

Macroeconomic Aspects of Opening up, Unemployment and Sustainable Growth in Transition Countries

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1 Introduction

Economic opening up has been a natural element of systemic transformation in the former Soviet Union and the smaller post-socialist countries of Eastern Europe. After high inflation rates and a massive transformational recession in the early transition stage – reflecting obsolescence of part of the capital stock and adjustment costs in the course of restructuring – in the first transition stage, most transition countries have achieved considerable economic growth. Countries with relatively low per capita income, a well educated labor force and a functioning banking system should indeed be able to record considerable economic growth if stable and efficient institutions, competitive pressure and opening up are combined in a sustained manner. It is not easy for transition countries with a young democracy to come up with the right combination of constitutional foundations and efficiency enhancing political learning, in particular since governments eager to generate quick improvement in some fields might favour short-term political action over long term growth strategies.

This analysis will focus on economic catching-up in the sense that we consider economies which become open for trade, foreign direct investment flows and technology transfer. We assume that the first stage of economic opening up is accompanied by a rise in price elasticities. However, in a second transition stage during which firms increasingly specialize in more technology intensive (and less price sensitive) products, requiring a higher share of sunk costs in investment, labor demand elasticity will be assumed to fall. As regards innovations, we will focus partly on process innovations, but more important here are product innovations in countries catching-up. Product innovations are new for the respective poor country but not new to the world economy so that from the perspective of a leading global economy, we focus on international diffusion phenomena. The following analysis presents certain analytical building blocs but not an integrated model, although one may combine the various blocs to a consistent meta model. Moreover, there will be no microeconomic foundations of behaviour at the macroeconomic level. This certainly is possible but as we will consider only minor – but powerful – modifications of well-known models, we are not so much interested in the aspects of microeconomic foundations.

We will emphasize that for certain analytical purposes, it is useful to take a look at the macroeconomic impact of both supply-side and demand-side impulses. In every economy, output dynamics can be understood to be a mixture of the impact of the supply side – its macroeconomic equivalence is the production potential $Y^{\text{pot}} = K^{\beta} L^{1-\beta}$ (K is capital and L is labor) – and of aggregate demand Y^{d} . In transition countries, both supply-side dynamics and the demand side are important with some sectors being dominated by supply-side developments while others are shaped by demand side dynamics. A hybrid approach can be written as follows:

$$Y = \alpha Y^{\text{pot}} + (1-\alpha) Y^{\text{d}} \quad (1.1)$$

An important question is what determines α (in the interval 0,1), the size of the relative supply-side impact parameter. It will reflect various forces, including ex-