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Political and Economic Institutions, Growth and Poverty –  
Experience of Transition Countries

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# **Political and Economic Institutions, Growth and Poverty – Experience of Transition Countries**

## **1. Introduction**

The role of good governance, transparency and accountability of governments in supporting economic growth is widely and increasingly recognized by the world community in recent years [see e.g. WDR, 2002]. Experience of the countries of Central and Eastern Europe and the former Soviet Union brought additional evidence in favor of a hypothesis that good political and economic institutions do matter a lot. These countries had to overcome the heritage of communist ideology, authoritarian regimes and centrally planned economy in the relatively short time.

The achieved results of transition process are uneven. Simplifying somewhat, we can distinguish two broad groups of transition countries, according to their progress in economic and political reforms. The first one, which may be called as the “leading reformers” group consists of middle-income countries of democratic capitalism of the Central Europe and Baltic region (CEB). The second group of less advanced reformers includes mainly lower- and lower-middle-income countries of the Commonwealth of Independent States (CIS) where both capitalism and democracy are still immature and sometimes heavily distorted.

During the first decade of transition, the first group represented a much better economic and social record in any respect than the second one. Trying to find causes of such differentiation one must inevitably come, sooner or later, to the role of political and economic institutions such as constitutional division of power, electoral systems, political parties, free mass-media, civil society organizations, rule of law, independent and efficient judiciary, central bank independence and others. Some of these institutional factors will be analyzed in this paper, taking into consideration their impact on economic and social performance of transition countries.

The paper is organized as follows: Section 2 presents the brief characteristics of the overall transition results in the economic and social sphere. These results give a ground for categorization of transition countries according to the above mentioned lines. Section 3 shows interdependence between economic and political reforms and role of political factors in

determining the results of economic transition. Section 4 contains a more in-depth analysis of the political models dominating in countries of the analyzed region and discusses the role of individual political institutions such as constitutional division of power, electoral law, and political parties. Section 5 is devoted to judiciary branch of government and rule of law. Section 6 deals with the role of stable money and institutional solutions guaranteeing this stability. Section 7 describes the transmission mechanism through which flawed political and economic institutions influence the economic and social performance. We try to show how people can be deprived of effects of economic growth, possibility to control their government, and participate in the globalization processes. Section 8 presents general conclusions.

## 2. Ten Years of Transition: Winners and Losers

Most of countries of Central and Eastern Europe started their transition to democratic capitalism in 1989-1990 while the beginning of the similar process in the former Soviet Union happened at least two years later. Major packages of macroeconomic stabilization and complex liberalization of the economy was launched at the end of 1989 and beginning of 1990 in Poland and former Yugoslavia, at the beginning of 1991 by former Czechoslovakia and Bulgaria, at the end of 1991 by Slovenia (one of successors of the former Yugoslavia), in 1992 by Albania, Estonia, Latvia, Lithuania and Russia, at the end of 1993 by Croatia, Macedonia, Moldova, and Kyrgyzstan, in 1994 - 1995 by Kazakhstan, Armenia, Georgia and Azerbaijan. Hungary being more advanced in building market mechanism in 1980s and having moderate level of inflation followed policies of more gradual changes. The same strategy was followed by Romania but with much worse results. Some countries such as Belarus, Turkmenistan, and Uzbekistan never started a serious full-scale transition to market economy.

The results of the first decade of economic transition are very uneven and are distributed according to a sub-regional pattern. Generally, one can distinguish two basic sub-regional groups of countries: (i) Central Europe and Baltic (CEB) region, and (ii) CIS countries. In addition, few Balkan countries can be classified as an intermediary category. However, the latter has a tendency to disappear as more and more countries from the Balkan region enter the pace of fast reforms and European integration.

The CEB group can be characterized as the 'leading reformers' or as middle-income countries of democratic capitalism being close to the EU membership. They manage to achieve:

- Sustainable growth after relatively short period of transformation output decline. **Figure 2.1** shows the growth record of individual transition economies and **Figure 2.2** compares growth performance of two analyzed sub-regions. This discrepancy was slightly diminished in years 2000-2001 when economic growth resumed (see below) in most CIS countries and, on the contrary, some CEB countries experience a certain slowdown of their growth rates.
- Low and stable inflation level. **Figure 2.3** demonstrates that all CEB countries apart from Romania are already below or very close to 10% annual inflation threshold considered as the low-inflation zone [see Dabrowski et al., 1999].
- Moderate or high monetization level: in most cases in the range of 25 to 45%, with Czech Republic and Slovakia representing level above 70%.

- Low-to-moderate level of fiscal deficit, which could be financed, in most cases, on a sustainable basis. However, CEB countries represent a very high level of fiscal redistribution (premature post-communist 'welfare state') well exceeding 40% of GDP.
- Serious progress in building the basic market institutions. **Figure 2.4** present a more detail picture of this sphere.
- Liberal entrepreneurial climate (particularly for small and medium size private firms – see **Figure 2.5**) and attract significant inflow of foreign investments (see **Figure 2.6**)
- Relatively well-developed, healthy and modern financial sector
- Trade/economic integration with the EU and clear perspectives of the EU membership

As we said above, Balkan countries are less advanced in transition process than the CEB group but the perspective of the EU integration (Bulgaria and Romania are already on the candidate list, Croatia and Macedonia may join this list in not so distant future) and acceleration of reform process during last few years make them more and more close to 'transition leaders' than to the CIS group.

The latter may be labeled as the 'less advanced reformers'. Their members can be characterized as mainly lower- and lower-middle-income countries representing distorted capitalist model and generally highly imperfect democracy. Their progress in economic and institutional transition can be characterized by:

- Long lasting and deep GDP decline and late take off. However, years 2000 and (probably) 2001 changed somewhat this picture (see **Figure 2.7**) but one must remember about the role played by high oil and other commodities prices, at least in the case of Turkmenistan, Russia, Kazakhstan, Azerbaijan and Uzbekistan.
- Moderate or low inflation level. This does not look, however, as sustainable achievement in most cases what was confirmed by the series of 1998-1999 financial crises. In addition, not all countries of this group managed to achieve even this moderate result. The latter relates to Belarus, Turkmenistan, Uzbekistan, and Tadjikistan.
- Low or very low monetization level what additionally confirms a hypothesis about fragility of achieved low inflation.
- Chronic fiscal crisis caused mainly by excessive government commitment in a social sphere, continuation of direct and indirect subsidization of enterprises, low level of tax collection and other similar factors. Although in 2000-2001 current fiscal balances of Russia, Kazakhstan and Ukraine improved but the key question is how much this positive outcome was influenced by high oil and other commodities prices, and to what extent can be attributed to real improvement in structural policies and fiscal management. In addition, Russia and Ukraine did not yet overcome the negative consequences of 1998-1999 debt crises and continue to have a closed access to the international financial markets.
- Weakness and immaturity of basic market institutions what is illustrated by **Figure 2.4**.

- Serious impediments to business activity (the so-called 'red tape') effecting in serious underdevelopment of officially registered small and medium size enterprises (see **Figure 2.5**) and minimal inflow of foreign investments (see **Figure 2.6**). On the contrary, many CIS countries (particularly those being commodity exporters) suffer a substantial capital outflow.
- Underdeveloped and fragile financial sectors suffering numerous irregularities and pathologies such as stripping and looting bank and enterprise assets, abusing minority shareholders rights, connected lending, excessively risky speculations on a foreign exchange market and corruption.
- Dominance of trade and economic relations inside the CIS what not necessarily should be considered as a negative phenomenon under condition that trade regime is open, transparent and fully market-based. Unfortunately, this is not always the case in CIS countries, which continue to have many tariff and non-tariff barriers. Their trade regulations are unstable and non-transparent. Many trade transactions have a non-market character, i.e. either result from government decisions, or are conducted on barter basis (reflecting soft-budget constraints in the enterprise sector). Trade and economic relation with the EU have rather marginal character (apart from Russia) and the European integration process did not go beyond the initial stage of implementation of the Partnership and Cooperation Agreements (PCA).

The CIS group, in spite of having some common historical and contemporary characteristics, remains heterogeneous. At least three countries – Belarus, Turkmenistan and Uzbekistan – can be considered as very little advanced in transition process and, in fact, trying to preserve significant components of the command system.

The reported differentiation involves not only the economic but also the social dimension. As **Figure 2.8** demonstrates, Gini coefficient increased in all post-communist countries during transition what should be considered as a 'normal' effect of departing from communist egalitarianism ('*uravnilovka*') towards a market determined income structure. However, this increase was, on average, much higher, among less advanced reformers than among the transition leaders.

Why the results of transition process are so uneven? One of the possible answers refers to history and resulting differences in starting conditions of the transition process.

Certainly, the history and starting point to democratic and market transformation were much more complicated in the former Soviet Union than in the rest of the former communist block, particularly in countries earlier experimenting with some kind of 'socialist market' economy such as the former Yugoslavia, Hungary and Poland. Shorter period of communist regime in the latter, their greater openness to the West, greater enterprise autonomy and some enclaves of the private sector tolerated under communism did matter. On the other hand, 'socialist industrialization' in the former USSR lasted much longer, was more intensive and more subordinated to the military needs, creating greater structural distortions, particularly in Russia, Ukraine and Belarus. However, the experience of Baltic republics, being a part of the USSR and considered now as the most successful reformers (particularly Estonia)<sup>1</sup> puts the

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<sup>1</sup> One must remember, however, that Baltic countries lived under communist regime only 45 years (as in the case of Central and Eastern Europe and Moldova) and not 70 years as the rest of the USSR. Besides, the pain connected with initial phase of transition (measured by the scale of output decline) occurred to be greater in Baltic countries than in Poland, Hungary or Slovenia.

hypothesis about the key importance of the starting conditions under a serious question. Obviously, the latter influenced the size of initial output decline and overall costs of the first stage of transition but the transition results depended rather on the ability to carry out the comprehensive and consistent reform package in fast and consequent way [see WEO, 2000, p. 159-164].

Thus, the importance of the initial economic conditions has been limited and decreasing over time. The same cannot be necessarily told about importance of the initial political conditions. As we show below they played a quite important role in determining the successful or unsuccessful course of reforms.

Another possible explanation relates to geography – proximity to biggest markets, access to seashore, distance from Brussels, etc. While the role of this factor seems to be obvious as it determines, at least to some extent, geographic structure of trade, and chances for participation in the European integration process (see next section) it should not be overestimated. Even a very superficial look into the above-referred transition effects show many cases do not fit well with this stereotype, particularly inside the less advanced reformers group. This relates, for example, to Belarus, excellently located on the East-West transition routes (similarly to Baltic countries) but being one of the transition outsiders comparing to much worse located Kyrgyzstan, Kazakhstan or Caucasus countries performing much better in terms of reform progress.

The above said means that such factors as the pace of reform, its comprehensiveness, consistency, proper sequencing, and consequence in implementation do matter a lot. The very hot, and sometimes emotional, intellectual and political debate on shock therapy versus gradualism erupted several times in the previous decade<sup>2</sup>, most recently provoked by two Stiglitz [1999a, 1999 b] papers<sup>3</sup>. In spite of this controversy, there is very little doubts that fast, radical and comprehensive reforms in economic and institutional sphere helped to achieve better transition results than gradual and compromise ones [for deeper empirical evidence see WEO, 2000; EBRD, 1999; EBRD, 2000; World Bank, 2000].

Generally speaking, fast reforms shorten the period of transitory vacuum when the previous administrative mobilization and controlling mechanisms do not work any longer (in most cases they spontaneously collapsed in the last stage of a communist regime) and market discipline does not influence enough an enterprise behavior yet. In fact, this argument relates to both macroeconomic and microeconomic sphere.

The speed and consistency of transition also influence the expectations. Their role in monetary policy and fighting inflation is obvious but cannot be ignored on the microeconomic level too. Very often, economic agents (particularly state owned or newly privatized firms) do not believe in the reform success and real change in rules of game in the near perspective. This may be well rooted in the past experience of partial and unsuccessful reform attempts. Hence, the radical package gives chance to influence microeconomic behavior and break up accumulated inertia much faster than in the case of gradual changes.

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<sup>2</sup> For the early and mid-decade debate on the speed of transition and importance of the early stabilization and liberalization see, among others, Fischer and Gelb [1991]; Nuti and Portes [1993]; Aslund [1994]; Balcerowicz [1994]; Balcerowicz and Gelb [1995]; de Melo, Denizer and Gelb [1996]; Dabrowski [1996]; Aslund, Boone, and Johnson [1996].

<sup>3</sup> Stiglitz [1999a, 1999b] papers questioning the rationale of fast transition, particularly in the context of Russian and Chinese experience were challenged, among others, by Dabrowski, Gomulka and Rostowski [2001].

