

**Krzysztof Falkowski\***

**ECONOMIC ASPECTS  
OF INSTITUTIONAL TRANSFORMATION  
IN POST-SOVIET COUNTRIES – CURRENT STATE  
AND CONSEQUENCES FOR THEIR DEVELOPMENT  
AND COMPETITIVENESS**

**INTRODUCTION**

A quarter of a century ago, in December 1991, the Soviet Union formally broke up, resulting in the creation of 15 new subjects of international law, which significantly changed the political map of the contemporary world. Obtaining independence by the former USSR republics in the early 1990s necessitated both political and economic institutional changes. In the changed geopolitical conditions it was necessary to create new, own structures of the state and power, but also to deal with extremely serious economic and social challenges emerging in the face of an increasing crisis which was the legacy of the ineffective Soviet centrally-managed economy.

The economic doctrine of that time, advocated by international financial organisations (the International Monetary Fund, the World Bank), as well as by western governments, with the United States in the lead, promoted a neo-liberal model of systemic transformation. In practice, it boiled down to as soon as possible transition from a centrally planned economy – based on the state ownership of the majority of economic resources to a market economy – based on the market coordination and to optimisation of activities of economic entities and the dominance of private ownership. While the countries of Central Europe have achieved it relatively quickly, most of the post-Soviet countries (except the Baltic states) have not done it so far.

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The subject of this article is the issue of institutional transformation, particularly its economic aspects, in the countries of the former USSR. Apart from the presentation of selected theoretical aspects of the subject, the main goal is to make a synthetic analysis of the level of advancement of this transformation in the post-Soviet area a quarter of a century after the collapse of the Soviet Union, with particular emphasis on the current deep differentiation in the aforementioned countries, as well as its consequences for the contemporary level of development and the international competitiveness of their economies. It is also worthwhile to reflect on the future of the transformational processes in the field of economic institutions towards a neo-liberal model of a free market economy in the post-Soviet area, where these processes cannot be regarded as completed for obvious reasons (and perhaps it is false and naive to think that in the post-Soviet countries, apart from the Baltic states, of course, such a model of functioning economies can be implemented and its optimal functioning can be expected?).

Three main theses are advanced in the article. First, the institutional transformation of the post-Soviet economies, forced by the breakup of the Soviet Union, has been strongly differentiated from the beginning, both in terms of the adopted transformational strategies and their effects. In the vast majority of the post-Soviet countries, it has not been completed yet, i.e. institutional systems specific to free-market economies have not been introduced. Second, the current level of development, as well as international competitiveness, of most post-Soviet economies *de facto* do not result directly from the state of advancement of their institutional transformation. Third, in the foreseeable future, we should not expect the completion of the institutional transformation processes and thus the introduction of a liberal institutional environment, which is typical of free-market economies.

## 1. INSTITUTIONAL TRANSFORMATION AND ITS RELATIONS WITH DEVELOPMENT AND ECONOMIC COMPETITIVENESS – SELECTED THEORETICAL ASPECTS

In international literature, the concept of institutional transformation is defined as *institutional transformation*<sup>1</sup>, *institutional transition*<sup>2</sup>, or as

<sup>1</sup> Chung, W. 2000. *Institutional Transformation and the Creation of Chinese Entrepreneurial Networks*. Washington: Department of Sociology, University of Washington.

<sup>2</sup> Shin, J.S. 2002. *Institutional Transition and Transition Cost: A Methodological Consideration*. The European Institute of Japanese Studies, EIJS Working Paper Series 160/2002.

*institutional change*<sup>3</sup>. This concept usually means a process of fundamental, far-reaching changes in terms of key principles and values that underlie the functioning of broadly understood institutions regulating in a formal or informal manner the social, economic and political relations in a given country. For example, referring to L. Balcerowicz's definition, the process of institutional transformation implies fundamental changes in the formal and informal institutions, necessary to achieve the so-called 'critical mass' of systemic transformation in post-communist countries<sup>4</sup>. It is therefore an immanent element of this transformation, which consists of both economic and political transformation, determining its final result in a cardinal way.

It is worth pointing out that the very concept of institution can be defined in various ways. For example, according to D.C. North, institutions are the rules of the game in society, and more formally, they are the human-made constraints that shape human interactions. Thus, they create a structure of stimuli in the political, social or economic exchange process<sup>5</sup>. According to the World Bank definition, institutions are standards, rules of operation, contract enforcement mechanisms, and organisations for market transactions. These institutions help in the flow of information, in the enforcement of property rights and contracts, and regulate competition in the market<sup>6</sup>. In turn, L. Balcerowicz defines institutions as a category that consists of three main elements: the general legal order and its constituents (the constitution, property law, contract law, business law, electoral law, the penal code, etc.), institutional structures (also called organisations), as well as institutionally determined social mechanisms<sup>7</sup>.

The previously mentioned 'critical mass' of transformation is a term often used by economists dealing with the course, conditions and consequences of transformation processes in post-communist countries<sup>8</sup>. Its achievement

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<sup>3</sup> Kingston, Ch., Caballero, G. 2006. *Comparing Theories of Institutional Change*. International Society for New Institutional Economics.

<sup>4</sup> Balcerowicz, L. *Institutional Change After Communism*. European University Institute, p. 4. Available at: <http://www.eui.eu/Documents/MWP/Conferences/ConstitutionsMarkets/BalcerowiczConstitutionsMarkets.PDF> [Accessed: 19 June 2017].

<sup>5</sup> North, D. 1990. *Institutions, Institutional Change and Economic Performance*. Cambridge: Cambridge University Press, p. 3.

<sup>6</sup> The World Bank. 2002. *Building Institutions for Markets*. World Development Report 2002. Washington, p. 4.

<sup>7</sup> Balcerowicz, L. 1997. *Socjalizm, kapitalizm, transformacja. Szkice z przelomu epok.* [Socialism, capitalism, transformation. Sketches from the turn of the epoch.] Warszawa: PWN, pp. 13–14.

