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# Stylized Facts from 25 Years of Growth in Transition

This brief summarizes the growth experience of transition countries 25 years after the dissolution of the Soviet Union. We divide our sample into two main groups: the 10 transition countries in Eastern Europe and the Baltics that became EU members in 2004 and 2007 (EU10); and the 12 countries (ex Baltics) that emerge from the Soviet Union (FSU12). The growth experiences of these two groups have been distinctly different. The magnitude of the initial transition decline in output was much more severe in the FSU12 group. Despite growing almost 2 percentage points faster than the average EU10 for the following fifteen years, the FSU12 group is still further behind the EU10 group than they were at the beginning of transition. This illustrates how hard it is for countries to recover from large negative income shocks and thus the importance for countries to avoid such negative events. However, there are no signs of transition countries being stuck in a low or middle-income trap or that natural resource wealth leads to lower growth during this period.



2017 marked the 25-years anniversary after the dissolution of the Soviet Union and the beginning of the transition for the economies in the region. In a recent paper, we explore the growth experience of transition countries over these 25 years (Becker and Olofsgård, 2017). The paper has four main parts: an overview of the transition literature focusing on growth; a part that provides a detailed description of growth in transition; an analytical section that investigate if we can explain growth in transition countries with a standard growth model; and finally an exploration of whether institutional and other variables that have been highlighted in the transition literature (but are excluded from the basic growth model) are correlated with growth in transition countries. This brief summarizes the descriptive part of the paper, while the more analytical sections will be the topic of future briefs.

For most of the paper, we divide our sample into two main groups; the 10 transition countries in Eastern Europe and the Baltics that became EU members in 2004 and 2007 (EU10); and the 12 countries that emerged from the Soviet Union (FSU12). In addition, we include three transition countries that are not part of either group (Croatia, Albania and Macedonia - Other3) and we also divide the FSU12 group into the four countries that export significant amounts of fuel (FSUF) and the eight countries that do not (FSUNF). There are of course remaining differences within these groups, but this aggregate analysis allows us to see certain patterns in the transition process more clearly.

## Initial output collapses

The focus in economics is often on how to generate higher growth and not about protecting against significant drops in output. There are some exceptions, including Becker and Mauro (2006) and Cerra and Saxena (2007), where the focus is on output losses and how countries recover after crises. For transition countries, a very important feature of the economic

development process is exactly the initial drop in income and the time it has taken countries to recover from the initial phase of transition. Table 1 shows how much income fell in the different country groups and the time it took to get back to the pre-transition income level.

*Table 1. Output drops and recoveries*

	Initial decline in GDP (% of initial GDP)	Years to bottom	Years to recover
All 25	-38	5	15
EU10	-25	3	11
FSU12	-51	6	19
FSUF	-47	6	16
FSUNF	-53	6	21
Other3	-29	4	12

*Source:* Becker and Olofsgård (2017)

The initial collapse in the FSU12 group was enormous, with income cut in half. The EU10 countries also had massive output losses, but “only” lost a quarter of their income on average. This took over a decade to recover from, while the path back to pre-transition income levels in the average FSU12 country was almost twice as long. There have been many papers written on the economic chaos that was part of the initial transition process, and explanations for this decline has been attributed to, e.g., misleading data, lack of functioning markets, shock therapy and poor economic and legal institutions in general. All of these factors have likely played important roles in the process, but regardless of the explanation, this was a very unfavorable time in terms of economic outcomes for hundreds of millions of people in these countries. Avoiding such costly drops in output should be a top priority for economic policy makers in any country at all times, not just in transition.

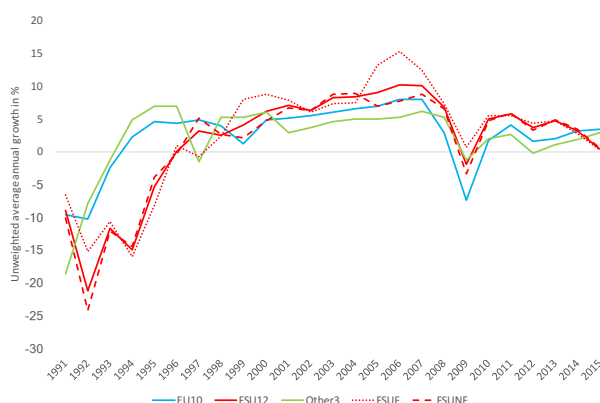
## From collapse to growth

In most transition countries, the initial phase of decline in transition lasted several years, but eventually the negative growth rates turned positive (Figure 1). Again, we can see that the



EU10 group had fewer years of declining incomes with growth resuming in 1993, while for the FSU12 group, growth in transition only started in 1996/7.

Figure 1. Bust-Boom countries



Source: Becker and Olofsgård (2017)

What is less visible in Figure 1 due to the wide scale needed to capture the initial output drops is that the FSU12 groups has shown significantly higher growth than the EU10 group in the last 15 years. Over the more recent period, the average FSU12 country has grown by close to 6 percent, while growth for the EU10 has been around 4 percent per annum (Table 2).

