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Juhani Laurila

Transition in FSU and sub-Saharan countries: The role of institutions

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Contents

Abstract 5

Tiivistelmä...6

1 Introduction...7

2 Institutional differences between post-Soviet regions and sub-Saharan Africa 10

3 The role of institutions in promoting markets and economic growth.........................15

3.1 States and governments 15
3.2 Social capital..17
3.3 Economic freedom, property rights and rule of law...19
3.4 The state and markets 23

4 The significance of state capacity in development issues..26

4.1 FSUCEE and SSA facts..26
4.2 Economic growth...27
4.3 Trade and trade policy 31
4.4 Population and income distribution...36
4.5 Foreign debt and poverty 40
4.6 Development hazards..45

5 Summary and conclusions 46

5.1 Summary..46
5.2 Conclusions 47

References 50

Appendix 59

All opinions expressed are those of the author and do not necessarily reflect the views of the Bank of Finland.

Juhani Laurila

Transition in FSU and sub-Saharan countries: The role of institutions

Abstract

This study compares transition processes in countries of Central and Eastern Europe, the former Soviet Union (FSU) and sub-Saharan Africa. By widening the scope from most- to least-developed transition economies, the study establishes the importance of a strong state with evolved institutional capacity to protect citizens, enforce property rights and generate social capital. The evidence presented further argues that enforceable, credible property rights with associated market discipline are among the best antidotes to corruption, shadow economies, criminal injustice and poverty. The presence of accountable institutions also influences economic growth and the ability of a country to attract trade and foreign direct investment. Consequently, when institutions of FSU and sub-Saharan countries develop to the point they become attractive to traders and investors from rich countries, their governments need to focus on abolition of barriers to trade, investment and capital. The author commends the recent reorientation of the international donor community towards encouraging recipient governments to commit credibly to increasing capacities of their state institutions with a view to supporting property-based rule of law and social order.

JEL classification: F0, I3, K1, O5, O17, P2

Keywords: sub-Saharan Africa, former Soviet Union, property rights, institutions, growth, international trade, development assistance

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Juhani Laurila

Siirtyminen markkinatalouteen entisen Neuvostoliiton ja Saharan etelänpuolen maissa: instituutioiden merkitys

Tiivistelmä

Työssä tarkastellaan entisen Neuvostoliiton maiden, Keski- ja Itä-Euroopan maiden sekä Saharan etelänpuoleisen Afrikan maiden talouksien etenemistä kohti markkinataloutta. Tarkastelun ulottaminen kaikkein köyhimpiin maihin tuo esiin laadukkaiden instituutioiden merkityksen kehitystekijänä. Riittävästi kehittyneet valtiolliset instituutiot kykenevät suojelemaan kansalaisia, ylläpitämään omaisuudensuojaa sekä luomaan riittävää sosiaalista pääomaa yhteistoiminnan luomiseksi. Uskottava omaisuudensuoja ja siihen perustuva markkinakuri ovat paras lääke korruption, harmaan talouden ja rikollisuuden synnyttämää epätasa-arvoa ja köyhyyttä vastaan. Talouden kasvu ja kyky käydä ulkomaankauppaa sekä houkutella maahan ulkomaista pääomaa ovat seurauksia vahvojen ja uskottavien valtiollisten instituutioiden olemassaolosta. Kansainvälisen kaupan ja pääomanliikkeiden esteiden poistaminen tuleekin tärkeäksi lähinnä silloin, kun entisen Neuvostoliiton ja Saharan etelänpuolen Afrikan maat ja niiden taloudet vahvistuvat siinä määrin, että niistä tulee kiinnostavia kauppakumppaneina ja sijoituskohteina. Tutkimuksessa pidetään tervetulleena sitä, että kansainvälisen avun järjestöt aiempaa enemmän rohkaisevat ja velvoittavat apua vastaanottavia hallituksia kehittämään valtiollisella tasolla omaisuudensuojaa ja turvallisuutta lisääviä instituutioita.

JEL-luokittelu: F0, I3, K1, O5, O17, P2

Asiasanat: Saharan etelänpuolen Afrikka, entinen Neuvostoliitto, omaisuudensuoja, instituutiot, kasvu, kansainvälinen kauppa, kehitysapu

1 Introduction

This study compares two regions: sub-Saharan Africa (SSA) and the region comprising former Soviet Union and other Central and Eastern European transition countries (FSUCEE).[1] These regions represent distinctly different levels of economic, social and financial development. Some FSUCEE countries have established solid economic growth and currently are well on the way to matching living standards of Western Europe. In contrast, economic growth and social development have eluded most countries in SSA. The purpose of this study is to examine whether the quality of state institutions account for any of this widening gap?[2] We premise our line of argument on the notion that the quality of institutions, measured in terms of the economic and political freedom they deliver, affect economic growth, foreign trade, foreign direct investment (FDI), as well as reduction of poverty and political or exogenous hazards.

As shown in Table 1, this regional dualism has little to do with recent trends in globalisation, growth of international trade or advancement of transport and communications technology; these differences in economic growth have persisted for at least a century and a half.

Table 1. Development of GDP per capita in 143 countries (in constant 1990 Geary-Chamis dollars and average annual growth from 1820-1992)

	1820	1900	1992	1820-1992
Western Europe	1292	3092	18313	1.5
Eastern Europe	1093	3081	5897	1.0
Africa	450	500	1236	0.6
World	554	868	2613	0.9

Source: Maddison 1995, Table F-7, p. 224. For world and average GDP per capita, 1820-1992 average annual growth uses compound interest for the period. For more on the Geary-Chamis approach, see Maddison 1995, p. 163.

Our results support the increasingly accepted view of Abramowitz (1997), North (1991, 1997) and North and Thomas (1973) that institutional development goes hand in hand with economic development. The World Bank, for example, devoted its recent World Development Report to the relationship of institutions and economic and social growth (World Bank Studies 2001, World Bank GGP 2001, World Bank 2002, and World Bank WDR 2000/2001). The EBRD, too, has elaborated measurement of institutional factors and their relation to economic development in the FSUCEE region (EBRD 1999 and 2000).

[1] Nigeria and South Africa are often excluded in SSA studies, because they dominate the region in terms of population, GDP and foreign trade. Here, we include Nigeria, as it fairly can be considered a transition economy, while excluding the more developed South Africa. For the same reason, we also include the giant Russian Federation.

[2] The idea for this paper stems from professor G.V. Smirnov's (1999) book "Theory and Practice of Transition to Market Economy: Russia and the African Countries" and an attached letter from Smirnov and Vladimir K. Vigand addressed to the World Bank commenting on World Development Reports 1996 and 1997 (Smirnov 1999 and Smirnov & Vigand 1999).

Studies of former socialist economies during early transition find that citizens took the goal of establishing a well-functioning market economy as self-evident. This perception dominated transition literature of that time and largely eclipsed the subject of legal and institutional reforms (Tanzi 1999). Researchers and policymakers alike gave surprisingly little attention to the fact that institutions inherited from socialist systems were poorly attuned to serving market economies even as otherwise ambitious macroeconomic reform programs failed to generate new institutions spontaneously.

As the problem became recognised, researchers turned their focus to the role of institutional reforms in successful transition and creation of a sustainable market economy (Clement & Murrel 2001, pp. 6-7, Fries et alia, EBRD 1999, Roland 2001). Moers writes,

> "Standard economic theory is ill suited to explain transition …(because it) implicitly assumes that the relevant institutions are there, exogenous to the theory, while transition seems mainly a dynamic process of institutional change." (Moers 2001, p. 19, and Snowdon 2001 and Stiglitz 1999).

This topic is pursued in depth by Smyth (1998) and mentioned in Havrylyshyn's (2001) comprehensive review of transition literature.

We draw upon Weder's (2001) ranking the FSUCEE countries and a number of other developing countries (including some SSA countries) in terms of institutional quality, then reference Weder's typology match with rankings of economic freedom and financial risk derived from the "2002 Index of Economic Freedom" study of O'Driscoll, Holmes and O'Grady, and the March 2002 issue of *Euromoney*. The quality of state institutions is thus assessed indirectly through perceived economic freedoms and financial risks rather than from direct observations (e.g. number of public sector employees, public sector share of GDP and organisational structures).

When ranked by institutional quality, we see that countries of both regions overlap. Logically, economic and institutional development from the poorest SSA country to best performing EU member candidate represents a continuum (Gros & Suhrcke 2000, Kornai 2001, Weder 2001) of countries that may readily be extended to include advanced industrial countries.

During most of the 90s, development aid strategies followed two lines. The first involved securing political objectives. The second derived from academic growth theories that assumed a certain combination of production factors were decisive to sustainable economic growth (e.g. Harrod and Domar, Solow).

The second approach characterises most aid granted after the dissolution of the Soviet Union. For many the label "transition economies" brackets a category of thinking related to the emergence of independent former-Soviet states seeking to move from planned to market economies. The focus on macroeconomic reforms is enshrined in the "Washington Consensus" and great debate on speed of transition.[3]

In retrospect, the debate between shock therapists and gradualists seems exaggerated. Shock therapy proponents claimed governments had to exploit fully the window of opportunity and set reforms on an irreversible path (Balcerowicz 1995, Gaidar 1999), while gra-

[3] The "Big Bang" theory and debate over "shock therapy versus gradualism" split economists into two camps on how to introduce economic reforms, i.e. liberalisation, stabilisation and privatisation, to replace or transform institutional structures originally designed for command economies. Shock therapists emphasised the importance of fully exploiting a narrow "window of opportunity" to create a critical mass for reforms so that the transition process would not be mired in a mixed economy. Many international organisations favoured shock therapy, even when they acknowledged inevitable political and economic costs from high inflation and massive structural unemployment (IMF & The World Bank & OECD & EBRD 1991, Volumes 1-3).

dualists wanted to keep the pain of transition within tolerable limits. Kornai suggests the dichotomy had little meaning as speed is not the primary measure of success in nation-building (Kornai 2001, p. 60). Moreover, the debate, which engrossed many following FSU transitions and produced a good deal of interesting modelling work (e.g. the Aghion-Blanchard model of optimal speed of transition), was seen as largely irrelevant to the rest of the developing world.

As the Era of Big-Banging ebbed, interest shifted to sustainable performance. Development of institutions, enforceability of property and contract rights and generating adequate social capital entered the discussion. The buzzwords in today's transition discussions are egalitarianism, poverty reduction, income distribution and globalisation. On the surface, these issues are reminiscent of accusations made in the 1960s and 1970s against capitalist exploiters and multilateral donors working to increase the wealth gap. Back then, however, critics could characterise communist and socialist countries as saviours or benefactors. With the East-West paradigm replaced by a North-South paradigm, anti-globalists now focus on the alleged inability of market mechanisms to reduce poverty and narrow the gap between rich and poor nations. Notably, scholars on both sides of the current North-South debate agree that development of institutional capacity is important in assuring retention of economic gains.

Models for development derived from the economic textbooks work well in developed countries and advanced transition countries. Such countries can regulate their environments, e.g. through restricting immigration or imports of agricultural products through tariffs, subsidies and quality certifications. Textbook models are inapplicable, however, to countries with poorly functioning state structures. Taking a pragmatic approach, Scott (2001) suggests that the central the role of technical and financial assistance should be development of state structures and services. The enforceability of clearly defined property rights and maintaining law and order emerge as the main tasks of the state and represent the cornerstone of an honest market economy.

> "Many observers now admit that the transition economies needed appropriate property rights and an effective state to enforce those rights as much as they needed liberalisation of prices. Indeed, liberalisation without property rights turned out to be the path to gangsterism, not capitalism. China, with a more effective state, achieved much greater success in its transition than did Russia, even though Beijing proceeded much more slowly with liberalisation and privatisation." (Scott 2001, p. 161).

In section 3, the writings of Olson (1995 and 2000) and Hedlund (2001) illuminate the significance of property and contract rights as a basis of institutional development. Recent contributions on institutional capacity-building include de Soto's examination of bureaucracy's role in hindering the growth of capital (de Soto 2000) and Easterly's work on the role of economic incentives in the economic growth and development assistance (Easterly 2001).

Despite abundant empirical evidence that good governance promotes development, the causality seems recursive, i.e. rich countries can better afford good governance than poor countries (Kaufmann et alia, 1999). This is particularly true when the notion of good governance includes income redistribution – rich countries have more to redistribute. In section 4, the inter-linked issues on development of institutions, poverty reduction, economic growth, international trade and trade policy, income distribution, indebtedness and globalisation are discussed. The World Bank research of Dollar and Kraay (2001, a–d, and 2002, a and b) highlight many aspects of income distribution, reduction of poverty, and actual and alleged impacts of globalisation.

2 Institutional differences between post-Soviet regions and sub-Saharan Africa

Transition is commonly defined as the process of converting a centrally planned command economy into a capitalist free-market economy. This definition conveniently covers FSU economies and the CEE countries. Rankings of progress of the former socialist countries towards market economies often arrange best to worst (or slowest) reformers as follows:

1) The CEE countries (Hungary, Poland, the Czech Republic and Slovenia),
2) The Baltics (Estonia, Latvia and Lithuania),
3) Central CIS (Russia, Ukraine and Belarus),
4) Caucasus (Georgia, Armenia and Azerbaijan), and
5) Central Asia (Kyrgyzstan, Kazakhstan, Uzbekistan, Tajikistan and Turkmenistan).[4]

The literature, however, seldom extends such rankings beyond countries that gained independence around the time of the dissolution of the Soviet Union in 1991, which raises the question: What differences in relation to CEE and FSU countries might be observable in the experiences of other developing countries?

The typology of the CEEFSU countries in Table 2 follows the typologies used in the EBRD's Transition Reports.[5] The UNDP report (1997) also characterises the Czech Republic, Hungary, Poland as Central European states with democratic and institutional traditions that pre-dated the Soviet era. Estonia, Latvia and Lithuania also had pre-Soviet democratic traditions. The Russian Federation, Belarus and Ukraine are the core countries of former Soviet Union in the categories 3 and 4. Lumped in are the Southern Caucasus and the Central Asian republics. Although the Southern Caucasus countries, Armenia, Azerbaijan and Georgia, and Tajikistan in the Central Asia have been afflicted with wars, no CEEFSU countries ranked in category 5.

Weder (2001) grouped 150 countries, including most FSU, CEE and SSA countries, with respect to their institutional qualities into homogenous groups using K-means cluster analysis. The former socialist countries and other developing countries, including several sub-Saharan countries, were put into a comparative context by arranging them in 5 categories from highest (1) through intermediate (3) to lowest (5) levels of institutional development and GDP. The clusters were based on several criteria (see Table 3). Choosing her criteria from the perspective of market development, Weder observes,

> "The underlying concept is that a market economy can only operate if there are certain rules of the game and, in particular, that property and contract rights have to be defined, and there have to be mechanisms that will credibly enforce them. A well working institutional framework guarantees these rights by enforcing them against violation by third parties as well as by the state. For instance, corruption, discretionary action of bureaucrats, unpredictable changes in rules and policies, unreliable judiciaries are all means by which the state can de facto expropriate private agents."(Weder 2001, p. 4).

[4] See, for instance, the EBRD Transition Report, (Fries et alia, EBRD, p. 27).

[5] The South-Eastern Europe zone, which includes the Balkans, is omitted here.

Table 2. Weder's (2001) typology applied to FSU, CEE and SSA countries.

Countries are grouped according to their institutional quality and economic growth in five clusters: 1) highest, 2) high, 3) intermediate, 4) low and 5) lowest.

FSU & CEE

1.	2.	3.	4.	5.
Czech Rep.	Latvia	Armenia	Azerbaijan	
Estonia	Lithuania	Georgia	Belarus	
Hungary	Slovak Rep.	Kazakhstan	Turkmenistan	
Poland		Kyrgyz Rep.	Uzbekistan	
Slovenia		Moldova	Tajikistan	
		Russian Fed.		
		Ukraine		

SSA

1.	2.	3.	4.	5.
	Botswana	Benin	Angola	Sierra Leone
	Cote d'Ivoire	Burkina Faso	Chad	Somalia
	Gambia	Cameroon	Congo	Sudan
	Ghana	Gabon	Guinea-Bissau	Burundi
	Namibia	Guinea	Kenya	Cape Verde
	Tanzania	Lesotho	Liberia	Central African Republic
		Madagascar	Niger	Comoros
		Mali	Nigeria	Congo, Dem. Rep.
		Mozambique	Togo	Equatorial Guinea
		Senegal		Eritrea
		Swaziland		Ethiopia
		Uganda		Malawi
		Zambia		Mauritania
		Zimbabwe		Mauritius
				Mayotte
				Rwanda
				Sao Tome and Principe
				Seychelles

Her conclusions may be summarised as follows:

- EU accession candidates Czech Republic, Estonia, Hungary, Poland and Slovenia have achieved institutional capacities indistinguishable from the most advanced industrial countries. (Weder 2001, p. 18).
- There are large differences in the institutional performance between the groups of economies of the FSUCEE and SSA. (Weder 2001, p. 3)
- Measured by institutional quality and GDP, the countries and groups of FSUCEE and SSA countries overlap.
- Institutional variables are closely associated with investment and growth (p. 4), but the direction of causality is unclear. Good institutions promote economic growth, but economic growth and investment also seems to promote institutional quality.