<sup>8</sup> See more in, among others, Aslund, A. 2002. *Building Capitalism. The Transformation of the Former Soviet Bloc*. Cambridge: Cambridge University Press; Portes, R. 1993.

means the effective replacement of the previously existing system (centrally planned economy) with a completely new one (market economy), with full violation of the paradigms of the operation of this former system<sup>9</sup>. In the case of economic system transformation, the achievement of this 'critical mass' implies effective institutional changes, consisting mainly of: the introduction of market principles of functioning of the economic system in which the role of the state is limited to the necessary minimum<sup>10</sup>, the establishment of private ownership as the dominant form of ownership and guaranteeing the rules of free competition for economic operators operating within the system<sup>11</sup>. According to L. Balcerowicz, the finally desired achievement of this 'critical mass' of institutional transformation will be linked with three types of reformist actions, namely: (1) the liquidation of 'old' institutions that do not fit the 'new' reality of market economy; (2) the creation of completely new institutions that did not function in the system being departed from; and (3) the reorganisation of the functions of 'old' institutions and adapting them to the 'new' standards and needs<sup>12</sup>.

In the field of institutional transformation of the economic system, two fundamental models can be distinguished on theoretical grounds, namely radical (shock) institutional transformation and gradual (incremental) institutional transformation.

Radical (shock) institutional transformation is characterised by an attempt to carry out the necessary systemic institutional changes in a violent manner, immediately, as soon as possible, in the shortest period of time. Fast and complex changes are expected to achieve the so-called critical mass of transformation (the establishment, i.e. the introduction of a free market system) with the maximum use of the social trust at the beginning of the transformation (before certain transformation social costs occur). On the other hand, the radicalism of transformational reforms is to allow for the shortening of the so-called transition period.

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From Central Planning to a Market Economy. In: Islam, S., Mandelbaum, M. eds. *Making Markets. Economic Transformation in Eastern Europe and the Post-Soviet States*. New York: Council on Foreign Relations Press, pp. 16–52.

<sup>9</sup> Jeffries, I. 1993. *Socialist Economics and the Transition to the Market. A Guide*. London, New York, p. 333.

<sup>10</sup> Acocella, N. 2002. *Zasady polityki gospodarczej. [Principles of economic policy.]* Warszawa: PWN, p. 62.

<sup>11</sup> Balcerowicz, L. 1997. *Socjalizm, kapitalizm, transformacja. Szkice z przelomu epok. [Socialism, capitalism, transformation. Sketches from the turn of the epoch.]* Warszawa: PWN, p. 196.

<sup>12</sup> *Ibidem*, p. 12.

The strongest supporters of systemic institutional changes in terms of radical (shock) institutional transformation are, among others, O. Blanchard, R. Dornbusch, P. Krugman, R. Layard, L. Summers<sup>13</sup>; M. Boycko<sup>14</sup>; J.C. Brada<sup>15</sup>; S. Fisher, A. Gelb<sup>16</sup>; J. Kornai<sup>17</sup>; J.D. Sachs<sup>18</sup>. All of them emphasise that the prolongation of structural institutional changes, and thus the lack of consistency and uniformity of reforms, critical to the transformation effectiveness, can lead to the creation of a 'new' system even more inefficient than the previous centrally planned (command) economy. Thus, extending the period of systemic institutional changes (the so-called transition period) significantly reduces the chances for the success of the entire systemic transformation. Moreover, M. Lavigne directly stresses the fact that institutional changes in the post-communist economic system must be carried out quickly and decisively, as there is a justified fear that the social costs associated with this transformation may cause social rejection of the implemented changes and thus the fiasco of the whole process<sup>19</sup>.

In the case of the other model of institutional transformation of the economic system, i.e. gradual (incremental) institutional transformation, although the final achievement of the 'critical mass' is assumed, the desired systemic institutional changes are introduced gradually over a longer period of time.

Proponents of this approach to institutional change maintain that there is an inverse proportional relationship between the scale of benefits from radical systemic institutional changes and the size of social costs involved, which fully justifies the need for a deliberate slow-down in the pace of reforms. A. Przeworski presents this view and emphasises that the radical strategy

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<sup>13</sup> Blanchard, O., Dornbusch, R., Krugman, P., Layard, R., Summers, L. 1991. *Reform in Eastern Europe*. Cambridge: MIT Press.

<sup>14</sup> Boycko, M. 1991. Price Decontrol: The Microeconomic Case for the Big Bang Approach. *Oxford Review of Economic Policy*, no. 7 (4)/1991, pp. 35–45.

<sup>15</sup> Brada, J.C. 1993. The Transformation from Communism to Capitalism: How Far? How Fast? *Post-Soviet Affairs*, no. 9 (1)/1993, pp. 87–110.

<sup>16</sup> Fisher, S., Gelb, A. 1991. The Process of Socialism Economic Transformation. *Journal of Economic Perspectives*, no. 5 (4)/1991, pp. 91–105.

<sup>17</sup> Kornai, J. 1990. *The Road to a Free Economy. Shifting from a Socialist System: The Example of Hungary*. New York: Norton.

<sup>18</sup> Sachs, J.D. 1991. Crossing the Valley of Tears in East European Reform. *Challenge*, no 34 (5)/1991, pp. 26–34; Sachs, J.D. 1992. The Economic Transformation of Eastern Europe: The Case of Poland. *Economics of Planning*, no. 25/1992, p. 5–19.

<sup>19</sup> Lavigne, M. 1999. *The Economics of Transition. From Socialist Economy to Market Economy*. London: Macmillan Press.

of institutional transformation is characterised by significantly higher social costs, i.e. first of all a rapid increase in unemployment and an accompanying decline in consumption, which in turn will lead to increased dissatisfaction, plummeting support for the reformers and, consequently, to a halt to the transformation process, consolidating economic stagnation at a very low level of development. In addition, he draws attention to the fact that liberal institutional reforms carried out violently in the economic system significantly weaken democratic institutions just starting to develop<sup>20</sup>.

M. Dewatripont and G. Roland<sup>21</sup>, as well as P. Aghion and O. Blanchard<sup>22</sup> belong to the group of proponents of gradual institutional transformation. Just like A. Przeworski, they believe that radical institutional transformation will lead to a sharp decline in production and higher social reform costs than in the case of a gradual systemic institutional change. This, in turn, forces the reformers to create a special scheme of social protection to mitigate these costs. In addition, their opposition to rapid and decisive institutional reforms also arises from the assumption that radical reforms are bound to be accompanied by a more expanded system of high taxes, which in turn will effectively hamper the development of the private sector, which will further hinder the rapid overcoming of the transformation shock.

Another proponent of gradual institutional changes is P. Murrell<sup>23</sup> who consciously rejects the legitimacy of implementing a radical reform programme as a way to carry out systemic institutional changes towards a market economy, considering it to be internally inconsistent and harmful, while stressing that it is simply not possible to demolish the 'old' system overnight even if it was economically irrational.

