

Globalization and Equity

**Paper prepared by Elida Recj
Albanian Public Private Finance Institute**

Cost/ Benefit Analysis of globalisation for CEE. Was it equitable?

While many poor people may benefit from globalisation, the challenge is to extend the improvements in income, health, education, and participation to those left behind by taking actions at local and global levels (WB Development Indicators 2002)

The main aim of this paper it will be to provide an overview of current stage of globalisation and equity in CEE region¹, describe and analyse some of the factors that have influenced such development of these economies, at the same time provide briefly for the methodological approach to measure the degree of globalisation and equity. This paper ends with some findings and suggestions on how the issue of globalisation and equity in CEE region should be a more discussed and elaborated topic, where research is needed most, and what might be the appropriate methodologies to measure them. The main aim of all this it will be to better define the problems and come up with some solutions at the national and regional levels and harmonize them with solutions at the international levels.

I. Overview of CEE Development

In the early 1990s, when the first signs that the socialist experiment was finally over appeared, surprise and optimism immediately followed. The surprise arose because of the speed with which communist regimes collapsed, culminating in the dissolution of the Soviet Union in 1991. The optimism arose because the removal of the overwhelming apparatus of political control over economic activity could only mean prosperity in the medium term.

The countries of Central Europe were well prepared for rapid takeoff: they were industrialized, they had reasonably educated and healthy labour forces, and their population growth was minimal. Technology was lagging, but with the free flow of information and Western assistance, that could be overcome. Moreover, the substantial technical progress in the defence sector could perhaps spill over into the

¹ CEE region in terms of this paper would include 5 CEE countries and SEE countries together. The 5-CEE would include respectively (Hungary, Poland, Czech Republic, Slovak Republic, Slovenia), while the SEE would include (Albania, Bulgaria, FYR of Macedonia, Romania, Croatia, Bosnia-Herzegovina and FR of Yugoslavia).

economies, reinforcing optimistic predictions. Some countries, notably Poland, had to tackle macroeconomic imbalances first, but economists felt it was well equipped for this task. Prosperity was, finally, around the corner. (Campos, Corriceli)

A different picture was present at that time in Southern European countries, that due to geopolitical position and old history were still holding a lot of conflicts, a high population growth and a low level of industrialization. It seems now, that a decade of delay was expected for them, being prepared for the takeoff after the conflict could have been addressed.

Now almost ten years latter, the EU membership represents the major challenge for many CEE countries. A strategy to achieve the requirements rapidly for participating in the single-market and the monetary union, if combined with accelerated privatisation, reduction of excessive tax burdens, and social security reform will help to sustain high growth. Financing necessary environmental investments however will be demanding.

A different story lies for South Eastern Europe². The past decade of transition and conflict has been exceptionally difficult for the people of South Eastern Europe. Hostilities have created deep-seated resentments. Emerging from these hostilities is a polarized patchwork of nation states, formed largely along ethnic lines. Conflict, an absence of a political consensus for reform, shallow democratic traditions and weak institutions have all combined to constrain economic and political development in most countries in South Eastern Europe. In turn, delays in the implementation of reform programs have prevented economies from embarking irreversibly on the path towards becoming fully functioning market economies.

Consequently, these economies have experienced an inferior economic performance and in many cases, declining living standards, rising unemployment and inadequate progress in reducing poverty.³

While steadfast reform and the clear prospect of EU accession have led to sustained economic progress in Central Europe, which share characteristics similar to the SEE countries, even determined implementation of reform programs has not yielded the expected positive results, because of civil conflicts, weak institutions and poor

² Map including countries under SEE region can be found in page: <http://www.seecon.org>

³ Data on Gini coefficient and degree of openness is provided in the tables attached to this paper

governance. Conflicts and ethnic tensions among the SEE countries have opened rifts that will not be easily healed. According the World Bank Strategy for SEE countries, it will take time to achieve the intra-regional cooperation and trust necessary for peace and stability.

A. Macroeconomic stability

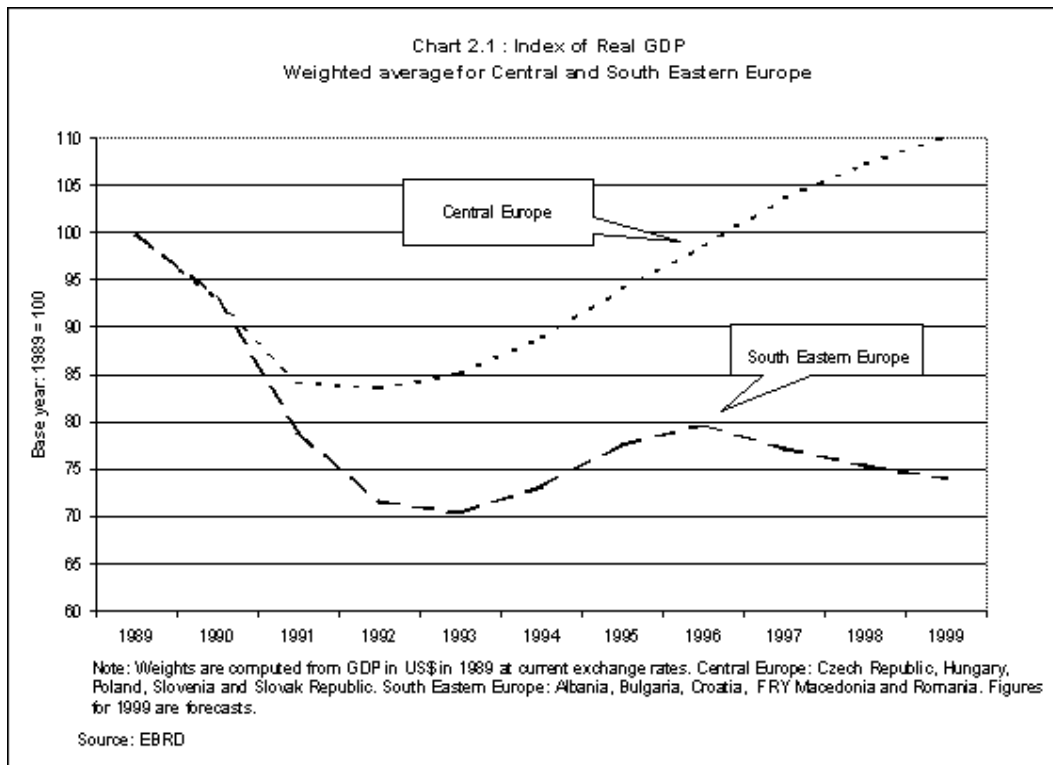
Poor initial conditions have combined with conflict and uneven implementation of reform programs to yield a relatively poor economic performance since the onset of the transition. **Progress in achieving macroeconomic stability has been good recently, but remains tenuous and subject to reversals.**

