9TH INTERNATIONAL ASECU CONFERENCE ON
"SYSTEMIC ECONOMIC CRISIS: CURRENT ISSUES AND PERSPECTIVES"

Božidar Cerović
Faculty of Economics – University of Belgrade, Serbia
Aleksandra Nojković
Faculty of Economics – University of Belgrade, Serbia

TRANSITION, ECONOMIC GROWTH AND GLOBAL CRISIS: MISSED POINTS AND THE WAY-OUT

UDC:338.24.021.8(4-11),,2008/2011"
UDC:338.23.338.45(4-11),,2008/2011"

Abstract

The analysis in the paper starts with a brief presentation of our findings in an earlier paper on growth models in transition putting the foundations for further analyses. We continue with investigation of growth models in these countries under the global crisis. The analyses conducted point at the importance of some growth forces, particularly industrial output and exports, that are not usually found in transition projects. This suggests that apart from market oriented reforms a certain industrial policy in each country appears necessary for a sustainable and stable growth. Moreover, the results suggest that such a policy had to be implemented much earlier and was even requested by the reforms level achieved in the mid-phase of reforming process. Additionally, we have analysed the role of political and civil liberties in enhancing economic growth of transition economies. The issue seems important since political and civil liberties are frequently seen as a part of transition process and make a part of an overall institution building of a country. Our results show that political and civil liberties seem to be related to growth but in an adverse and unexpected way. After a brief theoretical discussion on the matter our additional analyses show however, that political and civil liberties – similarly to other growth determinants – change the direction of their impact on growth and become growth supportive at a higher level of reforms completion and accordingly, at a higher level of economic development, but appear again adverse related to growth under the crisis. Further on we test a hypothesis that political and civil liberties primarily depend on growth and initial conditions of a country and corresponding estimations confirmed our hypothesis. Putting pieces together we conclude that the necessity of development and industrial policies is one of the most neglected and missed points in general transition projects and explain why the right way-out from the crisis should rely on establishing of these policies specific for each country, which should lead to a sustainable growth and further advancement in political freedom.

1. Introduction

Since the global crisis and/or depression erupted from 2008 some structural weaknesses of transition economies have been remarked. A subsequent discussion pointed at the need of a new growth model for these countries. Actually, the reforms that were seen as a principal force of economic growth in transition appeared to be insufficient, sometimes even counterproductive. Economic development based upon a high degree of liberalisation and fast privatisation that was suggested for transition economies, has produced an improper economic structure (low share in manufacturing and/or tradables production and low exports) and high dependence on foreign savings usually used for enhancing (import) demand. Consequently, it appeared that lack of industrial policy and development strategy in these countries was particularly destructive under the crisis.

In our paper (Cerovic and Nojkovic, 2011) we have examined a pooled panel model for transition economies pointing at certain break points that change growth patterns over time. We found that various growth factors perform different impact on economic performance in regard to the implementation progress of reforms. The break points identified show that in the medium phase of transition (that is after a first wave of reforming activities) some additional policies are necessary (apart from the reforming ones) that will direct further development of a transition economy. Among other results it appeared that growth of industrial output should be particularly supported thus pointing at the need of proper industrial policy based upon the inherited conditions of a country. We have argued that this was one of important missing points in major transition schemes.

In this paper we shall particularly discuss the matter analysing the period of crisis and try to estimate the importance of these missed points during the recent economic downfall. The findings have to indicate what should to be done for faster way-out from the crisis. It should be noted that our results were not particularly specific and unique. There is a number of studies that found similar results highlighting the importance of industrial production in the second decade of reforms and diminishing and even negative effects of reforming policies if seen as the only pillar of economic progress.

