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GOVERNMENTS AND ECONOMIES IN TRANSITION - SOME EARLY EXPERIENCES*

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ABSTRACT

The paper analyzes the role of government in transition economies. The following presents some of the ways in which it can operate: in creating the ideal environment for entrepreneurial growth, implying the speedy application of privatization and activation of the financial market, in radically discontinuing with the administration of the economy, in ensuring social stability and finally, in practicing stable, macroeconomic policies. Also looked into are some of the earlier experiences with transitions, especially the effect of economic liberalization on economic growth, inflation, employment, privatization and political freedom. The end deals with specific aspects relative to the transition of the Croatian economy, indicating some open issues which need government intervention in various directions, in order to be solved.

Key words: *government; economy; transition; economic liberalization.*

INTRODUCTION

Even though it is quite clear, since the appearance of Keynes's economic analysis, that governments are responsible for the overall functioning and for the aftereffects of an economic system, the question is still in how active should governments be with their participation in the economic life of contemporary economies.

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On the other hand, the economic liberalization of countries in transition leads to fundamental changes in the economic features of these economies and directly influences economic growth, inflation, employment, privatization and political freedom.

This paper will consider the particularities of the new role governments play in transition economies. It will also look into some of the early experiences of transition economies, in terms of the application of economic liberalization and its' effect on macroeconomic goals, with special attention paid to the problem of privatization and the interdependent ties of political and economic liberalizations. Considering that the transition of the Croatian economy in the recent past was carried out under special conditions, created by war and aggression, the particularities related to the transition of the Croatian economy will be especially considered and certain actual problems will be identified, which still remain open and are yet to be solved.

1. THE GOVERNMENT'S NEW ROLE AND CHANGES IN THE MAIN ECONOMIC FEATURES OF ECONOMIES IN TRANSITION

J.M. Keynes pointed out the great possibilities of governments in regulating economic life. According to Keynes's interpretation, the problem of high unemployment in his time was possible to resolve through the government's increase of effective demand, in the first instance, by public works. The phenomenon of J.M. Keynes and his macroeconomic theory meant a break from the classical view regarding the inevitability of balance under conditions of full employment and it opened wide possibilities for the government in carrying out the macroeconomic policy of stabilization. Post-war periods for the majority of economies were marked by strong, governmental regulations, by strengthening of the public sector and by operations on the open market, which meant the government's strong role in regulating economic flows. However, since the seventies, the monetarist approach has proved the inevitability of decreasing government intervention in the economy through narrowing its' legal interference, privatization of the public sector and abolishing the budget deficit. Although, according to Keynes, the government's active role does not mean in any way the complete suppression of the market mechanism.

The question is: How actively should the government participate in economic life, or which are the most desirable areas of participation in contemporary economies?

Experiences from the seventies and eighties demonstrate that countries achieved higher rates of growth when government intervention in the economy was less, (the example of the "four tigers" of East Asia: Hong Kong, Singapore, South Korea and Taiwan). Since the eighties, it is

also a fact that the process of reprivatizing government enterprises, as well as great public systems (especially in transport and in communications) exists in some developed countries - for example, the United States, France, and the United Kingdom.¹ The experiences of these countries demonstrate that private enterprises are more efficient than public ones. Accordingly, the government should abandon its' function of production, as it is best materialized through market competition. The government, as the basic allocating mechanism and largest owner and entrepreneur, should withdraw itself from the economy. Government involvement is of special significance with respect to human capital, scientific research, improving the infrastructure (physical and social), creating the ideal environment for entrepreneurial growth, stabilizing economic movement, the growth of overall productivity factors and advancing global competition. The economic policy of contemporary economies should emphasize these areas.

The question now is: What particular role does the government have in transitional economies?

Different sources offer varying views on the government's role in those transition economies which take into consideration the particularities of a country. A. Bim, considering the choice of strategies in relation to the government's role in the transition economies of the former Soviet Union, says that, there are basically three theoretically possible variants: (a) a classic, Marxist-Leninist variant, which implies government domination in political and economic life through the dominance of state ownership; (b) a social-democratic variant, which implies variety in forms of ownership, the existence of a developed market and the obligatory, prominent government role in regulating economic and social processes and (c) a liberal strategy, in which government participation in formulating and developing the economy is significantly limited and in which market relationships are the

1 Since the eighties, almost fifty of the largest businesses in the United Kingdom were privatized (see data from the period of 1979 to 1995 in Bailey, S.J. (1995): *Public Sector Economics - Theory, Policy and Practice*, Macmillan, Houndmills, p.291 and 296-297). Only from 1981 to 1987, 13 public enterprises were privatized for the amount of 12 billion pounds (of which, in 1984, 4.1 billion pounds for British Telecom and in 1986, 1.8 billion pounds for British Gas) - Hemming, R., Mansoor, A.M. (1988): **Privatization and Public Enterprises**, International Monetary Fund, Occasional Paper No. 56, Washington, D.C., p. 7.

In the middle of 1986, the French government announced a five-year privatization plan for 65 public enterprises, including larger banks and insurance, holding and industrial companies. From October 1986 to June 1987, 13 enterprises were privatized for 55 billion FF (of which, 12.6 billion FF for Paribas, 10.0 billion FF for Compagnie Generale d'Electricite and 17.0 billion FF for Societe Generale) - *ibidem*, pp. 8 - 9.

basic regulators for the overall picture of production, innovation, exchange and distribution.²

Generally speaking, the role of the government in transition economies encompasses all that has been already mentioned concerning the role of the government in contemporary market economies. Due to the fact that these are economies in transition from a non-market to a market economy and that the establishing of an enterprising economy is at the same time an economic and a political project, the following will demonstrate the particularities inherent to the government's new role.³

The government must create the ideal environment for entrepreneurial growth. Carrying out privatization and activating the financial market are first in the required series of activities. There is no generally accepted model of privatization which could be applied for all transition economies, but a country should use more than one method, if it wishes success in privatization (the return of property to original owners, the sale of government property, mass or voucher privatization and privatization through the formation of new firms). In privatization, it should be kept in mind that advantages lie in speedy reforms. It is also necessary to differentiate the problems of privatization from that of the accumulation or the formation of capital. Privatization should not be considered as a source of accumulating fresh capital based upon income from enterprise sales. Further, a government whose goals are to develop the market and a competitive microeconomy must **radically break off with the administration of the economy and develop the competitive character of the market by using legislation**, such that it is the market that influences enterprise decisions regarding output and/or cost and not the

2 See - Bim, A. (1992): **The Role of the State in Transitional Postcommunist Economies in the Experience of Economic Reforms in the 1980s and 1990s and Problems in the Foreseeable Future**, in Aslund, A. (ed.): *The Post-Soviet Economy - Soviet and Western Perspectives*, Pinter Publishers, London, p. 182.

V. Naishul also points out, considering the new Russian state, that if citizens wish to have internal peace, there is one function which cannot be taken away from the government. The government must guarantee that, if the conflicts in society cannot be resolved on the basis of mutual agreements, the government must resolve them with enough force so that they cannot be disputed by nongovernmental, physical and legal persons. See - Naishul, V. (1994): **Economic Reforms: A Liberal Perspective**, in Aslund, A. (ed.): *Economic Transformation in Russia*, Pinter Publishers, London, p. 179.

3 On the particularities of the government's role in transitional economies, see - Benić, Đ. (1997): **The Role of Government in the Transition Economies**, *2nd International Conference on Enterprises in Transition*, Proceedings, DAAAM International, Vienna, Austria & University of Split, Faculty of Economics, Split, Croatia, pp. 41-46.

government. Next, **the labour market should not be repressed**. Let us mention here that the successful economic growth of "the four tigers" of East Asia did not base itself on repression of the labour market, rather growth followed the improved labour market.⁴ However, **a government must ensure social stability**, as at first, high unemployment follows economic liberalization in transition economies. And finally, a government must, alongside ensuring economic and social rights, as well as individual freedom, direct special activities towards **an open economy and the carrying out of a stable, macroeconomic policy**. This policy implies a rigid monetary and flexible fiscal policy as there is **no successful transition possible without stable monetary values**.