Anticipating the rest of this article, referring at this point to the experience of the institutional transformation of economic systems in the countries of the former Soviet Union, it should be clearly emphasised that except for three Baltic states (Estonia, Lithuania and Latvia), all the others consciously or not *de facto* chose the second model of institutional transformation mentioned

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<sup>20</sup> Przeworski, A. 1995. *Sustainable Democracy*, Cambridge: Cambridge University Press, p. 85.

<sup>21</sup> Dewatripont, M., Roland, G. 1992. The Virtues of Gradualism and Legitimacy in the Transition to a Market Economy. *Economic Journal*, no. 102/1992, pp. 291–300.

<sup>22</sup> Aghion, P., Blanchard, O. 1994. On the Speed of Transition in Central Europe. In: Fischer, S., Rotemberg, J. eds. *NBER Macroeconomic Annual 1994*. Cambridge: MIT Press, pp. 283–320.

<sup>23</sup> Murrell, P. 1992. Evolutionary and Radical Approaches to Economic Reform. *Economics of Planning*, no. 25 (1)/1992, pp. 79–95.

above, which seems to have been a decisive factor in the failure of this transformation.

The course, and in particular the results, of the institutional transformation of the economies of the countries in which this transformation takes place is extremely important from the point of view of overcoming deep transformational shocks that sooner or later have to emerge as a consequence of the changes that have to be made, connected with the necessity to find oneself in the new economic reality, but also to join the path of economic growth and development, the external institutionalisation of the economy, and to improve its competitive position on the international stage, desirable for economic and social reasons.

Considerable significance of institutions and thus of institutional transformation in the process of economic development, where existing institutions do not function efficiently, is best explained by broadly understood new institutional economics<sup>24</sup>, according to which institutions are treated as non-economic economic resources, having a large (or even significant) impact on the development or regression of the country. For example, D. North even thinks that broadly understood institutions, and in particular their quality (stability, transparency, efficiency) are a factor which, in the longer term, has an impact on the accumulation of human and material capital, which is treated as a priority in this approach, and which stimulates the necessary technological progress and the level of innovativeness of the economy, and therefore also the level of its growth and economic development<sup>25</sup>.

There is no doubt that institutions, both public and private ones, as well as formal and informal ones, are of profound significance in shaping the course of broadly understood economic processes in a given country, a consequence of which is the achieved level of not only economic growth but also of international competitiveness. J. Bossak and W. Bieńkowski explicitly state that ‘the quality of institutions has a major impact on the level of transaction costs and systemic risk (...). The higher the quality of institutions, the lower transaction costs and systemic risk, and the greater opportunities for economic development’<sup>26</sup>, and thus the higher competitiveness of the economy. It must

<sup>24</sup> Opper, S. 2008. New Institutional Economics and its Application on Transition and Developing Economies. In: Brousseau, E., Glachant, J.M. eds. *New Institutional Economics. A Guidebook*. Cambridge: Cambridge University Press, pp. 389–406.

<sup>25</sup> North, D. 1990. *Institutions, Institutional Change and Economic Performance*, Cambridge: Cambridge University Press.

<sup>26</sup> Bossak, J., Bieńkowski, W. 2004. *Międzynarodowa zdolność konkurencyjna kraju i przedsiębiorstw. Wyzwania dla Polski na progu XXI wieku. [International competitiveness of*

be borne in mind that excessive bureaucracy, corruption, dishonesty in public procurement, lack of public confidence, lack of transparency and credibility or of the independence of the judiciary significantly increase transaction costs and thus slow down the entire economic development process, as well as considerably lower the ability to compete in the international arena<sup>27</sup>. In this context, effective institutional transformation (within the aforementioned institutions) is an extremely important determinant of the level of this international competitiveness<sup>28</sup>. The introduction of the notion of institutional competitive advantage to the theory and empiric of economic research demonstrates the particularly tremendous importance of institutions in this context<sup>29</sup>.

## 2. THE LEVEL OF ADVANCEMENT OF INSTITUTIONAL TRANSFORMATION OF ECONOMIES IN THE POST-SOVIET AREA

Assessing the degree of advancement and the effects of the institutional transformation processes of the post-Soviet economies, 25 years after the collapse of the USSR, it is important to emphasise considerable differences in this respect.

Undoubtedly, only three Baltic states (Estonia, Lithuania, Latvia) have achieved an unquestionable transformational success in the post-Soviet area, which can be seen in Chart 1 and Chart 2 which show the stage of

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*the country and enterprises. Challenges for Poland on the threshold of the 21st century.*] Warszawa: SGH, p. 61.

<sup>27</sup> Falkowski, K. 2013. *Międzynarodowa konkurencyjność gospodarek Białorusi, Rosji i Ukrainy.* [International competitiveness of the economies of Belarus, Russia and Ukraine.] Warszawa: SGH, p. 31.

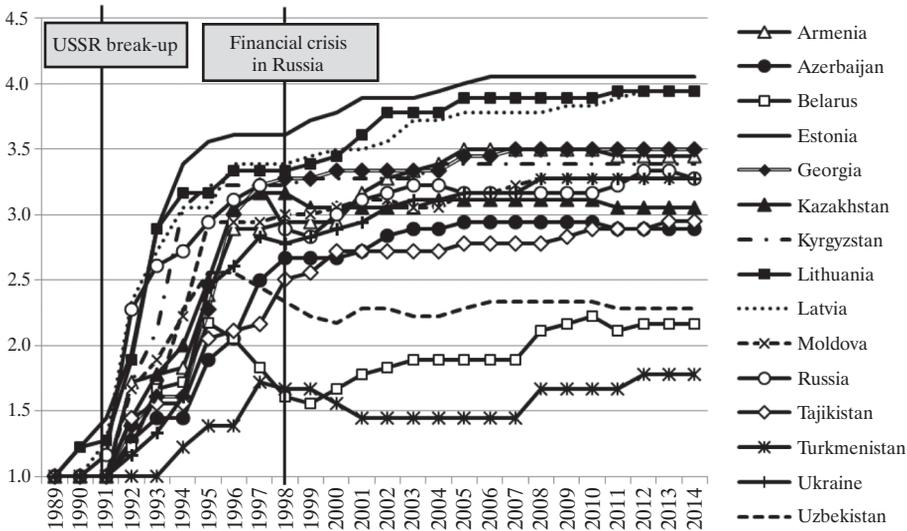
<sup>28</sup> Bieńkowski, W. 2005. *Wpływ instytucji na rozwój gospodarczy i konkurencyjność krajów postkomunistycznych. Kilka uwag w odniesieniu do Polski i Rosji.* [The impact of institutions on the economic development and competitiveness of post-communist countries. A few comments on Poland and Russia.] Paper for the conference: *Nowe uwarunkowania instytucjonalne a rozwój współpracy gospodarczej z krajami bałtyckimi, Białorusią, Rosją – Obwód Kaliningradzki i Ukrainą.* [New institutional conditions and the development of economic cooperation with the Baltic states, Belarus, Russia – Kaliningrad Oblast and Ukraine.] June 2005. Augustów; Winiecki, J. 2012. *Transformacja postkomunistyczna. Studium przypadku zmian instytucjonalnych.* [Post-communist transformation. A case study of institutional changes.] Warszawa: Wydawnictwo C.H. Beck; Yeager, J.T. 2004. *Institutions, Transition Economies and Economic Development.* Boulder, Colorado: Westview Press.