While the five economies of Central Europe were able to stabilize the macroeconomic situation largely by the mid-1990s, most of the SEE countries have struggled with establishing macroeconomic stability late in the 1990s. Albania, Bulgaria and Romania have suffered severe bouts of macroeconomic instability during 1996-1999. Recently, good progress has been achieved on improving the macroeconomic situation in Albania (through fiscal tightening and a reduction in domestic financing of the budget deficit) and in Bulgaria (with the introduction of a currency board). Romania has also made progress, although inflation remains high and a substantial degree of macroeconomic uncertainty remains. FRY also continues to suffer from extreme exchange rate instability and high inflation. The gains in macroeconomic stability have been achieved through the implementation of consistent monetary and fiscal policies along with supporting exchange rate regimes.

B. Economic Growth

While recent gains in macroeconomic management are encouraging, **economic growth has been and remains disappointing.** The transition recession in the Central European economies lasted for some three to four years, and the decline in output was about 15 percent of the 1989's output level on average. In contrast, in SEE, the decline was greater; the recovery slower and in 1999 aggregate GDP has begun to fall again (see Chart 2.1). The cumulative decline in output was about 30 percent of the 1989 output level. As a group, the SEE economies have contracted by more than one percent per annum, since 1989 (see Table 1).

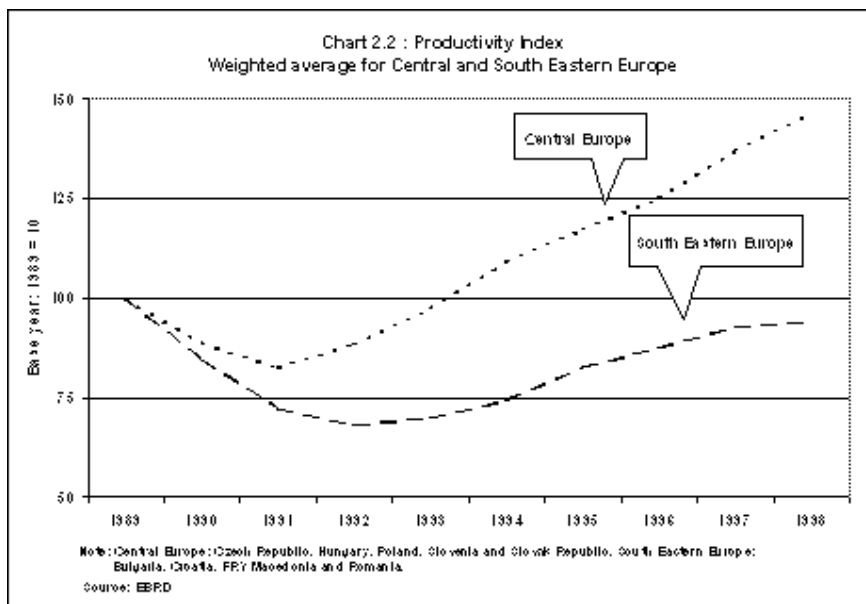
In comparison, the five economies of CEE grew by almost 1 percent per year. The six SEE economies have only reached 75 percent of their pre-transition (1989) levels of economic activity. This can be compared to the five Central European countries, which on the backs of more resolute and coherent reform programs and more stable political conditions, have grown by nearly one percent per annum on average. As a result, the CEE economies are now nearly 10 percent larger than their pre-transition levels. And despite that the SEE economies have experienced increasing divergence with Western Europe. Per capita GDP (on a purchasing power parity basis) drifted from 33 percent of the EU average in 1990 to 24 percent in 1998.



While growth has resumed in some SEE economies at the end of the 1990s, it does not seem to be a steady movement, as most countries have failed to experience sustained increases in productivity. In all transition countries in Europe, productivity declines were experienced early in the transition. Developments in productivity were dominated by the decline in output, as many firms initially avoided large-scale layoffs even though demand for their products had collapsed. This decline in measured productivity began to be reversed in most countries after two or three years—primarily due to further employment reductions.

C. Productivity

In 1999 some of the Central European countries have entered a phase of productivity growth, driven by product innovation, fresh capital investment, improved technologies and modern management methods (that is, by deep restructuring). Many Central European countries exhibit a J-curve pattern for labour productivity, with especially rapid increases in Hungary and Poland. In contrast, productivity growth in the South Eastern Europe has generally stagnated. Whereas CEE's productivity in 1998 was almost one-and-a-half times as high as the 1989 level, in the SEE economies it only reached about 90 percent of its 1989 level (see Chart 2.2). Deeper enterprise restructuring and new investment will be needed to sustain productivity improvements achieved primarily through the shedding of jobs during the early years of the transition.



A key factor underlying the poor growth and productivity performance of the SEE region has been inadequate investment. The investment-to-GDP ratio in the SEE region (excluding Bosnia and Herzegovina) has declined from 23 percent of GDP in 1992 to only 18 percent of GDP in 1998 (see Table 2). Investment levels in recent years have been particularly low (less than 20 percent of GDP) in Albania, Bulgaria, and Romania. All three countries have experienced bouts of macroeconomic instability recently, which have depressed investment levels. By comparison, the average investment-to-GDP ratio in the more rapidly growing CEE economies has increased from 19 percent of GDP in 1992 to 28 percent in 1998. As noted above,

investment has been a driving force behind the productivity gains experienced in the five CEE economies.

