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DEVELOPMENT & TRANSITION 1

HUMAN DEVELOPMENT IN EUROPE AND EURASIA

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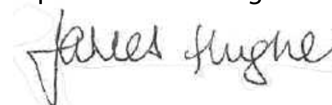
Editor's Note

Dear Reader,

Welcome to the Newsletter on Development and Transition in Europe and Eurasia, which will be published quarterly as a joint enterprise between UNDP and LSE. As the title suggests, the Newsletter aims to be a forum for policy-oriented discussions and debates about how the nature, evolution and challenges of development and transition intersect in these regions. Each issue will focus on a theme, and have several related short contributions. Our aim is to discuss and think differently about policy frameworks by bringing together a variety of viewpoints and analytical approaches from researchers and practitioners to explore and explain the core issues and problems, and to extract the best practices from lessons across countries. Our editorial policy is to promote innovative approaches to complex issues, irrespective of the orthodoxies in the academic or policy worlds. It is not that we actively seek to promote divergence and diversity in the contributions to the Newsletter, it is simply that this is a true reflection of the best thinking in the real worlds of academia and policy-making. To capture quality insights from different disciplines (economics, political economy, political science, law, sociology) requires that we be as inclusive as possible. We will provide synopses of the latest UNDP reports and papers relating to our themes, many of which will be produced by UNDP regional offices. We also encourage the inter-disciplinary exchange of ideas, and hope that our Newsletter will contribute to this. In sum, our readers will have a menu of choices by which they can inform themselves of the most important challenges of development and transition, and draw out policy recommendations.

The first issue analyses and debates the commonly used key terms and concepts of 'development' and 'transition' from several perspectives. We demonstrate how these terms are understood differently, both between economists, and between economists and political scientists. Subsequent issues will address other core themes in a similarly nuanced way, including: the management of minorities and migration, the impact of EU enlargement, the relationship between productivity and prosperity, and the consequences of conflict for development and transition.

My role as editor is supported by an editorial board consisting of Ben Slay and Jonathan Brooks for UNDP, and Gwendolyn Sasse and Andrei Sarychev for LSE. The Newsletter will include a regular section of news about relevant events and conferences and links to freely available papers, reports and articles that deal with our thematic priorities. The Newsletter is published in English and Russian, and is distributed widely within UNDP and LSE's extensive international knowledge and alumni networks. It is our goal that the Newsletter be an easily accessible vehicle for communicating ideas that will assist key practitioners who are involved in policy discussions for the Europe and Eurasia regions.



Comments on and submissions to Development and Transition should be submitted to: J.Hughes@lse.ac.uk.

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The Millennium Development Goals in The CIS Countries

Kalman Mizsei, Ben Slay and Louisa Vinton

Are the MDGs relevant to the CIS?

The Millennium Development Goals (MDGs) are at the heart of the international development agenda. The goals have their origin in the Millennium Declaration, which appeals to the universal values of freedom, equality, solidarity, tolerance, respect for nature and shared responsibility to rouse the world to an ambitious effort to eradicate poverty and other social ills. The MDGs were defined with an eye to the development realities of the world's poorest countries, and analysis and policy thinking about them has been oriented to a large degree to Sub-Saharan Africa. This was the case, for instance, with Investing in Development: A Practical Plan to Achieve the Millennium Development Goals, the action plan to achieve the MDGs that was prepared by the Millennium Project led by Jeff Sachs and commissioned by the UN Secretary General and sponsored by UNDP.

But are the MDGs relevant to the Russian Federation and the varied countries that comprise the Commonwealth of Independent States (CIS)—some of them middle-income, some of them suffering from dire poverty? Are the goals relevant in their 'pure' global formulations, or should they be tailored to suit national realities? If the latter, how should concrete targets be defined so that pursuit of the MDGs is most beneficial for these countries? How can the CIS countries achieve these goals, as appropriately defined? And how should progress be measured?

These questions are at the heart of UNDP's approach to the MDGs in Russia and the rest of the CIS. UNDP's experience across the region underscores the relevance of the MDGs, both as an inspiration to energetic efforts on behalf of the world's poor and as a flexible framework within which countries can adapt the 'global' goals to address their own specific challenges. Much of the MDG effort rests on the technical work of economists, statisticians and policymakers, whose job it is to map the main challenges in poverty, education, health, and environment, and to plot solutions. But when dealing with the technicalities of goals, targets and indicators (something UN experts produce in large quantities), it is important not to lose sight of the values behind the MDG effort.

GDP per head
at purchasing power parity (US$)

Country	GDP per head
Nigeria	860
Tajikistan	**980**
Kenya	1,020
Rwanda	1,270
Uganda	1,390
Moldova	**1,470**
Côte d'Ivoire	1,520
Kyrgyzstan	**1,620**
Uzbekistan	**1,670**
Sudan	1,820
Cameroon	2,000
Ghana	2,130
Angola	2,130
Georgia	**2,260**
Zimbabwe	2,370
Armenia	**3,120**
Azerbaijan	**3,210**
Swaziland	4,550
Ukraine	**4,870**
Namibia	6,210
Botswana	8,170
Russia	**8,230**
South Africa	10,070

An inspiration for social solidarity

The ideal of social solidarity is at the core of the MDGs and the Millennium Declaration that inspired them, and this is what makes the Declaration such an important document and, incidentally, such uplifting reading: "Those who suffer or benefit least deserve help from those who benefit most", the Declaration proclaims. This is the first time that this fundamentally moral imperative has been expressed with such clarity in an international context. Looking at the MDGs from this angle, it is obvious not only that the goals make profound sense in the CIS context but also that they address the spiritual vacuum that is a painful legacy of the Soviet system.

The Soviet Union enshrined an official ideology based on social solidarity, yet this was violated in everyday practice. Instead, Soviet reality promoted a cynical individualism that bordered on survival of the fittest. This outlook has persisted after the collapse of communism. 'Oligarchic' business elites are very different from the

laissez-faire ideals of liberal pro-market advocates, and market institutions have developed without proper regulatory underpinning or the safeguard of competition against monopolistic profiteering. Income and asset inequality increased in the CIS in the early years of transition. Hence the compelling need to reintroduce, in a dramatically different institutional setting and with very different consequences, the message of genuine social solidarity. For the poorest countries of the CIS in Central Asia, the Southern Caucasus and Moldova, the international dimension of social solidarity is also compelling.

Applying the MDGs

The MDGs are relevant not only as a moral inspiration, however. The poorest CIS countries are much poorer than is generally assumed, in part because of a widely held illusion that the industrialisation brought development to all corners of the Soviet Union. The traditional, 'global' MDGs are thus directly applicable to parts of the CIS. The fit is best in the Central Asian countries, due to the sub-region's legacy of post-Soviet economic collapse, unfavourable landlocked geography, and generally low per-capita GDP, but the Caucasus countries and Moldova are also impoverished. Income poverty is quite apparent in these countries, particularly in rural areas. So are unfavourable trends in education, infant mortality, and other MDG indicators.

For these reasons, the Millennium Project report has recommended that Kyrgyzstan and Tajikistan, as well as Armenia, Azerbaijan, Georgia and Moldova, put the MDGs at the centre of the national development agenda by aligning them with poverty reduction strategy papers. Moreover, the report has classified Armenia, Azerbaijan, Georgia, Moldova, Kyrgyzstan, and Tajikistan as 'MDG fast-track' countries that could be eligible for increased official development assistance. A closer look at the plight of these countries explains why these are sound proposals.

A comparison of GDP per head provides some striking results. Tajikistan's GDP per head, US$980 at purchasing power party, is lower than that of many of Africa's poorest countries, including Kenya (US$1,020), Rwanda (US$1,270) and Uganda (US$1,390). In the European CIS, Moldova's GDP per head (US$1,470) is lower than that of Sudan (US$1,820), Ghana or Angola (both at US$2,130). Even Russia's GDP per head, the highest in the CIS, is only 80 percent of that of South Africa, Sub-Saharan Africa's richest country. While the nature and genesis of poverty in the CIS may be very different from that in Africa, its magnitude is actually, and sadly, comparable.