In addition, there are important arguments related to the complicated political economy of transition. Obviously, most of necessary reform steps in the economic sphere are considered as socially painful, at least in a short term. This relates to fighting inflation/hyperinflation, liberalizing domestic prices, exchange rate and foreign trade, cutting widespread subsidies, imposing hard budget constraints *vis a vis* state enterprises and privatization of the latter. Usually, in 'normal' circumstances, these kinds of steps are highly unpopular and meet the strong resistance of various groups of special interests. But in the onset of transition when the old regime collapsed many of these groups were in disarray, not able to resist changes, and new lobbyist groups did not manage to emerge so quickly. On the other hand, political enthusiasm coming from the collapse of communism, gaining the political freedom and independence (full independence in the case of former Soviet satellites) made societies more patient and ready to bear the costs of changes, even if they did not understand fully their nature.

This special window of opportunity in the beginning of transition called by Leszek Balcerowicz as the 'period of extraordinary politics' [Balcerowicz, 1994] could not last indefinitely. Thus, the crucial problem was how the individual countries used this chance. They could decide either on fast reform track and try to carry out the critical mass of market reforms (in order to make them irreversible when political situation will deteriorate), or they could move slower but the latter usually involved the necessity to build some palliative solutions helping to avoid the above mentioned systemic vacuum. So the significant part of political energy should have been spent on arranging the prolonged transition period instead of just trying to concentrate on final model. Moreover, considered as temporary the compromise/palliative regimes became long living as the newly formed groups of interests started to defend them. This kind of additional political economy costs of gradual liberalization (reform) has been also observed in developing countries.

### **3. Politics Behind Economics: How Political Factors Determine Economic Performance?**

The above referred observations and arguments on superiority of fast reforms in comparison with the slow ones leads us to another important question. Why did some countries manage to choose fast, comprehensive and consequent reform track (even being handicapped with bad starting conditions as in the case of Baltic states) and some others could not do this? In order to answer this question we must come back to the concept of a 'period of extraordinary politics' and answer two additional questions: did all the post-communist countries enjoy such a political window of opportunity and could they use them effectively?

Analyzing political developments in very general terms (a more in-depth analysis of political systems is presented in the next section) it is easy to find that this special political window of opportunity was not observed in all the countries under consideration in the initial stage of transition. It was virtually absent in the Central Asia, Belarus, and Serbia, and rather weak in Romania, Ukraine and Russia.

The absence or shortness and weakness of the 'period of extraordinary politics' in a significant part of the former Soviet Union can be explained by a number of factors. First, anti-communist and pro-democratic tendencies in the former USSR were less popular than in some Central European countries such as Poland or Hungary, despite all the achievements of the *glasnost* ('openness') and *perestroika* ('reconstruction') period. They could be observed mainly in the biggest cities and inside the intellectual elite.



Second, the 'independence' factor so powerful in many former communist countries, including some republics of the former USSR (Baltic and Caucasus ones, Moldova) was virtually non-existent in Russia, Belarus and most of the Central Asia, and not strong enough in Ukraine. On the contrary, many people and significant part of political elite in Russia (but partly also in some other Soviet republics) were upset by the loss of the Soviet empire (in the wide sense, including the former satellite countries of Central and Eastern Europe) and attributed this unfortunate (in their minds) event to democratic and market reforms<sup>4</sup> initiated by Mikhail Gorbachev and continued by Boris Yeltsin and 'young reformers' in Russia from the end of 1991.

So the 'patriotism' in Russian politics of the last decade was strongly associated with the opposition to market oriented reforms. Only very recently, advocates of strong Russian state and its continuing super-power status start to understand that modernization of the economy based on some market principles constitutes one of the preconditions of building the international position of their country.

Third, the absence of the 'European factor' in CIS countries must be also taken into account. Unlike their Central European, Baltic or even Balkan neighbors, societies and political elite of the CIS countries were not strongly interested in a political and economic integration with the Western Europe what politically helped the former in conducting market oriented reforms<sup>5</sup>. Neither this kind of geopolitical perspective was ever offered to CIS countries by the EU.

In order to use effectively the initial political window of opportunity political elites of individual countries had to define the right priorities, to find a good professional team to carry out economic reforms (what was not easy at that time) and provide this team with the necessary political backing. Unfortunately some countries, which enjoyed the period of 'extra-ordinary' politics (usually having the form of 'independence enthusiasm'), waste the energy either for ethnic conflicts (examples of Georgia, Armenia, Azerbaijan, Moldova, and Croatia) or for populist policies (Ukraine; Slovakia after gaining independence). Among countries where political environment was much more difficult, Russia built in the end of 1991 the strong economic team (with Yegor Gaidar as its leader) and tried to carry out a quite ambitious reform program. However, the political window of opportunity was too limited to enable this country to join the group of leading reformers.

The history of transition did not finish with the period immediately following the collapse of communism. Countries, which lost the first chance (or did not experience this chance to sufficient extent) had to wait for the next window of opportunities in order to catch up frontrunners. The latter had to continue structural and institutional changes, as the transition agenda was too difficult and complicated to be completed in few years even by the most radical reformers. However, each time the same questions came back: which factors could create the political window for conducting difficult reforms and the ability of political elite to use this window in effective way.

This leads us to the issue of political reform and its interrelation with the economic transition.

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<sup>4</sup> A somewhat similar situation could be observed in Serbia.

<sup>5</sup> This relates particularly to the later stage of transition when the first 'revolutionary' enthusiasm was over and the perspective of the EU accession played a role of powerful factor stimulating further reforms, especially in the institutional and legal sphere.

Comparing the EBRD transition indicators (see **Figure 2.4**) with the Freedom House political and civil liberties index (see **Figure 3.1**) we can establish a very strong correlation between them as illustrated in **Figure 3.2**. The first conclusion, which can be drawn, is the almost complete lack of empirical evidence in favor of 'pinochetism' (i.e. authoritarian regime implementing radical market reforms), the idea being quite popular, for example, in the part of a Russian liberal elite. In fact, we can find only one example of such a (rather temporary) phenomenon, i.e., Kazakhstan in 1995-1996 (what is partly reflected in **Figure 3.2**, where Kazakhstan is located well below 45-degree axis).

**Figure 3.2** does not explain, however, how democracy and economic reforms are mutually related (in terms of causality). According to EBRD [1999, Box 5.3, p.113] the influence is going in both directions, i.e. democracy and the market economy are mutually reinforcing. On the one hand, democracy increases transparency of government actions, constraints opportunity of rent seeking and capturing the state institutions, and give chance for long-term guarantee and stability of property rights. On the other hand, market system helps to develop civil society institutions, a broad middle class, and culture of cooperation based on self-interest what reinforce democracy.

The above EBRD observations are correct but do not fully capture the specifics of transition process, particularly of its initial stage. As we mentioned earlier, economic transition was a quite complicated exercise with far going changes in all basic rules of economic and social life. The old rules were defended by the old communist elite unless this elite came to conclusion that its own interest called for changes in status quo (but even in such a case changes had a limited and rather inconsequent character). Thus, starting real transition and its consequent and efficient continuation required far-going political changes [see Aslund, 2002]. The above-discussed concept of the period of 'extra-ordinary' politics also corresponds to this finding. So, we think that these are political developments and political reforms, which seriously influence the course of economic transition in individual countries although we do not reject the importance of opposite relation (i.e. success of economic reforms helps to consolidate democracy).

#### **4. Scenarios of political changes and their outcomes**

Post-communist countries, apart from conducting market reforms, have to build reliable institutions and procedures of modern politics. These institutions should be able to cope with enormous cost of transition and, as we have showed earlier, progress in this sphere has an enormous importance for the course of economic reforms and their social effects. An important part of this objective is to create proper relationships between society and institutions of state power through building the effective channels of representation and balancing various interests.

After the old system had fallen, almost all the post-communist countries declared their intention to build democracy and market economy. After ten years, however, only a part of them can be perceived as consolidated democracies (see **Figure 3.1**). What factors determine the success or failure of democratization processes?

Any comparative analysis of emerging political system is not an easy undertaking because countries in transition differ in their size, level of economic and social development, and historical background. To simplify this task we can concentrate on the institutional choices made by political actors in the initial phase of transition, in order to show their

implications in terms of promoting democracy, rule of law, market economy, and civic society on further stages of change. Institutional choices are depicted as the strategies, by which elite actors seek to gain access to the power resources of the state or to deny access to the others [Easter 1999, p. 188]<sup>6</sup>. We are convinced that the origin and nature of the political elite as it emerged from the breakdown phase of communism best explains its preferences for model of constitutional regime and their ability to create a favorable framework for social participation in decision-making process.

Making elite the culprit of the analysis, we should underline that the outcome cannot be perceived as a result of wise or wrong policy choices *per se*. The opposite is true. On the one hand, institutional choices made by political actors reflect broader context, such as a historical heritage, legacies of communist rule and a degree of elite's own integrity (totalitarian, patrimonial, national-accommodative, bureaucratic-authoritative), intensity of political and social conflicts during that period and the scope of economic reform undertaken in the end of the old regime in particular country. All these factors shaped the nature of the elite. On the other hand, institutional choices became, to a high degree, a result of spontaneous political process reflecting competition of the old elite and strength of the new actors as well as the results of elections and other contextual factors.

On the eve on transition three different structures of the political elite can be identified - **dispersed, reformed** and **consolidated**. Stemming from this typology three different trajectories of development can be conceptualized respectively: pathway towards **consolidated democracies, transitional regimes** or **consolidated autocracies** [Karatnycky et al., 2000; 2001]. Within these framework a stress will be laid on such crucial factors as participation, constitutional models, electoral law, and building a system of political parties.

Three components of institutional design of post-communist countries, reinforcing each other, have had a great impact on the ultimate outcome of the process: electoral law, regulations on political parties and constitutional model of the state.

#### **4.1. CEB model: towards a consolidated democracy and broad participation.**

If the communist elite experienced internal fragmentation and the new non-totalitarian actors were (relatively) strong, all actors agreed to follow equal rules of political game. In few cases the new rules of competition were formalized in result of intensive negotiation between representatives of both elites. The experience of Round Table Talks in Poland, which was followed by Hungary and Bulgaria, can serve as the best example here. In many other East European countries mass demonstrations, elections, boycotts and other forms of activity of civil society brought the momentum of change during the last period of communism. These actions dislodged old regime elite from the position in power (Czechoslovakia, Romania, Baltic republics, and Slovenia) and dispersed them in different political directions. It provided an opportunity for new political actors to influence the process of institutional change, to a greater extent than in the rest of the former Soviet Union or the former Yugoslavia<sup>7</sup>.

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<sup>6</sup> This section of the report has drawn from the following studies: Ester [1999], Karatnycky et al. [2000; 2001], and Kitchelt et al [1999].

<sup>7</sup> A similar spontaneous process of change that had begun in some other Soviet republics was marred by open confrontation between old and new elite (Georgia and Azerbaijan 1991-1992, Armenia in 1998), civil wars (Tajikistan in 1992-1997) or ethnic and territorial disputes (Moldova 1992, Croatia and Yugoslavia for the long period). The change of power that was not of normal political process but the result of instability and conflicts pull these countries out of the first trajectory toward the second or third model.

#### 4.1.1. Electoral law

Electoral law adopted by most CEB countries tends to promote the idea of representation rather than of creating a stable political power. First non-communist elections were predominantly held under the proportional systems of voting without any legal thresholds (Poland, Bulgaria) and accompanied by rather proportional method of distribution of the parliamentary seats (the Hare-Nemeyer or Saint-Lague methods). Only a few countries (Czechoslovakia, Hungary, and Lithuania) introduced moderate thresholds (3%-4%) for the party lists. Two of them (Hungary and Lithuania) adopted mixed electoral system for the first elections. In many countries the requirements concerning the minimal turnout were eliminated and attempts were made to formalize equal access to the media.

New arrangements contained many other innovations such as observation of democratic standards in the organization of elections, vote counting and publication of the results, restrictions concerning interventions of state officials in the process, fixed campaign expenditures etc. In consequence, elections were fair and free and nearly all the mandates were distributed among the candidates running from party and quasi-party lists. Thus, almost all significant political actors gained representation in the parliaments. Only Baltic countries introduced some restrictions to limit participation of Russian minority in the first elections.

Large fragmentation of the legislatures occurred to be a price of their highly representative character although situation differed thorough the region (six parties in the Hungary in 1990, versus 29 parties and election committees represented in the Polish Sejm elected in 1991). The latest case made difficult to form any stable ruling coalition and contributed to instability of the governments.

Further development of electoral systems was determined by two simultaneous processes: crystallization of political parties and increasing the minimal thresholds for the party lists (predominantly 5%, except Bulgaria – 4%), and sometimes higher for coalitions (8% in Poland) as well as D'Hondt method of allocation of seats. It took time, however, until parties adjusted to the new regulations and started merging into broader entities. Subsequent elections decreased significantly the number of parties represented in the national legislatures and limited fluidity of the political landscape. Electoral coalitions still exhibit a tendency to disperse and re-emerge in the new configurations (Polish AWS). Perhaps, the most radical measure to stop this trend was a decision of the Estonian parliament to abolish a right to form electoral coalitions just few months before the March 1999 elections. Only single parties could run in parliamentary elections. This resulted in smaller number of political parties in the new legislature.