While investment levels overall have been lower in the SEE countries than the CEE countries, foreign direct investment (FDI) as a percentage of GDP has been roughly the same or only slightly less in the SEE economies. This indicates that higher domestic investment levels will be the key to improving the SEE region's growth prospects. It is important to note, however, that the growth impetus flowing from FDI in the SEE economies has been less, as the efficiency of FDI inflows in the SEE region has been diminished by the weaker reform effort. Thus, a strengthening of the reform effort will likely induce both higher levels of investment, as well as improved investment efficiency.

As with most transition countries, the SEE countries inherited and largely continue to have social indicators, which are significantly better than countries of similar income levels in other parts of the world. Nonetheless, the heterogeneity of the SEE region is also reflected in variations in living standards and social indicators between countries (see Table 2). The contrast between Croatia—which ranks 55th in the world on the UNDP's Human Development Index and has almost an OECD-level infant mortality rate- and Albania or Kosovo is stark.

The poor economic performance and regional conflicts during the past decade have taken their toll on living standards within the SEE region, as they have sharply declined during the 1990s. Employment and wages trends provide one indication of this trend. Real wages have declined throughout the 1990s in the SEE countries, whereas in the five Central European economies they fell less in the initial transition period and have risen far above their 1990 level by 2002.

D. Employment

In addition to the deteriorating position of those in wage employment, **a large pool of unemployed emerged in most SEE countries.** Registered unemployment in several SEE countries was easily the highest in the entire ECA region (see Table 3).

Registered unemployment had reached 36 percent and 30 percent in FYR Macedonia and FR Yugoslavia, respectively. Estimates of combined registered and unregistered unemployment in Bosnia and Herzegovina are over 55 percent for

1998. While unemployment data in transition economies need to be treated with caution, as many registered unemployed work in the informal economy, this is offset partly by the non-registration of the genuinely unemployed, and removal of people from the unemployment roles upon exhaustion of benefits. Unemployment rates are therefore reasonable indicators of the general declines in living conditions, particularly as the unemployed have been found to have amongst the highest poverty rates in SEE countries.

While it is important to note that the five Central European economies also experienced high persistent unemployment, the rate has broadly stabilized since the mid-1990s at a significantly lower level than in most SEE countries.

II. Globalisation/openness

The relationship between globalisation and equity is a topic, over which uniformed discussion typically overwhelms serious debate based on empirical evidence in those days.

Openness to international trade accelerates development is one of the most widely held beliefs in the economics profession, one of the few things on which Nobel Prize winners of the both the left and the right agree. The more rapid growth may be a transition effect rather than a shift to a different steady state growth rate, but clearly the transition takes a couple of decades or more, so that it is reasonable to speak of trade openness accelerating growth, rather than merely leading to a sudden, one-time adjustment in real income. (David Dollar and Aart Kraay, March 2001)

Actually there is no agreement on what globalisation is, or how to measure its importance. However, there is a wide consensus amongst economists that there are three elements/channels of international economic interdependence: trade, FDI and financial flow. Based on these three elements, let's analyse the degree of globalisation/openness for CEE.

Indicators	Trade in goods as % of GDP		Trade in goods as % of goods GDP		Changes in trade as shares of GDP 1990-2000	Growth in real trade less growth in real GDP 1990-2000	Gross private capital flows as % of GDP		Gross FDI as % of GDP	
	1990	2000	1990	2000			1990	2000	1990	2000
Albania	29.0	35.7	34.5	46.2	..	7.8	18.0	6.5	0.0	3.8
Bulgaria	48.9	93.1	70.8	190.3	..	3.3	939.2	20.7	0.0	8.4
Croatia	89.3	64.6	165.6	123.7	..	4.5	..	19.8	..	5.5
Czech Republic	84	120.5	..	..	..	9.8	..	23.7	..	9.3
Hungary	61.5	131.9	102.4	214.8	81.8	8.8	4.6	25.0	0.0	5
Macedonia FYR	103.8	100.3	168.9	186.8	..	7.2	..	17.4	..	4.9
Poland	43.9	51.1	75.2	99.7	..	8.4	11	13.3	0.2	6.6
Romania	32.8	63.8	45.2	116.7	..	7.9	2.9	7.7	0.0	2.8
Slovak Republic	110.8	128.5	192.1	290.2	..	9.3	..	30.6	..	12.2
Slovenia	102.4	103.9	196.5	209.6	..	0.5	3.4	12.5	0.9	1.3
Yugoslavia FYR	..	64.2	..	..	..	..	..	..	..	..

Source: World Bank Development 2002



The shift from planned to market economies was a social and economic transformation of unprecedented scale. Despite the specific design of policies, their sequencing, and their speed of implementation, the broad consensus for reform have included the macroeconomic stabilisation, price and trade liberalisation, tax and public administration reform legal and judicial reform, etc. A Liberalization Index developed to quantify progress in the transition to a market economy has measured the extent of economic policy reform.

While there is quite a lot of debate on the speed of reform in CEE region, some indirect evidence is provided by the finding that output in each year is significantly associated with the level of policy reforms achieved up to that year – that is, with cumulative policy reform. So the quicker a high level of liberalization is reached and sustained the sooner the economy can attain higher growth.

There are significant differences in the levels of foreign direct investment flowing to the transition economies. Cash privatisation of large enterprises has driven much of these FDI flows; cumulative FDI is highly correlated with cumulative privatisation revenue (EBRD), however FDI has flown as a response to improved policies and improved overall business environment. Some studies have shown clear statistical relationship between the growth of FDI and indices of economic liberalization (Selowsky and Martin, 1998). In addition to spillovers of improved technology, better management skills, and access to international production networks, FDI has proved to be resilient in volatile international capital markets.

The global financial crisis, and particularly its spread to Russia in mid-1998 had a big effect on the other transition economies in the region. For many countries the first effect was disrupted trade with Russia-as demand contracted and trade finance and payments system arrangements were interrupted. The global crisis, also deepened the recession in Western Europe, hurting the export performance of CEE. The crisis made foreign financing scarce and expensive. Net flows of private debt finance to the region fell by 50% between 1998 and 1999. For many countries the privatisation prospects were dampened. Despite initial fears, however net FDI and portfolio equity flows increased in 1999 and 1998 over 1997 in advanced CEE countries.