Finally, we shall introduce the notion of political freedom and civil liberties and their advancement will be analysed as a possible factor of growth during transition. We have added these 'political' variables for two reasons. Firstly, it is broadly accepted that political reforms should go together with economic ones and secondly and even more essentially, they could be seen as a measure of the entire advancement in institution building within a country (or a requirement for introducing proper institutional surroundings). However, two questions will arise – how fast they can be introduced and do they really support growth from the very beginning of transition. In answering this question we shall try to assess their importance in the period of crisis.

The paper is organised in three principal parts. In the first one we shall briefly present our earlier findings in order to ease understanding of further analyses. The second section will deal with the period of crisis effects in transition economies. The third part will analyse the institutional factors in terms of political and civil liberties. The results will bring us to conclusions that suggest certain measures and moves, which can ease the road that leads to a better economic performance.

2.Growth under transition: a necessity of industrial policy

As we have pointed in our earlier (above-mentioned) paper on growth patterns in transition our basic idea was to analyse how and when certain factors of growth do change their impact on economic performance in transition countries. The issue may seem pretty scholastic today unless the conclusions derived have some valuable use in present crisis and suggest what could be a proper way-out. For that reason, in this section we shall try to particularly underline those findings that could affect present performance of the economies in question.

In our analyses we have estimated a pooled panel model that takes the GDP annual growth rate as a dependent variable while the explanatory variables are: initial conditions represented by a first principal component of a set of variables (taken from de Melo *et al.* 2001), inflation rate lagged for a year (in log terms), average value of nine EBRD indicators as a measure of transition progress, and two more variables that correspond with the new idea claiming that industrial output and exports are pivotal elements for a 'new growth model' in transition countries. These two explanatory variables were: the share of industrial output in GDP of a country and the trade balance (exports minus imports) to GDP ratio. Additionally, we have applied a version of Chow test[1] to find out whether there are some hidden structural breaks in relation to transition or reform progress[2]. The sample includes 25 transition economies.

Our panels cover two periods: (a) 1990-2007 defined as 'normal' period with no major economic disturbances and (b) 1990-2009 to capture the effects of the global crisis. However, the results in both cases showed that there were two break points suggesting the change of growth pattern at certain level of transition advancement. Namely, we found break points at reform index of 2.25 and 2.96 for the sample 1990-2007 and 2.33 and 2.92 for the sample 1990-2009 (in terms of the EBRD indices that range from 1 to 4.33). Correspondingly, the three different growth models could be identified.

For the topic we discuss in this paper the most important result concerns the mid-phase of reforms (between the two breaks). Represented by a scale 0-100 (instead of the EBRD's scale 1-4.33) the result shows that at the level of approximately 40-60% of full reforms

[1] We used the methodology developed by Bai (1997) and Bai and Perron (1998, 2003) that allows us to identify unknown structural breaks when the location of breaks and also their number are unknown.

[2] The idea for this kind of analysis we get from Fidrmuc and Tichit (2007).

package completion we encounter a major change in growth pattern: after the first phase of reforms when they appeared as a significant factor of growth (higher level of reforms made transition recession shorter and shallower), in the medium phase the reforms became insignificant. It was low inflation, higher share of industrial output and better trade balance to GDP that appeared as the main force of growth together with a permanently significant impact of initial conditions.

Since the break points were found as reform related phenomena an economic interpretation of these results could be put as follows: at a certain degree of transition progress reforms cannot enhance growth alone but do need some additional policies that will be oriented toward specific structural adjustments – in this case to support industrial production and export oriented industries. These policies are known by definition as industrial policy[3]. Or in other words – reforms themselves do urge for certain industrial policy after the first moves in liberalising market forces in transition economies were done. This is in full accordance with the ideas promoting a 'new growth model' for transition economies during the crisis. However, the results suggest that such a change should be taken much earlier that is, in the mid phase of transition.

