A LIMPING TRANSITION: THE FORMER SOVIET UNION THIRTY YEARS ON

Marek Dabrowski

The post-communist transition in the Soviet Union's successor states has been discouraging in many ways. The foundations of market economies were put in place by the early 2000s but adopted policies and institutions have proved suboptimal and distortive in many countries. Overall, the region has demonstrated how economic and political transition are closely correlated, with the latter impacting strongly on the former. In particular, the autocratic drift in Russia has caused reversals in economic reforms and aggressive policies against its neighbours, culminating in the devastating war in Ukraine.

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A limping transition: the former Soviet Union thirty years on

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FOREWORD

Few analysts of post-communist economic and political transformation – commonly referred to as transition – quite match Marek Dabrowski. As a policymaker, policy advisor, public intellectual and private citizen, he has lived transition, giving him an unmatched understanding. Yet, he approaches the subject with the critical eye of the outside observer.

In this concise comparative essay, Marek describes 30 years of transition in the countries that emerged from the dissolution of the Soviet Union. His message is pessimistic yet nuanced. First, few countries – only the Baltic states – managed to fulfil the hopes that many of us had for all post-Soviet countries: that they would emerge as democratic market economies closely integrated with Western Europe. Second, there is wide variance in the economic and political trajectories of the rest. Interestingly, this is not closely correlated with geography, with Georgia and Armenia doing better on most transition indicators, and much better on long-term growth, than Moldova, Russia or Ukraine, for example. Third the divergence of transition outcomes was mostly achieved by the mid-to-late 2000s, after which transition stagnated in most countries (including in those that had not transitioned very much at all). Fourth, economic and political transition are closely correlated.

Will the laggards will catch up? Marek's essay offers both dark and hopeful answers.

The hopeful one is that even during the period of stagnation that set in about halfway through the 30 years surveyed in the essay, individual countries experienced improvements, even 'breaks.' Examples include Ukraine's 2014 Maidan Revolution and Armenia's 2018 Velvet Revolution, both of which led to sharp improvements in democratic accountability, as well as slower – but sustained – improvements in the rule of law and the control of corruption. Similarly, Uzbekistan has been experiencing a political and economic opening since the death of post-communist dictator Islam Karimov, albeit more slowly and from a low level. Whether it will continue to catch up or will again become "*stuck in transition*" (to quote the title of the European Bank for Reconstruction and Development's Transition Report 2013, which described the phenomenon) remains to be seen.

The dark answer has to do with Russia's role. As Marek points out, until the mid-2000s, Russia was generally a positive force in fostering reform in the region. Since then, however, Russia has not only become stuck in transition itself, but has grown as a threat to the political and economic transitions in the countries over which it wields influence. Milestones include Putin's 2007 decision to cling to power after the expiration of his second presidential mandate, Russia's 2008 invasion of Georgia, its support for Ukraine's corrupt president from 2010 until 2014, the 2014 annexation of Crimea and of course its full-blown invasion of Ukraine in 2022.

As Marek argues, with the notable exception of the Baltic states, which became members of the European Union and NATO in 2004, the future of the countries of the former Soviet

Union will depend to a great extent on how this threat is dealt with. In the short run, defeating Russia's aggression against Ukraine is essential not just for Ukraine and the security of Europe, but also for the prosperity and democratic transformation of its neighbours. In the longer run, the future of the region may well depend on Russia's ability to transform itself.

Jeromin Zettelmeyer,
Director, Bruegel
Brussels, February 2023

1 UNEVEN AND DISCOURAGING TRANSITIONS

On 26 December 1991, the Union of Soviet Socialist Republics (USSR), popularly called the Soviet Union, ended its formal existence. Twelve republics, which remained at that time Union members[1], gained full sovereignty. Although some market-oriented reforms had been undertaken after 1987, under the *perestroika* (reconstruction) policy initiated by Mikhail Gorbachev, General Secretary of the Communist Party of the Soviet Union (CPSU), they had had a partial and often chaotic character, causing severe macroeconomic imbalances and making the Soviet economy unmanageable (Dabrowski, 2022a). Thus, the dissolution of the USSR, the collapse of the political and ideological monopoly of the CPSU (formally dissolved at the end of August 1991), and the dramatic economic crisis of 1989-1991 created the political space and need to initiate a more comprehensive economic transformation.

However, the political and economic conditions in the successor states of the former Soviet Union (FSU) differed, which caused an uneven pace of reform. The Baltic states

1 Three Baltic republics (Estonia, Latvia and Lithuania) gained full independence four months earlier, at the end of August 1991, immediately after the failure of the short-lived *coup d'état* initiated by the hard-line group within the CPSU leadership.

chose a strategy that proved successful of rapid and comprehensive political and economic reform, resulting in their accession to the European Union in 2004. Market transition in other FSU countries moved at a pace between slow and moderate, resulting in numerous structural and institutional distortions, unfavourable business and investment climates, and continuous macroeconomic disequilibria.

The result of the political transition has been even more discouraging. After a short period of partial political freedom and democracy, which was initiated under the *glasnost'* (openness) policy of Mikhail Gorbachev at the end of the 1980s and continued in the period immediately after the dissolution of the USSR, successor countries started to rebuild the autocratic system of political power. This trend started in Central Asia (apart from Kyrgyzstan) immediately after gaining independence, followed by Belarus and the Southern Caucasus in the second half of the 1990s, and Russia in the early 2000s. As of the early 2020s, only four countries (Armenia, Georgia, Moldova and Ukraine) are rated by the Freedom House's *Freedom in the World* survey as partly free. All remaining FSU countries are ranked as unfree (Repucci and Slipowitz, 2022). As this essay shows, and as noted elsewhere (Dabrowski, 2022b), economic and political transitions in the post-communist countries have been correlated, with the political transition impacting the pace of economic reform.

This essay analyses the speed and extent of the post-USSR transitions in twelve FSU countries. The three Baltic countries are excluded from the analysis because they chose another, more radical, reform path from the beginning of their independence in 1991. They are now EU and the North Atlantic Treaty Organisation (NATO) members. However, they serve as a benchmark for other FSU countries when such a comparison is relevant and analytically helpful. While political and geopolitical changes in the region are not the central topic of this analysis, they are considered essential determinants of economic policies and reforms.

The purpose of this essay is to assess where FSU countries are 30 years after the break up of the USSR in terms of their economic and political systems. How far have they travelled from the Soviet past and what do the varying transitions they have been through mean for their socioeconomic development prospects? Russia's invasion of Ukraine and the resulting war, which have dramatically affected the entire region, have stimulated a broad interest in the region's economic and political developments. Finally, more than 30 years of academic research and advising on policy in the region, including personal involvement in the post-communist transitions of most FSU countries, give the author an opportunity to share first-hand knowledge and experience.

The analysis starts with a short characterisation of the Soviet economic legacy, which determined the initial conditions of the post-communist transitions in the early 1990s (section 2). Section 3 deals with macroeconomic instability, which was one of the legacies of the Soviet economy, and macroeconomic stabilisation, which took a lot of time to complete. Sections 4 and 5 then analyse the critical transition process components: economic liberalisation and privatisation. Section 6 deals with institutions and governance. Section 7 analyses economic growth performance in the post-Soviet period. Section 8 summarises and looks ahead.

The dominant analytical approach in the empirical part of this essay is a cross-country statistical comparison based on harmonised international data sources. National data sources are used exceptionally, mainly for illustrating individual country cases. The analysis of socioeconomic indicators, we relies on international databases provided by the International Monetary Fund (IMF), World Bank, World Trade Organisation (WTO), European Bank for Reconstruction and Development (EBRD), United Nations Conference on Trade and Development (UNCTAD) and others. It is crucial to note that some of these databases remain incomplete, especially for the first years of transition and for countries that were the reform laggards and preferred to stay closed to the outside world in informational terms. In these cases, the quality of statistics is often problematic, even if processed and verified by international financial and development institutions.

The measurement problems become even more challenging when one tries to quantify more complex phenomena and qualitative characteristics, for example, various aspects of economic freedom, the business and investment climate, governance and corruption. The most common way to measure and compare between countries is to use composite numeric indices produced by global development institutions and non-governmental organisations (NGOs). These allow for cross-country comparisons and dynamic analyses of changes in individual countries.

However, it is necessary to be aware of the methodological difficulties in constructing and interpreting such indices. First, quantifying phenomena with a qualitative character requires reliance on selected proxy indicators. Second, measuring such proxy indicators is usually done by surveying the opinions of experts and business practitioners. That is, proxy indicators have, by definition, a subjective character. Third, the way composite indices are constructed can also be disputable, in terms of their composition (selection of detailed measures) and the weights attached to individual components. Fourth, frequent correlations exist between these components (multicollinearity), which may distort the final results. Finally, the detailed methodologies of some surveys have changed over time.

2 THE SOVIET ECONOMIC LEGACY

The Soviet economic system was formed at the end of the 1920s and early 1930s by Joseph Stalin, and was based on Marxist-Leninist orthodoxy. That is, it replaced private ownership of means of production with state and collective ownership, and market mechanisms by central planning. Private ownership was condemned on ideological grounds and forbidden in law. The former owners of the means of production became subjects of brutal repression as 'class' enemies.

The command economy of the Soviet type was characterised by the dominant role of the central plan and strict multi-level vertical management. The State Committee of Planning (Gosplan) set production targets, allocated inputs (including labour) and took investment decisions. The lower levels of the administrative hierarchy (sectoral ministries, branch organisations and enterprises) were obliged to comply, subject to material and non-material reward and punishment. Prices, financial flows and budget constraints played a secondary role. Prices and wages were determined administratively. There was a state monopoly in foreign trade, and the currency remained inconvertible, resulting in multiple exchange rates. The Soviet economy was broadly isolated from world markets.

Between the late 1920s and early 1950s, the five-year plans aimed at forced industrialisation, with the priority on heavy industry and military production, at the cost of other sectors and heavy human losses and suffering (famine in the early 1930s and the second half of 1940s; use of forced labour on a mass scale; deportation of large groups of people from the European part of the USSR to Siberia and Central Asia; the Great Terror of 1937-1939[2]). Collectivised agriculture was the primary source of financing industrialisation, at least in its early stages.

The economic model and policy were modified partly after Stalin's death in 1953. Mass terror, deportations and forced labour were abandoned, and part of resources was moved from heavy industries to consumer industries and agriculture. However, the main pillars of the Soviet economic system, such as the monopoly of the state and collective ownership and the centrally planned economy command system, remained unchanged until the late 1980s.

Over 60 years of central planning[3] resulted in profound structural distortions and limited the international competitiveness of the Soviet economy, which developed in isolation from world markets. The production of natural resources was the only sector capable of competing in these markets. Since the 1970s, this has been mainly the oil and natural gas industry (Gaidar, 2007).

The Soviet economy was over-industrialised (Blanchard, 1997) and had an underdeveloped service sector. Within the

2 For an overview, see Ellman (2000, 2007).

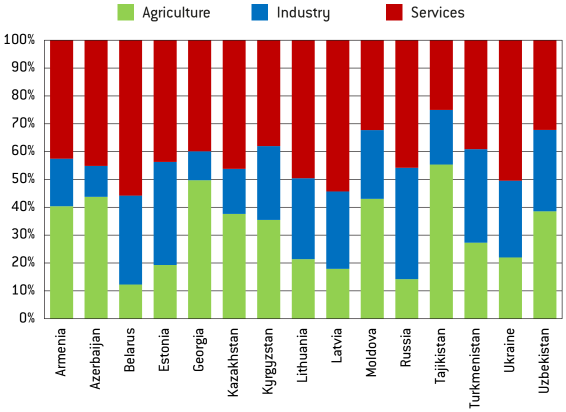
3 In the Baltic states, Moldova, Western Ukraine and Belarus, which were annexed by the USSR in 1939-1940, this period was shorter by approximately 10-15 years. On the other hand, Central Asian republics did not have any experience of capitalist economy before the Bolshevik revolution (the dominance of the feudal system).

industrial sector, the dominant role was played by the military industry. According to Cooper (1998), military spending in the USSR was equal to 16.6 percent of gross national product (GNP) in 1987. Because of the far-reaching autarky in producing Soviet military hardware, this figure had to be translated into a substantial share of the military industry in gross domestic product (GDP).

Structural distortions were distributed unevenly between the Soviet republics. Figure 1 illustrates this indirectly. It presents the sectoral structure of employment in 1991. By these metrics, Russia was the most industrialised republic (40 percent of total employment), followed by Estonia (37 percent), Turkmenistan (33.6 percent) and Belarus (31.9 percent). At the other end of the spectrum were Georgia (10.4 percent), Azerbaijan (11.1 percent), Kazakhstan (16.2 percent), and Armenia (17.1 percent).

Figure 1 also shows the substantial share of agriculture employment in several republics, with the highest shares in Tajikistan (55.4 percent of total employment), Georgia (49.8 percent), Azerbaijan (43.8 percent), Moldova (43.0 percent), Armenia (40.4 percent), Uzbekistan (38.6 percent), Kazakhstan (37.7 percent) and Kyrgyzstan (35.5 percent). This can be considered both a blessing and a curse. On the positive side, it offered a reservoir of surplus labour that could be redirected to higher-productivity industries and services, similarly to several developing countries, not least China (Sachs and Woo, 1997). On the other hand, Soviet agriculture was ineffective, heavily distorted and in need of painful restructuring, related in particular to large state-owned and collective farms (sovkhozes and kolhozes), which had dominated this sector since the 1930s (as a result of collectivisation).

