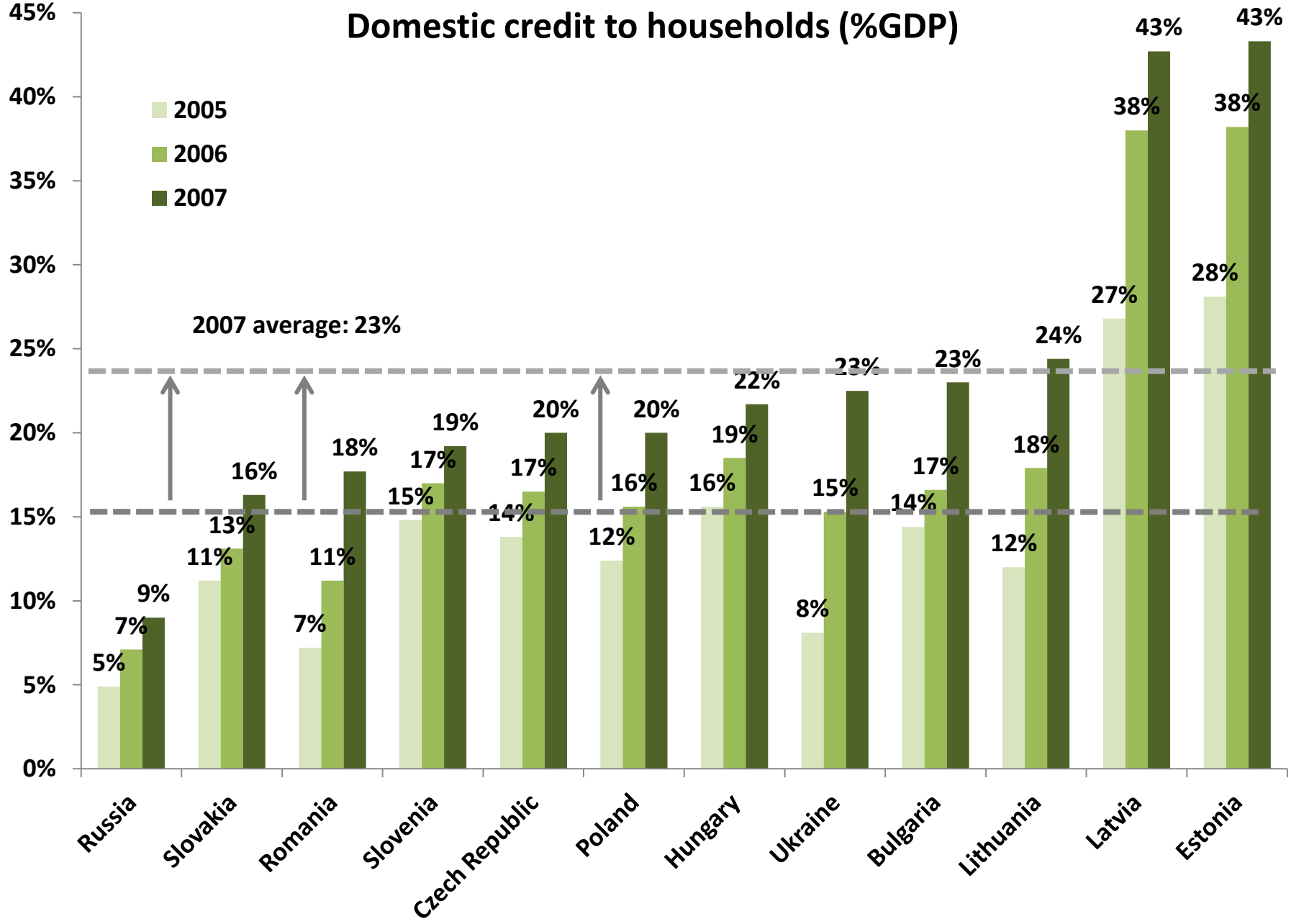
Some crucial factors conducive to long-term economic growth are also conducive to environmental improvement and to favourable health-related developments, e.g.