<sup>29</sup> Martin, X. 2014. Institutional advantage. *Global Strategy Journal*, no. 2014/4, pp. 55–69.

institutional transformation of the economies of the former USSR countries in 1989–2014. To compile the charts I used the data of the European Bank for Reconstruction and Development (EBRD), which in its reports assesses the scope and effectiveness of institutional change reforms, particularly with respect to changes in the ownership structure (so-called small and large privatisation), management and restructuring of enterprises, liberalisation of prices, trade and financial markets, and competition policy<sup>30</sup>.

Chart 1

The level of advancement of the institutional transformation of the economies of individual post-Soviet states according to EBRD in 1989–2014\*



\* The latest data in this area are available for 2014.

Source: own study on the basis of the data of the European Bank for Reconstruction and Development (database: <http://www.ebrd.com/what-we-do/economic-research-and-data/data/forecasts-macro-data-transition-indicators.html>, accessed: 15 June 2017).

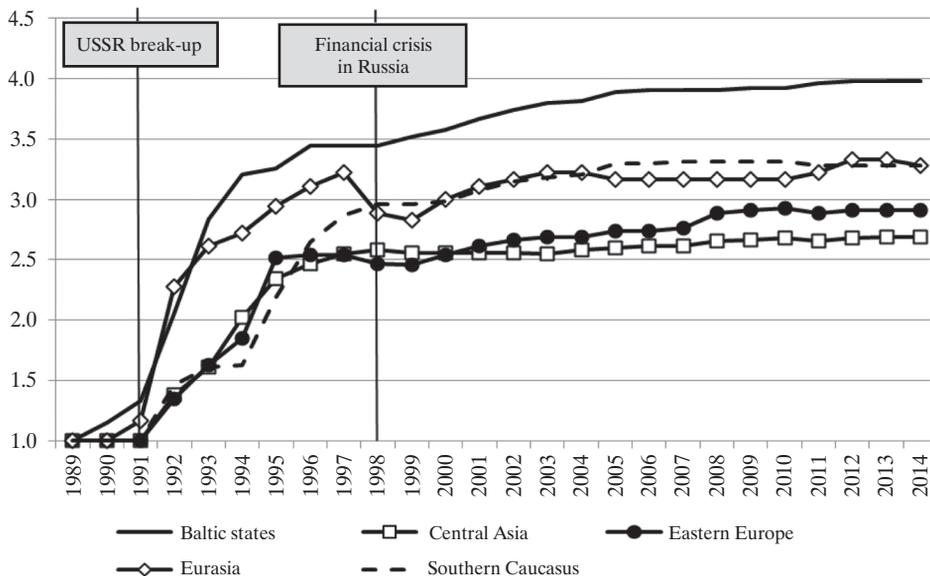
The data in Charts 1 and 2 show that definite leaders of pro-market reforms in the post-Soviet area are the Baltic states, already mentioned in this context, in turn, the group of so-called transformation outsiders includes the post-Soviet states from Central Asia, and Turkmenistan, Belarus and Uzbekistan when the countries are considered individually. Moreover, in

<sup>30</sup> EBRD. 2012. *Transition Report 2012*. London, p. 12.

the case of these three countries, it is important to underline the significant regress of the undertaken transformational activities, and consequently the far-reaching restoration of the centrally managed economy from the Soviet era. This is connected with A. Lukashenka’s coming to power in Belarus (1994) and the radicalisation of Islamic fundamentalism, which resulted in a significant increase in the authoritarian power of President S. Niyazov in Turkmenistan and President I. Karimov in Uzbekistan.

Chart 2

The level of advancement of the institutional transformation of the post-Soviet economies by regions according to EBRD in 1989–2014\*



*Baltic states:* Estonia, Lithuania, Latvia  
*Eastern Europe:* Belarus, Moldova, Ukraine  
*Southern Caucasus:* Armenia, Azerbaijan, Georgia  
*Eurasia:* Russia  
*Central Asia:* Kyrgyzstan, Kazakhstan, Tajikistan, Turkmenistan, Uzbekistan

\* The latest data in this area are available for 2014.

Source: own study on the basis of the data of the European Bank for Reconstruction and Development (database: <http://www.ebrd.com/what-we-do/economic-research-and-data/data/forecasts-macro-data-transition-indicators.html>, accessed: 15 June 2017).

Referring to the EBRD data on the advancement of market-oriented economic reforms in the post-Soviet countries, it may be tempting to divide these processes into periods and as a result to distinguish three main periods in this regard. The first (and crucial) date is 1991, that is the formal end of the USSR, and the forced start of economic changes necessary to adapt to new economic and political conditions. The second extremely important date not only for Russia, with which it is directly related but also broader, for the entire post-Soviet area is 1998 – the year of the Russian financial crisis.

In the first period, i.e. in the years 1989–1991<sup>31</sup>, despite the formal existence of the Soviet Union all the time, according to the EBRD, one may point to some limited, yet pro-market changes in the economic systems of the then Baltic Soviet republics. These changes concerned the partial liberalisation of the prices of industrial goods (since 1990 in Estonia and Lithuania, since 1991 in Latvia). The second period, 1991–1998, was generally characterised by a significant acceleration of transformation processes in all post-Soviet states. On the other hand, in the third period, i.e. from 1998 up to the present day, stagnation of institutional changes in individual post-Soviet countries (with the exception of the Baltic states) is clearly visible.