Figure 1: Structure of employment (modelled ILO estimate) in the Soviet republics, % of total employment, 1991



Source: World Bank's World Development Indicators database.

The declining growth rate in the subsequent five-year plan periods (Table 1) demonstrated the ineffectiveness of the Soviet economic model. In the late 1980s, it reached zero or even became negative.

Table 1: Average annual growth rates of the Soviet economy, 1970-1989 (%)

Indicator	1970-75	1975-80	1980-85	1986	1987	1988	1989 [a]
GNP	3.1	2.1	1.9	4.0	1.3	1.5	-1.0
Industry	5.6	2.4	2.0	2.7	2.9	2.4	
Agriculture	-2.3	0.2	1.2	10.3	-4.0	-3.2	
Services	3.4	2.7	2.2	2.3	3.2	3.5	

Source: Ofer (1990). Notes: a = preliminary assessment.

In addition to declining growth rates, structural distortions and the absence of market institutions, macroeconomic disequilibrium was another acute legacy of the Soviet era. The chronic imbalance between demand and supply and a rigid administrative pricing system produced a physical shortage of goods, ie repressed inflation. Long lines of people trying to buy basic food and non-food items, the widespread black market and corruption (despite criminal penalties for such activities), and special stores with better supplies for privileged groups were a common picture, especially in the late 1980s and early 1990s.

Using Kornai's (1980) terminology, the "*shortage economy*" also had other sources, namely the lack of interest of state-owned and collective enterprises in maximising profits, and their involvement in constant bargaining with higher authorities for lower planned targets and more resources. External disequilibria took the form of persistent tensions in the balance of payments, leading to strict import rationing.

In the second half of the 1980s and early 1990s, macroeconomic imbalances further deteriorated as a result of the coincidence of several negative factors:

1. A sharp drop in world oil prices since 1985.
2. The anti-alcohol campaign of 1985 damaged a reliable and easily-collected source of fiscal revenue, and deepened the imbalance of the USSR budget.
3. Catastrophes, including the accident at the Chernobyl nuclear power plant (26 April 1986) and the earthquake in Armenia (Spitak, 7 December 1988), caused additional unplanned budget spending.
4. The costs of the war in Afghanistan (1979-1989).
5. The substantial increase in social expenditures resulted from the search by the country's political leadership for social support and legitimacy in the context of partial political liberalisation (*glasnost'*).
6. The same political trends, in the absence of a well-elaborated and coherent concept of economic reform, led to the erosion of the central planning system and the associated discipline of command management, causing a dangerous systemic vacuum: unmanageability of the country's economy.
7. The lengthy public discussion on price liberalisation (see section 4.1) increased inflationary expectations.
8. The political emancipation of the Soviet republics that began in 1990 led the Union's government and the State Bank of the USSR (Gosbank) to lose control over fiscal and monetary policies.

As a result, in 1991, the consolidated budget deficit of the USSR and the Russian Federation reached 31 percent of GDP (IMF, 1992). It was fully funded by printing money (Gaidar, 2007).

The rapidly growing fiscal and current-account deficits were at first compensated for by external borrowing, which was possible thanks to political rapprochement with the United States and its allies. However, in 1990-1991 this source became exhausted. On the eve of the systemic transformation, the USSR and its legal successor, the Russian Federation, became virtually bankrupt, accumulating a sizeable external debt with extremely limited international reserves (Gaidar, 2007; Christensen, 1993).

3 MACROECONOMIC STABILISATION[4]

The process of disintegration of the Soviet ruble area began already in 1990, before the formal collapse of the USSR. It lasted until the second half of 1993, when all FSU countries (except Tajikistan, which did so in May 1995) introduced national currencies (Table 2). The interim period, during which the FSU central banks, controlled by the respective executive and legislative bodies of newly independent states, conducted their national monetary policies using the same currency (the Soviet ruble), deepened monetary anarchy and accelerated inflation (Dabrowski, 1995).

Failure to dissolve the Soviet ruble zone in a timely and orderly manner was not the only obstacle to macroeconomic stabilisation in the FSU.

Years of administrative pricing, non-market allocation of resources and macroeconomic imbalances during the *perestroika* era led to the accumulation of a sizeable monetary overhang (Cottarelli and Blejer, 1991). As a result of price liberalisation (see section 4.1), this overhang was unfrozen, bringing repressed inflation into the open. Wholesale and

4 This chapter draws extensively on Dabrowski (2022a).

retail prices increased by several hundred percent. The price adjustment could have had a one-off character under a tight monetary policy and with control of wage growth in enterprises (similarly to central Europe). However, both were absent in the FSU. In most cases, the initial price adjustment quickly transformed into a high inflationary spiral.

Meanwhile, macroeconomic disequilibria and high inflation were contributed to by large fiscal deficits, subsidised loans (with negative real interest rates) granted in response to the pressure of agricultural and industrial lobbies, multilateral clearing of inter-enterprise debt arrears (Rostowski, 1998, pp. 183-225), armed conflicts and political instability.

As a result, the disinflation process in the 1990s was slow, with numerous setbacks. Three countries experienced hyperinflation: Georgia, where 12-month inflation reached 50,654 percent in September 1994; Armenia, which hit 29,600 percent in May 1994; and Ukraine, with 10,155 percent in December 1993.

Table 2: Timetable of the introduction of the new currencies by FSU countries, 1992-1995

Country	Date of complete separation from the Soviet ruble area	Name of new currency unit	Remarks
Estonia	22/06/1992	Kroon	Currency board, with a peg to the German mark
Russia	01/07/1992 (non-cash transactions)		Introduction of daily balancing of correspondent accounts of FSU countries in the Central Bank of the Russian Federation (CBRF). It meant the end of the single currency (Soviet ruble) in non-cash transactions, although CBRF technical loans to other central banks softened this decision until 1993.
Latvia	20/07/1992	Lats	Latvian ruble (rublis) at the beginning, gradually replaced by lats (from March 1993); peg to SDR
Lithuania	01/10/1992	Litas	Talonas at the beginning, replaced in June 1993 by litas; currency board from April 1994, with a peg to the dollar
Ukraine	11/11/1992	Karbovanets	Replaced with hryvnia in September 1996

Belarus	November 1992	Belarusian ruble	The Soviet ruble was accepted until July 1993
Kyrgyzstan	15/05/1993	Som	
Russia	26/07/1993 (cash transactions)	Ruble	Termination of the circulation of Soviet banknotes in Russia and replacing them with new Russian banknotes
Georgia	02/08/1993	Coupon	Replaced with lari in October 1995
Turkmenistan	01/11/1993	Manat	
Kazakhstan	15/11/1993	Tenge	
Uzbekistan	16/11/1993	Sum	
Armenia	22/11/1993	Dram	
Moldova	29/11/1993	Leu	Earlier, in July 1993, Moldovan coupons became the *de-facto* national currency
Azerbaijan	11/12/1993	Manat	
Tajikistan	May 1995	Tajik ruble	Replaced with somoni in October 2000

Source: Bruegel and Odling-Smee and Pastor (2001), Table 1.

Estonia, Latvia and Lithuania were the first to achieve relative macroeconomic stability. They left the ruble zone in 1992 (Table 2), introduced national currencies, and adopted the hard peg to selected convertible currencies: Estonia to the German mark, Latvia to International Monetary Fund Special Drawing Rights, and Lithuania to the dollar. They also balanced budgets and started processes of radical microeconomic, structural and institutional reform. The countries of the Southern Caucases, in 1995-1996 after pausing military conflicts, chose a similar strategy for fighting inflation, based on a fixed exchange rate and tightening of monetary and fiscal policies, giving good results. Exchange rate management in the form of a temporary horizontal peg, horizontal band, crawling peg or crawling band was also used in Russia, Ukraine, Kazakhstan and other FSU countries. However, the results were less sustainable because of fiscal imbalances and the slow pace of microeconomic and institutional reforms.

Unsustainable fiscal policies led to the FSU financial crises of 1998-1999. Notwithstanding the external trigger (the contagion from the Asian crises of 1997-1998, the decline in world oil prices), the financial turmoil that broke out in Russia on 17 August 1998 and, within a few weeks and months, spread to others FSU countries could be characterised as a typical 'first-generation' crisis (Dabrowski, 2016). Its essence was the inconsistency between a pegged exchange rate and expansionary fiscal policy.

The financial crisis of 1998-1999 resulted in profound devaluations of FSU currencies, except for those of Azerbaijan and Armenia. Russia stopped servicing its debt to private creditors, and Ukraine was forced to negotiate with creditors to restructure its public debt. Russia, Ukraine, Kazakhstan and Kyrgyzstan suffered from banking crises.

The macroeconomic situation stabilised in the period of post-transformation growth recovery (see section 7) and the global commodity boom in the early and mid-2000s. Rapidly growing prices for exported commodities improved the terms of trade, eased balance-of-payments constraints and increased budget revenues. As a result, current account balances improved, central bank international reserves increased and exchange rates stabilised or appreciated, except for Belarus and Tajikistan. Disinflation continued slowly and at various speeds in the different countries (see below), and demand for domestic money increased. Fiscal balances in most of the region improved. The oil and natural gas exporting countries (Russia, Kazakhstan, Azerbaijan, Uzbekistan and Turkmenistan) were able to create sovereign wealth funds out of budget surpluses.

A period of rapid growth and favourable global macroeconomic conditions came to an end in mid 2008 as a result of the global financial crisis (GFC), caused by the collapse of the financial system in the United States and other advanced economies. The adverse shock was transmitted to FSU economies through several channels, with the leading role played by the bursting of the bubble in the global markets for oil and other commodities (Figure 2). Remittances from labour migrants, a significant source of balance-of-payments receipts in Tajikistan, Kyrgyzstan, Uzbekistan, Moldova, Armenia and Georgia, also declined sharply.

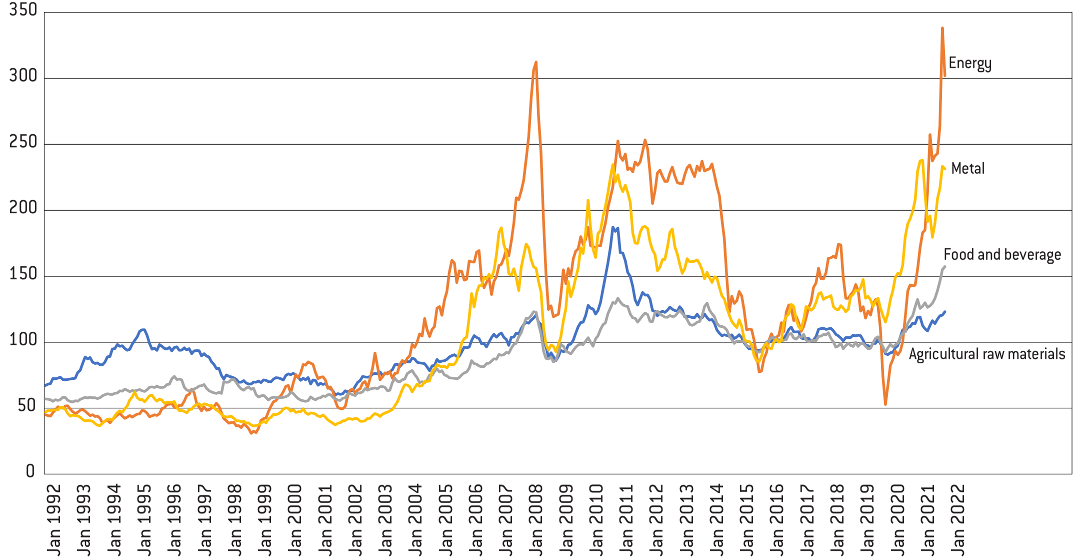
Equally important were the events in the financial and stock markets. The implosion of the financial system in advanced economies triggered capital outflows from emerging markets. Stock market indices plummeted, and many financial and non-financial corporations found it challenging to settle their liabilities in a timely way. As a result, banking and corporate crises erupted in several FSU economies: Russia, Kazakhstan, Ukraine, Belarus, Moldova, Kyrgyzstan and Armenia. Banks and large companies (many of which had invested abroad on the eve of the crisis) needed government support, which was financed either by the sovereign wealth funds (Russia, Kazakhstan) or by IMF rescue programmes (other countries). The government rescue often involved nationalising banks and non-financial corporations (see section 5).

Unfortunately, FSU economies became more vulnerable than other emerging-market and developing economies, especially in Asia and Latin America. The vulnerability manifested itself in the depth of recessions (see section 7), the deterioration of current account balances and fiscal accounts, and the weakening of FSU currencies. Azerbaijan was the least affected by the GFC because of the peak in oil production and exports.

The GFC made visible the fragility of FSU banks. They suffered from weaknesses including insufficient capitalisation, poor-quality loan portfolios (a result of either politically motivated or connected lending and corruption), imbalances between foreign exchange assets and liabilities, and excessive dependence on short-term refinancing in the international financial market.

Because of rule-of-law shortcomings and the weak protection of property rights (see section 6), several large FSU corporations transferred part of their capital abroad. They replaced it with short-term financing in the domestic or foreign market (Rogov, 2014), which increased their vulnerability during the crisis.

Figure 2: Global commodity prices, 2016=100, 1992-2022



Source: IMF Primary Commodity Price System, https://data.imf.org:443, retrieved on 1 June 2022.

