An Examination of the Former Centrally Planned Economies 25 Years After the Fall of Communism

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Key findings

This report examines the changing economic and political institutions of 25 former centrally planned (FCP) economies following the collapse of communism and analyzes how the changes have impacted performance. The key findings of the study are:

1. Seven of the 25 FCP economies ranked in the top quarter of the 159 countries included in the Economic freedom of the World project in 2015. These seven countries – Georgia, Estonia, Lithuania, Latvia, Romania, Armenia, and Albania – had a 2015 Economic Freedom of the World (EFW) summary rating of 7.5 or higher. Another nine countries – Czech Republic, Bulgaria, Poland, Slovak Republic, Hungary, Kazakhstan, Macedonia, Croatia, and Slovenia – had 2015 EFW summary ratings between 7.0 and 7.5 and ranked in the second quartile worldwide. All of these countries achieved substantial increases in economic freedom during 1995-2015. Another nine FCP economies – Kyrgyz Republic, Tajikistan, Montenegro, Serbia, Bosnia and Herzegovina, Russia, Moldova, Azerbaijan, and Ukraine – have 2015 EFW summary ratings of less than 7.0. This latter group has moved more slowly toward the institutional framework of a market economy.

2. The countries with more economic freedom grew more rapidly than those that were less free. Six of the seven countries in the most-free group achieved a robust annual growth rate of per capita GDP of 4.0 percent or higher during 1995-2015. The exception was Romania, which was a late reformer and achieved a growth rate of 4.56 during 2000-2015 after adopting reforms supportive of economic freedom. Among the nine countries in the middle group, only Poland and Kazakhstan achieved an annual growth rate greater than 4 percent. Among the eight countries in the least free group for which data were available, only Bosnia and Herzegovina and Azerbaijan achieved an annual growth rate greater than 4 percent. The growth rate of Bosnia and Herzegovina was almost certainly exaggerated because of its low 1995 per capita GDP as the result of civil war, while the high growth rates of both Azerbaijan and Kazakhstan were elevated by the increasing and abnormally high oil prices during 2002-2014.

3. International trade (imports plus exports) as a share of GDP increased substantially in most all of the countries in the most free and middle group during 1995-2015. The increases in the size of the trade sector were particularly large for the ten FCP countries that joined the European Union during 2004 and 2007. Net foreign direct investment as a share of GDP also increased...
substantially during the first decade of the 21st century. These trends are indicative of greater integration into the world economy. However, the foreign investment rate has fallen substantially since 2010. This decline is a sign of potential trouble ahead.

4. The poverty rates rose in several FCP economies during the transition phase of the 1990s and early years of the 21st century. However, the poverty rates declined rapidly thereafter. By 2015, the moderate poverty rate ($3.10 per day in 2011 dollars) was lower than the 1995 rate in all the FCP economies. In 2015, the moderate poverty rate was less than 10 percent in 21 (and less than 5 percent in 18) of the 25 FCP economies.

5. During 1995-2015, the political institutions of most FCP economies moved toward protection of civil liberties, democratic decision-making, and better control of corruption. The following nine countries had 2015 political institutions most consistent with civil liberties protection, political democracy, constraints on the executive, and absence of corruption: Estonia, Lithuania, Latvia, Czech Republic, Poland, Slovak Republic, Hungary, Croatia, and Slovenia. In contrast, the political institutions of Kazakhstan, Tajikistan, Russia, and Azerbaijan were least consistent with protection of civil liberties, democratic principles, and absence of corruption.

6. The per capita GDP of the FCP economies rose substantially during 1995-2015 relative to the high-income countries of Europe and the world. The largest increases in relative income were registered by Georgia, Lithuania, Latvia, Armenia, Albania, Kazakhstan, Azerbaijan, and Bosnia and Herzegovina. The per capita GDP of each of these countries relative to the mean of the world’s 21 high-income countries more than doubled between 1995 and 2015. Five of these eight countries are in the group with the highest 2015 economic freedom ratings.

7. Regression analysis was used to estimate the impact of initial income, economic freedom, population, demographic factors, net foreign direct investment, and net fuel exports on the growth of per capita GDP. This comprehensive model explained approximately two-thirds of the cross-country variation in growth of per capita GDP among the 122 countries for which the data were available during 1995-2015 and 2000-2015. The regression model indicates that economic freedom exerts a positive and highly significant impact on economic growth, even after accounting for the other factors included in the model. The dummy variable for the FCP group with a 2015 EFW rating above 7.5 was always significant, indicating that the growth rates of these countries was more rapid than the world’s 21 high-income countries.

8. Regression analysis was also used to examine the determinants of life satisfaction, a measure developed from the World Values Survey. A set of personal attributes (such as employment, relative income, gender, and age) and country specific measures including the summary EFW rating, per capita GDP, the Polity IV democracy score, and language fractionalization were incorporated as independent variables. The results indicate that economic freedom exerts a significant positive impact on life satisfaction both directly and indirectly (through per capita GDP). While the life satisfaction of persons living in FCP countries was well below that of similar individuals in other countries during the 1990s, the gap has declined, and by 2010-2014, it was virtually eliminated.
9. The economic freedom area ratings of the FCP countries increased substantially in areas 1 (size of government), 3 (access to sound money), 4 (international trade) and 5 (regulation of finance, labor, and business) during 1995-2015. In these four areas, the economic freedom ratings of the FCP countries, particularly the 11 that are now members of the European Union, are approximately the same as the ratings of the high-income European countries.

10. There is a huge gap in the quality of the legal systems (EFW Area 2) of the FCP countries compared to the high-income countries of Europe. Moreover, the FCP countries have failed to improve in this area. There are even some signs of deterioration in several FCP countries. Unless the FCP countries improve their legal systems, their future growth will slow and their gains relative to high-income countries come to a halt. This may already be happening, as foreign direct investment has declined sharply and real economic growth slowed since 2010.