The second important point of our findings is that in the sample covering 1990-2009 (i.e. when the years of crisis entered analysis) the role of reforms has drastically changed. Namely, all variables appeared significant but reform index has changed its sign indicating negative impact of reforms on growth. This was not remarked in the sample 1990-2007. We suggest that this is an outcome of inappropriate policies which have only accelerated reforms with no other policy measures and/or strategies regarding economic growth and development. Our position is particularly strengthened because the variable pointing at initial conditions remained significant, which could be understood that over-accelerated reforms uniformly designed for all countries may become counter-productive if not adjusted to the inherited conditions in each country.

In order to further check these findings we have augmented our model by adding two more variables that do correspond with some other policies frequently recommended for transition economies. The two variables are openness of a country (exports plus imports to GDP) and size of government expressed by the government expenditures to GDP. Although we found only one break point in both samples our results did not change much compared with the previous analyses.

The reform related break point changed its place in the two samples observed. In the sample that covers the period before the crisis (2007) the only break appears at the approximately equal level of reforms where the first reforming phase ends in our previous

[3] We recall here a notion of industrial policy as defined recently by Chang (2009): 'It is what is commonly known as 'selective industrial policy' or 'targeting' – namely, a policy that deliberately favours particular industries over others, against market signals, usually (but not necessarily) to enhance efficiency and promote productivity growth'.

model (41% of reforms completion). When the period was extended for two years (2009) the break finds at the level that corresponds to the second break point from the previous model (55%). Moreover, the growth models identified differ accordingly. In the first sample (until 2007) the model before the break resembles to the one from initial reforming phase while beyond the break it is similar to the mid-phase model from the previous analysis (it points at industrial output, positive trade balance, low inflation, initial conditions adding lower government expenditure while reforms remain significant but with a low coefficient indicating a small effect on growth). In the second sample (includes 2008 and 2009) the model before the break is similar to the one from the mid-phase while beyond the break it looks like the one for advanced phase of reforms in the previous analysis (negative impact of reforms, importance of industrial production and stable macroeconomic surroundings – low inflation and low government spending). As to the openness of the economy the corresponding variable appeared insignificant except for the entire period (from 1990) but with a negative impact on growth. Similarly trade balance appears mostly insignificant but with a positive sign, which leads to a conclusion that for a transition economy it is better to be less open but with a better trade balance than *vice versa*.

Finally, we may conclude that reforms that is, liberalisation of markets, privatisation and economic openness cannot become a substitute for industrial policy or development strategy of each country, but rather the opposite: in the longer run, these reforms cannot be growth supporting if not followed by a set of industrial and/or development policies that should favour manufacturing and exports and correspond with the inherited conditions of a country (since variables for initial conditions proved to affect growth rates all over the periods analysed).

3.Missed points revealed under the global crisis

As it was mentioned above the global crisis drew attention to some neglected aspects of transition that particularly concern economic development. Although our presented results suggest that a certain change in growth model and corresponding policies should be applied earlier in transition economies it was the crisis that has stressed these issues while the idea of a new growth model and the necessity of industrial policy was starting to be accepted on a broader base. In order to demonstrate why the crisis appeared so convincing regarding the growth model change we shall estimate a pooled panel model of growth that covers a four year period since the first effects of the crisis have been observed in transition economies, that is the period 2008-2011.

As in our previous analysis the dependent variable will be GDP growth rate while the explanatory variables will be IC1 and IC2 for inherited conditions (first two principal components of a set of initial conditions of each country in 1989-90 according to de Melo *et al*, 2000, as explained above), inflation rate lagged for a year in log terms, an average of the EBRD transition indicators (that are calculated for six only phenomena since 2010 – instead of nine until that year) also lagged for a year, industrial output share in GDP (IND), and trade balance to GDP ratio (TB).[4] The results estimated are presented in the following table 1.