The magnitude of subsequent macroeconomic shocks (2008-2009, 2014-2015, 2020, and 2022) was deepened by capital flight and panic reactions among the population and small businesses in the foreign exchange market and banking system. When the first signs of instability (or uncertainty) appear, people buy foreign currency and withdraw money from bank accounts.

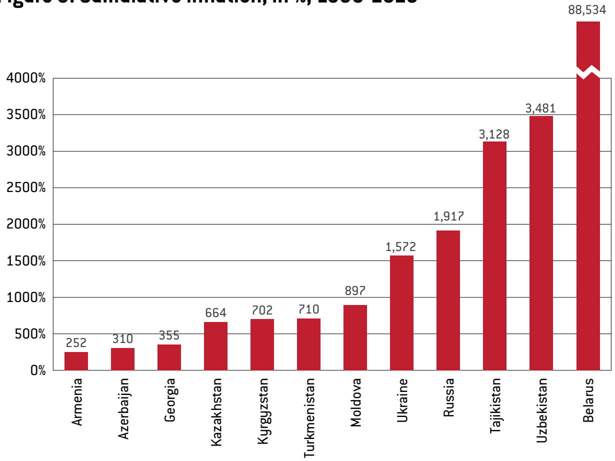
The macroeconomic and financial crisis, which started in the second half of 2014 and lasted until early 2016, was caused by the sharp decline in global commodity prices, especially oil (Dabrowski, 2016). In Russia and Ukraine, the crisis was deepened by the annexation of Crimea (by Russia), the war in Donbas, the Western sanctions against Russia and Russian retaliatory measures (Dabrowski and Avdasheva, 2023).

Then in 2020-2021 the entire region was hit by the COVID-19 pandemic and associated lockdowns (although to a lesser degree than other regions, for example, the EU or Latin America), and the consequences of the Russian aggression against Ukraine in 2022, which affected especially the European part of the FSU.

In the 2014-2015 and 2020 crises, the transmission channels from the global markets were similar to those in 2008-2009.

Overall, macroeconomic indicators point to moderate progress in macroeconomic stabilisation in the post-Soviet era. Cumulative inflation from 1996 to 2020 – after the introduction of national currencies and the overcoming of the initial period of very high inflation or even hyperinflation, and before the post-pandemic inflation acceleration in 2021-2022 – was high or very high, depending on the country (Figure 3).

Figure 3: Cumulative inflation, in %, 1996-2020



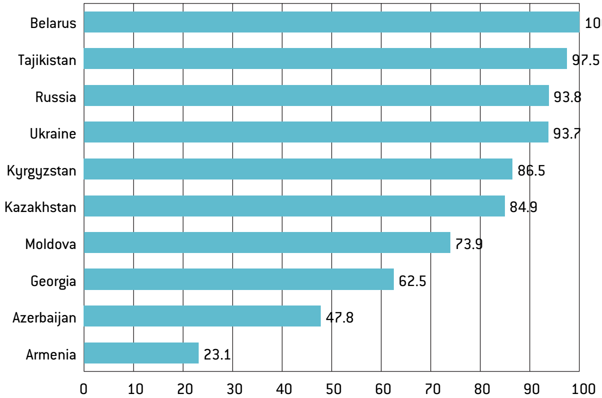
Source: Bruegel based on World Economic Outlook database, October 2021.

Only three countries – Armenia, Azerbaijan, and Georgia – recorded only moderate cumulative price increases. Belarus was at the opposite end of the spectrum, with a cumulative price increase of almost 900 times during the analysed period. Elsewhere, double-digit inflation was still the norm in the 2000s and early 2010s. Only the second half of the 2010s brought partial progress, thanks to the application of the inflation-targeting strategy. Since 2021, this progress has been under threat from growing global inflationary pressures and the war in Ukraine.

Figure 4 shows the degree of depreciation of the FSU currencies against the dollar over the same period. Except for the Armenian dram and Azerbaijani manat, other currencies lost more than half of their end-1995 value. The Belarusian ruble lost almost 100 percent, the Tajikistani somoni (including its predecessor, the Tajikistani ruble) depreciated by 97.5 percent, the Russian rouble by 93.8 percent and the Ukrainian hryvnia by 93.7 percent.

Large-scale depreciation of exchange rates undermined confidence in FSU currencies. This is reflected in the dollarisation of the financial sector's liabilities (Table 3). Despite a slight decline since the mid-2000s, dollarisation remains high throughout the region. In addition to the dollarisation of bank assets and liabilities, use of cash dollars and other global currencies is widespread in business transactions.

Figure 4: Cumulative depreciation of the FSU currencies against the dollar, in %, 31/12/1995 – 31/12/2020



Source: Bruegel based on IMF International Financial Statistics.

When one looks at the level of public debt (Figure 5), two groups of countries can be distinguished: exporters of oil and natural gas, and others. The gross debt level in the first group can be considered low (Russia, Azerbaijan, Kazakhstan and

Turkmenistan) or moderate (Uzbekistan), especially since these countries have sovereign wealth funds. That is, their net debts are lower than gross debts.

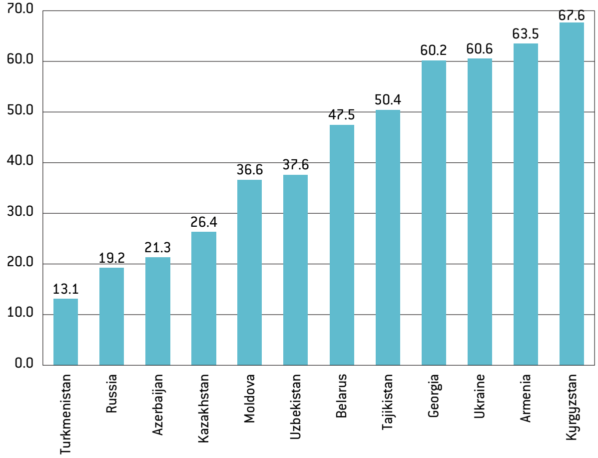
Table 3: Share of foreign currency-denominated liabilities in total liabilities of the financial sector, in %, 2005-2020

Country	2005	2009	2013	2015	2017	2019	2020
Armenia	66.8	67.6	63.9	65.7	60.0	55.4	52.8
Belarus			63.5	74.1	67.6	61.2	63.7
Georgia	77.3	78.2	65.9	70.7	63.5	60.1	59.1
Kazakhstan		55.5	40.4	66.6	44.0	38.0	
Kyrgyzstan			55.0	64.9	46.6	39.8	42.6
Moldova		53.8	51.0	52.8	44.1	41.8	42.9
Russia		31.5	25.4	39.9	23.0	21.0	23.2
Tajikistan		61.8	55.4				
Ukraine	43.5	55.8	43.3	52.8	52.8	42.8	39.1
Uzbekistan							59.7

Source: IMF Financial Soundness Indicators. Note: no data available for Azerbaijan and Turkmenistan.

The situation is less rosy for the remaining seven countries: their gross debt in 2020 ranged from 35 percent of GDP to 70 percent of GDP. These are high figures, although not catastrophic, compared to advanced economies and other emerging market and developing economies. In the cases of Tajikistan, Kyrgyzstan, Armenia, Georgia and Moldova, part of their debts (sometimes significant) is financed by long-term loans received on concessional terms from international financial institutions and bilateral official donors.

Figure 5: General government gross debt, % of GDP, 2020



Source: IMF World Economic Outlook database, October 2022.

At the time of writing, Belarus and Ukraine look vulnerable, especially given the war damages (Ukraine) and sanctions (Belarus). In the past, they repeatedly faced difficulties accessing international financial markets, even with lower debt levels, and were forced to negotiate to restructure their debt obligations. The unfinished COVID-19 pandemic and the consequences of the war in Ukraine will further worsen their fiscal balances and increase public debt in the coming years.

4 ECONOMIC LIBERALISATION

Economic liberalisation was vital to restoring market mechanisms and dismantling the remnants of a central planning command system. Economic liberalisation had domestic and external components.

4.1 Domestic liberalisation

Price deregulation played the most critical role on the domestic front, allowing market allocation of resources to work, and eliminating massive consumer and producer subsidies, the primary source of fiscal deficit and macroeconomic disequilibria (see section 2). At the same time, it was the most politically difficult component of market transition. In the USSR, the necessity of price liberalisation was publicly discussed in 1989-1991, which increased inflationary expectations. However, until the end of 1991, political authorities were not ready to take such a decision[5].

Ultimately however, confronted with the widespread shortages of goods on the consumer and producer markets,

5 See Fischer (1992) for an overview of economic reform programmes discussed in the USSR in 1990-1991. See also the opinion of Grigoriev (2019) that reforms should have started a year or two earlier.

the government of the Russian Federation, led by President Boris Yeltsin, with Deputy Prime Minister Yegor Gaidar in charge of economic reforms, decided to free prices on 1 January 1992. Energy products and services, public transportation, housing rents and other utilities were excluded from this decision. Most FSU countries followed this decision, although not all immediately and in the same way. For example, in Turkmenistan and Ukraine, price liberalisation was delayed by two years (Figure 6). In 1997-1998, Uzbekistan returned to tighter price controls, and price deregulation was resumed only after 2016. Belarus also, in 1998-1999, partially reversed price liberalisation for the next ten years. Some other FSU economies experienced smaller and shorter reversals of free pricing.

Figure 6 shows the European Bank for Reconstruction and Development's assessment of the price liberalisation process until 2014 (the last year for which EBRD transition indicators were published). A score of 1 means most prices continue to be formally controlled by the government, while a score of 4.3 means standards and performance typical of advanced industrial economies – that is, complete price liberalisation with no price controls outside housing, transport and natural monopolies[6].

Apart from the laggards mentioned earlier, FSU countries completed price deregulation in the second half of the 1990s, a few years later than Baltic and former communist central European countries. Only three FSU countries – Armenia, Georgia, and Kyrgyzstan – obtained maximum scores of 4.3, meaning they fully liberalised their price systems. However,

6 See https://www.ebrd.com/transition-indicators-history for the transition indicators methodology.

Armenia returned in 2010 to a more regulated price regime.

Allowing the unrestricted creation of private enterprises of various types, and their access to free markets, was another condition to facilitate market competition, balance demand and supply on consumer and producer markets and effectively allocate resources. Most FSU countries adopted constitutional changes and ordinary legislation, including Western-style civil codes[7]. However, the actual degree of entrepreneurial freedom has remained restricted because of overregulation and poor governance (see section 6).

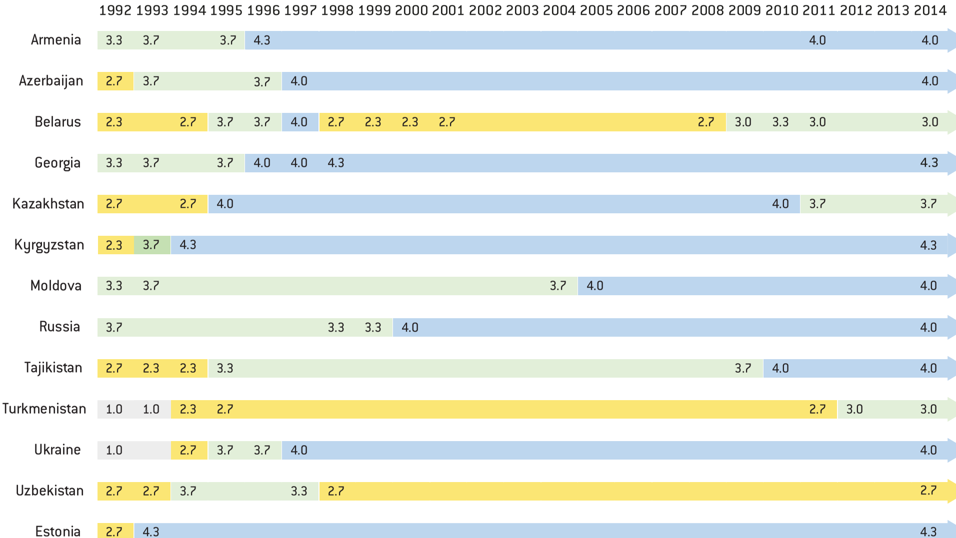
4.2 External liberalisation

Given the autarkic model of the Soviet economy, the absence of private firms, and the dominance of large enterprises organised according to the branch/sectoral scheme (to facilitate central planning and command management in the Soviet era), opening to foreign competition played a crucial role in building a market mechanism. It required dismantling of the state monopoly on foreign trade, a process already initiated in the late-Soviet period, reduction of tariff and non-tariff barriers to imports and exports, and introduction of convertibility of national currencies, at least for current-account transactions.

Figure 7 provides the EBRD assessment of this process on a scale of 1.0-4.3 (similar to price liberalisation, Figure 6). A score of 1 means widespread import and export controls or minimal legitimate access to foreign exchange, while 4.3 indicates standards and performance norms of advanced industrial economies: removal of most tariff barriers and membership of the WTO.

7 See Hartwell (2023) with respect to Russia.

Figure 6: EBRD's indicator of price liberalisation (1.0 - 4.3), 1992-2014



Source: https://www.ebrd.com/sites/Satellite?c=Content&cid=1395245467784&d=&pagename=EBRD%2FContent%2FDownloadDocument.
Note: grey fill = 1.0 to 1.9; yellow = 2.0 to 2.9; green = 3.0 to 3.9; blue = 4.0 to 4.3.