It is widely believed at both political levels and population (several surveys and studies have been undertaken to a large pool of population), that success hinges

critically on a credible and predictable path to integration with European and global structures, particularly the European Union. Such a path will anchor expectations and provide both an incentive for reform and intra-regional cooperation. The sustained commitments that such a path requires will facilitate political and social changes, and discipline the formulation and implementation of domestic reforms in the SEE region. Politically, a credible commitment of integration for this generation will give a strong incentive to today's political leaders to move forward rapidly to improve governance and undertake reforms. Integration with the rest of Europe also raises the cost of bad neighbourly policies or improper governance. Ample evidence demonstrates that economic integration with developed economies can accelerate growth, lend credibility to reforms and provide a securer environment for investors.⁴

III. Equity

But how does the inequality situation stand for CEE countries? The CEE countries started the transition with some of the lowest levels of inequality in the world⁵. Since then the inequality has increased steadily in all transition economies and dramatically in some of them.

Changes in inequality during the transition

Countries	Gini Coefficient		
	1987-90	1993-94	1996-98
Bulgaria	0.23	0.38	0.41
Croatia	0.36	-	0.35
Czech republic	0.19	0.23	0.25
Hungary	0.21	0.23	0.25
Poland	0.28	0.28	0.33
Romania	0.23	0.29	0.3
Slovenia	0.22	0.25	0.3

Source: World Bank 2000b

Recent studies show that the positive developments largely explain the rise of inequality in CEE countries; rising returns to education, decompressing wages, and emerging returns to risk-taking and entrepreneurship. Despite the increase in inequality, these forces are welcomed as signals of a rewarding more mature market

⁴ WB Strategy on development of SEE countries.

⁵ World Bank 2000b.

economies. While higher demand on strong social transfers and other similar measures have been placed on their government.

The variations of Gini coefficient across countries are larger than before the transition started. In 1998 one in five people in the region survived on less than US\$ 12.5 a day, a standard poverty line⁶. A decade before, fewer than one lived in such absolute poverty. While in some of them the increase is smaller in some others the inequality measure is almost doubling.

The initial efforts to study causes of rising inequality in CEE resulted with the following findings⁷: The inequality lies:

- In the prevalence of widespread corruption and rent seeking, there is a strong correlation between higher corruption and the increase of inequality (higher poverty) in the region. The poor are disproportionately affected by corruption.

- In the capture of the state by narrow vested interests, which have modified policy to their advantage, often at high social costs. These interests have been able to limit competition and concentrate their economic power through mechanisms such as special licenses and monopolies. This way they block the reform and institutions that would be able to provide public goods.

- In the resulting collapse of formal wages and income opportunities. People, except for a privileged few, are stuck in their low paying jobs. They supplement their incomes with diverse forms of self-employment, much of it subsistence agriculture. Access to connections and informal networks and the ability to pay are key to find a job and this has led to highly unequal incomes.⁸

However, while the inequality has been increased almost everywhere, the more advanced reformers 5-CEE countries show much more equal compared with less advanced reformers. And surely, such difference can't simply be explained by different conditions across countries at the start of transition, other factors should also be taken into consideration such as political development, etc.

Competitive democracies – based on widespread political rights to participate in multiparty elections- have taken place in Central Europe, but in contrast limitations on

⁶ World Bank 2000a. The estimates are based on 1993 purchasing power parity rates.

⁷ World Bank 2000c

⁸ These characteristics correspond to South Eastern Europe Countries, rather than Central European Countries.

rights to participate in elections and constraints in civil liberties have concentrated political power in many countries in SEE. Nevertheless such concentration has been associated with diminishing state capacity to produce public goods needed for the market economy. As a result a wide spread corruption, weak public sector management, and in some cases war and civil strife have been the characteristics of transition for the southern part of the region.

The transition has been generally disappointing for the countries in South Eastern Europe. Growth has yet to recover to pre-transition levels. Some countries still face problems of macroeconomic stabilization and in others, stability is still fragile and subject to reversals. These problems have been especially pronounced over the past three years, when a number of countries have experienced bouts of macroeconomic instability. None of the countries have yet established a firm foundation for sustainable growth and progress on improving living standards has also been disappointing.

Its total population is 56 million, about 84 percent of the population of the five Central European countries (CEE) and 15 percent of the European Union's population of 375 million. There is a large variation in size: Romania with 22 million people is ten times larger than FYR Macedonia. Total GDP stood at US\$100 billion in 1998, only slightly more than one-third of the five CEE countries. It is important to note, however, that in almost all countries official GNP figures are likely to be underestimated, possibly significantly, due to the large informal sectors in these economies. Per capita incomes in the SEE countries also span a wide range from US\$4,520 per capita in Croatia—which is roughly equivalent to the CEE average—to US\$810 per capita in Albania. The per capita income of FRY—for which there is no official figure—is difficult to estimate. However, prior to the war per capita income was estimated at about US\$3,500 and now, it is believed to have fallen to about half this level.

According several studies and research⁹ reveal that not only will continued instabilities and stagnating economic growth adversely affect the welfare of the people of the SEE region, continued instabilities will also affect Western European economies and societies as well as other countries in the region. An unstable region is a fertile breeding ground for crime, smuggling, illegal activities, which will not only affect the lives of people in the SEE countries but also those in neighbouring

⁹ EBRD Transition reports, WB ten years of transition, UNDP human development report, etc.

societies. A more prosperous, stable SEE region would also benefit Western Europe economically, by opening up new markets for investments, sources of skilled, low wage labour and trade opportunities.

