SOME PECULARITIES OF GROWTH IN THE COURSE OF TRANSITION

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Abstract

Transition is described as a unique process of transformation of the former socialist countries from a system of central planning to a free market economy. It encompassed various changes in social, political, institutional and economic life in former socialistic countries, resulting in various paths of recovery and growth among transition economies. Having in mind it exceptionality, there was no already made theory that explained all the movements in the course of transition. Instead, most of the transitional studies of growth adhered to existing paradigms, neoclassical and new growth theories rooted in the reality of developed industrialized economies, or paradigm of development theories related to growth in less developed countries. This study challenges the conceptual framework commonly used to study growth and develops a theoretical debate claiming that transition processes stands apart from the typical development of a market economy. Namely, many of the assumptions of the growth theories which are rooted in reality of a developed market economy; do not accommodate transition reality accurately, which consequently challenges their application to the analysis of growth in transition context. Hence, the inference suggest that the application of the growth theories to explore growth in the course of transition, should take into consideration all the restraints, and also should consider adjusting and relaxing many of the assumptions of the models of growth in order to fit the transition reality properly.

Key words: *transition, growth, developed economies, less developed countries.*

Clasificare JEL*: O40, P20*

1.Introduction

Past century was marked with the existence of three economic systems: a capitalist First World; a developing Third World; and a socialist Second World that emerged after the World War II (Sachs and Warner, 1996). Many features distinguished those systems: the role of the state in the economy ranging from complete planning of economic activity to completely free markets; the character of industrial ownership, varying between state, social and private; varying levels of economic activity measured by Gross Domestic Product (GDP) per capita; different standards of living; different ideologies, values and norms; different growth policies and, consequently, various growth patterns. However, the idea of three worlds was drastically changed at the beginning of the 1990s, the years that witnessed the collapse of socialism and the emergence of the process named transition.

Generally, transition was described as a unique process of transformation of the former socialist countries from a system of central planning to the institutional arrangements of a free market economy (Blanchard, 1997). Leaving aside all the political and social considerations of such a fundamental change, the main argument in favour of moving to a market economy was a widespread certainty that the introduction of a market economy would improve productivity and also the living standards in former socialist economies (Glün and Klasen, 2000). It was anticipated that after some short period of adjustment and contraction of economic activity the new system should lead to recovery and sustained growth. However, for a number of reasons these aims and "wishes" have not been realized equally in all transition economies (TEs). While some were successful and managed to recover very rapidly, accessing European Union; others experienced prolonged transitional recession that lasted much longer than expected, accompanied by deeper contraction and recovery which has not been as smooth as predicted. Notably, in this group belong the countries from the Balkan and The Commonwealth of the Independent States, former Soviet Union countries. Instead of rapid recovery and robust growth, the prolonged recession turned out to be a Great Transition Crisis, continuing in "lagging" transition countries for almost three decades (Havrylyshyn, 2001).

Given the ambiguity and its diversified results, transition has come sharply into research focus, attracting vast scientific attention. Yet there is no unified theory that explains it in all its dimensions. This is mainly due to the lack of coherent theory that encompasses and explains all the movements during transition (Havrylyshyn, 2001). There was no "already made" theory to guide real growth processes in transition countries at the time when transition started, i.e. in the early nineties, so the new and unique changes and processes were to be undertaken in the absence of comprehensive awareness of the possible outcomes (Havrylyshyn, 2001). Implemented growth strategies and economic policies were guided by countries' goals, by the "copy-paste" advices from foreign advisers, by countries' own experience and in some cases by "trial-and-error" politics. In fact, in reality, a number of questionable policy choices were made, while exerting significant social constraints on the efforts to bring about reforms (Svejnar, 2002, Easterly et al., 2006). In consequence, the results differed widely across the transition world (Kornai, 2006).

Influenced by the chaotic reality and lack of an appropriate theory, contemporary growth studies that explain or model growth process in transition economies mostly obey the neoclassical growth theory or new growth theories, developed on the basis of assumptions embedded in the reality of developed economies. However, as it will be discussed, transition processes stands apart from the typical development of a market economy, hence, many of the assumptions of the growth theories do not accommodate transition reality accurately, which consequently challenges their application to the analysis of growth in transition context.

The main aim of the study is to bring forward the theoretical debate on several important peculiarities of growth in the course of transition. Firstly, to detangle whether growth pattern of transition economies stands apart as a specific process, or it had some similarities with the typical development of a market economy, and also whether their development was similar to the developments in the less developed countries (LDCs). The incentive is to apprehend whether transition reality can be encompassed by the assumptions in the growth theories mainly rooted in the developed economies reality. In addition, the study deliberates on one more peculiarity of transition - the short length of the process and the data available, which poses a problem in the growth studies as it is not long enough for the analysis of long-run growth of output and its determinants as understood by classical and new growth theories.

The study is structured as follows. The first part discusses growth in transition vs. developed or mature economies, followed by the analysis of growth in transition vs. less developed economies. Afterwards, the specific time length of transition is discussed, as an additional challenge to conducting growth analysis for transition economies. Final part concludes the discussion, suggesting that mainstream growth theories should be used with caution. They should be adapted and modified to the peculiarities of the transition process itself in order to deliver reliable results.

