What factors have contributed to the significant differences in economic outcomes for former soviet states?

Abstract

The purpose of this research paper is to analyze different indicators of economic growth in the post-soviet space, including the former Soviet Union; the Baltic States: Estonia, Lithuania and Latvia; Central Asia: Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan; the South Caucasus: Armenia, Georgia and Azerbaijan; the Eastern European countries: Ukraine, Belarus and Moldova. After receiving their independence, the post-soviet republics did not follow the same path of economic development. Countries such as Estonia, Latvia and Lithuania displayed a more promising picture of economic progress. Private enterprise became more prosperous in these countries, technological innovation started to develop, specialization was reoriented towards engineering and computer science and the role of bureaucratic systems declined considerably. All these factors made the three Baltic republics comparable to a large extent to other Western economies. This paper proposes and analyses several factors that could have played a significant role in the economic growth of the fifteen republics after the soviet occupancy. In particular, we will analyze the role of regional cooperation, geographical location, history, international aid, intraregional and international trade and economic reformation and discuss the extent to which each of these factors influenced the economics outcomes of the post-soviet countries.

Introduction

More than twenty years have passed since the collapse of the Soviet Union. The year of 1991 was crucial for the fifteen republics, all of which had been under the governance of an oppressive, communist system for more than five consecutive decades. Mikhail Gorbachev, the first president of the Soviet Union, tried to prevent the collapse by issuing the Union Treaty, established with the purpose to save the Union. The legalization of the Union Treaty was stopped by a strong anti-democratic movement in August 1991, followed by the decentralization of the soviet system. The year of 1991 represented a year of liberation for all the countries previously occupied by the Russians; but it also represented a year of radical changes, instability and economic downturn. The collapse of the Soviet Union was followed by a major economic crisis that brought along high levels of inflation, unemployment, poverty and economic chaos. The recession was followed by a period of economic recovery, one that was different for every country. This article will discuss a series of factors that could have caused differences in economic outcomes for former soviet states.
Literature Review

Impact of Regional Integration and Pro-Cooperation Treaties

Analysis of economic outcomes in the post-soviet space has been a subject of interest for many researchers. After the independence, a process of cooperation and regional integration started to take place in the post-soviet space. Countries with common political and economic objectives formed coalitions to surpass the economic chaos and instability caused by the crisis. Zhukov and Reznikova speak about several regional agreements that were formed after the collapse: the Commonwealth of Independent States (CIS), which includes all post-soviet republics except Estonia, Latvia and Lithuania; the Eurasian Economic Community (Russia, Kazakhstan, Belarus Kyrgyz Republic, Tajikistan and Uzbekistan); the United Economic Space (UES—Belarus, Kazakhstan, Russia, and Ukraine); GUAM (Georgia, Ukraine, Azerbaijan, and Moldova); the union state of Belarus and Russia (Reznikova, Zhukov, 2007). Although these pro-integration entities had well-stated goals to ameliorate the economic situation in the post-soviet space, some researchers argue that all these pro-integration attempts were not successful during the economic crisis in the 1990’s (Olcott et al., 1999). One of the possible causes was that during that time, the post-soviet states had biased attitudes towards domestic trade, and this factor blocked and stagnated cooperation initiatives (Fidrmuc and Fidrmuc, 2003; Elborgh-Woytek, 2003, Alexander Libman and Evgeny Vinokurov, 2011).

Geographical Location

Zhukov and Reznikova argue that geographical factors such as the distance to major economic centers of production, topography, climate, and border countries played a significant role in the economic development of the post-soviet republics (Reznikova, Zhukov, 2007). Countries like Armenia, Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan have no access to the sea or to the international trade routes. Moldova, Georgia, Belarus and the Ukraine are surrounded by countries that do not exhibit high economic potential and are still highly dependent on Russia. In the context of geographical indicators, Estonia, Latvia and Lithuania have a comparative advantage. These countries have both access to the Baltic Sea and to the market of developed economies of Northern and Western part of Europe. Due to this fact, these three Eastern European countries have had access to the global world, as a result, their dependency on Russia’s economy considerable decreased over time. Maris G. Martinsons refers to these countries as “the bridge economies between Russia and the West” (Martinsons, 1995). Russia’s trade with the Western part of Europe occurs through the ports located on the Baltic Sea, causing these countries to play an important role as intermediaries for trade. The rest of the post-soviet states share common borders with Russia, a big impediment that limits the access to the world market and international cooperation.
Historical background

Martinsons also argued that favorable economic outcomes of the three post-soviet countries do not depend only on their geographical location, but also on their history and early economic development. Their economic performance is different from that of the other post-soviet countries, partially due to their European heritage but also to a pre-soviet economic growth. Although these countries were already under the Russian influence as early as the end of the 18th century, their economies were not affected by soviet ideologies, taking into consideration that the first Soviet economic model of state feudalism and bureaucracy did not start until 1918 (Raiklin, 2005), the year when Estonia, Latvia and Lithuania first became independent from the Russian Empire (Martinsons, 1995). The first authoritarian soviet model of economic growth lasted for three years, until 1921, and at the time when the bureaucratic systems were first introduced, the Baltic States were developing independently of Russia. These economies were very successful during the interwar period. The three Baltic States registered a period of high economic prosperity: development of private enterprise, expansion of the grey markets, technological innovation, increase in the demand for engineers, making them comparable to developed Western European economies (Martinsons, 1995). Signs of collaboration between the Baltic States started shortly after the 1918. In 1934 Estonia, Latvia and Lithuania signed the Baltic Pact, targeted towards independence, international affairs and cooperation. In 1990 the Baltic Market Co-operation Council and Baltic Executive Commission was created that refortified the principles of the Baltic Pact. Literacy rates and published books per capita placed them in Europe’s top quartile during the 1930s while their percentages of university students topped the entire continent (Bilmanis, 1951). Literacy rates and access to education were much more developed in these countries than in other post-soviet states. Schools adopted the German model of education and the U.S. style business-schools were created. Scandinavian and British governments played an important role in the development of business and entrepreneurship. As we can see, there were several factors that influenced and contributed to the economic development of the Baltic States: their European heritage, an interwar period of economic blooming, cooperation with the Western counterparts, little dependence on Russia, implications from Western and Nordic countries.