On the other hand, economic liberalization affects all transition economies in similar ways, as they have a common legacy, which the process of transition sometimes changes in either greater or lesser measure. The economic features handed down to transition economies and their expected changes, brought about by the market system using the liberalization of prices, trade and the entrance of the private sector, can be looked at briefly, as follows.⁵

The five main economic features of command economies were as follows:

(1) **macroeconomic balance by direct control**, where prices and salaries were fixed, thereby determining the household purchasing power and where wage level was the critical factor in balancing supply and demand;

(2) **high employment**, which was maintained according to plan;

(3) **coordination through plans**, where economic activities based themselves on a central plan and preference was given to the production of capital over consumer goods, and where the development of the service sector was restricted through planned resource allocation;

(4) **little private ownership** - with few exceptions, the government was the owner of generally quite large enterprises, private ownership was not allowed, consequently showing low efficiency due to the lack of motives for maximizing profits;

(5) **distorted relative prices**, as prices have a financial role coordinated to the central plan, such that the cost of housing, energy, education and medical care were kept low, including trade margins and the prices of final goods did not reflect the differences in distribution costs.

4 See - Fields, G.S. (1994): **Changing Labor Market Conditions and Economic Development in Hong Kong, the Republic of Korea, Singapore, and Taiwan, China**, *The World Bank Economic Review*, Vol. 8, No. 2, pp. 397-403.

5 Compare with - de Melo, M., Denizer, C., Gelb, A. (1996): **Patterns of Transition from Plan to Market**, *The World Bank Economic Review*, Vol. 10, No. 3, pp. 399-402.

Economic liberalization brings about the following changes in these features:

(1) **initial macroeconomic destabilization followed by restabilization** - stability is lost through the liberalization of prices and salaries, inflation grows especially in those countries where inflation was repressed, which requires a change from a passive to an active monetary policy; the pressures of inflation can last due to inherited production structures, where large subsidies were made to ensure the survival of government enterprises; however, economic liberalization can facilitate restructuring and hence a reduction in such subsidies, resulting in the decline of inflation;

(2) **growth of unemployment**, as a consequence of the collapse of great government enterprises and the impossibility of the newly-formed private sector to employ all those left unemployed; the role of the government in solving this problem must be an active one, especially in the field of fiscal policies (not only in the domain of government expenditure but also in stimulating the growth of investment activities through taxes) and in institutionally creating such an environment which stimulates entrepreneurial growth;

(3) **output declines from disruptions in the coordinating mechanism** - disruptions in the coordinating mechanism affect both useful and unwanted production up until the time that an efficient market coordinating mechanism is developed (this decline is greater in those countries where central planning was powerful, where disruptions of such a system were more intense and where the development of a new market coordinating system was slower);

(4) **output gains from private ownership and private sector growth** - output gains are enabled by the legal regulation of private activities and facilitated by the entry of new private companies, whereas, efficiency growth is the result of increased competition among numerous smaller enterprises in the private sector, now orientated towards the market, that is, to the consumer, in comparison to earlier enterprises;

(5) **microeconomic and sectoral reallocations** - the liberalization of prices and trade, as well as subsidy cuts and changes in demand, result in microeconomic and sectoral reallocations, emphasizing growth in previously restricted sectors (services) and a decline in sectors which had received various kinds of subsidy (examples found in industry and in agriculture, in many countries); output gains result from the reallocation of resources and activities for which demand is low, to those activities in high demand.

According to the aforementioned, economic liberalization initially leads to declines in output and employment and a rise in inflation. However, in the long run, these problems are solved with growth in the role of those sectors where development was restricted by planned resource allocation.

2. ECONOMIC LIBERALIZATION, GROWTH, INFLATION AND UNEMPLOYMENT

The countries of Central and Eastern Europe, including the republics in the former Soviet Union, even though they commonly had command economies, followed their own road towards reform at varying speeds and intensities. The results were various in achieving general macroeconomic goals: economic growth, stable prices and full employment.

As pointed out in the first section, output declines resulted from the disruption of the coordinating mechanism in transition economies. Transformation to a market economy began in Eastern Europe towards the end of the eighties, markedly in 1989. Even so, these economies, including all the transition economies portrayed in Table 1, register declines in gross domestic product for the years 1991 and 1992 (excluding Poland and Turkmenistan in 1992). Only in 1993 did the majority of the economies in Eastern and Central Europe halt the initial decline in output, either stabilizing or increasing output by 1994. Whereas, the economies of countries formerly belonging to the Soviet Union suffered output declines in 1993 and in 1994.

On the other hand, in the early nineties, high inflation was noted until 1992 for all the transition economies considered, when certain countries (Czech and Slovak Republics, Hungary) managed to detach themselves according to their success in combatting inflation. Inflation was significantly lowered by the end of the considered period (1994) in most of the economies of Eastern and Central Europe (Albania, Croatia, Poland, Romania, Slovenia), including some countries from the former Soviet Union, foremost by Estonia, Latvia and Lithuania (see Table 2).⁶

Literature offers many examples of research on the experiences of certain countries regarding economic liberalization. Authors M. de Melo, S. Denizer and A. Gelb give an analysis of the experiences of 26 transition economies. They point out the two paradoxes of transition: first, the attempt to maintain output through subvention of an enterprise results in greater output declines than would appear with the policy of reducing subvention, and second, the liberalization of price results in lower inflation than with the policy of continued price control. The following can be pointed out from that analysis.⁷

6 The 1993 price growth in some countries (Czech, Slovak, Poland, Romania, Hungary) was partially the result of introducing taxes on additional values, so that almost half of the annual inflation in the Czech and Slovak Republics and a third in Hungary are attributed to the introduction of this tax. See - Bujas, G. (1996): *Tranzicijske zemlje na prekretnici, Ekonomska misao i praksa*, Vol. 5, No. 1, pp. 99 - 100.

7 See in general - de Melo, M., Denizer, C., Gelb, A., *ibidem*, pp. 403-410.

Table 1: Growth of GDP in transition economies 1991 - 1994

(Percentage change over same period of preceding year)

Country	1991.	1992.	1993.	1994.
Albania	-27,7	-9,7	11,0	7,4
Bulgaria	-11,7	-5,7	-1,5	0,2 ^a
Czech Republic	-14,2	-6,4	-0,9	2,6
Croatia	-20,9	-9,7	-3,7	0,8
Hungary	-11,9	-4,3	-2,3	2,0
Macedonia ^b	-12,1	-13,4	-14,1	-7,2
Poland	-7,0	2,6	3,8	5,0
Romania	-12,9	-8,2	1,3	3,5
Slovakia	-11,2	-7,0	-3,2	4,8
Slovenia	-8,1	-5,4	1,3	5,0
Armenia	-8,8	-52,3	-14,8	-2,0
Azerbaijan	-0,7	-22,6	-23,1	-22,0
Belarus	-1,2	-9,6	-9,5	-20,0
Estonia	-10,0	-14,2	-8,6	-
Georgia	-20,1	-40,3	-39,4	-30,0
Kazakhstan	-11,8	-13,0	-12,9	-25,0
Kyrgyzstan	-4,2	-16,4	-16,4	-26,0
Lithuania	-13,1	-39,3	-27,1	-6,5 ^a
Latvia	-10,4	-34,9	-14,9	-2,2
Moldova	-18,7	-28,3	-4,8	-30,0
Russian Federation	-12,8	-19,2	-12,0	-15,0
Tajikistan	-8,4 ^c	-31,0 ^c	-17,3	-12,0
Turkmenistan	-4,7	35,8	11,0	-
Ukraine	-11,6	-13,7	-14,2	19,0
Uzbekistan	-0,5	-11,1	-2,4	-4,0

Note: a. January - September only. b. Gross material product (value added of the material sphere including depreciation).c. Net material product (produced).

Source: *Economic Survey of Europe in 1994-1995*, Economic Commission for Europe, United Nations, June 1995, p. 70.