Millennium Development Goals:

1: Eradicate extreme poverty and hunger

2: Achieve universal primary education

3: Promote gender equality and empower women

4: Reduce child mortality

5: Improve maternal health

6: Combat HIV/AIDS, malaria, and other diseases

7: Ensure environmental sustainability

8: Build new global partnerships for development

Against this background, the world community's indifference to the plight of the poorer countries of the CIS often seems outright discriminatory. President Vladimir Putin of Russia recently called attention to this discrepancy when, while endorsing UK proposals to increase international aid to Africa, he remarked on the need for international assistance to the CIS.

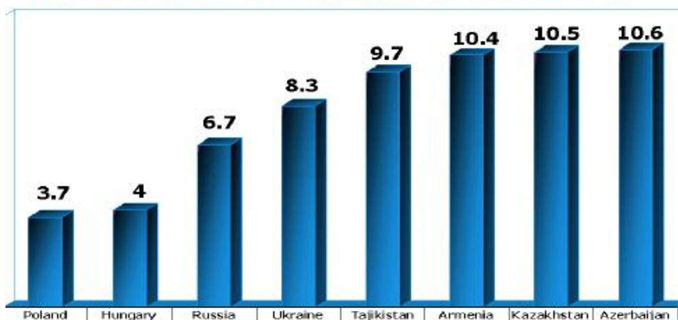
The Millennium Project has, to a limited extent, reckoned with this issue by including Tajikistan into the first round of pilot projects of its 'needs assessment', alongside Asian and African countries (Bangladesh, Cambodia, Ghana, Tanzania and Uganda). This methodology, whereby the government, with the support of external experts, sets poverty reduction goals for 2015 and then drafts a programme of how to achieve them, including international donor support, should be applied to all CIS countries with extremely low levels of GDP per capita. The compelling reason for this is that these very poor countries will need large-scale international assistance as well as economic growth and sensible social policies to achieve the MDGs.

Adapting the MDGs

What of the wealthier countries of the CIS? Official statistical data in Russia, as well as in Belarus and Ukraine, do

not point to widespread or extreme poverty. Likewise, poverty reduction strategy papers are not used as mechanisms to coordinate macroeconomic and social policies, or to structure official dialogue with the international development community. Poverty nonetheless remains high on the agenda of even middle-income CIS countries. Mr. Putin has declared that, in addition to doubling gross national product over the next 10 years, Russia's development priorities include reducing poverty and income inequalities, as well as improving living standards and the quality of social services. Other CIS leaders have expressed similar sentiments.

Regional variations in the depth and breadth of poverty, as well as in the other areas covered by the MDGs, nonetheless put a premium on tailoring the goals to specific national needs. Doing so often means disaggregating national statistics, in order to reveal pockets of income poverty, unfavourable health and education trends, or other manifestations of social exclusion that may be hidden by national averages. A goal-by-goal review of how Russia and the CIS countries are doing in the main areas covered by the MDGs is an indicator of just how useful such tailoring could be.



The good news: Growth and income poverty (MDG 1)

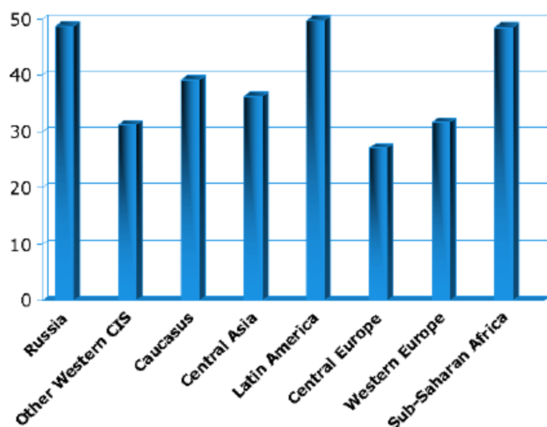
Recent GDP trends suggest that the threat of absolute income poverty in CIS countries is receding. Annual average GDP growth during 2000-2004 in Azerbaijan, Armenia, and Tajikistan—some the region's poorest countries (measured in per-capita GDP terms)—averaged 10-11 percent. Russia, Ukraine, and Moldova, with average annual GDP growth rates of 6-8 percent during this time, were ironically among the CIS 'laggards'. Even these rates were roughly double GDP trends for these years in the Central European economies that joined the European Union (EU) in May 2004. In addition, Central European rates were in turn significantly above those for the EU as a whole.

A growing body of evidence shows that this robust economic expansion has helped to bring about a fall in poverty rates. Recent World Bank data show that Russia halved absolute income poverty from 42 to 20 percent during 1999-2002. Tajikistan—the region's poorest country, in per-capita GDP terms—reduced the share of those living on less than $2.15 per day (in purchasing power parity terms) from 83 percent to 64 percent during 1999-2003. Armenia cut poverty overall from 55 percent in 1999 to 43 percent in 2003; extreme poverty fell in the same period from 23 percent to 7.4 percent—a level that the government had not expected to reach until 2013. In Kazakhstan, the percentage of the population classified as living below the subsistence minimum dropped from 39 to 24 percent during 1999-2002, and has almost certainly declined further since.

These trends suggest that some good things are happening in the CIS countries, in terms of MDG 1. Unfortunately, this rising tide is not lifting all boats equally: large variations in poverty remain apparent across and within countries. In 2002, Russia's poverty rate varied from 3 percent in the richest region (Moscow city) to 56 percent in the poorest. Much recent economic growth has been concentrated in urban areas: Russia's poverty rate was 30 percent in rural areas versus 16 percent in urban areas in 2002.

Relative inequality in the CIS has in fact risen sharply during the past fifteen years. In Soviet times the Gini coefficient, a measure of inequality, was around 0.25, or at Scandinavian levels. It is important to remember, however, that this tool is at best a very rough measure of inequality in Soviet times, given the concealed nature of many privileges and benefits under communism. Still, by the late 1990s, income disparities in some CIS countries had reached levels more commonly found in Latin America and Sub-Saharan Africa. This contrasts with the new EU member states, where Gini coefficients have generally remained at European levels.

Promisingly, recent evidence suggests that growth may also be causing inequality to recede. In Armenia, the Gini coefficient for income fell from 0.535 in 2001 to 0.438 in 2003, and for consumption from 0.344 to 0.275—and the latter is a value typical of many European countries. In Russia, inequality increased until 1998, but then declined somewhat subsequently. The Gini coefficient for consumption increased from 0.370 in 1997 to 0.392 in 1998, before declining to 0.368 in 2002. In both countries, it's worth noting that inequality in expenditure, incomes, or assets is substantially higher than consumption inequality.

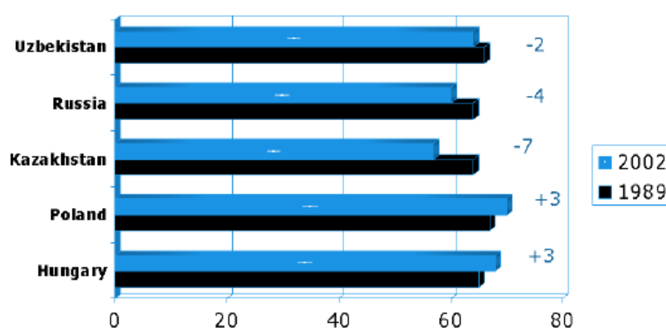


Rapid economic growth combined with continuing high levels of inequality suggest that social assistance programmes in many CIS countries are not as effective as they could be. Recent World Bank data indicate that Russia has one of the least effective social assistance programmes in the world: half the benefits of targeted social assistance go to the richest 60 percent of the population. Social policy reform, to build the capacity needed to effectively target social assistance to those most in need, can help reverse these trends. Reforms introduced in the Central European countries as part of their preparations for EU accession were key to building this capacity. This is apparent in the large differences between poverty rates before and after the payment of social transfers. Armenia's recent household survey data point to progress in targeting: some 40 percent of households classified as 'extremely poor' receive poor family benefits and pensions, compared to 27 percent of those classified as 'poor' and 19 percent of those classified as 'non-poor'. In fact, the IMF recently credited Armenia's "increase in social transfers through a well-targeted family poverty benefits programme" with helping to reduce inequality.