#### 4.1.2. Political parties

Most CEB countries introduced a set of incentives to accelerate a process of emergence of political parties and crystallization of the party systems. The first condition relied on relatively low requirements concerning membership (a support of 15 adults was enough in Poland for a political party to be registered) and simple procedures of registration. Beside it, some schemes of financial support were also launched like direct state subsidies to political parties (Hungary since 1993, Poland since 1997) or refunding costs of parliamentary elections' campaigns, proportionately to the number of seats gained in both chambers of parliament (Poland since 1993<sup>8</sup>). Political parties have been also allowed to run some business

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<sup>8</sup> From 1997 election proportionally to the number of votes obtained over the threshold of 3%.

activities free of taxation.

The above favorable legal conditions helped to form a large number of political parties defining themselves along the historic and symbolic references, economic and social programs, and sometimes also religious or ethnic identities. Many of them occurred to be very small, politically insignificant and short-lived. After 2-3 rounds of parliamentary elections the political landscape has been clarified in the course of process of a natural selection. Forming the government and government coalitions contributed significantly to the party discipline and accountability.

As a result, political systems in CEB sub-region are institutionalized relatively well with a small number of parties and clear left-right division, although their stability differs in individual countries. Parties monopolize the process of nomination of candidates to parliament making independent MPs rare and marginal case. Many features of the systems of political parties in CEB resemble the attributes of Western democracies. The quality of post-communist democracy in this sub-region is generally positive although less so in the case of Romania and some post-Yugoslav countries.

#### 4.1.3. Dynamics of constitutional changes

A dynamic competition between dispersed elite of old regime and new political actors experiencing ideological fragmentation influenced the choice of constitution model. Generally speaking, on the eve of political change the old communist elite preferred presidential regime perceived as an instrument useful in preserving its dominant position, whereas the opposition opposed it. Parliamentary regime was considered as better serving the latter's political interest than the presidential one.

The situation changed when the new actors came to power. This related, for example, both to Vaclav Havel in Czechoslovakia (and later in the Czech Republic) and Lech Walesa in Poland as well as representatives of some nationalist or right-wing parties. However, none of these players was able to reach its goal fully in the competitive environment [Elster 1994]. Czechoslovak parliament refused to amend constitution in favor of stronger presidential power. The same happened with referendums in Albania, Hungary and Lithuania. In Poland, the constitutional National Assembly in 1997 even decreased President's prerogatives. As a consequence, parliamentary or rationalized parliamentary system prevails in the CEB region.

Executive power is vested mainly in hands of government backed by parliamentary majority. The presidents play mostly representative role (with some exceptions related, for example, to the right to impose veto on laws adopted by parliament like in Poland). In some countries indirect elections of the president by parliament have been replaced by popular elections (Lithuania, Poland, Slovakia and Serbia), which case be interpreted as a sign of the mixed (parliamentary-presidential) system.

#### 4.1.4. Consequences for political and economic reform

A combination of broad participation in political process, open and free elections and rationalized parliamentary system resulted in a sharp political break with the ancient regime. Steven Fish [1998] showed that the deeper changes in elite had happened as the outcome of the first elections, the quicker and deeper economic reforms were undertaken in the aftermath. The enormous social cost of those reforms led, in turn, to the change of parliamentary majority and government after the next elections. The mechanism of electoral pendulum had

positive effect for maintaining democracy, as the losing parties were interested in keeping democratic rules of the game, which should make them possible to fight for regaining power in the subsequent elections.

The debate on economic reforms and distributing their social costs did not only shape the party systems but also produced other mechanisms of representing group interests and their mediation (tripartite commissions, consulting opinion of the interested groups on particular laws, different forms of social bargaining).

The third result of the initial elite change was the transformation of former communist parties into social-democratic parties or social-liberal parties. When these parties came back to power (usually after the second round of free election) they continued the process of economic and political reforms.

The pace of political and economic reforms was slower in countries where - as a result of the first elections - the forces of old regime (Bulgaria, Romania) or nationalistic parties (Slovakia, Croatia, Serbia and Montenegro) came to power. Subsequently, these countries were knocked out of the development trajectory followed by transformation leaders (the Czech Republic, Hungary and Poland). Yet, in the late nineties those countries managed to speed up their development thanks to maintaining the mechanism of democratic elections and desire to join the EU.

#### **4.2. European CIS model: transitional regimes and limited participation.**

The course of political developments was different in the former Soviet Union. Apart from the Baltic republics, the rest of the new independent states had neither significant experience in democratic governance, nor even independent statehood in the twentieth century (except Russia). In many cases old communist elite persisted - although not intact - until the breakdown phase. Their self-destruction did not happen, despite political cleavages along generation, ideological, ethnic or regional lines, and removal of some parts of the old elite from power. Anticommunist opposition was generally too weak to force the old elite to alter the means of acquiring power. Apart from the Baltic republics, noncommunist movement took power in Armenia, Georgia and Azerbaijan, for the short period of time only. In other republics (Russia, Ukraine, Belarus) either the former high-rank members of the Communist Party alone or the coalition of former communists and reformers took the highest government positions during the early transition phase. Therefore, the new constitutional solutions were determined by the intense intra-elite game rather than by the result of parliamentary elections.

##### 4.2.1. Evolution of the constitutional order towards the presidential-parliamentary regimes

The course of events was determined mostly by the fact that presidential elections were held prior to free parliamentary elections. In such circumstances, newly elected presidents with strong electoral legitimacy could broaden the scope of their power. Almost all post-Soviet states started with the constitutional order blending Western European type of parliamentary system and US-style presidential power. This had to lead to open conflicts between old legislatures and new presidents and contributed, in one way or another, to forming the presidential-parliamentary systems, in which most power is concentrated in the hands of the chief executive. The concrete solutions vary across the region. While strong presidential power was imposed in Russia after bloody conflict of 1993 and subsequent referendum, the Ukrainian president has been fighting for a substantial extension of his power

until now. Alexander Lukashenko converted the presidential-parliamentary system of Belarus into personal dictatorship through referendum (1996) whereas similar leaning of president Luchinski resulted in imposition of a parliamentary system in Moldova (1999-2000).

The president is usually directly elected for fixed term (4 or 5 years) with a maximal two-term limit. President nominates all ministers. Only candidature of the Prime Minister is a subject of parliamentary approval. In Russia, if the State Duma rejects presidential candidate for the Prime Minister three subsequent times it may be dissolved by President and new elections are called. Parliament has the power to take resolution on non-confidence to a government, which can be rejected by President. If parliament repeats a second non-confidence vote within 3 months, the president must respond either by sacking the cabinet or dissolving the parliament. It must be added that the Russian president must propose a new Prime Minister for the State Duma approval only after the presidential elections. It means that election of the new parliament does not require formation of the new government (the same concerns Ukraine).

The legislation initiative belongs to President, the government and parliament. President can veto all laws adopted by two-chamber Federal Assembly (Russia) or one-chamber Supreme Council (Ukraine). The veto can be overridden only by two-third majority of the parliament (both chambers of parliament in the case of Russia). In Russia, President can also issue decrees being equal to laws, which are not the subject of parliamentary review. In Ukraine, Presidential decrees relate to issues not regulated by laws only and may be subject of parliamentary veto.

In both countries, however, functioning of political system has depended much more on the personality of the president than on the pure constitutional regulations. Indeed, presidents have frequently resorted to decrees, appeals, voluntary interpretation of the constitution, and referendums what should be considered as a clear violation of the principle of separation of powers. The President Administration, which should play purely technical role according to constitution, has become a kind of very influential super-government not bearing, however, any constitutional responsibility for their actions. This creates association with the role of the Central Committee of the Communist Party under the old regime strengthened symbolically by the fact the most of the President Administrations in countries of the former Soviet Union is physically located in former communist parties headquarters.

The lack of effective institutional framework that might have bound president and parliament to a single set of policies, normally approved in national elections tends to produce a system of “court politics” involving struggle for influence and various favors between official advisers, cronies, and intimates [Taras, 1997].

Legislative and judiciary branches of government have little control over the executive. President appoints senior members of the judicial and executive branches. In Ukraine and Belarus president nominates the heads of regional administration (governors) while in Russia all of them are elected since 1996.

#### 4.2.2. Weak political parties and shortcomings of the election law

In most European CIS countries the entry barriers for the new political parties occurred to be much more complex than in the CEB countries. As a rule, they had to meet much more stringent membership requirements for registration (5000 in Russia, 3000 in Ukraine) and faced competition from non-political organizations in the course of electoral

process (the right of working collectives and other non-political organizations to nominate candidates). Neither the electoral law encouraged the stability of parties and party system.

The majority of European CIS countries with the exception of Moldova introduced the electoral system based on single-member constituencies, 'first past the post' principle or the mixed system (containing both proportional and 'first past the post' components), and a high 50% turnout requirement. These arrangements appeared to be much less favorable for institutionalization of fragile parties and emergence of the stable party system than proportional elections of party lists. Electoral studies showed that the Duverger's well-known observation (single-member districts tend to produce two-party system, whereas multimember districts and proportional representation produce multi-party system) does not apply to reality of Eastern Europe [Gebethner, 1999; Moser, 1999; and Rose et al., 2001].

In the CIS countries the opposite tends to be true. In Ukraine and Belarus the 'first past the post' system produced a very dispersed representation, and independent candidates won a pretty large number of seats. For example, in parliamentary elections in Ukraine in 1994 independents won 56% seats, whereas the two largest political parties – communists and national democrats won 22% and 5% seats respectively. Turnout provision resulted in numerous runs-off.

In these circumstances a composition of the Ukrainian parliament was very unclear and unpredictable. It was characterized by the strong left block and broad fluid center, with a tiny margin of political parties on the right side of the spectrum. Neither president, who started economic reform, nor his opponents were able to collect majority of supporters. In such circumstances, the reform policy was slowed down. Political parties did not participated officially in the government, but some their representatives did on the individual basis. In 1998, electoral system was changed into a mixed system (with the 4% threshold in proportional voting on the party lists) following similar scheme in Russia.

In the latter this system was introduced in 1993 with half of the seats of the State Duma elected according to the 'first past the post' principle and half – on the proportional basis from the party lists (with the 5% threshold). Turnout threshold was reduced to 25%.

However, the mixed system also tends to produce a very fragmented composition of the parliament. In Russia where only few parties were able to meet 5% threshold and obtain seats from the party lists (9 parties in 1993, 4 parties in 1995 and 6 parties in 1999), fragmentation stems predominantly from single-member districts where majority of candidates runs for the seats without a party label.

The weakness of Russian parties meant that they often failed to nominate candidates in all the districts. The biggest parties – Communists and liberal Yabloko - were able to nominate candidates for half of single-mandate constituencies only in 1999 [Rose et al. 2001] Electorate prefers voting for independents rather than for party representatives. In result, independent deputies won 61% of seats in 1993, 33% in 1995 and 51% in 1999 (in Lithuania 3% only in 1996). Majority of them was either former government officials or managers of enterprises who benefited in their election campaign from organizational and financial assets of regional authorities or enterprises [Thames, 2001].

On the other hand, proportional elections to the "party halve" of the State Duma did not produce the proportional representation. The single-member constituencies stimulated enormous mushrooming of a number of federal parties and federal electoral lists (registering a



federal list gave access to federal mass media and increased chance to win seat in the single-member constituency). So big fragmentation - a number of parties running for seats from proportional list increased from 13 in 1993 to 43 in 1995 and to 26 in 1999 – led to failure of most of them to meet the 5% threshold. As result, 49,5% of votes were lost in 1995 and 18.7% in 1999. The similar phenomenon could be observed in Ukraine during 1998 parliamentary elections [Gortat 1998].

The above situation makes the stability and accountability of a party system illusory. In Russia, only three parties managed to participate in all three parliamentary elections. The remaining used to appear before and disappear after the ballot. It prevents voters be loyal to a particular party and vote strategically.

The extreme instability of the party structure is manifested, among others, by the permanent changes in party affiliation by the already elected MPs. Both in Russian Duma and Ukrainian Supreme Council independents join existing party factions, form new ones, stay unaffiliated or float between different groupings. As result, the actual political structure of parliament differs sometimes significantly from the proportion of votes endorsing each party list during last election. Secondly, high fragmentation of parliament, in which none party has more than one fourth of mandates, provokes new divisions. The new political coalitions tend to be formed *“without regard to party labels, ideology or the accountability to the electorate, being dictated instead by opportunities for enrichment and access to power”* [Rose et al. 2001, p. 440].