Figure 7: EBRD's indicator of trade and forex system (1.0 - 4.3), 1992-2014

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Armenia	2.0		2.0	3.0	4.0							4.3											4.3
Azerbaijan	1.0			2.0		2.3	3.0	3.3			3.7		3.7	4.0									4.0
Belarus	1.0			2.0		1.0			1.7	2.0	2.3									2.0	2.3		2.3
Georgia	1.0			2.0	3.0	4.0			4.3														4.3
Kazakhstan	1.0	2.0		3.0	4.0			3.3					3.7										3.7
Kyrgyzstan	2.0		3.0	4.0				4.3															4.3
Moldova	2.0			4.0						4.3													4.3
Russia	3.0				4.0	4.0	2.3			2.7	3.0	3.3								3.3	4.0		3.7
Tajikistan	1.0			2.0			2.7		3.3													3.7	3.7
Turkmekistan	1.0																2.0				2.3		2.3
Ukraine	1.0			3.0			2.7	3.0			3.3			3.7		3.7	4.3	4.0					4.0
Uzbekistan	1.0		2.0			1.7		1.0					1.7	2.0						1.7			1.7
Estonia	3.0		4.0						4.3														4.3

Source: https://www.ebrd.com/sites/Satellite?c=Content&cid=1395245467784&d=&pagename=EBRD%2FContent%2FDownloadDocument.
Note: for cell fill colours, see note to Table 6.

A comparison of Figures 6 and 7 suggests a slower pace of external economic liberalisation than domestic price deregulation. In 1992, only Russia accomplished meaningful progress on this front. The long and painful process of the dissolution of the Soviet ruble area (see section 3), and the introduction of new national currencies in most FSU countries only in the second half of 1993, postponed their convertibility. Seven FSU countries accepted Article VIII of the IMF Articles of Agreement related to current account convertibility between 1995 and 1997. These were Kyrgyzstan, Moldova, Russia, Kazakhstan, Ukraine, Georgia and Armenia (Table 4). Belarus, Uzbekistan, Azerbaijan and Tajikistan did so in the early 2000s. Turkmenistan has not accepted this article yet, remaining in the regime determined by the Article XIV of the IMF Articles of Agreement (IMF, 2022).

Table 4: Date of acceptance of Article VIII of the IMF Articles of Agreement and presence of exchange restrictions/ multiple exchange rates at the end of 2020

	Acceptance of Article VIII	Exchange restrictions/ multiple exchange rates at the end of 2020
Armenia	29 May 1997	No
Azerbaijan	30 November 2004	No
Belarus	5 November 2001	No
Georgia	20 December 1996	No
Kazakhstan	16 July 1996	No
Kyrgyzstan	29 March 1995	No
Moldova	30 June 1995	No
Russia	1 June 1996	No
Tajikistan	09 December 2004	Yes
Turkmenistan		Yes
Ukraine	24 September 1996	Yes
Uzbekistan	15 October 2003	No

Source: IMF (2022).

However, acceptance of Article VIII has not necessarily meant full current-account convertibility in practice. For example, Uzbekistan continued to apply various exchange restrictions and multiple exchange rates until 2017. Tajikistan returned to multiple exchange rate practices in the 2010s. Belarus and Ukraine resorted to exchange restrictions during subsequent currency-crisis episodes. At the end of 2020, Tajikistan, Turkmenistan and Ukraine still continued some limits on current account transactions. In the case of Tajikistan and Turkmenistan, this resulted in multiple exchange rates (IMF, 2022).

The degree of capital account convertibility has been even lower. FSU countries have maintained various capital-control instruments (Dabrowski, 2013; IMF, 2022). Only Armenia and Georgia have enjoyed relatively liberal regimes.

Russia's aggression against Ukraine in 2022 changed the picture dramatically. Ukraine had to introduce far-going foreign exchange restrictions to protect its balance of payments in the war economy conditions. Because of Western financial sanctions, Russia also had to seriously restrict its capital account and partly restrict current account convertibility (Dabrowski and Avdasheva, 2023).

Tables 5-6 present data on import tariff rates on non-agricultural and non-fuel products. Table 5 contains the declared most-favoured nation (MFN) rates. Table 6 shows effectively applied rates, that is, taking into account free trade agreements (FTAs) and other preferential trade agreements (PTAs). Again, the tables confirm the gradual character of trade liberalisation in FSU economies, with several reversals. Nevertheless, the average level of tariff barriers is relatively modest compared to other emerging-market and developing economies.

Table 5: MFN import tariff rates on non-agricultural and non-fuel products, annual, weighted average, in %

Country	1997	2002	2008	2012	2015	2020
Armenia		1.9[b]	2.9	3.3	4.6	5.1
Azerbaijan		6.9	5.5	6.1	6.2	7.7
Belarus	11.0	10.2	8.6	7.1	5.2	5.1
Georgia		8.4	0.3	1.2	1.0	0.9
Kazakhstan			4.0	7.8	5.0	4.0
Kyrgyzstan		7.1	3.3	4.3	5.9	5.2
Moldova	2.3[a]	2.9[b]	3.3	3.3	4.2	3.9
Russia	11.5	10.0	9.0	6.7	4.6	4.5
Tajikistan			7.1c	8.1	5.5	8.1
Ukraine	5.1	6.2	6.5	3.3	3.1	3.5
Uzbekistan		6.2[b]	12.1	11.2	8.4	-

Table 6: Effectively applied import tariff rates on non-agricultural and non-fuel products, annual, weighted average, in

Country	1997	2002	2008	2012	2015	2020
Armenia		1.9[b]	2.5	2.9	3.4	3.6
Azerbaijan		6.9	3.9	4.8	5.1	6.2
Belarus	11.0	10.2	4.3	3.6	2.5	2.2
Georgia		8.4	0.1	0.4	0.2	0.0
Kazakhstan			2.4	4.1	4.6	2.0
Kyrgyzstan		7.1	2.7	3.6	3.7	2.7
Moldova	2.3[a]	2.9[b]	2.6	2.7	3.4	1.1
Russia	11.5	10.0	8.4	5.6	2.9	4.0
Tajikistan			4.7[c]	7.0	4.7	7.0
Ukraine	5.1	6.2	5.3	2.7	2.5	1.9
Uzbekistan		6.2[b]	9.1	8.4	8.4	-

Source for both tables: https://unctadstat.unctad.org/wds/TableViewer/tableView.aspx. Notes : a – 1996 ; b – 2001 ; c – 2006.

Non-tariff barriers (NTBs) often impose higher costs to trade than tariffs, especially in countries with rule-of-law deficits and high corruption. Unfortunately, only a few comparative studies, published some time ago, have tried to quantify the NTB level in the FSU region. For example, Taran (2008) found a high frequency of NTBs, especially in the agriculture sector, with the overall burden for importers higher than that from import tariffs. Among five countries compared in 2004, Russia and Kazakhstan had the highest frequency of NTBs, while Belarus has a medium frequency, and Kyrgyzstan and Ukraine had low frequencies.

4.3 Economic integration

On 8 December 1991, during the trilateral summit in the Belovezha Forest in Belarus, leaders of Belarus, Russia and Ukraine decided to dissolve the USSR and replace it with the international organisation called the Commonwealth of Independent States (CIS). On 21 December 1991, during the Almaty summit, eleven Soviet republics (except the Baltic states and Georgia) confirmed the decision to dissolve the USSR and join the CIS. The CIS was originally to serve as the area of free movement of goods, services, people and capital, a forum of cooperation in various areas of domestic and foreign policy, and a guarantee of fulfilment of the external obligations of the former USSR[8]. The multilateral FTA and free-of-visa movement of people were the fundamental economic mechanisms of this integration bloc.

However, in the subsequent decades, the CIS gradually eroded because of geopolitical tensions in the region, various

8 See https://cis.minsk.by/page/174.

speeds and models of economic reform, and the joining of other integration projects. Turkmenistan never participated actively in CIS. In 2005, it declared its interest in associate member status. Georgia, which joined the CIS in December 2003, left in August 2009 after the Russian military intervention a year earlier. Ukraine, which never ratified the CIS Charter (similarly to Turkmenistan), but which actively participated in CIS activities, left the CIS in 2018 in response to Russia's annexation of Crimea and support for the separatist movement in Donbas. The visa-free multilateral framework was partly revoked because of various bilateral conflicts and partially replaced by bilateral visa-free agreements. The FTA was also undermined by unilateral trade sanctions (in most cases, imposed by Russia on its CIS partners[9]), and was partly superseded by deeper integration projects such as the Eurasian Economic Union (EAEU, see below).

Looking back, the CIS helped ensure a largely peaceful political dissolution of the USSR in the first half of the 1990s, and limited the negative trade shock from establishing economic borders between FSU countries. The latter could not be avoided totally because of the dissolution of the Soviet ruble area, various speeds and models of economic reform, and the divergence of national legal frameworks. It is also worth remembering that the division of labour and trade links within the USSR originated from the arbitrary decisions of central planning authorities, instead of microeconomic choices based on profit-maximisation. These decisions had to be corrected, and they were indeed corrected when the market transition started.

9 Revoking of the bilateral FTA with Ukraine by Russia on 1 January 2016, as Russia's reaction to the entry into force of the EU-Ukraine Association Agreement, is the most serious example of such sanctions.

In addition to the CIS, Russia and a few other FSU countries (mainly Belarus and Kazakhstan) tried to form a deeper integration bloc. The first such attempt, the Eurasian Economic Community (EurAsEC), founded in 2000 by Belarus, Kazakhstan, Kyrgyzstan, Russia and Tajikistan[10], aimed to create a customs union and a Single Economic Space. However, the integration process went slowly and was finalised only at the beginning of 2015, with the creation of a new organisation, the EAEU, formally replacing the EurAsEC. The EAEU has five members: Armenia, Belarus, Kazakhstan, Kyrgyzstan and Russia.

The EAEU is a deeper integration bloc than the CIS and EurAsEC, trying to follow the experience of the EU. However, it faces several problems of both an economic and political nature.

First, its external tariffs and NTBs are higher than in the EU. Therefore, its potential for trade-diversion effects is more extensive. It is not helpful for emerging-market economies that need imported technology and intense external competition to speed up modernisation processes. For Armenia, Kazakhstan and Kyrgyzstan, joining the EAEU required increasing their import tariffs, and for Armenia and Kyrgyzstan it required renegotiating their earlier WTO commitments.

Second, the uneven pace of economic reforms does not help in constructing the Single Economic Space. This in particular concerns Belarus, the least advanced in building a market system. Nor has Belarus joined the WTO yet.

Third, Russia's aggression against Ukraine in 2014-2015 and 2022 have undermined the EAEU in many ways. The Western sanctions against Russia and Russian countersanctions have

10 Uzbekistan belonged to EurAsEC between 2005 and 2008.

paralysed a substantial part of the trade of the most prominent EAEU member. In 2022, the Western sanctions also hit Belarus, which helped Russia in its invasion of Ukraine. Other EAEU members are unaffected by sanctions and have not joined Russia's countersanctions. They also did not join Russia's trade sanctions against Ukraine in 2016 (see above). All these 'asymmetries' have undermined a common trade policy, a basic foundation of a successful customs union.

Fourth, the increasing international isolation of Russia limits the chances that the EAEU will be able to conclude PTAs with third countries.

Fifth, asymmetry in the economic and political potential of EAEU does not help build up partnership relationships between them, especially in the context of Russia's aggressive regional policies. Russia's territory, population, GDP and military potential exceed by several times the next largest partner, Kazakhstan.

As well as participating in regional-integration projects, eight FSU countries joined the WTO between 1998 and 2015 (Table 7). The remaining four countries (Azerbaijan, Belarus, Turkmenistan and Uzbekistan) have observer status and are conducting accession negotiations. However, only Uzbekistan is trying to advance these negotiations and to adopt the legislative measures required to complete the accession process.

Table 7: Dates of WTO accession

Country	Date of accession
Kyrgyzstan	20 December 1998
Georgia	14 June 2000
Moldova	26 July 2001
Armenia	05 February 2003
Ukraine	16 May 2008
Russia	22 August 2012
Tajikistan	02 March 2013
Kazakhstan	30 November 2015

Source: https://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm.

The Partnership and Cooperation Agreements (PCAs) and Interim Trade Agreements signed between the EU and FSU countries in the 1990s established the MFN principle in bilateral trade, even before the WTO accession of those FSU countries. In 2014, Georgia, Moldova, and Ukraine signed Association Agreements with the EU, which included provisions on Deep and Comprehensive Free Trade Areas covering the EU and the respective countries. When fully implemented, the Deep and Comprehensive Free Trade Area will offer these three countries partial access to the EU single market.

After Russia invaded Ukraine, the European Council in June 2022 granted Moldova and Ukraine EU candidate status[11], leaving the door open to a potential similar decision concerning Georgia at a later date, subject to meeting specific conditions (Dabrowski, 2022c). This gives the three countries a chance of full integration with the EU single market.

11 See European Council conclusions of 23 and 24 June 2022, https://www.consilium.europa.eu/media/57442/2022-06-2324-euco-conclusions-en.pdf.

5 PRIVATISATION

As mentioned in section 2, the Soviet economic model was based almost exclusively on the state and collective[12] ownership of means of production, with a few exceptions, such as household plots in agriculture (formally, these plots remained part of *kolkhozes* or *sovkhozes* (state-owned farms) but were only used privately). Hence, the post-communist transition had to include the rebuilding of private ownership and entrepreneurship. To achieve this goal, various avenues of ownership change had to be considered: the creation of new domestic private firms (see section 4.1), green-field foreign direct investment (FDI), restitution of private property rights from the pre-communist era (re-privatisation), privatisation of housing, privatisation of land and privatisation of state-owned enterprises (SOEs).

