

Davorin Kračun. *Economics of Transition: Stabilization and Economic Performance.* Maribor: Inštitut za ekonomsko diagnozo in prognozo, Univerza v Mariboru, 2000. 81pp. (paper). ISBN: 9616396005.

Economic transition from a centrally planned to a free market economy is a complex process that presents a series of challenges for policy makers. Building a suitable institutional framework to support the functioning of newly established markets, the stabilization of inflation arising from huge price disproportions inherited from the planning period, and achieving satisfactory economic growth while keeping unemployment within acceptable limits are only a few of these. Slovenia built an institutional framework in the initial stages of transition and during the process of EU accession, but this task is not yet complete. The privatization of banks and insurance companies is currently underway, and the problems related to this are commensurate to its importance. Therefore, this contribution to the economics of transition logically focuses on the problems of stabilization and economic performance. Placing the model into the ever-changing institutional framework has presented a special challenge for researchers. The author, however, has managed to make good use of the (otherwise short-run oriented) input-output framework, adjusting it to incorporate certain dynamic characteristics, including the effects of economic policy measures. The openness of the economy presented an additional difficulty, which necessitated modeling the complexities of international trade and financial flows.

The work investigates the long-lasting moderate inflation that plagues most advanced transition economies. It has arisen from at least three sources. First, the decay of socialist central planning left newly emerged democracies with a legacy of huge relative price disproportions because the prices in place did not reflect the market forces of supply and demand. Thus, the reestablishment of a market-based relative price structure worked itself out through increases in prices and, consequently, the price level. This effect was relatively short-lived, but may have left its traces in the hysteresis of inflationary expectations. The second source is likely to have longer lasting effects. Large structural anomalies in the planned economy (large industrial complexes, or the “socialist dinosaurs”) place lasting pressure on government budgets, and large “socialist” enterprises struggle to keep their monopolistic positions. Both of these can thus contribute to inflationary pressures. The third element that is likely to contribute to inflation is the high share of unionized labor force. The unions are trying to preserve some of the social benefits workers enjoyed under the previous system. Thus, inflation rates of 8% or higher in Slovenia are often similar to those in other advanced transition economies and cannot compare with the low rates found in the EU or the US (1–3%).

The book is divided into two logical parts. In the first part of the book, the author uses a linear sectoral price function to derive an inflation multiplier that measures the response of the price level to exogenous shocks such as monetary or fiscal policy measures. The

inflation multiplier formalizes the loop connecting inflation and individual price-setting decisions. The author also discusses the effects of money and income freeze policy. In the face of supply-side shock, economic policy may attempt to dilute or prevent its effects by freezing the money supply, income, or exchange rate. This, however, does not eliminate the multiplication effects based on costs and inflation inertia. Although the inflation multiplication effects weaken under this policy, there is a stronger autonomous component. Thus, the analysis provides the measure of maximal effects of such a policy. The theoretical analysis is then applied to Slovenian data within an econometric case study.

The second, major part of the book presents the results of a model simulation for economic policy measures. The model is a result of many years of research and its structure is very complex, reflecting the complexities in an economy. However, the core of the model is an input-output matrix with dynamic adjustment mechanisms for the coefficients in the matrix and exogenous variables. Using a methodologically consistent approach and econometric estimates, the author calculates simulated dynamic responses to different economic measures, such as the introduction of the Value Added Tax (VAT). The model-based approach allows for the investigation of different possible scenarios and thus gives some idea about possible ranges for different variables. Four different scenarios are considered: optimist, export-aggressive, export-aggressive with wage expansion, and export-aggressive with rigid wages. For all four scenarios the model is calculated twice: without and with VAT (the difference thus being caused by the introduction of VAT). The optimistic scenario includes the actual or forecasted measures of economic policy at the beginning of 1999. The response of an open economy to recession may also be in the form of forced depreciation, which gives rise to the export-aggressive scenarios (they incorporate different degrees of price control). The possibility of a 1.5% increase in tax rates in different sectors (5% in construction) due to the introduction of VAT is considered. For the model, calibrated to Slovenian data, this can cause an inflation response between 2.9 and 3.9% higher than without VAT, and the response for production is between -0.21 and -0.35 %.

The book is a scientific contribution to economics of transition in which the author presents a relationship between economic policy measures and economic outcomes under the transition environment in a rigorous scientific analysis. Methodological consistency, which is possible within the model-based approach, and concise expositions are perhaps the most important qualities of the book. A theoretically well-founded discussion of the transition process in its advanced stages is also a welcome contribution.

Because the book is published in English, it should therefore be accessible to a broader but rather specialized audience with a professional interest in transition economies. In addition to economists, this may include political scientists, financial analysts and others. Although it documents the Slovenian experience, its theoretical findings apply to

other economies in transition, because they share several important characteristics.

The successful attempt at a theoretically and methodologically coherent study unfortunately limits the accessibility of the book to the general public. Thus the short non-technical summaries of the contents are a welcome addition to the concise text.

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