- **economic reforms** → **less waste**
- **economic reforms** → **less environmental deterioration and less damage to health**
- **economic reforms** → **healthier foodstuffs become more available and relatively cheaper**
- **stronger rule of law** → **ecological regulations are more strictly observed**
- **privatisation (separation of companies from the state)** → **ecological regulations are more strictly observed**

3. The boom years and the global financial crisis



Source: IMF, World Economic Outlook



Source: EBRD Transition Report 2008,

Dependence on commodities export

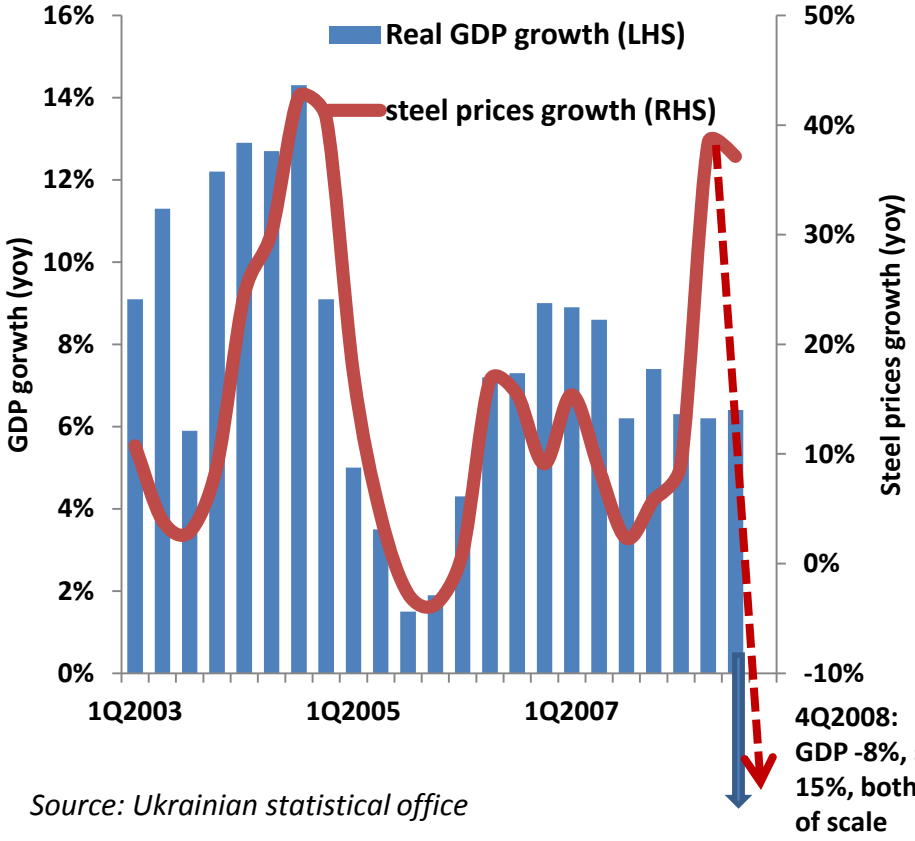
Ukraine

In 2008 steel export (with world prices well above long term average) represented 15% GDP (40% of overall export).

Russia

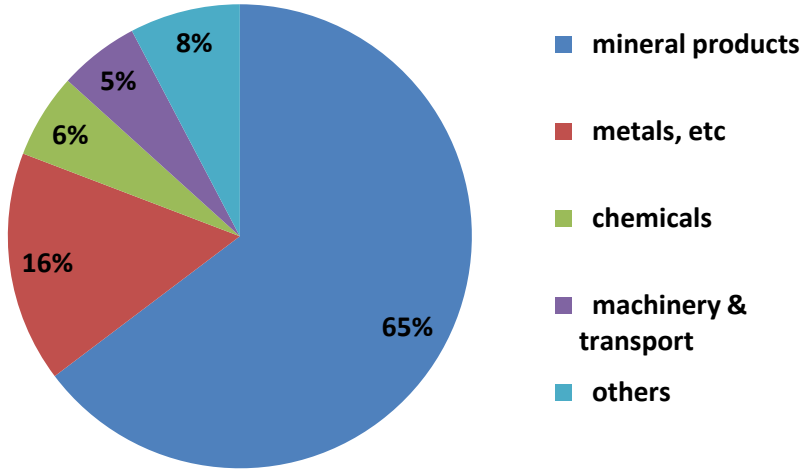
In 2007 minerals (including gas and oil) together with metals represented 80% of Russian export and quater of GDP. Machinery represented only 6% of export, but over 50% of import.