Table 2: Change in the consumer price index in transition economies, 1991-1994

(Percentage change over the same period of preceding year)

Country	1991.	1992.	1993.	1994.
Albania	104,0	266,0	85,0	22,6
Bulgaria	254,3	79,4	72,9	96,0
Czech Republic	56,7	11,1	20,8	16,0
Croatia	123,0	665,5	1.517,5	97,6
Hungary	36,0	23,0	22,5	19,1
Macedonia	-	1.690,7	349,8	118,9
Poland	71,1	42,2	34,6	33,3
Romania	161,1	210,4	256,0	136,8
Slovakia	61,2	10,0	23,2	13,4
Slovenia	117,7	201,3	32,3	19,9
Armenia	140,0	800,0	1.820,0	4.960,0
Azerbaijan	112,0	939,0	1.113,0	1.780,0 ^a
Belarus	99,0	970,0	1.190,0	2.220,0
Estonia	263,0	1.073,0	89,0	47,6
Georgia	79,0	746,0	1.278,0	-
Kazakhstan	115,0	1.510,0	1.663,0	1.880,0
Kyrgyzstan	113,0	1.089,0	1.194,0	280,0
Latvia	172,0	949,7	109,0	35,8
Lithuania	216,4	1.620,0	410,7	72,0
Moldova	114,0	1.109,0	1.183,0	490,0
Russian Federation	100,0	1.468,0	875,0	303,0
Tajikistan	113,0	907,0	2.136,0	240,0 ^a
Turkmenistan	112,0	770,0	1.631,0	2.710,0
Ukraine	94,0	1.650,0	4.735,0	876,0
Uzbekistan	97,0	415,0	1.232,0	1.550,0

Note: a. Retail prices.

Source: *Economic Survey of Europe in 1994-1995*, Economic Commission for Europe, United Nations, June 1995, p. 97.

It is possible to construct an annual liberalization index and using cumulative experiences with liberalization obtained between 1989 and 1994, it is possible to classify countries into four groups. The liberalization index ranges from 0 to 1, with 0 representing an unreformed country and

1 representing an extensively reformed country. The liberalization index is the weighted average of liberalization rankings in the following three areas:

(1) internal markets - liberalization of domestic prices and the abolition of state trading monopolies (weight:0,3)

(2) external markets - liberalization of the foreign trade regime, including elimination of export controls and taxes, and substitution of low-to-moderate import quotas and high import tariffs; current-account convertibility (weight:0.3)

(3) private sector entry - privatization of small-scale and large-scale enterprises and banking reform (weight:0.4).

It is necessary to define the cumulative liberalization index (CLI), as in each moment, economic possibilities are constantly being determined not only by the level of liberalization currently in force, but also by the structural, institutional, and behavioural changes which stimulated earlier political reforms. CLI is the cumulative liberalization index showing the duration and depth of reforms from 1989 to 1994. In this manner, four groups of countries have been obtained, as follows (see Table 3):

- (1) **Advanced reformers** ($CLI > 3$);
- (2) **High-intermediate reformers** ($2 < CLI < 3$);
- (3) **Low-intermediate reformers** ($1,3 < CLI < 2$);
- (4) **Slow reformers** ($CLI < 1,3$).

A fifth group - **countries affected by regional tensions** - is added to the above group of countries (included is Croatia, whose regions were affected by a four-year war) as non-economical reasons influenced their economic achievements.

Using a statistical analysis, it is possible to indicate the connection of liberalization to the experiences of transitional countries and to demonstrate that a return to positive growth is associated with declines in inflation to double digits or less.⁸

Table 3 indicates that initial output declines were suspended in countries grouped as advanced reformers and that these economies either stabilized or showed output growth from 1993-1994, such that the lowest levels of output were about 80 percent of those noted in 1989. Countries grouped as high-intermediate reformers, lost about a third of their gross domestic product, however, most were able to stabilize output. A high output was noted for Albania, resulting from structural reforms and foreign investment, especially in the agriculture, construction and service sectors. Countries grouped as low-intermediate reformers came off the worst and output losses were noted in 1994. Countries grouped as slow reformers,

⁸ See the statistical analysis in - *ibidem*, pp. 407-408 and Fischer, S., Sahay, R., Vegh, C. (1996): **Stabilization and Growth in Transition Economies: The Early Experience**, *The Journal of Economic Perspectives*, Vol. 10, No. 2, pp. 56-59.

including those countries affected by regional tensions, did not succeed in arresting output declines, but some of them (Uzbekistan, Croatia) managed to halt a further decline.

The inflation of 1993 - 1994 indicates the basic differences between particular groups of countries, but the negative interconnection of liberalization and inflation is obviously strong. Generally, in comparison to countries grouped as slow reformers, those of advanced reformers were relatively successful in repressing the inflation which followed price liberalization. However, excepting the Czech Republic, advanced reformer countries show the highest rate of unemployment (the highest is in Macedonia, which does not belong to this group) and the positive connection of liberalization to unemployment is evidently strong. It is necessary to keep in mind that in the Czech Republic, low unemployment is the result of an efficient process of transitional restructuring, in comparison to countries of the former Soviet Union, where low rates warn that the process of transitional restructuring is still at the start.

Table 3: Liberalization, Growth, Inflation and Unemployment

Country	Cumulative liberalization index (CLI) 1994	Average liberalization 1993-94	Average annual inflation 1993-94 (percent)	Average annual growth in GDP 1993-94 (percent)	Average annual GDP in 1993-94 as a percentage of 1989 GDP	Unemployment rate 1994
Advanced reformers						
Slovenia	4.16	0.82	26	3.0	84	14,5
Poland	4.14	0.84	34	4.2	88	16,0
Hungary	4.11	0.84	21	0.0	81	10,9
Czech Republic	3.61	0.90	16	0.8	81	3,2
Slovak Republic	3.47	0.86	19	0.4	79	14,8
<i>Average</i>	3.90	0.85	23	1.7	83	11,9
High-intermediate reformers						
Estonia	2.93	0.85	69	0.9	69	8,1
Bulgaria	2.90	0.68	81	-1.4	73	12,8
Lithuania	2.72	0.79	231	-7.3	44	3,8
Latvia	2.45	0.71	73	-4.4	60	6,4
Albania	2.30	0.70	57	9.5	74	19,5
Romania	2.29	0.66	194	2.2	69	10,7
Mongolia	2.27	0.64	164	0.6	84	10,1
<i>Average</i>	2.55	0.72	124	0.03	67	10,2
Low-intermediate reformers						
Russian Federation	1.92	0.63	558	-13.5	57	2,2
Kyrgyz	1.81	0.68	774	-13.2	61	0,7
Moldova	1.62	0.53	558	-17.0	53	1,2
Kazakhstan	1.31	0.37	1,870	-18.5	57	1,0
<i>Average</i>	1.67	0.55	933	-15.6	57	1,3
Slow reformers						
Uzbekistan	1.11	0.37	640	-2.5	89	0,3
Belarus	1.07	0.35	1,694	-16.6	73	2,1
Ukraine	0.80	0.20	2,789	-18.6	56	0,3
Turkmenistan	0.63	0.19	2,751	-15.0	69	0,0
<i>Average</i>	0.90	0.27	1,968	-13.2	72	0,7
Affected by regional tensions						
Croatia	3.98	0.83	807	-0.7	69	12,8
Macedonia	3.92	0.78	157	-10.7	57	31,8
Armenia	1.44	0.42	4,595	-7.4	38	5,6
Georgia	1.32	0.35	10,563	-24.6	24	2,0
Azerbaijan	1.03	0.33	1,167	-17.7	50	0,9
Tajikistan	0.95	0.28	1,324	-26.3	35	1,7
<i>Average</i>	2.11	0.50	3,102	-14.5	45	9,1

Source: de Melo, M., Denizer, C., Gelb, A., (1996): *Patterns of Transition from Plan to Market*, *The World Bank Economic Review*, Vol. 10, No. 3, p. 405 (columns 2, 3, 4, 5 i 6); Murrell, P., (1996): *How Far Has the Transition Progressed?*, *Journal of Economic Perspectives*, Vol. 10, No. 2, p. 38 (column 7).

3. THE PROBLEM OF PRIVATIZATION

A government must create the ideal environment for entrepreneurial growth. A radical change in existing ownership structures should be first in the line of activities needed, that is, the carrying out of privatization and the activation of the financial market.