Restitution of pre-communist property rights for housing, agriculture, residential land and small factories, practised in most of central and eastern Europe, including the Baltic countries (Kozminski, 1997), was not a practical option for FSU

12 In practice, collective enterprises, for example, kolkhozes in agriculture and retail cooperatives, did not differ from state-owned enterprises in terms of property rights or management regimes.

countries, given the more than seventy years of the communist regime and the devastating consequences of the civil war of 1918-1921, Stalinist collectivisation and terror, and the Second World War (the Great Patriotic War in the Soviet and Russian narrative).

Privatisation of land, especially in agriculture, and the participation of non-residents in this process met political obstacles. In several FSU countries, unrestricted privatisation of agricultural land, including free trading of land, has not been allowed or has been permitted only with considerable delay (Lerman, 2017). For example, it took until March 2020 for the Ukrainian parliament (Verkhovna Rada) – under IMF pressure – to adopt a law that partially lifted the moratorium on the sale of agricultural land, which had been in place since 2001. A new law entered into force in July 2021. Given the existing restrictions on land ownership and trading, long-term land leasing (*arenda*) continues to be a widespread form of agricultural land use.

On the contrary, housing privatisation was carried out relatively quickly at the beginning of the 1990s (Struyk and Daniell, 1995; Broulikova and Montag, 2020).

Privatisation of SOEs could be conducted in various ways: initial private offerings (IPO), sales to strategic investors (domestic or foreign), joint ventures with foreign firms, employee and management buyouts (often leveraged), voucher/coupon privatisation, and sales of the assets of those SOEs, which either went bankrupt or were closed down. The last method prepared the ground for the so-called small-scale privatisation.

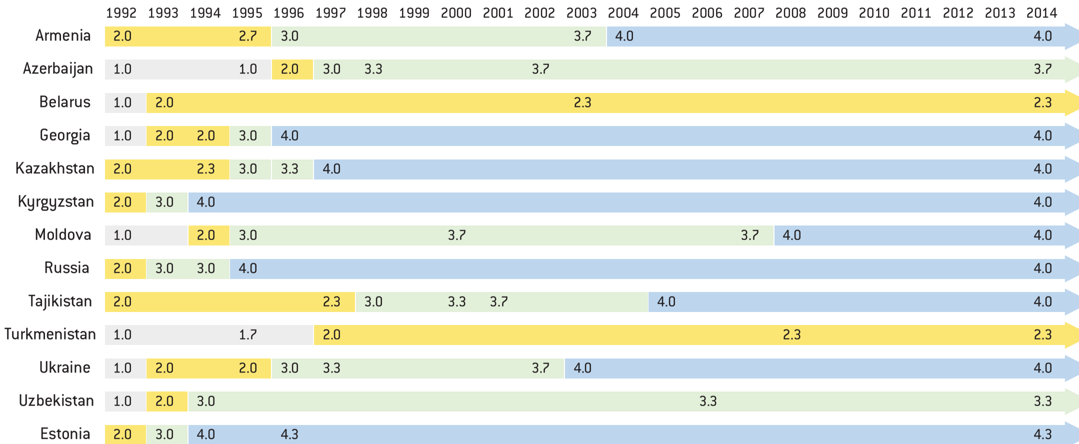
FSU countries adopted various privatisation strategies. Concrete privatisation methods were determined by each country's structural and institutional legacy, political-economy considerations and policymakers' preferences.

Some privatisation schemes were challenging to apply in the early stages of the transition for technical and institutional reasons. IPOs, for example, were difficult because of the non-existence or institutional infancy of the stock market. The widespread reservation about foreign investors, combined with their risk aversion, limited the possibilities for involving them in purchases of controlling packages of shares of privatised enterprises, or for forming joint ventures, at least at the beginning. The delayed macroeconomic stabilisation and resulting high inflation (see section 3) made the correct valuation of privatised firms difficult.

In such an institutional and macroeconomic environment, in most FSU countries, the priority was given to a combination of a voucher method and heavily leveraged employee/management buyouts. However, small-scale privatisation also significantly impacted retail trade and services (Figure 8). Overall, it progressed faster than large-scale privatisation, that is, privatisation of large and medium-sized enterprises (Figure 9). In both cases, the speed of ownership changes was slower than in Estonia, chosen in this analysis as a benchmark case of rapid economic transition (see Figures 8 and 9). It was also slower than domestic and external liberalisation (Tables 6 and 7), a phenomenon observed in other transition economies. Privatisation is a more complex and time-consuming process than liberalisation.

Kyrgyzstan, Russia, Georgia and Kazakhstan advanced small-scale privatisation in the mid-1990s and became leaders in the FSU region. Ukraine, Armenia, Tajikistan and Moldova joined the leader group later – in the early and mid-2000s. In Turkmenistan and Belarus, small-scale privatisation did not take off until 2014, the last year of the EBRD ranking. All FSU countries lagged behind Estonia.

Figure 8: EBRD indicator of small-scale privatisation (1.0 - 4.3), 1992-2014



Source: https://www.ebrd.com/sites/Satellite?c=Content&cid=1395245467784&d=&pagename=EBRD%2FContent%2FDownloadDocument.
Notes: 1 = little progress, 2 = substantial share privatised, 3 = comprehensive programme almost ready for implementation, 4 = complete privatisation of small companies with tradable ownership rights, 4.3 = standards and performance typical of advanced industrial economies: no state ownership of small enterprises; effective tradability of land. For cell fill colours, see note to Table 6.

Figure 9: EBRD indicator of large-scale privatisation (1.0 - 4.3), 1992-2014

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Armenia	1.0			2.0	3.0						3.3			3.7									3.7
Azerbaijan	1.0					2.0		1.7		2.0													2.0
Belarus	1.0	1.7			1.0												1.7						1.7
Georgia	1.0			2.0	3.0	3.3								3.7		4.0							4.0
Kazakhstan	1.0	2.0			3.0																		3.0
Kyrgyzstan	2.0		3.0										3.7										3.7
Moldova	1.0	2.0		3.0																			3.0
Russia	2.0	3.0				3.3								3.0									3.0
Tajikistan	1.0			2.0				2.3															2.3
Turkmenistan	1.0					2.0	1.7			1.0													1.0
Ukraine	1.0			2.0		2.3			2.7	3.0													3.0
Uzbekistan	1.0		2.0	2.7																			2.7
Estonia	1.0	2.0	3.0	4.0																			4.0

Source: https://www.ebrd.com/sites/Satellite?c=Content&cid=1395245467784&d=&pagename=EBRD%2FContent%2FDownloadDocument.
Notes: 1 = little private ownership, 2 = comprehensive scheme almost ready for implementation; some sales completed, 3 = more than 25 percent of large-scale enterprise assets in private hands or in the process of being privatised (with the process has reached a stage at which the state has effectively ceded its ownership rights), but possibly with major unresolved issues regarding corporate governance, 4 = more than 50 percent of state-owned enterprise and farm assets in private ownership and significant progress with corporate governance of these enterprises, 4.3 = standards and performance typical of advanced industrial economies: more than 75 percent of enterprise assets in private ownership with effective corporate governance. For cell fill colours, see note to Table 6.

Slow progress is even more clearly seen in the case of large-scale privatisation (Figure 9). Only Georgia advanced in this process to the same degree as Estonia (a score of 4.0). However, change in Georgia happened more than a decade later than in Estonia, in the second half of the 2000s. Kyrgyzstan and Armenia were close to Georgia's record (scores of 3.7). They were followed by Russia, Moldova, Kazakhstan and Ukraine (scores of 3.0).

Russia is an interesting case because it started its mass-privatisation programme in 1992 and by the the second half of the 1990s and early 2000s had become a privatisation leader in the FSU region (a score of 3.3). However, after the politically motivated crackdown on Yukos, the largest Russian oil company, and its forced takeover by the state-owned Rosneft in 2003-2005[13], Russia's score decreased to 3.0. At the other end of the ranking spectrum, one can find Turkmenistan (1.0), Belarus (1.7) and Azerbaijan (2.0).

Quantitative results from the various avenues of ownership change can be summarised by changes in the private-sector contribution to GDP in the 2000s (EBRD estimates, Table 8). They are broadly in line with the earlier analysed processes of small- and large-scale privatisation (Figures 8-9). In 2010, the private-sector share of GDP reached 75 percent in Armenia, Azerbaijan, Georgia and Kyrgyzstan, 65 percent in Kazakhstan, Moldova and Russia, 60 percent in Ukraine, 55 percent in Tajikistan, 45 percent in Uzbekistan, 30 percent in Belarus, and 25 percent in Turkmenistan. The high share of the private sector in Azerbaijan, despite low scores on small- and large-scale

13 For details, see UNCTAD Investment Policy Hub, available at https://investmentpolicy.unctad.org/investment-dispute-settlement/cases/213/yukos-universal-v-russia.

privatisation, can be attributed to greenfield FDI in the oil and natural gas sector.

Table 8: Private sector shares of GDP, in %, 2004-2010

Country	2004	2005	2006	2007	2008	2009	2010
Armenia	75.0	75.0	75.0	75.0	75.0	75.0	75.0
Azerbaijan	60.0	60.0	60.0	75.0	75.0	75.0	75.0
Belarus	25.0	25.0	25.0	25.0	30.0	30.0	30.0
Georgia	65.0	65.0	70.0	75.0	75.0	75.0	75.0
Kazakhstan	65.0	65.0	65.0	70.0	70.0	70.0	65.0
Kyrgyzstan	75.0	75.0	75.0	75.0	75.0	75.0	75.0
Moldova	55.0	60.0	65.0	65.0	65.0	65.0	65.0
Russia	70.0	65.0	65.0	65.0	65.0	65.0	65.0
Tajikistan	50.0	55.0	55.0	55.0	55.0	55.0	55.0
Turkmenistan	25.0	25.0	25.0	25.0	25.0	25.0	25.0
Ukraine	65.0	65.0	65.0	65.0	65.0	60.0	60.0
Uzbekistan	45.0	45.0	45.0	45.0	45.0	45.0	45.0
Estonia	80.0	80.0	80.0	80.0	80.0	80.0	80.0

Source: www.ebrd.com/downloads/research/economics/macrodata/sci.xls.

Interestingly, the EBRD estimates in three countries suggest a reversal of the earlier privatisation progress. In Russia, this resulted from the crackdown on Yukos in 2003-2005 mentioned above, and the government's bailout of distressed financial and non-financial corporations during the GFC. Similar bailouts were provided by the governments of Ukraine and Kazakhstan between 2008 and 2010.

After 2010 (the last year of the EBRD estimates), the renationalisation process in Russia continued, so by the end of

2010s, the private-sector contribution to GDP had shrunk to approximately 50 percent (Abramov and Radygin, 2023). On the other hand, the share of the private sector in GDP most likely increased in Belarus and Uzbekistan, as a result of ownership changes implemented in the second half of the 2010s.

A qualitative assessment of privatisation results is even more complicated than the quantitative one. Figure 10 shows limited progress in corporate governance and enterprise restructuring. The best scores (2.3), recorded in 2014 by Armenia, Georgia, Russia and Ukraine, meant moderately hard budget constraints, weak enforcement of bankruptcy legislation and few changes in corporate governance. Other FSU countries accomplished even less impressive results.

Disappointing governance and restructuring scores reflect not only weaknesses of the privatisation process in the FSU countries, such as the long periods of diluted ownership resulting from the adoption of voucher methods and preferences for employees and managers, and limited participation of foreign investors. It is also a result of delayed and incomplete macroeconomic stabilisation and liberalisation (see section 4), lack of upfront de-concentration and de-monopolisation of large sectoral and branch trusts and companies, and the rule of law deficit (see section 6).

Nevertheless, most empirical research demonstrates that even imperfect privatisation was better than no privatisation (see Megginson and Netter, 2001).

Figure 10: EBRD indicator of governance and enterprise restructuring (1.0 - 4.3), 1992-2014

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Armenia	1.0			2.0							2.3												2.3
Azerbaijan	1.0			1.7								2.0											2.0
Belarus	1.0			1.7		1.0											1.7						1.7
Georgia	1.0			2.0										2.3									2.3
Kazakhstan	1.0				2.0																		2.0
Kyrgyzstan	1.0		2.0																				2.0
Moldova	1.0		2.0									1.7											2.0
Russia	1.0		1.7	2.0				1.7	2.0	2.3													2.3
Tajikistan	1.0						1.7											2.0					2.0
Turkmenistan	1.0					1.7			1.0														1.0
Ukraine	1.0			2.0														2.3					2.3
Uzbekistan	1.0			2.0					1.7														1.7
Estonia	2.0	3.0								3.3				3.7									3.7

Source: https://www.ebrd.com/sites/Satellite?c=Content&cid=1395245467784&d=&pagename=EBRD%2FContent%2FDownloadDocument.
Notes: 1 = soft budget constraints, few other reforms to promote corporate governance; 2 = moderately tight credit and subsidy policy, but weak enforcement of bankruptcy legislation and little action taken to strengthen competition and corporate governance; 3 = significant and sustained steps to harden budget constraints and to promote corporate governance effectively; 4 = substantial improvement in corporate governance and significant new investment at the enterprise level, including minority holdings by financial investors, 4.3 = standards and performance typical of advanced industrial economies: effective corporate control exercised through domestic financial institutions and markets, fostering market-driven restructuring. For cell fill colours, see note to Table 6.

