

Review Questions

1. What are the major theories that explain the collapse of output in transition economies?
 - (a) Why is the collapse of output in the early stages of transition a theoretical curiosity?
 - (b) Why might the collapse in measured output overstate the true effect?
 - (c) Which explanations of the output fall make the most sense? Explain.
2. Empirical studies suggest that countries that chose faster liberalization have been the first to experience resumption of growth. What is the logic behind this result? To what extent is this empirical finding illusory? Explain.
3. Describe the common characteristics displayed by output in transition economies. What are the important differences among these economies?
4. Why is it difficult to judge the performance of a transition economy simply by observing the path of output? Does a decline in output following liberalization necessarily imply that welfare has decreased? Explain. Does output growth necessarily mean that reform is proceeding?
5. The fall in power consumption relative to that of GDP has been greater in the former Soviet Union than in Central European Economies. Some observers take this fact as evidence that the fall in output in the FSU is overstated.
 - (a) Carefully explain the logic behind this argument
 - (b) Is this the only interpretation of this difference? What alternative explanations can be offered? Carefully explain.
6. External liberalization in transition economies is complicated by the problem of industries that actually destroy value at world prices.
 - (a) Carefully explain the meaning of negative value added at domestic prices and at world prices.
 - (b) Why are transition economies plagued with problems of negative value added producers? Why is the presence of sectors that produce negative value added problematic for liberalizing economies?
 - (c) Why was this competitiveness problem more severe in Russia than in many East European transition economies?
 - (d) How can the same industry produce value added at domestic prices but destroy value at world prices?

7. Why is the collapse of output in the early stages of transition a theoretical curiosity?
 - (a) Why might the collapse in measured output overstate the true effect?
 - (b) What are the major theories that explain the collapse of output in transition economies? Distinguish systemic causes from policy-induced factors.
 - (c) If transition involves an adjustment from an inefficient state sector to a more efficient private sector how can output fall? Explain.

8. Transition economies often experience a depreciation in the value of their currencies in the wake of external liberalization. Why does this occur?
 - (a) How does the depreciation in the value of the currency impact on the relative competitiveness of domestic production in transition economies?
 - (b) Why is the depreciation of the value of the currency a transitory phenomenon? Explain.
 - (c) Why would we expect the value of the currency to appreciate as transition proceeds? What would be the likely impact of this appreciation?

9. Disorganization is a popular theory of the fall in output in transition economies. Carefully explain what is meant by disorganization. How can this theory explain differences in the magnitude of the output fall across economies? What predictions of this theory run counter to the facts of the output fall?

10. What is the role of monopoly power in explaining the output fall? Explain. What is double marginalization?

11. External liberalization in transition economies is complicated by the problem of industries that actually destroy value at world prices. Carefully explain the meaning of negative value added (NVA) at world prices. How can the same industry produce value added at domestic prices but destroy value at world prices?
 - (a) Why are transition economies plagued with problems of NVA producers? Do you find this problem in market economies? Explain.
 - (b) Why is the presence of enterprises that produce NVA problematic for liberalizing economies? Why is the problem of whole sectors that produce NVA a problem for liberalizing economies?
 - (c) Why was this competitiveness problem more severe in Russia than in many East European transition economies?

12. The process of structural adjustment involves the movement of resources from the state sector to the private sector. If the private sector is more productive than the state sector why is this a complex problem?
 - (a) If the process of structural adjustment were smooth and frictionless what would happen to labor productivity in the transition? How does this compare with what actually happens to labor productivity in transition?

- (b) What does your answer to part (a) suggest about the nature of structural adjustment?
 - (c) What are the most important features that govern the process of structural adjustment in transition? Be as specific as you can.
13. What is the *status-quo bias* in economic reform? What is the source of the bias? How can reforms that benefit a majority *ex post* be opposed by a majority *ex ante*?
- (a) Under what conditions does bundling of reforms help?
 - (b) When does bundling make reform more difficult?
 - (c) Why does it matter if reforms are complementary? Explain.
 - (d) What is the role of compensation and commitment in the reform process? Explain.
14. Why is inflation a problem in the early period of transition? What are the sources of this inflation? Why is it hard to control?
15. How can measured real income fall and welfare rise when prices are liberalized. Analyze this in terms of the model with excess demand and queuing.
16. What are the distributional consequences of price liberalization? Who gains and who loses? Why?
17. Use the specific factors model to analyze liberalization. What happens to wages in the short run after liberalization? What happens over time? What is the source of delay?
- (a) What implications does this model have for the path of output in transition? Explain.
 - (b) How does the predicted path compare with the actual path of output in transition?
 - (c) What are the three critical factors that determine the length and severity of the adjustment process? Explain.
18. Why is it difficult to measure the output fall in transition?
- (a) what is the role of changes in the statistical system?
 - (b) what is the role of sampling?
 - (c) what role is played by the hidden economy? Explain.
19. What is the Camellia effect? What does it imply about the output fall in transition?