Social sphere: Unsettling education, health, and demographic trends (MDGs 2-6)

The second Millennium Development Goal in its global form concentrates on ensuring universal primary education. This goal is often redefined in middle- and upper-income countries to focus on issues of secondary and tertiary education and their links to labour markets. Such redefinitions seem quite appropriate in CIS countries, where problems of adapting the generally high levels of Soviet-era human capital to post-Soviet labour market trends are compelling. However, the issue of primary school enrolment may be becoming increasingly important in some of the poorer CIS countries. In Tajikistan, primary school attendance fell to 88 percent in 2003.

The post-1999 economic growth reported in many CIS economies has not yet reversed declines in public health, life expectancy, and disease. (This is not surprising, since a number of these problems predate the Soviet collapse.) Along with gender, these issues are at the heart of MDGs 3-6. Male mortality trends reported in many CIS countries are both unusual and disturbing: life expectancy for men in Kazakhstan dropped by seven years during 1989-2002, while rising by three years in Hungary and Poland during this time. Life expectancy at



birth in Russia is among the lowest for industrial countries: 65 years on average, compared with 79 years in Western Europe. Moreover, the gender gap is huge: life expectancy is just 59 years for Russian men, against 72 years for Russian women. If 2000-2001 mortality trends were to continue, only 58 percent of Russian men then 15 years old would live to be 60. In Poland this figure would be 77 percent.

These unfavourable demographics make the epidemiological trends in terms of HIV/AIDS, tuberculosis, and other infectious diseases reported in many CIS countries particularly worrisome. HIV prevalence rates in Russia and Ukraine (as well as in neighbouring Estonia) are rising above 1 percent of the adult population, and are on the verge of entering the general population. Reported tuberculosis cases in Russia (at 134 per 100,000 inhabitants) exceed those reported in China (113 per 100,000) and Brazil (64 per 100,000), not to mention the countries of the European Union.

Lifestyle and behavioural factors seem to be part of the problem, particularly in terms of alcohol consumption and diet, as well as car accidents and violent crime. But health care systems also seem to be to blame: the high-

er personal incomes associated with economic recovery are not always translating into the provision of adequate medical services. High-cost curative care is too often emphasised over lower-cost preventive care, and the proliferation of 'informal payments' for medical services has limited access to quality health care for low-income households.

These considerations suggest that MDGs 2-6 are quite relevant for CIS countries. In contrast to the situation in developing countries, responding to these challenges need not require massive injections of external assistance in those CIS countries with higher per capita income. Social policy reform via the appropriate decentralisation, restructuring, and modernisation of state administrations is the key. In the poorer CIS countries, massive external assistance is inevitable.

More good news: MDGs 7-8

MDGs 7 and 8 concern environmental issues and global partnerships for development. To be sure, national environmental policies in CIS countries are often inconsistent with best international practices. The region continues to struggle with the development legacies of Soviet-era environmental disasters in the Aral Sea Basin, Chernobyl, Semipalatinsk, and the like. Access to potable water is a serious issue in a number of the poorer CIS countries, particularly in rural areas.

On the other hand, Russia's ratification of the Kyoto Protocol enabled the protocol to come into force. The CIS is likely to, and should, emerge as one of the world's most active carbon trading regions, due in part to the large reductions in greenhouse gas emissions experienced during the economic declines of the 1990s. Regional leadership in Kyoto implementation will serve not only to protect the global environmental commons; it can also work to provide innovative new funding mechanisms for financing green economic growth in the CIS.

CIS countries are contributing to global partnerships for development in other ways as well. Russia is now moving to expand its technical assistance for some CIS and developing countries, with an initial focus on Armenia and Tajikistan. Azerbaijan, Armenia, and other CIS countries, while remaining recipients of official development aid, provided humanitarian assistance to the Southeast Asian countries that were devastated by the December 2004 tsunami. And, as the new EU member states have already demonstrated, Russia and the other CIS countries may also have broader lessons and transition expertise to contribute to the international development community.

How UNDP can help

As in many other regions, UNDP can help government, NGO, and private-sector partners in CIS countries to achieve the MDGs. Survey research conducted within the framework of the intergovernmental 'Decade of Roma Inclusion' has identified pockets of poverty and social exclusion among Roma, refugees, and internally displaced persons in Central and Southeast Europe. This mapping and measurement of poverty among vulnerable communities, and the development of MDG-consistent indicators to track poverty trends over time, underscores the relevance of the MDGs in middle- and even high-income countries.

UNDP is likewise assisting the Russian government in devising national indicators to measure the effectiveness of social policy. UNDP since the late 1990s has been helping the governments of the new EU member states to become more effective donors, and increase the region's role in international development cooperation. It stands ready to do the same for Russia and other CIS countries, as they move to increase their technical assistance efforts.

Last but not least, UNDP's climate change expertise and country office infrastructure can offer governments of the region the opportunity to move quickly to capture the economic and environmental benefits of the Kyoto protocol.

UNDP's global mission is to provide countries with assistance in meeting the MDGs. The best way to apply the MDGs differs from country to country, even within regions sharing similar histories, as is the case with the CIS. In some cases, particularly where extreme poverty remains a widespread threat, the MDGs in their traditional, global formulation are entirely applicable. In others, where poverty is confined to specific regions or groups, a more tailored approach is appropriate. As the experience of Russia and the rest of the CIS makes clear, however, the message of the Millennium Declaration—the ideal of social solidarity—is relevant everywhere.

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Development Versus Transition

Ben Slay

One of the ironies facing the international development community working in the countries of Central Europe, the Balkans, and the Commonwealth of Independent States (CIS) lies in the fact that these countries do not face traditional economic development challenges per se. First and foremost, they face problems of economic transition. When differences between development and transition are not fully understood, conceptual and policy mistakes can— and sometimes do —occur.

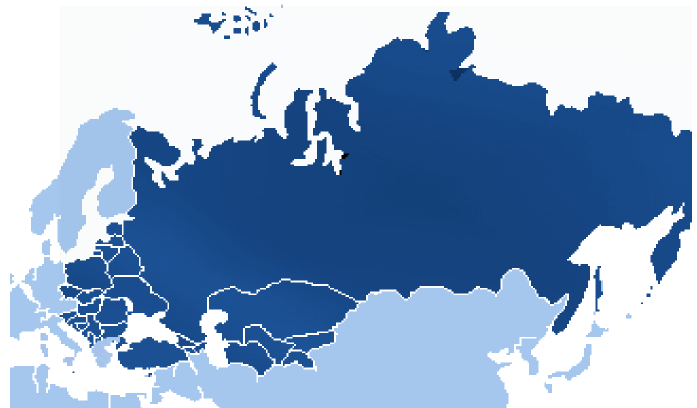
What is economic development?

Various definitions of economic development can be found, reflecting different methodological and ideological perspectives. In some sense, all countries and social systems are always in the process of development: even small quantitative changes of population or wealth can lead to major systemic qualitative changes. But in its classical sense, economic development can be reduced to the problem of capital accumulation. Developing countries typically have extensive reserves of labour and (in some cases) natural resources, but possess small endowments of capital. Physical capital consists largely of residential, agricultural, and commercial buildings, and stocks of grazing and farm animals. Human capital is limited by the absence of well-developed education systems: attaining universal primary education and basic literacy are major challenges. Only a small percentage of the population has access to higher education, and a good number of university graduates migrate to developed countries where the return on their human capital is higher.

Acquiring this missing capital is not easy: low incomes and high propensities to consume typically limit domestic savings and force developing countries to tap into foreign savings. Populations are young and rapidly growing, endowing developing countries with relatively large but unskilled labour forces. The education systems needed to generate human capital cannot be established overnight. Underdeveloped medical systems and unhealthy lifestyles keep life expectancies low.

Economic development is also about tradition. Developed economies are characterised by extensive specialisation and division of labour, which is coordinated by markets and/or (before 1990, at least) planning mechanisms. Individuals' career decisions are influenced by incentives created by market signals or central labour allocation. Developing countries by contrast are characterised by a less extensive social division of labour. Self-sufficiency and tradition play a greater role in the provision of food, shelter, and other basic needs. Career decisions are influenced by family, gender, and social traditions: if your parents are farmers, you will be a farmer as well.