In sum, in the mixed systems used both in Russia and Ukraine both halves produced skewed vote-to-seat ratios and therefore helped create a disproportional legislature, which does not mirror the revealed preferences of electorate. Politics is highly personalized and many political parties are formed around a single individual or group of individuals. Decision-making process is more like undercover fight than a public debate. Political patronage and protection of business are important characteristics of both Russian and Ukrainian reality. Parliamentary and local elections increasingly serve as the arena for the big business supported by the subordinated media, on which it competes for big money, rather than the field of citizens' activity.

#### 4.2.3. Consequences for political and economic reform

The almost permanent conflict between executive and legislature and the far-going fragmentation of the latter have complicated a lot the process of economic reforms. Presidents and governments could not rely on a stable parliamentary support in carrying out uneasy institutional and structural changes, or at least in conducting the responsible fiscal policy. They have had to gather support in the case of each individual law or decision what usually has involved substantial compromises, concessions in other fields or corruption practices. On the other hand, they have become practically out of control of the parliament.

Highly fragmented and not being responsible for forming government, parliaments have behaved in highly irresponsible and populist way. They have also become easy targets of lobbying pressure of various interest groups. This has led to the creation of an oligarchic system characterized by a lack of transparency and accountability (see section 7).

The 'first past the post' election scheme has not helped in building the modern and stable party system articulating various political interests and helping to exercise the popular control over the executive power. Mixed electoral systems helped in producing a bit better

results in this sphere, particularly in the countries where political parties were more developed or, at least, one bigger party existed (Georgia until very recently). However, development of the political party system in the European CIS countries is lagging well behind what could be observed in CEB countries.

The constitutionally strong presidents are not usually interested in building the stable political party system. On the contrary, their actions usually support fragmentation and instability of the political scene what could be observed on several occasions in Russia, under Boris Yeltsin, in Ukraine, both under Leonid Kravchuk and Leonid Kuchma, in Moldova, under Petro Luchinsky, and recently in Georgia, under Eduard Shevardnadze. Consequently, they favored 'first past the post' and single-member constituency electoral system and oppose the proportional principle of voting for the party lists. One can give here the example of Boris Yeltsin attempt to reverse the mixed election scheme before 1999 Duma elections or vetoing by Leonid Kuchma the new election law in 2001, increasing the share of proportional component.

Generally speaking, political systems in the Western part of the CIS represent a great dose of instability and seem to have still a transitory character. They are subjects of various kinds of pressures, which probably will cause their further evolution. On the one hand, this is a temptation of the ruling presidents to strengthen further their power what would mean a danger of evolution towards the Belarus or Central Asia type authoritarian model (see below). On the other hand, still weak but gradually developing institutions of civil society, increasing pluralism of interests inside the political elite (and oligarchs), and the membership in the Council of Europe push these countries in the opposite (European) direction.

### **4.3. Central Asia's model: consolidated autocracies and restricted participation**

The collapse of the Soviet Union brought the different political effects in Central Asia republics than in the rest of the CIS. The old communist elite came through the breakdown phase structurally intact and retained all power resources in their disposal. In the new circumstances they preferred a pure presidential regime, which – as a matter of fact - transformed first secretaries of the republican communist parties into the autocratic presidents<sup>9</sup>.

In 1992, the former first secretaries of the republican communist parties were elected as the presidents of independent republics of Uzbekistan, Turkmenistan and Kazakhstan in a popular vote. The only exception was the President of Kyrgyzstan, professor of physics who did not belong to the typical party 'nomenclature' earlier. In Tajikistan, the conflict between the old nomenclature and the new political forces led to outburst of a long-lasting civil war.

#### 4.3.1. Towards the pure presidential regime

Constitutional choices were made immediately after getting independence. New constitutions were adopted in 1992-1993 by parliaments inherited from the Soviet period to which new actors, even if they appeared, had no access.

Turkmenistan introduced a very strong presidential system at once, making President the Chairman of the Council of Ministers. A similar model was established in Uzbekistan

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<sup>9</sup> For the political development of Central Asia countries see, among others, Gleason [1997], Bremmer & Taras [1997], and Anderson [2000].

although a position of the Prime Minister has been maintained<sup>10</sup>. Imposition of pure presidential rule became somewhat constrained in Kazakhstan and Kyrgyzstan, experiencing deeper political liberalization at the beginning of their independence. Heated parliamentary debates concentrated around such key issues as the prerogatives of President, right to nominate heads of a local administration and judiciary, role of religion in the state, official language, etc. As a result, the mixed presidential-parliamentary model was adopted in both countries. More power to president was given by the Tajikistan constitution adopted in 1994 by the winners of a civil war.

Formally, all constitutions were based on the principles of division of power, declared free elections and guaranteed freedom of expression, assembly, association and religion. However, implementation of these provisions has differed, sometimes substantially, from the declared ones although the scale of abuses has varied across the region.

#### 4.3.2. Manipulated election process, restricted party system and further strengthening the presidential power

The first parliamentary elections after getting independence were held in Central Asia relatively late – in 1994 or 1995 - and were conducted exclusively under the 'first past the post' system and 50% turnout requirement. Electoral law maintained many provisions from the Soviet times and there were not real guaranties for equal competition (limited access to media, myriad of electoral abuses). It would be risky, however, to repeat in this context the thesis that 'first past the post' electoral scheme became the main obstacle to development of the modern and democratic system of political parties in these countries. Reality has been much more complicated.

In Turkmenistan, for example, there was no room for any political pluralism or competitive elections. The communist party was simply renamed the Democratic Party of Turkmenistan and maintained all its previous power and structures. Although the Peasant Justice Party was created in 1992 at the wish of President Saparmurat Niyazov, in order to play the role of alternative party it ceased to exist in 1995. Since then no new party has been registered or permitted to operate. The government forbids the formation of any organization with even a slight suggestion of political agenda. Few political opponents were banned or arrested many years ago.

President leads the party and the state personally in the old indigenous style (Turkmenbasha). Elections to the 50-member legislature, held in 1994 and 1999, had strictly ceremonial character as the President selected all the candidates and maintained tight control over the parliament. Most frequently, however, he bypasses its ruling by decrees. President controls all government and public institutions and is enshrined in Stalin-style personal cult. First term of his power was extended until 2000 by plebiscite and then the Peoples' Council declared him 'President for the lifetime'. According to President Niyazov, the parliament will be granted more power in 2006 and political parties will be able to appear in 2008.

President Islam Karimov in Uzbekistan acted in a similar way – renamed the Communist Party of Uzbekistan as the Democratic Party of Uzbekistan and let the Progress of Fatherland Party be formed to make impression of pluralism. However, real opposition parties that emerged under *perestroika* time (Birlik, Islamic Renaissance Party, Adolat) were declared illegal and their leaders were arrested or banned.

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<sup>10</sup> The very similar model was introduced by President Lukashenko in Belarus (in spite of their geographical location close to Central Europe) after the constitutional coup d'état in 1996 (through referendum).

During the first parliamentary elections in December 1995 even a very moderate party Erk and some famous individuals were not allowed to run. As a consequence, only two pro-presidential parties obtained seats in 250-members legislature. Elections were not free and fair under the OSCE standards. The same refers to the January 9, 2000 elections, in which four other parties participated. All of them declared loyalty to President Karimov regime. Legislature has minimal influence on government and its policy, playing a role of the rubber stamp for President's decisions. Parliament chairman is a member of the President cabinet.

Presidential elections in 1995 were not held because President chose to extend his term until year 2000 by referendum. In January 2000 election only one candidate opposed Karimov but he did not make any visible effort to challenge the incumbent.

Policy of repression in relation to opposition activists, religious and ethnic groups was sharpened after the terrorist attack in Tashkent in February 1999. Since then, Karimov's regime started to face a growing popular support to the Islamic Radical Movement (IMU). The lack of political will to soften the authoritarian regime may produce an adverse effect for the future stability of the country.

Kazakhstan and especially Kyrgyzstan have been perceived as more democratically advanced republics with respect to civil rights and freedoms. However, even in this case several legal restrictions and unfair political practices impede the development of political parties and independent media.

In Kazakhstan regular elections are still far from being the routine. The first parliament elected in 1994 was dissolved a year later by the president Nursultan Nazarbaev who then ruled by decree until the end of 1995. In the meantime, he called referendum twice to amend the constitution and extend his term until 2000. The new constitution broadened the prerogatives of the president, at expense of the parliament. Legislature was reduced in terms of the number of MPs and divided into two houses. Since then, only deputies of the Lower House have been elected by popular vote. The opposition has considered the new structure of the parliament as a vehicle to legitimize authoritarian rule of the president.

Irregularities and manipulations marred both parliamentary elections of 1995 and 1999, as well as the unexpected presidential elections of 1999. Some parties and candidates (like former Prime Minister Akezhan Kazhegeldin) were excluded from the competition. Controversial constitutional amendments of October 1998 extended the term of office for the President from 5 to 7 years, and removed the age limit and the limit of two terms in office for the same person. On the other hand, the requirement of the 50-percent turnout for valid elections was removed and 10 percent of parliamentary seats were left for the party list in proportional voting. Six political parties have their representatives in the parliament, three of which are pro-presidential. The impact of pluralistic representation on the decision-making process is minor in the context of consolidation of power in President's hands.

The similar drive to consolidate power around the President, which results in narrowing citizens' participation in politics, is visible in Kyrgyzstan, the most liberal country of the region. The Constitution of the Kyrgyz Republic was revised twice in referendum and, subsequently, the structure of parliament was also changed twice. Despite the relatively favorable conditions to act in the first half of the nineties, opposition parties tend to be very weak. Under the 'first past the post' electoral system all political parties managed to win only about 10% of seats in the legislature in 1995. During presidential elections of 1995 and 2000 several key candidates (such as the former Vice-President and Mayor of Bishkek Felix Kulov)

were excluded from competition prior to the vote.

The second parliamentary elections were held in February 2000 under the new election law, which, for the first time, included one quarter (15 mandates) awarded on the proportional basis from the national party lists. At the same time authorities barred four parties, including the three most popular opposition ones from participating in the election process. Some opposition candidates were also de-registered from single-mandate constituencies before the second round of elections. Unequal coverage by media, harassment of individual opposition figures, restriction on NGO monitoring efforts and the lack of transparency in counting votes forced OSCE observers to conclude that elections failed to comply with democratic standards.

It is hard to imagine that Tajikistan could escape from the typical authoritarian drive of the Central Asia. The only contribution to the political pluralism and stability of the country was inclusion of the Islamic opposition (the United Tajik Opposition, or UTO) to the electoral process in 1999-2000, which should have ended five years of a civil war. In the presidential elections of November 1999 five candidates were denied to be registered as they failed to obtain 145 thousand signatures each, required by the law and the only representative of the opposition received 2.1% votes.

President Ali Rakhmonov used the election victory to strengthen his personal control over the country by amending constitution and extending his presidency to seven years. Before parliamentary elections of February-March 2000, unicameral parliament was split into lower and upper house. Then the first one – House of Representatives - was subject of the first Tajikistan multiparty elections. One third of deputies was elected from the party lists (7 percent threshold) and the remaining two thirds from the single mandate districts. Rakhmonov's ruling Democratic Party of Tajikistan won nearly 65%, Communists obtained 22 and The Islamic Renaissance Party - 7 percent.

Both elections failed to meet the minimal democratic standards of transparency, fairness and accountability. Nevertheless, they were approved by an international community, which had perceived the elections as a way to avoid the new round of the civil war. Readiness of President Rakhmonov to abide the power-sharing arrangement with the opposition should be proven in the future. Nevertheless, Tajikistan is the only country of a post-Soviet Central Asia where the Islamic party is allowed to participate in a political life.

#### 4.3.3. Consequences for political and economic reform

The presidential regimes in Central Asia while consolidating the political power and providing a certain political stability in individual countries and the region as a whole significantly impede the process of democratization, development of civil society, and market reform. In respect to the latter one can observe differentiation of adopted transition strategies and achieved results. The most politically liberal countries of the region – the Kyrgyz Republic and Kazakhstan – chose the trajectory of relatively fast market reforms not differing (or even outpacing in some periods) the European CIS countries. However, even in the case of these two countries a visible authoritarian drift in the political sphere has damaged, through the increasing impact of clan politics and the rampant corruption, the speed and effectiveness of economic transition.

Other, much more authoritarian and politically oppressive regimes (Uzbekistan, Turkmenistan, and Belarus in the European part of the former USSR) helped to preserve the economic positions and interests of the former communist oligarchy what resulted in a very

limited economic changes as we analyzed in section 2.

Although one may argue that the authoritarian but secular regimes in the Central Asia region are better than the danger of religious fundamentalism or uncontrolled ethnic clashes, economic populism, widespread corruption and nepotism, increasing income inequality, and high level of political repression in some of these countries can create a very good ground for political extremism in future.