Even though there is no doubt of needing to carry out privatization, doubts and the temptation to lean towards various solutions do exist with respect to the manner of how to carry out privatization, such as: at what speed (fast or a slow and gradual change); in which manner (sales or the division of state or rather public property); the role of the government in this process (is it a coordinator of the process or the first, temporary owner and/or the cashier for collecting income from enterprise sales); its' indirect goal (maximizing privatization's reach or maximizing the accumulation of fresh capital based on enterprise sales) and so on.⁹ Not going any further into the analysis of these doubts, it is necessary to emphasize that the advantage lies on the side of fast reforms, as they lessen the public deficit which stems from missing the benefits to be had from changing existing ownership structures.

There are various methods of privatization: restitution to original owners, sale of state property, mass or voucher privatization and the growth of the private sector "from below", through the formation of new firms.¹⁰

Privatization is a relatively easy matter to carry out in the case of giving restitution to the original owners of agricultural land. The example of Bulgaria is a case in point, showing how 1,7 million requests for restitution were accepted, leading to a return of 23% of arable land to their rightful owners, by the beginning of 1993. However, it is more complicated to carry out privatization when dealing, for example, in apartments or housing, shops, factories or mines, due to state investment over many years. An acceptable solution is in compensating original owners through either a cash or voucher system. The problem is compounded all the more due to the significant contribution of such assets to the national resource. For example, it is estimated that the restitution of larger properties in the Czech Republic amounts to 5-10% of total state property, whereas, in Slovenia it amounts to 10% of social property.¹¹

In transition economies, the majority of apartments and a significant number of industrial factories can be privatized through sales to employees

9 Jurin, S. (1992): *Strategija gospodarskog razvoja Republike Hrvatske, Ekonomska misao i praksa*, Vol. 1, No. 1, p. 35.

10 See - Brada, J.C. (1996): *Privatization Is Transition - Or Is It?*, *The Journal of Economic Perspectives*, Vol. 10, No. 2, pp. 68-76.

11 Ibidem, pp. 69-70.

or managers, having had no prior ownerships and having been constructed as state property. A few goals are achieved in this manner: the government can realize an income and the faster restructuring of enterprises, which attracts foreign investment. The most successful privatizations are with smaller firms, such as shops or restaurants. For example, between 1990 and 1992 in the Czech Republic, 26,000 firms of this kind were sold by auction and in Hungary, 8,700 firms by the middle of 1993.¹²

However, the sale of large industrial enterprises, regardless whether to domestic or foreign investors, is much more complicated and is less successful, excepting the cases of Germany and Hungary.¹³ A case in point is Poland, whose basic problem is in privatizing 400 large, industrial factories.¹⁴

However, it is important to emphasize at this time, that the problem of privatization and the problem of accumulating or forming capital, are two separate issues. It is incorrect to try and solve the two together. The successful solution of the first issue (privatization) will enable the successful solution of the second issue (entrepreneurial expansion followed by the accumulation and investment of capital).

Privatization through the issuing of vouchers, eliminates the expensive and complicated processes needed for determining enterprise value. Enterprise shares can be issued in nominal values, determined either on the base of the estimated accountable value of a particular enterprise or on the sum of all accountable values of all the enterprises to be privatized, with the proportionate share of each citizen included in this value. A voucher is a receipt for the right to purchase shares. Mass privatization using vouchers is carried out by distributing free vouchers to all adult citizens in equal proportions of the total nominal value.¹⁵ The voucher holder can then buy on the market, the shares of enterprises being privatized by investment agencies dealing in their sales (initially, shares are purchased through vouchers and not with cash).¹⁶ The Czech

12 Ibidem, p.70.

13 Between 1990 and 1994, through Treuhand in Germany, 13,000 state enterprises were privatized at very high costs, as the enterprises were sold at low prices and the new owners were paid to take over the enterprises under guarantee of a successful future (in this manner, Treuhand accepted \$ 50 billion and spent \$ 243 billion). On the other hand, in Hungary, the SPA (State Property Agency) privatized 30% of the capital it held by the end of 1993 and half of the realized income (\$ 1.6 billion) came from foreign investors. See - ibidem, pp. 71-72 .

14 See - Jefries, J. (1992): *Industrial Reforms in Socialist Countries*, Edward Elgar Publishing Limited, England, pp. 278-279.

15 See - Jurin, S., ibidem, p. 39.

16 In the Czech Republic, vouchers were marked by dots and citizens could

Republic is an example showing how the first wave of privatization using vouchers privatized 988 state companies, with the participation of 77% of the eligible population between October 1991 and December 1992. Between August 1992 and November 1994, the second wave privatized a further 861 companies, with an even higher participation of the population.¹⁷

Finally, privatization is also carried out through the formation of new enterprises by both domestic and foreign entrepreneurs. Even though the statistical data does not show any differences between such enterprises and those created through other methods of privatization, the data does show that the number of small enterprises increased rapidly in most transition economies. For example, in Hungary, from 25,000 at the end of 1989 to 211,000 by September 1994; in Russia, by the middle of 1993, there were 440,000 partnerships and 220,000 sole-owner companies; in the Czech Republic in 1993, there were a million registered entrepreneurs.¹⁸

Transition countries must employ all the aforementioned methods for privatization to be successful.

Table 4 indicates data for seven transition economies regarding privatization already carried out and the dominant methods of privatization for medium- and large-scale enterprises still not entirely privatized. In Estonia and in Hungary, the dominant method of privatization was in sales to buyers external to the enterprises, and in the Czech Republic, Lithuania and in Mongolia, vouchers were the dominant form of privatization. In Russia, sales to managers and internal employees is the dominant form of privatization. This method was greatly employed in Croatia, Poland, Romania and Slovenia. Many of the firms privatized through Lithuania's and Mongolia's as well as Georgia's voucher programs effectively became management - employee buyouts as employees and their families used vouchers and cash to buy major stakes in their own firms.¹⁹

buy a coupon block for \$ 1.25 and register it for \$ 35, while vouchers in Russia had a nominal value of 10,000 rubles and citizens purchased them for 25 rubles.

17 Brada, J.C., *ibidem*, pp. 72-73.

18 *Ibidem*, p. 75.

19 **From Plan to Market**, *World Development Report 1996*, Oxford University Press, for The World Bank, 1996, p. 54.

Table 4: Methods of privatization for medium-size and large enterprises in seven transition economies
(percentages of total)

Country	Sale to outside owners	Management employee buyout	Equalaccess voucher privatization	Restitution	Other ^a	Still in state hands
Czech Republic						
By number ^b	32	0	22* ^c	9	28	10
By value ^d	5	0	50*	2	3	40
Estonia^e						
By number	64*	30	0	0	2	4
By value	60*	12	3	10	0	15
Hungary						
By number	38*	7	0	0	33	22
By value	40*	2	0	4	12	42
Lithuania						
By number	<1	5	70*	0	0	25
By value	<1	5	60*	0	0	35
Mongolia						
By number	0	0	70*	0	0	30
By value	0	0	55*	0	0	45
Poland						
By number	3	14	6	0	23*	54
Russia						
By number	0	55*	11	0	0	34

Note: Numbers with * show the dominant model in each country. Data are as of the end of 1995.

a. Includes transfers to municipalities or social insurance organizations, debt-equity swaps, and sales through insolvency proceedings.

b. Number of privatized firms as a share of all formerly state-owned firms. Includes parts of firms restructured prior to privatization.

c. Includes assets sold for cash as part of the voucher privatization program through June 1994.

d. Value of firms privatized as a share of the value of all formerly state-owned firms. Data for Poland and Russia are unavailable.

e. Does not include some infrastructure firms. All management buyouts were part of competitive, open tenders. In thirteen cases citizens could exchange vouchers for minority shares in firms sold to a core investor.

Source: **From Plan to Market, World Development Report 1996**, Oxford University Press, for The World Bank, 1996, p. 53.

