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REFORMS, DEMOCRATIZATION AND GOOD GOVERNANCE – KEYS FOR ECONOMIC RENESSANCE OF EMERGING MARKETS (MOLDOVA AND UKRAINE: COMPARATIVE ANALYSIS)

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In 2013-2014 emerging markets, which have been generating more than two thirds of global economic growth during last five years, lost their mojo. For the first time since 2007 the U.S., Europe, Japan and other developed markets contributed more to the growth of $74 trillion global economy than the emerging markets, including those of BRICS block (acronym of Brazil, Russia, India, China and South Africa). What explains this sizable slowdown in economic growth of these countries? [15, p.41-43]. These evolutions refocused the researchers' analysis to politics and economics of reforms and democratization [1, p.76-77], [16, p.203], [5, p.179-204], to pitfalls of economic development [26, p.325-369], to decay and refounding of the modern economy [6]. To address these challenges it is very important to learn the right lessons from economic reforms, democratization and governance in emerging economies of Central and Eastern Europe (former Soviet Union and Eastern European socialist countries), particularly, Moldova and Ukraine.

Keywords: *of emerging markets, reforms, democratization, good governance, economic growth, economic renaissance, economics politics.*

REFORMELE, DEMOCRATIZAREA ŞI BUNA GUVERNARE – CĂI PENTRU RENAŞTEREA ECONOMICĂ A PIEȚELOR EMERGENTE (MOLDOVA ŞI UCRAINA: ANALIZĂ COMPARATIVĂ)

În 2013-2014 pieţele emergente, care au contribuit cu peste doua treimi la ascensiunea globală din ultimii cinci ani, au început să piardă rolul de „generator" al creşterii economice. Pentru prima dată, din 2007 SUA, Europa, Japonia şi alte pieţe dezvoltate au o contribuţie mai importantă în creşterea economiei mondiale ce valorează 74 trilioane dolari americani, decât pieţele emergente, inclusiv cele cunoscute sub acronimul BRICS (Brazilia, Rusia, India, China şi Africa de Sud). Care este explicaţia acestei încetiniri semnificative a creşterii lor economice? [15, p.41-43]. Aceste evoluţii au redirecţionat cercetările analitice asupra politicii economice a reformelor, democratizării şi bunei guvernări [1, p.76-77], [16, p.203], [5, p.179-204], asupra „capcanelor" dezvoltării economice [26, p.325-369], asupra decăderii şi renesansului economiei moderne [6]. Pentru a găsi soluţii la aceste probleme trebuie să se ţină cont de învăţămintele derivate din reformele economice, ale experienţei de democratizare şi guvernare în economiile emergente ale Europei Centrale şi de Răsărit, în particular ale fostelor republici sovietice Moldova şi Ucraina.

Cuvinte-cheie: *pieţe emergente, reforme, democratizare, buna guvernare, creştere economică, renaştere economică, politici economice.*

Introduction

In 2013 emerging markets, which have been generating more than two thirds of global economic growth during last five years, lost their mojo. For the first time since 2007 the U.S., Europe, Japan and other developed markets contributed more to the growth of $74 trillion global economy than the emerging markets, including those of BRICS block (acronym of Brazil, Russia, India, China and South Africa). What explains this sizable slowdown in economic growth of these countries? [15, p.41-43] One of the most important factors is that they lost sight of the need to keep up reforms that boost productivity and innovation, to develop their human capital-health, education, skills [31], [25]. These evolutions refocused the researchers' analysis to politics and economics of reforms and democratization [16, p.203], [5, p.179-204], to pitfalls, of economic development [26, p. 325-369], to decay and refounding of the modern economy [6].