The data presented in Table 1 testify to the current state of advancement of the institutional transformation of the post-Soviet economies. In general it should be noted that so-called ‘small privatisation’, liberalisation of prices and liberalisation of trade and financial systems look definitely the best. With the exception of Belarus, Turkmenistan and Uzbekistan, all other countries have been rated as ‘4’ or ‘4+’ (the Baltic states), which means full implementation of the transformational goals assumed in this regard.

In turn, generalising, a specific transformation ‘Achilles heel’ among the post-Soviet states, after nearly a quarter of a century of their independent functioning and their ability to implement their own economic policies and structural institutional reforms, is the low range of desired changes in management and restructuring of enterprises, as well as competition policy. In both of these cases, in all analysed countries, except for Estonia, Lithuania and Latvia, the situation is dramatic.

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<sup>31</sup> In 1989 the European Bank for Reconstruction and Development began to evaluate the transformation effects for all so-called transition countries, i.e. of the former ‘Eastern Bloc’.

Table 1

The level of advancement of the institutional transformation of the post-Soviet economies in terms of individual categories according to EBRD in 2014<sup>\*32</sup>

	Privatisation		Management and restructuring of enterprises	Liberalisation of prices	Liberalisation of trade and financial system	Competition policy
	'big'	'small'				
Armenia	4-	4	2+	4	4+	2+
Azerbaijan	2	4-	2	4	4	2-
Belarus	2-	2+	2-	3	2+	2
Estonia	4	4+	4-	4+	4+	4-
Georgia	4	4	2+	4+	4+	2
Kazakhstan	3	4	2	4-	4-	2
Kyrgyzstan	4-	4	2	4+	4+	2
Lithuania	4	4+	3	4+	4+	4-
Latvia	4-	4+	3+	4+	4+	4-
Moldova	3	4	2	4	4+	2+
Russia	3	4	2+	4	4-	3-
Tajikistan	2+	4	2	4	4-	2-
Turkmenistan	1	2+	1	3	2+	1
Ukraine	3	4	2+	4	4	2+
Uzbekistan	3-	3+	2-	3-	2-	2-

\* The latest data in this area are available for 2014.

Source: own study on the basis of the data of the European Bank for Reconstruction and Development (database: <http://www.ebrd.com/what-we-do/economic-research-and-data/data/forecasts-macro-data-transition-indicators.html>, accessed: 18 June 2017).

The advancement of the institutional transformation of the post-Soviet economies can also be assessed on the basis of the existing scope of economic freedom. According to the Heritage Foundation, the level of this freedom in the post-Soviet countries varies significantly and closely corresponds to the extent of the advancement of institutional change in these countries (Table 2).

<sup>32</sup> According to the EBRD methodology, the degree of advancement of institutional transformation in individual countries in key areas of this transformation is evaluated from 1 (lowest rating, no transformation) to 4+ (highest rating, full transformation in the given category). Cf. EBRD. 2012. *Transition Report 2012*. London.

The highest level of economic freedoms (as of 2016) can be found in the three Baltic states and in Georgia (the result of deep neo-liberal economic reforms and deregulating changes from the times of President Saakashvili). These countries were classified as generally free (mostly free) economies. Estonia was by far the best rated in this field (9th among 178 economies assessed by the Heritage Foundation). Armenia, Kazakhstan and Azerbaijan were included in the next group of moderately free economies. In turn, Kyrgyzstan, Moldova, Tajikistan and Russia were classified as essentially unfree, and the worst situation in the area of post-Soviet economic freedom is in Belarus, Ukraine, Uzbekistan and Turkmenistan, which was classified as 174. Four above-mentioned countries were included in the worst group of repressed economies, which in practice means a very high degree of regulation of the economy by the state, weakness or lack of free market mechanisms, weak investment climate, weak or lack of mechanisms for effective protection of ownership rights, and high corruption of these economies.

### 3. INSTITUTIONAL TRANSFORMATION OF ECONOMIES IN THE POST-SOVIET AREA AND THEIR LEVEL OF DEVELOPMENT AND INTERNATIONAL COMPETITIVENESS

Undoubtedly, the main goal of any institutional change introduced under the broadly defined systemic transformation is to ultimately improve the standard of living of the country's population by increasing the efficiency of the use of resources and raising the efficiency of the overall economic system. From this point of view, as has already been pointed out in the theoretical part of this article, there is a direct link between the scope of introduced market-oriented reforms and the level of development of a given economy. The situation in this area among the post-Soviet countries is presented below.

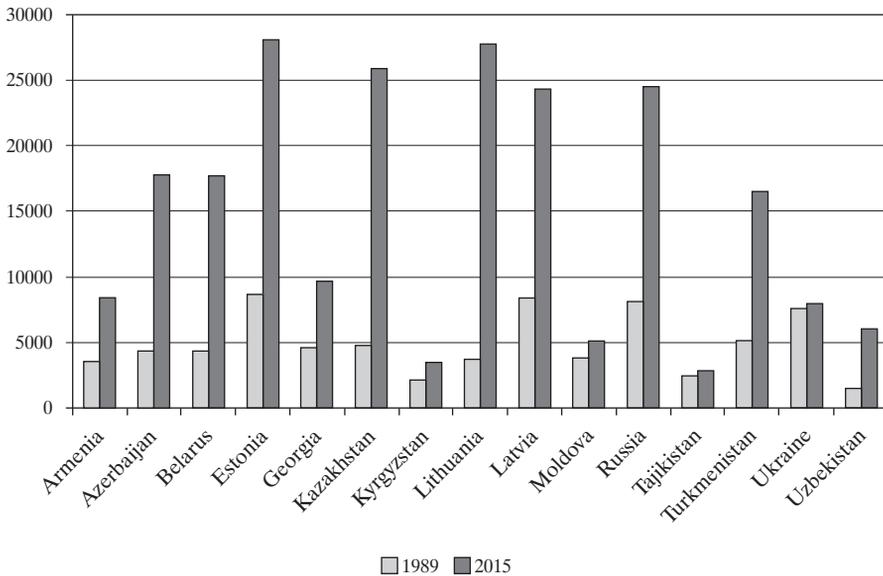
Referring to the International Monetary Fund data presented in Chart 3, it is clear that in 2015 the highest level of economic and social development (measured by GDP per capita PPP) in the post-Soviet area was in: Estonia (28.1 thousand USD), Lithuania (27.7 thousand USD), Kazakhstan (25.9 thousand USD), Russia (24.5 thousand USD) and Latvia (24.3 thousand USD). The worst situation in this regard was in: Tajikistan (2.8 thousand USD), Kyrgyzstan (3.4 thousand USD), Moldova (5.0 thousand USD) and Uzbekistan (6.0 thousand USD).