No developing country fully conforms to this model. Still, the challenges posed by rapid population growth, the importance of tradition, and the imperatives of acquiring capital and modern technologies are major features of such developing economies as China, India or Brazil. Highly developed countries like Germany and Japan, on the other hand, have aging, shrinking populations, and are major exporters of capital and savings to the developing world. As skilled work forces in developed countries seem uninterested in performing manual labour, they import labour – the gastarbeiter phenomenon – from less wealthy countries. Whereas developing economies typically seek to import capital and export (unskilled) labor, developed economies do the opposite.



Are they developing economies or transition economies?

Seen from this perspective, the Balkan and CIS economies are most definitely not developing economies. They do not suffer from capital shortages: socialist development left these countries with universal primary education, 100 percent literacy rates, well developed rail (and, to a lesser extent, road) infrastructures, and developed public health systems. Uzbekistan—whose per-capita GDP in 2002 (in purchasing power parity terms) was only $1670—was a major producer of aircraft and agricultural machinery during the Soviet period. Traditional subsistence, family-based agriculture in the region was largely destroyed by collectivisation, and replaced by large, mechanised (and, in Central Asia, irrigated) farms that were integrated with

food or cotton processing industries. Of the 20 Balkan and CIS countries, only seven (Albania, Azerbaijan, Kyrgyzstan, Tajikistan, Turkey, Turkmenistan, and Uzbekistan) are reporting population growth. The typical demographic profile in this region is instead one of a shrinking, aging population, with particularly sharp declines in fertility rates and numbers of children moving through primary and secondary education systems. Most of these countries are exporting (unskilled) labour and importing capital.

Some—Russia, Ukraine, and Uzbekistan, for example—now consistently report current account surpluses, indicating that they are net exporters of capital. And Russia is a major recipient of migrants within the CIS.

The challenges facing these economies are not issues of development — they are challenges of mis-development arising from the large-scale misallocation of physical and human capital during the socialist era. Before 1990, millions of people in the Socialist bloc were trained to use inefficient managerial and technological systems to produce goods that could not be sold on world markets. Factories built to produce Wartburgs, Zhigulis, and Trabants in the protected markets of shortage economies could not compete with imported used cars once foreign trade was liberalized. Education systems that pumped out the engineers needed to 'build socialism' are unable to train the legal, business, and information specialists for a market economy. Public health systems that were constructed to eradicate diseases like cholera and measles must now provide preventive care and empower patients to adopt healthier life styles.

Resolving these challenges does not require replacing tradition with markets or importing foreign savings. They require transforming the human and physical capital that is frozen in socialist-era factories and skill profiles into forms and structures that can produce goods and offer services that are competitive on the world market. Resolving these challenges also means developing the political, social, and cultural conditions required for an effective market economy, in which workers as well as entrepreneurs are empowered to think for themselves and defend their interests. A functioning market economy not only requires private enterprise — it also needs effective state structures that regulate without disempowering, that correct for market failure instead of causing it, and that can partner the private sector and cooperate with NGOs to offer communities the right mix of public services and private choices. For CIS and Balkan countries with weak pre-1990 traditions of statehood, and which had to introduce national currencies and economic policy institutions from scratch in the early 1990s, creating these state structures has proven to be more difficult than the mass privatization of state enterprises.

Do differences between economic transition and development matter?

The past fifteen years have shown that this transition is neither simple nor easy. When combined with the socio-political conflicts and disruption associated with the collapse of the Soviet and Yugoslav federations, as well as the misguided macroeconomic policies that produced hyperinflation during the early 1990s in most of the CIS and the Balkans, the difficulties posed by privatizing thousands of state enterprise, taming severe macroeconomic imbalances, and creating new governance institutions from scratch, have in some cases been overwhelming. Notwithstanding contested data, the bulk of the 20 CIS and Balkan economies have low GDP growth. In 2004 only four countries (Albania, Belarus, Turkey and Uzbekistan) were reporting GDP levels that exceeded 1992 levels.

These trials of transition have generated voluminous literatures documenting 'mistakes' made by economic policymakers in these countries — and by the international financial and development institutions that have advised and supported them. Many economic policy mistakes clearly were made in these countries, particularly in the early 1990s. It is also clear that at least some of the critiques of transition in the Europe and CIS region suffer from the failure to fully distinguish between challenges of economic development and transition. Comparisons with 'more successful' transition economies in East Asia (like China and Vietnam), countries that avoided sharp declines in GDP during their transitions from plan to market, are cases in point. At the start of their transitions in the 1970s and 1980s, China and Vietnam were quintessential developing economies. They were endowed with young, rapidly growing, predominantly rural populations that were abundant in unskilled labour and (some) natural resources, but in little else. Relatively little physical capital or skilled labour was trapped in unviable farms and factories created by socialist planners. Huge increases in labour productivity and household incomes were therefore generated via de facto agricultural de-collectivization, as capital-poor collective farms were turned over to peasant families with minimal losses of physical and human capital.

In contrast to the European and CIS cases, economic reformers in China and Vietnam did not have to face the challenges of value-subtracting state enterprises and state banks drowning in bad loans. They could simply

wait while these problem sectors became shrinking islands in growing seas of private enterprise. For China and Vietnam, successes in economic development have to date dominated problems of economic transition. Not being developing economies, and possessing large amounts of mis-developed human and physical capital, the countries of the Balkans and the CIS simply did not have this option.

The good news . . . and the bad

In Europe, arguably, a policy regime that is capable of generating successful economic transitions has emerged in the form of the EU accession process. The Central European and Baltic countries that became members of the EU in May 2004 have restructured and modernised their economies, attracted billions of dollars in foreign direct investment, and reoriented their foreign trade toward one of the global economy's growth engines. In contrast to their eastern and southern neighbours, the Central European economies today report GDPs that are well above pre-transition levels. Their economic policies, institutions, and problems now closely resemble those of the other EU countries; challenges of transition are giving way to challenges of convergence.

This is not a coincidence. In part, this was because EU accession required the adoption of policies promoting macroeconomic stability and private enterprise. More importantly, EU accession required the public sector reforms needed to create effective but accountable state structures that are subject to democratic controls. Preparing to adopt the body of European law and regulations known as the acquis communautaire meant that the accession countries had to reform state administrations and judiciaries, introduce independent but accountable sub-national governments, and create the space needed for the third sector to flourish. The acquis communautaire may not be an optimal remedy for successful transition and sustainable development—but it has proven to be robustly superior to other strategies for repairing socialist mis-development, while simultaneously introducing democratic rules of the game.

The "European anchor" may yet prove to be sufficiently strong to pull the candidate and aspiring candidate countries of the Balkans toward the 'made in Brussels' solution to the challenges of transition. It is somewhat less likely (although still possible) that the financial, political, and market access benefits of the European Neighbourhood Policy (ENP) to be introduced during 2007-2013 will be sufficient to put at least some of the countries of the Western CIS (Ukraine, Belarus, Moldova) and the Caucasus (Armenia, Azerbaijan, and Georgia) onto the track of integration with the EU. But the ENP is rejected by the government of Belarus, and does not apply to the Russian Federation and the Central Asian countries (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan). The potency of the 'made in Brussels' solution to the problems of transition weakens as it moves east.

Moreover, traditional problems of economic development may be reappearing in the poorest transition economies. This is apparent in terms of primary education and infant mortality data: in Tajikistan, enrolment rates in the first nine grades had dropped from near 100 percent in 1990 to 88 percent by 2000. In Turkmenistan and Kyrgyzstan, only one 18 year-old in three is in school. In each of the Central Asian countries (and in Azerbaijan), infant mortality rates remain above 50 deaths per every 1,000 births. Tajikistan's under-five mortality rate in 2002 was higher than in 1970, standing at 116 cases per 1,000 births. The longer the transition continues in these countries, the more the physical and human capital that is trapped in socialist-era forms and structures depreciates, and the less valuable it becomes. Transition economies with vastly depreciated capital stocks may be converging towards . . . developing economies. If so, this would be one of the greatest ironies of transition.

