

## Transition Economies in Eastern Europe

Econ 233, Spring 2002

Time: M,W 8:30am-9:45pm

Room: Seely

Office Hours: Tue, Wed, Fri 2:00 - 4:00pm

<http://www.williams.edu/Economics/dvorak>

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**Course description:** This course has two objectives. The first one is to apply economic principles to the experiences of transition economies. Ten years of transition from centrally planned to market economies offer us many opportunities to apply economic theory to real world situations. Transition countries pursued different economic policies with differing results. We will learn how to join economic data with analytical tools to improve our understanding of why some countries have been more successful than others.

The second objective is to study the lessons which the transition provided for the field of economics. Many of the initial policy prescriptions in transition were based on the view that a free market is enough to achieve rapid growth and stable economy. These prescriptions grossly failed and economists realized the importance of institutions which support a market economy. We will explore which institutions are necessary for an effective capitalist society, and how to build them.

The course combines topics from international macroeconomics and institutional microeconomics. We will analyze macroeconomic aggregates such as output, inflation, money, interest rates, government deficit, investment, employment, exchange rates, trade balance, capital flows and stock market returns. At the microeconomic level we will examine the rationale and mechanisms of privatization, corporate governance and securities regulation.

**Prerequisites:** The only formal prerequisite is a course in principles of economics. Informal prerequisites include a strong interest in applied economics and enthusiasm to work with economic data.

**Readings:** There are two types of readings for this course: recommended and required. Recommended readings are marked with an asterisk in the list that follows, and are placed on reserve in the library. The required reading packet is available in Seely 6. It has required readings for the first half of the semester. There will be a second packet available in March. *Privatizing Russia* by Boycko, Shleifer and Vishny has required readings on privatization and is available in the bookstore. It is

assumed that students are familiar with the material in *Principles of Economics* by Mankiw. Particularly important chapters are listed on the course outline and should be reviewed prior to class. A copy of the text is on reserve in the library. In addition, short articles will be handed out in class.

**Course requirements:** Your grade will be determined according to the following weighting scheme:

Midterm	20%
Homework	35%
Final	30%
Class participation	15%

There will be 8 homework assignments. These will consist of problem sets, short essays and one class presentation. You are encouraged to discuss the homework with one another. However, each student must submit their work individually.

**Course outline:**

## I. Introduction to Transition

1. Course Overview and Motivation (February 1)
2. How Did the Old System Work? (February 4 & 6)
  - “And now for the hard part”, *The Economist*, April 1990.
  - “A picture of failure”, *The Economist*, April 1990.
  - Political Control of Economic Activity, chapter 2 in *Privatizing Russia*.
  - \*Ericson, Richard, 1991, The Classical Soviet-Type Economy: The nature of the system and implications for reform, *Journal of Economic Perspectives* 5(4),11-27.
3. Accounting for Economic Performance (February 11)
  - Chapter 24 in *Principles*
  - Mankiw, Gregory, 1994, Accounting for the sources of Economic Growth, appendix to chapter 4 in *Macroeconomics*.
  - \* Gregory, Paul R; and Robert C. Stuart, 1999, The Command Economies: Performance and Decline, chapter 13 in *Comparative Economic Systems*, Houghton Mifflin Company.
4. Neoclassical Market Model (February 13)
  - Chapter 7, 14 and 15 in *Principles*

- Milgrom, Paul, and John Roberts, 1992, Using Prices for Coordination and Motivation, chapter 3 in Economics, *Organization and Management*, Prentice Hall.
  - \*Murrell, Peter, 1991 Can Neoclassical Market Model Underpin reform?, *Journal of Economic Perspectives*,
5. Is Market the Best Way to Organize Economic Activity? (February 18)
    - Ronald Coase, 1937, The Nature of the Firm, *Economica*, 386-405.
  6. How to Organize Transition? I (February 20)
    - “The Best of All Monopoly Profits”, *The Economist*, August 11, 1990.
    - Fischer, Stanley, and Alan Gelb, 1991, The Process of Socialist Economic Transformation, *Journal of Economic Perspectives* 5(4), 91-105.
  7. How to Organize Transition? II (February 25)
    - Murphy, Kevin M, Andrei Shleifer, and Robert W. Vishny, 1992, The transition to market economy: Pitfalls of partial reform, *Quarterly Journal of Economics*, 889-906.
    - Brady, Rose, 1999, The Shock of Economic Freedom, chapter 2 in *Kapitalizm*, Yale University Press.
    - \*Murrell, Peter, 1993, What is Shock Therapy? What Did It Do in Poland and Russia?, *Post-Soviet Affairs* 9(2), 111-140.