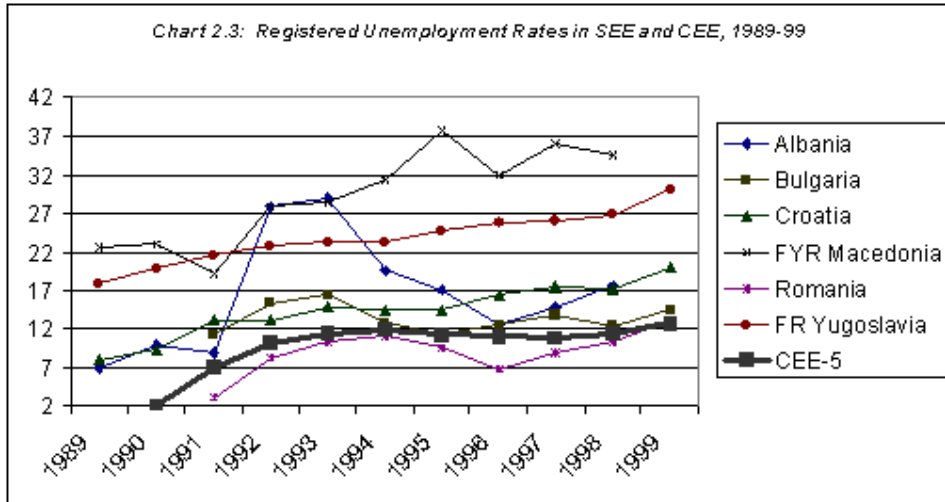
Nevertheless, it is unlikely that sustainable growth will materialize and a virtuous circle of increased prosperity and security can be established solely on the basis of national reform programs and intra-regional cooperation. As the Kosovo conflict has demonstrated, neighbouring countries bear significant economic and political costs, even if they are not directly involved in the conflict. The former isolation of FRY also adversely affected the region, as important trading and transport links are disrupted. Moreover, small closed economies do not have sufficient effective demand to sustain growth. Small states that are surrounded by instability and conflict will also be unattractive for investment. Several strategies argue that an approach focused on country-by-country reform and intra-regional integration is necessary, but not sufficient, to achieve peace, stability and prosperity in South Eastern Europe.

Data on poverty are more difficult to obtain and trends are therefore, difficult to discern. Despite these data difficulties, country-specific analyses reveal several consistent findings about the features of poverty in the CEE region. The limited reliable time series data that are available from individual countries show that **poverty is likely to have worsened dramatically** in recent years. (Box 1) In Bulgaria, the poverty survey found that the headcount rate increased by around seven times between 1995 and 1997, but there may be comparability issues arising from the dramatic increase in prices in 1997. In Romania, the poverty headcount increased fivefold between 1989 and 1998. The dramatic drop in the overall consumption level has been the main driver of increased poverty, with increased inequality a lesser but quite important factor, and probably increasing in importance as time passes.

The evidence also suggests that **inequality has increased significantly** in the region over the decade. It is important to note, however, that artificially compressed wages and more limited returns to education in the socialist period made some increase in inequality during transition highly likely.

The Gini coefficient—the most common inequality measure—has deteriorated significantly (e.g., Romania, Bulgaria and FYR Macedonia) and the same is true for other measures, such as the decile ratio, which focuses on the extremes of the

distribution: Inequality in Bulgaria increased sharply between 1995 and 1997, with the Gini rising from 27.1 to 31.4. In FYR Macedonia, the Gini rose from under 20 in 1993 to almost 30 in 1996. Romania experienced an increase in the Gini from 21 in 1989 to 30 in 1994. Recent work by the World Bank finds a Gini for expenditures of 30 in 1998. In Croatia, there also appears to have been a deterioration in inequality. The Gini for expenditures is estimated at 32 for 1998. Although no reliable time series data are available, Bosnia and Herzegovina would appear to have among the highest income inequality, but there are significant shortcomings in the data.



There is clearly a cause for concern if such trends continue. At the same time, SEE countries started with low inequality, at least some of the increase should be seen as a reflection of increasing returns to skills in the labor market. With the exception of BiH and Romania, even the higher percentages place the SEE countries in a normal range for OECD countries. However, this would soon cease to be the case if trends during the 1990s continue. In addition, if one takes CEE as the relevant comparator, inequality levels in SEE by the mid-1990s were already high, with a CEE average Gini for earnings of 30 in 1997. Finally, close attention needs to be paid to measures of poverty such as the decile ratio which focus on the extremes of the distribution, to monitor the share of income accruing at the very top of the distribution, as such glaring inequalities can become a source of social instability.

While the characteristic of CEE countries has been the development, it is important to examine human welfare and living standards in the SEE region from perspectives other than income and expenditures. One important factor that has adversely affected living standards in the SEE region is the **large population movements that**

have been the result of the conflicts in the former Yugoslav republics. This is a special feature of the SEE region during the transition period. Estimates indicate that some three million people have been displaced either temporarily as was the case during the Kosovo conflict or on a longer term basis, such as ethnic groups in the minority in particular areas, for example in Bosnia and Herzegovina, and Croatia. These displaced persons have been separated from their assets, e.g., housing and land, and from their sources of employment. In many cases, their assets were destroyed. The loss of assets, as well as the social and psychological impact of physical dislocation, has resulted in substantially lower living standards for significant numbers of people in the region.

Basic services and infrastructure, such as education, health, water supply, sanitation and roads, provide another measure of living standards. Diminished access or quality is likely to show up with a lag, as labour market outcomes deteriorate or the longer term impact of inadequate health care systems shows in morbidity and other health indicators. The distribution of services and infrastructure also matter, as they tend to be unequally distributed within the SEE countries, which adversely affects the poor.

The demographic structures of SEE countries are quite heterogeneous: a mix of typical CEE old age structures, alongside regional outliers like Albania and Kosovo, which have the largest share of young in their populations and the highest fertility rates in Europe. In terms of demographic dynamics, the SEE region has experienced substantial declines in total fertility rates (TFR) during the 1990s, a phenomenon which is typical of transition economies (see Chart 2.4). However, it is also important to note that declines in TFR were just as dramatic in the 1980s in most SEE countries. The trends suggest that fertility decline is at least partly the usual downward movement of such rates over time, and not solely a large fertility response to economic shock.

IV. Methodologies - a comparative analysis of current and potential ones.

The countries of CEE have started the transition with different initial conditions (initial income, urbanization, natural resource endowment, location, over-industrialization, black market rate for foreign exchange, years under central planning, etc). This means that the impacts of those initial conditions into structure, distortions and institutions give a higher importance on their role in the transition of CEE countries.