Ukraine: GDP growth vs. steel prices



Source: Ukrainian statistical office

Russian export structure



Source: Federal state statistics service

GDP growth 2008 - 2011

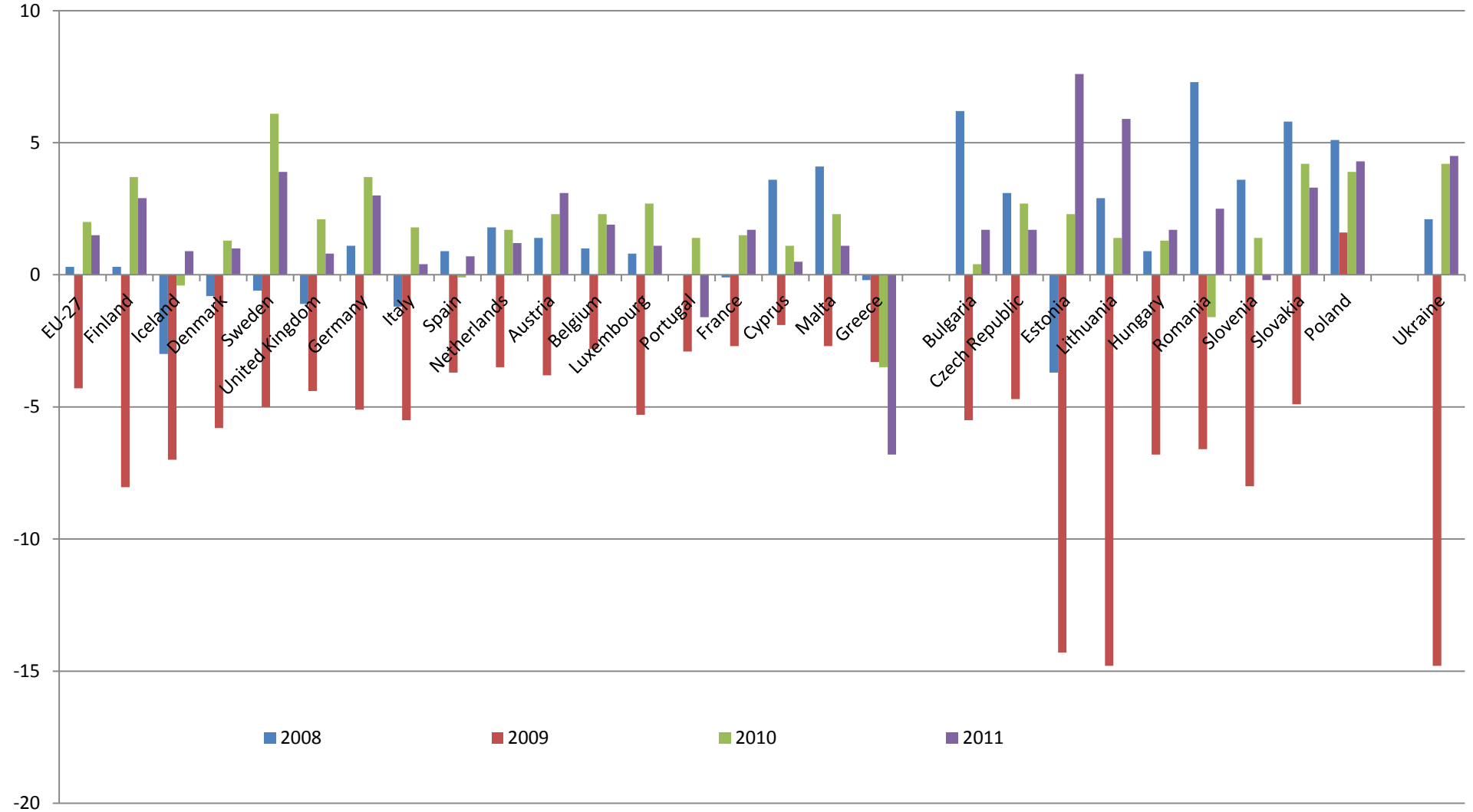
(Percentage change compared to corresponding period of the previous year)