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Lost in Transition: When is transition over?

Gwendolyn Sasse

Transition is a term used by political scientists to refer to the interlude between the overthrow of a regime and the consolidation of a new regime. There is no requirement that the new regime be a democratic one, but in practice since the early 1970s the use of the term transition has generally assumed a 'transition to democracy'. Evaluating how and when transition processes begin is as contested as judging when they come to an end.

When do transitions begin?

Political scientists generally have two main explanations for the causation of transitions to democracy. Firstly, democratisation is seen as a product of long term socio-economic modernisation and structural adaptation of the political system to developments in the socio-economic structure – the emergence of capitalism, the spread of education and literacy, urbanisation, and mass communications. Some social scientists, notably Seymour M. Lipset and Barrington Moore, focus on structural aspects such as the abundance of wealth that is generated by capitalism and its key role in sustaining the position of the middle class as the bedrock of democratic societies. In contrast, the work of Samuel Huntington argues that modernisation renders autocratic or authoritarian regimes obsolete. Leaders choose to democratise because it is the most efficient means of managing capitalism, and thus strengthens their capacity to compete in the international system. Huntington developed the concept of the 'King's dilemma' to explain this process – authoritarian leaders who reform will perish, and equally those who do not reform will still perish.

Secondly, democratisation is seen as the product of elite pacts and institutional engineering irrespective of a specific socio-economic background. Dankwart A. Rustow famously stressed the role of elites and their decision calculus in the making of transition – it occurs when there is an agreement among elites to institutionalise democracy.

Political scientists have tended to treat transition as an endogenous development rather than focusing on the external factors and pressures that may induce and shape transition. The international dimension has been particularly evident in the case of Eastern Europe where Gorbachev's perestroika unleashed unmanageable pressures for political change. It was only with the revolutions of 1989 and the collapse of communism that serious attention was paid to the role of international factors in the transitions across the whole Soviet bloc. Once revolutionary processes erupted in Eastern Europe they spread with demonstration effects. The geographical proximity to the EU, the role of public and private external aid and investment, and the international conditionality and incentives set by the Western states and EU for integration into the democratic world have been critically important exogenous factors in the post-communist transitions. The continuing importance of the international factor of transition has been reiterated more recently in the 'coloured' revolutions in Serbia, Georgia and Ukraine.

Most political scientists engaged in the study of transition concentrate on the role of institutional design in the consolidation of democracy. There is a huge field of debate as to which institutional choices are optimum for transition: presidentialism or parliamentarism? Cen-

Transition

The term 'transition' refers to an interim period of regime change. It implies a linear development from a point of departure towards a clearly defined end goal: a liberal democracy and a market economy. The study of transition (transitology) shares many of the assumptions of the theories of modernisation of the 1960s and 1970s, which saw socio-economic development as the precondition for democratisation. From the 1980s studies emphasised more the contingent role of elites, and the importance of institutional engineering for successful transition to democracy. Samuel Huntington saw the transitions to democracy of Eastern Europe and the USSR as a logical continuation of the 'third wave' of democratisation in Southern Europe and Latin America. The political and economic changes taking place in post-communist countries, however, are distinguished by being more far-reaching and by the so-called 'dilemmas of simultaneity'. Post-communist transitions, especially in the Former Soviet Union, are best understood as 'triple transitions' involving political reforms, economic reforms and state- and nation-building. The post-communist experience demonstrates that despite a shared socialist legacy transition paths can vary considerably.

tralised or decentralized government? What kind of party system? What kind of electoral system? The question of institutional choices is framed by bigger questions such as whether one thinks it is preferable to have shock therapy reforms or gradualism, what one's views are as regards the sequencing of political and economic reforms, and how much importance one attaches to the stability of government-state-society relations.

When do transitions end?

If transitions may begin incrementally as a long-term process, or can be triggered by some sudden revolutionary eruption, we can view their ending in similar terms. Some transitions may end in a long drawn out process, where an end-point will be difficult to demarcate. Some argue that the entry of the Central and East European states into the European Union is a dramatic signal that their transitions are indeed over. The difficulty of finalising the end-point of transition has led political scientists to employ the term 'consolidation' in order to distinguish the early transition phase of fundamental regime change and reform from the subsequent deepening of the reform process The distinction between 'transition' and 'consolidation' is a fluid one, and creates a further definitional conundrum. It highlights the divergence between post-communist countries and other 'normal' European countries.

Can transition be over when voter turnout in national elections drops well below 50 percent only a decade after 1989, as in Poland? Can it be over when there are serious government crises as in Poland or the Czech Republic , when 10-20 percent of the population of Estonia and Latvia are stateless residents, and when the social costs of transition are still running high. It is a fallacy to argue that a transition is over when a country has secured EU membership. Transition can only be judged to be over when there is an elite and public consensus on the fact that it is over, both domestically and internationally. In each case this recognition is based on an objective and subjective measure of political stability, economic well-being, societal cohesion and the implementation of the rule of law. Equally, the multi-dimensional nature of transition means that progress may be uneven across these measures. Some countries, for example, may do better on democratic reform than economic reform, and vice-versa.

Ultimately, also, the question 'when is transition over?' is a question about the stability of the new democracy and its potential for backsliding. According to Juan Linz and Alfred Stepan, democracy is successfully consolidated when there is no significant domain of power or actors challenging the state from outside the democratic structures, and when a strong majority accepts the legitimacy of the new democracy. When there is little or no potential for reversion to authoritarianism, then, we should say the transition to democracy is over.

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Linking Economic Development and Transition

Waltraud Schelkle

Is the challenge of economic transition specific and different from economic development? How has the transition experience enriched development economics? Which mistakes in transition policies could have been avoided if insights from development economics had been taken on board earlier?

Economic transition poses some specific challenges in former Soviet bloc countries which set them apart from traditional 'development' cases. They did not suffer from a lack of real capital, if anything, transition economies were over-capitalized following decades of planned heavy industrialization. Health and education levels of the workforce were generally quite good and in some respects, such as gender equality, even surpassed OECD standards. The government was fundamentally involved in all economic activity while governments in developing countries often fail to provide even basic services.

The social implications of transforming the employment system are likely to make for lasting differences in political economy terms between former transition countries, such as Hungary or Russia, and other emerging markets, like South Korea or Brazil. While workers in developing capitalist economies always lived in precarious employment situations, relying primarily on the safety net of the family and community, the socialist enterprise provided job security, vocational training and sometimes even housing or childcare facilities. This low-standard, yet robust, social security has been largely destroyed by the establishment of the price and profit

mechanism in labour allocation during transition. The privatisation of employment risks to allow for massive sectoral and regional shifts of jobs created persistent problems of poverty and income inequality. These problems make the Millennium Development Goals relevant for even the EU accession countries among the transition economies. Low levels of trust in government in countries like Poland, despite the spectacular achievements of transition, suggest that the political imperative to provide social security has not disappeared with the demise of the socialist state. The restructuring of social welfare and its profound political implications will make the political economy of transition a distinct field of study for some time to come.

The transition experience was immediately relevant for debates about the role of the financial system in development. The policy debate revolved around the question of how to create a functioning dual banking system, with a central bank stabilising the macroeconomy and commercial banks sustaining hard budget constraints, both for themselves and for borrowing firms. This required dealing with the monetary overhang to ensure the solvency of the banking system and to contain inflationary pressures. The complex linkage of microeconomic, macroeconomic and institutional reforms during transition was in stark contrast to traditional views of the role of finance in development. The dominant perception was that developing countries lacked financial resources, even though the debt crisis of the early 1980s and currency crises caused by large capital flow reversals demonstrated that too much capital can sometimes stall development. This message was largely ignored. Early structuralists diagnosed market failure causing 'under-banking' and an inherent dearth of credit, and called for interest rate ceilings and for central banks to act primarily as development banks. The neoclassical counter-revolutionists diagnosed government failure in the disguise of 'financial repression', calling for interest rate liberalisation to mobilise savings and a central bank confined to strict money supply control. Alas, the structuralist recipe created sickly banks, not strong ones, while neoclassical shock therapies fostered endemic financial crises. The transition experience thus bolstered innovations in development economics that analysed indigenous financing arrangements not as symptoms of failure but as credit instruments adapted to the risks and constraints borrowers and lenders face in volatile markets.

