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# PACE OF DISINFLATION AND THE DEVELOPMENT OF BUDGET CRISIS IN POST-SOCIALIST ECONOMIES

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***Abstract***

During recent years, almost three dozen countries with different levels of development, different size and structure of the economy, and different national customs have faced problems caused by the crisis of late socialism and the hardships of post-socialist transition. During this time the countries experienced numerous changes of governments - from ultraliberal to consistently communist -and tried various options of economic policy, with related consequences. With all the differences of national paths of transition towards a market economy, a profound analysis of the accumulated experience allows the identification of some general trends emerging from the specifics of individual countries. Nowadays, it is impossible to discuss economic and political problems of any post-socialist country without mention of those trends.

The specifics of the politico-economic system of the post-socialist countries also emerge from consideration of the paths taken towards market transition: at this point the factors of a crucial importance are the difference in the pace of reform, chosen variants of structural transformation, and duration of the period of high inflation. Given that the socio-economic genotype of the emerging market economy is determined to a greater extent by its socialist past, the first years of reforms become its "childhood" which sets the contours of its development for many years ahead.

This paper is an attempt to identify the mechanisms of the emergence of budget crisis, its relationship to the transformation path taken, and possible ways to resolve problems arising at (he current stage of post-socialist transition. It is assumed that the crucial point in this respect is an analysis of the interconnection between the pace of disinflation and evolution of the post-socialist countries' budgetary and monetary systems.

## *1. INTRODUCTION*

During the initial years of reforms the question as to whether monetary stabilization is a necessary prerequisite for renewal of economic growth or, on the contrary, whether it is the growth in output volume which allows to stabilize finance and money circulation was intensively discussed in economic literature. By now this issue has been clarified. Based on the data characterizing development of Latin American, Asian and African countries, it was proved that a high (over 40% annualized) inflation rate creates serious obstacles in the way of economic growth.[i[i]] Recent findings show that the aforementioned conclusion is also completely applicable to the post-socialist countries. The concensus among economists is that in the overwhelming majority of cases, ODP growth starts only after suppressing inflation to a lower rate using monetary policy measures.[ii[ii]] Economic growth, as a rule, revives approximately two years after launching a serious financial stabilization program. The average duration of the transitional recession in the countries, which started their economic growth by 1995, was 3.6 years (and the

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average fall in production volume -33.6%).

Hence, the suppression of the inflation rate to below 40%, though not a sufficient prerequisite for a sustainable economic growth, is, at least a necessary one.

In some post-socialist countries, national political elites have proved to be capable of comprehending this regularity and implemented a vigorous disinflation program. Those countries that succeeded in the implementation of reliable disinflation programs, became leaders in increasing their output volume. In other countries, changing governments have been trying for a long time to resolve the problems of getting out of the crisis through acceleration of the money supply, substantiating that as a support to maintenance of production and control of social problems.

The results of such policy, extensively described in publications on the economy of populism[iii][iii], have been standard acceleration of inflation rate, flight from the national currency, a sharp fall in the exchange rate, dollarization of economy, intensification of social differentiation, and further decline in output. In such countries, the post-socialist crisis has become longer, while the production decline, as a rule, has proved to be more intensive. In some cases it required several bursts of inflation to convince the authorities that the monetary stabilization program had to be implemented anyway. *Experience shows that the post-socialist monetary stabilization may be postponed, but not rejected.*

## *2. THE DEVELOPMENT OF BUDGET CRISIS IN POST-SOCIALIST ECONOMIES*

The characteristic feature of socialist economy is an abnormally high (taken into account a specific country's level of development) burden of public expenditures upon its economy. After the collapse of socialism it has becomes clear that in market conditions it is extremely complicated, or even impossible, to provide such a large-scale redistribution of financial resources. That is a universal source of the budgetary crisis which, to a greater or lesser extent, has battered almost all East European countries and former socialist republics at the stabilization stage. Budget (fiscal) crises create serious threats to the mere existence of the new social institutions that emerged during recent years.

The dynamics of the post-socialist budget crisis have been studied in every detail, primarily on the data related to East European countries[iv][iv]. M. Dabrowski singles out four stages of the crisis:

- • fiscal destabilization prior to the start of reforms;
- • macroeconomic stabilization connected with liberalization of the economy:
- • secondary fiscal crisis in the wake of the stabilization; renewal of fiscal potential related to economic recovery and expansion of reforms in the public finance system.

The sequence of events is as follows: political crisis and inconsistent reforms in the course of late socialism lead to the weakening of the government control over the national economy, shortfall in budgetary revenues, and creation of a huge budget deficit The start of reforms, liberalization of the economy, transfer of the suppressed inflation into an open one, contraction of the inflationary pressure on the economy allow a 'radical improvement of the state of the budget. However, with the progress of monetary stabilization, slowdown of inflation rate, fall of inflationary incomes, related decrease in profit tax, the budgetary revenues experience a renewed contraction.

