Opinion Corner*: A third of a century of economic transformation

BY GRZEGORZ W. KOLODKO[1]

Although a third of a century has passed since the Polish Round Table and the fall of the Berlin Wall, we do not know when the post-socialist political and economic transformation really began – or whether it is already over. All things considered, it has proved a great and historic success, even if the scale of it has varied across different countries. Alternative measures of living standards that go beyond GDP suggest that the gap between post-socialist countries and the West may now be smaller than is customarily believed.

Just as there are days that are special to people, certain dates are special to countries. Undoubtedly, 6 February 1989 – just over a third of a century ago – was an important date in the history not only of Poland, but of the whole of Europe and the world. Then, as they sat down at a Round Table in Warsaw, the representatives of Poland's reformist circles in power and the democratic opposition advanced the wheel of history. Things have been different ever since, and certainly the reality around us is generally better – although not everywhere and not for everyone.

MEASURING THE SUCCESS OF TRANSITION

Many analyses lump almost all the European post-socialist countries together, even though the state of affairs at the beginning of the transformation varied. Thirty years later, the entire Eurasian region is even more diversified than at the start of the transition.

So how much better is it now? What is the place of the formerly centrally planned economies in the world today? In answering these questions, national income – traditionally measured as the value of gross domestic product (GDP) – is often used for comparison. In Poland, GDP per capita in terms of purchasing power parity (PPP) (in constant 2017 USD) in 2021 reached 278% of its 1989 level,[2] which can be interpreted as a clear success story. But on this score, the absolute record-holder is China, with an increase of 1,274%. It has followed a specific economic model that I refer to as 'Chinism' – a hybrid system, based on meritocracy and combining in an intelligent way the power of the invisible hand of the market with the (sometimes all too) visible hand of the government.

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2 Calculation based on data of 'World Economic Outlook', International Monetary Fund, Washington, DC, April 2022.

The reforms of the past three decades have also resulted in a tectonic shift, with consequences that extend far beyond the post-socialist economies. Whereas in 1989, China's GDP was about half of Russia's, now it is over seven times greater: last year, China accounted for 18.6% of world output (3 percentage points ahead of the US), while Russia's share was only 3.1% (all indicators according to PPP). The countries of the former Soviet Union have witnessed far-reaching changes: whereas in the last year of the USSR's existence, the ratio of GDP per capita of its richest republic (Estonia) to its poorest (Tajikistan) did not exceed 3:1, the figure now is 10:1. In Central and Eastern Europe in 1989, Ukraine enjoyed GDP per capita that was 40% higher than in Poland, whereas in 2021, Polish income was already 164% higher than Ukrainian: the ratio had altered from 7:5 in favour of Ukraine to 8:3 in favour of Poland. In Czechia, the richest post-socialist country, GDP per capita is about 3 times the income of the poorest European countries of Kosovo, Moldova, Albania and Ukraine.

REASONS FOR THE DIVERSITY OF TRANSITION OUTCOMES

There are four main reasons behind the divergent paths of economic transformation. First, the starting conditions were different: they were better in countries that had already undertaken at least partial liberalisation of their regulatory and governance systems. Poland and Hungary were the best prepared for the transition to a new economic and political system, thanks to the considerable structural and institutional reforms of the previous two decades, whereas Albania and Romania – orthodox socialist states – were the least prepared. In Asia, pro-market economic reforms were most advanced in China and Vietnam.

Second, more important than privatisation was the ability to build institutions that foster entrepreneurship and fair competition, and that block the emergence of oligarchies. In this regard, examples of good practice include Estonia, Poland and Slovenia; instances of bad practice would be Bulgaria, Montenegro and Ukraine.

Third, the quality of political leadership mattered, including the level of courage and determination to implement difficult reforms consistently. Leadership is always constrained by various internal and external factors, and by material and cultural conditions. This was all the more so in the climate back then, as long-term vision was needed, rather than simply the illusion that the abandonment of central planning and the privatisation of assets would suffice. Especially important was open-minded leadership committed to a social market economy and EU integration.

Fourth, the geopolitical situation favoured the countries of Central and Eastern Europe (rather than, for example, the post-Soviet republics), which took advantage of their proximity to Western Europe, adopting the principles of the EU economy, with which they integrated. Some (especially Poland, Hungary, Czechia and Slovenia) were closer to Western culture than the rest, and some enjoyed strong economic links to the West – for instance Poland, where over half of foreign trade was with Western countries.

GOING BEYOND GDP

Comparisons of living standards are not easy, and yet we like to compare – Croatia to Italy, North Macedonia to Greece, Slovakia to Austria, Latvia to Finland, Poland to Germany. Is there a more comprehensive indicator than GDP to measure the distance that separates one country from another? What matters more – the income gap or the gap in human and social capital?

For instance, how far is Poland from the level of development already achieved by neighbouring Germany? Poland’s GDP per capita in 2021 reached 65% of Germany’s (USD 37,786 and USD 58,377 at PPP, respectively). However, we are now in a beyond-GDP reality, as GDP is an unreliable measure of living standards, since it fails to take into account important factors such as the quality of human capital or the distribution of income. From this perspective, arguably a more appropriate indicator is the Inequality-adjusted Human Development Index (IHDI) – the human capital index adjusted for inequalities in income and access to public services.[3] It takes equal account of the level of income, the level of school enrolment and the healthiness of societies. In the case of Poland, IHDI stood at 0.813 in 2019 (the theoretical maximum is 1.00), which corresponds to 93.6% of the IHDI of Germany. If we look at another indicator, the Planetary pressures-adjusted Human Development Index (PHDI) – which, in addition to the factors included in IHDI, also takes into account the impact of economic activity on the environment – Poland stood at 0.752, i.e. 92.4% of the German level.[4]

This demonstrates that the difference in the level of development between post-socialist countries and the West may be smaller than is commonly assumed, when we regard reality through the prism of current earnings. Thanks to systemic transformation and their engagement in win-win globalisation, these economies are catching up with the richer countries. Certainly, the gap is much narrower than it was a third of a century ago.

[3] UNDP (2021), *Inequality-adjusted Human Development Index*, http://hdr.undp.org/en/content/inequality-adjusted-human-development-index-ihdi (accessed 30 August 2022).

[4] UNDP (2021), *The Next Frontier: Human development and the Anthropocene* (*Human Development Report 2020*), https://www.undp.org/serbia/publications/next-frontier-human-development-and-anthropocene (accessed 30 August 2022).