Every transition economy had its banking crises and stock markets did not flourish as expected. If insights

Economic Development and Economic Transition

Development means structural change of the economy and qualitative improvements in the use of productive factors. The founding model of development economics, which won Arthur Lewis a Nobel Prize, conceptualised economic development as transition from a predominantly agrarian, rural economy to an industrialised, urban one. The role for the government and external aid was to raise agricultural productivity, both to sustain the increasing non-agrarian workforce and to finance a higher capital-labour ratio in the developing economy. Moreover, the industrial workforce had to be trained to be able to use the scarce capital stock profitably. Later accounts build on this understanding even if they tend to see a more modest role for government and a greater role for market mechanisms. Transition, by contrast, was not about industrialisation but about privatising and downsizing industry; not about creating the skills for more gainful employment but about reorganizing the employment system; not about state intervention but about strengthening market forces. The fundamental difference between development economics and the economics of transition hinges on the balance between the state and the market in the economy.

from development economics had been taken on board, perhaps the banking crises, the misguided focus on stock market development and other failures of transition policy could have been contained. These failures have their roots in a simplistic application of the Coase theorem. It states that what matters for efficient market outcomes is only that property rights are defined; it is irrelevant who exactly gets the rights as long as transaction costs of exercising them are negligible. Development economists, in contrast, did not disregard the difficulties of exercising property rights or the distributional relevance of their allocation. They looked at how institutions not only lower these transaction costs but also help to adapt property rights to the circumstances of developing markets. This turns the Coase theorem on its head: who gets the property rights matters immensely. Where transition policy ignored this simple insight it led to disastrous voucher privatisations, little regard for supervision of financial enterprises or their role in corporate governance, and misguided policies based on the assumption that the distributional effects of price liberalisation were temporary. It is high time therefore to review the lessons of development for transition, and vice versa.

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Poverty during the early transition

Nicholas Barr

According to World Bank data, two percent of the population of Central and Eastern Europe and the Soviet Union were poor in 1988, based on a benchmark of $2 .15 per day; by 1998, the figure was about 20 percent. The number of people living on less than $4 per day increased more than tenfold, from 14 million in 1989 to 168 million in the mid 1990s. Poverty rose substantially in radically-reforming countries, from 6 percent to 20 percent of the population in Poland between 1989 and 1996, and from 1 percent to 37 percent in Estonia (see Table overleaf). The increase was even sharper in less successful reformers, in Romania from 6 percent to 59 percent, in Russia to 50 percent and in Ukraine to 63 percent.

Notwithstanding major and well-known problems with data and methodology (see Box), the trend is stark and undisputed. Why, with historical hindsight, is there an awful inevitability about such an outcome? The movement to a market economy had three initial effects: falling output, declining job security, and widening inequality of incomes.

Output fell. Output fell on a scale not seen in the West since the Great Depression of the 1930s. In Poland and Hungary the countries least-badly affected, output fell by 18 percent over the first three years of transition, and in the Baltic countries by up to half. By 2003, EBRD data show that output in the countries of Central and Eastern Europe – mainly those which joined the EU in 2004 –

Who are the Poor?

Due to conceptual and measurement problems, there is no unambiguous definition of who is and is not poor. Defining poverty faces three sets of problems.

- What indicator of welfare – income, expenditure or consumption? None is definitive. And none allows us to separate choice from constraint: someone may eat no meat and have low expenditure and income, and so be poor according to all three measures; but if he is a vegetarian Ascetic, looking at outcomes overstates poverty.
- What choice of income unit – the individual, family, or extended family?
- What concept of poverty – related to subsistence (absolute poverty), to living standards in the society in question (relative poverty) or to people's perceptions about their living standard (subjective poverty)?

None of these questions has unambiguous answers. Measuring poverty is difficult even in advanced economies. Transition countries face additional problems. Data are inaccurate, and interpretation is complicated by large changes in relative prices, and by the increased availability of goods as market supply took root.

Even where a definition has been agreed, measurement is problematic. Policymakers are interested in how many people are poor (the head count), how far below the poverty line they fall (the poverty gap), and for how long –whether their poverty is transient or long term.

had recovered, by then averaging nearly 20 percent above 1989 levels. In contrast, across the CIS, output was only three-quarters of its level before transition.

Job security ended, creating particular problems for women with family responsibilities, older workers, unskilled workers and ethnic minorities.

Income disparity increased. While falling output is unambiguously adverse, a wider income distribution can be good or bad. Economic liberalisation meant that people with skills valued by the market could command a market wage, assisting quality and encouraging workers to move to more productive jobs and to acquire new skills. Of course workers also have important non-financial motives, notably job satisfaction, but the issue during the early transition was to put right an inheritance where wages were almost completely unrelated to individual performance. Separately, liberalized property ownership increased the incomes of wealth holders and contributed to the growth of new enterprises.

But not all income differences are beneficial. A rising tide of unemployment, poverty and insecurity accompanied liberalization. Exploiting a monopoly position can – and in some countries did – prevent competition and hence harm growth. Even more malign, criminal behaviour, often backed by violence, increased during the early transition and remains a problem in some countries. As the rule of law strengthens, inequalities for these latter reasons – it is to be hoped – will decline.

In many circumstances market forces improve incentives, hence labour-market efficiency, hence economic growth – one of the core purposes of transition. There is increasing empirical evidence that excessive inequality can harm growth, but the communist experience shows that too little inequality is also harmful. Thus a wider distribution of earnings and income is not just a feature of transition but a permanent part of the post-communist landscape.

Why was rising poverty inevitable? As a proposition in pure logic, falling output coupled with a widening income distribution increases poverty. To explain why, suppose that the distribution of income widens but average income remains constant. It must then be the case that there are more people with lower incomes as well as more with higher incomes. If economic growth is positive, the effects of rising income might outweigh the effects of rising inequality, i.e. the entire income distribution might shift enough that poverty falls. In contrast, if inequality widens and growth is negative, it must be the case that there are more people with lower

Poverty rates, selected transition countries, 1987-8 and 1993-5 (percent of population)

	Poverty headcount	
	1987-88	1993-95
Central and Eastern Europe and the Baltic countries		
Bulgaria	2	15
Czech Republic	0	<1[b]
Estonia	1	37
Hungary	1	4
Latvia	1	22
Lithuania	1	30
Poland	6	20
Romania	6	59
Slovakia	0	<1[b]
Slovenia	0	<1[b]
CIS		
Belarus	1	22
Moldova	4	66
Russia	2	50
Ukraine	2	63
Average CEE & CIS without Central Asia	3	43

Source: Milanovic, Branko (1998), Income, Inequality and Poverty during the Transition from Planned to Market Economy, Washington: World Bank. (Table 5.1).

Notes:
a) The poverty line is 120 international dollars per capita per month
b) Care is needed interpreting the figures. Richer countries, e.g. the Czech Republic, Slovakia, and Slovenia, had few people with incomes below $4 per day in either the late 1980s or mid-1990s and, on that measure, experienced little increase in poverty. That does not mean that people did not experience a fall in income — merely that, relative to a benchmark of $4 per day, poverty increased very little.

incomes. Since the early transition was characterised by negative growth and widening inequality, an increase in poverty was inevitable.

Poverty relief is thus a core part of the reform agenda. A remedial strategy includes poverty relief specifically, through benefits aimed at poor people via an income test or in other ways; policies to assist labour markets to adjust, including unemployment benefits and better information about available jobs; and broader social policies, notably education and training.