Berg, Borensztein, Sahay, Zettelmeyer (1999), introduced a extensive exploration of these issues in model specification. A very general initial model that included (i) macroeconomic variables (fiscal balance, inflation, and exchange rate regime); (ii) structural reforms (Liberalization index plus interaction term defined by multiplying the liberalization index by the share of private sector in the economy); (iii) initial conditions from de Melo and others; and (iv) other controls(average OECD growth, terms of trade and dummies for conflicts or war). The summary of this model is associated more with differences in policies rather than initial conditions. If this stands, it will be necessary to have it subject of further discussion. There is a strong evidence, (somehow in a brief way provided at the beginning of this paper), that developments in SEE has been driven by a different approach than the development in CEE.

While there are similar characteristics on the trends of macroeconomic variables, somehow similar characteristics of development of structural adjustments, there are relatively large divergencies on the initial conditions and dummied for conflicts.

In my opinion, while this model has been used efficiently for explaining the differences between CIS and CEE, the model still include some constraints for being fully used to measure the differences of CEE and SEE. Why is this important? Would it make sense to use different models for two parts of the same region? How should we compare the outcomes afterwards? All these are the questions that a lot of economists and policy makers are discussing and working on in frame of Stability Pact and it would be worthwhile to discuss this issue over here as the growth and inequality has been addressed at this regional inclusion.

Campos, and Coricelli (2000) in their study on Growth in Transition, what we know, what we don't and what we should" use the Liberalization Index¹⁰ providing for the correlation and significance of indicators as inflation (significant/negative impact on growth), institutional variables, such as rule of law and quality of bureaucracy

¹⁰The Liberalization Index is introduced for the first time in the paper of Melo, Denizer, Gleb and Tenev, 1997 and it is defined as a weighted average of policy reforms in three areas: internal markets, external markets, and privatization and private sector entry.

(significant/positive). Also some initial conditions are measured as the principal component.

Fischer, Sahay and Veight (1999), in their paper find that the Liberalization Index and stabilization variables (inflation and fiscal deficit) are closely associated with growth and they introduced “reform time” to adjust for different starting points of transition process in different countries.

Castanheira and Popov (1999) address the measurement/modeling issue again in their paper on political economy of growth in CEE. According it, the use of Liberalization Index was significant and instead of using the initial conditions, as referred to De Melo’s model (2001) on initial conditions they introduce the Index of Initial Distortion ($\text{defense expenditure/GDP} - 0.03 + \text{deviations in industrial structure and trade openness from normal level} + \text{share of trade with FSU} + \text{share of trade with CEE}/3$), the initial level of GDP per capita, the decline in government revenues/GDP and shadow economy/GDP. The question over here has to do with the initial conditions. What initial conditions matter and when do they matter? It is reasonable to expect that factors that do explain the initial output collapse are not entirely the same as those determining latter the economic performance. (i) Some developments such as the break down of payment system are expected to have a stronger impact on the initial stage of transition with the likelihood to dissipate over time. However there are other initial conditions that were having a impact on the performance of those countries longer in the early and also at a latter stage of transition. (ii) Initial distortion in the economy including factors such as absence of “market memory”- years under transition- or general development of national institutions as determined by length of prior experience as nationhood- are strongly associated with variations in performance (iii) while initial conditions have a greater impact on the initial collapse of output, the impacts of policies become stronger with the progress of transition even though their initial impact remains crucial.

According Selowsky and Martin (1998) the Liberalization Index is found to be highly significant and to exhibit significant differences between its initial and long-term impacts.

The industrial revolutionary forces are thought to have an impact on inequality can be offset or reinforced by demography, skills and globalization. (Williamson, NBER, 1997). The assessment of the role of globalization, via mass migrations and vice

versa show how demography can have a significant impact on GDP per capita growth.

Klaus Deininger and Lyn Squire have produced an inequality data base for a panel of countries from 1960s to the 1990. This has served as the basis of research for Higgins, Williamson, (NBER 1999), who by decomposing the sources of inequality into three central parts: the demographic or cohort size effect, the so-called Kuznets Curve or demand effect and the commitment to globalization or policy effects tend to analyze the impacts of globalization and inequality.

In having a more filled data base to include all CEE countries also for the period of time at least till 2000, studies for the region can be based on the application of such methodology, addressing in this way the complexity of issues and provide the right approach to base conclusions for the inequality.

We find so often in literature that the inequality before transition in CEE countries was at lower levels than the one today. There are good grounds to believe that such statement is fully appropriate. As Keane and Prasad (2000) and Garner and Terrel (1998) question whether the comparison of inequality indices before and after transition is meaningful. The point brought up here is that the pre transition figures on income distribution were often distorted and that comparisons are undermined by the use of surveys with differing methodologies, coverage, and objectives. As a result, they tended to be biased toward the average household and to exclude non standard households – in particular, marginal groups with a high probability of being poor. This, the distribution of income was usually truncated, leading to an underestimation of true income disparities. The analysis of the individual country's survey methodologies, definitions, and coverage confirms that comparing income distributions before and after the transition is indeed difficult.

However there are few issues that need to be addressed in the future such as the limits of GDP measurements in transition economies. GDP has some limitations as a welfare indicator for transition economies, particularly when comparing output performance to transition period. These limits fall into three groups: index number problems, omission of informal activities and effects of the changes on the composition of output.

The combination of methodologies bring a far better results in trying to measure the level of performance of CEE countries during the transition, however the large number of indicators for measuring the initial conditions, their variability and interlink with each other, makes this approach very useful for statistical power, but makes it more difficult to determine what initial conditions really matter (Transition Report, WB).

This first decade has brought several models for CEE development and as the stages of development within region are facing new trends further development of methodologies would be required to measure next development and further more provide for the links of growth with inequality through new and old variables. The measurement of short term and long term impacts of transition in CEE countries on globalisation and equity, based on as many variables, as the development of this region does require it is not an easy task. A lot of efforts are being repaid as the model gets more often used and referred to (such as Liberalization Index), while the others either with positive/negative impacts still do lay basis for further development of models and methodologies to measure growth and development.