geo\time	2008	2009	2010	2011
EU-27	0,3	-4,3	2	1,5
Finland	0,3	-8,04	3,7	2,9
Iceland	-3	-7	-0,4	0,9
Denmark	-0,8	-5,8	1,3	1
Sweden	-0,6	-5	6,1	3,9
United Kingdom	-1,1	-4,4	2,1	0,8
Germany	1,1	-5,1	3,7	3
Italy	-1,2	-5,5	1,8	0,4
Spain	0,9	-3,7	-0,1	0,7
Netherlands	1,8	-3,5	1,7	1,2
Austria	1,4	-3,8	2,3	3,1
Belgium	1	-2,8	2,3	1,9
Luxembourg	0,8	-5,3	2,7	1,1
Portugal	0	-2,9	1,4	-1,6
France	-0,1	-2,7	1,5	1,7
Cyprus	3,6	-1,9	1,1	0,5
Malta	4,1	-2,7	2,3	1,1
Greece	-0,2	-3,3	-3,5	-6,8
Bulgaria	6,2	-5,5	0,4	1,7
Czech Republic	3,1	-4,7	2,7	1,7
Estonia	-3,7	-14,3	2,3	7,6
Lithuania	2,9	-14,8	1,4	5,9
Hungary	0,9	-6,8	1,3	1,7
Romania	7,3	-6,6	-1,6	2,5
Slovenia	3,6	-8	1,4	-0,2
Slovakia	5,8	-4,9	4,2	3,3
Poland	5,1	1,6	3,9	4,3
Ukraine	**2,1**	**-14,8**	**4,2**	**4,5**

Source: Eurostat, Word Bank

GDP growth 2008 - 2011

(Percentage change compared to corresponding period of the previous year)