In parallel to that. the process of structural reforms increases the share of social expenditures in the budget. With the beginning of economic growth, the adaptation of the tax system to functioning in market conditions, under low inflation rates, the growth in budget revenues allows management of the budget crisis. This picture is, of course, stylized[v[v]], nevertheless it describes the development of events in eastern Europe quite correctly.

Within the post-Soviet zone, the emergence of the financial crisis was modified by a longer period of high open inflation.

The trend to contraction in tax revenues in conditions of high inflation (Olivier-Tanzi effect) is a well-studied economic phenomenon[vi[vi]]. The post-socialist experience allows a richer understanding of the process's mechanism. Long-term high inflation forms a soft financial environment: there is no efficiently operating mechanism providing responsibility for fulfillment of financial obligations; mutual non-payments become a mass form of tax evasion; the disdainful attitude towards tax obligations takes its roots as a social norm,

At the same time it is well known that bad tax traditions are formed more easily than changed - they become an independent factor which has its impact on long-term prospects of the budgetary policy. Even when the political elite at last comprehends the necessity of monetary stabilization (which causes a restriction of the growth rate of money supply and, accordingly, in scope for a budget deficit, and a fall of inflationary revenues, etc.) taxpayers do not respond with an immediate growth of discipline.

As a result, the countries which have chosen the path of a 'painless' transition towards market economy and passed through the period of long-term high inflation have to cut down public expenditures to levels significantly lower than in the countries which had implemented a radical disinflation strategy.

The following Table shows the revenues, expenditures and the percentage share of budget deficit in GDP in some post-socialist countries of Eastern Europe in the period of 1990-1997.

Table 1

Revenues, Expenditures and Budget Deficit (as % of GDP) in Post-Socialist Countries of Eastern Europe

| Countries | | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 |
|---|---|---|---|---|---|---|---|---|---|
| Albania | Revenues | 47,1 | 30.9 | 23.7 | 34.9 | 18.8 | 20.5 | 16.9 | 14.9 |
| | Expendit. | 62.1 | 61,9 | 44.0 | 34,9 | 31.2 | 30.8 | 29,0 | 27.6 |
| | Deficit | -15 | -31 | -20.3 | -14,4 | -12.4 | -10.3 | -12.1 | -12.7 |
| Bulgaria | Revenues | — | — | 38.4 | 37.2 | 39.9 | 35.7 | 31.9 | 31.3 |
| | Expendit. | — | 45.6 | 43,6 | 48,1 | 45,7 | 41.3 | 42.3 | 33.4 |
| | Deficit | — | — | -5.2. | -10.9 | -5.8 | -5.6 | -10.4 | -2,1 |
| The Czech Republic | Revenues' | — | — | | 42.4 | 42.1 | 414) | 40.7 | 39.5 |
| | Expendit. | — | ---- | — | 41.9 | 43,3 | 42.8 | 41.8 | 41.6. |
| | Deficit | | -1.9 | -3.1 | 0.5 | -1.2 | -1.8 | -1.2 | -2.1 |
| Macedonia. FYR | Revenues | — | — | 38.6 | 41.5 | 47.6 | 41,9 | 41.0 | 39.0 |
| | Expendit. | — | — | 48.2 | 55.3 | 50.5 | 43.1 | 41.5 | 39,4 |
| | Deficit | — | — | -9.6 | -13,8 | -2.9 | -1.2 | -0.5 | -0.4 |
| Hungary | Revenues | 53.9 | 52.5 | 53,6 | 55.1 | 52.5 | 47,2 | 45.2 | 48.0 |
| | Expendit. | 53.5 | 55.4 | 59.4 | 60.6 | 60.9 | 53.9 | 48.3 | 52.9 |
| | Deficit | 0.4 | -2.9 | -6.8 | -5.5 | -8.4 | -6.7 | -3.1 | -4.9 |
| Poland | Revenues | 42.9 | 42.3 | 42.8 | 47.4 | 45.8 | 45.1 | 44.2 | 45.0 |
| | Expendit. | 39.8 | 49.0 | 49.5 | SW | 48.9 | 47,9 | 47,5 | 48.1 |
| | Deficit | 3.1 | -6,7 | -6.7 | -3.1 | -3.1 | -2.8 | -3.3 | -3.1 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Romania | Revenues | 39.7 | 42.0 | 37.4 | 33.8 | 32.0 | 31.9 | 30.1 | 30,7 |
| | Expendit. | 38,7 | 38.7 | 42.0 | 34.2 | 33,9 | 34.5 | 34,1 | 34.3 |
| | Deficit | 1.0 | 3.3 | -4.6 | -0.4 | -1.9 | -2.6 | -4.0 | -3.6 |
| Slovakia | Revenues | — | — | — | 44.0 | 46,7 | 47.2 | 47,1 | 47,2 |
| | Expendit. | — | — | — | 51.0 | 48.0 | 47,0 | 49,0 | 51.0 |
| | Deficit | — | — | — | -7,0 | -1.3 | 0.2 | -1.9 | -3.8 |
| Slovenia | Revenues | 49.3 | 43,7 | 45.8 | 47.0 | 45.9 | 45.7 | 45.2 | 44.6 |
| | Expendit. | 49.6 | 41.1 | 45.6 | 46.7 | 46,1 | 45.7 | 44.9 | 45.7 |
| | Deficit | -0.3 | 2.6 | 0.2 | 0.3 | -0.2 | 0.0 | 0.3 | -1,1 |
| Croatia | Revenues | — | — | 32.2 | 34.2 | 42.2 | 44.0 | 45.2 | 44.8 |
| | Expendit | — | — | 36.1 | 35.0 | 40.6 | 44.9 | 45.6 | 46.1 |
| | Deficit | — | — | -3.9 | .0.8 | 1.6 | -0.9 | -0.4 | -1.3 |

*Source:* EBRD data.