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Productivity, prosperity and development

Andrei Sarychev

The 70-odd years of socialism were the biggest man-made experiment in economics. The ideas of Marx inspired the creation of socialist systems, but also planted the seeds of their ultimate demise. The reason for the demise was the failure of socialist economies to keep productivity growth on a par with Western economies. From the 1950s the productivity gap steadily grew, eventually resulting in the inability of the Socialist bloc to finance the arms race with the West and contain internal pressures due to stagnating living standards. Many of the problems which the former socialist countries are now facing in the social, demographical and political spheres are the consequences of their low productivity or are impossible to resolve without increases in per capita GDP, and hence in productivity.

Diagnosing the problems involved in raising productivity is a tricky undertaking. The reason for this is the emphasis made in neo-classical economics (which used to be the dominant paradigm for explaining income disparities across the world) on the accumulation of factors of production, such as physical and human capital. A textbook developing country possessed little of both; it was easy to conclude that invest-

What is Productivity?

Economists use the concept of total factor productivity (TFP) to measure productive efficiency of an industry or a whole country. This is the extent to which output is affected by everything other than measurable factors of production. Countries with higher TFP produce more given the same levels of labour, physical and human capital.

Specific investment is an outlay made by the firm that enhances its productivity in a particular use or in a particular relationship with another firm, but may be worthless in the market. When this investment is irreversible, courts do not have leverage over a deviant firm.

Social norm is a coordinated way of reacting to particular activities, e.g. a collective boycott of firms/individuals that committed a breach of trust that is beyond the reach of courts to prosecute.

Market institutions is the umbrella term for social norms, networks, thick markets, the distributed expertise of arbitrators, independent analysts and judges that permit the economy to function at full steam.

ment in machines and more education for the workforce was all that was required. It was recognised that enforcement of contracts and private property protection could be a concern for development, but the standard prescription was limited to the need for a strong independent judiciary and a transparent and liberal set of laws.

Superficially checking the levels of available inputs, one would then expect the transition economies to do quite well. The newly adopted laws are as good and sometimes better than those in OECD countries. In practice, however, private firms often create mediocre value-added even with cutting-edge western equipment and highly trained workforces. Why is productivity low in transition economies?

The reason is the lack of market institutions (a factor neglected in the neo-classical analysis) which in developed economies have evolved together with the capital stocks. The transition economies have factor endowments roughly similar to the market ones, but vastly inadequate institutions to match those endowments.

Listed below are the problematic areas specific to the transition economies in which improvements can be most productive.

Contract enforcement (in dealings among firms). A firm will not undertake specific investment that generates high returns without the assurance that it will be rewarded. Contrary to the simplistic view that courts can instill contractual discipline, most of the enforcement in reality is provided by informal institutions. These are a complex mesh of social norms, information-sharing in business and social networks, and expert agencies that work outside the legal enforcement mechanisms. When these institutions are in their infancy, fear of 'hold up' may cause firms to forgo the most specialised and profitable contracts where cheating is most lucrative.

Corporate governance. Hired managers may be tempted to engage in asset stripping. When the market for managerial labour is undeveloped, managers are hard to discipline. Similarly, in publicly held companies the majority shareholders have incentives to expropriate assets from minority shareholders. Regulatory intervention in the stock market can go a certain length in preventing the most blatant forms of such expropriation, but the bulk of enforcement (by means of coordinating market reaction to breaches of fiduciary duty) is provided by informal institutions. When these are undeveloped, companies have severe problems attracting finance for restructuring or investment in the stock market.

Barriers to entry. Many formerly state-owned enterprises are notoriously inefficient because their production processes were devised under the distorted stricture of pre-transition prices. Production efficiency is improved by the destruction of the old inefficient firms, the creation of new efficient firms, and the reallocation of labour and capital from the former to the latter. Further innovations and increases in productivity also tend to happen in newly created small businesses. However, especially in the Former Soviet Union countries, there are huge costs of entry due to predatory taxation and extortion by the authorities. If a new firm decides to avoid official entry barriers and enter the shadow economy instead, it loses recourse to courts and other government agencies and falls prey to protection rackets. Rackets tend to expropriate all surplus from further investment/expansion, thus ridding the firm of the incentive to invest or innovate.

Human capital obsolescence and frictions in the labour market. A degree in rocket science is not worth much if there is no demand for rockets. Retraining workers to match the market demand for skills is subject to a prolonged intermediate phase in which advanced skills are lost and the educational attainment falls temporarily. This is due to the frictions in the labour market preventing retrained/new specialists from getting returns to their human capital.

Regional segregation and worker mobility.
Particularly in the larger FSU countries, regional segregation is important. As a legacy of socialism, regional labor markets are often monopsonistic, with employment provided by a single mammoth enterprise. Getting workers to move on from the enterprise implies getting them to move out of the region. This is difficult in the undeveloped housing and personal loans markets, as workers lack liquid resources to move to the markets paying good salaries.

The transition experience demonstrates how countries may fail to prosper even when they seem well endowed with physical and human capital. What matters are market institutions. These institutions are for the large part informal and take time to emerge. Studying the biggest experiment in economics helps us to understand the way market economies function and what is needed for developing countries to catch up.

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Ukraine's Transition: The first 100 days of the new government

Iryna Akimova

Ukraine's Orange Revolution brought an ambitious government to power. The revolution also imprinted itself on the policies of the incoming government, namely in the call for more democratisation, a tougher fight against corruption, and faster integration with Europe. The government's first 100 days in office marks an appropriate moment to take stock. What have been the economic and social priorities and achievements of the new government? What are its key challenges?

Achievements

Domestic Reform

In the area of state reform, important steps have been made: local government reforms have been pursued in order to create powerful local self-governmental units with well-defined responsibilities for delivering public services and sound revenue sources. Territorial reform has concentrated on reducing the number of local self-government units and restructuring at the regional and local level. Judicial reforms have got underway but are a long-term task. An ambitious administrative reform, aiming to increase functional efficiency of the ministries while reducing corruption, has been launched, though it lacks a clear strategy and resources. So far the government has chosen a quantitative approach to administrative reform, which manifests itself in the exchanging of almost 17,000 civil servants at the central and regional governmental levels. Some aspects of the reform process, however, are contradictory, for example the presidential veto on the Code of Administrative Justice.

EU Integration

Ukraine's new leadership has played its cards well. It held back on its participation in the Common Economic Space with Russia, Belarus and Kazakhstan while signing an Action Plan with the EU under the European Neighbourhood Policy. This Action Plan is meant to help Ukraine implement EU-approved reforms, such as the adoption of market-friendly legislation in various areas and an improvement in the efficiency of state agencies. It extends various European education and research exchanges to Ukraine. Most importantly, it offers an as-yet vaguely worded prospect of a free trade agreement with the EU and a special agreement on steel. Ukraine is also on course for WTO membership before the end of 2005. The progress in Ukraine's relations with the West ultimately depends on the implementation of sound domestic economic and social policies. In this area there is a clear gap between the liberal intentions expressed in the government's programme 'Towards the People' and the non-liberal instruments of implementation that the government has adopted.

How Reformist is the New Government?

Economic policy did not feature prominently in the Orange Revolution. The new government inherited a huge pension bill of 16 percent of GDP – easily the highest in the world – from the outgoing government which had doubled pensions on 1 September 2004. Budget expenditures have further grown as a result of additional social obligations accepted by the new government: social expenditures are 160 percent higher in the 2005

budget compared with 2004, and social transfers (46.1 percent) are higher than salaries (42.1 percent) as a share of personal income. This situation has three serious consequences for economic policy in 2005.

First, the scramble for additional budget revenues has shifted the attention of the government away from structural reforms. In current conditions, a tax reduction and the completion of a major tax reform are impossible. Despite the government's good intentions to increase the transparency of financial markets and promote the further development of financial institutions, moves in this direction have been postponed, thereby limiting investment and preserving the speculative nature of the stock market.

Second, the parliamentary elections scheduled for March 2006 already overshadow government policy. It is politically difficult to start complex social reforms in a pre-election year. The popular goal of raising living standards remains closely tied to government spending in the social sector. Little attention has been paid so far to the sustainability of social services provision, in particular the development of a system of private provision and an increase in the efficiency of public expenditures by using a pay-for-service approach to the distribution of public funds among social service providers.