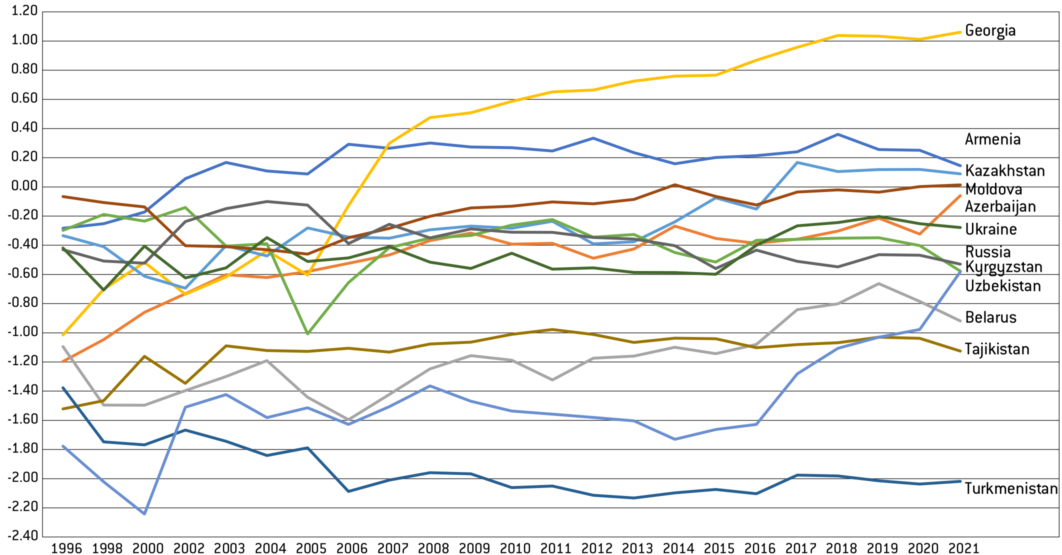
6 INSTITUTIONS AND GOVERNANCE

Measuring institutional progress is even more difficult than measuring progress in liberalisation and privatisation. Practically all available indices are based on the opinions and judgments of experts and practitioners, and have a subjective character, by definition.

Our analysis concentrates on the World Bank's Worldwide Governance Indicators (WBWGI), which provide a systematic evaluation of governance quality dating back to 1996, according to a harmonized methodology, comparable cross-country and over time[14].

14 Some other popular surveys suffer from frequent methodological changes, which complicate dynamic analysis for a longer period of time.

Figure 11: Worldwide Governance Indicators: regulatory quality, 1996-2021



Source: https://databank.worldbank.org/reports.aspx?source=worldwide-governance-indicators#.

The WBWGI is a composite index that summarises various aspects of a governance system. It presents scores in six categories: control of corruption, government effectiveness, political stability and absence of violence/terrorism, regulatory quality, rule of law, voice and accountability, on a scale from +2.5 (good governance) to -2.5 (poor governance). It is based on a broad definition of governance as "... *the traditions and institutions by which authority in a country is exercised*"[15]. More specifically, the concept of governance includes "... *the process by which governments are selected, monitored and replaced; the capacity of the government to effectively formulate and implement sound policies; and the respect of citizens and the state for the institutions that govern economic and social interactions among them*".

We analyse the evolution in scores in four categories – regulatory quality, rule of law, voice and accountability, and control of corruption – between 1996 and 2021.

On average, the governance scores of FSU countries look relatively poor. In most cases, they are in negative territory. Compared with Estonia (not included in Figures 11-13 for readability), they are worse by at least 1 point (in the case of FSU leaders in their best years), but in other instances by a wider margin.

In the category of regulatory quality (Figure 11), Georgia is an undisputable leader. It has demonstrated systematic improvement in its scores since 2005, which can be attributed to the consequences of the so-called Rose Revolution in 2003. Armenia, Kazakhstan and Moldova are next; these are the only FSU countries with scores above zero. Kazakhstan and

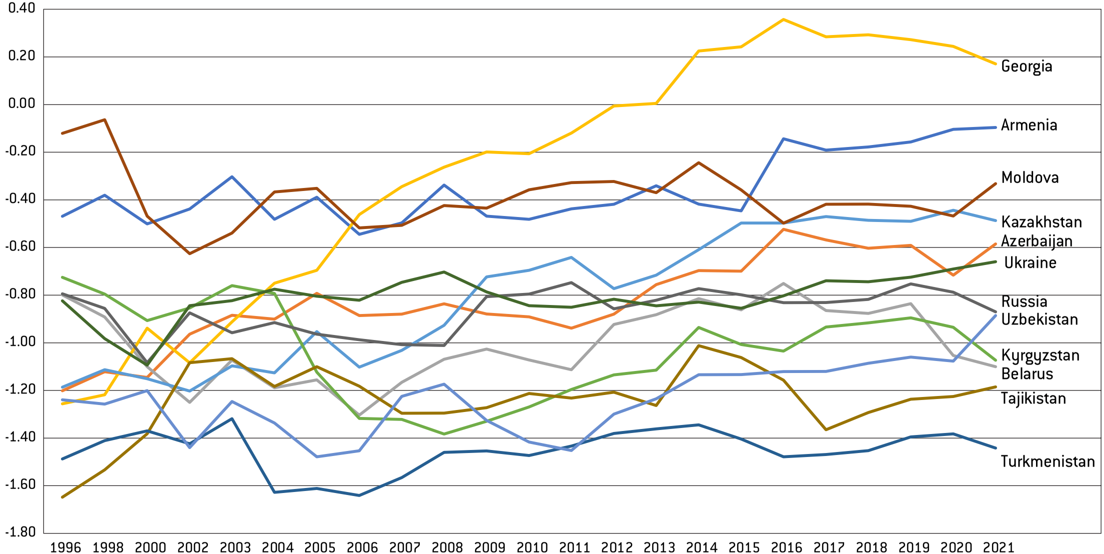
15 Daniel Kaufmann, Aart Kraay and Massimo Mastruzzi, 'Governance Matters 2009: Learning From Over a Decade of the Worldwide Governance Indicators', op-ed, *Brookings*, 29 June 2009, https://www.brookings.edu/opinions/governance-matters-2009-learning-from-over-a-decade-of-the-worldwide-governance-indicators/

Moldova have shown some improvement since the mid-2000s. The performance of Armenia has stagnated or, since 2018, even deteriorated.

Among the laggards, Uzbekistan has demonstrated a visible improvement since 2016. On the other hand, Kyrgyzstan records considerable fluctuations, with a substantial drop in its scores in the second half of the 2000s and their gradual rebuilding through the next decade. The score of Russia and Turkmenistan have deteriorated steadily. Turkmenistan is the worst performer in the analysed group.

The rule-of-law scores (Figure 12) provide a similar picture, although only Georgia has been in the 'positive' territory (scores above zero) since 2014. However, its score has started to slide since 2018, after several years of rapid improvement. Similarly to regulatory quality, Armenia, Moldova and Kazakhstan rate next best. The worst performers are Turkmenistan, Tajikistan, Belarus and Kyrgyzstan (below -1.0). Uzbekistan, which belonged to this group for quite a long time, has systematically improved its scores since 2012.

Figure 12: Worldwide Governance Indicators: the rule of law, 1996-2021



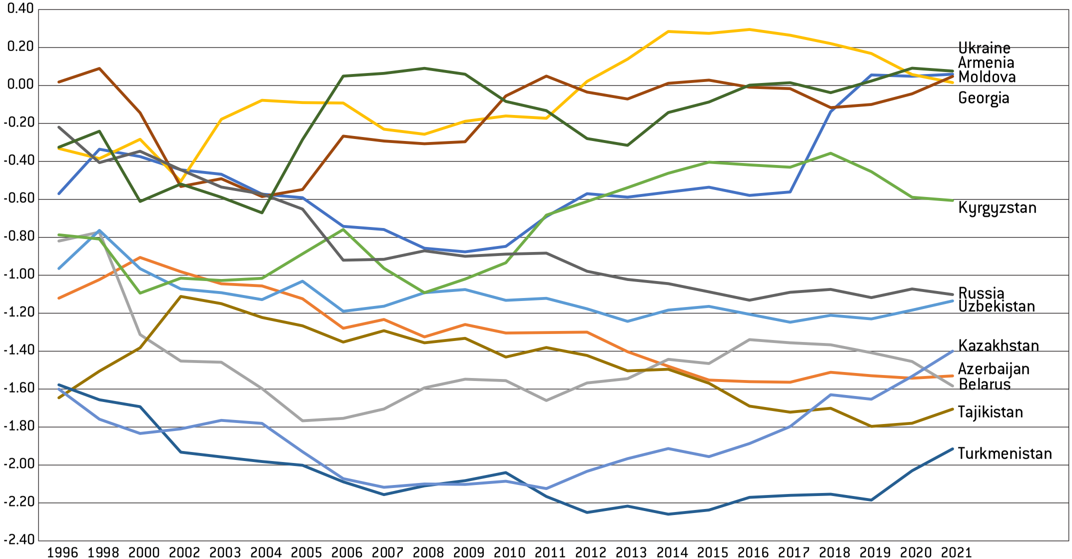
Source: https://databank.worldbank.org/reports.aspx?source=worldwide-governance-indicators#.

In the voice and accountability category, which is a proxy for the level of democratisation and political freedom (Figure 13), four countries (Georgia, Armenia, Moldova and Ukraine) hover around zero, with significant fluctuation over time. They are followed by Kyrgyzstan, for which a moderately good score has deteriorated since 2019. The scores of Russia, Kazakhstan, Azerbaijan, Tajikistan and Turkmenistan have continuously declined since the survey started in 1996. Among the laggards, only Uzbekistan has recorded some improvement since 2012. The scores of Belarus show a lot of fluctuation in the analysed period, but it has always remained at the bottom of this ranking.

The picture in Figure 13 is in line with the results of Freedom House's rankings (see below) and other democratisation and political freedom surveys.

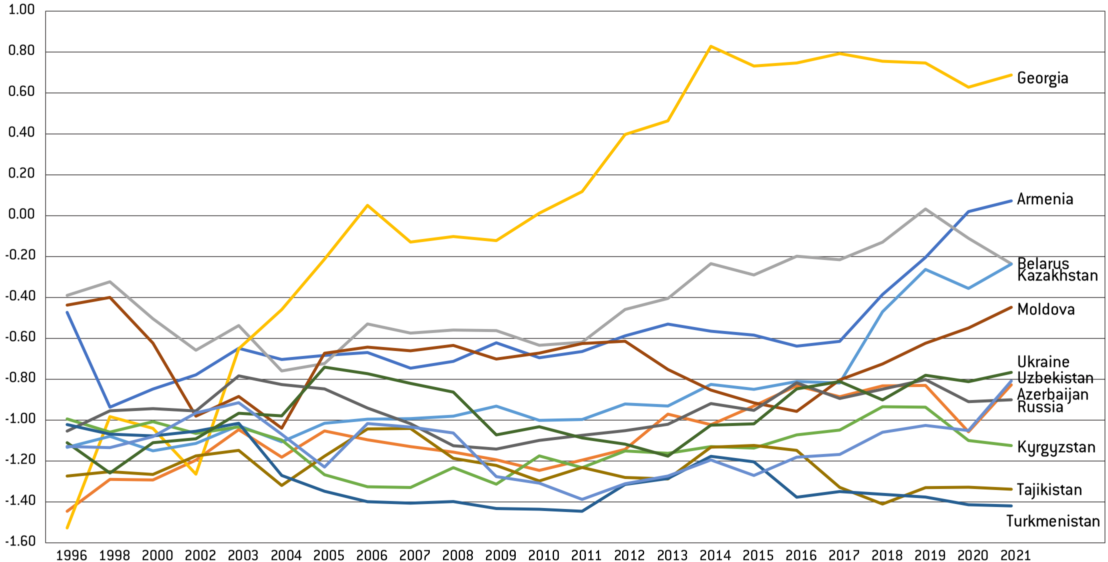
Georgia is the only country with a positive score (above 0) in the control of corruption category (Figure 14), clearly outperforming other FSU countries. Armenia, Belarus, Kazakhstan and Moldova rank next, showing some improvement in the 2010s. The scores of the remaining seven countries are most recently between -0.80 and -1.40. Ukraine and Uzbekistan showed moderately positive trends in the second half of the 2010s. Turkmenistan and Tajikistan are at the very bottom of the analysed ranking.

Figure 13: Worldwide Governance Indicators: voice and accountability, 1996-2021



Source: https://databank.worldbank.org/reports.aspx?source=worldwide-governance-indicators#.

Figure 14: Worldwide Governance Indicators: control of corruption, 1996-2021



Source: https://databank.worldbank.org/reports.aspx?source=worldwide-governance-indicators#.

The analysis of the WBWGI provides a picture of oversized and overcentralised government in most FSU countries, except perhaps Georgia. Such governments interfere with business activity and the private life of citizens, which is reflected in low scores for economic freedom and civil liberties (see below). However, it cannot provide essential public goods such as public security, property rights and civil rights protection, or sufficient technical and social infrastructure.

The Soviet institutional legacy seems to remain strong, despite far-reaching reform and legislative efforts in the 1990s and 2000s, often with the assistance of international financial and development institutions including the IMF, World Bank, EBRD and Asian Development Bank (ADB), other bilateral and multilateral donors and non-governmental organisations.