The data in Table 1 are self-explorising.

However, I want to point out to characteristic example of interconnections between the inflationary crisis and dynamics of public revenues is the budgetary evolution in the Baltic States. They are similar in their geographic location, structure of their economics, economic and political orientation. While Estonia and Latvia had survived a high inflation between 1991-1993 and managed to stabilize their monetary systems rapidly, Lithuania conducted less consistent and less determined anti-inflationary policy, with inflation rate higher and inflationary period longer than its neighbors. In this region the countries which rapidly halted inflation stabilized the share of public revenues and expenditures at a substantially higher level afterwards. This is shown in the following table.

*Table1* Public Revenues. Expenditures and Budget Deficit *(as % to* GDP1 in the Baltic States

| Countries | | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 |
|---|---|---|---|---|---|---|---|
| Estonia | Revenues | 34.6 | 39.6 | 40.5 | 40.1 | 39.0 | 39.6 |
| | Expendit. | 34.9 | 40.3 | 39.2 | 41.4 | 40.5 | 37.4 |
| | Deficit | -0.3 | -0.7 | 1.3 | -1.3 | -1.5 | 2.2 |
| Latvia | Revenues | 27.4 | 35.1 | 34.1 | 34.7 | 36.6 | 39.6 |
| | Expendit | 28.2 | 35.2 | 38.2 | 38.2 | 38.0 | 38.2 |
| | Deficit | -0.8 | 0.6 | -4.1 | -3.5 | -1.4 | 1.4 |
| Lithuania | Revenues | 32.0 | 31.8 | 33.0 | 32.3 | 29.6 | 32.9 |
| | Expendit. | 31.5 | 35.1 | 38.5 | 36.8 | 34.1 | 34.7 |
| | Deficit. | 0.5 | -3.3 | -5.5 | -4.5 | -4.5 | -1.8 |

*Source:* EBRD data

When we concentrate on the CIS states, we can draw some interesting conclusions.

As the data presented in Table 3 shows, none of the CIS states which had passed through the long period of high inflation up to 1996 have managed to provide monetary stabilization with the level of public revenues over 35% of GDP* in the majority of cases, the respective indices were substantially lower.

*Table 3* Public Revenues, Expenditures, and Budget Deficit (as % to GDP) in the CIS States