The panels of the "2002 Index" (O'Driscoll et alia, 2002) and *Euromoney* (2002) assess economic freedoms and financial country risks, respectively, applying criteria shown in Table 3.

Table 3. Criteria for Institutional Quality (Weder), Economic Freedom (2002 Index) and Financial Country Risk (Euromoney)

Institutional Quality, Weder	2002 Index of Economic Freedom	Euromoney, March 2002
Rule of Law	Trade	Political Risk
Low Graft	Tax burden	Economic Performance
Low Regulatory Burden	Government Interventions	Debt Indicators
Accountability and Voice	Monetary Policy	Debt in defoult or rescheduled
Government Effectiveness	Foreign Direct Investments	Credit ratings
Predictability of Rule Changes	Banking and Finance	Access to Bank Finance
Credibility of Gov. Announcements	Wages and Prices	Access to short-term Finance
Information about Changes in Rules	Property Rights	Access to Capital Markets
Consultation	Regulation	Discount for Forfaiting
Property Rights Enforcement	Black Market	
Judiciary Reliability		
Predictability of Bribes		
Freedom from Discretionary Bureaucrats		

To see how the above criteria relate to Weder's typology (Table 3), scores of economic freedoms according to the Heritage Foundation/*Wall Street Journal* (O'Driscoll, Jr. et alia, 2002) and financial risks according to *Euromoney* were assigned to Weder's typology according to individual countries. Total scores by country are given in Appendix Table 2 and averages calculated for the groups of countries appear in Table 4 and Appendix Table 1.

The rankings by indicators of economic and financial freedoms appear largely in line with Weder's (2001) results, particularly for FSUCEE countries. No SSA countries rise to challenge the EU accession candidates, while a number of African countries (mostly war affected) lag the least-developed FSUCEE countries. This result is confirmed by other studies (e.g. Kolodko's 2002 examination of GDP per capita in PPP).

There are several explanations as to why the rankings differ. First, as shown in Table 3, each query applies somewhat different criteria. The SSA4, as a "mostly free" group of countries, scores better than the "mostly unfree" group FSUCEE3 including Russia. The FSU countries, and Russia in particular, developed elaborate state machinery and administrative practices non-conducive to free markets, particularly at local and regional levels. On the other hand, state administrative institutions in SSA4 countries, while undeveloped, unsophisticated and inefficient, evolved far enough to be conducive to a market economy and freer economies under the criteria of the 2002 Index.

Table 4. Countries grouped by institutional quality (Table 2), with average scores by group indicating economic freedom and financial risk

	Economic freedom	Financial risk	Nr of countries	
Scores from best to worst	1-2-3-4-5	100=>0		
FSUCEE1	2.5	68	5	CEE and Baltics
FSUCEE2	2.6	58	3	CEE and Baltics
FSUCEE3	3.5	32	7	Russia, south Caucasus and Central Asia & Ukraine
FSUCEE4	4.1	29	5	Southern Caucasus and Central Asia & Belarus
FSUCEE5	0.0	0	0	none
FSUCEE total	**3.2**	**44**	**20**	
Russia	3.7	36		
Nr of countries			20	
SSA1	0.0	0	0	none
SSA2	3.1	25	6	Coastal West Africa; Namibia and Tanzania
SSA3	3.2	28	14	Uganda, Madagascar, Zimbabwe, etc
SSA4	2.8	24	9	Nigeria, Congo, Kenya, Angola, etc.
SSA5	4.0-4.3	25	18	Ethiopia, Sudan, De. Rep. Congo, Somalia, small islands
SSA TOTAL	**2.7**	**26**	**47**	
SSA5 all	4.0		18	
SSA5 less small islands	4.3		12	
Nigeria	3.6	21	1	
Grand total	**2.9**		**67**	

Note: Economic freedoms are rated as "free" <2.0, "mostly free" 2.0<3.0, "mostly unfree" 3.0<4.0, and "repressed" 4.0-5.0. Financial risks represents a total score of 9 weighted components (see appendix Table 1), where the possible maximum score = 100. The 2002 Index criteria have equal weights, whereas *Euromoney* attaches percentage weights 25-25-10-10-10-5-5-5-5 to the nine criteria (Appendix Table 1).

Ranking countries by financial risk does not match Weder's typology. Even least-risky African countries fall below the riskiest FSU countries (with the possible exception of Tajikistan). From the viewpoint of financial risk, SSA countries generally do not overlap FSUCEE countries. Notably, the absence of economic freedoms does not seem to make a country exceptionally risky from the financial standpoint. There are countries where financial risks are minimised through authoritarian rule shared by a somewhat corrupt, rent-seeking political elite that benefits from the sale of oil concessions and other resources abroad (e.g. Azerbaijan). African countries with institutional structures either inadequate to start with or weakened by corrupt and inept officials are not necessarily able to protect effectively foreign financial interests (e.g. Nigeria).

Slovenia is considered safer for foreign investors than Armenia, which scores "mostly free" with regard to economic freedoms, whereas Slovenia with its relatively restrictive trade regime and governmental fiscal burden is ranked behind of Armenia as "mostly unfree." Here again, Slovenia, with a less corrupt but costlier state administration, is considered better for investors than the freer, institutionally weaker Armenia, which has little in the way of oil or other natural resources.

Other reasons may also explain the anomalies in country rankings. The marching order of the 20 FSUCEE countries has been fairly well established for the past ten years. In contrast, the rankings of the 47 SSA countries shift constantly. Typically, when a country is politically and economically unstable, any fresh developments, positive or negative, will influence its assessment.

The group averages of both regions include small and large countries with equal weight, distorting the picture. Tiny African island states grab the top scores (e.g. Mauritius and Seychelles) ahead of major actors of the region. Nigeria's GDP, for example, accounted for 21 % of the total SSA GDP of $881 billion in 2000. Similarly, Russia's GDP in 2000 accounted for 37 % of the entire FSUCEE region's GDP of $684 billion at current prices. Nigeria and Russia have almost equal scores and ranked as "mostly unfree" economies and both rank as "mostly unfree" or "repressive" with respect to almost every criterion. With respect to financial risk, Russia beats out Nigeria (Appendix Table 1), as does the entire FSUCEE compared to the SSA region (Table 3).

The 2002 Index of Economic Freedom does not rank eight sub-Saharan countries that have recently or are still involved in wars or suffered severe social disorder (Democratic Republic of Congo, Sudan, Eritrea, Somalia, Angola, Burundi, Liberia and Sierra Leone). Including these countries and assigning each the lowest score of 5 for economic freedom, the total score of group 5 falls to 3.9. Leaving out the midget-state islands, such as Mauritius, Seychelles, Sao Tomé and Principe (which have sometimes have moderate scores), the average total score falls to 4.3, i.e. a "repressed" economic situation. Lumping both groups together gives a slightly higher average of 3.9.

The ratings of economic freedoms have improved since 1996 fastest in the CEE and Baltic countries. In SSA, the improvement has been somewhat more modest than in FSUCEE countries. The most prominent ratings improvements occurred in the groups SSA3 and SSA4. Botswana, Mali, Ivory Coast and Namibia obtained improved ratings mainly through reduction of their black markets. No SSA countries obtained the rating of "free," but some countries (Botswana, Ivory Coast, Mali and Namibia) ranked as "mostly free" for the first time.[6] Absence of property rights, excessive regulation and black markets, as well as banking and access to FDI, continue to be rated as the most depressing factors both in the FSU and SSA countries.

Some anomalies appear when comparing country rankings by economic freedoms and financial risks (Appendix Table 2). These may reflect the different criteria sets (e.g. financial risks ratings seem generally to be more conservative than ratings of economic freedom). Moreover, panellists may simply be unfamiliar with some SSA countries. Many hold little interest for international investors.

[6] South Africa, which has a "free" rating, is not counted as an SSA country here.

3 The role of institutions in promoting markets and economic growth

3.1 States and governments

Political and economic textbooks use the terms "state," "government" and "public sector" interchangeably. In standard Anglo-Saxon usage, government may refer to the cabinet named by the president or prime minister or it may refer to the entire state apparatus. It may also designate the political management. For the purposes of this study, we differentiate between the terms state and government, and between strong government and large government.

The state consists of institutions and organisations. Institutions represent the formal and informal rules governing economic performance and the costs of production and transactions. These rules reflect behavioural norms by which agents interact. They may be formal (written law), or informal (unwritten codes of social conduct). Organisations consist of groups of individuals bound by a common objective such as the maintaining or changing of institutions through enforcement of the formal and implied rules. The state is governed through ministries and executive organs under them, as well as legislative bodies supported by political parties. Settlement of disputes and application of law belongs to independent judiciary bodies (North 1997, EBRD 1999, p. 6, World Bank 2002, pp. 6-7).

The state can also refer to the territory of a country and the administrative machinery available to its political decision-makers (e.g. heads of state, government) in exercising sovereign political power. This machinery consists of ministries, central offices, the central bank, the army, police, customs, tax authorities and security services, and more generally, institutions that represent security, continuity and technical-administrative expertise that does not change from election to election.[7] A number of services (e.g. postal services and railways) traditionally provided by the state can, in principle, be provided by private enterprises.

The term "government" denotes political rule and administration, i.e. a system or format for the ruling of a society. It is part of the state machinery, but narrower and changing according to the results of political elections. The government consists of people receiving and leaving their posts as a result of political elections (president, ministers, members of parliament and their personal assistants in the central, regional and local government). The success of a government may depend on the availability of support of state institutions (Marangos 2002).

This distinction between government and state is important. Governments and rulers come and go, but states are typically long-lived. Russia presently has a reform-oriented government attempting to function in the midst of inherited Soviet state machinery and a booming officialdom.[8] Part of this odd state of affairs reflects the increased independence of regions and localities in governing Russian territory. The Russian state is still by and

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[7] A state can be understood as a social contract between members of a group of people deciding to organise structures to maintain law and order, protect themselves with an army and police force against external threats, produce basic indivisible infrastructures like transportation networks, production of energy and take care of basic health and social services. The state has large machinery with large powers to enforce law and order and run the above functions under the auspices of ministries and government. The state also comprises an independent judicial system.

[8] The number of administrators and bureaucrats in the state machinery (excluding army, education, health and social services) has doubled in the past ten years to three million.

large unable to serve the ends of a free market economy, and this in turn has slowed development of a corporate sector. Bureaucratic customs procedures have impeded the growth and diversification of foreign trade. The enforcement of property rights, despite recent legislation, remains sporadic. It may well take several decades before Russian officials in the state machinery and judiciary learn to behave consistently as benign civil servants, enforcing the law fairly and effectively without bribes or undue influence.

States can be violently created or ended through war or peacefully as in the cases of the termination of the Soviet Union or East Germany.[9] The Soviet Union ceased *de jure* on 21 December 1991. Gorbachev's reforms lessened the possibilities for monitoring the activities of rent-seeking low-level bureaucrats. This corroded the authority structures of institutions and gave incentive to individual bureaucrats to operate on their own within the machinery. With exception of the army, most Soviet state machinery disintegrated before the *de jure* end of the Soviet state (Hildebrandt 1983, Solnick 1998, Wedel 2001). Traditions resiliently burdened by opportunistic behaviour carried over into the new Russian state administration along with legacies of excessive bureaucracy, corruption, patronage and coercion. Critics note that the state was not only robbed, but converted into an instrument for robbery (Hedlund 1999, p. 335). The rebirth of the Russian government from the Soviet government was, according to Yavlinski, "just as a snake sheds its skin." Unlike American tycoons, who were not averse to investing in their home country, Russia's robber barons generally preferred investing abroad. This seriously impeded the emergence of a Russian middle class (Yavlinski 1998).

After independence, many African countries experienced changes of political leadership, governments – even their country names – while the state apparatus persisted. Their institutional capacities were feeble at best and too weak to defend their citizens against natural catastrophes or the abuse of political power. These states were unable to provide adequate infrastructure and public services to support their economy or attract FDI. They lacked human and financial resources, and even sovereign control over their own territory in some cases. Parts of the population had no access to public or private services. As a result, the SSA states today exhibit a wide range of institutional qualities.

When states suffer war or challenges by ethnic groups within the territory, the state may be unable to convince citizens of the importance of common values. The common result in Africa is an authoritarian government that relies on force, violence and repression of political freedoms to impose values not shared with most of population. Before independence, African political leaders commonly promised that gaining independence and establishing social programs would solve most problems (Olcott 2001). Declarations of independence were often little more than changes of legal status. While some African leaders are specialists in expounding rhetoric on the benefits of independence to appease the population, this skill does little to solve the lack of investment in education, raise living standards, reduce unemployment or overcome sluggish economic growth (Smirnov 1999, p. 150).

[9] For example, the state of the Soviet Union ceased *de facto* through the Minsk declaration of 8 December 1991 on establishment of the CIS. It was signed by Yeltsin for the Russian Federation, Shushkevich for Belarus and Kravchuk for Ukraine (Izvestiya 9 December 1991). The Soviet Union ended as a state *de jure* on 21 December 1991 through the declaration of Alma-Ata (Izvestiya 23 December 1991). Its territory was reduced to the territory of the Russian Federation. The last government of the Soviet Union, led by prime minister V. Pavlov, was excused in August 1991, so in fact the Soviet Union was technically without a prime minister during its final months. Ivan Silayev, acting prime minister of the Russian Federation up to 20 September 1991, followed Pavlov. Boris Yeltsin assumed actual power, taking over the position of prime minister of the sovereign Russian Federation in September 1991. Gaidar followed in June 1992.

Africa suffers from a dearth of people with education and administrative experience. New political leaders must create national solidarity and stability from scratch. During the Cold War, not only the West, but China, the Soviet Union, East European countries and Cuba filled the gap by providing military and technical aid in exchange for assimilation of political leaderships in larger interest contexts. With independence and the loss of Cold War support, SSA countries found themselves on their own. Maddison (1995, p. 56) comments,

> "Suddenly, these countries had to create a political elite, staff a national bureaucracy, establish a judiciary, create a police force and armed forces, send out dozens of diplomats, find school teachers and build up health services. The first big wave of job opportunities strengthened the role of patronage and rent-seeking , and reduced the attractions of entrepreneurship. The existing stock of graduates was too thin to meet the new demands and there was heavy dependence on foreign personnel."[10]

3.2 Social capital

"Social capital" in an entirely content society is imperceptible as its existence is manifested when social needs motivate action. Social capital provides the *gravitas* for democratic action, allowing political parties, NGOs, and interest groups such as trade unions and the media to make expressions of political will that parliament can legislate into norms and that executive ministries can enforce (see World Bank WDR 2000/2001, p. 131 and chapters 6-8).

Social capital can be mobilised at supranational, national, regional or local levels. In most democracies, where the president or regent holds titular authority, the prime minister and coalition cabinet best recognise social capital as they wield actual political authority in implementing the mandate of democratic elections. Indeed, the lack of social capital explains much of the institutional backwardness in SSA and the FSU, and contrasts starkly with certain CEE countries and the Baltic countries where democratic forces purposefully mobilised soon after independence.

Party systems channel political action by providing a means for selection of members to parliament and local government. A common feature in early transition economies is an abundance of single-issue factions. While juvenile platforms may detract from serious debate at election time, the biggest problem is the confusingly large number of factions from which potential voters must choose (Hedlund 1999, p. 276) [11]. The serious side of democratic politics focuses on balancing the allocation of social wealth to growth-supporting investments and production of public goods and services. Indeed, the classic demarcation runs between defenders of free markets, who seek to maximise economic growth and promoters of social welfare, who seek redistribution of the fruits of economic growth to raise the general well being of the population. This all-important struggle is characterised e.g. as right-left, Republican-Democrat, or Tory-Labour. Mechanisms to guide the creation social

[10] In Africa, the European colonial powers drew the boundaries to suit their mutual convenience without regard to local traditions or ethnicity. In the twenty years after the end of the Second World War, 22 states emerged from what were once French colonies, 21 from British colonies, five from Portuguese, three from Belgian and two from Spanish colonies (Maddison 1995).

[11] Russia's 1995 parliamentary elections had 78 quasi-political and political parties, including a Beer Drinkers Party. See www.nns.ru/parties/parties.html.

capital are necessary because wealth redistribution constitutes an infringement of private property rights and economic freedoms. On the other hand, wealth redistribution under optimum circumstances supports economic growth by reducing political instability, raising purchasing power and enhancing labour force skills.

All CEE countries and the Baltic countries have accumulated sufficient social capital to operate as genuine democracies. In contrast, most FSU and SSA countries remain essentially clan states, despite formal democratic constitutions and institutions. Clans (families or regionally organised extended families) use their informal networks to appropriate property. At the start of Russian transition, well-placed individuals concentrated assets in their own hands by exploiting uncertain property rights, underdeveloped legal systems and poor investment conditions (Johnson 1997, p. 360).