V. Some comments for the best approach

A first temptation goes to attribute increasing inequality to reforms, liberalization, and globalization. This is an attitude that needs to be address more frequently at all levels in our societies. And the best way to approach it, it is to openly and widely discuss the causes of huge increase in inequality, as the first step to address those causes with proper policies and adjustment to bridge the gap of inequality within each country of the region, across countries, as well as the gap of region with other regions of world.

Economist Paul Krugman, while commenting on violent manifestations that tried to disrupt several world summits in the last years, says that “anyone who thinks that the answer to world poverty is simple outrage against global trade has no head or chooses not to use it”

Globalisation has expanded both opportunities and risks. It brought significant trade expansion, international investment, and technological advances, but the gains from global integration have been unevenly distributed accros and within nations.

(Solimano,WB). The quickening pace of globalisation has generated also social tensions that development policies have failed to tackle. The underlying assumption has been that once economic fundamentals are corrected, social issues will resolve themselves of their own accord, and that well-functioning markets will not just create wealth, but will also resolve problems of human welfare.

Actual development with a growing numbers of unemployed, uneducated and poorer people does reveal that not all of that is true. Millions of people are poorer than ever before, with growing indices of inequality. The advocates of adjustment had hoped for a trade-off: long term economic gain in return for short-term social costs. United Nations Research Institute in Social Development (UNRISD) explains: when the market goes too far in dominating social and political outcomes, the opportunities for and rewards of globalisation spread unequally and inequitably-concentrated power and wealth in a select group of people, nations, corporations, marginalizing the others. Globalisation in this era seeks to promote economic efficiency, generate growth and yield profits. But it fails on the goals of equity, poverty eradiction and enhanced human security. Economic growth is an important input for human development if the expansion of private income is equitable, and only if growth generates public provisioning that is invested in human development- in schools and health centers rather than arms. Reduced public spending weakens institutions of redistribution-leading to inequalities.

We face the challenge of setting up rules and institutions for stronger governance – local, national, regional and global –that put the health and well-being of each individual, community and nation at the centre.

Globalisation expands the opportunities for unprecedented human advance for some, but shrinks those opportunities for others and erodes human security. It is integrated economies, culture and governance, but it is fragmenting societies and ignoring the goals of equity, poverty eradiction and human development.

At this stage addressing and trying to overcome poverty is/must be seem as the main ethical and political challenge. Experience shows that the most appropriate programmes are long term initiatives of a comprehensive/multi-dimensional and multi-sectoral nature, aimed at breaking down the mechanisms, that perpetuate poverty from one generation to another.

Development patterns need to be oriented to make equity – that is, the reduction of social inequality – the central pillar. Education and employment present two master keys for development. Education has an impact on equity, development and citizenship, and therefore needs to be assigned top priority in terms of social policy and public spending. AT the same time a job-creation process needs to be put in place. (Gasman,Hart, 2001)

According Solisman, the attention need to be focused on harmonizing national and global growth oriented policies in a way that they reduce the volatility and promote social equity.

According Yusuf, a comprehensive approach to globalisation, managed and abetted by good policies, can magnify the effects of growth-promoting measures. As he finds out, (i) returns from investment in skills are much greater in a more technologically advanced and integrated economy., (ii) trade, by enlarging markets, reinforces those gains, and the option to migrate further augments the value of skills. The growing worldwide gap in income between skilled and unskilled workers suggests how much more fruitful skills are under globalisation; (iii) opened combined with neutral domestic policies and the scaling back of regulatory constraints on domestic business activities, can unleash the full force of agglomeration economies and networking externalities, allowing industrial clusters to emerge in regions.

A sound development strategy that produces sustained growth over the medium-to-long term is a far more effective way of achieving integration with the world economy than freeing up trade and investment and waiting for it to work its magic. (D. Rodrik,2001)

VI. Conclusions

Today we have more evidence and data on the transition of CEE countries. The variability of growth across countries has been intensified, while poverty and income inequality in some of those countries have increased at the levels not foreseen earlier. It is widely recognized that while the first years of transition are critical, decisive and sustained reforms are important for recovery growth, however all those should be accompanied by social policies design to protect the most vulnerable groups until growth takes hold.

The up to now experience has shown that the need to create institutions in support of open market economies, a lot of emphasis should be given the investment in people as a key to growth. Beyond output decline in the first years of transition, the intensity of reform policies and degree of openness, and despite differences in the trends of economic growth from one country to another one within the region, important new lessons highlight some key tradeoffs facing CEE countries. These lessons can and should be translated into priorities for policy. A lot of efforts and studies have been undertaken to measure the type of policies. **How can all these be achieved it is a matter of discussion and research.**

Annex

Table 1: Economic Performance, 1989-1998		
	<i>GDP gr. Ann. Aver. 1990-1998 (%)</i>	<i>1998 GDP as % of 1989 GDP^c</i>

Albania	-0.8	86
Bosnia and Herzegovina	29.9 ^d	n.a.
Bulgaria	-4.0	66
Croatia	-2.4	78
FR Yugoslavia	n.a.	n.a.
FYR Macedonia	-1.2	72
Romania	-2.9	76
SEE-6 Av. ^b	-1.2	75 ^c
CEE-5 Av. ^{a b}	0.8	107
<p>a. Countries include: Czech Republic, Hungary, Poland, Slovak Republic, Slovenia.</p> <p>b. Weighted by GNP; excludes FRY.</p> <p>c. Excludes Bosnia-Herzegovina.</p> <p>d. 1995-99 only.</p> <p>e. GDP estimates converted at PPP exchange rates were used to calculate the index.</p> <p><i>Source:</i> World Bank staff estimates; EBRD Transition Report, 1999.</p>		