Table 2. Real GDP/cap growth

	Annual average in %		
	1991-2015	1991-1999	2000-2015
All 25	1.9	-3.1	4.7
EU10	2.3	-0.5	3.9
FSU12	1.6	-5.9	5.8
FSUF	2.5	-5.1	6.8
FSUNF	1.1	-6.2	5.3
Other3	1.9	-0.5	3.3

Source: Becker and Olofsgård (2017)

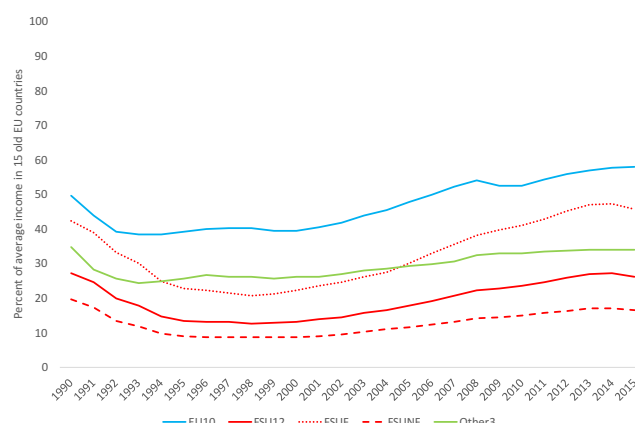
The faster growth in FSU12 countries is particularly pronounced among the fuel exporters, which were growing by one and a half percentage point faster than the non-fuel exporters between 2000 and 2015. But the table also shows that the very negative growth experience during the first ten years of transition is hard to erase and the EU10 countries have grown faster over the full 25-year period compared to the FSU12 countries. In terms of

understanding the growth experience of the different country groups and time periods, it is clear that the sharp increase in international oil prices during the last 15 years of the period generated high growth in the fuel exporting countries in the FSU12 group. Interestingly though, also the non-fuel exporters grew faster than the EU10 in this time period. This is likely linked to spillovers from Russia to the other countries in the region, but could also be related to some recovering after the massive initial declines in output. Such macro and external factors are not always stressed in discussions of growth in transition countries, which more often focus on the pace of reforms or strength of institutions, but seem to be relevant at this aggregate level when comparing the initial and later phases of transition.

## Relative incomes in transition countries

Growth or the lack thereof is of importance in determining income *levels*, which is what we generally think is what influences welfare. The question is then what the growth processes we have analyzed imply for income levels in transition countries, and in particular, how the income levels in these countries compare with other countries.

Figure 2. Income relative to 15 old EU countries



Source: Becker and Olofsgård (2017)

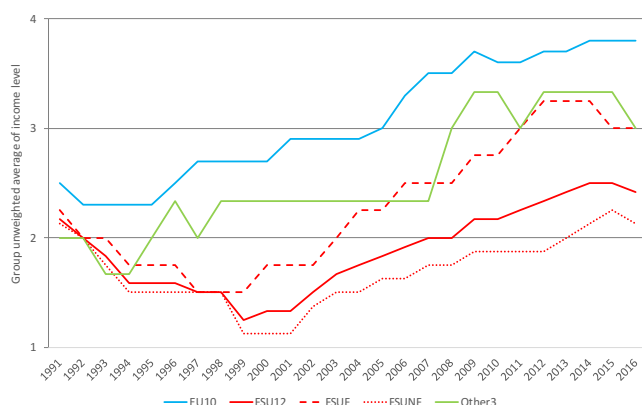


The short story here is that the relative ranking of the different groups is largely unchanged from the start of transition until the end of 2015. The group of countries that eventually joined the EU has the highest income level while the non-fuel exporting FSU countries have the lowest. However, the leading group still only has around 60 percent of the income of the average “old” EU country while the average FSU12 country has half of that or around 30 percent of the income of the old EU countries. This puts the relatively high growth rates of the FSU12 group over the last 15 years in perspective; the road to reach old EU level incomes is long indeed. Also, within the FSU group, it is clear that there is a sharp dividing line between the fuel exporters and the rest. This is in stark contrast to the notion of a “natural resource curse” that is often blamed for poor growth in oil and mineral rich countries.

## Growth traps in transition?

One issue that comes up with regards to both low and middle-income countries is if they are stuck at a certain level in the relative income rankings of the world. This is referred to as the low or middle-income trap and the question is if there are signs of transition countries being stuck in such traps.

*Figure 3. Moving up the income ladder*



Source: Becker and Olofsgård (2017)

Figure 3 shows how transition countries are classified into the World Bank's income groups

low income (1 in the Figures scale), lower middle income (2), higher middle income (3) and high income (4) groups.

It is clear that the FUS 12 group of countries was sliding down the scale initially, but since the beginning of the 2000's, all of the transition countries have been climbing up the World Bank income ranking scale without any apparent signs of a low or middle-income trap.

## Policy conclusions

There are of course country differences along all the dimensions discussed in this brief but grouping the transition countries together provides some interesting general observations of growth in transition. First of all, it is clear that it is very hard to fully recover from large drops in income. Even with the help of some extra growth following a crisis, it seems to take a long time for most countries to make up for lost ground. This suggests that policy makers in transition as well as other countries need to take measures to hedge the really bad outcomes and not only focus on how to generate an extra one percent of growth.

The other observation is that at the aggregate level, external factors and more mechanical macro boom-bust-boom type of growth factors may dominate what we generally think of as the long-run determinants of growth (such as institutions, education, and micro level reforms to make markets work better) over very long time spans. This does not mean that the focus on the more fundamental growth drivers should diminish, but it is important that reforms in these areas are complemented with a macroeconomic framework that reduces the risks of costly output collapses.

Finally, it is clear that the incomes generated by natural resources can produce growth at the macro level and that there is little evidence that transition countries should be stuck at any particular level in the global income rankings. Go transition countries!



## References

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