## **5. The role of judiciary**

The rule of law and independent, impartial and efficient judiciary constitutes one of the basic public goods conditioning the proper functioning of any society and economic development.

The picture of post-communist countries in this respect is highly differentiated and shows a strong correlation with progress in democratization (see **Figures 3.1** and **5.1**). Consequently, the CEB countries represent the relatively well-developed system of justice administration while former Soviet republics of the Central Asia lag far behind the standards of developed and democratic countries [Karatnycky et al., 2001]. However, even the current EU candidates are rather critically assessed by the European Commission [see EU, 2001] from the point of view of meeting the European standards, particularly in respect to judiciary independence and law enforcement.

### **5.1. Constitution interpretation and enforcement**

Giving courts the prerogative to interpret and enforce the constitution should be considered as one of more important steps towards strengthening the rule of law. In most transition countries this prerogative belongs to special constitutional courts. Only in Estonia and Croatia the Supreme Court carries out this function and in Kazakhstan – the Constitutional Council appointed by and subordinated to President.

However, the power of constitutional courts is differentiated across the region. For example, in Bulgaria, the Czech Republic, Georgia, Hungary, Lithuania and Poland they have the right to review all the legislation and take the final binding conclusions while in Romania decisions of the CC can be overturned by parliament. In Russia and Macedonia the CC ruling are often ignored in practice. Finally, in Belarus the competence of CC were reduced significantly, with no right to review the presidential decrees.

In some countries with the strong position of the CC (the Czech Republic and Hungary) the competence conflict between CC and Supreme Courts can be observed.

In most countries CC have no right to raise cases on its own motion and the list of institutions, which can do it, varies significantly – from a very narrow (Armenia) to quite extensive (Poland). Individuals enjoy the right of petition to CC, among others, in Albania, the Czech Republic, Lithuania, and Poland. In many other countries CC are practically inaccessible to ordinary citizens.

In the CEB countries nomination of chairmen and judges of CC usually needs cooperation of the parliament and President while in Russia, Caucasus and Central Asia this is mainly President's prerogative (sometimes with some minor role of parliament). The term in office of the judge of CC lasts usually between 7 and 11 years and one person can serve one

or maximum two terms.

## 5.2. Legislation process and law enforcement

Looking in accomplishments of the legislation process one may find relatively weak dependence between the level of the rule of law and accountability, on the one hand, and adoption of the new legal codes. Generally, four typical scenarios can be observed:

- Although new comprehensive legal codes were not adopted but a large number of amendments to the old ones and other measures strengthening rule of law brought the important qualitative changes (example of the Czech Republic).
- All the basic legal codes were changed but nothing was done to implement them in practice (Azerbaijan in 2000, before accession to the Council of Europe).
- New codes were adopted only partly (for example, either the Criminal Code or the Civil Code) and the rule of law practice is differentiated. This scenario relates to most of the analyzed countries.
- No progress was achieved, i.e. old Soviet courts and legal practices continue to exist (example of Tadjikistan).

Some basic recommendations and provisions of the Council of Europe and other international organizations have been at least formally accepted in most of the countries under consideration. This relates, for example, to elimination or at least suspension of the death penalty. Nevertheless, the level of repressiveness of the criminal law differs among countries with Russia and Lithuania being the leaders in this respect.

Individual constitutions guarantee prosecuted the right of free defense when they do not have sufficient financial means. However, the governments usually have not established a reliable system ensuring that this right could properly realized. Even in such democratically advanced countries as Poland, the Helsinki Foundation for Human Rights has questioned the proper implementation of this constitutional right to have legal counselor, in particular when it concerns the poor. On the opposite end of the spectrum, prosecuted in Central Asia countries very often do not know about their constitutional right to have legal defense.

There is still a great deal of legal and practical differentiation in relation to condition under which citizen can be arrested or imprisoned. On the one hand, in countries such as the Czech Republic all these criteria are well legally defined (prosecutor decision for a short-term arrest, court decision for an extending period of arrest, strict maximal time limit of arrest before trial starts, humanitarian treatment of arrested and prisoners) and usually respected in practice. In other countries (Bulgaria, Georgia, Macedonia), in spite of the presence of similar legal norms, their practical executions remains highly unsatisfactory, very often being abused by the police and other law enforcement agencies. On the other hand, in countries such as Armenia or Central Asian republics both the procedural regulations (representing still a legacy of the Soviet norms) and the law enforcement practice (particularly arbitrary behavior of the police forces and their corruption) fall far behind the international human rights standards.

The humanitarian conditions of imprisonment in all the post-communist countries remain problematic but in the CIS countries they are dramatically poor with high rate of

tuberculosis and other diseases as well as with the high mortality rate.

### **5.3. Judiciary independence and effectiveness**

Generally, in most of the post-communist countries, the law enforcement as well as real independence, effectiveness and transparency of judiciary create the biggest problem even if the material legislation is not already so far from the international standards. Organs of justice are not impartial, their decisions do not rise social confidence, they are subjects of political, business and criminal pressure, and their decisions are not executed or executed with a significant delay. These weaknesses of judiciary are caused by a number of constitutional, legal, organizational and material factors, which we will try to analyze briefly.

Obviously, the procedure of nomination of judges and senior judicial bodies is one of the key issues. Parliament and President nominate judges in various combinations. Parliament plays, for example, the dominant role in the Czech Republic and Baltic countries while President – in most of the CIS countries.

The biggest differences concern, however, judges of the ordinary courts. In CEB countries and Russia they get the life tenure, are practically irremovable and enjoy the personal legal immunity. They are nominated either by parliament (the Czech Republic, Latvia), by President on the basis of the National Judiciary Council proposal (Poland), by President with parliamentary approval (Lithuania), or by President himself (Russia). Ukraine and Moldova have the kind of intermediate regime – before getting the life tenure, judges are first nominated for the five years term (Ukraine), or for five and then ten years term (Moldova). Belarus and Central Asian country represent the opposite end of the spectrum: President nominates judges for 4-5 years term, can dismiss them, decides on their salaries, sometimes even on their flats and other social benefits. In Belarus, judges can be subject of criminal prosecution.

The level of remuneration of judges, prosecutors and other judiciary functionaries create another serious problem. While in CEB countries their salaries are relatively not so bad (although still relatively much lower than in developed countries), in CIS countries, particularly in the Central Asia and Caucasus region situation is really dramatic. Poorly paid judges and prosecutors become the easy targets of corruption practices. Low salaries also impede the process of personal re-qualification of judges and bringing the new, young and better-educated people to this profession, so badly needed particularly in the case of commercial and financial disputes.

General understaffing and insufficient legal and economic education in terms of understanding basic principles of a market economy, the types of transactions, commercial and financial practices, etc., are the common problems in all the transition countries but take the most dramatic forms in Central Asian and Caucasus countries. Approximately, one half of the current judges in Latvia, almost two-third in Lithuania and over 80 percent in Central Asia hold their positions from the Communist times. In the Czech Republic this proportion amounts to 35 percent of the overall judges' population.

In addition, courts are very badly equipped, lack in enough office space, overburdened with bureaucratic procedures, etc. In many countries, courts have problem with paying their wage bills, buying equipment, paying phone bills and undertaking building repairs.

Trying to summarize, in Central Europe courts are relatively free of political influence,



judges have life tenure and are jealous about their independence (the Czech Republic, Hungary, Poland). Judicial decisions in criminal cases are effectively enforced. In civil (commercial) cases, courts are much less efficient, procedures long lasting, and big lines of court clients waiting for solving their disputes. Offices of enforcement are seriously understaffed, badly equipped, poorly organized and, therefore unable to enforce judicial decisions fully. This influences negatively the effectiveness of contractual relations in the economy.

On the other end of the spectrum, in Belarus and post-Soviet Central Asia, judiciary is neither independent, nor impartial, particularly when dealing with an opposition movement. In post-Soviet countries, including Baltic states, most judges have inadequate judicial training, and the inefficiency of the judiciary limits the fair administration of justice. In many post-Soviet countries enforcement of judicial decisions continues to be a major problem, raising serious human rights issues.

What are the consequences of inefficient state judiciary for the economic and social life and how the citizens and enterprises fill this vacuum? There are several alternative solutions and we will mention briefly some of them:

- Resorting to decisions of foreign courts in solving the commercial disputes. This way is very expensive and available only to the biggest corporations (financial institutions) involved into the international transaction and being (at least partly) owned by the non-residents<sup>11</sup>.
- Resorting to various kinds of non-court mediation involving state administrative organs (which under the central planning system solved most of commercial conflicts between enterprises), business associations and chambers, and local communities (patrimonial traditions in Central Asia, Caucasus, and part of the Balkans).
- Corrupting courts and legal enforcement agencies (examples of various 'oligarchs wars' in Russia and Ukraine).
- Resorting to 'private' law enforcement services involving a broad spectrum of semi-legal (for example, private firms helping in debt execution) and illegal practices (racketeering).

Most of these possibilities are not available to poor people. In addition, two last substitutes (corruption, spontaneous 'privatization' of justice administration and law enforcement) undermine the stability of the state and elementary perception of law and order, justice and security of most of the citizens.

## **6. Institutions guaranteeing stable money**

Stable money should be considered as another basic public good and irreplaceable precondition of building the healthy economy. High inflation destroys money in its basic functions as a mean of transaction, saving and calculation. High or very high inflation discourages saving, demand for domestic money and damages the public finances. In social terms, it hurts mainly poor people, increases income and wealth differentiation, and stimulates numerous pathologies.

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<sup>11</sup> Generally, justice administration in post-communist countries is very badly prepared to deal with international transactions. This is true even in the case of the most advanced transition economies.

As shown in **Figure 2.3** and discussed in section 2 of this paper, post-communist countries experienced a lot of problems in fighting high inflation and not all of them achieved the definite success in this battle [see Dabrowski et al., 1999]. Political fragility and the lack of sufficient consensus around the consequent anti-inflationary policy are the main reason of these mixed results. Hence, the role of institutional solutions guaranteeing stable money is even more important than in the developed countries.

Generally, there are two ways of guaranteeing stable a currency and low inflation. The first one recommends giving up a national monetary policy and joining other currency area. In the case of transition countries it can be done either by introducing the currency board mechanism or unilateral adoption of the foreign currency<sup>12</sup>. On the other extreme, country can choose to continue its sovereign monetary policy but delegate it to the independent central bank institutionally isolated from the current political pressure and turbulence.

Estonia (in 1992), Lithuania (in 1994), Bosnia and Herzegovina (in 1996), and Bulgaria (1997) chose the first strategy, i.e. adoption of a currency board. In addition, Montenegro and Kosovo (both in 1999) introduced German Mark (now Euro) as their own currency unit. The remaining countries follow their own monetary policies but the level of central bank independence differs across the region.

CASE empirical research conducted by Maliszewski [1997] covered sixteen transition countries carrying out their own monetary policies. Ten of them represented CEB sub-region – Bulgaria (prior to introducing currency board), Croatia, the Czech Republic, Hungary, Latvia, Macedonia, Poland, Romania, Slovakia and Slovenia. Other six - Belarus, Georgia, Kyrgyzstan, Moldova, Russia and Ukraine – belonged to the CIS. Following methodology proposed by Grilli, Masciandaro and Tabellini [1991] author constructed indexes of political and economic independence on the basis of analysis of a central bank law in each country.

According to Grilli, Masciandaro and Tabellini [1991] the political independence is influenced by three elements: the relationship between the government and central bank in formulation of monetary policy, the procedure for appointing the central bank's governor or board and the formal goal of the bank with respect to monetary policy. These elements are evaluated using eight criteria: appointment procedure for high officials of the bank (the governor and the board), length of their term in office, participation of the government representative in the board, government approval of monetary policy, legal provision strengthening the bank's position against the government in case of conflict, and statutory obligations to maintain price stability. Economic independence is affected by legal constraint on the central bank's lending to the government and the location of banking supervision. The bank is assumed to be more economically independent if the direct credit facility is of limited amount, not automatic, temporary and at the market rate. In addition more independent bank sets the discount rate, does not participate in the primary market for public debt and is not engaged in the commercial banks' supervision.

Correcting Grilli, Masciandaro and Tabellini [1991] criteria Maliszewski [1997] assumed that central bank is more politically independent if the provisions for governor's dismissal are non-political only (e.g. loss of ability to perform his duties or sentence for criminal act). Consequently, the new variable was added to the political index. In addition, the parliament or government prior approval of monetary policy was regarded as a limitation to

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<sup>12</sup> In future, the current EU candidates will have one more option, i.e. joining the multilateral monetary union - the EMU.

CBI (instead of government approval only in the original methodology). Finally, in the index of economic independence, the government borrowing from CB was assumed to be less “harmful” if all direct credit was securitized.