Table 1 Dependent variable: GDP growth rate, 2008-2011

Variable	Coefficient	Prob.	t-Statistic
Intercept	6.3734		(1.071)
Inflation, lagged	-0.4822	***	(4.116)
IC1	1.6764	**	(2.018)
IC2	-3.3569	***	(3.174)
EBRD, lagged **(6)**	-1.8817		(1.186)
IND	0.1145	**	(2.034)
TB	0.0325	*	(1.726)
R^2	0.434		
adj. R^2	0.390		
F-stat (probability)	9.727		(0.000)
N	83		

Note: significant levels are indicated as 1% (***), 5% (**) and 10% (*).

Estimation results point at several interesting issues. Firstly, we may see that reforms (defined as an average of six transition indicators that the EBRD statistics continue to present since 2010 – instead of nine before) are insignificant as a growth factor and yet negatively related to growth rates, suggesting that reform advancement (probably even over-accelerated) cannot offset the shocks induced by the crisis (rather the opposite). Secondly, the results confirm the importance of stable macroeconomic environment as represented by a low inflation rate that remains significant and positive factor of growth. Not surprisingly if compared with our previous results, higher shares of industrial output (or in other words of tradable goods) and better trade balances significantly help transition economies under the crisis. Also, despite a long period passed the observed economies are still affected by their initial conditions from pre-transition period suggesting that the speed of reforms and applied policies should always correspond to their inherited structures and starting development levels.

Since the EBRD statistics has been publishing data on nine EBRD indicators for transition advancement until 2010 we were able to use these data as well for the period observed (due to the fact that our variable showing transition progress was lagged for a year). When we

[4] Due to the changes in available data in EBRD statistics that we used earlier (EBRD, 2011) we added the data for trade balance and for inflation from World Bank statistics (World Bank, 2013).

estimated a model that includes all these indicators the results were slightly changed and are presented in the following Table 1a.

Table 1a Dependent variable: GDP growth rate, 2008-2011

Variable	Coefficient	Prob.	t-Statistic
Intercept	10.9654	*	(1.713)
Inflation, lagged	-0.4605	***	(3.951)
IC1	1.0844		(1.184)
IC2	-2.6298	**	(2.291)
EBRD , lagged **(9)**	-3.4026	*	(1.864)
IND	0.08433		(1.424)
TB	0.03458	*	(1.853)
R^2	0.449		
adj. R^2	0.406		
F-stat (prob)	10.326		(0.000)
N	83		

Note: significant levels are indicated as 1% (***), 5% (**) and 10% (*).

As can be easily seen from the table above, low inflation and better trade balance remain as positive factors of growth and one of the principal components for inherited conditions (PC2) stays significant. However, there is an important change in the results: reform advancement became significant but negatively related with growth while industrial output share turned out to be insignificant though positively affecting growth. Bearing in mind that nine EBRD indicators that measure transition progress include indicators that assess the market economy characteristics of financial sector (banking and non-banking) and of the governance in infrastructural sectors (in contrast to six used in Table 1), we may conclude that this kind of reforms advancement offsets positive effects of the progress in tradable goods production in transition economies. Even more briefly, we may state that formal advancement towards a free market model in financial sectors during transition actually, has not been based on sound foundations.

The analysis presented could hardly avoid a conclusion that the original design of transition, from the very beginning, has been neglecting important issues regarding production structure of an economy and the mode of its opening to the world markets. Correspondingly, the role of industrial policy was fully ignored. Transition project was predominantly designed to quickly change pattern of economic coordination in both real and financial sectors, expecting markets to find optimal solutions. The crisis has revealed that this was not feasible and yet has proved to be harmful for transition economies. On the other hand, this is not to say that the general idea of transition was erroneous: the change was necessary and the direction of changes was correct. However, these changes were not realistic without any regard to the inherited conditions in each country, without proper development strategies and corresponding industrial policy and under a noticeable lack of proper institutions that should be persistently built and developed. However, as we shall explain below even institution building cannot be forced without certain preconditions achieved.