Table 2: SEE Region—Aggregate Savings-Investment Balance (as percentage of GDP)					
	Actual				Estimate
	1995	1996	1997	1998	1999
SEE -6- Average ^a					
Gross Domestic investment	20.5	22.0	22.9	20.1	18.3
O/w Gov't Inv.	4.2	5.3	4.9	4.7	3.8
Gross national savings	15.0	15.2	15.0	12.1	11.8
Government savings	..	-0.2	1.9	2.3	2.2
Non government savings	..	15.3	13.1	9.8	9.6
Foreign savings	5.5	6.8	7.9	7.9	6.4
CEE -5- Average ^b					
Gross Domestic investment	23.9	26.4	28.0	28.6	28.3
O/w Gov't Inv.	..	..	..	..	..
Gross national savings	24.9	23.2	24.3	24.5	23.4
Government savings	0.4	0.7	0.3	0.6	..
Non government savings	24.5	22.5	24.0	23.9	..
Foreign savings	-1.0	3.2	3.7	4.1	4.9
<p>a. This is an average of Albania, BiH, Bulgaria, Croatia, FYR Macedonia and Romania. See Annex Table 2.8 for weights.</p> <p>b. The weights are: Czech Republic 0.180; Hungary 0.159; Poland 0.524; Slovak Republic 0.069; Slovenia 0.068.</p> <p>Source: World Bank staff estimates; country sources.</p>					

Table 3: Summary of Social Indicators for SEE, 1997			
Country	HDI score and ranking 1997 ^b	IMR (1997 unless stated)	Life expectancy at birth 1997
Albania ^a	0.699 / 100 th	25.8	72.8
Bosnia and Herzegovina ^c	N/A	12.7	72.3
Bulgaria	0.758 / 63 rd	17.5	71.1
Croatia	0.773 / 55 th	8.2	72.6
FYROM	0.749 / 73 rd	15.7	73.1
FY Yugoslavia ^c	N/A	14.3	72.3
Romania	0.752 / 68 th	22.0	69.6
<p>Note: (a) IMR for Albania is 1996; (b) HDI is composite index of three components: life expectancy at birth; educational attainment (as measured by adult literacy and enrollment rates); and real per capita GDP (in \$PPP); (c) FRY life expectancy 1996, and BiH 1995.</p> <p>Source: WB ECA Social Protection Strategy (1999 draft); UNICEF Transmonee report (1999); UNDP Human Security in SEE (1999).</p>			

Table 4: Infant Mortality Rate (per thousand live births)				Table 2.5: Under-five Mortality (per thousand live births)			
	1990	1997	Annual Change (%)		1990	1997	Annual Change (%)
Albania	28.3	25.8	-2	Albania ^a	41.5	30.6	-4
Bosnia and Herzegovina	15.3	12.7	-3	Bosnia and Herzegovina	17.2	n.a.	n.a.
Bulgaria	14.8	17.5	+2	Bulgaria	18.7	23.5	+3
Croatia	10.7	8.2	-4	Croatia	12.5	9.5	-4
FR Yugoslavia	22.8	14.3	-6	FR Yugoslavia	26.2	16.5	-6
FYROM	22.8	15.7	-5	FYROM	34.9	18.5	-9
Romania	26.9	22.0	-3	Romania	35.7	26.4	-4
SEE-6 average	22.3	18.2	-3	SEE-6 average ^b	29.3	22.3	-4
CEE-5 average	16.4	9.2	-8	CEE-5 average	18.8	11.0	-7
Source: MONEE database.				a. No data for 1997; 1996 rate is used for 1997 b. Excludes Bosnia and Herzegovina; see (a) above. Source: MONEE database.			

Box 1: Characteristics of Poverty in the SEE Region

There are strong regional variations in poverty levels in all countries: between upland/mountainous areas and the coastal plain in Albania; between Republika Srpska (RS) and the Federation in BiH (and within each entity); and between the North and the South in Romania. Differentials in terms of consumption are reinforced by variable access to quality social services, increasing the likelihood of geographical areas of persistent poverty.

Rural poverty is worse than urban in all countries. Rural poverty rates were: 80 percent higher in Romania (1994); 23 percent higher in Bulgaria (1997); around five times higher in rural Albania than non-Tirana urban areas (1996); and substantially higher in Croatia (1998). In addition, the depth of poverty (i.e., how far the average poor person falls below the poverty line) and the severity of poverty (which takes account of inequality amongst the poor) are significantly worse in rural areas.

The educational attainment level of the household head is strongly correlated with poverty, with university qualifications making a household highly unlikely to be poor, and households headed by those with less than secondary education having far higher than average poverty rates. Those with less than secondary education account for around 80 percent of all poor in FYR Macedonia and Albania, and over 40 percent of the poor in BiH.

Households with unemployed heads have amongst the highest poverty rates.

In spite of the high poverty rates among the unemployed, households with working heads make up a substantial share of the total poor, due to their large share in the overall population. For example in Albania, around 70 percent of the poor work. In Romania in 1994, around 70 percent of the poor were either working or pensioners.

Larger households are poorer. In Albania, the poor have larger households, and an average of 3.4 children against the population average of 1.5 children. In FYR Macedonia, the number of children in a household is positively correlated with poverty, with households with three or more children having almost double the national poverty rate and constituting almost half of the total number of poor people. In Bulgaria, poverty rates are also worse for large households, and children are more at risk of poverty than the elderly. The one country where this does not appear to be the case is Croatia, where the elderly—who live in smaller than average households—dominate amongst the poor. Preliminary results from BiH also suggest this same pattern; and

The Roma stand out as very poor and persistently poor, though this is difficult to quantify in due to restrictions on ethnicity questions in some surveys. Roma households typically display several characteristics associated with high poverty rates, including high birth rates, low education attainment (including substantial illiteracy), and high unemployment. In Bulgaria, Roma poverty rates were around 85 percent, or almost two and a half times the national

average. This is also consistent with findings from CEE, e.g., Hungary.

Source: These conclusions are based on a series of World Bank studies: Albania: Growing Out of Poverty (1996), and Albania: Poverty and Social Welfare (Rashid et al., 1999); Poverty in Bosnia and Herzegovina: the Legacy of War (Bisogno, draft mimeo, WB, 1999); Bulgaria: Poverty During the Transition (WB, 1999); Croatia: Economic Vulnerability and Social Welfare Study, Issues Paper (mimeo, WB, 1999); FYR of Macedonia: Focusing on the Poor (two vols., WB, 1999); and Romania: Poverty and Social Policy (two vols., WB 1997).