**Figures 6.1 and 6.2** summarize Maliszewski [1997] results. In most cases at least some internationally recognized standards of central bank independence were adopted. The governor was usually appointed for more than five years and the government had no direct influence on his appointment. In most cases the government had no influence on the nomination of the board members and had no representatives in the board. However, board members’ terms of office were usually shorter than governor’s, exacerbating political pressure on the bank. Usually, there was no formal influence of the government on the bank policy, although only eight analyzed statutes provided some provision supporting the bank in case of conflict with the government. The goal of maintaining price stability was enumerated in almost all statutes (with exception of Ukraine).

The laws also seemed to guarantee the economic independence of the banks although the political consensus on imposing the limits on the government borrowing from the bank was probably more difficult to attain. Only five statutes (Georgia, Hungary, Macedonia, Moldova and Russia) specified that the interest rate on all credit to the government should be market determined. Only in seven countries (Belarus, the Czech Republic, Georgia, Macedonia, Moldova, Poland and Slovakia) the law required securitization of the credit. Only two countries (Hungary and Slovakia) had the banking supervision outside the central bank. Thus, the supervision seemed to be perceived as a traditional role of the central bank.

To avoid arbitrariness, indices of political and economic independence were calculated as a sum of elements in the tables. Latvia, the Czech Republic, Macedonia and Moldova had the most politically independent central banks, while the banks in Hungary, Kyrgyzstan and Ukraine were the least independent. The most economically independent banks were in the Macedonia, Georgia, Slovakia and Hungary; the least independent were the banks in Latvia, Romania and Ukraine.

The measure of an overall independence was obtained by summing two indices. Macedonia received the highest score in this ranking, closely followed by the Czech Republic and Georgia. The central banks in Latvia and Moldova also enjoyed high degree of legal independence.

As in the case of empirical research related to other regions [see e.g. Grilli, Masciandaro and Tabellini, 1991; Alesina and Summers, 1993; Cukierman et al., 1995] also in transition economies a strong correlation between the central bank correlation and disinflation performance can be established [see Maliszewski, 1997]. On the other hand, even very superficial examination of **Figure 2.3** shows that the countries, which chose the alternative option, i.e. currency board (Estonia, Lithuania and Bulgaria) achieved a remarkable success in fighting high inflation and stabilizing it on the low level.

## **7. How the flawed institutions contribute to poverty and inequality?**

The analyzed institutional developments, economic policy and politics of transition have had a mutually reinforcing character. Below we will try to demonstrate, using the stylized facts’ method, how this mechanism works.

Countries, which experienced the initial political momentum in favor of radical reforms (the 'period of extraordinary politics' – see section 3) and managed to use it in the effective way achieved a serious progress in forming the new political and economic system in a relatively short period of time. The accomplished 'critical mass of changes' made them irreversible. The new economic actors engaged in building capitalism emerged and were strong enough to oppose effectively attempts to go back to a command economy or try the populist experiments of searching the 'third way'. The new political institutions with significant components of checks and balances were established and they became the effective barriers against temptations to restore authoritarian regime or numerous social and political pathologies. This concerns, for example, a free mass media and civil society organizations actively fighting corruption, nepotism, political clientism, and power abuse. The new elite provided the new economic and political perspective. Also the old elite (or their political successors) went through a serious transformation and started to accept the new rules of game, and the new economic and political system. Finally, the orientation towards European integration and transatlantic security cooperation (membership in NATO) declared in a relatively early stage of transition became the important external anchor strengthening the process of both political and economic reforms.

Early radical macroeconomic stabilization and liberalization as well as early start of the privatization process helped to limit the scale of the transformation 'recession' and widespread pauperization connected with a long period of high inflation or hyperinflation. These policies also brought earlier output recovery on a sustainable basis. They created broader and more equal access to the new entrepreneurial and employment opportunities – the fast development of the new private firms occurred to be the most effective factor of cushioning the social costs of transition. The relative macroeconomic stability, institutional progress, political predictability and prospects of the EU integration attracted a significant inflow of foreign investments. All these factors helped to increase income per capita in the second half of the last decade, start the process of catching up the more developed countries, and strengthen constituency in favor of democracy and market system. This, in turn, helped in continuing economic and political reforms, further converging this group of countries to developed countries standards.

On the other hand, countries, which did not experience the 'period of extraordinary politics' or lost this window of opportunity, found themselves in a slow reform equilibrium (or trap). The prolonged period of macroeconomic instability, high inflation or hyperinflation not only hurt seriously the economy and damaged its growth perspective but also caused a widespread devastation of state institutions and pauperization of the mayor part of society. Slow progress in the sphere of liberalization, privatization and institution building helped to preserve significant remnants of the command economy and create the new distortions.

This hybrid economic regime helped to grow the new powerful group of interests – oligarchs - extracting various kinds of rent opportunities coming from a high inflation, multiple exchange rate, direct and indirect subsidies, tax exemptions, selective trade barriers, widespread licensing, export and import quotas, restricted and non-transparent privatization process [see Gelb, Hillman, .1995]. Both the old post-communist and the new oligarchic elite captured most of the basic public institutions – executive, legislative and judicial power, regional and local self-government, political parties, and mass media. Oligarchs have been interested in weak and fragmented parliaments, which can be easily manipulated and, hence, they have opposed to proportional electoral systems and other institutional measures strengthening political parties (other than their own 'pocket' creatures). They have also supported the presidential or presidential-parliamentary regimes because in the environment

of the permanent conflict between president and parliament and complex and non-transparent executive it has been easier to conduct the 'court' politics.

Oligarchic capitalism has deprived the rest of society equal access to business activity because of the bureaucratic 'red tape' connected with a widespread corruption. Distorted political institutions caused that society has lacked in many instruments of controlling a government existing in democratic countries such as the stable political parties accountable before electorate, fair election process, independent and impartial judiciary, free mass media, and civil society organizations. Apart from purely economic pauperization caused by the prolonged output decline and high inflation there have been frustration and political apathy coming from the above described deprivation.

This has created a very good ground for political manipulation and populism, which have made situation even worse. Oligarchic elite and politicians seeking for an authoritarian power (the example of Alexander Lukashenko in Belarus) can play cynically social slogans, promise to fight corruption, and help the poor. But the results are always opposite to these demagogic promises. Thus, poverty, inequality and lack of elementary social justice have very often a self-reinforcing character. They contribute to bad political choices, which, in turn, impede chances to reform flawed institutions and policies.

The similar 'vicious circle' can be observed in the sphere of external relations. Because of the initial delay in economic and political reforms, and poor economic and institutional record slower reformers were not considered as the serious candidates to join the EU and NATO, and were completely excluded from this process. The potential foreign investors also did not consider these countries as the prosperous markets. As a result, they lost both economic and political benefits coming from participation in the globalization process.

There were some cases where such a negative 'vicious circle' was overcome in some point as a result of internal mobilization of society and political elite usually caused by economic or political shock. In Slovakia it was, for example, realization that the country lost certain important historic opportunities, after not being admitting to NATO and the first round of EU accession negotiation. In Bulgaria it was 1996-1997 severe financial crisis, which pushed this country towards the policy of radical economic reforms. In the case of some post-Yugoslav countries (Croatia, and recently Serbia) there were consequences of a series of tragic ethnic conflicts and the NATO/EU intervention combined with a perspective of participation in the EU integration process. Possibly the same EU accession perspective will push finally Romania towards faster and more consequent reforms. And maybe Russia is just at the beginning of the way towards more consistent and consequent process of reforming both economic and political institutions in order to rebuild its international economic and political position.

Never is too late to start fighting distortions and reform its ineffective institutions. However, later this process will start more chances and opportunities will be lost and bigger development gap will have to be closed.

## **8. General conclusions**

In this paper we did analyze the selected institutional pillars of democratic society and market economy: constitutional regimes (relation between executive and legislature), system of political parties, electoral systems, justice administration and monetary institutions. In all

these spheres transition countries should pass the long and difficult way from the communist dictatorship and command economy to the democratic and competitive capitalism. This process is not finished yet in none single transition country in any of the analyzed aspect. As we said earlier there is a group of countries (the advanced EU candidates), which can be considered of being relatively close to this final destination of transition process<sup>13</sup>. But other countries, mainly CIS members and part of the Balkan region managed to build so far only the distorted capitalism and very immature and fragile democracy. Few among them (part of the Central Asia and Belarus) cannot claim even these limited achievements. They continue authoritarian regime and try to keep as much of the command economy mechanism as possible.

We are ready to confirm the opinion that fast and complex reforms bring, on average, better economic and social results than slower and more gradual changes. This is determined by both the nature of an economic transition itself (shortening the period of a temporary system vacuum and breaking down the inertia of the old system) and the political economy of the reform process (exploiting maximally the initial political window of opportunity and making changes irreversible).

The ability of individual countries to follow this kind of reform strategy was determined, to a large extent, by the scale of the initial political changes and further developments in the sphere of institutional and political reform. If the old communist elite was replaced by the new one convinced in building a new democratic order and market economy (and being able to do it) it gave a country the chance of a longer period of 'extraordinary politics' and exploiting this window of opportunity in a proper way. The early success of economic transition helped to strengthen the constituency in favor of further reforms, both political and economic ones. Also the perspective of the European integration has played an important leveraging role in both spheres.

Generally, a very strong correlation between the progress in political and economic reforms can be observed. Looking at the role of specific institutional solutions one must underline the advantage of the parliamentary or parliamentary-presidential regime over the presidential or presidential-parliamentary system. The former helps to build the transparent and relatively stable system of the political parties while the latter contributes to political fragmentation, irresponsible legislature and oligarchic capitalism. In extreme cases presidential model may represent an authoritarian drift as it happened in the part of the former Soviet Union. The same can be said about the electoral systems. In the emerging democracies the proportional scheme with a minimum threshold helps better to form a stable and consolidated system of political than a 'first past the post' principle.

There is not a simple recommendation how to build the competent and impartial judiciary in a relatively short period of time. This requires a well coordinated and consequent legislation effort, several organizational measures, and promoting a political and social consensus in favor in strong and independent judicial branch of government. The same concerns the consensus around stable money and independent central bank (or importing the external monetary stability in the form of currency union).

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<sup>13</sup> In fact, transition is a never-ending story, as all the countries, even those most developed, must continuously reform their policies and institutions. However, we analyzed in this paper the fundamental transition from communism to capitalism, and this process will finish in some point of time.

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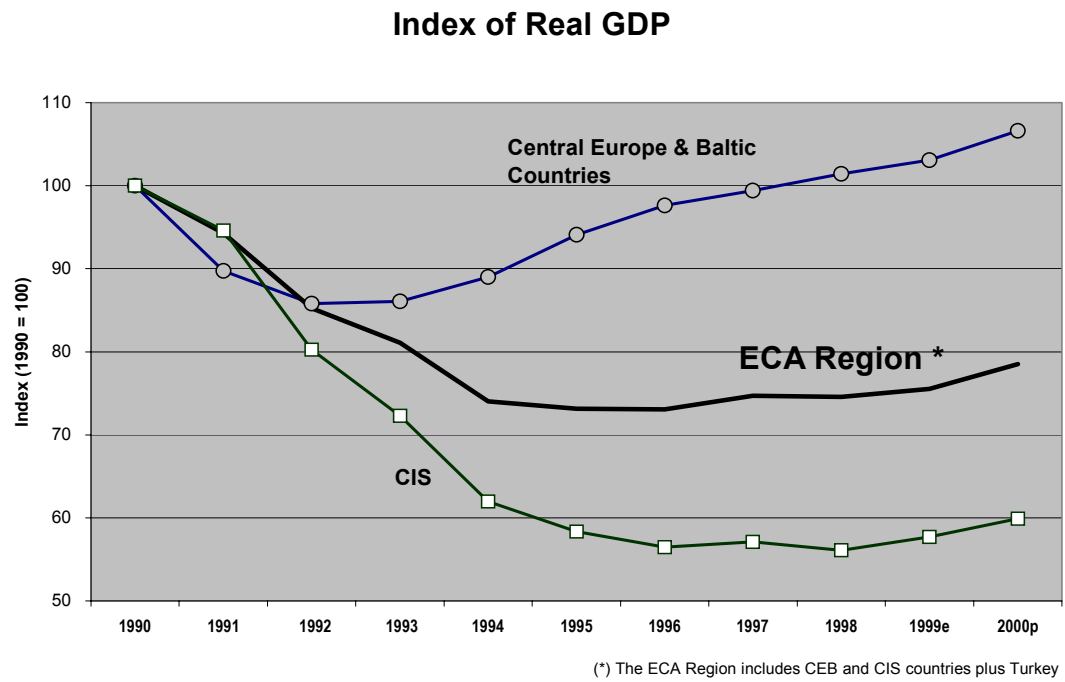
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**Figure 2.1: Growth in real GDP in transition economies, 1989-2000 (in percent y/y)**