4. Institutional environment: political and civil liberties

In this section we shall extend our model adding a new variable that can indicate how institutional environment could affect economic performance of a transition country. In economic literature on the issue one can find a number of various measures for institutional building and development. They usually combine several 'objective' and 'subjective' indicators, indicators on political and/or economic freedom and are composed comprising data from various sources (see for example: Grogan and Moers, 2001; Bock and Laeven, 2006; Estrin *et al.* 2009 etc.).

In the following model, for better consisteny, we shall use the only one source of data that is, the Freedom House indices on political freedom and civil liberties. Although basically politically oriented political freedom and civil liberties could represent a development level of the entire institutional environment of a market economy. Additionally, they are often seen as factors that could improve general institutional arrangement and enhance economic performance. Our model shall be defined as follows:

$$G_{i,t}=f\,(IC1_i;\ \text{inflation}_{i,t-1};\ \text{reform index}_{i,t-1};\ \text{industry}_{i,t};\ \text{trade balance}_{i,t};\ \text{FH index}_{i,t-1}) \qquad (1)$$

The variables used are: $G_{i,t}$ growth rate of a country i in the year t, inflation is defined as before, reform index stays for an average of nine EBRD indicators lagged for a year, industry and trade balance are defined as IND and TB before, while FH index $_{i,t-1}$ represents an average of the two Freedom House indices (2013) for political freedom and civil liberties in a country i lagged for one year. We used a pooled panel specification covering a period from 1990-2009 and the estimation results are presented in Table 2.

Table 2 Dependent variable: annual GDP growth rate (sample 1990-2009)

Variable	Coefficient	Prob.	t-Statistic
Intercept	-14.2495	***	(4.092)
Inflation, lagged	-3.5932	***	(7.324)
IC1	0.9189	**	(2.332)
EBRD , lagged **(9)**	5.1605	***	(7.374)
IND	0.0729	*	(1.720)
TB	-0.0110		(0.472)
FH index, lagged	1.6857	***	(5.791)
R^2	0.391		
adj. R^2	0.382		
F-stat (prob)	44.156		(0.000)
N	420		

Note: significant levels are indicated as 1% (***), 5% (**) and 10% (*).

Looking at the results we may remark that FH index appears as highly significant though with an unexpected sign: the sign is positive which means that less democratic countries exhibit higher growth rates (note that higher FH indices represent lower freedom levels, so they are associated with higher growth rates)[5]. However, since the model presented is similar to the models recalled in the first section covering the same sample (countries and period) we applied the Chow test and have identified one reform related break at the level of 2.92 for the reform index. After this break the FH index changes its sign indicating that political freedom plays major part in regard to economic performance at the higher level of transition reforms accomplishment but is still insignificant. Shortly, we shall comeback to this issue.

As to the other variables it should be mentioned that reform index for the entire sample appears significant and positively related with growth but in the sub-sample after the break is insignificant and negative – similarly to the findings in our model from the first section that is, without the FH index – while inflation exhibits the same characteristics as in the earlier model. From the standpoint of the production structure of a transition economy it is important to remark that industrial output appears significant which has not been remarked for the entire sample in the earlier model without FH index.

[5] In the Freedom house methodology the levels of political freedom and civil liberties are ranged from 1, indicating the highest level of freedom, to 7 representing the least free political regime in a country.

In addition we estimated a pooled panel model for the critical period 2008-2011 adding to the model presented in Table 1a above the FH index variable. The results obtained we present in the Table 3.

Table 3 Dependent variable: annual GDP growth rate (sample 2008-2011)

Variable	Coefficient	Prob.	t-Statistic
Intercept	-0.7252		(0.071)
Inflation, lagged	-0.4471	***	(3.853)
IC1	0.3801		(0.370)
IC2	-2.1022	*	(1.761)
EBRD , lagged (9)	-1.4137		(0.626)
IND	0.0739		(1.248)
TB	0.0501	**	(2.353)
FH index, lagged	1.1854		(1.475)
R^2	0.465		
adj. R^2	0.415		
F-stat (prob)	9.299		(0.000)
N	83		

Note: significant levels are indicated as 1% (***), 5% (**) and 10% (*).

