Stability vs. Volatility: Why the CIS Is Not a Shining Example for Central Europe

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Editor's Note: The article by Anders Åslund titled "Trade Access versus an Economic Model" appeared in the Winter 2003 issue of *Demokratizatsiya*. The following is a response to that article. Anders Aslund's rebuttal appears at the end.

Getting It Wrong

In a contribution to *Demokratizatsiya*'s recent tenth anniversary issue, Anders Åslund tenders a forecast of the economic paths that the former communist countries are likely to take in the foreseeable future.[1] Åslund, a specialist on economic transformation in the former Soviet Union and a senior economic adviser to three post-Soviet states, contrasts the member states of the Commonwealth of Independent States (CIS) with the countries of Central Europe, most of which will soon become members of the European Union (EU). In his prediction, Åslund comes to the surprising conclusion that the economic honeymoon period for Central Europe has come to an end and that the CIS economies are going to outrun their western postcommunist counterparts. His forecast rests on two complementary claims: (*a*) the EU imposes a regulatory regime on the Central European countries that will undermine liberal reforms and thereby stall economic growth; and (*b*) whereas Central Europe backtracks from liberal reforms, the CIS countries have increasingly adopted a liberal paradigm, which induces governments to ease control over the economy, thereby promoting economic growth.

As much as we hope for a quick economic recovery of the CIS countries after the financial meltdown in 1998, Åslund's prophecies embody a significant distortion of reality, making his forecast highly questionable. Two major shortcomings undermine his work. First, he relies on an unbalanced assessment of the EU and its policies. Second, as do many other neoliberal economists, Åslund underestimates the indispensable role of a strong state in economic transformation. By correcting those inadequacies, I come to the conclusion that the EU is not likely to hurt Central Europe's economies—at least, not in the manner or to the extent that Åslund foresees. Central European markets are based on solid economic and

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political institutions, which enable their economies to grow at a steady pace. In contrast, the CIS economies suffer from their governments' inability to establish a solid economic framework. Any economic recovery is therefore likely to be only temporary, followed by economic downturns that will especially hurt the socially vulnerable segments of society. The CIS is therefore hardly a shining example for Central Europe.

The EU's Liberal Agenda

Åslund claims that the EU embodies a "social democratic ideology of a social welfare state with extensive state regulation, high taxes, large social transfers, and substantial public expenditures," all of which are undermining economic growth.[2] This is a rather peculiar interpretation of the EU. Although most of the EU's member countries are social welfare states, the EU itself has a far more deregulative than re-regulative effect on the member states' economies. For instance, the creation of the Single Market has led to the abolishment of myriad formal and informal trade barriers, including health and environmental regulations, state subsidies, and social provisions. In other words, although the 80,000 pages of European legislation (the *acquis communautaire*) appear to be the spawn of bureaucratic eagerness, the *acquis* has, in many ways, streamlined and superseded an even vaster body of national rules and regulations.

In contrast to their deregulative zeal, the EU member states' willingness to re-regulate the liberalized European market is rather underdeveloped. For instance, the EU has been unable so far to make member states agree on common tax rates. Fiscal policy, despite the Monetary Union, above all remains a national matter. Likewise, the Social Charter merely constitutes a lowest common denominator that does not require from any member state the introduction of extensive welfare provisions. In fact, the Social Charter is mainly concerned with health and safety measures at the workplace and equal pay for women and men. Labor unions have lamented that lack of a "social Europe" for years. Nevertheless, partly because of the lack of any effective cross-border union solidarity, labor representatives have so far been unable to pressure EU institutions to impose more stringent welfare and labor market provisions. Mainly, labor unions have been concerned with protecting their own national turfs, rarely reaching out to their colleagues in neighboring countries.

In sum, in contrast to Åslund's claims, neither the EU nor West European labor unions are likely to impose highly regulative regimes on the new member states in Central Europe. Fiscal and social policies, including labor market regulations, will remain within the framework of domestic policy making. If anything, the EU, in combination with globalization, will further advance the liberal policies of the new member states.

