I Overview

The transition from predominantly socialist ownership and central planning to a market economy with private ownership is a complex process involving profound changes in the political, economic, institutional, legal, and social domains. While there may not be a simple unifying theme to capture this complexity, the quest for economic recovery and sustained growth is certainly an important common thread for all the transition countries. This paper reviews the record of growth performance in 25 countries, comprising central and eastern Europe (CEE) and the Baltics, Russia, and other countries of the former Soviet Union (BRO).

First, it summarizes the emerging consensus of what, conceptually, transition means and, in particular, of how recovery and growth are expected to come as transition proceeds. A comparison with growth analysis for market economies highlights the common points and those unique to transition. Then it presents the basic facts on growth with an elaboration of the main patterns to be observed. Finally, it assesses the key factors that may explain the differences in growth performance among transition countries, including how IMF programs and their implementation in transition countries have been associated with growth performance. Although complete data are available only through 1997, and the bulk of the study was prepared in mid-1998, one cannot ignore the dramatic reality of the financial crisis in Russia in August 1998, with its resulting reversal of growth and spillover to neighboring countries. Thus, the discussion of growth performance includes preliminary estimates for 1998, and the final conclusions reflect different interpretations of the Russian crisis and how it informs the lessons drawn by the study on the determinants of recovery in transition.

While the process of transition may be historically unique, and the period of transformation still is too short to think of all market economy phenomena as fully relevant, it is nevertheless useful to begin in Section II with a brief summary of the general (and vast) literature on "new growth theories." This section also reviews a number of recent studies that attempt to explain growth in transition countries. A key conclusion is that the medium- to long-term determinants of growth emphasized in the traditional literature (investment, growth in human capital, and the resource base) are unlikely to be as important in the early period of transition as policies aimed at financial stabilization, price liberalization, enterprise financial discipline and restructuring, building a stable market-oriented institutional environment, and openness to foreign trade.

This analytical framework sets the basis for a closer investigation in Section III of the record and nature of growth observed so far, which describes the different patterns for groups of countries, and to what extent underlying resource reallocation, structural shifts, and productivity improvements have occurred.

Section IV attempts to isolate a small number of key factors that differentiate countries more successful in recovery from those less successful. Evidence is reviewed here to support various hypotheses:

- The initial output decline is greatest where reform is bolder, but so too is the subsequent recovery.
- Early growth is based as much on efficiency improvements as on new investment.
- Financial stabilization is a necessary but not sufficient condition for sustained growth.
- Comprehensive progress on all elements in each broad area of reform is a condition for sustained growth.
- Initial conditions such as significant overindustrialization can be a deterrent but are readily offset by stronger efforts on reform.
- Foreign direct investment may contribute to growth, but only if the underlying conditions favorable to growth are already in place.
- Privatization matters in a broad sense, but it is too early to see definitive evidence of effects from different types of privatization.
- Countries that perform well on economic growth also exhibit a higher degree of effective implementation of IMF programs.