In 2004 Francis Fukuyama in his book *State-Building* mentioned "Weak and failing states have arguably become the single most important problem for international order" [4]. Ten years later the turmoil in Ukraine confirmed the risk that failed and weak states pose for global security, provoking one of the most acute international crises after the end of the Cold War a quarter of century ago. Starting with Russia's first great setback of democratization after the fall of the Berlin Wall (1989), the political and economic crises in Egypt, Turkey, Thailand, Argentina, Venezuela and in many other developing countries represent the stalled progress in the most successful political idea of the 20th century. According to Freedom House, American think-tank, 2013 was the eight consecutive year in which global freedom declined; democracy's global advance has come to a halt, and may even have gone into reverse [28, p.48]. Democracy is struggling even in those 10 post-communist countries of Eastern Europe that embraced European Union during last decade and that had to prove their liberal and democratic credentials according "Copenhagen criteria" before being admitted. Almost all of them are experiencing profound political crises [21, p.14].

Another major setback is disappointment in emerging markets economic growth that put on hold the fragile tendency of convergence – the catch up ("converge") of their income with that in advanced nations. In fact these countries are "deconveging", overturning the optimistic forecasts of some scholars, including the Nobel price winner Michael Spencer. He wrote in his 2011 book *The Next Convergence* that "after two centuries of high speed divergence, a pattern of convergence has taken over" [13, p.5]. From the all time high average growth of over 7% a year reached by these countries in the middle of last decade, the emerging world fell back to four percent in 2013, losing about $2 trillion in stock market value since the beginning of the Great Recession in late 2007, or a third of these countries $9 trillion market capitalization [25].

What explains the setback of democracy and slowdown of economic growth in emerging markets, even in those of the BRICS countries? Are there any connections, relationships between democracy and economic reforms, can political freedom hinder or facilitate economic reforms? Why nations fail? What are the lessons of transition from Plan to Market? How to build a successful development model?

To address these questions I will focus on important lessons and challenges of economic reforms and democratization in emerging economies of Central and Eastern Europe, particularly in Moldova and Ukraine.

Lessons from Moldova's transition

Why Moldova matters? This is a small south-European country that gained its independence in 1991 after the dissolution of the Soviet Union and made a strategic choice: toward European future through democratic, economic, social and political reforms. Even communist government that ruled Moldova for eight years adopted pro-European rhetoric, although their actions were taken in opposite direction. In 2009 the communists' rule come to an end after massive protests of youth known as "Twitter Revolution", brutally repressed by the then government in the central square of Chisinau, capital of Moldova [9, p.145]. These events made the headlines in the world press, perhaps for the first time on such a scale since Moldova became independent. What's happened in Ukraine capital Kiev's *Maidan* Square in 2014 is de-facto the same drama that Moldova suffered in 2009.

On February 27, 2014, the European Parliament voted overwhelmingly for the abolishment of the visa regime for Moldovan citizens. Along with visa liberalization, European Union (EU) opened green line for export of the most important Moldova's product - wine to its market. I would mention also Moldova's 8% increase in GDP in 2013 with good prospects for more than 4% annual growth and structural changes for the next three years. (*Moldepress*, 2014, February 11). This is the most performing economic growth in emerging markets of Central and Eastern Europe. In June 2014 Moldova signs Association Agreement, including Deep and Comprehensive Free Trade Agreement (DCFTA) with European Union. The current Moldova's governance, - one of the most professional and reform-oriented, deserves credit for these achievements. Of course, they are based on foundation established in earlier 90s, in the first round of democratic, economic and political reforms when Moldova was considered by many western officials and experts a successful model of economic reforms and democratization. In 1999 when I presented my letters of accreditation as Moldovan Ambassador to the U.S. President, Bill Clinton, he mentioned: "…we indeed appreciate the achievements in promoting democracy and market reforms in Moldova after obtaining independence in 1991. The Land Privatization Program and the achievements in promoting democracy and the observance of the human rights constitute a success model for the countries in the region. By promoting the economic reforms Moldova has made her choice".

The Gorbachev's *perestroika and glasnost'* of late 80s inspired Moldovan reformers and got an overwhelming support from the people.