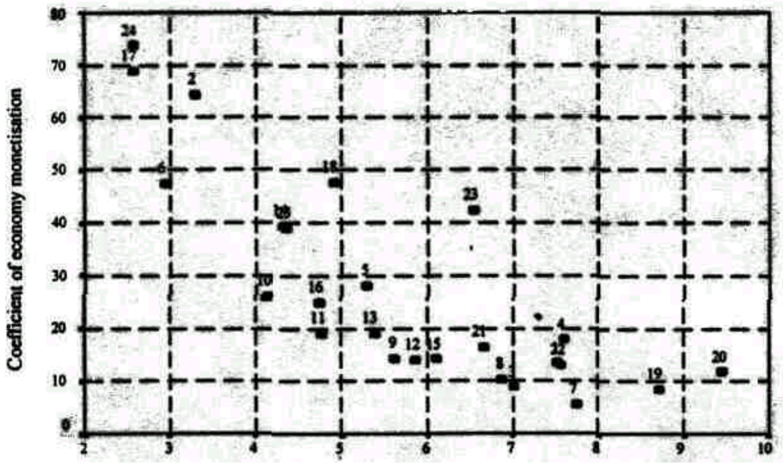
| Country | | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 |
|---|---|---|---|---|---|---|---|
| Azerbajzhan | Revenues | — | 40.6 | 33.8 | 17.5 | 17.6 | 19.7 |
| | Expendit. | — | 55.9 | 45.9 | 22.4 | 20.4 | 21.4 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | Deficit | — | -15.3 | -12.1 | -4.9 | *-2.8* | -1.7 |
| Armenia | Revenues | 32.8 | 28.2 | 32.4 | 15.6 | 14.4 | 18.2 |
| | Expendit. | 46.7 | 82.9 | 42,9 | 26.6 | 23.7 | *24.5* |
| | Deficit | -13.9 | -54.7 | -10.5 | -11.0 | -9,3 | -6.3 |
| Belarus | Revenues | 46.0 | 54.3 | 47.5 | 42.7 | 41.0 | 44.7 |
| | Expendit. | 46,0 | *56.2* | 50.0 | 44.6 | *42.6* | 46.8 |
| | Deficit | *0.0* | -1.9 | *-2.5* | -1.9 | -1,6 | -2.1 |
| Georgia | Revenues | 10.3 | 9,7 | 16.1 | 7.1 | 9.7 | 10,6 |
| | Expendit. | 33.7 | 35.9 | *23.5* | 11.6 | 14,1 | *14.4* |
| | Deficit | -25.4 | -26.2 | -7.4 | -4.5 | -4.4 | *-3.8* |
| Kasakhstan | Revenues | *24.5* | 23.8 | 18.7 | *17.4* | 15.5 | 16.6 |
| | Expendil. | 31.8 | 25.2 | 25.9 | *19.9* | 18.6 | *20.3* |
| | Deficit | *-7.3* | -1.4 | -7.2 | *-2.5IS* | -3,1 | -3,7 |
| Kyrgystan | Revenues | — | — | — | *16.7* | 15.9 | *16.9* |
| | ExpendiL | — | — | — | *33.7* | 24,9 | *26.3* |
| | Deficit | — | — | — | -17,0 | -9.0 | *-9.4* |
| Moldova | Revenues | 30.4 | 22.0 | 31.9 | 34.0 | 32.0 | 34,3 |
| | Expendit. | 56.6 | 29.4 | 40.6 | 39.7 | 38,7 | 41.8 |
| | Deficit | -26.2 | -7.4 | -8.7 | -5.7 | -6.7 | *-7.5* |
| Russia | Revenues | 33.1 | 33.3 | 36.9 | 31.3 | 31.8 | *333* |
| | Expendit. | 37.2 | 40.7 | 45.9 | *37.0* | 40,1 | 40,7 |
| | Deficit | -4.1 | -7.4 | -9.0 | *-5.7* | -8.3 | -7.4 |
| Tadjikistan | Revenues | 26.6 | 27.1 | 40.6 | *15.3* | 12.1 | 13.T |
| | Expendit | 55.0 | 50,7 | 54.8 | 26.5 | 17.9 | *17.0* |
| | Deficit | -28.4 | *-23.6* | -102 | -11.2 | -5.8 | -3.3 |
| Turkmenistan | Revenues | 55,4 | 18.7 | 18.7 | 10.9 | 16,7 | 29.21 |
| | ExpenditL | 42.2 | 19.2 | 10.4 | 12.5 | 16.9 | 29.2 |
| | Deficit | 13.2 | *-0.5* | -1.4 | .1.6' | -02 | 0.01 |
| Uzbekistan | Revenues | 25.0 | *36.0* | 29.2 | 34.6 | 34,3 | 30.5 |
| | Expendit. | 43.4 | 46.4 | 35.3 | 38.7 | 41.6 | 32.8 |
| | Deficit | -18.4 | -10.4 | -6,1 | -4.1 | *-7.3* | *-2.3* |
| Ukraine | Revenues | 33.0 | 38,3 | 36,7 | 29.9 | 28.4 | 29.2 |
| | Expendit. | 58.4 | 54.5 | *45.8* | 37.4 | 31.6 | 34.8 |
| | Deficit | -25.4 | -16.2 | -9.1 | *-7.5* | -3.2 | -5.6 |

*Source:* EBRD

* in 1997 the inflation rate in Belarus made up 63% (as of the end of the year), and the country was rather far from monetary stabilization.

*Chart 1*




Cumulative inflation. 1989-1997 (a logs)

Note: 1 - Azerbaijan; 2 - Albania; 3 - Armenia; 4 - Belarus: 5 • Bulgaria: 6 - Hungary: 7 • Georgia: 8 . Kazakhstan; 9 - Kyrgyzstan; 10 - Latvia; 11 - Lithuania: 12 - Macedonia: 13 . Moldova; 14 -Poland; 15 -Russia: 16- Romania: 17-Slovakia: 18-Slovenia: 19-Tajikistan: 20. Turkmenistan:
21 - Uzbekistan; 22 - Ukraine; 23 - Croatia; 24 - Czech Republic; 25 - Estonia.

A long period of high inflation leads to undermining of confidence in the national currency, sharp fall in monetization of gross domestic product, and high level of dollarization of the economy. These are regular characteristics which can be only slowly overcome in course of the consequent monetary stabilization period.