There are two principal findings. Firstly, reform advancement as presented by an average of nine EBRD indices remains negative although insignificant but FH index appears positive again (negatively related with growth) though insignificant as well. On the other hand the model strongly points at the TB variable indicating that during the crisis and/or in the first years of modest recovery, an export oriented policy could be a proper choice for transition economies. In fact, this can be seen as the most evident result in this part of the analysis (apart from standard importance of low inflation).

Finally, we wanted to additionally explore the unexpected result regarding the negative relationship between FH index that represents the level of political and civil liberties and economic performance. Knowing that certain factors of growth do change their impact over time we made an additional experiment to find out at which level of transition progress FH index could become significant and growth supporting. We found that this should happen at the reform index level of approximately 3.1 and beyond (or at the level of 63% of all reforms accomplishment). However, as we have seen this negative relationship re-emerged during the crisis leaving apparent doubts on the impact of this institutional variable.

How can we explain these results? Do they suggest that a lower level of democratic rights is required for faster development at least in countries in transition? Such a conclusion will be pretty upsetting (despite some historical experience – Pacific Tigers, for example). In our view this kind of reasoning will be misleading if taken that straightforwardly. There are several points that should be re-considered before we could come to a final explanation of the result obtained.

Firstly, we may think of the negative impact of political and civil liberties on growth in a transition economy as if they represent a specific phenomenon connected with poor economic performance of transition economies. There are some arguments in literature that could support such a hypothesis. Thus, for example, Dixit argues (Dixit, 2004) that self-enforcing arrangements could be more effective than formal institutions at the lower development level. Nevertheless, overall experience of transition economies seems to deny such a possibility. On the other hand, a warning that 'institutional rigidity pays off when lack of credibility and time inconsistency are the main problems of the day, but that it can eventually become a drag on growth' (Rodrik, 2008) could be considered as a realistic one (particularly having in mind many recepies that were being delivered to transition countries from outside without a proper study of local inherited circumstances). However, this also cannot be taken as a definite answer unless an additional study was done. The same could apply to the statement that for similar policies interdependence of institutions and initial conditions may have a significant effect on how those policies ultimately affect the economy (Vonnegut, 2009). Finally, there are claims that transition economies are still in the process of developing proper institutions so that they still cannot fully affect business environment, which depends on informal institutions (Raimbaev, 2011).

In considering these and other findings (e.g. Acemoglu *et al*. 2006, on the role of institutions in the countries that are distant from the global technology frontier) we came to a hypothesis that fast enforcement of institutions that are compatible with developed market economies cannot be done successfully without some necessary prerequisites. The basic prerequisite would be a certain level of development of a country. Namely, if one tries to force and quickly implement all institutional arrangements that have been developing in advanced market economies for centuries could ultimately place an additional burden on a fragile transition economy. In our view this hypothesis comprise a good number of findings quoted above and can explain two basic points: (a) why institution building in transition economies is usually assessed to be slow and insufficient and (b) why instantaneous enforcement of projected institutions could negatively affect growth. For that reason we shall test a hypothesis stating that political and civil liberties primarily depend on inherited conditions and economic growth of a transition country.

We shall analyse a very similar model to the one used in estimating growth rates. However, FH index of a country i in the year t will be taken now as a dependent variable while growth rate will enter the model as an independent one and lagged for one year for capturing the expected lagged effects. We shall omit reform index from the model to escape a possible multicollinearity since the two variables – being more or less simultaneously developed during transition – are frequently correlated. We shall also omit inflation variable since cannot remark its direct impact on political freedom. Finally, our model will be defined in the following way:

$$FH_{i,t} = f\,(IC1_i;\ G_{i,t\text{-}1};\ industry_{i,t};\ trade\ balance_{i,t};) \qquad (2)$$

We estimated simultaneous system consisting of equation (1) and equation (2) by two-stage least squares (2SLS). A systems approach carries two main advantages: first, it allows an insight into what drives the political and civil liberties, and second, it controls explicitly for feedback effects that may be biasing the coefficients from the single-equation estimation. The estimation results of equation (3) are presented in Table 4.