A state may be small or large and it may be strong (efficient) or weak (inefficient), particularly if contaminated by personal rent-seeking and corruption. As long as the state respects the values of its citizens and allows them to retain incentives for work, it may well be able to persuade them to accept tax rates sufficient to cover high expenditures. After all, free citizens may opt for maximisation of private profits or choose heavy state structures and associated high taxes – whichever arrangement they feel is more likely to deliver their welfare optimum, e.g. national security, healthy environments or social safety nets (Easterly 2001, UNDP 1997).

Schematically, we posit good states S_g and bad states S_b; good governments G_g and bad governments G_b. Here 'good' ($_g$) is defined as efficient, honest, benign, or providing fair treatment, and 'bad' ($_b$) is the opposite. Thus, G_gS_g would represent a developed welfare state where the government takes good care of all physical and legal persons and the public sector share of the GDP may be fairly large. G_bS_b might describe many SSA countries, while G_gS_b might come close to the current Russian situation, whereby a corrupt state with Soviet legacies bogs down even good reforms by not enforcing the legislation, particularly in the area of property and contract rights. The CEE and Baltic countries already approach G_gS_g, whereas the rest of the non-Russian FSU (with possible exception of Belarus, Ukraine, and Turkmenistan) are starting to develop their institutional capacities with the support of Western technical assistance. G_bS_g implies an authoritarian *coup de tat* that transforms S_g into S_b.

Centrally planned economies inherited large institutional structures created by the state. In the 1980s, for example, the state sector's share of value-added was 96 % in the Soviet Union (1986), over 90 % in Czechoslovakia, East Germany and Bulgaria, around 80 % in Poland, and between 60 and 70 % in Hungary. In the OECD, the share averaged below 20 % (including commercial state-owned enterprises, and excluding government services). In African countries in the 1980s, the share of government varied from close to zero to 30 % of GDP. For example, the share of the state sector in Malawi was 25 % in 1984, in Kenya 15 % in 1984 and 10 % in Niger in the 1980s (Schwartz 1993).

The size of the state is quite often determined by the size of the territory (Pirttilä 1999). To extend supply of public services over a large territory requires a large officialdom and infrastructures (buildings, transport and communications). Often institutional structures have central, regional and local levels. If sparsely populated, expenditures per capita may be heavy. Costs may also depend on degree of diversification, degree of privatisation and quality of public services. Other factors may include great income inequalities that enlarge the state and public sector due to higher spending on redistributive programs (Gupta et alia 2001).

On the other hand, La Porta et alia (1998) find consistent evidence that better performing governments are often larger and note that labelling big government as bad government can be highly misleading. The number of ministries, state committees and govern-

mental departments vary little no matter how big the country. However, a large territory may require hierarchical structures to make public services available to all (UNDP 1997, pp. 16-22). In a welfare state, a relatively large bulk of existing legislation predetermines the level of government expenditures. Governments are tied by such legislation and can usually only marginally influence the size of the budget.

Åslund (2002) finds a connection between corruption and the size of the public sector, i.e. the larger the public sector's share of GDP, the more room for corruption as a large corrupt sector makes the country more corrupt than a small corrupt public sector. Åslund concludes, however, that the statistical material is not convincing. Given that the public sector's share of GDP in the CEE countries is 40 %, but only 25 % in Armenia, Georgia and Kyrgyzstan, and 20 % in Tajikistan and Turkmenistan, leads to the highly questionable conclusion that the latter countries are less corrupt than the former (pp. 152-154).

Abolishing the state or reducing its size, as suggested from time to time (e.g. N'Diaye 2001), does not end corruption or mismanagement. Moreover, corruption can exist in the private sector. In weak states, criminal activities cover such tasks normally handled by legal state enforcement agencies. Informal process substitutes or augments legal processes. Such informal networks benefit participants, but reduce overall economic efficiency (Kali 2001). Some of the world's least corrupt countries (Canada, Denmark, Finland, the Netherlands, Sweden) have both large public sectors and strong states.

Finally, the way the state operates and carries out its functions is important. This depends on the quality of state institutions (Tanzi 1998 and 1999), because such quality is tightly anchored to the state's ability to enforce property rights. To operate effectively, well-designed institutions and organisations must exist.

3.3 Economic freedom, property rights and rule of law

Economic freedoms

Hoskins & Eiras (2002) observe that economic freedom includes the exclusive right of individuals to use their resources as they see fit as long as they do not violate someone else's rights, and the ability of individuals to transfer or exchange these rights on a voluntary basis. The enforcement of economic rights is a necessary condition for a market economy. On the other hand, economic freedoms are constrained by the amount and quality of the property that belongs to the individual. Poor people have little, if any, economic freedom, because the resources to which they have exclusive rights are small. A vulgar misinterpretation of economic freedoms particularly common in economies in transition says that money gives freedom and power regardless of others' rights. This fundamentally misstates property law in developed nations, where the market economy in of necessity subject to regulation. The better view is that *a market economy is economic regime least restrictive on economic freedoms as long as its rules are enforced consistently, because it provides equal opportunities to all.* Thus, a properly functioning market economy gives everyone the chance to maximise their economic freedoms through earning more money, wealth, as long as they do so without violating the rights of others rights to do the same. What the market economy specifically does not promise is equal income and wealth to everyone.

The principle of freedoms without violation of the others' corresponding freedoms is incorporated in the principle of rule of law. An essential feature of the rule of law is that both rulers and those ruled have equal obligations, particularly with respect to their pro-

perty and contract rights. This requires an adequate institutional base to run the market economy. A fully functioning institutional base enforces property and contract rights and rule of law so that political and economic freedoms are optimised and risks for potential investors minimised.

Hedlund provides an excellent overview of the development of the philosophy of ownership and contract rights from Roman times. Medieval feudalism seems to be the watershed in the evolution of Western and Eastern Europe. In the West, the lord and vassal had mutual rights and obligations. Vassals had the right and implicit duty to rebel if the lord failed to hold his contract. In the old Russia, the ruler not only held autocratic power but also had claim on all productive assets. Thus, nobility held assets as compensation for life-long service, but not technically own them. In old Russia, the law served as an administrative device rather than as a set of rules governing the position and acts of state officials. In short, Western Europe inherited the tradition of rule of law, while Eastern Europe got rule by law (Hedlund 2001, pp. 217-222).

The Soviet regime introduced collective ownership, the use of which was dictated by the Communist party through a huge, centrally planned bureaucracy. Despite the emergence of a state and government, there were no private property or contractual rights. As Hedlund puts it,

> "In such a (Soviet) system, as it had been in old Russia, there can be no rights, only mercy." (Hedlund 2001, p. 224).

This system, lacking private property to defend and the incentives of free competition, was run by an administrative order and lubricated by bribes, corruption (*blat*), personal relations and networks, and barter (Pipes 1974, Olson 1995). Collective ownership meant property was badly maintained; the lack of individual ownership encouraged theft.

Stalin established a system extremely hostile to private ownership in the 1920s. Basically, the autocrat expropriated all natural and tangible capital stock by levying a 100 % wealth tax and then investing these resources in the production of capital goods. This explains the extraordinarily high capital accumulation in the former Soviet Union financed by tax receipts – an amount almost equal to all non-labour income! Stalin used this implicit taxation by taking virtually all profits of state-owned enterprises rather than imposing explicit taxes on individuals. Olson notes that no other autocrat in history has ever succeeded at state banditry on such a scale – and Stalin did it in the name of increasing savings, investment and national output! Not just forced labour, but all labour, was made available to the state at low cost through collectivisation of labour and life.

When an autocrat insists on obtaining 100 % of the rents, profit, and interest earned by the natural resources and tangible capital of his domain and sets the wages of workers to maximise the implicit tax on labour, there is *almost no private property or privately managed production to be guarded by subjects in their own self-interest* (Olson 1995, pp. 446-455).

Colonialism accomplished in Africa what Russian feudalism and the Soviet system did for ownership rights and governance in the FSUCEE region. When most African countries gained their independence a few decades ago, they often retained the arbitrary colonial boundaries that today divide populations, ethnic groups and resources. Moreover, rapid population growth has outstripped development of resources and prevented economic growth in per capita terms (Smirnov 1999, pp. 143-144).

Colonialism never acknowledged or honoured pre-colonialist property rights, rather it pursued predatory extraction of natural resources and exploitation of the labour force without assuming obligations to the local population.

Botswana offers a shining exception. Acemoglu et alia (2002) report that good institutions (private property rights and rights to invest) have long been in place, which, in turn, have enabled the government to conduct sound economic policies. As a result, Botswana has enjoyed exceptionally high growth rates (7.7 % between 1965 and 1998), reaching a PPP-adjusted income per capita of $5,796 in 1998 – nearly four times the African average. British colonialism was only marginally interested in Botswana and therefore did not destroy its pre-colonial institutions. Maintenance and strengthening of the property rights both against state expropriation and predation by private agents was in the interest of the cattle breeding rich elite, which had also possibilities to accumulate their property via investments. Botswana is rich in diamonds, which constitutes a good basis for the national economy. On the other hand, there are other SSA countries rich in diamonds and other natural resources (Democratic Republic of Congo, Liberia or Senegal) with dismal economic and political records.

Botswana illustrates the importance of preserving the pre-colonial institutional inheritance. Somalia, for example, is a relatively homogenous nation in terms of culture, language and religion. It inherited institutions made dysfunctional by factional conflicts originating from perennial competition between clans over scarce resources. To this day, its institutions cannot constrain fights among political elites or the formation of coalitions along clan lines. In Lesotho, the Boer War and the British support to Lesotho's political leadership during that time undermined traditional *kgotla* institutions. Institutional developments in Ghana and Ivory Coast also evidence that a lack of constraints on the political leadership creates political and economic instability and leads to lower economic growth (Acemoglu et alia, 2002).

There are few transition economies that maintain and enforce transparent property and contract rights. As a result, economic freedoms are also ambiguous and restricted (de Soto 2000, Olson 2000). Hedlund (2001) points out that, in the absence of solid and enforceable property legislation and a benign bureaucracy to enforce it, property, by definition, does not exist. Rather citizens possess property like (citing Olson 2000) a "dog possesses a bone." Taken literally, there is no property in developing countries, only possessions. This situation has two consequences. First, the material capital in transition and developing economies is dead or stalemated due to the high costs of bad bureaucracy. Second, the size of the non-legal economy is large because most enterprises cannot afford the costs of entry into the legal economy (or, for that matter, exit from the illegal economy).

The legitimacy of bureaucracy

Freedoms do not materialise without adequate institutional set-ups. De Soto notes that, although good bureaucracy does not guarantee the growth of capital, bad bureaucracy surely inhibits capital growth. Good bureaucracy requires unambiguously defined enforceable property and contracting rights and the rule of law. Property as an economic concept represents the transformation of physical property into shares, bonds, deeds, bills of sale or other claims or contracts carrying essential information on the underlying physical objects from which their economic or commercial value can be derived. Fixing the economic potential of assets by describing the property's economic and social qualities and registering it, the property is brought "from the material world into the conceptual universe where the capital lives" (de Soto 2000, p. 42).

A good bureaucracy:

1) Integrates dispersed information into a single system to make the property information standardised and universally available;
2) Makes people accountable by implying that all property has owner who can be located;
3) Networks people;
4) Protects transactions, and
5) Makes assets fungible.

Fungibility implies that any physical bloc of property, once transferred to “the conceptual universe where the capital lives,” can be divided in shares to be sold to different owners and included in their respective portfolios. The security of both the ownership and transactions transferring the ownership rights has to be publicly and privately guaranteed and insured. Awareness about easily accessible "conveyer belt markets" with standardised procedures and low transaction costs also contains an incentive to take care and improve material property, because an improvement will be reflected in the market value of the paper at its sale. In the Russian privatisation process, much of the property was purchased at low prices (for instance, in closed auctions) just to get it sold at a higher price without any improvement of the underlying real property.

In a primitive bureaucracy, the burden of proof lies with the citizen, not the officials. In practice, this allows state officials to treat anyone as a potential criminal until the citizen produces required documents or verifications. Often the official is vested with wide discretionary powers, opening the doors to corruption and increasing the importance among citizens for knowing the “right persons.” Hence, an official (e.g. customs, police, tax office) has potent incentives to maximise his or her administrative power and extract bribes. There is no risk of complaints, only pleas for mercy. Such a bureaucracy is inefficient and costly. It is the main reason entrepreneurs and other agents in transition and developing economies opt for operating outside the law.[12]

Another technical reform necessary for creating the “conceptual universe where the capital lives” is the introduction of international accounting standards. From a purely technical standpoint, this involves several years of training, rearrangement of data collection systems, and the implementation of internal and external audit functions. To make well-defined property rights transparent, property values and changes of those values must be in books. When buying or selling the property, all claims affecting the value of the property must be found in the books. Audited accounts, indicating profitability, liquidity and solvency and value of the collateral, as well as project analysis about the profitability of the project to be funded should be available to a prudential bank director or loan officer in commercial bank. Awareness about competition should provide enough incentives to ensure that the funds will be then allocated efficiently. Presently, “business plans” are under preparation in most FSU and SSA countries describing eloquently the firm and its past and

[12] Goskomstat assumes the shadow economy accounts for about 25 % of Russian GDP. Some experts believe the shadow economy is larger, and adds perhaps 50 % to the registered GDP. Due to the prohibitively costly entry, most enterprises stay extra-legal, even when their activities are not in themselves illegal (of course, the resulting tax or customs duty evasion is). At the beginning of 2001 there were 2.9 million firms, of which 51% did not state profit-and-loss calculations on their balance sheets. About a quarter (around 740,000) of all Russian enterprises are located in Moscow. Of these enterprises 65 % do not file in any tax declarations and about 70 % of them pay no taxes (Rytkönen 2001).

planned activities. The bottom line, based on audited, standardised bookkeeping, is still absent.

De Soto's notion of the importance of replacing restrictive bureaucracies with liberal ones is noteworthy because it emphasises cooperation to grow the economy. The problem is that the requisite market practices takes decades to establish and can be easily derailed in weak states. For example, disputes about assigning property rights to new settlements or squatters (absent clear adverse possession rules) will almost inevitably infringe on the rights of former owners. Even after decades of the technical implementation of an infrastructure "universe where capital lives," yet another decade perhaps will be needed before the emergence of a credible, liquid securities market.

3.4 The state and markets

The juxtaposition of state and market is unnecessary and can be grossly misleading. In early 1990, when reformers contemplated what to do with state-run socialist countries, many insisted on a minimalist state and encouraged sharp reductions in government and public expenditure. The result was a serious deterioration in the quality of public administration (UNDP 1997). The state exists to promote and cooperate with market. The markets, in turn, embrace consumers and investors, employees and entrepreneurs, and physical and legal persons. The state's task is to protect and advance their interests within a framework of democratically agreed rules. There is no inherent conflict between state and markets in economic and social policy. Porter (2001) states that competitiveness in a productive, growing economy requires rising skill levels, safe working conditions, health care, decent housing, a sense of equal opportunity, assimilation of underemployed citizens into the productive workforce and high environmental standards. Social policy must be aligned with productivity so as to prepare citizens for and sustain their participation in the market system.

Development literature traditionally neglects the historical fact that the state, together with the private sector entrepreneurs, exist at the outset to arrange the provision of the basic material infrastructures, e.g. energy production and distribution, transportation and communications, and basic local or municipal utilities. The state organises security, the preservation of law and order (police and army), as well as basic judicial, educational and health services. The primary initiative has come from the state, and only once the private sector and markets are made more functional, traditionally state run functions have been increasingly privatised. Still, the courts, army and police forces, or, for instance, lighthouse services, are publicly produced. Private initiatives are typically casual and supplementary at the beginning, increasing along with the development of the market. In the absence of well-functioning markets and in the presence of badly functioning states in the FSU, mafias take over certain services that in more developed societies with well functioning state and corporate sectors are typically viewed as public services.

In the historical perspective, the military and economic rivalries between European nation-states prompted these nation-states to develop agriculture, commerce, and technology (e.g. in the areas of shipping and weaponry). The need to form interest-bearing capital forced political leaders (rural nobility) to share power and wealth with private entrepreneurs (urban merchants). This led to the development of banks, corporations and stock markets, and in general, reallocation of society's resources both in public and private hands to mobilise these resources to earn returns and accumulate wealth. The conceptions of time and competition were introduced, while these developments were not observable in Asia or

Africa (Scott 2001, 172-173). Emigration from Europe transplanted these developments to North America.

Demand for market-supporting institutions may arise from the creation of markets. The supply of institutions depends on the government and the introduction of benign governance to the state administration. The state is expected to withdraw from direct interference and directing economic activities by restrictions and regulations and, instead, take a supportive attitude towards markets and private entrepreneurs and provide them with equal access to public services (Fries et alia, EBRD 1999, p. 39).