## II. Macroeconomics of Transition

1. Macroeconomic Stabilization (February 27)
  - Chapter 27 and 28 in *Principles*
  - Fischer, Stanley, Ratna Sahay, and Carlos A. Vegh, 1996, Stabilization and Growth in Transition Economies: The Early Experience, *Journal of Economic Perspectives* 10(2), 45-66.
  - \*Cochrane, John H., and Barry W. Ickes, 1995, Macroeconomics in Russia, in Edward Lazear, ed., *Economic Transition in Eastern Europe and Russia*, Hoover Institution Press.
2. Balance of Payments Accounting (March 4)
  - Chapter 29 in *Principles*
  - Balance of Payments Accounts and Analysis, Chapter 4 in *Macroeconomic Accounting and Analysis in Transition Economies*, IMF.

3. Balance of Payments Analysis (March 6)
  - Chapter 30 in *Principles*
4. Capital Flows in Transition (March 11)
  - “Bohemia’s fading rhapsody”, *The Economist*, May 31, 1997.
  - Calvo, Guillermo A.; Leonardo Leiderman and Carmen Reinhart, 1996, Inflows of Capital to Developing Countries in the 1990s, *Journal of Economic Perspectives* 10(2), 123-39.
  - \*Lankes, Hans Peter, and Nicholas Stern, 1997, Capital Flows to Eastern Europe, in *International Capital Flows* Martin Feldstein ed., NBER.

### Midterm Exam (March 13)

5. The Russian Crisis (April 1)
  - “In a Financial Gamble, Russia Lets Ruble Fall, Stalls Debt Repayment”, *The Wall Street Journal*, August 18, 1998.
  - Gaddy, Clifford G., and Barry Ickes, Russia’s Virtual Economy, *Foreign Affairs*, September/October 1998.
6. Country Risk Project (April 3)
  - Joint BIS-IMF-OECD-World Bank statistics on external debt: Background summary.
  - “On Watch”, *The Economist*, May 15, 1999.
7. Financial Liberalization (April 8)
  - Mishkin, Frederic S., 1998, Portfolio Choice, chapter 5 in *The Economics of Money, Banking, and Financial Markets 5th ed.*, Addison Wesley.
  - Stulz, René M., 1999, Globalization of Equity Markets and the Cost of Capital, NYSE Working Paper 99-02.
  - \*Building a Financial System, chapter 6 in *From Plan to Market*, World Bank.
8. Monetary and Exchange Rate Policy Before EU Accession (April 10) (November 13)
  - Corker, Robert, Craig Beamont, Rachel van Elkan, and Dora Iakova, 2000, Exchange Rate Regimes in Selected Advanced Transition Economies

- Coping with Transition, Capital Inflows, and EU Accession, IMF Policy Discussion Paper.

### III. Microeconomics of Transition

1. Institutions Necessary to Support a Market Economy (April 15)
  - North, Douglass C., 1991, Institutions, *Journal of Economic Perspectives* 5(1), 97-112.
  - Legal Institutions and the Rule of Law, Chapter 5 in *From Plan to Market*, World Bank.
2. Privatization in Theory (April 17)
  - Chapter 3 in Boycko et al.
  - Chapter 10 in Principles, p.208-209 Coase Theorem
3. Privatization in Practice (April 22 & 24)
  - Chapters 4 and 5 in Boycko et al.
4. Corporate Governance and Securities Laws (April 29 & May 1)
  - “Hot shares, bothered investors”, *The Economist*, July 24, 1999.
  - “Who’s boss now? Eastern Europe’s capitalism”, *The Economist*, May 20, 1995.
  - Johnson, Simon, and Andrei Shleifer, 1999, Coase v. the Coasians, Working Paper.
  - \*Shleifer, Andrei, and Robert W. Vishny, 1997, A Survey of Corporate Governance, *Journal of Finance* 52(2), 737-783.

### IV. Evaluating Transition and Future Prospects

1. Evaluating Transition (May 6 & 8)
  - Stiglitz, Joseph E., 1999, Wither Reform, keynote address at World Bank ABCDE Conference.
  - Aslund, Anders, 1999, Why Has Russia’s Economic Transformation Been So Arduous?, paper presented at World Bank ABCDE Conference.