Overregulation, oppressive criminal codes and the ambiguous content of many laws allow public administrations and law-enforcement agencies to interpret and enforce rules arbitrarily. This leads to frequent abuse of power for personal benefit, and to administrative harassment and extorting of money and assets from private businesses. The business community often calls it state racketeering.

As a result, the business and investment climate in most FSU countries is not considered favourable by the business community, as shown by, among others, the Heritage Foundation Index of Economic Freedom (HFIEF). This is a composite index, an average of 12 detailed indices, grouped into four categories: the rule of law (property rights, judicial effectiveness and government integrity), government size (tax burden, government spending and fiscal health), regulatory efficiency (business freedom, labour freedom and monetary freedom) and open markets (trade freedom, investment freedom and financial freedom). The composite index is estimated on a scale from 0 to 100. Countries with scores above 80 are ranked as 'free,' between 70 and 80 as 'mostly free,' between 60 and 70 as 'moderately free,' between 50 and 60 as 'mostly unfree,' and below 50 as 'repressed.'

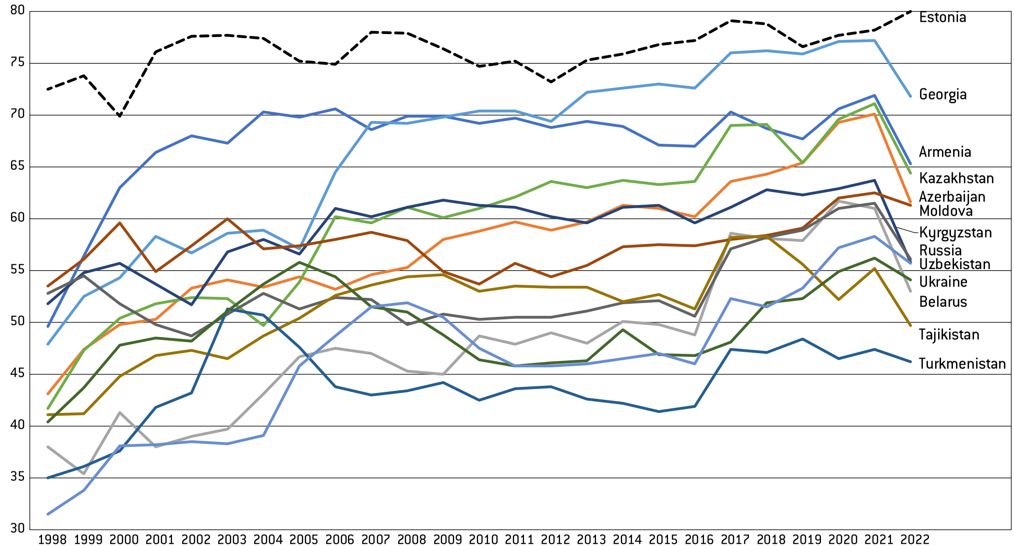
Figure 8 shows that although FSU countries improved their ratings on average between 1998 and 2020, most have remained either in the 'mostly unfree' or 'repressed' group. Only Georgia has belonged to the 'mostly free' group since 2009, while Armenia, Kazakhstan and Azerbaijan found themselves in this group occasionally. However, all four systematically underperform compared to Estonia, a comparator country in our analysis. Armenia and Kazakhstan were rated 'moderately free' during most of the analysed period, as were Kyrgyzstan, Moldova, Russia and Belarus. The scores of all FSU countries deteriorated in 2021, probably because of restrictions related to the COVID-19 pandemic.

The Russian aggression against Ukraine, which started on 24 February 2022, caused a further dramatic deterioration of the business and investment climate in the entire FSU region – not yet reflected in the HFIEF and other international surveys. The decline is evident in Ukraine, the victim of the conflict, and Russia and Belarus (the aggressors, who have become the subject of international sanctions). However, other FSU countries are also perceived as belonging to the zone of increased security and geopolitical risk.

Table 9 presents the disaggregation of the HFIEF 2021, which assesses the degree of economic freedom in 2020. Even in the best performers of Georgia, Armenia, Azerbaijan and Kazakhstan, the scores for government integrity, judicial effectiveness and property rights (and in Kazakhstan, also investment freedom) are below the overall scores, sometimes significantly. In other FSU countries, the situation looks much worse.

Unsatisfactory governance and economic freedom scores, and their deterioration in many cases, can be explained by an authoritarian drift in the political systems, which started in the 1990s. This drift is illustrated by Freedom House's Nation in Transit (FHNIT) scores (Figure 16). The FHNIT is another composite index that summarises scores in seven categories: national democratic governance, electoral process, civil society, independent media, local democratic governance, judicial framework and independence, and corruption, on a scale from 0 to 100, defined as the 'democracy percentage'.

Figure 15: Heritage Foundation's Index of Economic Freedom, 0-100, 1997-2021



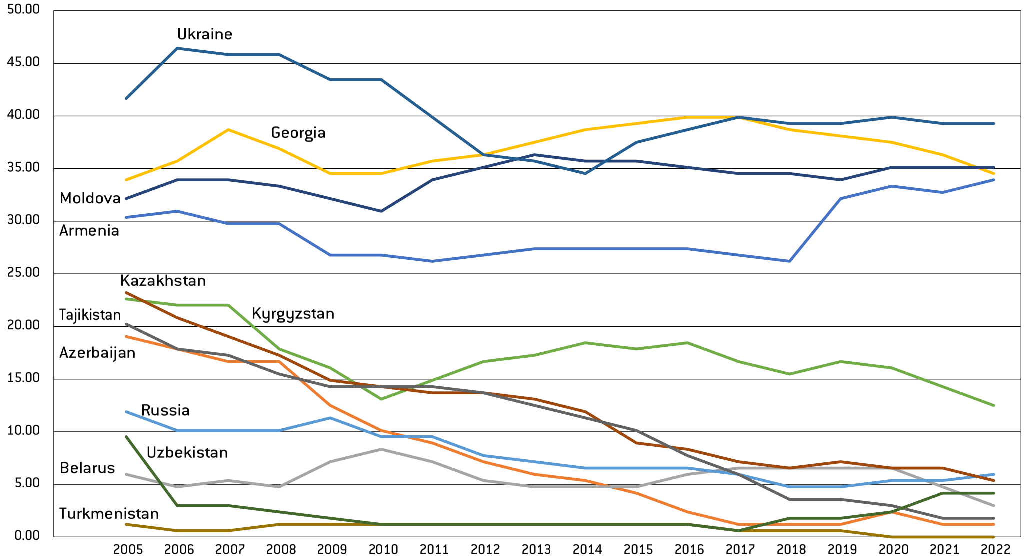
Source: http://redirect.heritage.org/index/explore?view=by-region-country-year&u=638034298287453524. Note: years of survey in the 'X' axis; the HFIEF scores in a given survey year characterise the situation on the ground a year earlier

Table 9: Disaggregation of the Heritage Foundation's Index of Economic Freedom 2021

Country	Global rank	Overall score	Property rights	Government integrity	Judicial effectiveness	Tax burden	Government spending	Fiscal health	Busine ssfreedom	Labour freedom	Monetary freedom	Trade freedom	Investment freedom	Financial freedom
Armenia	32	71.9	57.3	45.0	55.3	87.1	81.3	84.3	81.9	74.5	76.9	73.8	75.0	70.0
Azerbaijan	38	70.1	67.9	46.8	55.8	88.1	65.2	99.4	80.5	65.9	73.2	68.0	70.0	60.0
Belarus	95	61.0	58.6	39.8	40.4	92.9	55.5	96.5	75.9	75.7	70.2	76.0	30.0	20.0
Georgia	12	77.2	66.9	64.6	59.3	89.1	76.9	94.9	84.9	76.7	76.7	86.0	80.0	70.0
Kazakhstan	34	71.1	60.2	44.6	62.8	93.6	86.7	98.3	76.2	86.2	70.0	74.6	50.0	50.0
Kyrgyzstan	78	63.7	46.0	33.7	23.3	94.8	63.8	90.6	72.6	79.5	77.5	72.8	60.0	50.0
Moldova	85	62.5	60.6	38.7	29.9	94.0	71.0	96.5	66.2	39.2	71.5	76.8	55.0	50.0
Russia	92	61.5	54.4	41.7	42.4	93.0	66.1	99.6	84.1	55.4	67.3	74.0	30.0	30.0
Tajikistan	134	55.2	41.6	35.2	48.8	91.9	68.6	75.1	62.3	46.2	68.5	69.6	25.0	30.0
Turkmenistan	167	47.4	27.7	22.0	20.0	92.6	93.2	96.3	30.0	20.0	72.8	74.2	10.0	10.0
Ukraine	127	56.2	48.5	37.9	41.1	88.7	48.2	87.7	63.5	48.7	65.8	79.2	35.0	30.0
Uzbekistan	108	58.3	57.8	30.5	50.8	92.4	79.9	98.3	73.5	61.2	60.3	55.4	20.0	20.0
Estonia	8	78.2	81.8	86.4	80.8	81.0	54.4	99.6	72.7	57.8	79.7	84.0	90.0	70.0

Source: http://redirect.heritage.org/index/excel/2021/index2021_data.xls. Note: the HFIEF 2021 presents an assessment for 2020.

Figure 16: Freedom House's Nation in Transit scores (democracy percentage), 0-100, 2004-2021



Source: https://freedomhouse.org/sites/default/files/2022-04/All_Data_Nations_in_Transit_NIT_2005-2022_For_website.xlsx. Note: years of survey in the 'X' axis; the FHNIT scores in a given survey year characterise the situation on the ground a year earlier.

In terms of the factors that facilitate authoritarian drift in the FSU region, one should point to the dominance of the executive branch of government over the legislative and judicial branches, and the extensive prerogatives of the heads of state. Autocratic leaders were usually elected in more-or-less democratic ways. However, then they gradually dismantled constitutional checks and balances including independent judiciaries, regional autonomy (as in Russia), independent media and civil society organisations (Dabrowski, 2021). Not surprisingly, Armenia, Georgia, Moldova and Ukraine, which were rated 'partly free' in Freedom House's *Freedom in the World 2021* (Repucci and Slipowitz, 2022), departed from the presidential form of government in favour of either a parliamentary-cabinet regime or a mixed system.

Limiting the independence of the legislative and judicial branches of government, and restricting the media and civil society organisations, reduced their capacities to monitor the executive branch. This resulted in the lack of transparency and accountability of the latter. It created fertile ground for special interest groups, rent-seeking and state and business capture by oligarchic groups, and various forms of corruption.

Several comparative cross-country analyses confirm a positive correlation between changes in political and economic systems (Dabrowski, 2021; Bertelsmann Stiftung, 2022). This should not be surprising if one analyses the impact of democratic mechanisms and institutions on the functioning of a market economy (De Haan and Sturm, 2003). Apart from the role of political checks and balances, and the monitoring role of the media and civil society organisations, in limiting the concentration and abuse of political power, the democratic rotation of political elites and their accountability to the electorate may also reduce the incidence of abuses of power, corruption and state capture. Furthermore, civil liberties support and supplement economic freedom. It is hard to imagine the effective functioning and development of a contemporary post-industrial (service-based) economy without the freedoms of movement, expression, speech and assembly, and the right to private property, privacy and equal treatment under the law, among others, and their adequate judicial protection. Autocratic regimes are also less open to the external world (Lundström, 2005), hurting economic and social development.

The invasion of Ukraine in 2022 caused a further tightening of the autocratic regimes in Russia and Belarus by closing down the remaining independent media, further reducing freedom of speech, introducing draconian criminal penalties for opposition activities and opinions, and reducing other civil liberties. The state of war has not helped development of democratic institutions in Ukraine either.

7 RESULTS OF SYSTEMIC TRANSFORMATION: THE GROWTH RECORD

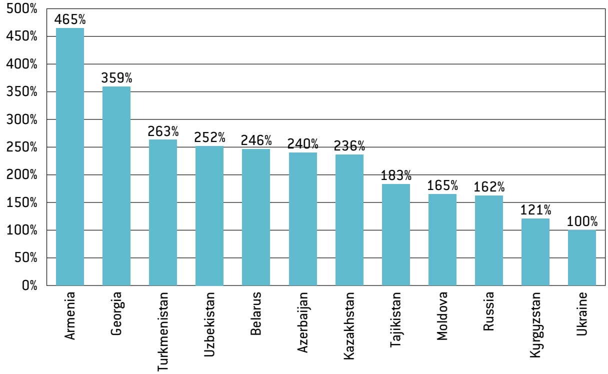
Changes in real GDP *per capita* can serve as a proxy measure of the economic progress accomplished by FSU countries since the dissolution of the USSR, and as a summary result of the reforms put in place. GDP is not an ideal indicator, and is the subject of many conceptual and methodological disputes (see Fleurbaey, 2009), but we do not have anything better to assess socioeconomic development synthetically.

Figure 17 shows cumulative real GDP *per capita* changes measured in 2017 international dollars in purchasing power parity (PPP) from 1992 to 2021. It is the most extended available data series for all FSU countries. It also accounts for uneven population changes across FSU countries: population growth in post-Soviet Central Asia and Azerbaijan, compared to population declines elsewhere.

Unfortunately, there is no data for the former Soviet republics for 1991 and earlier years, so 1992 must serve as the base year. We cannot include the 1989-1991 period, when the Soviet economy had already contracted (see section 2), and the first year of independence (1992) into our estimation of cumulative GDP *per capita* changes. We also leave aside the controversial question of methodological accuracy of GDP statistics in the former USSR (reconstructed *ex post* from the net material product statistics) and in the first years of transition (see Aslund, 2001).