Country	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	1999 1989=100
Albania	9.8	-10.0	-28.0	-7.2	9.6	8.3	13.3	9.1	-7.0	8.0	7.3	7.0	95
Bulgaria	0.5	-9.1	-11.7	-7.3	-1.5	1.8	2.1	-10.9	-6.9	3.5	2.4	4.0	67
Croatia	-1.6	-7.1	-21.1	-11.7	-8.0	5.9	6.8	6.0	6.5	2.5	-0.3	3.5	78
Czech Republic	1.4	-1.2	-11.6	-0.5	0.1	2.2	5.9	4.8	-1.0	-2.2	-0.2	2.0	95
Estonia	8.1	-6.5	-13.6	-14.2	-9.0	-2.0	4.3	3.9	10.6	4.7	-1.1	5.0	77
Hungary	0.7	-3.5	-11.9	-3.1	-0.6	2.9	1.5	1.3	4.6	4.9	4.5	6.0	99
Latvia	6.8	2.9	-10.4	-34.9	-14.9	0.6	-0.8	3.3	8.6	3.9	0.1	4.5	60
Lithuania	1.5	-5.0	-5.7	-21.3	-16.2	-9.8	3.3	4.7	7.3	5.1	-4.2	2.2	62
Macedonia	0.9	-9.9	-7.0	-8.0	-9.1	-1.8	-1.2	1.2	1.4	2.9	2.7	5.0	74
Poland	0.2	-11.6	-7.0	2.6	3.8	5.2	7.0	6.1	6.9	4.8	4.1	5.0	122
Romania	-5.8	-5.6	-12.9	-8.8	1.5	3.9	7.1	3.9	-6.1	-5.4	-3.2	1.5	76
Slovakia	1.4	-2.5	-14.6	-6.5	-3.7	4.9	6.7	6.2	6.2	4.1	1.9	2.0	100
Slovenia	-1.8	-4.7	-8.9	-5.5	2.8	5.3	4.1	3.5	4.6	3.8	4.9	5.1	109
<b>CEB/Balkan group</b>	-0.1	-6.6	-10.7	-3.2	0.3	3.7	5.4	4.1	3.6	2.6	2.1	4.1	97
Armenia	14.2	-7.4	-11.7	-41.8	-8.8	5.4	6.9	5.9	3.3	7.2	3.3	3.5	42
Azerbaijan	-4.4	-11.7	-0.7	-22.6	-23.1	-19.7	-11.8	1.3	5.8	10.0	7.4	7.5	47
Belarus	8.0	-3.0	-1.2	-9.6	-7.6	-12.6	-10.4	2.8	11.4	8.3	3.4	2.0	80
Georgia	-4.8	-12.4	-20.6	-44.8	-25.4	-11.4	2.4	10.5	10.8	2.9	3.0	3.0	34
Kazakhstan	-0.4	-0.4	-13.0	-2.9	-9.2	-12.6	-8.2	0.5	1.7	-1.9	1.7	8.2	63
Kyrgyzstan	8.0	3.0	-5.0	-19.0	-16.0	-20.1	-5.4	7.1	9.9	2.1	3.6	5.0	63
Moldova	8.5	-2.4	-17.5	-29.1	-1.2	-31.2	-1.4	-7.8	1.3	-8.6	-4.4	-3.0	31
Russia	0.0	-4.0	-5.0	-14.5	-8.7	-12.7	-4.1	-3.5	0.8	-4.6	3.2	6.5	57
Tadjikistan	-2.9	-1.6	-7.1	-29.0	-11.0	-18.9	-12.5	-4.4	1.7	5.3	3.7	5.0	44
Turkmenistan	-6.9	2.0	-4.7	-5.3	-10.0	-17.3	-7.2	-6.7	-11.3	5.0	16.0	20.0	64
Ukraine	4.0	-3.4	-11.6	-13.7	-14.2	-23.0	-12.2	-10.0	-3.0	-1.9	-0.4	3.0	36
Uzbekistan	3.7	1.6	-0.5	-11.1	-2.3	-4.2	-0.9	1.6	2.5	4.4	4.1	1.0	94
<b>CIS group</b>	0.6	-3.7	-6.0	-14.1	-9.3	-13.8	-5.2	-3.5	0.9	-3.5	2.8	5.9	55
<b>ALL REGION</b>	0.3	-5.0	-8.1	-9.3	-5.1	-6.0	-0.5	-0.2	2.0	-1.1	2.5	4.8	68

Source: EBRD [2000], Table A.3.1, p. 65.

**Figure 2.2: Cumulative changes of GDP in sub-regions, 1990-2000 (1999 = 100)**



Source: World Bank [2000]

**Figure 2.3: End-of-year inflation in transition economies 1991-2000.**

Country	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
<b>CEB and Balkan countries</b>										
Albania	104.0	236.6	30.9	15.8	6.0	17.4	42.1	8.7	-1.0	4.2
Bulgaria	338.7	79.4	63.8	121.9	32.9	310.8	578.6	0.9	7.0	11.2
Croatia	...	937.0	1120.5	2.4	4.6	3.7	3.8	5.6	3.8	6.9
Czech Republic	52.0	12.6	18.8	9.7	7.9	8.6	10.1	6.8	2.6	4.0
Estonia	...	942.2	35.7	41.6	28.8	15.0	12.5	4.5	3.8	5.0
Hungary	32.0	24.7	21.1	21.2	28.3	19.8	18.4	10.3	11.2	10.0
Latvia	...	958.2	34.8	26.2	23.3	13.2	7.0	2.8	3.2	1.8
Lithuania	...	1162.5	188.8	45.0	35.5	13.1	8.5	2.4	0.3	1.4
Macedonia	115.0	1935.0	241.8	55.0	9.0	-0.6	3.2	-3.1	2.5	6.1
Poland	60.3	44.5	37.7	29.5	21.6	18.5	13.2	8.6	9.8	8.6
Romania	223.0	199.2	295.5	61.7	27.8	56.9	151.6	43.8	54.8	40.7
Slovakia	58.3	9.1	25.0	11.7	7.2	5.4	6.4	5.6	14.2	8.4
Slovenia	247.0	88.2	22.9	18.3	8.6	8.8	9.4	5.7	8.8	10.6
<b>CIS countries</b>										
Armenia	...	1241.2	10896.1	1884.5	32.1	5.8	22.0	-1.1	2.1	0.3
Azerbaijan	...	...	1293.8	1788.0	84.5	6.7	0.4	-7.6	-0.5	2.2
Belarus	...	1557.8	1994.0	1957.0	244.2	39.1	63.4	181.7	251.3	108.0
Georgia	...	1178.5	7484.1	6473.0	57.4	13.7	7.2	10.6	10.8	4.6
Kazakhstan	...	2962.8	2169.1	1160.3	60.4	28.6	11.3	1.9	17.8	9.8
Kyrgyzstan	...	1257.0	766.9	95.7	32.0	34.9	14.7	18.3	39.8	9.5
Moldova	...	2198.4	836.0	116.0	23.8	15.1	11.1	18.4	82.7	18.5
Russia	...	2321.6	841.6	202.7	131.4	21.8	11.0	84.5	36.6	20.1
Tadjikistan	...	...	7343.7	1.1	2133.3	40.5	163.6	2.7	30.1	60.6
Turkmenistan	...	...	...	1328.5	1261.5	445.9	21.8	19.8		
Ukraine	...	2001.0	10155.0	401.1	181.4	39.7	10.1	20.0	20.2	23.9
Uzbekistan	...	910.0	884.8	1281.4	116.9	64.4	50.0	26.0	26.0	28.2

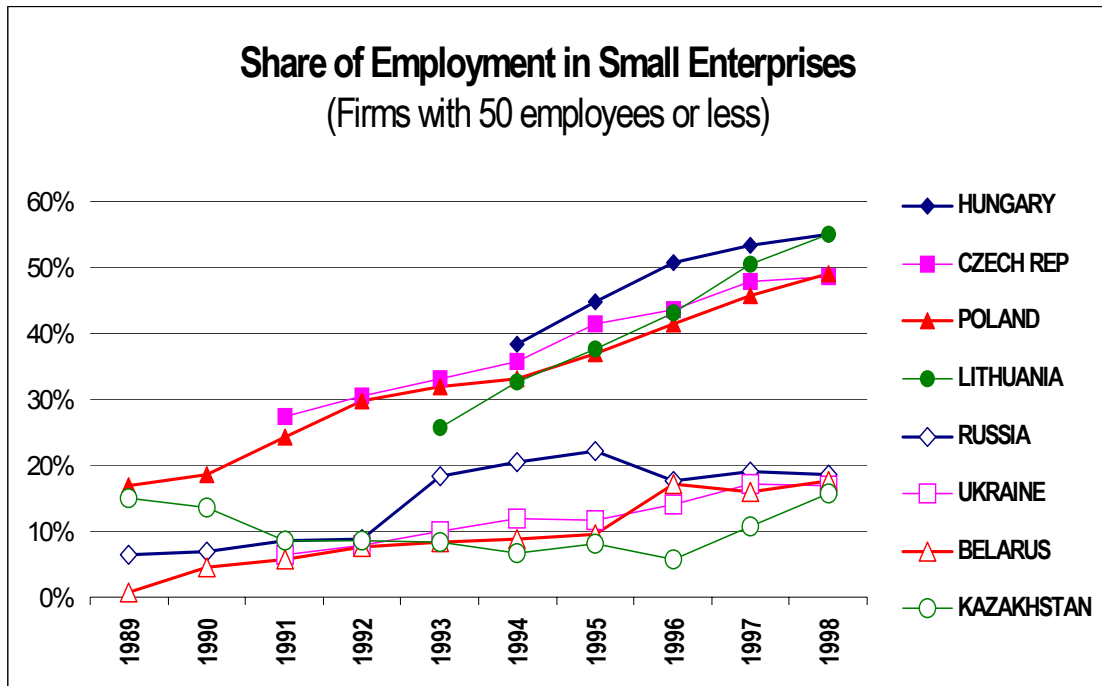
Source: IMF, EBRD and PlanEcon data

**Figure 2.4: Institutional progress in transition, 2000**

Country	Private sector share of GDP in %	Large-scale privatization	Small-scale privatization	Governance and enterprise restructuring	Price liberalization	Trade & foreign exchange system	Competition policy	Banking reform & interest rate liberaliz.	Security market & non-bank financial institutions
<b>CEB and Balkan countries</b>									
Albania	75	2	4	2	3	4+	2-	2+	2-
Bosnia & Herz.	35	2	2+	2-	3	3	1	2+	1
Bulgaria	70	4-	4-	2+	3	4+	2+	3	2
Croatia	60	3	4+	3-	3	4+	2+	3+	2+
Czech Republic	80	4	4+	3+	3	4+	3	3+	3
Estonia	75	4	4+	3	3	4+	3-	4-	3
Hungary	80	4	4+	3+	3+	4+	3	4	4-
Latvia	65	3	4+	3-	3	4+	2+	3	2+
Lithuania	70	3	4+	3-	3	4	3-	3	3
Macedonia	55	3	4	2+	3	4	2	3	2-
Poland	70	3+	4+	3	3+	4+	3	3+	4-
Romania	60	3	4-	2	3	4	2+	3-	2
Slovakia	75	4	4+	3	3	4+	3	3	2+
Slovenia	55	3	4+	3-	3+	4+	3-	3+	3-
<b>CIS countries</b>									
Armenia	60	3	3+	2	3	4	1	2+	2-
Azerbaijan	45	2-	3+	2	3	3+	2	2	2-
Belarus	20	1	2	1	2-	2-	2	1	2
Georgia	60	3+	4	2	3+	4+	2	2+	2-
Kazakhstan	60	3	4	2	3	3+	2	2+	2+
Kyrgyzstan	60	3	4	2	3	4	2	2+	2
Moldova	50	3	3+	2	3+	4	2	2+	2
Russia	70	3+	4	2	3	2+	2+	2-	2-
Tadjikistan	40	2+	3+	2-	3	3+	2-	1	1
Turkmenistan	25	2-	2	1	2	1	1	1	1
Ukraine	60	3-	3+	2	3	3	2+	2	2
Uzbekistan	45	3-	3	2-	2	1	2	2-	2

Source: EBRD [2000], Table 2.1

Figure 2.5: Share of Employment in Small Firms, 1990-1998



Source: World Bank [2000]