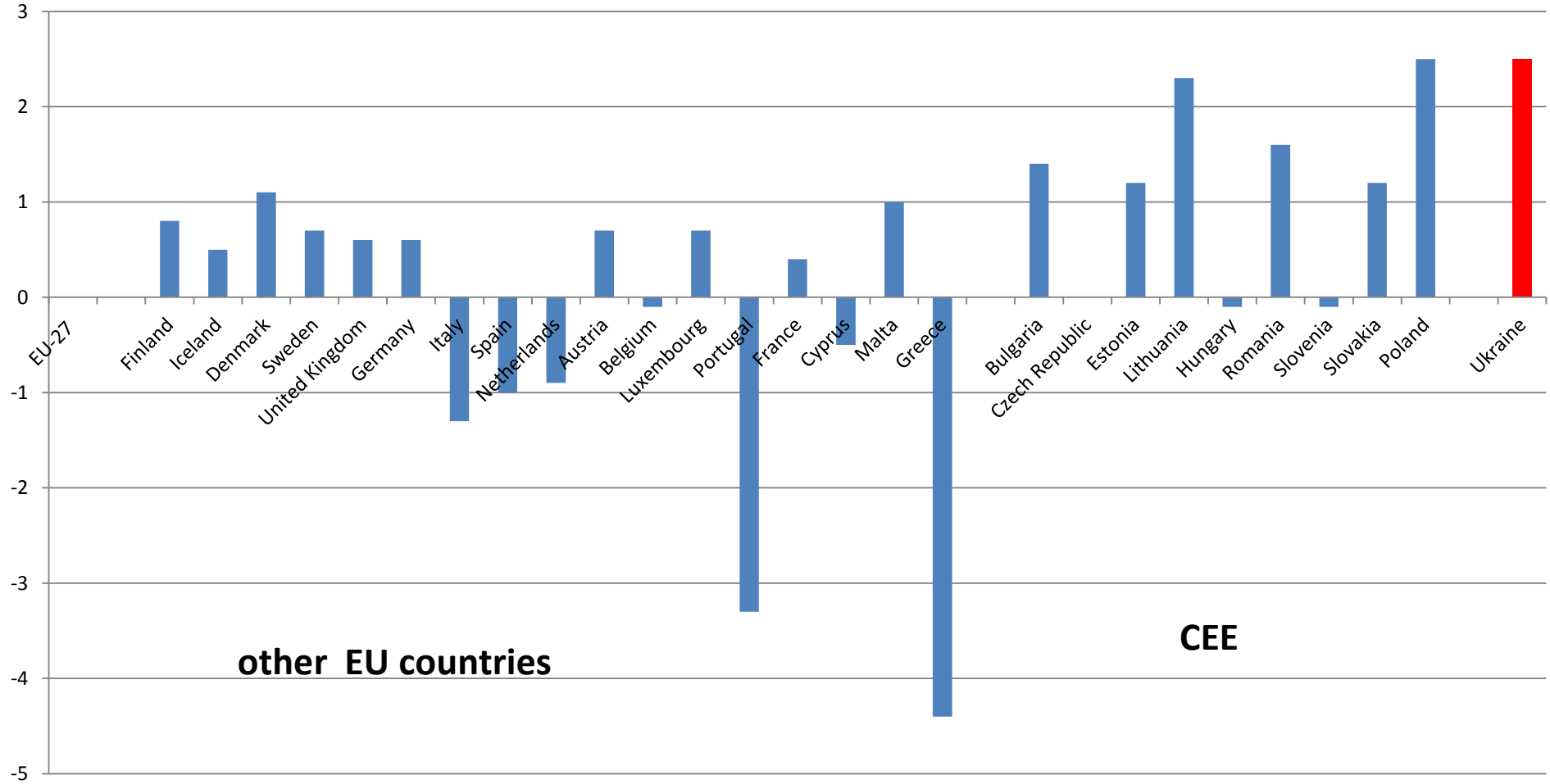


Source: Eurostat, Word Bank

4. The Economic Forecasts for Europe

GDP growth 2012

(Percentage change compared to corresponding period of the previous year)



Source: Eurostat, Word Bank

5. The systematic forces versus factors responsible for growth breakdowns

The systematic growth forces versus factors responsible for growth breakdowns

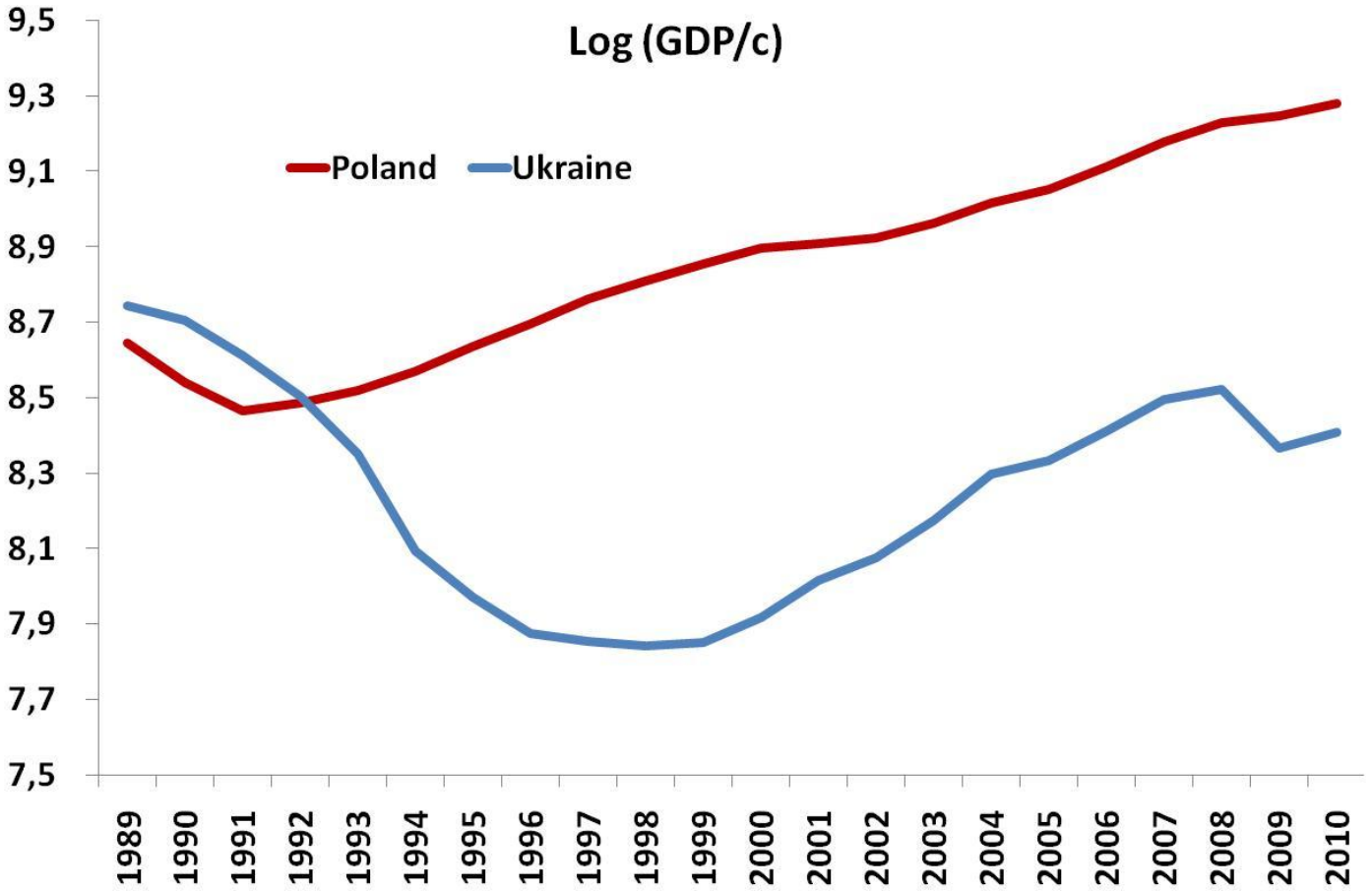
It is analytically useful to distinguish two kinds of forces which shape the growth trajectories:

I. The Systematic Forces - by definition they operate all the time or for a long time, albeit with variable intensity. These forces are responsible for the periods of growth.

II. Factors responsible for the growth breakdowns.

Both types of forces depend on the domestic institutional systems as well as on the other factors.

Ukraine versus Poland



After small GDP per capita declines at the beginning of the transformation Polish economy has entered the path of uninterrupted economic growth.

Ukraine's GDP per capita did not start to grow until 1998. subsequent growth was faster than in Poland, but ended with sharp contraction in 2009.

GDP per capita in 1990 US$ (converted at Geary Khamis PPPs)

Source: The Conference Board and Groningen Growth and Development Centre, Total Economy Database, January 2009,

L. Balcerowicz, A. Rzońca, „The Puzzles of Economic Growth. The Propelling Forces and the Crises: the Comparative Analysis", 2010

Growth mechanisms: transitional and innovation-based

There are two main kinds of growth mechanisms:

I. **Situation-specific and transitional**, e.g.:
   i. *Raising the employment ratio*
   ii. *Allowing the catching up growth of previously repressed sectors (e.g. services under the socialism)*
   iii. *Shifting part of the bureaucracy to more productive occupation*

II. **Innovation-based growth** (including the technology transfer): the only universal and potentially lasting mechanism.

The strength of this mechanism ultimately depends on the quality of propelling institutions: the property rights, the extent of competition, the scope of free (flexible) markets, the fiscal, regulatory and corruption burdens, etc.

What causes the growth breakdowns?

The relative role of free markets and political powers (the state) in producing serious (non-institutional) shocks

Consider the frequency and the magnitude of shocks under the following institutional systems:

I. Socialism

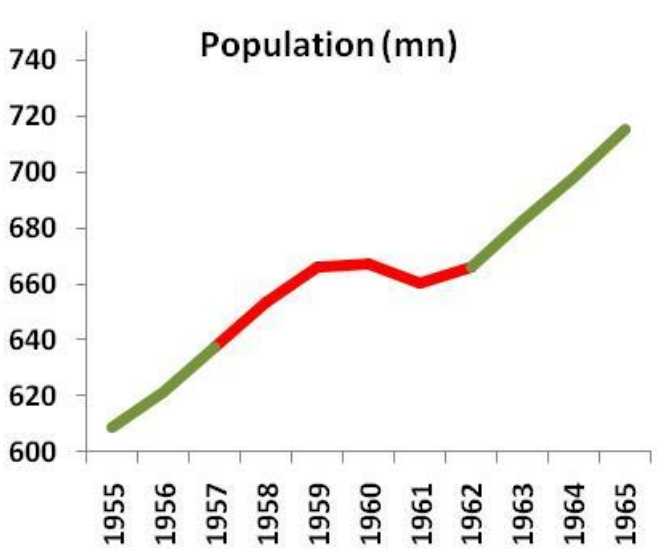
II. Quasi-socialism

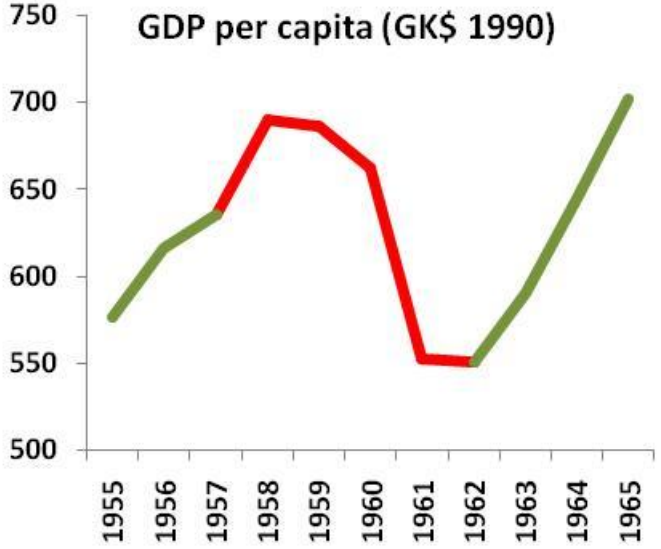
III. Crony-capitalism

IV. Arms's length capitalism

Socialism - political power, fused with the economic power, is unlimited and almost totally crowds out legal markets, e.g.:

Great Leap Forward: China 1958-1962

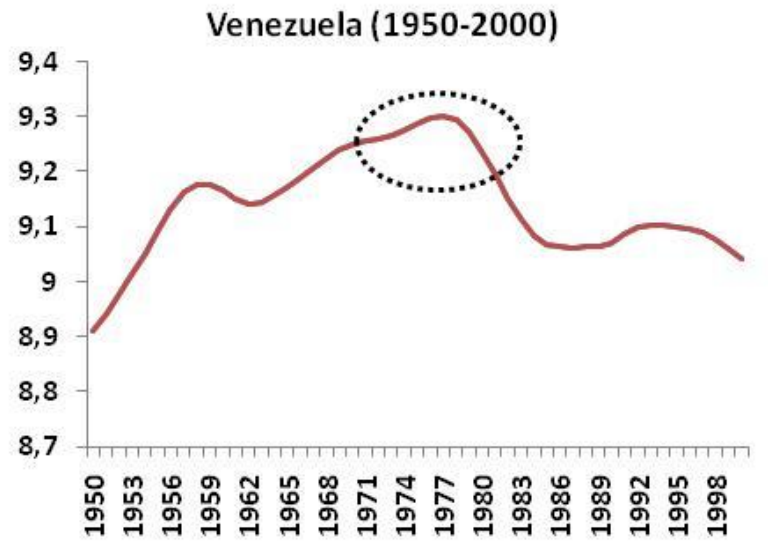


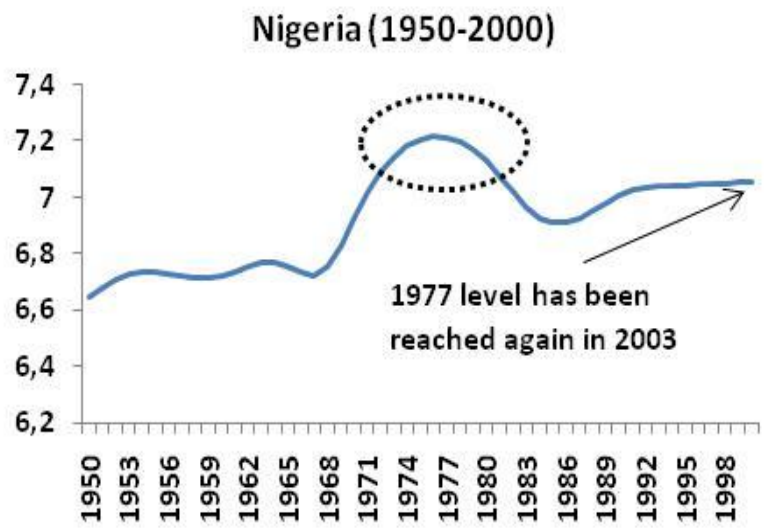


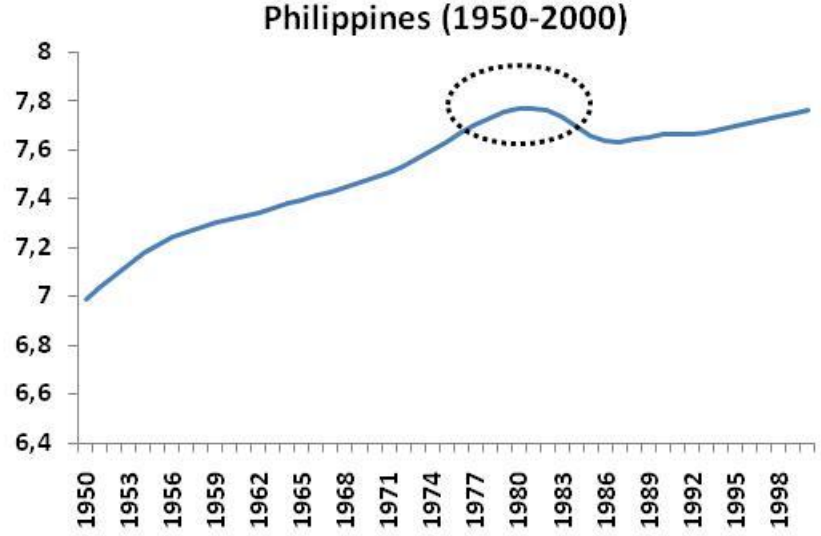
Growth rates								Great Leap Forward							
	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965
GDP	9,6%	9,5%	2,7%	0,9%	3,5%	6,9%	3,2%	8,6%	-0,6%	-3,5%	-16,5%	-0,4%	7,2%	9,2%	8,8%
Population	2,0%	2,1%	2,2%	2,4%	2,2%	2,1%	2,6%	2,5%	2,0%	0,2%	-1,0%	0,8%	2,5%	2,3%	2,4%

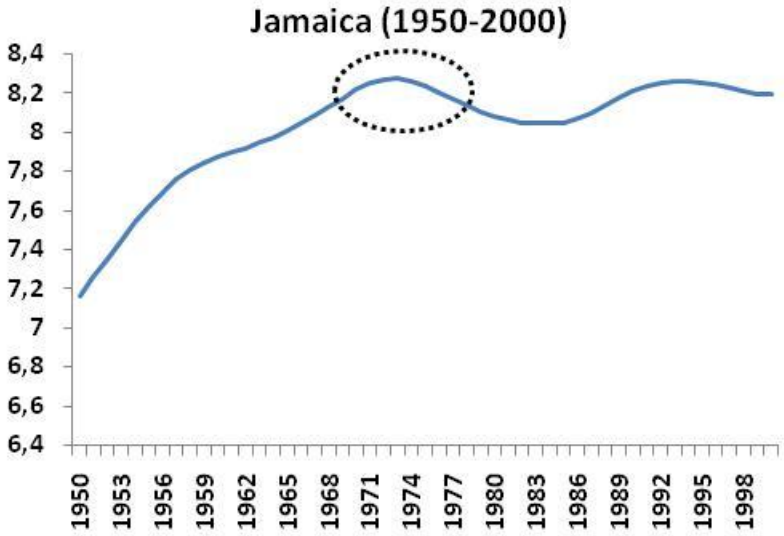
Source: Maddison, Statistics on World Population, GDP and Per Capita GDP, 1-2006AD

Crony-capitalism









Data smoothed with HP filter (λ=6.25)

Source: Maddison, Statistics on World Population, GDP and Per Capita GDP, 1-2006 AD

Thank you for your attention

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