International Aid

Patricia Davis and Peter Dombrowski argued that one of the other factors that could have influenced the post-soviet transition was the international aid. In this research, they mention three important economic actors: the United States, Germany and the European Union. Their study debates that provision of foreign aid can be biased, as “donors do not aid all potential recipients equally, they prioritize the countries that receive aid according to strategic, foreign policy, and commercial interests” (Davis, Sombrowski, 2000). The United States issued the Freedom Support Act, through which aid was offered to Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan. When George Bush was the
president of the United States, Russia was the main recipient of US aid. In the following years, under Clinton’s governance, this direction shifted, partially due to the fact that Russia did not see American foreign policies as favorable as they used to. The US shifted gears towards the Ukraine, country that received more aid than the Russian Federation. In the year of 1997, Ukraine received more bilateral assistance than the Russian Federation: $222 million versus $95 million (United States Agency for International Development, 1999). Armenia, Georgia and Kazakhstan were among other countries which benefited from US aid.

Germany had other criteria of distinguishing the newly independent states (NIS)-former communist countries, including the post-soviet republics. Based on their economic performance, they were labeled by Germany as “middle and East Europe” and “Southern Europe”. In the first category we have Russia, Belarus, Ukraine, Poland, Hungary, the Czech Republic, Slovakia, Romania, and Bulgaria. This category was included in the primary assistance program called: “Transform Advising Program”, run by the Foreign Ministry and the Ministry of Economics. The second category included only developing countries: Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, and Uzbekistan. These countries were not included in Germany’s Advising Program, instead, these countries received official economic assistance, administered by the Ministry for Economic Cooperation and Development (Davis, Sombrowski, 2000). Preferred countries for Germany were Russia and Poland. The EU assistance program, known as “TACIS” does not differentiate European and Asian NIS of the Soviet Union. They all, with the exception of Baltic States fall under the same administration in Brussels: the Directorate General for External Relations (DG1A). Again, the biggest portion of the TACIS aid was awarded to Russia.

Intraregional and International Trade

The CIS countries, in comparison with the European Union, had very limited intraregional trade. If in the EU, intraregional trade counted for 56 percent of total exports, for the post-soviet space, intraregional exports were less than 20 percent (Reznikova, Zhukov, 2007). Research studies show that the manufacturing sector of an economy is one of the primary drivers for interregional trade. Manufacturing sectors in the post-soviet space were very weak, a factor that explains why interregional trade was so limited. The most inactive actors in the interregional trade were the GUAM countries, as they had very limited resources to trade with each other. The five countries of Central Asia also registered limited interregional trade, due to a shift in focus on the international trade. Kazakhstan, Russia, Azerbaijan and Turkmenistan shifted their exports of oil and gas to the global economy. Estonia, Lithuania and Latvia traded with their Western counterparts. Estonia’s main trading partners are Sweden, Finland and Germany. China started to play an important role on the markets of Russia and Central Asia.
Economic Reformation in the Soviet Space

Kari Liutho argues in her study on “Entrepreneurial Transition in Post-Soviet Republics: The Estonian Path” that one of the main indicators of economic differences between the post-soviet republics is the adoption of economic and political reforms. Under the oppressive soviet occupancy, all the soviet republics had very limited mobility to adopt and implement reforms to restructure the economic system. Estonia, on the contrary, served as “the economic laboratory of the Soviet Union” (Van Arkadie & Karlson, 1992). Due to the fact that the Soviet Union used Estonia as the center of economic experiments and reformation, entrepreneurship and economic conditions improved, reaching levels of economic growth comparable to its Western counterparts (Liuhto, 121). Private entrepreneurship started to develop under the influence of the workers’ cooperatives. Although entrepreneurship was more developed in Estonia than in any other soviet republics, it did not play a significant role in the economic growth of the country. However, its role in generating a spirit of enterprise cannot be neglected. In 1920, for example, one third of the population was paid by wage while two-thirds were involved in some sort of entrepreneurial ventures.

A crucial period of strong economic reformation in Estonia was the period after World War I, when Estonia, as well as the other soviet republics suffered significant losses and instability. The recuperation process, however, was enhanced by a series of reforms that took place at that time. In 1919, Estonia reinvented its own monetary system, switching from Russian rubles to Estonian marks (Hanson, 1992). The enterprise sector before the independence was primarily concentrated in the hands of the wealthy. During the inter-war period, ownership of enterprises and private cooperatives expanded considerably. Another powerful factor that influenced the economic growth of Estonia was the high level of foreign ownership that already existed at that time. Great Britain was one of the most influential actors in the foreign investment sector. High levels of ownership can also be explained due to the favorable geographic location of Estonia. Liuhto calls Estonia the “gateway connecting Soviet Russia and Western Europe” (Liuhto, 123). After World War II, the Soviet Union played a monopolistic role in the private ownership of the post-soviet space. High levels of bureaucracy impeded the registration of new firms and corporations, owners of the already existent enterprises were persecuted and blamed to take advantage of the state property for their own purposes. Although official private entrepreneurship was restricted by the Soviet power, the unofficial entrepreneurship continued to develop, having a big impact in all regions of the Soviet Space. Estonia was able to develop in spite of all these restrictions and regulations.