If, on the other hand, we compare the level of economic and social development measured by GDP per capita PPP from 2015 to that of 1989

we can clearly see which of the post-Soviet countries developed the most in that period. The highest increase in gross domestic product per capita was recorded in Kazakhstan (5.4 times), Uzbekistan, Belarus and Azerbaijan (4.1 times), Estonia and Turkmenistan (3.3 times). On the other hand, the progress was particularly slow in Moldova (up 34%), Tajikistan (up 17%) and Ukraine (where GDP per capita in 2015 was higher by only 5% than in 1989!).

Chart 3

The level of economic and social development in individual post-Soviet countries (measured by GDP per capita PPP) in 1989 and 2015 (USD)



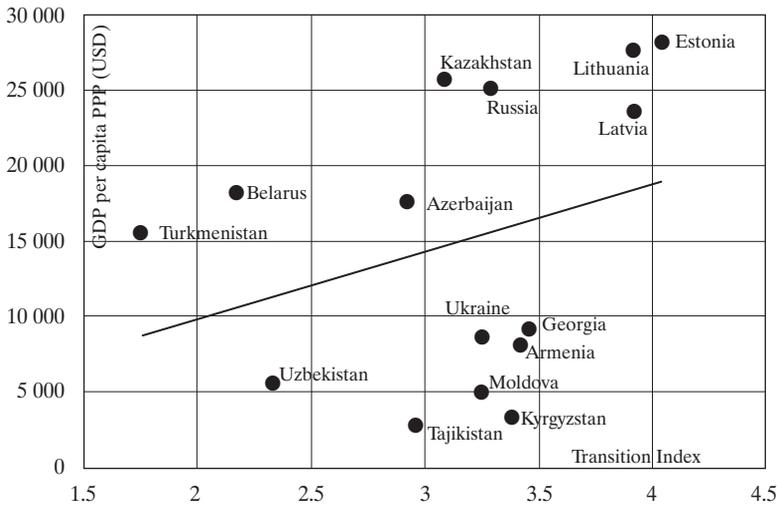
Source: own study on the basis of the data of the IMF.

There is, however, an essential question at this point about the reasons for the economic development of most post-Soviet countries, and especially the role of institutional changes towards the development of a liberal, internalised, market economy system. In response to the above question, it should be very clearly emphasised that only a very small group of the post-Soviet countries, that is only the Baltic states (Estonia, Lithuania and Latvia), effectively transformed their economies and introduced a liberal, free-market economic system. For this reason only in these countries their economic success can be linked with successful institutional transformation.

The economic and social development in other post-Soviet countries, where it occurred (see Chart 3), unfortunately cannot be linked to the progress of institutional transformation in these countries (Chart 4). The best proof of this is that there are such post-Soviet countries as Kazakhstan, Russia, Belarus, Azerbaijan and Turkmenistan, whose higher than average socio-economic development (in the post-Soviet area) does not correspond to liberal market reforms (which *de facto* have never been there). In this case, the dynamic development (as measured by the increase in GDP per capita PPP from 1989 to 2015) should be explained by a favourable price situation in the international markets to which these countries export their commodities and raw materials, or in the case of Belarus, its close economic co-operation with Russia and, in return, preferential prices of energy raw materials, which given the high energy intensity of the Belarusian economy, was an extremely strong factor of economic growth.

Chart 4

**The advancement of institutional transformation in individual post-Soviet countries and the level of their socio-economic development**



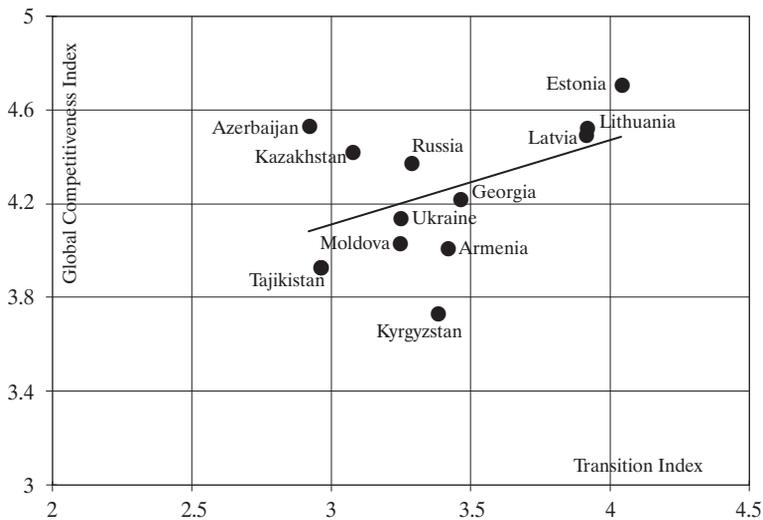
Source: own study on the basis of the data of the European Bank for Reconstruction and Development (database: <http://www.ebrd.com/what-we-do/economic-research-and-data/data/forecasts-macro-data-transition-indicators.html>, accessed: 15 June 2017) and the International Monetary Fund.

The situation is very similar when we refer to the degree of the advancement of institutional transformation in individual post-Soviet

economies (measured by value of the Transformation Index, according to EBRD data) to the level of their international competitiveness (which is determined by the value of the Global Competitiveness Index prepared by the World Economic Forum).

Chart 5

The advancement of institutional transformation in individual post-Soviet countries and the level of their international competitiveness



Source: own study on the basis of the data of the European Bank for Reconstruction and Development (database: <http://www.ebrd.com/what-we-do/economic-research-and-data/data/forecasts-macro-data-transition-indicators.html>, accessed: 15 June 2017) and the World Economic Forum.

In the case of the international competitiveness of the post-Soviet economies, according to the methodology of the World Economic Forum<sup>33</sup>, we should note the relatively high level of competitiveness not only of the three Baltic states but also of Azerbaijan and Kazakhstan, and to a certain extent of Russia. It did not result from the extent of institutional change in these countries but from the size of their economies (relatively greater domestic demand compared to other post-Soviet countries), international trade (especially due to significant exports of mineral resources), and macroeconomic stability (resulting from the favourable price situation for

<sup>33</sup> Schwab K. ed. 2014. *The Global Competitiveness Report 2014–2015*. Geneva: World Economy Forum, pp. 3–11.

raw materials exported by these countries, with the exception of crude oil in the last 2-3 years).