The private sector has grown significantly in all transition economies. However, the question is asked: How much of this increase is purely formal? In order to be able to answer this question, it is necessary to

distinguish the difference between the growth of new, private enterprises and the transition of large, state enterprises into private ones. Empirical research has demonstrated the important role and the significance of new, private enterprises and the great difference in the performances of these enterprises with all others, while showing few differences between state and privatized enterprises.²⁰

Table 5 depicts the share of GDP in the private sector for particular transition economies, but there is some question as to the reliability of the statistics showing sizes in the private sector. Namely, some countries group state enterprises, which have been already transformed into share organizations, into the same category as private enterprises, giving no regard to the fact that the majority of shares, if not all, are either state-owned, in state banks or in other state-owned firms. The fact remains that the majority of transitional countries attempt to maximize given figures in the private sector, in order to present their efforts towards transition and privatization in the best possible way. Keeping this in mind, it can be said that in those countries where the private sector participates by over 50% in GDP, the private sector is then dominant in retail trade, services, construction, as well as in transport and in agriculture. In those countries where participation does not surpass 30%, privatization is most probably carried out by small firms offering services, shops and construction,²¹ while most of agriculture and industry remained under state ownership.

Country	Share of GDP in Private Sector (%)
Czechia	42
Hungary	38
Poland	32
Russia	21
Slovenia	11
Ukraine	08
Yugoslavia	08

20 Murrell, P. (1996): **How Far Has Transition Progressed?**, *The Journal of Economic Perspectives*, Vol. 10, No. 2, p. 39.

21 According to - Brada, J.C., *ibidem*, pp. 77-78.

Table 5: Privatization in transition economies - 1994

Country	Share of private Sector in GPD (%)
Bulgaria	24
Czech Republic	75-80
Croatia	40
Hungary	55
Poland	55
Romania	35
Slovak Republic	40
Slovenia	40
Armenia	40
Azerbaijan	20
Belarus	15
Estonia	55
Georgia	20
Kazakhstan	16
Kyrgyzstan	30
Latvia	55
Lithuania	50
Moldova	20
Russia	50
Tajikistan	15
Turkmenistan	15
Ukraine	30
Uzbekistan	20

Source: Brada, J.,C., (1996): **Privatization Is Transition - Or Is It?**, *The Journal of Economic Perspectives*, Vol. 10, No. 2, p. 77.

4. THE INTER-CONNECTION OF POLITICAL AND ECONOMIC LIBERALIZATIONS²²

Economic liberalization is closely connected to political changes. Also, it is quite clear that the economic growth of a country depends on whether it belongs to a democratic society or to a dictatorship or to an autocracy.

Democratic societies are those where individual rights to property and contract are confidently expected to last across generations. It is of no surprise that capital often flees from countries with continuing or episodic dictatorship (even when these countries have relatively little capital) to the stable democracies, despite the fact that they can be relatively well-supplied with capital and thus offer only modest rates of return. Generally, the gains from contract-intensive activities such as banking, insurance and capital markets are realized by those countries with stable democracies, such as, for example, the United States, the United Kingdom or Switzerland. It is true that cases do exist of relatively poor countries being able to achieve high rates of growth when led by strong autocrats capable of practising good economic policies, however, such growth is of short duration, depending on the length of autocratic rule. It is of no coincidence that those countries which have attained the highest level of economic development and which have enjoyed high economic achievement for generations are countries with stable democracies. Let it not be forgotten that in war, democracies have overcome dictators twice.²³

22 This part of the paper is a part of the work of Benić, D. (1996): **Ekonomska liberalizacija i političke slobode u zemljama u tranziciji**, presented during the scientific conference on "*The Transition of Economy*" held at the Economic Faculty in Mostar, December 10, 1996.

23 According to - Olson, M. (1993): **Dictatorship, Democracy, and Development**, *American Political Science Review*, Vol. 87, No. 3, p. 572.

In 1995, almost 20% of the global population in 76 countries lived in free societies, enjoying full political freedom and civil rights, 40% in 61 countries lived in partially free societies where some basic rights were limited, while 40% of the global population in 54 countries lived in societies that were not free and in which basic rights were not acknowledged. - Karatnycky, A. (1995): **Democracies on the Rise, Democracies at Risk**, *Freedom Review*, Vol. 26, No. 1, p. 5.

Table 6: Political and Economic Liberalization, 1989 - 1994

Country	Democratic Rights Index 1989	Democratic Rights Index 1994	Degree of Economic Freedom 1989	Degree of Economic Freedom 1994
Albania	0	58	0	73
Armenia	25	58	3	43
Azerbaijan	25	17	3	37
Belarus	25	50	3	37
Bulgaria	0	83	13	73
Croatia	42	50	43	87
Czech	17	92	0	90
East Germany	17	92	0	100
Estonia	25	75	7	90
Georgia	25	33	3	37
Hungary	58	92	37	87
Kazakhstan	25	25	3	40
Kyrgyzstan	25	58	3	77
Latvia	25	75	3	80
Lithuania	25	83	3	83
Macedonia	42	58	43	80
Moldova	25	50	3	57
Mongolia	0	85	0	67
Poland	58	83	23	87
Romania	0	58	0	73
Russia	25	58	3	67
Slovakia	17	75	0	87
Slovenia	42	92	43	83
Tajikistan	25	0	3	30
Turkmenistan	25	0	3	23
Ukraine	25	58	3	27
Uzbekistan	25	0	3	43

Source: P. Murrell, P., (1996): How Far Has the Transition Progressed?, Journal of Economic Perspectives, Vol. 10, No. 2, p. 28.

Political freedom is of great importance to economies in transition. All transitions imply a break-away from the past and the introduction of the new, which has social consequences. Some people become wealthier,

their income increases, while others are impoverished.²⁴ However, transition cannot be successful without democratic rights and economic freedom, so it can be emphasized that political freedom affects the speed of liberalization.

The question is now asked: How to measure political freedom? Since 1973, *Freedom House* annually gives a survey measuring traditional political freedom and civil rights in western democracies. This methodology is frequently used in literature. Countries are ranked based on the judgements of a project team, that consults published material, as well as regional experts and human rights specialists.²⁵

Table 6 shows the political and economic liberalization indexes for 1989 and 1994, measured from 0 - 100 (minimum and maximum). A few East European countries have managed to achieve, starting at the lowest levels, results comparable to their West European neighbours. The concept of democracy, as yet unrefined, has been established with lightning speed in the majority of ex-socialist countries. Normally, it often indicates a different picture. Thus, for example, freedom of press does not have great significance when the private sector is low on funds and when the competition from the state-owned press is stronger. Or, the question of political decentralization - still far from the reach of transitional countries, in comparison to developed, capitalist democracies. In countries where reforms are advanced (ie. Poland, Czech Republic, Hungary), the local democracy is well established, whereas, central control is still strong in the majority of other countries, due to numerous reasons. For example, centers in Russia still provide resistance, while in other countries such as Uzbekistan and Kazakhstan, development is impeded by autocratic politicians.

In conclusion, it can be pointed out that the majority of countries in transition have established central processes of democratization, which seemed hardly possible prior to the fall of communism. However, the uncertainty of maintaining present positions exist in most countries, especially in the former Soviet Union (all the more, when you consider current economic and especially social changes). An old dictum states - democracy is firmly in place when two governments have quietly left office on losing elections. Not enough time has passed for most countries to

24 See the analysis on the social effects of transition from socialist to capitalist economies, especially the experience of Hungary, in - Rona-Tas, A. (1994): **The First Shall Be Last? Entrepreneurship and Communist Cadres in the Transition from Socialism**, *American Journal of Sociology*, Vol. 100, No. 1, pp. 40-69.

25 On methodology in general, see - Ryan, J.E. (1995): **Survey Methodology**, *Freedom Review*, Vol. 26, No. 1, p. 10.

use this test, but the fact remains that in Russia, no leader has ever left office voluntarily.²⁶

A second question is now asked: How closely connected are economic liberalizations to political freedom?

Before providing an answer to this question, we would like to point out here that numerous studies have been made on the effects of democratization on economic growth. J.F. Helliwell²⁷ analyzed the dual relationship of democracy and economic growth for the period 1960 to 1985, using data from 125 countries. He showed that income affects democracies in a strong and positive manner, but that it is still not possible to identify any kind of general, net result of democracy on future economic growth. It is therefore neither possible to point out the magical nor the ideal time for democratization, which lies behind the general result of the analysis - the probability of a country becoming more democratic surely increases with the level of its' income. From this he concludes that the democracy delayed does not have to be a loss for democracy, as long as existing governments enable the steady increase of living standards.²⁸ However, the lack of general ties between political freedom on the one hand and income and growth on the other, points to the need of studying the association of economic liberalization to that of political freedom in particular countries, especially those in transition.