Yet the impact of the EU on the Central European and Baltic states is not going to be entirely laudable. The decision of the EU to provide the new member states with only a fraction of the agricultural subsidies that the "old" member states receive is going to inflict some harm on farmers in Poland, Estonia, Slovenia, and so forth. Not only are the farms in the EU's new member states less efficient than their counterparts in the West, but the discrepancy between agricultural subsidies will further disadvantage the farmers in the former communist states. The outcome of that regrettable decision will be a painful transition period in which many farmers in Central Europe will go out of business. In the long run, however, restructuring the agricultural sector in the new member states might strengthen their overall competitiveness and is unlikely to inflict severe harm on the economy.

The Rise of Liberalism in the CIS?

Contrasting the CIS region with Central Europe, Åslund further argues that because of the strong influence of the World Bank and the International Monetary Fund (IMF) on the CIS, "a liberal paradigm has taken hold in the whole region."[3] He cites low taxes, welfare cuts, and flexible labor markets as the primary expressions of this paradigm. However, the reduction of tax rates and welfare benefits and the almost complete absence of labor regulations cannot serve as examples of a liberal economic agenda—they rather illustrate the dramatic extent of state failure in that region. Governments of the CIS, for example, have realized that "normal" (by Western standards) tax rates were unfeasible in the light of widespread tax evasion and corruption in the tax departments. According to the former resident representative of the IMF, Hunter Monroe, Georgia could and should have had higher tax rates if corruption levels were lower. In Georgia, lowering tax rates clearly represented a surrender in the face of widespread bribery and tax evasion, not the victory of a liberal agenda.

In the absence of sufficient tax revenues, it is also not surprising that the CIS governments have begun to cut social transfers. In addition, curtailing welfare in those countries means plugging financial holes in several public agencies whose officials are notorious for embezzling social funds (for example, by pocketing retirement benefits of deceased pensioners). In other words, many policies in the CIS respond to the absence of a strong and autonomous state apparatus. They also serve as window-dressing exercises to placate the demands of international financial institutions. To portray them as deliberate liberal reforms surely misses the point. As Martha Brill Olcott argues in regard to Central Asia, "Plans to speed up the pace of economic reform in the region have been more talk than action."[4]

The failure of the state in the CIS becomes most visible if one looks at the extent of the black market that, according to some estimates, makes up between 40 and 70 percent of the region's GDP. Now, a market that escapes all state controls can be seen as a completely liberalized market. However, the absence of formal rules does not imply that black markets are not regulated. In fact, informal rules and norms (for example, corruption and clientelism) sharply increase transaction costs and curtail the freedom of black markets, making them highly inefficient institutions.

In sum, the pervasiveness of corruption, clientelism, and black markets in the CIS attest to the absence of any coherent and widely respected state and market institutions. Liberal reforms are therefore unlikely to succeed. Moreover, the absence of strong market institutions has led to a widening gap between rich and poor that has largely impoverished the middle class. Yet in the absence of a strong middle class economic growth is necessarily fragile, as even liberal economists, such as Paul Krugman, concede.

Conclusion

There is little doubt that the period of double-digit growth in Central Europe has come to an end. Central European economies have greatly benefited from rapid and thorough liberalization and related foreign investment. Because those economies initially experienced severe contractions as part of the "transitional slump," their subsequent growth rates were impressive. Yet at some point those economies necessarily had to come in line with the growth rates of their neighboring countries and main trading partners. Nevertheless, having established solid economic institutions and a growing middle class, the Baltic and Central European countries are likely to experience solid single-digit growth rates in the future. Membership in the EU will not undermine their economies, because the EU does not impose any regime on them that would force them to depart from their current market models.

In contrast, the rapid growth of *some* CIS economies is unlikely to be permanent. Their growth is the result of rising oil and gas prices, not of comprehensive liberal reforms. In fact, growth rates in CIS countries that do not command vast energy resources (such as Georgia and Kyrgyzstan) have remained rather modest. It is more likely that in the absence of solid institutions and a vibrant middle class, economic development in the CIS will remain highly volatile. Unfortunately, in the absence of vigorous welfare systems, economic downturns will hit especially the poor, who constitute the largest segment of CIS societies. The region therefore fails to provide an economic and social model to the new member states of the EU.

NOTES

1. Anders Åslund, "Trade Access versus an Economic Model," *Demokratizatsiya* 11, no. 1 (2003): 17–25.
2. Ibid., 20.
3. Ibid., 22.
4. Martha Brill Olcott, "Taking Stock of Central Asia," *Journal of International Affairs* 56, no. 2 (2003): 3–17.