Third, the macroeconomic situation, which looked favourable before the elections of 2004, is a concern. The annual GDP growth rate peaked at 14.2 percent in the third quarter of 2004 and then decreased rapidly to 9.1 percent in the fourth quarter of 2004, and fell to 5.4 percent in the first quarter of 2005. While the exceptional political circumstances at the end of 2004 affected the economy negatively, the data for 2005 definitely signals a downward trend. The 2005 budget deficit can be expected to be 4-7 percent of GDP rather than the official estimate of 1.5 percent. It will be extremely difficult for the Ukrainian government to maintain a single-digit inflation rate.

The new government has declared that it will not facilitate the trade in land, and the re-privatization of enterprises has become the hot political topic. For five months Ukrainian officials have discussed the scope of re-privatization (between 29 and 3000 enterprises). Both the government and some parliamentarians have drafted several versions of a law on the re-evaluation of assets. The plethora of drafts allow the reversal of much of Ukraine's privatisation without offering transparent procedures and credible protection of good faith purchases. The main goal of privatisation – the creation of efficient owners – may be lost in the political infighting. Instead, the re-privatisation debates promote populist ideas of a fair re-distribution of assets, while the government's aim of raising additional budget revenues from re-privatisation is only weakly disguised. The extensive discussions about re-privatisation have contributed to the marked slowdown in investment and production during the first quarter of 2005.

The non-liberal approach to privatisation is complemented by policies based on the preservation and strengthening of the state sector, for example by postponing privatisation or nationalizing 'strategic' enterprises. While the latter is not feasible for fiscal reasons, privatisation plans have stalled. The government aims to raise the efficiency of state enterprises by changing the managers and increasing incentives. Profits of state enterprises are considered to be an important source of budget revenues, as demonstrated by a government decision to transfer 50 percent of the net profits of state companies to the state budget. The ideology of a strong state sector that contains the most important firms is unproductive and will harm a country's growth potential.

The government's capping of prices and profits for meat and gasoline is further evidence of an interventionist approach to markets. The policy resulted in shortages. State regulation of prices of this kind endangers the government's target to secure market economy status for Ukraine by the end of 2005. President Yushchenko finally intervened and abolished direct price regulation in the oil market by decree, however, the episode cast doubt over the cooperation between Yushchenko and Prime Minister Tymoshenko.

Despite a rhetorical emphasis on market reforms, competition policy has been surprisingly low on the government's agenda. No attempt has been made to increase the powers and political independence of the Anti-Monopoly Committee. Instead, the Ministry of Economy

has been charged with preparing a concept to prevent collusion among firms in selected markets (predominantly oil). The development of independent regulators in infrastructure industries has yet to be discussed. The abolishment of tax privileges in free economic zones was yet another money-raising exercise without any attempt made to simplify or lower taxes. The discussion of the Draft Law on State Aid, which is of crucial importance for WTO accession, has been postponed. The moratorium on the bankruptcy of state-owned companies underpins doubts regarding a level playing field for all companies. The small business sector, which depends on stable and simple tax rules, has come under pressure by a tax reform that removed simplified taxation for a range of activities, established an additional pension contribution (which previously was a part of unified tax), and decreased the annual turnover threshold for the registration of an entrepreneur as a Value Added Tax payer.

The Way Forward

Several policy mistakes have to be corrected in order to restore investors' confidence. If for political reasons reprivatisation cannot be reversed, it should be limited in scale and quickly implemented. The process must allow for voluntary action, and the protection of those who purchased assets in good faith, while not hindering ongoing privatizations. State interference in price setting has to be ruled out. Competition policy has to become a government priority, and the simplified system of taxation, accounting and reporting should be restored. Moreover, the enforcement of the Law on the Principles of Regulatory Policy in Economic Activities is of the utmost importance. All regulatory bodies, including the government, must adhere to transparent state regulatory principles in order not to hamper the private sector. Ukraine needs fiscal adjustments, including a complex social reform easing the pension burden through an increase in the effective retirement age, the elimination of various privileges and the targeting of social benefits to the most vulnerable. There is an urgent need to initiate discussion on pay-for-service systems in health care and education.

Without a sound fiscal adjustment, the recent exchange-rate policy geared at revaluing the Hryvna in order to reduce inflationary pressure has few chances for success. In the medium term, the National Bank of Ukraine faces a fundamental choice: either float the exchange rate and concentrate on controlling monetary

aggregates (which is tantamount to adopting an inflation targeting strategy), or resort to a hard peg (preferably to the Euro). Resorting to the tax system to perform fiscal functions is a dangerous path that can hamper economic growth. Already in the short term, the government should pay attention to putting the relationship between tax authorities and taxpayers onto a normal voluntary service basis by decriminalising most tax violations and abolishing the tax police. Ukraine needs to adopt modern corporate legislation, notably a law on joint stock companies. The Economic Code should be abolished since it contradicts the Civil Code, and the Civil Code needs to be further developed. Finally, administrative reform has to be linked to the anti-corruption campaign. The powers of different executive authorities and agencies responsible for administrative reform, including the National Security and Defense Council, have to be more clearly defined.

The new government's performance so far has been disappointing. The government continues to enjoy widespread popular support, but given the economic situation this may ebb during 2005-06 and its window of opportunity for reform is closing fast. Consequently, the current honeymoon period must be used more effectively. Short- to medium-term priorities and appropriate implementation mechanisms must be well defined. The Ukraine-EU Action Plan offers a sound strategic basis for designing, implementing and monitoring reforms. Whether the government will adhere to it is an open question.

Iryna Akimova is Chief Technical Advisor, UNDP Ukraine

The VII World Congress of the International Council for Central and East European Studies will take place at the Humboldt University in Berlin, Germany, from 25th-30th July 2005. The theme of the Congress is "Europe - Our Common Home?" Some 15 years after the change of regime in the countries of Central and East Europe, the Congress offers an opportunity for academics and policymakers from across Europe and Eurasia to examine the state of the continent concerning all apects of European integration processes. How far has the idea of a common-home-Europe already been realised? Which are the new common features and values within Europe, and where are new divides?
www.iccees2005.de

Workshop on Developments and Patterns of Migration Processes in Central and Eastern Europe
25 - 27 August 2005 in Prague, Czech Republic. The Multicultural Center Prague and Faculty of Humanities of Charles University in Prague will hold a three-day workshop on 'Migration Processes in Central Eastern Europe'. The aim is to bring together researchers and experts from academia and non-governmental organisations to discuss current migration patterns and related issues in the countries of Central and Eastern Europe (CEE). The workshop will incorporate debates about migration theories, presentations of empirically based research in the 'region,' and experiences of non-governmental representatives dealing with the issue of migration in CEE.
www.migrationonline.cz/workshop.shtml

UACES 35th Annual Conference and 10th Research Conference: 'The European Union: Past and Future Enlargements'. The 2005 University Association for Contemporary European Studies (UACES) conference will be hosted by the Faculty of Law at the University of Zagreb, 5-7 September 2005. The conference will look at past and future enlargements of the EU. As well as research sessions, there will be three plenary sessions which will focus on the key themes of: Identity and Diversity; Enlarging Europe; Croatia, South Eastern Europe and the EU.
www.uaces.org/

Conference on The Social Economy in Central, East and South-East Europe: Emerging Trends of Social Innovation and Local Development. This conference will take place on 22-23 September 2005 in Trento, Italy. It seeks to build on the interest registered at the Capacity Building Seminar in November 2004 to further explore the trends, opportunities and challenges that social economy actors face in countries of the Baltic States, Central, East and South-East Europe. This event is organised by the LEED Programme of the OECD and its Centre for Local Development based in Trento. For more information please visit the following webpage:
www.oecd.org

Parliamentary Roundtable on Security Sector Oversight to take place on 24-26 October 2005 in Prague. UNDP's Regional Centre for Europe and the CIS, in partnership with the Czech Government, will sponsor a regional parliamentary roundtable on democratic oversight of the security sector. Parliamentarians from Armenia, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan and Uzbekistan will discuss techniques and obstacles for security sector oversight, and exchange experience with distinguished experts and specialized institutions, including the Geneva Centre for the Democratic Control of Armed Forces (DCAF). For more information contact:
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