Table 4 Dependent variable: political and civil liberties (sample 1990-2009)

Variable	Coefficient	Prob.	t-Statistic
Intercept	3.824	***	(14.355)
IC1	1.242	***	(19.281)
GDP growth (lagged)	-0.014	*	(1.772)
IND	-0.008		(0.877)
TB	0.022	***	(4.446)
R^2	0.509		
adj. R^2	0.504		
F-stat (prob)	104.501		(0.000)
N	409		

Note: significant levels are indicated as 1% (***), 5% (**) and 10% (*).

It can be easily seen that the results confirm our hypothesis: political and civil liberties depend significantly on initial and inherited conditions of a country (as expected)[6] but also on growth rate – higher growth rates generate higher degree of freedom. Thus, we may conclude that the pace of political institution building or in broader sense, an effective functioning of democratic institutions is strongly determined by historical heritage but also by economic development of a transition country.

Ironically enough, this corresponds with an old yet neglected finding concerning the Marxian notion of 'relations of production'. In explaining this point we shall recall a frequently cited passage from Marx's preface for *A Contribution to the Critique of Political Economy*: 'In the social production of their existence, men inevitably enter into definite relations, which are independent of their will, namely relations of production appropriate to a given stage in the development of their material forces of production' (Marx, 1859). In others words, men cannot choose relations they desire to find in, or in more modern terms they cannot deliberately construct institutional arrangements at their will. This can explain why transition economies that were forced to accelerate institutional transformations and execution of recommended reforms did succeed neither in their institution building nor in

[6] Recently, a similar result could be found in: Bruszt *et al*. (2012).

achieving a faster economic development suffering finally, from the crisis even more than it was necessary. In rushing to fulfil recommendations all other development policies have been usually neglected.

On the other hand, results presented in Table 3 induce an important *caveat*: political and civil liberties as being functions of economic growth could be drastically jeopardised by downfalls and subsequent stagnation in economic performance during and after the global crisis. The latest reports by Freedom House (see, e.g. Freedom House, 2012) that cover recent period of crisis have indeed observed this unfortunate development.

5. Conclusion

Discussing our earlier findings it was demonstrated how growth model of a transition economy changes over time in regard to the reforms advancement. This finding also suggests that reforms cannot become the only force in enhancing economic growth nor they can replace industrial policy (by means of market liberalisation). Moreover, the results obtained show that this has become obvious at a medium level of reforming progress and how reforms do request an industrial policy aimed at supporting industrial (tradable) output and export oriented structure of a transition economy.

The global crisis has finally revealed this important though missed point of economic development in transition countries. We have shown that in the critical years of the crisis (2008-2011) transition countries with superior industrial output and more export oriented had better chances to pass the crisis and better opportunities for recovery. Besides, it was shown that reforms alone and particularly those in financial sector, although assessed as successful and proper from transition policies point of view, could negatively affect growth and even offset and/or diminish effects of improved production structure.

In analysing how political and civil liberties affect economic performance we were encountered with a surprising result suggesting that higher political freedom negatively affects growth. Although generally surprising this could be explained for economies in transition: as over-accelerated economic reforms can be counterproductive so can be institutional changes if done too fast. Namely, it seems that they were formally established but substantially ineffective (as it undoubtedly happened in many transition countries). On the other hand we found political and civil liberties to be dependent on economic growth (as well as on inherited, historical conditions of a country) pointing once again the importance of proper development policies in transition economies.