Generally speaking, it should be stressed that in the Global Competitiveness Reports, the post-Soviet countries, with the exception of the three Baltic states, have been poorly evaluated over many years in terms of broadly understood institutions (above all: judicial quality, ownership rights protection, the scale of corruption), the efficiency of financial markets, the efficiency of labour markets, and the development of the business environment. This fact must be clearly connected with the lack of effective institutional changes in the post-Soviet area.

#### 4. THE FUTURE OF INSTITUTIONAL TRANSFORMATION OF POST-SOVIET ECONOMIES

In the context of the institutional transformation of the post-Soviet economies, a fundamental question arises about their future because, with the exception of the three Baltic states, in the case of the other post-Soviet countries, we cannot *de facto* speak of achieving the 'critical mass', which, according to theoretical assumptions, would mean the successful conclusion of this transformation and the introduction of free-market principles to the functioning of their economies. Another extremely important question arises at this point, namely whether these countries, given their geographical, historical, political, social and cultural specificity, will be really able to achieve this neo-liberal 'critical mass' at all, which to a large extent is closer to the western way of thinking and functioning.

In this context, it is justified to say that, after a quarter of a century of functioning in completely new geopolitical realities, the changes and institutional transformations carried out in these countries so far have reached a peculiar peak of the possibilities for change in this area. This means that the transformation of economic institutions in most post-Soviet countries has already ended and that these countries have already reached their own 'critical mass', which is not at all the same as that promoted by the previously mentioned Washington consensus. Thus, looking at the existing economic, social and political realities in these countries, the introduction of neoliberal principles of market capitalism seems to be very unlikely. This is even more unlikely because as a consequence of the global economic crisis of 2008 the model of liberal, open and strongly internationalised economy has been discredited.

On the other hand, in the case of some post-Soviet countries, i.e. those that have expressed their aspirations for closer cooperation with the European Union (Eastern Partnership countries, except Belarus and Armenia), theoretically one can expect the continuation of market reforms (institutional transformation). Nevertheless, it should be strongly stressed here that it should not be expected that ultimately these countries will follow the transformation path of the Central European countries, and consequently that their achievements in this area will be identical with the accomplishments of Poland, Hungary, the Czech Republic and other post-communist countries of this part of Europe. Why? Because of three paradoxically very mundane reasons, namely<sup>34</sup>:

- firstly, because of the ‘time and place’ these countries are in now. It was much easier to carry out radical and complex institutional transformations in Central European countries in the early 1990s when Russia was weak and the international community actively helped in their transformation and when the societies of these countries – yet fully unaware of the negative social impact of these changes – euphorically supported the reformers. What is more, it is much easier to enforce the desired changes quickly, radically and comprehensively (as was the case in Central European countries in the early 1990s) than to do it gradually and slowly, exposing oneself to strong ‘interest groups’ not even remotely interested in the country becoming more democratic and the economy being more market-oriented which could threaten their own vested interests;
- secondly, due to the fatigue of the societies of these countries with hitherto transformations that have not led to the promised real improvement of the living conditions of the population. In this context it should be strongly stressed that the social capital of positive attitude to changes which appeared just after the collapse of the USSR has been deliberately squandered;
- thirdly, because of Russia’s strong interference in the internal affairs of these countries and the possibility of Russia further playing the national card in order to destabilise the situation in them in the name of advancing its own, particular geostrategic interests.

All this leads us to the conclusion that, taking into account the current determinants, it is difficult to assume that institutional transformation in

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<sup>34</sup> Falkowski, K. 2016. Testing the CEEs’ model of transformation in the ENP framework: challenges and opportunities: the Eastern Dimension. *Yearbook of the Institute of East-Central Europe*, vol. 14(6), pp. 9–25.

the post-Soviet areas may be completed in the foreseeable future according to the neo-liberal model of change experienced in the countries of Central Europe or the Baltic states (after all former Soviet republics). The scenario assuming the maintaining of the status quo in this area is much more likely, which unfortunately will involve stronger and stronger subordination of these countries to Russia.

## CONCLUSION

All institutional changes are always tedious, difficult, arousing much controversy and entailing certain costs, let alone those with which the States created after the collapse of the Soviet Union in the early 1990s had to face. They had to 'find themselves' in the new geopolitical reality and try to redefine their own rules on which to base their economic systems. In practice, however, the departure from the Soviet model of the centrally-managed economy and transition to a free market system (recommended by international financial institutions and western governments), based on competition, private property and the dominance of the market rather than of the state in the economy turned out to be extremely difficult and challenging for the post-Soviet countries, regardless of their implementation method.

Assessing today (25 years after the formal break-up of the USSR) the degree of the advancement of this institutional transformation in the group of these economies, it is important to underline its strong diversity, both in terms of the adopted transformation strategies and the effectiveness of their implementation. Consequently, in a vast majority of post-Soviet countries (except the three Baltic states – Estonia, Lithuania and Latvia) it has not been completed yet, i.e. they have failed to create institutional systems specific to free market economies, according to the neo-liberal doctrine outlined in the Washington consensus. Turkmenistan, Uzbekistan and Belarus fare definitely the worst from the perspective of those 25 years of institutional transformation of the post-Soviet area.

It is possible to point to at least several reasons for this state of affairs. Due to the formal limitation of the article, four selected, in the author's opinion the most important ones will be mentioned. First of all, most post-Soviet countries are characterised by a far more distinct cultural code than the European one (determining a number of informal institutions of social, political and economic life), among others, in relation to the attitude to the law, ownership, the state, another human being (including the social

position of women in Muslim countries), etc. In such societies it is much more difficult to create and implement liberal principles of the operation of the state and the economy. Moreover, under such conditions, the 'transplantation' of solutions that have worked in the West seems to have been doomed to failure as the transformation reality has verified.