The cumulative growth figures hide a volatile growth dynamic over time. The last years of the Soviet Union and the first years of independence were dramatic in this respect. Output decline started in 1989 (Table 1) and ended only in the late 1990s. Some countries that arrested the economic downturn in the mid-1990s (Kazakhstan, Moldova and Russia) experienced new recessions after the 1998 financial crisis (Dabrowski, 2022a). Overall, the economic decline lasted from four years in Armenia to ten years in Ukraine, and its cumulative depth varied from -18 percent in Uzbekistan to -78 percent in Georgia (Table 10).

Figure 17: Cumulative GDP *per capita* growth 1992-2021, constant prices, PPP, 2017 international dollars, 1992 = 100%



Source: Bruegel based on IMF World Economic Outlook database, October 2022.

On average, the FSU economic decline was longer and more profound than in central Europe and the Baltic states (Table 10). The difference resulted from more difficult starting conditions (more structural and institutional distortions) and macroeconomic imbalances (see sections 2-3), the disintegration of the Soviet economic space (Suesse, 2018), and slow and inconsistent reforms in most of the FSU region (De Melo *et al*, 2001; World Bank, 2002; Havrylyshyn, 2020). Armed conflicts in Moldova, Georgia and Tajikistan, and between Armenia and Azerbaijan, also played negative roles.

The period between the Russian and FSU financial crisis of 1998-1999 and the GFC of 2008-2009 was marked by high growth rates. These could be seen as the delayed positive effect of economic reforms conducted in the 1990s (reallocation of resources towards their more productive use). The FSU region also benefited from the global economic boom and high commodity prices in the early and mid-2000s (section 3).

The GFC resulted in a deep but short (one-year) recession in part of the region. Ukraine recorded the largest annual GDP decline in 2009 (-15.1 percent), followed by Armenia (-14.2 percent), Russia (-7.8 percent), Moldova (-6.0 percent), and Georgia (-3.7 percent). Other FSU economies continued positive growth, although at a slower rate than before the crisis.

Since the GFC, growth has been slower and more volatile than in the early and mid-2000s. It was interrupted by new crises caused by the rapid decline in commodity prices and the negative consequences of Russia's annexation of Crimea and the war in Donbas in 2014-2015, the COVID-19 pandemic in 2020-2021, and the war in Ukraine in 2022 (see sections 3 and 4.2).

Another message from Figure 17 relates to differences in cumulative growth *per capita* in the region.

Table 10: Cumulative decline in real GDP during the transition period, in %, 1990-2000

	Number of years of GDP decline*	Cumulative decline in GDP, %
Armenia	4	63
Azerbaijan	6	60
Belarus	6	35
Estonia	5	35
Georgia	5	78
Kazakhstan	6	41
Kyrgyzstan	6	50
Latvia	6	51
Lithuania	5	44
Moldova	7	63
Russia	7	40
Tajikistan	7	50
Turkmenistan	8	48
Ukraine	10	59
Uzbekistan	6	18
FSU (without Baltics)	6.5	50.5
Central Europe and Baltics	3.8	22.6

Source: World Bank (2002), Table 1.1, p.5. Note: Regional data represent simple arithmetic averages. * = consecutive years.

Two small economies we have referred to as the region's reform leaders – Armenia and Georgia – have recorded the highest cumulative growth figures. Interestingly, they are resource-poor countries. They are followed by three reform laggards (Turkmenistan, Uzbekistan and Belarus), and by Azerbaijan and Kazakhstan. All but Belarus are resource-rich economies. However, Belarus has enjoyed Russian oil and natural gas imports at discount prices, while exporting processed oil products at world prices, thus benefitting over a long period from part of Russian hydrocarbon rents. Furthermore, the quality and international comparability of statistics in three reform laggards that continued with elements of the centralised command system for several years have raised certain doubts[16].

Russia, the largest hydrocarbon producer in the region and one of the world's largest producers, has recorded the third-lowest cumulative growth figure. This was the consequence of the deep output decline in the 1990s and several episodes of macroeconomic turbulence in the subsequent two decades. The crises were caused by global shocks (2008-2009, 2014-2015, 2020) and regional conflicts (the annexation of Crimea, and the war in Ukraine, followed by sanctions and countersanctions; see sections 3 and 4). Analysis of long-term growth factors demonstrates that the shrinking working-age population and declining total factor productivity explain Russia's meagre growth record in the 2010s (Dabrowski, 2019; Voskoboynikov, 2023).

Kyrgyzstan and Ukraine have recorded even worse growth *per capita* figures. In the former, part of the explanation can be attributed to frequent episodes of domestic political

16 Chubrik (2005) suggested that continuation of the command system in Belarus, Turkmenistan and Uzbekistan might lead to overreporting of output. There were also cases of underestimating the GDP deflator (in Belarus). On the other hand, Zettelmeyer (1999), in an econometric analysis of growth factors in Uzbekistan, pointed to country-specific factors such as the low level of industrialisation at the beginning of transition (which explains the relatively modest initial output decline), favourable export conditions for cotton and energy self-sufficiency.

instability (2005, 2010, 2020). The case of Ukraine looks dramatic, with virtually no economic progress recorded over the 30 years of its independence. Interpretation of this unsatisfactory result is, to some extent, similar to Russia's. In the 1990s, Ukraine recorded the longest and one of the most profound output declines in the FSU region (Table 10), partly underpinned by delayed and insufficient economic reforms (Dabrowski, 2017). Later, it was hit by each external shock mentioned above and the consequences of the Russian aggressions of 2014-2015 and 2022. The ongoing war will have further negative implications for the Ukrainian economy and society that cannot be assessed at the time of this writing at the end of 2022.

8 SUMMARY AND CONCLUSIONS

The post-communist transition in the FSU cannot be considered entirely successful, especially in the political and institutional spheres. Nevertheless, in the economic sphere, the transition process succeeded in rebuilding the foundations of market economies based on private ownership by the early 2000s, even if the adopted policies and institutions have proved suboptimal and distortive in many countries.

Of course, the FSU region is not monolithic, and the transition results differ between countries. Estonia, Latvia and Lithuania have been the most successful in building mature, market-oriented economic systems and liberal democracies, and are now European Union and NATO members.

Two Southern Caucasus countries, Georgia and Armenia, have made substantial but less impressive progress (compared to the Baltic states) in economic and institutional areas, sustaining certain degrees of political freedom and democracy. However, they continue to suffer from unresolved territorial conflicts.

The political regimes of Ukraine and Moldova also belong to the 'partly free' group, according to the FHFIW ranking, but their accomplishments in economic and institutional spheres are more questionable. Furthermore, since 2014, Ukraine has become the object of Russian aggression. Moldova has not controlled part of its territory (Transnistria) from the very beginning of its independence.

Among the remaining eight FSU countries, Russia, Kazakhstan and Kyrgyzstan have made substantial progress in economic and institutional reforms in the 1990s and early 2000s. However, progress was subsequently either stopped or even partly reversed. Russia (until 2003) and Kyrgyzstan (1992-1999, 2006-2008, and 2010-2019) were rated in political terms as ‘partly free’ by Freedom House. Kazakhstan belonged to the ‘non-free’ category throughout the entire analysed period.

Azerbaijan and Tajikistan can be considered intermediate cases with delayed and incomplete economic reforms, but poor institutional and political scores (between 1997 and 2002, Azerbaijan enjoyed ‘partly free’ status in the FHFIW ranking). The difference is that while some of Azerbaijan’s liberalisation and economic governance scores have improved over time, Tajikistan’s scores have been systematically downgraded.

Finally, Turkmenistan, Belarus and Uzbekistan can be considered reform laggards. However, Uzbekistan has improved several of its scores since 2012 and has a good chance of a partial catch-up with more advanced reformers if the reform trend is sustained. Belarus has demonstrated a more volatile record with partial political freedom (according to FHFIW criteria) until 1995 and attempts at partial economic reforms in the 2010s. However, the rigged presidential election of August 2020 triggered a new wave of political repression and brought economic reforms to a halt.

Overall, the transition experience in the FSU region has demonstrated a correlation between political and economic reforms, with a strong impact of the former on the latter (Dabrowski, 2022b). The deficits in terms of democracy, civil freedoms and the rule of law have impacted negatively the course of the economic transition, causing significant delay, distortions and partial reversals. Kazakhstan, Azerbaijan and Russia (until 2014) have been partial exceptions from this rule; some market-oriented reforms and prudent macroeconomic policies continued under autocratic regimes. However, they have also demonstrated the limits of market-friendly autocracies.

Natural resources, particularly oil and natural gas, are not always an economic and political blessing in the FSU region. They have allowed economic upgrades and partial modernisation in resource-rich countries. However, they have also helped consolidate autocratic regimes, fuelled corruption and, in some instances, financed aggressive policies against neighbours. The volatility of global commodity prices has been one factor that has magnified external economic shocks (Dabrowski, 2022a). The green transition that the world economy may be on the brink of must be seen as a severe challenge to those FSU countries that rely heavily on producing and exporting hydrocarbon resources.

Any assessment of the results of economic, institutional and political transition in the FSU, and comparison with the transitions in central and eastern European and Baltic countries should take into consideration the role of the so-called external anchors in the reform process (Dabrowski and Radziwill, 2007), especially the future perspective of European integration (Roland, 2002; 2005). While central European and Baltic countries were offered the prospect of EU membership in the early and mid-1990s, and the Western Balkan region in 2003, FSU countries were not considered a potential part of the

EU for a long time. The EU made the political association and Deep and Comprehensive Free Trade Area offer to the European part of the FSU only in 2008-2009. The association agreements between the EU and Georgia, Moldova and Ukraine were signed in 2014. Only in June 2022, after Russia's invasion, did Ukraine and Moldova receive EU candidate status. The future will show whether the prospect of EU membership will help these two countries and Georgia (a potential EU candidate) to accelerate and complete economic, institutional and political reforms.

Instead of the prospect of EU membership, FSU countries have been exposed to changes in Russia's political and economic situation. Because of its territorial and population size, natural resources, economic and military potential, geopolitical role and ambitions, and historical and cultural ties, Russia dominates the FSU region. Other FSU countries have remained dependent on exports to and imports from Russia. For Central Asia and the Southern Caucasus, the main external trade, transportation and transit routes go through Russian territory. Therefore, they may be used easily by Russia as instruments of political pressure.

In 1990-1991, the Russian democratic movement and the first President of the Russian Federation, Boris Yeltsin, were instrumental (perhaps not intentionally) in the dissolution of the USSR and granting independence to all former Soviet republics. Political, institutional and economic reforms in Russia (the latter designed and implemented by the team of young reformers led by Yegor Gaidar), even if slow and incomplete compared to central and eastern European and Baltic countries, were copied by other FSU countries. In many instances, replication came with a time lag and was only partial because of the attachment of local elites to the Soviet political, institutional and economic model. On average, Russia's influence played a positive role in fostering reforms in the FSU region.

The situation started to change in the early and mid-2000s, with the rebuilding of an autocratic system of political power in Russia, and, since 2003, slowing down of economic reform or even partially reversing it. This has been accompanied by a more assertive Russian foreign policy, which has included, among others elements, the weaponisation of trade relations with Russia's neighbours. The Russian 'experience' started to serve as a helpful argument for anti-reform forces in individual FSU countries, particularly for their autocratic leaders. Furthermore, since the military intervention in Georgia in August 2008, Russia has started to be seen in other FSU countries as a challenge to their political and economic independence. This perception was strengthened after Russia's annexation of Crimea in March 2014 and Russia's support for the separatist rebellion in Donbas in 2014-2015. The invasion of Ukraine in February 2022 has further destabilised the entire region politically and economically.

It is hard to imagine that rapid economic growth and democratic and market-oriented modernisation of the FSU region will take place as long as Russia's aggression against Ukraine and its imperial policy towards other neighbours continue. Long-term prospects depend on many conditions and circumstances that are difficult to predict at the time of writing this essay, nearly one year into the Russian aggression against Ukraine. First, when and how will the war in Ukraine end? Second, will the political regime in Russia change and will the country return to the path of political and economic reform?

Third, can Russia stop considering the FSU region as its zone of special interest? Fourth, can FSU countries manage to resolve other territorial conflicts, not related to Russia's influence? Fifth, what will be the impact on the FSU countries of other neighbours, which largely non-democratic (China, Iran and Turkey), and in some cases are failed states (Afghanistan)? Can the societies of the FSU countries push their countries back onto the path of democratic and market transition?

The Western democracies should rethink their strategy of encouraging democratic and market transition in the FSU region, beyond containing aggressive Russian policies and the offers of EU membership for Ukraine, Moldova, and Georgia. Such a strategy might include political and security cooperation, help in resolving territorial conflicts (for example, between Armenia and Azerbaijan), an offer of trade liberalization, development assistance (financial and technical), facilitating less-restricted movement of people, cooperation and exchange in the areas of research, education (more scholarships for FSU students and academics) and culture, and developing transportation infrastructure (to minimise the adverse effects of landlocked locations, an unstable neighbourhood and dependence on transit routes via Russia. The strategy should be tailored to individual countries' specific circumstances and should quickly reward progress in political and economic reform. The wave of initiatives to support post-war reconstruction and transformation of Ukraine is an excellent example of such a comprehensive and holistic approach.

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