The dissolution of the Soviet Union marked an improvement in the general political climate and economic thinking in SSA, and led several countries to concentrate on growth of output and real capital income, as well as a degree of social improvement. Countries that have successfully promoted the market economy and liberalised foreign trade for more than ten years include Botswana, Mauritius and Uganda. More recently, they have been joined by Benin, Burkina Faso, Mozambique, Senegal and Tanzania.

In the 1970s and much of the 1980, most African countries governments still used price controls, interest rates and exchange rates to restrict production, distribution and trade to achieve economic and social progress (Smirnov). At the same time, SSA governments often pursued expansionary fiscal and monetary policies and financed their budgetary and public enterprise deficits through domestic and foreign borrowing. They neglected development of social services, which, aggravated by corruption, led to political instability that brought heavy indebtedness and poverty. Indeed, most African countries resisted market-oriented policies and reforms (Calamitsis 2001, p. 11).

Market development is predicated on the establishment of institutions that reduce transaction costs caused by inadequate information, define and enforce property rights, and minimise barriers to entry of new market participants. Institutions further assist in the managing of risks from market exchange and help increase efficiency and raise returns. Formal institutions include rules written into the law, codified and adopted by governments and public and private institutions and organisation, informal institutions refer to unwritten rules of game based on cultural tradition, religious or ethnic ties and trust. Governments play an important role in providing public goods such as defining property rights and judicial services to enforce these rights. Competition among firms promotes the development of corporate law (World Bank WDR 2002, pp. 5-7, 20-21).

Poor people bear the brunt of harms from weak institutions. Demand for bribes and unofficial fees hit those least able to afford protection. Growth supporting market institutions can reduce such vulnerability. For instance, financial institutions may help to reduce risks by allowing people to diversify their savings and smooth their consumption over good times and bad (Nsouli & le Gall 2001b, World Bank WDR 2000/2001).

In his critique of the de Soto's book, Woodruff maintains that de Soto makes land titling "sound like a free lunch" while ignoring wider needs of a modern market economy, like legislative improvements (Woodruff 2001, p. 1223). Samuelson (2001, p. 211) calls it a "single-bullet" theory of development that fails to see the true complexity of reality. De Soto does not explicitly refute the need necessary institutional capacity-building. Instead, he describes the institutional framework necessary to make property rights operational so that land titling centres institutions on the critical path of transition towards establishment of mechanisms that simultaneously takes advantage of and support property rights.

As banal as it sounds, reforms that support de Soto's system could include the introduction of international accounting standards. Enforcement the IAS system is such a technical requirement – a "single bullet" idea. Without it, other institutions, listed below, cannot function properly and efficiently. A firm cannot be managed in a market environment without knowing its profitability, liquidity and solvency. A bank can hardly reasonably

evaluate the creditworthiness of a potential corporate borrower. Standardised accounting systems are a vital part of the economic transparency and information to transfer price signals to economic agents and affect their behaviour.

De Soto's "conceptual universe where the capital lives" requires the following institutions or activities to function (Intriligator 1994):

- Stable money: there must be adequate amount of means of payment (coins, notes, cards, cheques, electronic money) serving as legal and generally accepted medium of exchange for settlement of any claims, unit of account and store of value. This implies sound macroeconomic policies from the government.
- Rights: a deal must have a legal contractual base. There must be sanctions and procedures and institutions to enforce them, i.e. an honest judiciary.
- Ownership: buyers and sellers must know what they own and are entitled to sell. A comprehensive register of title, accessible for all, must exist.
- Financial transparency of government, private enterprises and financial institutions to ensure the information base to enable competition and financial discipline.
- Information systems: sales promotion, advertising. Buyers and sellers must find each other.
- Financing and bank services: access to finance (availability of loans or equity capital). There must be a reliable and fast payment transfer system.
- Insurance: the parties of a deal must be able to get insured against credit and payment risks. Property insurance must be available.

In well-developed markets, agents have incentives to obey rules, because it minimises public sector interventions, often replaced by a trustful dialogue between the government officials and representatives of the corporate sector.

The applicability of de Soto's ideas in other cultural contexts deserves a note of caution. In many SSA countries, people's deepest connections are to their families, tribes and ancestors. People consider themselves as a part of a collective, so they may consider themselves without personal responsibility. They may be unwilling to follow disciplines other than those determined by their religion or group. The concept of private property may be vague. Freedom, including the economic freedom, is determined and perceived through collectively (family, clan, tribe, ancestry, religious group). Positive economic incentives (Easterly 2001) do not necessarily motivate them as they may be completely subservient and satisfied with the amenities they obtain as members of their collective. Collective ownership, which discourages competition, is still widely applied in the FSU, SSA and part of the Islamic world. While we wait for economic freedoms, private property rights and the rule of law to take root in these regions, we should consider the sobering thought that most basic disciplines and market-supporting institutional capacities took centuries to develop and have unique cultural roots in the common history of Europe (Samuelson 2001).

4 The significance of state capacity in development issues

4.1 FSUCEE and SSA facts

Over 300 million people in sub-Saharan Africa live on less than one US dollar a day. Almost half live in extreme poverty – relatively more than in any other region of the world. The corresponding percentage for the FSU is less than 10 % of the total population, which is to say that less than 30 million people in the FSU live in extreme poverty. The SSA region's share of the world trade continues to dwindle, FDI remains very modest and the income gap in relation to more advanced countries has widened. Africa has missed out on the benefits of globalisation.

In contrast, the FSUCEE region has generally marched towards a market economy. The CEE and Baltic countries are among the first wave candidates for European Union membership. Russia has enjoyed robust economic growth, surpluses in foreign trade, consolidated state budgets and healthy foreign exchange reserves. Yet, even if Russian legislators have passed an impressive body of reform-oriented legislation, Russian state institutions still lack the capacity to enforce laws. This situation has seriously hampered the growth of free markets and been accompanied by a deterioration of social conditions and public health.

The number of people living in sub-Saharan Africa increased from 508 million in 1990 to 643 million in 1999. Average growth during the period was 2.6 % per year, compared to a world average of 1.4 % during the same period). The share of people living in absolute poverty was 48 % of the total sub-Saharan population in 1990, and 46 % in 1999.[13] The average growth of the poor population during the ten years ranged from 1.3 to 3.3 % a year. Life expectancies increased in developing countries, they decreased in SSA. About 79 % of adults and 80 % of children with HIV in the world live in SSA (Wolfenson 2001).

Table 5. SSA and FSU, selected indicators

Selected statistics	SSA	FSU	SSA/FSU
Population, total (million), 2000	659	290	2.3
- average annual growth 1990-2000	2.6	0.0	
Land area (sq km)(million)	24	22	1.1
GDP (current US$ billion), 2000	322.2	392.2	0.8
GDP/capita, (current US$), 2000	489	1352	0.4
- GDP/capita (constant 1995 prices), 1992-1999	0.0	-1.5	
Exports of goods and services (current US$ billion), 1999	87.1	249.5	0.3
Exports of goods and services, % of GDP, 1999	26.9	46.3	
Foreign debt, total (DOD, current US$ billion), 1999	216.4	217.8	1.0

Sources: World Bank "Building Institutions for Markets," *World Development Report 2002*, World Bank & Oxford University Press, Washington D.C. 2002 Statistical Tables, and World Bank (World Bank CD-ROM 2001), and author's calculations. Annual growth rates are computed using a compound interest formula and the values of the first and last year of the period instead of selecting points from least-squares regression trends (as done by the World Bank to eliminate the undue influence of exceptional values).

[13] The World Bank estimates that 1.2 billion people, or 20 % of the world's population, live on less than a dollar a day.

Table 5 and Appendix Table 3 provide a broad view of areas to be compared. Sub-Saharan Africa and the former Soviet Union cover roughly equal areas, but SSA accommodates over twice that population. Population growth of the FSU stagnated during the1990s, increasing from 289 million in 1990 to 290 million in 1999. In contrast, the population in SSA grew at a rate of 2.6 % a year during the same period. FSU near-zero population growth was restrained by negative growth in the age group below 15 years, whereas the old age group increased slightly. The SSA population averaged growth over 2 % a year in all age groups.

In March 2002, 34 of the world's 42 heavily indebted poor countries (HIPCs) were in sub-Saharan Africa.[14] SSA owes more than $200 billion to foreign creditors, or about 67 % of their 1999 GDP (Appendix Table 3). Almost all HIPCs have very low GDPs and do not earn enough from exports to service their foreign debts. HIPC governments would lose their ability to fight poverty if foreign debt servicing was allowed to consume the lion's share of their budget revenues (Thomas 2001, Nsouli & le Gall 2001a).

4.2 Economic growth

Economic growth, foreign trade, distribution of income and reduction of poverty are interrelated issues. The comparison of growth, trade and income distribution among industrial countries, FSUCEE countries in transition, and the sub-Saharan countries, and between the countries within these groups, reveal major differences in the institutional development and justifies the conclusion that the level of the institutional development plays a major role.

Liberal governments may not immediately generate economic growth by increasing foreign trade, but instead influence growth through the creation of new state machinery or converting existing state machinery gradually to make it more conducive to development of a market economy, creation of a healthy business climate and accumulation of social capital. Institutions support markets, and markets are based on institutions to reduce transaction costs in the presence of inadequate information. Institutions define and enforce property rights and minimise barriers to entry for new participants. Institutions also assist in managing risks from market exchange, increase efficiency and raise returns. Formal institutions include rules of law, codified and adopted by governments and public and private institutions and organisations. Informal institutions refer to implied, unwritten rules based on cultural traditions, religious or ethnic bonds and trust. Governments play an important role in providing public goods such as defining property rights and judicial services to enforce these rights and establish the rule of law. Competition between firms catalyses the development of corporate law (World Bank WDR 2002, pp. 20-21).

Well-established economic freedoms go hand in hand with rapid economic growth (Barro 1994, O'Driscoll et alia 2002, Scott 2001). The FSU countries lag behind the industrial developed countries with respect of economic freedoms and economic growth. Obstacles to the emergence of good institutions include administrative traditions of state machinery, undefined property rights and excessive, corrupt bureaucracies. Just as undeveloped institutions can hinder economic growth, unfavourable economic developments may also discourage the development of institutions.

Drastic differences in the growth developments can be observed between Africa and Europe or Africa and Eastern Europe in the long run (Tables 1 and 6). Sub-Saharan Africa

[14] There are 47 countries in Sub-Saharan Africa. For details, see http://www.worldbank.org/hipc/country-cases/country-cases.html.

has failed to achieve even modest economic growth, and as a result the move towards market economies is almost glacial.

Table 6. GDP and population of SSA and Russia, 1960-1999

GDP per capita (constant 1995 US$)	1960	1970	1980	1990	1999
Russian Federation	1279	2050	3163	3668	2211
Sub-Saharan Africa	477	619	670	597	561
Coefficients of multiplication (RF/SSA)	2.7	3.3	4.7	6.1	3.9

Population, total (mill)	1960	1970	1980	1990	1999
Russian Federation	120	130	139	148	146
Sub-Saharan Africa	223	288	380	508	643
FSU	212	242	264	284	285
Coefficients of multiplication (RF/SSA)	1.1	1.2	1.4	1.8	2.3

Source: World Bank CD-ROM 2000. Note FSU figures for 1999 include Russian Federation and the new independent states (NIS).

GDP per capita in Western Europe was less than three times African GDP per capita in 1820, six times in 1900, and almost fifteen times in 1992. As seen in Table 1, Africa has yet to reach the level of GDP per capita Western Europe achieved more than 170 years ago. This cannot simply be a reflection of differences in natural resources or climatic conditions. Maddison (1995) lists a number of transformations in North America, Europe and elsewhere in the developed world, e.g. growth of capital stock, improvement in human capital, interaction among economies, the structural change from agricultural to industrial and service sectors, which never occurred in Africa. La Porta et alia (1998) also find such factors as ethno-linguistic heterogeneity, legal origin, religion and history matter in shaping the government. They establish the importance of good government in economic growth.

Often the majority of citizens in countries that live on exports of raw materials are poor, and getting poorer (e.g. Russia, Romania, and the Democratic Republic of Congo). Most such countries suffer from failures in state and institutional capacity building. In some cases, countries with market-supporting state institutions may depend on the quality of the policy conducted by their governments. Hoskins and Eiras note Australia and Argentina are fairly similar in terms of their natural resource endowments, yet Australia has a GDP per capita 2.7 times that of Argentina. This ratio was just 1.6 in 1900. They conclude that the difference has been driven by institutional evolution, particularly the more open liberal trade policy of Australia during the past 25 years (Hoskins & Eiras 2002).

When transition started in the FSUCEE region, GDP first fell in all countries. If we examine the 1990s using 1990 as the base year, we note a U-shaped curve. Some economies slower in their recoveries (Russia, Ukraine, Moldova, Kazakhstan, Tajikistan and Turkmenistan) display an L-shaped curve. Central European and Baltic economies appear fastest in their recoveries to the 1990 level. Official statistics may give a misleading picture, however (Åslund 2002, pp. 120-121, Easterly 2001). Actual Soviet-Russia pro-

duction and growth of GDP, for example, may not have fallen to the extent depicted by flawed, politically pragmatic or dishonest statistics.[15]

In Botswana, Mauritius and Uganda, no downward bend or contractions are visible in transition periods over ten years. Indeed, no U-shape pattern is generally visible in the GDP statistics of SSA countries. GDP per capita at constant 1995 prices decreased during the first part of the 1990s (bottoming 1992-1994) in some cases and then started to grow (e.g. Côte d'Ivoire, Gabon, Cameroon, Togo, Angola, Niger Mali, Swaziland). Even in these cases, the U-shape is either very mild or, in some cases, downward trending in 1998-2000 (Gabon, Niger, Swaziland, Lesotho). In other cases, the growth of the GDP has been monotonous (Benin, Ghana, Guinea, Lesotho, Uganda), falling (Sierra Leone, Zambia, Madagascar, Mozambique, Nigeria) or close to zero with minor irregularities (Chad, Guinea-Bissau, Nigeria, Republic of Congo, Zimbabwe) (Calamitsis 2001, World Bank Development Statistics).

The countries of SSA region demonstrate that economies do not necessarily grow (Olcott 2001) and may deteriorate. Development is a time-consuming, lengthy process. The average annual growth per capita of SSA countries was 0.9 % during 1820-1992 (Table 1), -0.1 % 1973-1992 and –0.9 % during 1980-1990, lagging behind corresponding for world totals of 1.2, 1.2 and 0.4, respectively. Chart 1 in the Appendix illustrates recent developments in sub-Saharan countries. Almost all lag behind their past growth figures.

Many reasons have been proposed for Africa's slow growth. Bloom and Sachs observe that Africa is geographically disadvantaged (Bloom & Sachs 1998). Easterly and Levine argue that Africa's high ethnic diversity complicates cooperation (Easterly & Levine 1997). High population growth is costly in per capita terms and a bad economy may even induce a baby boom. The prospect of a rise in the standard of living gives families incentives to have fewer children and provide them with better educations (Collier 1998, p. 275, Collier & Gunning 1999). Collier argues, that a low level of political rights is the reason. The predominant causes for civil wars are poverty and lack of political rights (voting rights).

In SSA, GDP growth per capita has been held to zero by the strong population increase. In the FSU, in contrast, stagnating population growth failed to prevent a fall in GDP per capita in the 1990s. The GDP of SSA in 2000 corresponded to 60 % of the GDP of the FSU. Although the exports from SSA countries increased rapidly during the second half of the 1990s (faster, in fact, than exports of goods and services from the FSU), they remained at a low level and corresponded to just over a third of exports from the FSU in 1999.

The 1980s was a lost decade for Africa (Smirnov 1999, p. 166). Agriculture was neglected, while investment was directed to mining instead of processing industries. The lack of resources prohibited the increase of productivity in agriculture. Fluctuation of production and instability characterised the agricultural sector, which perpetuated deficits in foodstuff supplies and led to food imports. Recovery started during the latter half of the

[15] Åslund concludes that the Soviet Union was in much worse shape than the official statistics indicated, and conversely, that substantial growth not reflected in the statistics occurred in the 1990s. The Soviet economy provided strong incentives to cheat, i.e. to give higher production figures than actual, whereas in transitional economies the statistical bookkeepers were not prepared to record new enterprises, the majority of which opted for not giving any information to evade taxes and the high costs of registration. After the dissolution of Soviet Union, this disarray likely had a negative impact on production. Part of this disarray might have been caused by the old inertia of the conservatives trying to resist or boycott the new system. There was also an actual decrease of defence production and consumption. Soviet defence expenditure, estimated to be more than 22 % of GDP, fell to 2-3 % of GDP at the beginning of the 1990s (Åslund 2002, p. 131). Hildebrandt (1982) estimates that the historical long-term growth trend of defence expenditures by 4-5 % a year reduced the annual growth rate of the Soviet economy between a tenth and a fifth of a percentage point and consumption by more than half a percentage point in the 1990s.

1980s. Improvements in industrial production took place in 1986-1995. They were based on growth of processing industries in SSA countries. In 1986-1990, the average annual growth of the GDP coincided with the annual growth of population (Smirnov 1999).