At the start of Moldova' transition from communism and central planning in the early 90s, the most important questions were not whether or not to implement reforms With exception of communist hardliners, everyone agreed that radical reforms were necessary. The most debated issues were how to promote them, what models to choose and how to accelerate transition to a socially-oriented market economy. An example of the broad social support was mass privatization: 95% of population received patrimonial bonds (vouchers) and 90% used them to privatize their homes, land, and other assets owned by the government and offered for privatization. It is hard to imagine any political party or leader to be advantaged with 90% of popular vote today and even then at the early time of independence. The benefits of these reforms, particularly of Land Privatization, are clearly visible today: this was one of the most successful and comprehensive reforms that destroyed *kolkhozes* – fortress of communism in rural area and put the basis for collective farms, established and protected private ownership rights, which led to increase productivity in agriculture, and set an example for other countries in the region. Not accidentally the World Bank Doing Business report credited Moldova with an impressive ranking of 17 among 183 countries for registering property due to lands titling and private ownership of land with an efficient and low cost land registration process.

Along with the successes comes responsibility and assessment by electorate of the reforms' result that does not always match people's expectations, and does not bring dividends overnight. As U.S. Vice President Joe Biden stressed three years ago in the statement to the Moldovan people in Opera House Square in Chisinau: "Political change is hard. Economics reforms can be even harder, especially when unemployment is high and prices are rising" [8].

There is a social cost, so-called "reform fatigue", when electorate's mood is dominated by the hardships, deception and disillusionment. By the end of 90s in Moldova, for example, the society's credit of confidence in reforms was gradually eroded due to several factors: a) lack of strong political will and responsibility of ruling class that was preoccupied by internal fights and personal interests rather than radical transformations in national interest; b) reforms were nor synchronized, neither adjusted to the real situation and real needs of the people. Their social cost was too high and especially painful for the old and retired who had been "forgotten in transition", as well as for the young generation, who was not so forgotten as never remembered; c) to some extend even the international assistance, although valuable, was not focused on what could be called "arithmetic" of transition – the basic needs of populations, social protections, education and healthcare programs.

A forgotten lesson of 1990s is that once reforms started they should be promoted firmly and consistently with minimum government interference, though the government must still supervise. In Moldova, however, the process was never straightforward and in many cases took "one step forward – two steps back". For example, when mass privatization started in 1994 the government was very worried about an eventual imbalance between the value of bonds distributed to population and the value of property submitted to privatization for these bonds. To address this issue the government arbitrarily and artificially increased the value of the state property while also banning the privatization of hundreds strategically important state owned enterprises (SOEs). Among them were Moldovan telecom operator Moldtelecom, electrical distribution networks, tobacco factories, public utilities companies, wineries etc. By the end of this process in 1998, more than 20% of state owned property designed for privatization through patrimonial bonds, was never privatized. Some of these "strategic" SOEs are still under poor government management; some others have been privatized to the "right people" during communist governance (2001-2008), but most of them have just been destroyed with their assets squandered. As a result, the majority of ordinary citizens never received the dividends they had expected.

The "hidden momentum" is the inertia of previously taken decisions, adopted laws, established patterns, anti-competitive (cartel) practices, and the monopolization and re-privatization of the most profitable businesses by the former Moldovan President (V.Voronin) and his clan. During the communists' post-2001 rule, no single reform was brought to its meaningful completion. The results had been corresponding: energy sector with its everlasting debts, outdated infrastructure with the worst roads in the world, inefficient public sector with an expensive education system, fragmented social assistance and high health spending, with corresponding indicators still much below EU averages; fiscally unsustainable pension system etc.

I would add to this murky picture of communist heritage a significantly increased migration of the most educated and skilful Moldovan workers abroad, which remittances accounted for almost a third of GDP, pushing Moldova among the top 5 world leaders on this indicator. Outflows of Moldovan professionals, young talented specialists – "brain drain" – were caused by discriminated selection of public servants according to the principle of "personal devotion" to the communist boss and not to their professional and moral qualities. To overcome this heritage it will take not one and not two years. It will take even more time to change the mentality of people still indoctrinated by communist's myths.