2.Analysis of growth in transition vs. developed or mature economies

The complex reality accompanied by the absence of appropriate theory affected the studies of growth in transition. Adhering to existing paradigms, many transition researchers analysed growth in transition through the writings of Solow and the pioneers of new growth theories, rooted in the reality of developed industrialized economies. In fact, former socialist economies at the beginning of the nineties shared some features with developed economies: they were highly industrialized; they had an educated labour force; although compared to industrial economies, technology development was lagging (Campos and Coricelli, 2002). However, diverging development paths among mature industrial economies and transition economies came into sight during the actual process of transition.

The initial contrast emerged because of the various nature and dynamic development paths of these two groups in the late nineties. Namely, while industrial countries had a long and gradual tradition in market mechanism and accompanying institutions, transition countries had to "build" or develop a new market apparatus on the inherited basis in a relatively short period (Rider and Knell, 1992). This huge requirement for transition countries produced numerous side effects and unexpected problems, some practically not found in industrial economies.

Furthermore, discrepancies between industrial and transition countries were especially evident during the first stage of transition with respect to policies implemented and to their achieved results. Namely, while transition economies were working on policies for the introduction of a market economy - such as large-scale privatization and hard budget constraints, macroeconomic stabilization, liberalization of prices and trade and so on - the industrial economies dedicated themselves to developing industrial policies, technology policies, research and development and educational improvement; i.e. policies appropriate for the problems and needs of mature market economies (Zecchini, 1997). Actually, at the beginning of the nineties, both groups of countries reacted completely differently to different sorts of recessions. The latter ones facing a "normal" recession, associated with an inventory cycle recovered rapidly, while the former faced a recession, or even better named, a crisis that destroyed their real assets - both physical and human - via sudden obsolescence; hence, their recovery was slower and more difficult (Stiglitz, 2010). Accordingly, while advanced industrial countries did unusually well in the 1990s, transition countries experienced sharp recessions (Svejnar, 2002).

Observing the severity of recessions in different TEs at the beginning of the nineties, Kornai (1994) emphasized the fact that the market recession of a mature industrial country is not comparable to the "transformational recession". While the former that comprises the downward part of the business cycle causes no fundamental structural changes in the economy, the latter is caused and causes major structural changes that may result in a prolonged recovery (Stiglitz, 2010). Hence, Stiglitz (2010) claimed that many assumptions of the models of growth cannot fit the transition reality properly and they need to be adjusted and relaxed in order to accommodate transition facts.

3.Analysis of growth in transition vs. less developed countries

If the view that transition as a process stands apart from the typical development of a market economy is accepted, a further question that arises in this theoretical debate is whether transition processes in former socialist countries have common features with developments in the third world or less developed countries (LDCs). Again, there are more differences than similarities. Namely, in the early nineties developing countries were facing many severe problems: high population growth, accompanied by low life expectancy, low levels of industrialization, low levels of productivity, high poverty and mortality, weak education and weak institutions (Griffiths and Wall, 2001, Agénor, 2000). In the same period, former socialist countries started with far better economic foundations that gave them more in common with the industrial world. Although former socialist countries experienced sharp decreases in economic activity accompanied by deterioration of some social indicators (Glün and Klasen, 2000), these changes were not comparable to the "poverty trap" development models characteristic for developing countries (Azariadis and Stachurski , 2005). Emphasizing the distinction, Ofer (2000) acknowledged that developing and transition countries have travelled distinctly different roads with the same destination of full economic modernization.

These brief discussions separate transitional experience as particular and different from both industrial and developing economies' growth paths. At the same time, it indicates the limitations of the standard growth framework in comparison to the transitional reality; neither the growth analyses of developed nor the growth models of less developed economies can accommodate transition stylized facts well.

4.Transition and the shocks in the economy

In general, all economic theories depend on assumptions that should be reasonably realistic, in order for the conclusions to be reliable (Solow, 1956, p.65). If the assumptions do not fit the reality, then the results of the theorizing or of the empirical studies can be doubtful. Hence, in that vein, here several assumptions related to the main components of growth in the growth theories shall be discussed with the view to assess their suitability to the transition reality.

One specific characteristic of the growth theories is the assumption that the economies are not hit by big shocks. Namely, based on the neoclassical growth theory, most of the developed countries growth studies discuss steady-state growth and consider whether all countries in the "convergence club" will reach the same happy level in the end (Pritchett, 2000). However, the description of steady growth around a well-defined and stable trend is not a good description of the actual growth experience of transition economies. In fact, data show that in these countries growth was irregular, and interrupted by big shifts from positive to negative growth rates, not only at the beginning of transition, but also in middle and late transition in lagging countries especially (World Development Indicators, 2017). Several main structural shocks can be emphasized:

- Huge increase in the depreciation rate due to rapid obsolescence of the physical capital at the beginning of transition, which caused sudden change in physical capital in transition economies, effect much alike to war causalities;
- Abrupt drop in the employment rate following the adjustment of the labour market, accompanied by obsolescence in human capital. This caused move to high unemployment rates much higher than natural rate of unemployment recorded in developed market economies;
- Corrosion in the institutional setting to an extent not witnessed in developed economies, and more comparable to less developed countries.