During the 1980s, SSA countries listened more carefully the advice of the IMF and the World Bank. Socio-economic reforms, including privatisation, liberalisation, property rights enforcement, were launched while state intervention in private business was reduced. Social safety nets were established, structural distortions corrected, macroeconomic reforms were implemented to pave the road for market economy. The financial sector was strengthened and markets were opened for FDI (Smirnov 1999, pp. 168-169). Unfortunately, African countries were unable to take advantage of the capital flows in the form of job creation and the transfer of technology, management and organisational skills (Laulajainen 1998). Africa remains a continent with weak economic and political management, poor infrastructure and inadequate legal frameworks (Ajayi 2001).

Voucher privatisation, where citizens, for the sake of social fairness, are given equal share of the former property of the state, was never attempted in sub-Saharan Africa. Instead, direct sale has been the most common method of privatisation, followed by sales on the stock exchange (e.g. most Nigerian privatisation sales were made through the stock exchange). Despite of domestic opposition, privatisation in Africa occurred because politicians and bureaucrats were able to claim the real benefits for themselves. In some cases (e.g. Kenya and Zambia), privatisation of critical companies was a precondition for further aid. Whatever the motivations, privatisation proceeded rapidly in most African countries, indeed, sometimes faster in socialist countries such as Mozambique and Tanzania than in capitalist-oriented countries such as Kenya or Côte d'Ivoire (Kayizzi-Mugerva 2001).

The Soviet economy grew after the 1920s by virtue of the strong capital accumulation in industries that absorbed inefficiently employed people from agriculture and created rapid growth of consumption and investment. The decline of the economy after the 1970s was due to inability of the planned system to adapt to a new situation (Allen 2001, Cohn 1983). There were a number of associated factors such as decline in both labour and total factor productivity. Productivity decline was caused partially by exogenous problems like bad weather conditions hitting the agricultural and agro-industrial production, recession of the Western economies during the second half of the 1970s reducing their Soviet imports and reduced Soviet hard currency earnings, and finally a slowdown in population movement from low productivity agriculture to higher productivity industrial sectors. In addition, the raw material base west of the Urals became depleted, which ate into the capital stock, particularly in transport and energy production and distribution.

The Soviet economy was unable to take advantage of technology transfers from the West. The heavy planning bureaucracy contributed decisively to the downturn of productivity, through coordination problems and deterioration of discipline in labour and plan enforcement. This was reflected e.g. in the excessive growth of unfinished construction. Soft budget constraints made socialist construction firms insatiable in their demand for materials, labour, and capital inputs, leading to an "economy of shortage." The economic failures together with observed growth of the underground capitalism, corruption and perceived double standards eroded Soviet citizens' confidence in their political and economic system (Allen 2001, Levine 1983).

The most recent developments in Russia call for focusing on reform of the heavy public administration and restructuring the heavy energy and transport sectors. The Russian government has made substantial reforms in tax laws, labour and land codes, laws on deregulation and pension system reform, customs code, bankruptcy legislation and electricity sector reforms. The hard part remains, i.e. administrative reforms, trade liberalisation and reform of natural monopolies and the banking sector. Personal rent-seeking and corrupt

practices, as well as a heavy administrative burden, hinder these reforms. The number of public administrators was 0.8 million in 1980, about 1.5 million consisting 2.1 % of all employees in the Soviet Union in 1991, and 2.9 million or 4.5% of all employees in 2000 (Goskomstat 2001, p. 141).[16] In Russia, the question is no longer about enlarging the public sector and state involvement, but whether Russia can reverse a decade-long trend and rebuild an effective state without compromising democratic values and civil liberties (Graham 2002, Fisher & Sahay 2000).

4.3 Trade and trade policy

International trade and the economic growth go hand-in-hand in long-term development. Dollar and Kraay found that a 20 percentage points increase in the trade share of the GDP increases growth by between 0.5 and 1 percentage point a year – a statistically significant and economically meaningful effect. Further, no reverse causation from growth to trade was observed (Dollar & Kraay 2001a).

Between 1820 and 1914 international trade grew faster than the global economy (trade from 2 % of world income in 1820 to 18 % in 1914). In the following period up to 1950, trade grew slower than income (World Wars, Great Depression) but then started to expand rapidly among industrialised countries due to trade liberalisation (GATT). International capital flows returned to the absolute 1914 level in 1980. Since then, international capital flows have evolved from infrastructure financing to FDI and to manufacturing and services (Dollar & Kraay 2002a, p.122). This change has been further supported by cheap and fast transportation and developments in telecommunications.

Between 1948 and 2000, world trade grew at an annual average rate of 6.2 %, outpacing the growth in world output of 3.8 % a year. During the same period the share of Africa of world merchandise exports declined from 7.4 to 2.4 % and the transition economies from 6.0 to 4.4 % The major winners were Asian countries with China, Japan and the Far East economies increasing their shares from 14 to 27 % (United Nations 2001a, pp. 154-156).

The growth of trade has been supported by development of international money and capital markets since the 1970s. Advances in information and computer technologies, globalisation of national economies and competition among the providers of intermediary services have led to financial globalisation. Both global gross capital flows and cross border flows have experienced fourfold increase in the 1990s, $7.5 and $1.2 trillion, respectively, in 2000 (Häusler 2002). These flows occurred mainly between the Far East, Western Europe and the United States, and had little to do with the FSUCEE and SSA countries (Laulajainen 1999).

Table 7 shows the trade marginalisation of SSA and transition countries. The shares of SSA and FSUCEE countries of the world trade remain modest in comparison to the shares of the developed countries and other developing countries ("rest of world"). Although the developing countries have been described as "exploited" for primary products (food, agricultural raw materials, fuels, minerals and other raw materials), the shares remain modest. The exports of SSA countries have collapsed from $142 billion to $35 billion between

[16] The reason for the large increase is unclear. Allegedly it relates to the efforts of presidents Yeltsin and Putin to solidify their power base through expansion of bureaucracy (Berezovsky 2002). The figures represent administrators and bureaucrats only, and exclude civil servants employed in the social sector, health services, education, science and culture. To get enlisted to the government is difficult for young well-educated applicants, because loyalty still takes the precedence over the competence in Russian civil service.

1985 and 1999, which represents average annual growth of –10 %. Indeed, many SSA countries have been forced to import food due to low productivity of their own agriculture and adverse weather conditions.

Table 7. Composition of merchandise trade in 1999, shares in % and growth 1985-1999.

	1999 Imports		1999 Exports		1985-1999 Annual average growth	
	Primary	Manuf.	Primary	Manuf.	Imports	Exports
FSUCEE	4.3	3.6	6.5	3.4	5.7	6.4
SSA	0.8	0.6	2.6	0.2	3.7	-9.9
Developed	68.6	69.5	49.1	69.1	9.0	9.1
Rest of the World	26.3	26.3	41.8	27.3	9.2	9.3
World, %	100.0	100.0	100.0	100.0		
World (US$ billion)	1022.1	4407.2	1023.3	4406.3	8.8	8.8

Source: United Nations 2001a, Tables A15 and A16, pp. 260-263. Note that growth figures are inflated due to the inclusion of intra-FSU trade flows, which were considered internal until 1992.

As shown in Table 8, the EU and other developed countries are the most important trade regions to both the FSUCEE and SSA countries. About 60 % of trade of both SSA and FSUCEE took place with the European Union and other developed countries. The EU is more important as a trading partner to the FSUCEE than to SSA countries. The share of trade among FSUCEE countries was relatively high (28 % of total trade) for obvious reasons of history and geographic affinity. Growth of that trade, however, has been modest. The share of trade between SSA countries was 10 % in 2000 and growing fast. Interestingly, the trade between SSA and FSU countries has grown rapidly between 1995 and 2000, although their shares of respective regions' total trade have been quite modest (only 2.8 % of SSA exports and only 0.4 % of FSUCEE exports).

Table 8. Direction of trade: exports (F.O.B.), 2000

	Share, %			Average annual growth 1995-2000		
Destination (below)	SSA	FSUCEE	World	SSA	FSUCEE	World
EU	39	48	35	4.1	8.5	2.8
Other developed c.	21	11	32	6.0	9.8	7.9
FSUCEE	3	28	4	17.8	0.8	4.5
SSA	10	0	1	7.8	19.7	4.5
Other developing c.	13	13	27	2.5	5.8	3.7
Unknown	14	0	1			
Total, %	100	100	100			
Total (US$ billion)	44	275	6341	7.8	5.7	4.5

Source: UN 2000, Table A.14, pp. 258-259.

According to Ajayi (2001), Africa's relatively isolationist policies and closed economies led to sluggish economic growth and marginalisation (p. 7). During the period 1960-1969, Africa's average share of total world imports was 5.0 % and exports 5.3 %. In 1990-98, these figures dropped to 2.2 % and 2.3 %, respectively. Restrictive trade regimes of African countries and high transport costs to and from markets are obvious reasons for the low rate of participation in the world trade. Still in the 1990s, despite liberalisation of trade regimes, SSA trade regimes remained more restrictive than those ones of their trading partners or competitors (Ajayi 2001, p. 7).

Foreign direct investment seems to avoid both the FSU and SSA regions. As shown in Appendix Table 1, restricted access to finance, uncertain property rights, heavy regulation, black markets, and treatment of the FDI (excessive restriction, minority rights) constitute major obstacles to FDI. Although economic freedoms are better than in SSA, the FSUCEE carries larger political risks. Table 9 affirms that basically these regions do not attract FDI, main flows of which are concentrated in high-income industrial countries.

Table 9. Foreign direct investment, net inflows, BoP-based, current US$in 1999

	Net inflows BoP US$ billion	Share, %	% GDP	Per capita US$	Avg. annual growth 1989-1999
Sub-Saharan Africa	7.9	0.9	2.5	12	11.6
Russian Federation	3.3	0.4	0.8	23	na
NIS	2.8	0.3	2.4	23	na
FSU	6.1	0.7	1.2	23	na
HIPC	8.1	0.9	4.0	13	27.7
High income countries, >= US$ 9,266	699.0	79.0	2.9	780	14.1
World	884.5	100.0	2.9	148	15.2

Source: World Bank CD-ROM 2001 and author's calculations

The commodity structure of the trade between East (Russia) and West (EU or Western Europe) follows an inter-industry pattern. Russia provides Western Europe with traditional Soviet-era exports of oil, gas and raw materials and receives in exchange for manufactured goods and food for well-to-do Russian consumers. About 50 % of exports from Russia consist of fuels (oil and gas). Together with ores, metals and gems, these items account for about 80 % of Russian exports. Russia is relatively vulnerable to oil price changes: a 10 % change in the oil price induces a more than 2 % change in the Russian GDP with two years' lag (Rautava 2002). Nearly 90 % of imports to Russia consist of fabricated or semi-fabricated consumer or investment goods (Goskomstat 2001). About 30-40 % of Russian foreign trade is inter-industry trade.

Russia is one-sidedly dependent on foreign trade, of which about 70 % takes place with European and about 35 % with EU member countries. These trade dependencies are asymmetric when looked at from the side of the EU countries: trade with Russia is not so important for them. The share of each EU member country's trade of its total foreign trade with Russia in terms remained at about 1 %, with several exceptions (e.g. Germany and Finland; IMF 2001). Moreover, the role of Russia as Europe's energy supplier was cemented through the "Partnership in Energy" concluded at the European Union and Russian summit on 15 October 2000 in Paris. The deal proposes "positive interdependence" by way of Russia increasing energy deliveries to Europe in exchange for investment and new tech-

nologies from the EU. Although this dependence has been a matter of concern for some Russian economists and politicians, one can safely assume that the structure of production is not going to change drastically in the foreseeable future. The structure of foreign trade typically changes slowly.

Similar features can be observed about the trade of SSA countries with their more developed trade partners. SSA countries often depend on a few export commodities and are far more sensitive in the negative change of terms of trade. Virtually all raw material prices are a their lowest levels in real terms in the last 10-15 years. Coffee and copper are presently about one half and cotton one third of end-1999 prices. In such situations, FDI draws back (Cotton & Ramachandran 2001). In Zambia, for example, the Anglo-America PLC announced it will withdraw after sinking €120 million during the last two years. Zambia is currently experiencing a drought, implying it will have to import food. Moreover, an even larger foreign trade deficit for Zambia, already one of the most highly indebted SSA countries, will only deepen its external debt problems.

Table 10. Trade dependency of selected African countries

Country	Raw commodity	Share, % of exports	Change in total exports		
			1998	1999	2000
Uganda	coffee	56	-11	-23	-28
Zambia	copper	56	-20	-26	-25
Mali	cotton	46	-11	-23	-28
Rwanda	coffee	45	6	-11	-25
Chad	cotton	42	-6	-15	-20
Burkina Faso	cotton	39	-4	-16	-25
Benin	cotton	38	-7	-14	-16
Tanzania	coffee	11	1	-7	-13

Sources: IMF, WTO, Karismo 2002

These features repeat themselves in the trade between SSA and industrial countries. The asymmetric trade dependency implies that trade with industrial countries is potentially important for SSA countries, but from an economic point of view, industrial countries can do without trade with SSA countries. As a rule, the exports of SSA countries depend on one or few products, usually from the primary sector with a fairly low degree of value-added. Trade between SSA and industrial countries is typically inter-industry trade.

Exports of fuels, minerals, diamonds, foodstuffs from African and FSU countries benefit the industrial countries. Export earnings tend to accumulate in the hands of the commercial and political elite of the exporting FSU or SSA country. In the worst case, export earnings, which optimally should be invested in the development of domestic industries, are spent on luxury consumption. Agricultural failures in SSA often force the government to use a large part of its export earnings to import foodstuffs. The extent the export earnings of returns from direct investments will benefit the poor people, depends on the preferences of the preferences of exporting country's government (Sharer 2001, Smirnov 1999).

On average, the trade regimes of African countries are more protectionist than those of other countries, including Africa's major trading partners. However, African countries made a substantial progress in their foreign trade liberalisation in 1990s. According to the IMF (IMF, "Trade Liberalisation in IMF-supported Programs) 75 % of the countries in the

region had trade regimes classified as "restrictive" in 1990, but by 2000 this percentage had fallen to 14 %. At the other end of the scale, 43 % of countries were classified as open in 2000, whereas ten years earlier there were no countries open to foreign trade in Africa (Table 11).

Table 11. Trade regimes (number of countries)

	Africa 1990	Africa 2000	Rest of world 2000
Open	0	43	61
Moderate	23	43	24
Restrictive	77	14	15

Source: Sharer 2001, p. 15

Open trade regime is expected to promote international trade provided that other preconditions exist. Although sub-Saharan Africa has made impressive progress in trade liberalisation during the past ten years and in structural reforms, it is still more protected than its main trading partners (Europe and North America) and other regions. According to Sharer, Africa's current average tariff of about 19 % is still higher than the average of 12 % of the rest of the world. At the beginning of the 1990s, the unweighted tariff rates accounted for 25 % and non-tariff restriction 47 % of trade, which compare to 22 % and 24 % of all countries (Sharer 2001, UNCTAD 1999, Cotton & Ramachandran 2001, Gondwe 2001).

Trade restrictions may be an impediment to regional integration of SSA. Sharer reminds that, although the benefits of regionalism in stimulating efficiency and reforms should not be underestimated, regionalism is no substitute for broad-based liberalisation of trade with Europe, North America and Asia. Intra-regional trade of SSA countries currently accounts for 10 % of total trade, but has been increasing rapidly at an annual average rate of almost 8 % in 1995-2000 (Table 6). Sceptics argue that regional organisations do not necessarily help solve common problems, i.e. weak states make weak partners. The overlapping of organisations reduces the gains from regionalism, poisons the investment climate, harms transparency and leads to costly duplication of administration (Sharer 2001, Olcott 2001). Similar problems, added by the different size of partners, have disturbed efforts at cooperation among CIS countries.

Rodriguez and Rodrik point out that both academic and policy discussions overstate the evidence of positive correlation between trade openness in favour of trade openness as a catalyst for economic growth. Openness and growth are related matters, they admit, but these do not justify the conclusion that, once governments dismantle their barriers of trade, growth will automatically follow. Trade policy, actual trade (or export) volumes and the economic growth are related issues lacking unambiguous causal links. The ambiguity of the causalities thus calls for a more sophisticated analysis (Rodriguez & Rodrik 1999, p. 39). Obviously, there are intervening variables between the trade policy and trade such as geographic and cultural distance, and political and legal environments.

Trade policies and the absence of trade barriers between neighbouring countries or trade partners having close trade relations are important, as are geographic and cultural distances. The CEE region is closest culturally and geographically to western Europe. Its next closest neighbours are Russia, Belarus and Ukraine, while Caucasus and Central Asia remain more distant. Tastes and traditions matter in generation of trade in consumption goods, training, R&D, industrial standards and traditions in manufacturing. While there are obvious links between actual development of trade and the economic growth, there are

several factors that can interfere with the openness of trade and actual trade development, or trade policies and economic growth.