26 According to - Murrell, P., *ibidem*, pp. 29-30.

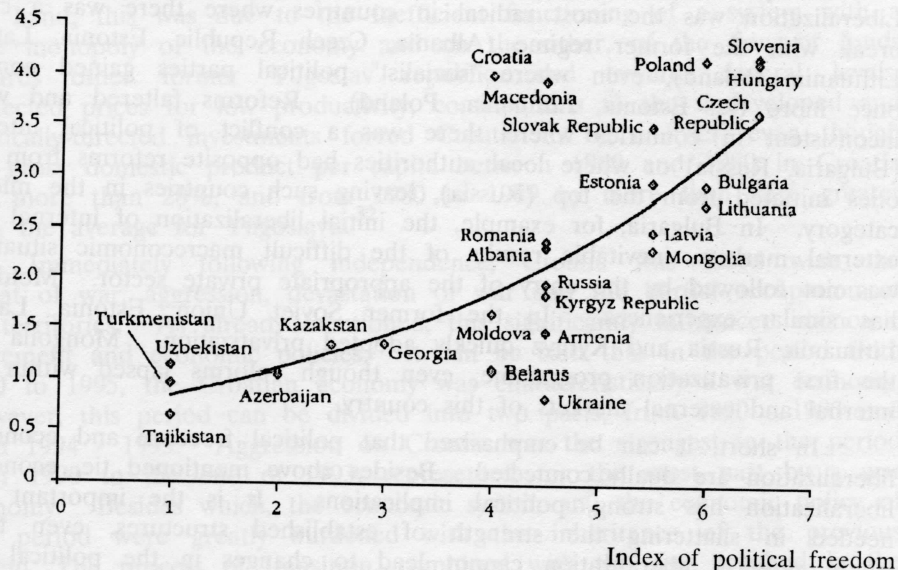
The following should be noted. According to the figures in Table 6, democratic rights in Croatia increased from the index of 42 in 1989 to 50 in 1994. Most probably, this estimate was greatly influenced by the war situation and the large areas of territory under occupation at this time, so-called regions and authorities which did not acknowledge the Republic of Croatia. For the sake of comparison, in the same period and according to the same source, democratic rights decreased from 42 to 17 in Serbia and Montenegro (SR Yugoslavia).

27 Helliwell, J.F. (1994): **Empirical Linkages Between Democracy and Economic Growth**, *British Journal of Political Science*, 24, Cambridge University Press, pp. 225-248.

28 *Ibidem*, p. 246.

Figure 1.: Political Freedom and Degree of Economic Liberalization in Twenty-Six Countries in Transition, 1989 - 1994

Cumulative liberalization index



Note: The curve is given by $y = 0,6236e^{0,2683x}$, with $R^2 = 0,6453$.

Source: de Melo, M., Denizer, C., Gelb, A., (1996): **Patterns of Transition from Plan to Market**, *The World Bank Economic Review*, Vol. 10, No. 3, p. 420 .

M. de Melo, C. Denizer and A. Gelb, on the basis of measuring political freedom, as done by A. Karatnycky, showed, through statistical analysis, the very strong link of economic liberalization to that of political freedom, using 26 transitional countries as examples.²⁹ Spearman's rank of correlation between economic liberalization and political freedom for all 26 countries is 0.8. Pearson's correlation coefficient for political freedom and for the cumulative liberalization index is 0.75, which, statistically, is very significant. Figure 1 shows the non-linear relationship of all 26 countries. One of the possible reasons for such a high correlation can be in that both variables are strongly connected to an unidentified, latent variable, such as income. However, the Pearson and Spearman correlations between each of these variables and per capita GDP are very low.

²⁹ Data according to - de Melo, M., Denizer, C., Gelb, A., *ibidem*, pp. 419-421.

How did political freedom affect economic liberalization in certain countries?

For very poor countries in transition, as for example, Kazakhstan, Turkmenia, Ukraine and Uzbekistan, reforms occur slowly and under economic pressure resulting from the disintegration of the Soviet Union. Liberalization was the most radical in countries where there was a clear break with the former regime (Albania, Czech Republic, Estonia, Latvia, Lithuania, Poland), even where "socialist" political parties gained control once more (ie. Estonia, Lithuania, Poland). Reforms faltered and were inconsistent in countries where there was a conflict of political interest (Bulgaria, Russia) or where local authorities had opposite reforms from the ones initiated from the top (Russia), leaving such countries in the middle category. In Bulgaria, for example, the initial liberalization of internal and external markets, inevitable results of the difficult macroeconomic situation, was not followed by the entry of the appropriate private sector. Moldavia has similar experiences. In the former Soviet Union, Estonia, Latvia, Lithuania, Russia and Kyrgyz quickly adopted privatization. Mongolia had the first privatization programme, even though reforms lapsed within the internal and external markets of this country.

In short, it can be emphasized that political freedom and economic liberalization are dually connected. Besides above mentioned tie, economic liberalization has strong, political implications. It is the important link needed in shattering the strength of established structures, even there where political liberalization cannot lead to changes in the political and managerial elite.³⁰

5. THE PARTICULARITIES OF TRANSITION IN THE CROATIAN ECONOMY

The Republic of Croatia followed the present way of transition under conditions entirely different to those of other countries in transition. Aggression and the four-year war in Croatia, the occupation of almost one third of state territory, the devastation of war, the impediment of communication, and approximately 700,000 displaced persons, all significantly influenced the economic achievements of the recent past.

30 With the exceptions of East Germany, where methods of loyalty and competence were applied and the Czech Republic, where the clean-up method was applied, the leading communists and managers used influential connections to take on new roles in commercial and business management - for theories on maintaining the elite, see - Rona-Tas, A., *ibidem*, pp. 44-47.

When transition started in 1990, Croatia (like Slovenia) was ahead of most of the other countries in the real socialist world.³¹ However, the realization of even greater results was hampered by the inheritance left by former Yugoslavia. Namely, during the entire period from 1945 to 1990, Croatia was fraught with a slower economic development than the country should have had according to its' material and human potential. On the one hand, this was due to the inefficient functioning of a system with a state monopoly of the economy and on the other, of the flow of funds towards other former Yugoslav republics and towards federal levels. Protected prices for low productivity, contributions to the undeveloped and politically-directed investments forced Croatia to be a loser, even though the gross domestic product per capita between 1960 and 1980 in Croatia was more than 20%, and from 1980 to 1989 by more than 25% greater than the average for Yugoslavia.³²

Immediately following independence, Croatia was faced with the threat of war, aggression, devastation of war and the partial occupation of its' territories. As already mentioned, this significantly influenced economic movement and economic policies. It can be said that in the period from 1990 to 1995, the Croatian economy was characteristically a war economy. However, this period can be divided into two parts, from 1990 - 1993 and from 1994 - 1995. Aggression on Croatia was the strongest in the period from 1990 to the end of 1993, represented for the most part by a war economy. Besides which, the economic system and the economic policy of this period were greatly burdened with the inheritance of the previous system. The process of transition, combined with the war, resulted in the decline of all economic activities (especially industry, mining, forestry, construction, hospitality, tourism and trade), that is, in gross domestic product (see Table 7) and that was followed by high inflation (1991 - 123%; 1992 - 665.5%; 1993 - 1,517.5%). Qualitative changes occurred in the period from 1994 to 1995, made possible by a decrease in the devastations of war and by the 1993 anti-inflation programme, which stopped hyperinflation and where price growths were brought to the lowest level of all transitional economies (1995 - 2.0%).³³ Besides which, the decline in gross domestic product was stopped along with reactivating

31 For example, the overall work productivity of socialist countries as compared to capitalist countries was behind by 25 - 34%, with Former Yugoslavia showing even lower percentages - see - Bergson, A., (1987): **Comparative Productivity: The USSR, Eastern Europe, and the West**, *American Economic Review*, Vol. 77, No. 3, pp. 342-357.

32 On differences and movement of gross domestic product per capita in the former republics of Yugoslavia for the periods 1953 - 1989, see - Vojnić, D. (1996): **Dva smjera kretanja zemalja u tranziciji**, *Zbornik Problemi razvoja gospodarstava u prijelazu stoljeća (holistički pristup)*, Klub za ekonomijsku politiku (KEP), Osijek, p. 37.