In the original growth models, the sudden change in physical capital is not assumed since the capital is worn out gradually (Barreca, 1999), hence depreciation rate is relatively stable. However, in transition countries the physical capital became obsolete and useless when transition economies opened to the World, a shock that cannot be easily incorporated in the balanced growth path of the growth models. In addition, considering the second main component – labour force, growth models are developed under the assumption of a high employment rate, or a very low/natural rate of unemployment. However, the course of transition recorded specific adjustments in labour markets characterized by low rates of employment, coupled with high rates of unemployment, decreased labour participation rate and substantial employment in the informal sector (Nikoloski 2009; Blanchard,1997). In addition, even the human capital experienced sudden obsolescence, as the workers skills were not in accordance with the demand of new markets, production, new technology (Arandarenko, 2007). The obsolescence of human capital was further emphasized by the problems in the educational system in the course of transition, as well as by the structural changes in the inherited economic structure.

Institutional development is also an important component for a country's growth, as it should create the economic environment in which economic agents function. Appropriate legal protection, enforcement of contracts, protection of the property rights creates the playground for businesses (Efendic et al., 2011). However, transition countries had to build new institutions, laws and social norms in a very short period of time which lead to severe institutional weaknesses to an extent not identified in developed countries, accompanied by many deviant processes such as: high level of corruption, weak rule of law, increased number of crimes. All this in transition literature is considered as institutional setting which is not appropriate to the needs of a market economy.

5.Transition and its specific time scope

Together with the lack of an appropriate growth model, an additional specific problem related to the time horizon of transition worth mentioning is that transition is a temporary process that has already ended in some transition countries. EU accession is usually considered an ending point of transition. However, it should be kept in mind that even after accession, transition countries differ from the old member states especially with respect to the technical developments. Furthermore, even in the case of lagging countries, the transition experience has lasted two decades, which is not long enough for the analysis of long-run growth of output and its determinants as understood by classical and new growth theories (Svejnar, 2002). Empirical studies for industrial countries concerning growth usually analyse periods of more than 40 years. However, although the short length of transition might direct research towards the short–run approach (the business cycle approach), yet mainly growth transitional studies are rather focused on medium-term growth, on the structural adjustments that occurred and had prolonged influence on growth patterns during transition; instead of the temporary disequilibrium and the movement of actual output from potential output. This determination is rarely discussed in the studies, but it can be justified on several grounds:

- firstly, the nature of the recession faced by the former socialist economies was deep, severe and far from a "normal" business cycle recession as recorded in developed mature economies in the nineties;
- secondly, the causes of these changes, particularly the huge adjustments in physical and human capital and institutions, are the determinants of growth which usually do not experience such huge changes in the course of a business cycle as typically described in the economic literature; and,
- finally, the results in terms of huge structural changes did not and in some cases still do not resemble the characteristics of a "normal" recovery as known in business cycles analyses (Durlauf et al. 2004; Kornai, 1998; Stiglitz, 2010).

Above given discussion accentuates one more challenge to the growth studies of transition and that is shortness of the data series. However, the reasons given justify the use of the growth approach in analysing transition countries growth patterns. It seems that it is better to use a growth approach and modelling that gauges the essence of the components and changes of growth in the course of transition, even with the problem of shortage of data; instead of a model, which substantially is not matching to the transition reality.

6.Conclusion

This brief discussion separates transitional growth experience as particular and different from both industrial and developing economies' growth. At the same time, it argues that transition process was marked by many peculiarities, not found in developed market economies, such as sudden shocks in the economy, due to the huge deprecation and obsolescence of physical capital, high unemployment and obsolescence of human capital, change and deterioration in the institutional setting. All these peculiarities of growth make transition growth pattern specific, interrupted and characterized by shifts from positive to negative growth rates. This is much different from the long – run single stable growth pattern, characteristic for developed economies. Hence, that means that growth theories and growth empirical models which are developed on the basis of assumptions embedded in the reality of developed economies, should be used with caution and alertness on their appropriateness for the case of exploring transition growth.

Deficiency of the "system paradigm" of transition, as Kornai (1998) names it, is rather expected simply because transition by definition is a profound but *temporary* change leading to capitalism. Transition is not a completed system but rather a developing process that is difficult to theorize due to its dynamism, constant changes and the lack of a steady state. In explaining the nature of transition, Kornai (2000, p.25) actually emphasized the uncertainty and unpredictability of the transition process, validating its exceptionality.

The transition from socialism to capitalism has to be an organic development. It cannot be done otherwise. It is a curious amalgam of revolution and evolution. It is a trial-and-error process, which retains or liquidates old institutions, and tries out, accepts or rejects new ones. Each element in the process might be very rapid, fairly rapid or slow. Each has its own appropriate speed. Some episodes call for a one-stroke intervention. Many other processes advance by incremental changes.

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