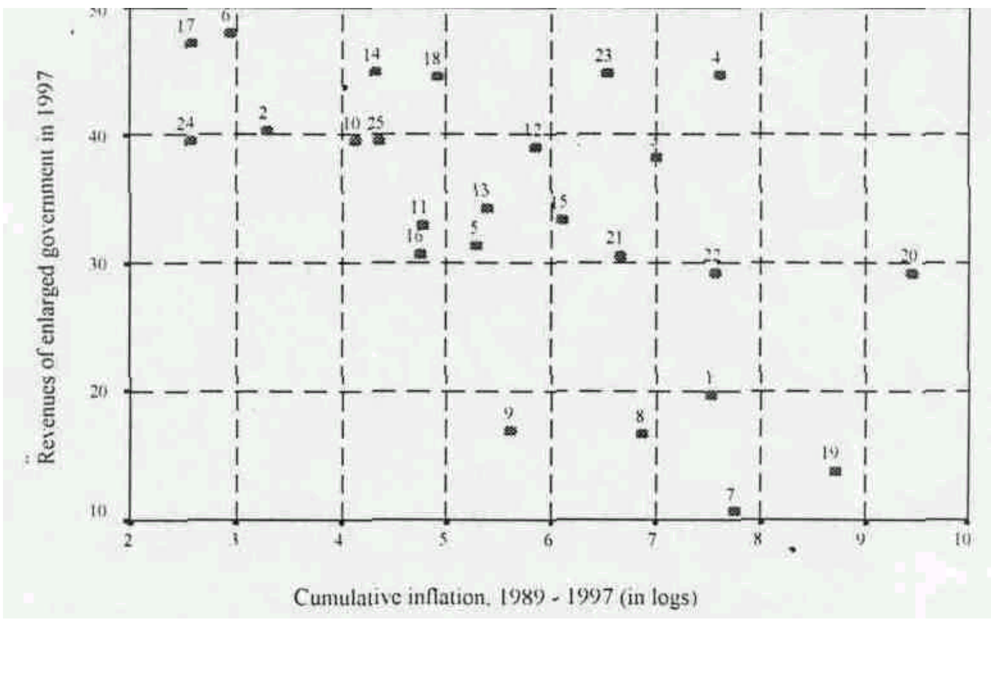
This can be seen in the Figure 1.

The changes of shares of budgetary revenues in GDP depends on the model of the anti-inflation program.

The set of behavioral stereotypes formed 111 the conditions of soft financial regime (off-sets, arrears, non-payments, barter transactions) causes a steady fall in the share of budgetary revenues in gross domestic product to values substantially lower than in the countries which had implemented the " shock therapy".

This is illustrated in the following Figure 2:

Chart 2



Note: 1 - Azerbaijan; 2 - Albania: 3 - Armenia; 4 - Belarus: 5 - Bulgaria: 6 - Hungary: 7 - Georgia; 8 - Kazakhstan: 9 - Kyrgyzstan; 10 - Latvia; 11 - Lithuania: 12 - Macedonia: 13 - Moldova: 14 -Poland; 15 - Russia: 16 - Romania; 17 - Slovakia: 18 - Slovenia: 19 - Tajikistan: 20 - Turkmenistan:

21 - Uzbekistan; 22 - Ukraine: 23 - Croatia: 24 - Czech Republic; 25 - Estonia.

### *3. OBSTACLES TO THE PROCESS OF STABILISATION IN POST.SOCIALIST EAST-EUROPEAN COUNTRIES*

The collapse of the socialist economy opens the so-called "emergency policy"[vii][vii] period: that is a situation in which traditional lobbies (especially industrial ones)" find themselves disoriented, and they have not yet managed to adjust themselves to the radically changed conditions. The room for possible economic and political maneuver therefore expands sharply. At this time, the policy of a drastic reduction of the donation/subsidy burden on the budget becomes possible. In those countries which implemented radical reforms, the stabilization was accomplished with a relatively high level of public expenditures: that provided room for maneuver not only for stabilization but also, in a number of cases, for growth in the share of social expenditures in GDP.

In the countries in which the transformation process became extended, the 'window of opportunity" was used to a substantially lesser degree. By the time the political elite at last realizes the necessity to curb inflation and starts to undertake the related measures, the lobby protecting industry's interests has already regrouped its forces and adjusted itself to the new conditions. Hence, the government experiences greater difficulties in its efforts to implement austerity measures, and its attempts to reduce subsidies encounter a mighty resistance. As a result, at the stage of completion of stabilization, public revenues become substantially lower than those attained by radical reformers, while the subsidy burden upon the budget is higher. In such a situation, it is primarily social programs which have to take a brunt of the reduction of public expenditures. At the end the possibility to finance social programs proves to be substantially lower than in the countries that implemented radical reforms.

Thus the characteristic features of the delayed stabilization become tighter budgetary policy, ultimately reduced possibilities for financing the budget deficit from domestic sources, compulsory radical restriction of public expenditures primarily at the expense of their social component. The radical disinflation policy, on the contrary, provides a substantially greater room for financial maneuver, allows stabilization of budgetary expenditures at a higher level and increases the financing of social programs. All the above shows the importance today of the analysis of the phenomenon of delayed disinflation and its consequences. The identification of further strategy for market reforms without such analysis is unlikely.

Within the post-Soviet zone, the conditions for the start of economic reforms differed substantially from those in eastern Europe: the period of socialist development in the former USSR states (except the Baltic States and Moldova) had been longer, and there was no social memory of traditions of private, market economy; there was no consensus within the political elite on the essential directions of economic policy, and the process of consolidation of new government institutions has taken pace much slower.

All the aforementioned phenomena were aggravated by the 'single Ruble zone' effect. The control over money circulation actually lost by the USSR Gosbank could have been compensated only in the course of time by the introduction of valid national currencies. The Baltic States which had begun to get themselves ready for monetary reforms since late '80s, were able to introduce their national currencies only in the second half 1992. At the same time for the majority of the post-Soviet states the existence of the Ruble zone just encouraged their rivalry in the pace of emission.