Secondly, from the point of view of the success of institutional transformation, the attitude of the elites in power towards the need for institutional changes in the economy is extremely important. In the post-Soviet countries, with the exception of the Baltic states, the post-communist political elites have very quickly sanctioned a very convenient for them mechanism of concentration of economic assets (especially raw materials and industry) in the hands of the state, while liberalising profits and nationalising costs. Consequently, they have not shown any will or need for any deep structural institutional changes. Thirdly, the fact that some of the post-Soviet countries have a large stock of resources and the associated possibility of discounting profits from their international sales to secure macroeconomic stability and economic growth, has demotivated their governments and has undermined the need for fundamental institutional change. Last but not least, we should not forget about the destabilising role of Russia itself, especially under Putin's rule, for which the liberal institutional transformations in the economies of the former post-Soviet states, still regarded as a zone of Russian geostrategic influence, has been considered a real threat to this influence. As a consequence, Russia has tried in various ways to torpedo potential market reforms, either discrediting the reformers in the eyes of the public of those countries, or blackmailing them economically.

The conducted analysis shows that the degree of advancement of the institutional transformation of various economies in the post-Soviet area does not entirely determine their present level of development as well as their international competitive position. In the case of the three Baltic states, there is a strong positive correlation between the institutional changes and their level of development and competitiveness. However, it cannot be said of countries such as Uzbekistan, Belarus or Turkmenistan, where the range of free-market institutional changes is the smallest in the entire post-Soviet area. There is no doubt that in this case the main factor of growth are raw materials, either owned, mined and exported (in the case of Turkmenistan and Uzbekistan), or purchased from Russia on preferential terms (in the case of Belarus). The same can be said of the Russian economy, whose extensive economic growth and international competitive profile depend *de facto* solely on the sale of its mineral resources.

Referring to the future of the institutional transformation of the post-Soviet economies, where these processes have not yet been completed, it should be emphasised that, given the present geopolitical conditions and highly expansive Russian policy towards the post-Soviet countries, we should not expect their completion and thus the introduction of the liberal institutional environment in these countries, which are typical of free-market economies.

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## ECONOMIC ASPECTS OF INSTITUTIONAL TRANSFORMATION IN POST-SOVIET COUNTRIES – CURRENT STATE AND CONSEQUENCES FOR THEIR DEVELOPMENT AND COMPETITIVENESS

### Summary

The subject of this article is the problem of institutional transformation, specifically its economic aspects, in countries of the former USSR. First, selected theoretical aspects related to institutional transformation of post-communist economies are discussed. Then, a synthetic analysis of the advancement of this transformation in the post-Soviet area and of its consequences for the development and international competitiveness of their economies is conducted. And finally, reference is made to the future of institutional transformation of post-Soviet economies. The analysis shows that: from the very beginning (i.e. the break-up of the USSR), the processes of institutional transformation of post-Soviet economies have been strongly differentiated both in terms of adopted transformational strategies and their

effectiveness, as evidenced by the very different results observed presently in this regard; the current level of development, as well as international competitiveness of most post-Soviet economies are not a direct consequence of the advancement of their institutional transformation; completion of the processes of institutional transformation is not to be expected in the foreseeable future and neither is the introduction of a liberal institutional environment typical for free market economies.

## EKONOMICZNE ASPEKTY TRANSFORMACJI INSTYTUCJONALNEJ W KRAJACH PORADZIECKICH – STAN ORAZ KONSEKWENCJE DLA ICH ROZWOJU I KONKURENCYJNOŚCI

### Streszczenie

Przedmiotem niniejszego artykułu jest problematyka transformacji instytucjonalnej, a konkretnie jej ekonomicznych aspektów, w krajach byłego ZSRR. W szczególności omówione zostały wybrane aspekty teoretyczne odnoszące się do transformacji instytucjonalnej gospodarek postkomunistycznych. Następnie dokonano syntetycznej analizy poziomu zaawansowania owej transformacji na obszarze poradzieckim, a także ich konsekwencji dla poziomu rozwoju oraz międzynarodowej konkurencyjności gospodarek tych krajów. W kolejnej zaś części odniesiono się do przyszłości transformacji instytucjonalnej gospodarek poradzieckich. Z przeprowadzonej analizy wynika, że: procesy transformacji instytucjonalnej gospodarek na obszarze poradzieckim od samego początku (tj. rozpadu ZSRR) były silnie zróżnicowane, zarówno pod względem przyjętych strategii transformacyjnych, jak i skuteczności ich realizacji, czego wymiernym rezultatem są dzisiejsze bardzo zróżnicowane efekty w tym zakresie; obecny poziom rozwoju, jak również międzynarodowa konkurencyjność większości gospodarek poradzieckich nie są *de facto* bezpośrednią konsekwencją stanu zaawansowania ich transformacji instytucjonalnej; w dającej się przewidzieć przyszłości nie należy oczekiwać dokończenia procesów transformacji instytucjonalnej i tym samym wprowadzenia liberalnego otoczenia instytucjonalnego, charakterystycznego dla gospodarek wolnorynkowych.

## ЭКОНОМИЧЕСКИЕ АСПЕКТЫ ИНСТИТУЦИОНАЛЬНОЙ ТРАНСФОРМАЦИИ В ПОСТСОВЕТСКИХ ГОСУДАРСТВАХ – СОСТОЯНИЕ И ПОСЛЕДСТВИЯ ДЛЯ ИХ РАЗВИТИЯ И УРОВНЯ КОНКУРЕНТОСПОСОБНОСТИ

### Резюме

Предметом настоящей статьи является проблематика институциональной трансформации, а точнее, её экономических аспектов, в государствах бывшего СССР. В частности, были обсуждены избранные теоретические аспекты, касающиеся институциональной трансформации экономических посткоммунистических систем. Затем произведён синтетический анализ уровня продвинутости этих трансформаций на постсоветском пространстве, а также их последствий для уровня развития и международной конкурентоспособности экономических систем этих государств. Следующая часть статьи касается будущего институциональной трансформации постсоветских экономических систем. Результаты анализа показывают, что процессы институциональной трансформации экономических систем на постсоветском пространстве с самого начала (под которым подразумевается распад СССР) сильно различались друг от друга – как с точки зрения предпринятых трансформационных стратегий, так и эффективности их реализации; измеримым исходом чего являются значительно дифференцированные результаты в данной сфере; современный уровень развития, а также международная конкурентоспособность большинства постсоветских экономических систем не являются *de facto* непосредственным последствием уровня продвинутости их институциональной трансформации; в обозримом будущем не следует ожидать завершения процессов институциональной трансформации и тем самым введения либеральной институциональной среды, свойственной экономическим системам со свободной рыночной экономикой.