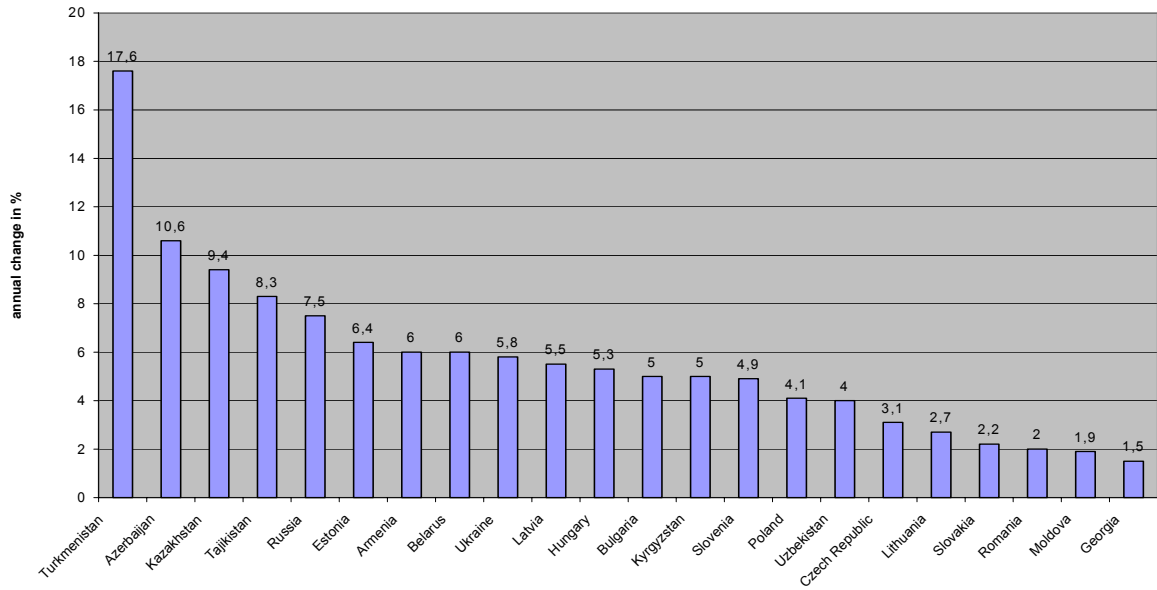
**Figure 2.6: Main Recipients of Foreign Direct Investment**

Country	1992-95		1996-99	
	US\$ Millions	% of GDP	US\$ Millions	% of GDP
<b>Central and SE Europe and Baltic States */</b>	<b>21,091</b>	<b>0.5</b>	<b>50,558</b>	<b>3.3</b>
Czech Republic	4,821	2.9	10,104	4.6
Estonia	647	3.9	1,050	5.2
Hungary	9,399	5.7	6,979	3.8
Poland	2,540	0.6	17,096	2.9
<b>Community of Independent States */</b>	<b>8,272</b>	<b>1.0</b>	<b>22,001</b>	<b>2.5</b>
Azerbaijan	237	4.2	3,222	20.9
Kazakstan	2,357	2.7	4,971	6.4
Russia	3,965	0.3	8,412	0.7
Turkmenistan	427	3.5	334	3.0

Notes: \*/ Shares of GDP are period average of medians for the group

Source: World Bank [2000]

**Figure 2.7: GDP growth rate in transition countries, 2000**



Source: WEO [2001]



**Figure 2.8: Changes in Inequality During the Transition: Gini coefficient for income per capita**

Country	1987-90	1993-94	1996-98
<b>CEB countries */</b>	<b>0.23</b>	<b>0.29</b>	<b>0.33</b>
Czech Republic	0.19	0.23	0.25
Hungary	0.21	0.23	0.25
Slovenia	0.22	0.25	0.30
Poland	0.28	0.28	0.33
Bulgaria	0.23	0.38	0.41
Croatia	0.36		0.35
Romania	0.23	0.29	0.30
Lithuania	0.23	0.37	0.34
Latvia	0.24	0.31	0.32
Estonia	0.24	0.35	0.37
<b>CIS countries */</b>	<b>0.28</b>	<b>0.36</b>	<b>0.46</b>
Russia	0.26	0.48	0.47
Ukraine	0.24		0.47
Moldova	0.27		0.42
Belarus	0.23	0.28	0.26
Armenia	0.27		0.61
Georgia	0.29		0.43
Kyrgyz Republic	0.31	0.55	0.47
Kazakhstan	0.30	0.33	0.35
Tadjikistan	0.28		0.47
Turkmenistan	0.28	0.36	0.45

Note:\*/ Median of countries with data.

Source: World Bank [2000]

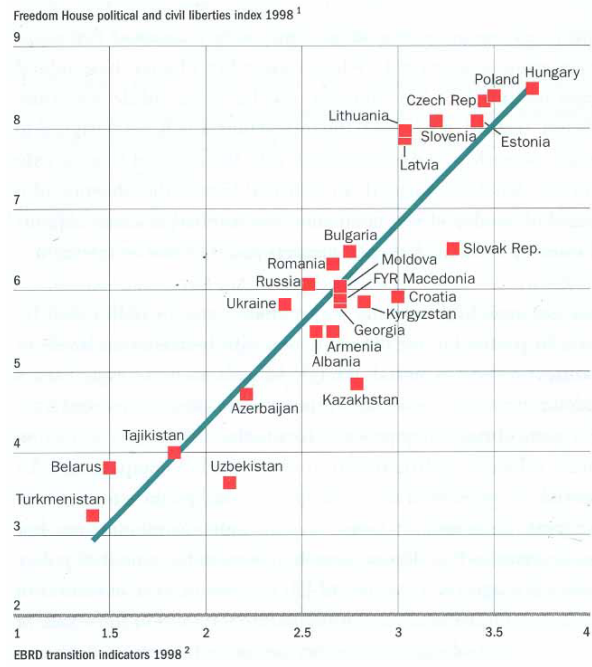
**Figure 3.1: Freedom House democratization index, 2001**

Country	Political progress	Civil society	Independent media	Governance & Public Administration	Democratization index <sup>a</sup>
<b>CEB and Balkan countries</b>					
Albania	4.00	4.00	4.25	4.25	<b>4.13</b>
Bosnia & Herzegovina	4.75	4.50	4.50	6.00	<b>4.94</b>
Bulgaria	2.00	3.50	3.25	3.50	<b>3.06</b>
Croatia	3.25	2.75	3.50	3.50	<b>3.25</b>
Czech Republic	1.75	1.50	2.00	2.00	<b>1.81</b>
Estonia	1.75	2.25	1.75	2.25	<b>2.00</b>
Hungary	1.25	1.25	2.25	3.00	<b>1.94</b>
Latvia	1.75	2.00	1.75	2.25	<b>1.94</b>
Lithuania	1.75	1.75	1.75	2.50	<b>1.94</b>
Macedonia	3.75	3.75	3.75	3.75	<b>3.75</b>
Poland	1.25	1.25	1.50	1.75	<b>1.44</b>
Romania	3.00	3.00	3.50	3.75	<b>3.31</b>
Slovakia	2.25	2.00	2.00	2.75	<b>2.25</b>
Slovenia	1.75	1.75	1.75	2.50	<b>1.94</b>
Yugoslavia	4.75	4.00	4.50	5.25	<b>4.63</b>
<b>CIS countries</b>					
Armenia	5.50	3.50	4.75	4.50	<b>4.56</b>
Azerbaijan	5.75	4.50	5.75	6.25	<b>5.56</b>
Belarus	6.75	6.50	6.75	6.25	<b>6.56</b>
Georgia	4.50	4.00	3.50	4.75	<b>4.19</b>
Kazakhstan	6.25	5.00	6.00	5.00	<b>5.56</b>
Kyrgyzstan	5.75	4.50	5.00	5.25	<b>5.13</b>
Moldova	3.25	3.75	4.25	4.50	<b>3.94</b>
Russia	4.25	4.00	5.25	5.00	<b>4.63</b>
Tadjikistan	5.25	5.00	5.50	6.00	<b>5.44</b>
Turkmenistan	7.00	7.00	7.00	6.75	<b>6.94</b>
Ukraine	4.00	3.75	5.25	4.75	<b>4.44</b>
Uzbekistan	6.75	6.50	6.75	6.00	<b>6.50</b>

Note: <sup>a</sup> average of PP, CS, IM and GPA ratings; scale 1-7 (1 - the highest level; 7 – the lowest level)

Source: Karatnycky et al. [2001], Table A.

**Figure 3.2: Correlation between economic and political transition, 1998**



Source: EBRD [2000]

**Figure 5.1: Rule of law and corruption rating in post-communist countries**

Country	1997	1998	1999-2000	2001	Corruption Rating 2001
<b>High Levels</b>					
Czech Republic	1.50	1.50	2.25	2.50	3.75
Estonia	2.25	2.25	2.00	2.00	2.75
Hungary	1.75	1.75	1.75	2.00	3.00
Latvia	2.25	2.25	2.00	2.00	3.50
Lithuania	2.25	2.00	2.00	1.75	3.75
Poland	1.50	1.50	1.50	1.50	2.25
Slovakia	4.00	4.00	2.50	2.25	3.75
Slovenia	1.75	1.50	1.50	1.50	2.00
<b>Middle Levels</b>					
Albania	4.75	5.25	5.00	4.50	5.50
Armenia	4.75	5.00	5.00	5.00	5.75
Azerbaijan	5.50	5.50	5.50	5.25	6.25
Bulgaria	4.25	3.75	3.50	3.50	4.75
Croatia	4.00	4.00	4.00	3.50	4.50
Georgia	5.00	4.75	4.00	4.00	5.25
Kyrgyzstan	4.50	4.50	5.00	5.25	6.00
Macedonia	4.25	4.50	4.25	4.25	5.00
Moldova	4.25	4.00	4.00	4.00	6.00
Romania	4.25	4.25	4.25	4.25	4.50
Russia	4.00	4.25	4.25	4.50	6.25
Ukraine	3.75	4.00	4.50	4.50	6.00
<b>Low Levels</b>					
Belarus	6.00	6.25	6.50	6.75	5.25
Bosnia & Herzegovina	Na	6.00	6.00	5.50	5.75
Kazakhstan	5.00	5.25	5.50	5.75	6.25
Tadjikistan	6.25	6.00	5.75	5.75	6.00
Turkmenistan	6.75	6.75	6.75	7.00	6.25
Uzbekistan	6.50	6.50	6.50	6.50	6.00
Yugoslavia	Na	5.00	5.75	5.50	6.25

Source: Karatnicky et al. [2001].

**Figure 6.1: Index of political independence (PI) of the central banks in selected transition economies, 1996**

Country	G1	G2	G3	B4	B5	R6	R7	C8	C9	PI
Belarus	*				*	*		*	*	5
Bulgaria	*			*		*	*	*	*	6
Croatia	*	*		*		*	*	*	*	7
Czech Republic	*	*	*	*	*		*	*	*	8
Georgia	*	*	*	*	*	*		*		7
Hungary		*	*					*		3
Kyrgyzstan	*		*					*		3
Latvia	*	*	*	*	*	*	*	*	*	9
Macedonia	*	*	*	*	*	*	*	*		8
Moldova	*	*	*	*	*		*	*	*	8
Poland	*	*	*	*		*		*		6
Romania		*			*	*		*		4
Russia	*		*	*				*	*	5
Slovakia		*	*				*	*	*	5
Slovenia	*	*		*	*	*	*	*		7
Ukraine	*			*		*				3

Notes:

- G1: Governor not appointed by the government
- G2: Governor appointed for more than 5 years
- G3: Provisions for governor's dismissal non-political only
- B4: None of the board appointed by the government
- B5: Board appointed for more than 5 years
- R6: No mandatory government representative in the board
- R7: Government/parliament approval of monetary policy is not required
- C8: Statutory responsibility to pursue monetary stability
- C9: Presence of legal provision supporting bank in conflicts with the government

Source: Maliszewski [1997]

**Figure 6.2: Index of economic (EI) and legal independence (PI+EI) of the central banks in selected transition economies, 1996.**

Country	D1	D2	D3	D4	D5	M6	M7	EI	PI + EI
Belarus	*		*	*	*	*		5	10
Bulgaria	*		*	*		*		4	10
Croatia	*		*	*		*		4	11
Czech Rep.	*		*	*	*	*		5	13
Georgia	*	*	*	*	*	*		6	13
Hungary	*	*	*	*		*	*	6	9
Kyrgyzstan	*		*	*		*		4	7
Latvia	*			*		*		3	12
Macedonia	*	*	*	*	*	*		6	14
Moldova	*	*			*	*		4	12
Poland	*			*	*	*		4	10
Romania	*			*		*		3	7
Russia	*	*	*	*		*		5	10
Slovakia	*		*	*	*	*	*	6	11
Slovenia	*		*	*		*		4	11
Ukraine	*					*		2	5

Notes:

D1: Direct credit facility is not automatic

D2: Direct credit facility is at the market interest rate

D3: Direct credit facility is temporary

D4: Direct credit facility is of limited amount

D5: All direct credit is securitized

M6: Discount rate is set by the central bank

M7: Supervision of commercial banks is not entrusted to the central bank (\*\*) or not entrusted to the central bank alone (\*)

Source: Maliszewski [1997]

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