As a result, the period of high inflation has become extended in all the post-Soviet countries. Even in Latvia and Estonia which had completed stabilization vigorously, the inflation rate during three years was over 50%, while in 1992 the price hikes had been extremely high (in 1992-1076% in Estonia and 951 % in Latvia).

In the CIS states, by the time when the dismantling of the Ruble zone opened a technical opportunity to conduct disinflation, either there was no political will to implement that at all (Ukraine), or that will was shaken (Russia). All the CIS states (except Moldova) had at least once experimented with the populist policy in an attempt to resolve the problem of development through accelerating the growth in money supply and emissionary financing of their budgets.

Within the former USSR zone, inflationary experiments have a common feature: by the time the political elites realize that there is no other option but the turn towards stabilization policy, the confidence in the national monetary system has been already undermined significantly, demand for money is low, and fiscal discipline has fallen. As a result, monetary stabilization takes place when the monetization ratio and share of public expenditures in GDP are substantially lower than characteristic in the Vyshegrad group stales.

In such a situation financing of budget deficit from domestic source on a scale which is small even by international standards, becomes dangerous. High interest rates on state borrowings at the same time lead to growth in expenditures related to debt servicing and increase the share of the domestic debt in GDP and so concentrate in themselves limited national monetary resources, which in turn stimulates expansion of non-payments in the real sector. Accordingly, any attempt to use these instruments vigorously after a short period of relaxation, merely necessitates yet tougher austerity measures with respect to public expenditures. One can identify three options of economic and political response to the challenge:

1. 1. Stabilization of public revenues and expenditures at the level of 35-40% of GDP, which is substantially lower than the respective indices of the Vyshegrad Group stales, though higher than the respective values characteristic of the post-Soviet countries: simplification of the tax system: reforms allowing adjustment of the volume of stale obligations to the given revenues. Until now among the post-Soviet countries complete monetary stabilization has been achieved only in those states whose disinflation policy has been most consistent (Latvia, Estonia)[viii[viii]]
2. 2. Stabilization of public revenues and expenditures at a low (by the post-Soviet zone's standards) level, *de-facto* or *de-jure* radical dismantling of the socialist system's social commitments (breakdown of the pension system, privatization of expenditures on education and healthcare). Such a development of the situation is characteristic of the countries which passed through a period of hyperinflation and socio-political chaos which once again opens [he way for the 'emergency policy". It is Georgia which is an example of such development of the situation[ix[ix]].
3. 3. Combination of a sharp contraction in the current financing of public revenues with the maintenance of a high level of declared government-obligations, a gap between budgetary obligations and actual financing. That is the Russian case which is also observed in the majority of the other CIS states[x[x]]. In such a situation, the government permanently fails Co fulfill its obligations, and this becomes a crucial factor in the preservation of traditions of financial irresponsibility which had taken root in the period of high inflation. That leads to farther erosion of the budget's revenue base, and compulsory contraction of actual public expenditures.

Such a development of the situation results from a certain equilibrium of social forces which takes shape at the stage of monetary stabilization. The memory of the preceding inflationary experience, resulting from populist experiments, is fresh enough to prevent the authorities from a new attempt to take the path of mass emissionary financing of budget deficit.

At the same time the mere fact of monetary stabilization, and curbed inflation, make the budgetary crisis emerge indistinctly and do not allow the elimination of political restrictions on the conduct of the structural reforms which would increase the efficiency of use of government funds, and bring state obligations into accord with real financial resources. Furthermore, in such a situation the politicians, who cannot give real money to their electorate, often intensify "competition of promises", i.e. lead to the expansion of state obligations and increase the gap between what the government promised and what is within its possibilities. Let us consider alternative options of economic policy pursued in such situations:

3a. Maintaining *status quo*. When the financing is limited by actual financial resources, the budget remains the crucial source of financial instability in the economy. In such a situation, the current distribution of financial resources is determined by the pressure by various social and professional groups on federal, regional, and local authorities. So long as the budget maintains its role as a generator of financial instability, effective measures on increasing the share of public revenues in GDP would be very unlikely to be implemented.

3b. Return to the large-scale einissionary funding of budget deficit, and an attempt to provide fulfillment of government obligations on that basis. A long-tern preservation of *status quo* pushes exactly to such a development of the situation[xi][xi]. Within the framework of such scenario consequences are projected easily: a fall in demand for the national currency, growth in dollarization of the economy, exhaustion of the Central Bank's foreign reserves, accelerated fall of the national currency exchange rate, sharp acceleration of inflation rate reaching possibly hyperinflation, sharp contraction of the share of money in GDP, further fall in the share of public revenues in GDP[xii][xii]. The crisis extends the room for political maneuver substantially, and leads to a drastic reduction in state obligations.

3c. Implementation of a set of reforms providing an increase in efficiency of budgetary expenditures, limiting the volume of state obligations to real revenues.