On the other extreme, taking any Central Asian or sub-Saharan land-locked country, geographically and culturally distant from markets, it hardly matters to such country's growth whether it maintains trade barriers or dismantles them. The Kyrgyz Republic, for instance, having joined to the WTO and most of the international organisations 1993, can do little about its lousy geopolitical location. Even if its government decides to implement the most liberal trade policy on earth, it will do little to substantially increase its foreign trade or economic growth. The same holds for a number of SSA land-locked countries such as Central African Republic, Chad, Niger and Mali (Dollar & Kraay 2002a, p. 132). Contacts of Northern African countries with relatively wealthy Mediterranean countries along with the historical trade routes (North African countries or South Africa) have obviously contributed to their higher rate of participation in the word trade and economic growth. For instance, the Arabic North-African countries have 1.2-2 times higher per capita GDP growth than SSA countries (Smirnov 1999, pp. 143-144).

4.4 Population and income distribution

Population: growth and qualities

Each year, the world population grows by about 83 million people, 82 million of them in developing countries. Pressures for migration nationally and globally are increasing. The rate of world population growth seems to have passed its peak, and no worldwide famine, as foreseen by Malthus, has taken place. In contrast, the production of food has also tripled the past thirty years. Although, there is no observed correlation between population growth and economic growth, Easterly makes the interesting point that in the long-run populations growth increases economic growth potentials, because larger populations have greater potential for innovation, human geniality, large-scale markets and application of improved technologies, which in turn enables the feeding of yet larger populations (Easterly 2001, pp. 96-97).

In the case of SSA, rapid population growth is generally seen as burden since national incomes have to be shared by many and there is not enough for anyone if divided evenly (Smirnov 1999). In contrast, Russia experienced a population decline, probably in response to the deterioration of social conditions after the dissolution of the Soviet Union. The relation between population growth and associated change in the age structure on one hand, and the economic growth and income distribution on the other, remains ambiguous. Probably the negative economic consequences depend on the weak state structures and safety nets in Russia, and total absence of such structures in SSA.

Moreover, when countries are hit repeatedly by natural catastrophes or wars, people are forced to think short-term just to survive. Short life expectancies support short-term thinking and leave few experiences to pass on to descendants.

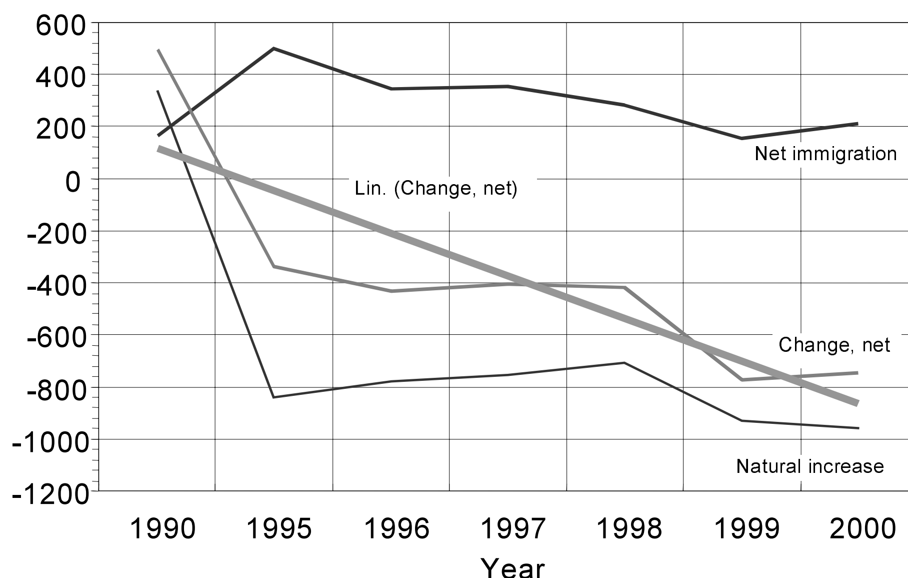
World Bank statistics indicate the annual average growth rate of SSA populations has been around 2.7 %, whereas the corresponding figure for Europe and Central Asia has been about 1 %. The total population of SSA had grown close to 660 million in 2000, when the world population hit the 6 billion mark (World Bank 2002). The population density of SSA remains, despite the strong population growth, fairly low, between 20-30 people per square kilometre. The corresponding figure is about 120 people per square kilometre in the Euro-Asian region.

Table 12: Changes in age structure in SSA, Russia and high-income countries in 1999, %

	SSA		Russia		High Income Countries	
	share of population	growth 1992-99	share of population	growth 1992-99	share of population	growth 1992-99
Population, age <15	44	2.3	22	-2.9	18	0.3
Population, age >64	3	1.7	11	1.7	14	1.7

Source: World Bank CD-ROM 2001 and author's calculations

Chart 1. Net changes in Russian population development in the 1990s, 1000 persons



Source: Goskomstat

The decrease of the Russian population as a result of natural decrease (subject to nativity and mortality developments) and immigration is seen in Chart 1 above. The population of the Russian Federation was 139 million in 1980, 148.5 million in 1990 and 146.5 million in 2000. There are two obvious reasons for the decline: 1) In the age-structure of the Russian population it represents the second cycle (1941-1948, 1966-1973, and 1991-1998) of the loss of people at age of 20-30 years in the Second World War. 2) The grave socio-economic situation resulting from the developments of dissolution of the FSU. In the case of Russia, a diminishing part of the population has to support a growing elderly population with fairly weak safety nets.

However, the level of education and openness and receptivity of the society for new information may matter more than age structure. This "perverted" age structure prevails in most developed industrial countries from a drop in fertility rates produced by higher standards of living. The decision of modern couples postpone the conception of their first child and limit their family size reflects their ambitions to gain higher education, have a good start in the competitive careers, and give better possibilities to their offspring. This trend seems to have slowed population growth in most developed countries (Easterly 2001). Due

to increased productivity based on elevated levels of education and professional skills, labour productivity can be expected to increase and perhaps offset the added economic burden of taking care of large older age groups. In the FSU economies, too, the younger generations and part of the older ones seem to be amazingly fast at assimilating the new ideas.

Easterly (2001) proposes that in FSU countries with ageing populations, the older generations may try to protect their own positions and vested interests and may, if not suffocate, at least slow, the younger generations' efforts to introduce new ideas and technologies to promote economic growth (Easterly 2001, pp. 179-185). Easterly makes the further point that Africa's younger generation could make a "big leap" to take advantage of the Internet and related IT businesses (e.g. India already has its own Silicon Valley).

In poor African countries, where life expectancies are about 40-50 years, life spans may be too short to gain an education and transfer it to the next generation. There again the physical age or the age structure may not be so important than the access to education and professions where the knowledge and skills can be applied, accumulated and converted into experience. This, in turn, requires an organised society and state powers to support education and a labour market.

In Russia, a diminishing part of the population has to support a growing elderly population with fairly weak safety nets. On the other hand, in comparison with the African countries, Russia may be better prepared to assume responsibilities for its elderly. In both the FSU and SSA, informal safety nets for family members and relatives and neighbours compensate for the absence of official arrangements.

Migration could cause high economic and social disadvantages as countries lose their best talent through emigration, as well as cause economic and social problems from immigration for receiving countries with large structural unemployment. However, in 2000, the total number of people not living in their country of citizenship was only 2 % of the world population (World Bank GGP 2001, p. 10). The economic consequences for the giving and receiving countries or regions would call for more economic research particularly, when the political debate and controversies are increasing.

Migration has been more intense within countries from rural and less-developed regions to the urban and metropolitan areas. In Russia, people migrate from fringe areas in the northern, eastern and southern regions to the growth centres, where they typically meet harsh conditions. The government lacks resources to improve the poor living conditions these immigrants must confront. Both in the FSU and SSA, the main problems have been the inability to develop industries to absorb the people moving from agricultural to urban areas. This has led to impoverishment of the migrants and creation of slums and squatter towns on the outskirts of Russia's large cities (Kontorovich 1997, Smirnov 1999).

Income distribution

Income and poverty move together. When the economies decline, poverty increases. This has been case in Russia and Central Asia, but holds also for sub-Saharan Africa. There is also causality, albeit ambiguous, between economic growth and income redistribution (Easterly 2001, p. 14).

A UNDP report (1999) emphasises that the strong growth of inequality and increased poverty in Russia are caused by the corrosion of the state machinery in charge of health care and social security. In the FSU, a pillar of the old Soviet system was an extensive social safety net. Reduced tax revenues, the abolition of universal social security coverage and privatisation in the post-Soviet era led to a breakdown of this social safety net. The UNDP report describes the dismantling of the former comprehensive system of social security as one of the great tragedies in the transition of the FSU and in much of eastern and

southeastern Europe. The WHO estimates that to normalise Russian health care, allocations must reach 5-6 % of GDP (UNDP 1999, pp. 52-55). The UNDP report also confirms that, given the prevailing "rule by law" and the deficit of social capital,

> "People are objects instead of participants in shaping policies that affect their daily lives." (UNDP 1999, p. iii).

In 1989, about 14 million people in the FSUCEE lived on less than four dollars a day. By mid-1990, that number had risen to about 147 million (UNDP 1999, pp. iii-iv). Table 9 presents Tikhomirov's (2000) calculations, according to which more than half of the Russian population falls into the low-income bracket. This share was slightly over one-tenth in 1990. At the beginning of the decade, more than a third qualified as high-income earners, but eight years later only 4 % could boast of being rich (probably very rich). The coefficient of income concentration (Gini coefficient) has increased from 0.289 in 1992 to 0.394 in 2000 (Maleva 2001).

Table 13. Percentage of Russian population belonging to low, middle or high income groups in 1990 and 1998

	1990	1998
Low-income-group (less than 0.5 of the average per capita income in 1990)	11	52
Mid-income group (0.5-1.0 of the average income per capita in 1990)	52	44
High-income-group (over 1.0 of the average income per capita in 1990)	37	4
	100	100

Source: Tikhomirov 2000, p. 192

As mentioned, about 300 million people in SSA live on less than a dollar a day, the line for extreme poverty. In very poor SSA countries, economic crises seem to increase poverty more than wealthier countries (including the FSUCEE), which are institutionally better prepared to protect their population. For instance, in case of Ivory Coast, Mali and Zambia, poverty increased rapidly during severe economic recessions. As noted above, the relation between the change of GDP and poverty remains empirically ambiguous.

The average annual growth of GDP per capita in constant 1995 prices has been slowest in SSA – slower than even low-income countries as a group, which include virtually all sub-Saharan countries. Given the per capita income growth rates at constant prices, it is impossible to conclude that income differences have narrowed between sub-Saharan Africa and the rest of the world. It is obvious from Table 11 that the gap in income and wealth between the major regions has widened in the long term and certainly during the recent decades.

Table 14. Level, growth, and comparison of the GDP by countries in different income groups, and SSA

	GDP per capita, dollars at 1995 prices			Average annual growth, %		GDP per capita compared to SSA GDP per capita		
	1960	1980	1999	1960-99	1980-99	1960	1980	1999
Low income <=US$755	248	340	461	1.6	1.6	1	1	1
Middle income US$756-9,265	746	1507	2064	2.6	1.7	2	2	4
High income US$9,266=>	10037	19748	28892	2.7	2.0	21	29	52
World	2587	4335	5439	1.9	1.2	5	6	10
Sub-Saharan Africa	477	670	561	0.4	-0.9	1	1	1

Source: World Bank CD-ROM 2001

If the per capita income in the high-income-countries was 21 times higher than in the sub-Saharan Africa in 1960, and almost 30 times higher in 1980, and 52 times higher in 1999, it is difficult to conclude that the gap between sub-Saharan poor countries and the high-income-countries has not been widening for the past 30 years. The same holds for low-income countries, which includes sub-Saharan Africa, India, Pakistan, Indonesia and a number of smaller countries. The high- and middle-income countries experienced slightly slower rate of growth between 1980-1999, but this has not narrowed the per capita income gap. In fact, negative growth in sub-Saharan Africa has widened the gap.

While noting flaws in measurements of income inequalities by GINI coefficients or Thiers T-test, Wade identifies four causes of increasing inequality:

- Differences in the speed of population growth between poor and rich countries,
- A fall in non-oil commodity prices by more than half in real terms during the 1980s and early 1990s,
- A debt trap, whereby middle-income countries anxious to consume and invest more than what could be financed by domestic savings, exceeded to their capacity to service their debts, and
- Production inputs, including the technological know-how tend to be attracted to places where they are best rewarded (Wade 2001).

4.5 Foreign debt and poverty

Debt and debt forgiveness

SSA production of goods and services decreased by 2.5 % in 1981-1985 and per capita production in 1985 was 15 % below the 1980 level. SSA countries failed to develop their own economies and invest in industrial production of investment goods, modern production technologies and know-how, instead of mining and production of raw materials. Moreover, funds were inefficiently allocated by receiving governments. Due to concessionaire terms and an inability to service debt, the external debt of SSA grew after1975 (Shuanglin & Sosin 2001, Smirnov 1999).

Poverty and high foreign indebtedness go together. The approximately 600 million citizens earning less than one dollar a day in the HIPC countries owe about $170 billion to foreign creditors. Almost all HIPC countries have very low GDPs ($325 per capita in 1999) and earn only enough from exports in net terms to service their foreign debts. Of course, HIPC governments would lose their ability to fight poverty altogether if foreign debt servicing was allowed to eat up their budget revenues (Thomas 2001, Trotsenburg 2001). Instead, they fall further into debt.

Out of the total of 42 HIPCs, 34 were among the 47 sub-Saharan African countries (see summary Table 3 in Appendix) in March 2002.[17] Almost half (39 of 79) of the world's countries eligible for international development aid financing are located in sub-Saharan Africa. The operational cut-off for IDA eligibility for fiscal 2002 was $885 (expressed in gross national income per capita in 2000).[18] The external debt of SSA accounted 67 % of GDP in 1999, while the corresponding figure for FSUCEE was 40 % and 36 % for middle-income countries. While the Russian Federation, the Baltic countries and the CEE countries have managed to cope with their foreign trade problems (Cottrell & Ostrovsky 2002), some FSU countries (notably the Kyrgyz Republic with a foreign debt of 200 % of GDP, and Tajikistan) face daunting problems in their foreign debt servicing (IMF 2002).

The share of foreign aid SSA countries has been 4 % of their GDP, but only 0.7 % to the FSUCEE countries. Critics claim assistance has been indiscriminately granted to SSA governments without regard for their corruption or inefficiency. Assistance has continued even when bad governments failed to improve their governance practices. Indeed, debt relief could similarly support corruption and bad administrative practices unless international organisations agree to refocus and enforce their conditions (Masood et alia 2001). The problem needs to be seriously addressed, because the poorest countries tend to be the most corrupt.

Thomas remarks that debt relief is unlikely to reach the poor, but rather will benefit corrupt leaders and government officials. Yet, poverty reduction is the reason for forgiving HIPC debts. Assistance and debt relief should be used to reduce poverty, but many countries having received development assistance never had adequate plans for use of these funds. In the worst cases, money saved from debt relief could be used to buy weapons or illegally diverted to government officials to protect their privileges.[19] Wolf (2002) rightly points out that development assistance should not be aimed to those who need it, but at those who can use it most effectively. No doubt corrupt leaders in Africa love to quote Wolf as they likely have their own opinions on most effective use. The donor's problem is identifying effective uses that benefit the poor in the medium term and provide immediate humanitarian relief in the short term when a state lacks credible property rights and accountable institutional capacities.

To promote African solidarity, good governance, to create preconditions for sustainable growth and abolish poverty, South Africa's president Thabo Mbeki launched "The

[17] http://www.worldbank.org/hipc/country-cases/country-cases.html

[18] http://www.worldbank.org/ida/eligible.htm

[19] A long list could be compiled about mismanagement of budgetary resources in general, and development funds in particular. Most governments are rife with high-level corruption. Donor funds are sometimes used to purchase weaponry and maintain the police force and army and to support luxurious life styles of the governing political elite. Thomas cites the egregious behaviour of Zaire president, Sese Seko Mobutu, who spent some $5 billion on personal expenses. The Central Bank and Treasury of Kenya lost $1.1 billion dollars to government officials, while Côte d'Ivoire's president Félix Houphouet-Boigny used $300 million of his 'own money' to build a basilica. Kenyan government officials siphoned away $1.1 billion from the national treasury and central bank. Nigerian leaders recently announced they plan to use substantial amounts of their country's IMF financing to construct a football stadium to Lagos and finance the Nigerian space program (Thomas 2001, pp. 38-45).

New Partnership for African Development" (Nepad). The goals include raising economic growth to 7 %, halve poverty and attract nearly € 70 billion FDI by year 2015. Unfortunately, the countries most in need of support in transition development (Angola, Democratic Republic of Congo and Zimbabwe) have not joined the programme (Mbeki 2001).

Speeding up debt relief programs may lead to badly designed poverty reduction strategies. Tight timetables may draw all attention to the compliance with formal conditions. In the longer run higher accountability requirements have to be established to governments managing aid money. Governments should be given enough time to make a credible spending plan and creditors should then see that poor people actually benefit (Thomas 2001, 44-45). Effective antipoverty actions are difficult to design, because poverty problems are complex and location-specific. Healey and Killick (2002) argue that donors should not withdraw from the poverty-reduction activities, even when modest successes justify the conclusion. International donor organisations lack specific comparative advantage in this area.