33 SYC - 96, Table 8-4, p. 140.

economic activities (see Table 7; the GDP in 1995 showed US\$ 18.1 billion and the GDP per capita US\$ 3.786³⁴).

Table 7: Gross domestic product, estimate in 1990 constant prices, change rates over previous year

	1990	1991	1992	1993	1994	1995
TOTAL	-6,9	-19,8	-11,1	-0,9	0,6	1,7
Manufacturing and mining	-11,3	-28,5	-14,6	-6,1	-2,6	0,2
Agriculture and fishing	-3,1	-7,7	-13,1	4,4	-3,2	0,7
Forestry	-14,3	-22,0	-9,4	-7,6	12,5	-7,5
Water management	5,8	-17,0	-4,8	5,1	0,7	0,7
Construction	-11,1	-29,5	-45,3	-11,7	-0,5	2,4
Transport and communications	-2,1	-20,3	-15,0	-4,8	0,1	2,8
Trade	-7,0	-25,7	-8,5	1,9	2,9	8,0
Hotels and restaurants, tourism	-10,3	-60,6	-2,1	11,1	31,9	-10,2
Crafts and trades, personal services	-5,9	-6,7	-8,1	0,4	4,8	5,0
Public utilities services	-6,0	-8,5	-15,9	-1,4	1,9	4,2
Housing services	0,2	0,2	-0,1	-0,1	0,0	0,0
Education, science and culture	-0,9	-5,9	-5,6	1,3	0,5	-0,6
Banks and insurance institutes	2,8	-2,4	-8,1	-2,8	2,0	5,7
Business services	-18,9	-12,1	-4,9	4,8	-4,7	2,4
Health care and social welfare	-0,1	-6,2	-3,1	1,0	-1,4	-1,8
Public administration	-6,1	-9,9	-9,4	0,0	0,1	6,0

Source: SYC - 96, table 9-6, p. 147.

Croatians paid a high price for their freedom and not only through the sacrifice of victims: the Croatian gross national product was cut back to a third after 1989, a combination of the devastation of war and the crisis of transition; in December of 1995, the industrial product index showed only 53.3% in comparison to the 1990 average, using 30.4% of the capacity level.³⁵

34 ibidem, Table 9-1, p. 146.

35 See - Dujšin, U. (1996): **Poticanje oživljavanja i rasta hrvatske privrede: mogućnosti ekonomske politike**, *Ekonomija*, Vol. 3, No. 3, p. 404. It is estimated that 50% of the reason for the decline in GDP levels in Croatia is attributable to the war - Vojnić, D. (1996): **Zemlje u tranziciji** -

Even though it is estimated that Croatia will retain the lowest rate of inflation among transitional countries even in 1996 - 3.3%³⁶, and that GDP growth will show about 5%³⁷, it is important to point out the following.

Unemployment is constantly on the increase since 1993 (1993 -243,096; 1994 - 247,555; 1995 - 249,070)³⁸ and remains a serious problem for the economy and society of Croatia. A series of activities are needed for its' solution, from re-education to the encouragement of entrepreneurship, which leads to the creation of new jobs. In the first half of 1996, almost two thirds of GDP went into government, rather, public expenditure, while in Southeast Asian countries, for example, it is 17%. According to a study carried out by the International Monetary Fund, the proportion of government expenditure in GDP should not exceed 30%, otherwise benefits decline, primarily due to the government crowding private investors out of the financial market.³⁹ During the last three years, the balance of foreign trade is negative (1993: Kn -3.1 billion; 1994: Kn -5.1 billion; 1995: Kn -15.5 billion)⁴⁰ with low import of investment products.⁴¹

Besides the aforementioned, inadequate accumulation remains a great problem for the Croatian economy. As the main source of accumulation is in savings (besides transferring foreign accumulation into the domestic economic system and the creation of accumulation by a credit-monetary system through the emission of money, which can have positive but also very negative effects), the key factor to strengthening the formation of domestic accumulation and the realization of increased growth rates, is in increasing the propensity to save. The rate of national savings in Croatia was 8,48% in 1995.⁴² The propensity to save, rather, the percentage of savings in GDP, should be between 30 - 40%, which requires extra

komparativni pregled s posebnim osvrtom na Hrvatsku, *Hrvatska gospodarska revija*, Vol. 45, No. 9, p. 7.

36 Dujšin, U., *ibidem*, p. 413.

37 Vojnić, D. (1996): **Zemlje u tranziciji...**, p. 8.

38 **SYC - 96**, Table 7-3, p. 128.

Since 1990, employment data show yearly decreases (1990 - 1,568,000; 1991 - 1,432,000; 1992 - 1,261,000; 1993 - 1,238,000; 1994 - 1,211,000; 1995 - 1,196,000 - **SYC - 96**, Table 5-1, p. 105).

39 Dujšin, U., *ibidem*, p. 404 and 412.

40 **SYC - 96**, Table 17-1, p. 289.

41 In the framework of product import according to the economic use of the product - the respective percentages of products for reproduction, investment and general consumption, were in 1994: 56%, 17.2% and 26.8% and in 1995: 55.3%, 17.5% and 27.2% - **SYC - 96**, Table 17-13, p. 299 and personal computation.

42 Babić, A., Lovrinčević, Ž., Mikulić, D., (1997): **Procjena BDP-a Republike Hrvatske za godine 1994. i 1995.**, *Ekonomski pregled*, Vol. 48, No. 1, p. 70.

measures towards increasing savings (reforms in the social security system, establishing life insurance, investment funds). It should be noted that international experience has shown that an increased propensity towards savings can only be counted upon following the revival of economic activities.⁴³ On the other hand, the expectation that foreign capital will significantly influence investment has not as yet been fulfilled, for which the war situation in Croatia is surely responsible. But it is necessary to keep in mind that only changes in economic conditions and stability in economic movement can attract foreign capital for long-term investment.

Further, figures on the financial condition of the Croatian economy in the last two years show a bad state of affairs, or rather, a worsening of business (see Table 8). The Croatian economy in 1995 had a net loss of 5,135 billion Kn, which is 62.9% more than in 1994. More than half of the losses come from industries. Net losses are also shown in tourism and hospitality, trade and agriculture, whereas, positive results are shown in forestry, water management, transport, communications and crafts. No liquidity is the most painful aspect of the Croatian economy. In 1995, there were about 7,700 blocked enterprises with 4.8 billion Kn in outstanding debts and in the first half of 1996, there were more than 13,000 blocked enterprises with outstanding debts amounting to 6.7 billion Kn or about DEM 2 billion. The blocked enterprises employed about 160,000 workers, of which 132,415 did not receive salaries for up to six months.⁴⁴

43 Dujšin, U., *ibidem*, p. 412-413.

The present trend towards savings in countries of advanced reformers is 21%, for instance, in the Czech Republic and 17% in Hungary. Increasing saving trends to 30% and decreasing the participation of the public sector by 17%, as in Southeast Asian countries, could lead to long-term growth rates of 7%, which means that the Czech Republic (with a present GDP per capita of US\$ 8,000) would achieve 70% of the average for the European Union in 10 years time and Hungary, in 13 years - see - *ibidem*, p. 407.

In the same manner, M. Tajnikar, based on the adapted achievements of the economy in Singapore, emphasizes that if transitional economies wish to join the developed world, they must establish four main goals of macroeconomic policy: achieving GDP growth rates from 7-10%; attaining inflation rates that match those of European Union countries; an economy directed towards export and a savings and investment rate of about 40% of GDP. - Tajnikar, M. (1996): **Ekonomaska politika oživljavanja gospodarstva v tranziciji**, Zbornik radova XX znanstvenog skupa "Susreti na dragom kamenu" *Problemi obnove u funkciji razvoja Republike Hrvatske*, Pula, p. 292.

44 Dujšin, U., *ibidem*, p. 404.

Table 8: Profits and losses in Croatian economy

(Kn 000)

Year	Profit	Loss	Difference
1994	4.072.000	7.225.000	-3.153.000
1995.	4.212.623	9.348.088	-5.135.463

Source: Privredni vjesnik, Zagreb, December 11, 1995 and October 15, 1996.