In the present circumstances only this variant allows management of the budget crisis and support of the monetary stabilization by financial. That will be implemented, sooner or later. At the same time the level of public revenues and obligations attainable on the basis of such reforms varies inversely with the time elapsed before the beginning of their implementation. Any delay in reform paves the way for a further fall in budget revenues, and for populist experiments; the only result in the medium-term is that the compulsory restriction of the state's role in the economy will be more intensive.

The author formulated this hypothesis for the first time in spring 1997[xiii][xiii]. Since then the further sequence of events in the Russian economy has been determined by the realization of scenarios 3a and 3b.

The attempt of the so-called "young reformers' government" to re-route the situation to the path of 3c scenario which took place between spring to summer 1997 did not receive the necessary political support and failed by autumn 1997. The gap between budgetary obligations and possibility to finance them out of current revenues leads to a rapid growth in the domestic debt, a growth in investors' concerns about the Russian government's ability to servicing that debt, and a parallel growth of social tension caused by the accumulation of unfulfilled social obligations of the state. The Asian crisis was just a trigger which determined investors' inevitable panicky withdrawal of their capital from the Russian debt market and the August financial crisis 1998.

The monetary destabilization and a return to the practice of a significant and large-scale emissionary financing of the budget since September 1998 have resulted in the next inflationary spiral and a sharp decline in the population's real income. The return to more moderate budgetary and monetary policy in 1999 which was determined by a necessity to restrain the inflationary wave of autumn-winter 1998-1999 is taking place at a time when the level of non-interest public expenditures is substantially lower than those characteristic of the first monetary stabilization period.

### *4. SWEDISH-TYPE SOCIALISM IS NOT POSSIBLE IN POST-SOVIET COUNTRIES*

Completion of monetary and budgetary stabilization, and the start of economic growth draw a line under the "emergency policy" period. The budget structure and monetary system become stable, and in such circumstances any radical changes cannot be implemented as easily from the political point of view.

In the post-socialist countries, with their relatively high educational level, but substantially lower level of GDP per capita compared with leaders in the world economy, it is the share of investment in GDP which becomes the crucial factor determining prospects of the post-socialist economies' growth. This parameter is known for its strict correlation with the norm of national savings[xiv[xiv]]. There also is, however, a reverse correlation between the savings norm and the social burden on the economy, particularly the degree of the government's generosity in funding the pension system[xv[xv]] In the Vyshegrad Group countries, the social burden on the economy and the share of public expenditures are unusually high for countries with that particular level of development. Hence, there is a serious risk that having exhausted the potential of post-crisis renewal and adjustment to market conditions, the countries of the Vyshegrad Group would show permanently low economic growth rates[xvi[xvi]]. The efficiency of a national tax system which allows financing of an abnormally high level of public expenditures invariably provokes expansion of the latter: all the money that the stale has at its disposal is bound to be spent - it is inevitable.

The essence of Swedish socialism lies in the excessive public burden on the economy which results in a chronic crisis of economic growth and lagging behind' the country's competitors. Swedish socialism presents a unique case of an efficient and tough fiscal system in an ethnically and culturally homogenous country, with a high level of taxpayer's loyalty. The current public burden in the Vyshegrad Group countries is not less abnormally high relative to their level of development than the burden in Sweden relative to highly developed countries. The path of radical post-socialist reforms and rapid disinflation has turned out to lead towards the world of "Swedish socialism" (with the characteristic problems of the latter!). It should be noted that in conditions of social and economic stability it is very hard to decrease the level of social burden on the economy[xvii[xvii]]. The future will show to what extent the national political elites of the Vyshegrad countries will be capable to manage the challenge to stability and implement reforms in time to open the way to acceleration of growth, thus preventing new crises.

In the post-Soviet countries (except the Baltic States) because the processes of budgetary and monetary stabilization are uncompleted, the level of public and, particularly, social burden on the economy cannot be forecasted unambiguously. Much will depend upon the national political elites' ability to conduct liberal economic reforms and on a social base for such reforms. Nonetheless, whatever peripeteias they will face in their socioeconomic development in the forthcoming future, one thing can be taken for granted: *for these countries, because the pro-tracted disinflation period and populist experiments so sharply reduced the share of budget* *revenues in GDP, and especially the social component of budget expenditures, for the foreseeable future the "Swedish way " is definitely closed.*

In light of the above, let us draw some conclusions:

1. 1. The necessary prerequisite for getting out from the post-socialist crisis is monetary stabilization, lowering of inflation rate to the levels compatible with economic growth. The timing of disinflation depends on national elites, though they cannot avoid disinflation.
2. 2. The procrastination of monetary stabilization paves the way for a long period of extremely high inflation. In the course of that period, the share of money in the economy and share of budget revenues in GDP both fall.
3. 3. When political elites realize that it is impossible to postpone stabilization any more, public expenditure has to be cut down more sharply, to a substantially lower level than in the countries which implemented rapid disinflation- A sharp budgetary crisis which coincides with the implementation of the monetary stabilization program is an inevitable price to be paid for the preceding "soft" monetary policy.
4. 4. The changes in the monetary and budgetary system (fall in the share of money in GDP, contraction of the base of budget revenues) which have taken place during the years of high inflation are stable and to a limited extent reversible in the mid-term perspective. They will determine the zone of tolerable values in the process of forming economic policy 5.
5. 5. Adaptation to the post-socialist reality has been gentler in the countries which completed rapid disinflation, even though their aggregate public expenditures stabilize at a level that is unusually high for market economies. In the countries which have experienced a protracted period of inflation the compulsory sharp contraction of social expenditures is a direct consequence of the chosen path of reform. In this case, society's adaptation to post-socialist conditions is rougher and pregnant with social conflicts, while the contraction of the public burden on the economy is more radical. 6. Procrastination in controlling the budget crisis based upon a realistic revision of budgetary obligations entails consequences similar to those characteristic of slow disinflation; public expenditures and obligations have to be adjusted to an even lower level of incomes.

## *5. CONCLUDING REMARKS*

In the countries which procrastinated disinflation and to a certain extent experienced the recipes of 'anti-shock', 'evolutionary', 'moderate' (as their authors believe) policies, the situation developed not in the way that their authors had foreseen, but almost as their opponents had forecast. That is what we would like to emphasize while formulating the following conclusion:

Measuring the level of 'sociality '(public obligations) in the market economy by such indices as the share of public expenditures in GDP and public expenditures on social needs in GDP, and measuring the degree of radicality of post-socialist reforms by the disinflation rate, it becomes clear that the level of 'sociality ' of the emerging market economy is directly and invariably related w the tactics of reforms. The more radical the reforms are, the faster the post-socialist inflationary crisis is overcome, and the bigger the final share of the state in the economy becomes. The analysis of the accumulated experience shows that regardless of their own aspirations and ideological preferences, it is the radical reformers of the post-socialist world who in fact have been leading their countries towards the social market economy. On the contrary, those who advocated a painless, slow transition towards the market economy, and inflationary financing,, regardless of their personal aspirations, in fact were pushing their countries towards implementation of an extremely desocializing policy.

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[i[i]] This correlation was convincingly demonstrated by M. Bnino and W. Estcrly on the aggregate of countries not including the post- socialist ones. See: Bruno M., Esterly W. Inflation

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ii[ii] *See* for example:. Fischer S.. Sahay R., Vcgh C. Economies in Transition: The Begining of Growth. . AEA Papers and Proceedings. 1996. vol 86. N2. P.229.233: Fischer S- Sahay R.. Vcgh Carios A., Stabilization and Growth in Transition Economies: The Early Experience. IMF Working Paper. 1996; Adelman I., Vujovic D. institutional and Policy Aspects of Transition: An Empirical Analysis. 1996.

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v[v] The Czech Republic and Hungary approached the beginning of reforms in conditions of a relative financial stability and had not experienced an intensive financial crisis under socialism.

vi[vi] Tanzi V. Inflation. Real Tax Revenue, and the Case for Inflationary Finance: Theory with an Application to Argentina. IMF Staff Papers. 1978. Vol 25 (September) P. 417.51.

vii[vii] Balcerowicz L., Gelb A. Macropolicies in Transition to a Market Economy. A Three - Year Perspective. Proceedings of the World Bank Annual Conference on Development Economic. 1994

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x[x] The analysis of emerging of budgetary crisis in Russia see:. Sinelnikov S. Budgetny Crisis v Rossii: 1985-1995.Moscow,1995. Rossiskaya Economica v Pervom Polugodii 1996. Tendencii i Perspektivy. Moscow, 1996.

xi[xi] The taboo on economic populism weakens along with the memory about the living in the conditions *of* an extremely high inflation, while the problems of the permanent budgetary crisis continue to intensify.

xii[xii] The economic crisis emerged between 1996 to 1997 in Bulgaria which had attained monetary stabilization by 1995 is a good illustration of practical consequences of implementation of such a course.

xiii[xiii] See: Gaidar Ye Detsie Bolezni Post-Socialisma (Voprosy o Prirode Budgzhetnykh Krizisov Etapa FinansovoyStabilizacii);Voprosy Ekonomiki. 1977

xiv[xiv] Feldstein M- Horioka C. Domestic Savings and International Capital Flows • Economic Journal Vol. 90 (June 1980) P. 314-324

xv[xv] Feldstein M. Fiscal Policies. Capital Formation, and Capitalism. NBER Working Paper N4885. 1994.

xvi[xvi] J.Sachs and A. Warner showed the gravity of the long- term problems of the development which the Vyshegrad Group countries have faced. Sec: Sachs J., Wamer A. Achieving Rapid Growth in the Transition Economies of Central Europe. Warsaw. 1996.

xvii[xvii] In Poland, with a broad awareness of gravity of long-term problems of the excessive social burden on the economy, the most radical variants of pension reforms proposed by an institution known for its consistently liberal views (CASE) in early 1997 provided a decrease in the share of pensions in GDP from 15.5% in 1996 to 15.1% in 2005. See: Dabrowski M. The Financial System in Poland and Trends of Its Development- • Economic Scenarios for Poland. 1997.