Putting these pieces together we may make our final conclusion. Bearing in mind that some essential policies and measures have been neglected during transition, the right way-out from the present crisis should rely upon specific development and/or industrial policies that will be designed in a diagnostic rather than prescriptive manner, contrary to up to date uniform recommendations for all transition countries regardless of their legacy, actual conditions, available resources and social capabilities.

REFERENCES

Acemoglu, D., P. Aghion and F. Zilibotti, (2006), 'Distance to Frontier, Selection, and Economic Growth', *Journal of the European Economic Association*, Vol. 4, pp. 37-74.

Bai, J. (1997), 'Estimation of a Change Point in Multiple Regression Models,' *Review of Economics and Statistics*, Vol. 79, pp. 551-563.

Bai, J., and and P. Perron (1998), 'Estimating and Testing Linear Models with Multiple Structural Changes, '*Econometrica*, Vol. 66, pp. 47-78.

Bai, J., and P. Perron (2003), 'Critical values for multiple structural change models', *Econometrics Journal*, *Vol*. 6, pp. 72-78.

Beck, T. and L. Laeven, (2006), 'Institution building and growth in transition economies', *Journal of Economic Growth*, Vol. 11, pp. 157–186

Bruszt, L., N. F. Campos, J. Fidrmuc, G. Roland, (2012), 'Civil Society, Institutional Change, and the Politics of Reform: The Great Transition' Chapter 8, in: Roland, G. (ed.), *Economies in Transition – The Long Run View*, Palgrave Macmillan.

Cerovic, B. and A. Nojkovic, (2011), 'New Model of Growth in Transition Economies: Should it be Developed Earlier?', in: *Recent Economic Crisis and Future Development Tendences*, Proceedings of the 7th International Conference of ASECU, Rostov on Don, October, 6-8.

Chang, H-J., (2009), 'Industrial Policy: Can We Go Beyond an Unproductive Confrontation?', Plenary Paper for ABCDE (Annual World Bank Conference on Development Economics), Seoul, South Korea, 22-24 June 2009, http://www.econ.cam.ac.uk/faculty/chang/pubs/ABCDE2009-Changpaper.pdf

De Melo, M., C. Denizer, A. Gelb and S. Tenev (2001), 'Circumstances and choice: the role of initial conditions and policies in transition economies', *World Bank Economic Review*, Vol. 15, no.1, pp. 1-31.

Dixit, A. K. (2003), *Lawlessness and Economics: Alternative Modes of Governance*, Princeton, NJ: Princeton University Press.

EBRD, (2011), http://www.ebrd.com/pages/research/economics/data/macro.shtml

Estrin, S., J. Korosteleva, T. Mickiewicz, (2009), 'Better Means More: Property Rights and High-Growth Aspiration Entrepreneurship', IZA Discussion Paper, No. 4396

Fidrmuc, J. and A. Tichit (2007), 'Mind the Break! Accounting for Changing Patterns of Growth during Transition', CEDI Discussion Paper Series 07-06, Centre for Economic Development and Institutions (CEDI), Brunel University.

Freedom House, (2013), http://www.freedomhouse.org/

Freedom House, (2012), *Nations in Transit 2012*, Washington, June 6.

Grogan, L., L. Moers, (2001), 'Growth empirics with institutional measures for transition countries', *Economic Systems*, Vol. 25, pp. 323–344

Raimbaev, A. (2011), 'The case of transition economies: what institutions matter for growth?' *Journal of Economics and Econometrics*, Vol. 54, No.2, pp. 1-33

Rodrik, D., (2008), 'Second-best institutions', January, http://www.hks.harvard.edu/fs/drodrik/Research%20papers/Second-best%20institutions%20paper.pdf

Vonnegut, A., (2009), 'Institutions and initial conditions in transition: reconciling neo-institutional and neo-classical conceptions', MPRA Paper No. 24563, http://mpra.ub.uni-muenchen.de/24563/

World Bank, (2013), http://databank.worldbank.org/data/home.aspx