Poverty is characterised by low income and low consumption levels, low food and nutritional status, poor clothing and housing, sub-standard access to health care and schooling, and the inability to make provisions for emergencies. Poverty may lead to social exclusion as inferior access to social services, labour market, collective social decision-making and social life. It often includes unequal relationships between landlord and tenant, debtor and creditor, worker and employer, man and woman. Therefore, poverty problems should be approached in their societal context. State structures are necessary to finance and run social safety nets. The state must strive to protect individuals from major natural catastrophes and assure people's safety. The fundamental problem here is how to create sufficient social capital to enable the state to bring together many diverse social groups and create incentives that trigger actions when and where needed. Democratic principles and good public governance are necessary to create such incentives and cooperation. The question of solving the poverty problem is therefore not just economic, but political (Healey & Killick 2002).

Globalisation, competition and redistribution of income

Although the discussion about alleged costs and benefits of globalisation falls outside of the scope of this study, links to international trade, income distribution and poverty reduction and large bulk of research (Dollar & Kraay 2001 a-c and 2002 a-b, White Paper 2000, number of World Bank and IMF publications) necessitate some comments. Globalisation is characterised, in particular, by increases in flows of cross-border trade, capital and information, and increased mobility of individuals. It has been promoted by technological development, followed by reduction of costs in transports and communications and computers (Douas 2001, p. 4). A global world economy could be also defined "as one in which neither distance nor national borders impede economic transactions" (Wolf 2001, p. 78).

The anti-globalist argument is that the international trade and increased freedoms in movement of all production factors, including information, increase the income gap and deepen the poverty gap between and within countries. Transnational corporations are singled out as carriers of the poverty and global misery, which is further promoted by international organisation that work to reduce barriers to international trade (e.g. the WTO).

As far as market economies are concerned, poor people represent no market – they have no money and no purchasing power. The better question here is whether it might not be preferable for the FSU and SSA attract foreign trade and FDI rather than close their gates to trade by raising tariffs and quantitative barriers in the name of anti-globalisation and autarkic isolation. The latter course deprives the FSU and SSA of opportunities for

economic and social development. Bhagwati (2002, p. 6) admits that multinational and international aid is there to mend these problems while waiting the recovery of the poor regions to solve the problems.

A number of general remarks are appropriate here. First, poverty and misery would exist even without economic growth and international trade. Second, closing an economy from international trade is likely to harm the economy, whereas opening may or may not support economic growth. Third, anti-globalists may be barking up the wrong tree. It is hard to name any organisation, private or public, that has done more than the United Nations in general, and the IMF and the World Bank in particular, in fighting poverty and providing assistance to the world's least developed countries to build material and institutional infrastructures, promote the health, education and social conditions.

Wolf (2002) points out that the economic liberalisation combined with Internet trade and increased mobility of the production factors make taxation more challenging for local governments. He rightly stresses that heavy taxation does not drive away citizens preferring high-quality education and well-functioning public transport. Governments are not benevolent welfare maximisers, but the competition between governments in integrated regions increases incentives to serve best those who pay the most taxes.

Globalisation makes national states even more important. As Wolf formulates it,

> "The bedrock of international order is the territorial state with its monopoly on coercive power within its jurisdiction." (Wolf 2001, 190).

Thus, a good institutional base with high-quality public goods and personal security for individuals offers the best starting point for integration and globalisation. Globalisation will not make the states unnecessary; on the contrary, any kind of global governance will depend on the quality of governance of nations.

Competition and rent-seeking are driving forces in the market economy to create economic growth. According to western values and economic discipline, the legitimisation of ownership rights have to be legally earned by one's own work, skills and ingenuity. Altruistic handouts and subsidies to those who do not work (the sick, handicapped or unemployed) seem to violate culturally deeply seated legitimacy of work-related ownership rights. Subsequently, the free market system based on rent-seeking, competition and property rights includes disincentives to voluntary distribution of profits to those not contributed in their accumulation. Thus, some institutional changes arising from competition do not increase the well-being of all members of society (Daouas 2001, p. 133).

The redistribution of fruits of economic growth is only possible to the extent it does not discourage incentives for economic competition. The quality of the tax regime leads to the question of institutional capacities. Arguably, a well-functioning tax regime reflects well-developed, healthy state capacities supported by adequate social capital to create adequate consensus about the tax rate and the use of revenues to protect those in need. This consensus is based on a further acknowledgement from entrepreneurs that taxes increase the long-run profits and the sustainability of economic growth for the benefit of rent-seeking corporate sector.

The basic social safety net (health and medical care, unemployment insurance, public pension, etc.) must be understood as a compromise that benefits the corporate sector and economic competition. Distribution of purchasing power benefits markets and economic growth. Creation of these understandings is possible only in the presence of adequate social capital and established democratic procedures. Violent outbursts to correct bad situations can kill economic growth and leave even less to be redistributed. A recent SSA example is the violent take-over the farms of white landowners in Zimbabwe. The mani-

festation of disregard of the existing ownership rights, even if they are perceived as correction of social injustice, zeroes the markets and kills economic growth.

An emerging line of discussion, following the traditions of debates in the 1970s, asks whether the gap between the poor countries is increasing or decreasing, and whether differences in income and wealth are increasing. These discussions refer to reliability and adequacy of GDP statistics and problems related to GINI and T-factors in measuring income distribution. In particular, Dollar and Kraay from the World Bank's Development Research Group defend the view that the global trend toward greater inequality peaked around 1975 and since has stabilised or possibly reversed by virtue of the accelerated growth by China and India (Dollar & Kraay 2002a).

Globalisation leads to faster growth and reduction of poverty in poor countries. The growth rates of rich countries have slowed during the past 30 years, whereas the growth rates of globalisers have accelerated. If true, globalisers are catching up with rich industrial countries, while non-globalisers are falling behind. In the 1990s, rich industrial countries grew at a rate of 2.2 % per capita, while globalising developing countries grew at 5.0 % per capita and non-globalising developing countries at only 1.4 % per capita. Considering the development within countries, growth rates following the growth of trade increased proportionally the incomes of the poor, while absolute poverty has been sharply reduced in globalising economies. Moreover, GDP growth per capita in the 1990s was 5 % for globalisers, 1 % for the non-globalisers and 2 % for rich countries. Since restrictions of trade only impose further hardship on poor people in developing countries, the authors conclude that open trade regimes tend to boost growth and reduce poverty in poor countries (Dollar & Kraay 2001b).

Dollar & Kraay's views have been challenged by a wave of anti-globalist research that maintains that globalisation has dramatically increased inequality between and within nations and that the policies of the international trade organisation and international donors only exacerbate the situation (e.g. Mazur 2000, Stiglitz 1999, Watkins 2002, Weisbrot et alia, 2000). They blame Dollar, Kraay and international donors for stubbornly sticking to rigid applications of standard economic theory. These critics maintain that the gaps between rich and poor, both within and between countries, have widened, not narrowed.

> "A world in which the assets of the 200 richest people are greater than the combined income of the more than 2 billion people at the other end of the economic ladder should give everyone pause." (Mazur 2000, p. 80).

Allegations that economic growth, increased openness and anti-inflationary policies are good for the poor are grossly misleading and have become a religion misguiding the general discussion, because "equal opportunities" do not guarantee "equal results." These policy recommendations are based on defective statistical data, and insignificant results derived from econometric analyses. In the background looms the failure to understand the essence poverty, and ultimately prescribe appropriate remedies, say the anti-globalist critics.

4.6 Development hazards

Economic development has been unpredictably interrupted by random events – man-made catastrophes such as war and epidemics (AIDS and tuberculosis), and natural disasters like earthquakes, floods, droughts, which are followed by famine and general deterioration of living conditions. Sub-Saharan Africa disasters are an obvious reason for the instability of economic growth. The Ivory Coast, Namibia were hit recently with natural disasters, (Easterly 2001) while poor harvests in Malawi, Zimbabwe, Swaziland, Lesotho and Mozambique are currently causing food shortages.

Insurance statistics indicate that both the number of incidents and economic losses have monotonically increased since the 1950s. The number of extreme weather events per decade from the 1950s through the 1990s (i.e. 20 major incidents in the 1950s, 27 in the 1960s, 47 in the 1970s, 63 in the 1980s and 89 in the 1990s) and corresponding economic losses ($41 billion, $73 billion, $132 billion, $204 billion and $629 billion, respectively) (Munich Re Group 2001) and (Heller & Muthukumara 2002 p. 30). Rural poor in the tropics and subtropics seem particularly vulnerable and unable to cope with natural catastrophes and their consequences such as diseases or malnutrition due to losses of crops and arable land.

Wars have retarded economic growth particularly in Ethiopia, Sudan, Liberia and Somalia. Ethnic controversies (Rwanda in 1994) and religion (Sudan) are usually considered as major reasons for African wars. There is no intrinsic hate between ethnic groups or intrinsic hostility in religions, but political leaders, supported by corrupt administrators, the police and the army, fuel rivalries between ethnic and religious groups to gain personal power and wealth for themselves. Often economic interests and nationalism are added to the mix, e.g. Sudan (Martin 2002). Similarly, diamonds are the theme in Liberia and land in Zimbabwe.

Wars tend to follow their own logic, a vicious circle nourished by hatred and revenge. They continue until the population has been impoverished and fatigued or the leader has escaped or been expelled (e.g. Idi Amin from Uganda or Mobutu from the Democratic Republic of Congo) or killed (UNITA leader Jonas Savimbi in Angola). The war in Sudan has raged for a quarter of the country's 45 years of independence, and resulted in two million fatalities and made four million people homeless out of a population of about 29 million. The Muslim northerners contempt for the Christian southern culture and feel that it is their right, if not duty, to subjugate the southerners and take over the oil resources for their own benefit. The war is not likely to end before this goal has been achieved (Martin 2002).

Of course, no war is needed to cause mass starvation. This can be accomplished by drought, flood, erosion, epidemics, excessive corruption or any combination of these. Civil wars led by corrupt dictatorships and governments continue in Angola, Democratic Republic of Congo, Burundi, Rwanda, Eritrea, Ethiopia, Sudan, Somalia, Liberia, Sierra Leone and Western Sahara. Nigeria, which has also had civil wars, continues to have chaotic politics. Nigeria got rid of its military government three years ago, and has since improved its image as a serious trading partner. Still, members of the corrupt government and administration are busy in grabbing large shares of the country's oil wealth. Ghana, which started its transition in 1983, has experienced a disaster with cut of the international financing due to its arrears. The situation was aggravated further by drought and the forced return of large number of Ghanaians expelled from Nigeria. Ghana has lately taken steps to diversify its production and exports and promote entrepreneurship. Uganda, which ended its terror regime ten years ago and Mozambique, which experienced war and extensive

floods in the 1990s, have been recently singled out as successful countries (The Economist, 6 April 2002, "Middle East and Africa," pp.38-40, Chand 1993, p. 353).

Although wars, conflicts and social disorder continue in Caucasus and affect the Central Asian Republics, the vulnerability of SSA demonstrates the inability of weak states and institutions to protect the people against madmen and warmongers, against the effects of natural catastrophes, drought, floods and diseases, against alleged or real exploitation from transnational corporations and the double-standard trade policies of developed countries. Strengthening of the institutional capacities of the state to protect citizens against development hazards should therefore be a primary task of governments in the economies in transition and the donors providing technical assistance and conditional financing or debt relief to them (World Bank WDR 2000/2001, particularly Chapters 9 and 10).

5 Summary and conclusions

5.1 Summary

Current development literature recognises the primacy of institutional development supported by property-rights-based economic freedoms. In the discussion above, we described a process whereby institutions foster the formation of "social capital," which helps provide the basis for sustainable economic growth. We further showed that countries with high-quality institutions conducive to economic freedoms tend to enjoy high economic growth.

Social capital (husbanded e.g. by the government, parliament, political parties, NGOs) provides incentive to citizens and companies to support the aims of their political leadership. Insufficient social capital with economic growth may lead to a dual economy in which income and wealth are unevenly distributed between social groups or regions. Societies with weak institutional capacities in generating social capita are typically politically unstable and unacceptably risky to investors over the long run.

While the redistribution of income and wealth runs counter to property rights and economic freedoms, most democratic societies accept as legitimate the need to reduce poverty and support those unable to participate in wealth production (i.e. children, disabled, old people and unemployed). The allowance for such redistribution is predicated on recognition of the value of social capital created through democratic procedures. This includes acceptance of the corporate sector. The optimal level of redistribution is country specific, depending on demographic factors, and the level and growth of GDP. Large economies with high factor mobility are more likely to accept larger inequalities than small economies or in large economies with low factor mobility.

The state consists of institutions vested with the task of protecting its members, both physical and legal persons, against external and internal threats. The rule of law in developed industrial countries seeks to equalise the position of citizens (individuals and firms) with respect to the power of the state. In practice, it places the burden of proof of compliance on officials so that citizens are presumed to act in a good faith until shown otherwise.

Administrative practices change slowly. Reform-oriented governments may encourage change in the government, but any permanent change has to be based on introduction and enforcement of economic freedoms deriving from clear, enforceable property and contract rights. Any redistribution must be backed by sufficient social capital to support it.

Macroeconomic reforms – liberalisation, stabilisation through fiscal and financial austerity, privatisation – can all be reduced back to economic freedoms based on the private property rights. Although most governments in both the FSUCEE and SSA have accepted the principles of macroeconomic reform, their enforcement and sustainability can be achieved only when such principles are understood and supported by state officials.

In FSU countries this is necessarily the case. Despite a reform-oriented government led by president Putin, enforcement itself is in the hands of Soviet-minded state officials who either do not understand or refuse to accept the rule of law. They act this way not just because the rule of law hampers personal rent-seeking efforts, but also because existing institutions have failed to provide them with standardised procedures, transparency and incentives to do things right. The absence of technical standards and arrangements necessary to make the administration operational can also be blamed. On the other hand, the tasks of building institutional capacity and ingraining appropriate attitudes are slow processes.

In SSA countries, state structures are often simply too weak to protect their citizens against natural disasters, crime, civil conflict and rent-seeking leaders. Moreover, colonial legacies hamper state capacity building and establishment of enforceable property rights. In just a handful of cases (e.g. Botswana), the pre-colonial experience assisted in balancing property rights between rulers and the ruled. The geographic and cultural distances of that separate SSA, Central Asia and the Southern Caucasus region from developed markets contrast sharply with the geographic and cultural affinities the CEE and Baltics enjoy with their European neighbours.

During the latter half of the twentieth century, the growth of international trade exceeded economic growth. However, the FSUCEE and SSA remained isolated (Tables 7 and 8), and their exports consisted almost exclusively of fuels and raw materials in the case of the FSU or commodities like cocoa, coffee, copper and diamonds in SSA (Table10). During the 1990s, the CEE and Baltic countries rapidly redirected their trade away from the Russia to Western Europe and simultaneously moved from inter-industry to intra-industry trade. As confirmed by substantial empirical evidence, growth of international trade has been a major factor contributing the economic growth in these countries – and it was achieved at a time when income and wealth gaps between the developing and developed world were otherwise widening.

5.2 Conclusions

The most profitable markets and investment opportunities are found in rich countries. To paraphrase US bank robber John Dillinger, "It's where the money is." Politically and financially risky societies, in contrast, are unable to protect property rights and subsequently attract trade and FDI. Trade and FDI in themselves are not development instruments, rather their presence or absence is the reflection of underlying factors. CEE and Baltic countries received more than 80 % of the capital inflows to the FSUCEE region from start of transition to 1997.[20] The fact that the share of the FSUCEE in total world capital inflows was larger than the share of SSA (Garibaldi et alia, 2002) has little significance given that major capital flows essentially avoided both regions (Laulajainen 1998).

The combined shares of FDI inflows to the FSUCEE and SSA amounted to only 1.6 % of the world's total FDI net inflows in 1999. The share of the merchandise imports

[20] Russia is a net exporter of capital.

of FSUCEE and SSA accounted for 4.4 %, and exports for 4.7 % of the world's total merchandise trade. In other words, over 95 % of FDI, trade and capital flows bypass these regions. The blessing of economic growth apparently is reserved for the benefit of rich and middle-income countries. A corollary of trade concentration in the rich countries is that trade policy is important only to rich countries. How could it mean anything to a poor country with a weak state and weak institutions that is isolated by geographic distance from markets and potential trade partners? As Rodriguez and Rodrik (1999) observe, the connection between trade policy and economic growth is largely irrelevant to poor countries with problems far more serious than trade policy that prevent them from participating in international trade.

In free markets the decisions to invest, export or import are made by private entrepreneurs, not donors. The role of donors then is improvement of state structures and institutions either through technical assistance or training of officials to increase the administrative capacities and assist those officials in organising the institutional capacities necessary to establish the rule of law and adequate enforcement of property and contract rights.