The absence of entrepreneurs, who could forcefully spur economic activity, is an important shortcoming of the Croatian economy, affecting the present situation (this is the sore point for all transitional economies). Some of the new entrepreneurs in Croatia are made up of war profiteers or those who made their wealth overnight during the transition. However, the problem lies in the fact that the majority of the new entrepreneurs are trying to get rich through trade, that is, through the resale of imported commodities or through hospitality, while there are too few willing to invest and to produce, without which there is no economic development. It is true that a new source of entrepreneurs can be found in returning Croatian emigrants, who have learned how to work and how to manage successful businesses in the developed world. However, it will be difficult to take a major step toward developed economies without raising the present levels of management know-how, professional training and furthering educational skills. How unqualified management can contribute to poor business dealings in the Croatian economy can be confirmed by an analysis which shows whether management increases or decreases the value of the capital it manages. The method EVA^{®45} shows that out of 400 of the largest enterprises in Croatia, 53 create economic values and 347 destroy substances. These 53 enterprises, using only 4% of capital, create 43% of total profits (base: 400 largest). Accordingly, knowledge and not capital are the base for a successful economy today and it is imperatively urgent to take action on improving management educational levels.⁴⁶

At the end, for the successful transition of the Croatian economy, it is vital to complete the privatization started. It can be said that in Croatia since 1991, the first phase of privatization was partially carried out (not including the public sector), which gave relatively modest results.

45 According to the EVA[®] method (Economic Value Added), capital costs are deducted from profit after taxes (this capital represents the entire enterprise value - office buildings, machines, know-how, stocks, etc.) which gives a figure portraying whether the enterprise is creating or destroying its' value.

46 See the analysis in - Pulić, A. (1996): *Kako iz balkanskog u globalno gospodarstvo*, *Ekonomija*, Vol. 3, No. 3, pp. 464-468.

Sales to enterprise management levels and internal employees represented the most popular model of privatization. Even though one of the advantages of this model should be in the speed of transition and in the effective control of the management, as employees have access to necessary information, it was shown to be a problem in many cases. Some of these could be defined as slower privatization in relation to the actual possibilities, various manipulations, irregularities and the crowding out of the small shareholder in ownership structures. Until the Privatization Law (NN no.21/96) took effect, transition and determining enterprise ownership was decided upon by the Law on Transforming Social Enterprises. Up to the end of 1995, the Croatian Privatization Fund issued 2,519 decrees, according the right to privatize enterprises (in 1994, the number of privatized enterprises was 2,010). These enterprises were purchased by 576,513 buyers, that is, the average number of buyers per enterprise is 228 and the estimated value of the enterprises is DEM 24.1 billion.⁴⁷ Of 2,257 firms in which transformations were carried out, the Fund is a minority owner in 1,142 corporation and a majority owner in 270 corporation.⁴⁸ The law on privatization clarifies the manner of privatization and requires privatization to be carried out through sales and transfer without compensation for property obtained by the Republic of Croatia in the process of transforming public property according to the Law of Transforming Social Enterprises and other special regulations. The right to shares without compensation (voucher privatization) is given to specific persons, ranging from war invalids and families of Croatian soldiers killed in war to displaced persons and refugees - returning emigrants and ex-political prisoners, such that the shares are freely issued in the manner following the example of the Czech model of voucher privatization. According to the Privatization Law, procedures should be completed for transforming public property, keeping in mind that based upon this law, privatization will not occur in certain large networks (INA - Industry of oil d.d., Croatian Electroenergy d.d., Croatian Radio and Television, HZ - Croatian Railroad, JP Croatian Post and Telecommunications -HPT, JP Croatian Roads and JP Croatian Forestry), including no privatization of health institutions, the privatization of which will be carried out through special legalities. In the same manner, the process of privatization cannot be completed prior to the establishing of a Law on Denationalization, that is, indemnity for confiscated property.⁴⁹

47 According to - Buljan, R. (1997): **Transformation, Privatization and Transition in Croatia: Successful or Not?**, *1st International Conference on Enterprise in Transition*, Part two, University of Split, Faculty of Economics, p. 16.

48 Račan, A. (1996): **Privatizacija imovine u državnom vlasništvu, Slobodno poduzetništvo**, Vol. 3, No. 17, p. 75.

49 The Privatization Fund has shares in its' care, which were reserved during the transformations for previous owners of confiscated property, however,

CONCLUSION

The particularities of the government's role in transitional economies are seen in that the government must create the ideal environment for entrepreneurial growth, which implies the fast application of privatization and activation of the financial market, must radically break with the administration of the economy and must encourage the competitive character of the market, without repressing the labour market. Besides which, the government must ensure social stability, directing special activities towards an open economy and must practice stable, macroeconomic policies.

The economic liberalization of transitional economies initially leads to a decline in output, employment and a growth in inflation. However, these problems are solved over extended periods of time by growth in the role of sectors where development has been stopped according to plan. Early experiences demonstrate that the initial decline in output was restricted in countries grouped as advanced reformers (Slovenia, Poland, Hungary, Czech and Slovak Republics) and that these economies either stabilized or had an output growth from 1993 - 1994. These countries proved to be relatively successful in repressing inflation, however, excluding the Czech Republic, they show the highest rates of unemployment. On the other hand, countries grouped as high-intermediate reformers (Estonia, Bulgaria, Lithuania, Latvia, Albania, Romania and Mongolia) lost about a third of their GDP, but most stabilized output and had less success in repressing inflation, as is the case for other countries slow in reform.

In all transitional economies, the private sector increased significantly, however, part of this increase is of a purely formal nature. The problem still exists on the reliability of private sector sizes obtained statistically. Privatization is carried out more successfully with smaller enterprises dealing in service activities and agriculture, whereas, the basic problem remains in the privatization of large, industrial enterprises, even in those countries grouped as advanced reformers.

Economic liberalization and political freedom are dually connected. So, on the one hand, political freedom has enabled the spread of liberalization and the successful carrying out of reforms, while on the other, economic liberalization has strong, political implications and is an important link in breaking down the power of established structures, even there where political liberalization does not lead to a change in the political and managerial elite.

The transition of the Croatian economy, in comparison to other countries, has been carried out under entirely different conditions.

the Denationalization Law still has to determine restitution rights for confiscated property and the manner of realizing these rights.

Aggression and the four-year war in Croatia significantly influenced the economic achievements of the recent past. The Croatian economy during the entire period from 1990 to 1995, was characterized by a war economy. During the second part of this period, in 1994 and in 1995, hyperinflation was stopped, price growths were brought to the lowest level of all the transition economies, including the arrest of GDP declines and the revival of economic activities. However, issues that still remain open are high unemployment, the large government expenditure, the foreign trade deficits, the low accumulation and inadequate growth, the economy's critical financial situation, the lack of entrepreneurship which would forcefully activate economic activities and the efficient finalization of privatization already started. The solution of these problems lies in various directions, from stimulating entrepreneurship and creating true entrepreneurs, establishing a financing system for suitable entrepreneurs, forming regulations that develop the market's competitive character, finalizing privatization and establishing a Denationalization Law, to an active, development policy, but all this with citizens trust and the support of the general public, as well as the support of international institutions.

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DRŽAVNA GOSPODARSTVA U TRANZICIJI - NEKA RANA ISKUSTVA

Sažetak

U radu se analizira uloga države u tranzicijskim gospodarstvima te se naglašavaju kao pravci njenog djelovanja: kreiranje najboljeg okruženja za razmah poduzetništva što podrazumijeva brzu provedbu privatizacije i aktiviranje financijskog tržišta, radikalni raskid s administriranjem u gospodarstvu, osiguranje socijalne stabilnosti i vođenje stabilne makroekonomske politike. Isto tako razmatraju se neka rana iskustva u provedbi tranzicije a posebice utjecaj ekonomske liberalizacije na gospodarski rast, inflaciju, nezaposlenost, privatizaciju i političke slobode. Na kraju se daju specifičnosti tranzicije hrvatskog gospodarstva ukazujući na neke otvorene probleme za čije rješenje je potrebna akcija države na više pravaca.

Ključne riječi: država, gospodarstvo, tranzicija, ekonomska liberalizacija.