The priority of development assistance should thus be improving the quality of state institutions to make them up to the task of sustaining free markets and democracy. This work needs to be continuously monitored and subject to recall in the case of failure. This is why is so important at this time to develop and update practical performance criteria (World Bank Studies 2001, Masood et alia 2001).

Unfortunately, the bulk of development literature still is devoted to discussion of developments and relations between variables depending primarily on private sector decisions and only indirectly on the results of development efforts of recipient governments and donors in a given country or region. Their recommendations recite a familiar laundry list of measures to be implemented and desirable outcomes.

In development work, macroeconomic reforms should be (and generally are) included as conditions, since they serve as a road map in creation the institutional capacities and define the role and behaviour of the state officialdom. Thus, stabilisation of the internal and external values of domestic currency is important because failure to do so leads to distribution effects that violate property rights and generate uncertainty. This hampers investments. By the same token, the absence of a property-rights-based standardisation promotes bureaucracy and corruption and contributes to slow growth of the financial and capital markets (de Soto 2000). Indeed, there is no justification for belittling the significance of the technical side of reforms and the importance of competent technical assistance extended to the governments to improve state structures. Even today, technicalities in reform design are routinely overlooked in development agendas. Minute technicalities do matter. The devil, as they say, is in the small, microeconomic details (Porter et alia 1999).

The public sector focus needs to be broad enough to include private institution building, development of democratic controls, transparency and party systems relevant in determining optimal income redistribution.

Academic discussion and research on development issues is also necessary. Donors typically face a rapidly increasing array of problems. Due to steepness of the learning curve, it often happens that as soon as the mistakes are observed and corrective measures taken, new problems emerge leading to new mistakes (Smirnov 1999). Thus, donors deserve credit for the work they accomplish in such dynamic environments. They must collect and analyse an astounding amount of data, as well as assist the developing country in constructing basic infrastructure, and later, extend technical assistance and financing to improve the health, education and training and social conditions (Einhorn 2001, Wolfensohn 2001).

The mission to improve the institutional capacities of national state structures and institutions, both in SSA and the FSUCEE, is in harmony in globalisation. Strong, institu-

tionally developed national states can protect their citizens against any drawbacks of globalisation. Therefore, the national state in a globalised, integrated world is not likely to become abundant. Failed, disorderly, weak or corrupt states are difficult to integrate with strong ones. A disciplined, honest state with high-quality institutions – not national isolation and autarky – is the precondition for globalisation. Increased competition due to globalisation makes the participating national states stronger (Wolf 2001).

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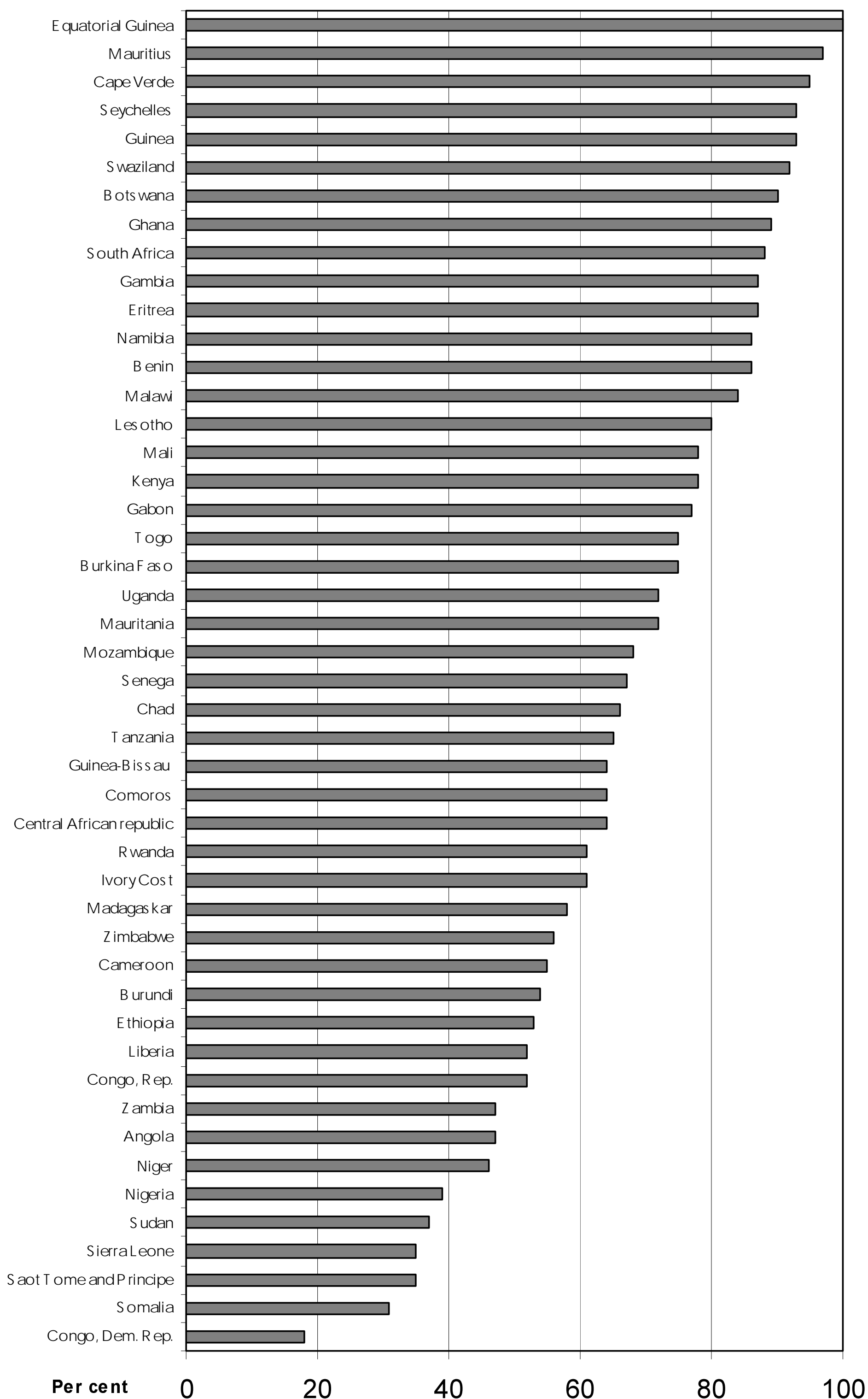
Appendix

Chart 1: Sub-Saharan countries: Level of 1998 GDP per capita as a share of maximum achieved



Source: United Nations 2001b, Table 1, pp. 6-7.

Table 1. Economic freedom and financial risk. Average scores for the FSUEEC and SSA using Weder's typology for levels of institutional quality and economic growth

Heritage Foundation & Wall Street Journal 2002

Free <2.0, mostly free 2.0<3.0, mostly unfree 3.0<4.0, repressed 4.0-5.0

	Total score 2002	Total score 1997	Change since -97 negat. = improved	Trade	Tax burden	Govt. interven.	Monetary policy	FDI	Banking & finance	Wage & prices	Property rights	Regulation
FSUCEE1	2.5	2.8	-2.6	2.2	4.3	2.0	2.6	2.0	1.8	2.2	2.2	2.6
FSUCEE2	2.6	3.0	-3.2	3.3	7.7	4.7	4.0	4.0	4.7	4.7	6.0	6.0
FSUCEE3, Russia	3.5	3.7	-1.3	3.0	3.3	2.8	4.3	3.0	3.4	3.0	3.7	4.0
FSUCEE4	4.1	4.3	-0.9	3.8	3.6	3.4	4.4	4.0	4.4	4.2	4.0	4.4
FSUCEE5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FSUCEETOTAL	3.2	3.5	-1.7	3.1	4.3	3.0	3.9	3.2	3.5	3.4	3.8	4.1
Russian Federation	3.7	3.6	0.8	4.0	3.5	2.5	5.0	3.0	4.0	3.0	4.0	4.0
SSA1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SSA2	3.1	3.3	-1.0	3.8	3.3	3.1	2.7	2.7	2.8	2.3	3.0	3.7
SSA3	3.2	3.3	-0.6	3.9	3.5	2.5	2.3	2.8	3.2	3.0	3.5	3.7
SSA4, Nigeria	2.8	3.0	-1.2	3.3	2.7	2.2	1.3	2.9	3.1	2.1	3.1	3.3
SSA5	2.0	2.0	0.5	2.1	1.5	1.3	1.1	1.4	1.6	1.5	1.7	1.8
SSATOTAL	2.7	2.8	-0.5	3.2	2.6	2.1	1.7	2.3	2.6	2.2	2.7	3.0
SSA5 all*	4.0			1.7	1.3	1.1	0.9	1.2	1.3	1.3	1.4	1.5
SSA5 less islands**	4.3											
Nigeria	3.6	3.3	1.7	4.0	3.0	3.0	1.0	4.0	4.0	3.0	4.0	4.0
Grand total	2.9	3.0	-0.9	3.1	3.1	2.4	2.4	2.6	2.9	2.6	3.0	3.3

Remarks: SSA5 includes only countries, scores of which have been indicated in the source statistics
*SSA5 all includes war countries, which have been assigned score of 5
**SSA5 all incl. war countries, which have been assigned score of 5 less small island states

Euromoney March 2002

Percentages, total max, 100 indicates zero-risk, different risks weighted as indicated in columns.
The smaller the score, the bigger are the financial risks.

	Total score	Political risk	Econ. perform.	Debt indicators	Debt in default or resched.	Credit ratings	Access to bank finance	Access to short-term finance	Access to capital markets	Discount for for-faiting
Max. possible/column	100	25	25	10	10	10	5	5	5	5
FSUCEE1	68	18	10	8	10	6	4	3	4	4
FSUCEE2	58	15	8	9	10	4	3	2	3	4
FSUCEE3, Russia	32	6	5	8	9	1	1	2	1	0
FSUCEE4	29	5	3	9	10	1	0	2	1	0
FSUCEE5	0	0	0	0	0	0	0	0	0	0
FSUCEETOTAL	44	10	6	8	10	3	2	2	2	2
Russian Federation	36	9	7	9	7	2	0	2	0	0
SSA1	0	0	0	0	0	0	0	0	0	0
SSA2	25	6	4	5	6	0	0	2	1	1

Table 2. Overlapping of FSUEEC and SSA countries by economic freedom and financial risk

Freedom						Financial risks					
FSUCEE			SSA			FSUCEE			SSA		
Rank (the smaller score, the better freedoms)	Total score 2002	Group	Rank (the smaller score, the better freedoms)	Total score 2002	Group	Rank (the larger score, the lesser risk)	Total score March 2002	Group	Rank (the larger score, the lesser risk)	Total score March 2002	Group
1 Estonia	1.8	1				1 Slovenia	73.8	1			
2 Lithuania	2.4	2				2 Hungary	70.2	1			
3 Czech Rep.	2.4	1				3 Czech Rep.	68.5	1			
4 Hungary	2.4	1				4 Poland	65.8	1			
5 Latvia	2.5	2				5 Estonia	63.5	1			
6 Poland	2.7	1				6 Slovak Rep.	62.5	2			
7 Armenia	2.7	3				7 Latvia	58.3	2			
8 Slovak Rep.	2.9	2							8 Mauritius	56.7	5
			9 Botswana	2.9	2	9 Lithuania	54.4	2			
			10 Cote d'Ivoire	2.9	2	10 Kazakhstan	47.9	3			
			11 Namibia	2.9	2				11 Seychelles	37.3	5
			12 Mali	2.9	3	12 Azerbaijan	37.0	4			
			13 Swaziland	3.0	3				13 Kenya	36.5	4
			14 Uganda	3.0	3	14 Russian Fed.	35.9	3			
			15 Mauritius	3.0	5				15 Gambia	35.5	2
			16 Mozambique	3.1	3				16 Ghana	35.5	2
			17 C.African R.	3.1	5				17 Uganda	34.8	3
18 Slovenia	3.1	1							18 Swaziland	34.8	3
			19 Gambia	3.1	2				19 Senegal	34.5	3
			20 Madagaskar	3.1	3	20 Armenia	34.1	3			
			21 Benin	3.2	3				21 Tanzania	32.8	2
			22 Cape Verde	3.2	5	22 Ukraine	29.8	3			
			23 Burkina	3.2	3	23 Turkmenis-	29.7	4			
			24 Senegal	3.2	3				24 Niger	29.6	4
			25 Kenya	3.2	4				25 Burkina	29.6	3
			26 Cameroon	3.3	3				26 Mozambque	28.9	3
			27 Gabon	3.3	3	27 Uzbekistan	28.9	4			
			28 Zambia	3.3	3				28 Madagaskar	28.8	3
			29 Guinea	3.3	3				29 Gabon	28.8	3
			30 Mauritania	3.3	5				30 Lesotho	28.7	3
31 Moldova	3.4	3							31 Cote d'Ivoire	28.6	2
			32 Ghana	3.4	2				32 Eq.Guinea	28.6	5
			33 Tanzania	3.4	2				33 Cape Verde	28.4	5
34 Georgia	3.4	3							34 Cameroon	28.0	3
			35 Lesotho	3.4	3				35 Mali	27.9	3
			36 Rwanda	3.4	5	36 Moldova	27.8	3			
37 Azerbaijan	3.5	4				37 Georgia	27.6	3			
			38 Niger	3.5	4				38 Sierra Leone	27.1	5
			39 Malawi	3.5	5	39 Belarus	26.9	4			
			40 Ethiopia	3.6	5				40 Togo	26.7	4
41 Kazakhstan		3							41 Ethiopia	26.3	5
42 Kyrgyz R..		3							42 Benin	25.8	3
			43 Chad		4				43 Namibia	25.6	2
			44 Nigeria		4				44 Malawi	24.9	5
			45 Togo		4				45 Guinea	24.9	3
46 Russian Fed.	3.7	3				46 Tajikistan	23.7	4			
			47 Congo	3.7	4				47 C.African R.	23.5	5
			48 Congo, D.R.	3.8	5	48 Kyrgyz Rep.	23.1	3			
49 Ukraine	3.9	3							49 Chad	22.5	4
50 Tajikistan	3.9	4							50 Congo	22.4	4
			51 Eq. Guinea	3.9	5				51 Eritrea	21.9	5
			52 Guinea-Bissau	4.0	4				52 Rwanda	21.3	5
			53 Zimbabwe	4.3	3				53 Nigeria	21.2	4
54 Belarus	4.4	4							54 Angola	20.8	4
55 Uzbekistan	4.4	4							55 Zambia	20.1	3
56 Turkmenistan	4.4	4							56 Burundi	19.9	5
			57 Angola	na	4				57 Sao Tome	19.6	5
			58 Liberia	na	4				58 Guinea-Bissau	18.9	4
			59 Sierra	na	5				59 Mauritania	17.8	5
			60 Somalia	na	5				60 Liberia	15.8	4
			61 Sudan	na	5				61 Zimbabwe	15.7	3
			62 Burundi	na	5				62 Congo,D.R.	14.1	5
			63 Comoros	na	5				63 Somalia	12.1	5
			64 Eritrea	na	5				64 Botswana	na	5
			65 Mayotte	na	5				65 Comoros	na	5
			66 Sao Tome and Principe	na	5				66 Mayotte	na	5
			67 Seychelles	na	5				67 Sudan	na	5

Table 3. General statistics on economic growth, foreign trade, debt and aid in 1999

	CEE+B	FSU-B	FSUCEE	SSA	LI	MI	HI
Numer of countries in the category	8	12	20	48	64	93	50
Population, million	74	283	357	643	2417	2665	896
GDP (current US$ billion)	318	517	835	324	1033	5519	24323
GDP per capita, PPP (current international $)	9689	5435	6317	1600	1918	5317	25707
Exports of goods and services (current US$ billion)	134	238	372	87	214	1600	5323
Imports of goods and services (current US$ billion)	149	169	318	100	245	1425	5266
Exports of goods and services (% of GDP)	42	46	45	27	21	29	22
Imports of goods and services (% of GDP)	47	33	38	31	24	27	22
External debt, % of GDP	39	41	40	67	55	36	na
External debt, total (DOD, current US$ billion)	125	210	335	216	572	1991	na
Total external debt service (TDS, current US$ billion) in 1999	23	18	40	14	47	342	na
DOD/TDS	5.4	11.7	8.4	15.4	12.2	5.8	
External debt, total (DOD, current US$)/capita	1689	742	938	336	237	747	na
Total ext. debt servicing (current US$ million/capita)	304	62	112	22	20	128	na
Aid per capita (current US$)	30	13	16	20	9	9	2
Aid, % of GDP	0.7	0.7	0.7	4.0	2.1	0.4	0.0

Source: Author's calculations based on data in World Bank's CD-ROM 2001. CEE+B stands for the Central Eastern European and Baltic countries. FSU-B stands for the Former Soviet Union countries excluding the Baltics. LI stands for Low-Income countries with GDP per capita of $755 or less. MI stands for Middle-Income countries with GDP per capita in the range of $756-9,265. HI is High Income countries with GDP per capita of $9,266 or more.

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