"Economies need a balance between the role of markets and the role of government – with important contributions by non-market and nongovernmental institutions", stressed Joseph Stiglitz, the Nobel Prize winner in economics in his book *Freefall* [7]. In Moldova there always was (and still is) an imbalance in favor of the government and its bureaucracy. That's the explanation why in the 2014 Index of Economic Freedom Moldova is remaining in a group of countries with "predominantly non-free economies", being placed on 110 position among 178 nations surveyed, with much lower than average scores on fighting corruption (29.5%), ownership rights (40%) and labor freedom (37.9%) (*Infotag*, March 5, 2014).

These lessons should not be ignored, otherwise the "barbarians" could once again take the "harvest" during the upcoming parliamentarian elections (November 2014) and Moldova could lose another chance for European integration in spite of all good intentions and signed good documents. It already happened in 2001 elections when the old fashioned, unrestructured communist party came to power on the wave of democratization, discontent of the people with economic hardships and lack of "dividends" from the painful transformation [32].

Moldova is now at the stony road to real economic and political integration into EU and has defined its priorities. Among them there are the implementation of the Roadmap for enhancing competitiveness and innovations, regulatory reforms, creation of attractive business environment for investments, increasing energy efficiency, diversification and decreasing energy dependency from one source - Russia. The question is: can Moldova stay on this road to Europe? Can Moldova resist to "high risk" of social unrest in 2014 and to the revenge of nostalgic forces?

Ukraine: quo vadis?

The World Economic Forum's latest annual report on global risks sizes the impact of 31 all-too real threats in the year ahead, putting in evidence Emerging Markets uncertainties: "Existing undertones of social unrest may be aggravated by externally driven economic shocks and the unsatisfactory implementation of far-reaching domestic reforms, even more so where political succession planning is unclear" [14]. The authors of this report did not attribute political and social instability to economic risks. Neglect of politics in economic analysis, as Daren Acemoglu and James Robinson, emphasized in a recent article, is often justified in one of three ways: a) politicians are interested in social efficient policy that may help them to keep the power or to be reelected, regardless of the economic costs and benefits; b) politics is always viewed as "a random factor, just creating severe and unsystematic grit on the wheels of economic policymaking" (for example, disastrous economic policy of Liberian dictator Samuel Doe, or that of ex-Moldovan President Vladimir Voronin and ex-Ukrainian President Victor Yanukovich); and c) political economy matters as long as "good economics is good politics", but sometimes ruling elites could turn even good economics into bad politics [16, p.203].

After the collapse of the Soviet Union (1991), Ukraine emerged as potentially one of the most important geo-strategic partners to the United States and European Union. With a population of 46 million and territory comparable to that of France, Ukraine has a significant economic potential. Ukraine's economy, after a decade (90s) of severe economic contraction, has enjoyed six consecutive years (1999-2005) of growth during which GDP expanded by more than 50 percent and poverty fell sharply. In 2006 Ukraine registered unprecedented four fold increase of Foreign Direct Investment (FDI) - one billion dollars, totaling cumulatively $17.4 billion. This tendency was expected to be strong. The agricultural sector grew up to 6 percent per year in 2005-2008, with upward potential depending on the pace of further market liberalization and land reform. Industrial growth continued to be healthy.

Everything looks good by the middle of the last decade, at least in economics, and Ukraine's Orange Revolution government seemed like it would fulfill popular demand of radical political reforms and rapid integration into Europe. But those expectations quickly faded, because "good economics" this time turned into "bad politics". Democratic President Victor Yushchenko and democratic prime-minister Yulia Timoshenko proved to be incapable to work together, choosing public clashing and criticism to economic and democratic reforms, discrediting themselves and the idea of European integration. Alexander Motyl, Professor at Rutgers University in Newark, mentioned that "Ukraine's dysfunctional political system become known to Ukrainians as a *durdom*, or "madhouse". The situation was aggravated by the global economic crisis: country's output declined by 15%, exports – by 25% and import – by 40%, with rapidly increasing consumers' price index, and as a consequence - increased popular anger and frustration [20, p.125].

In 2010 presidential elections Ukrainians voted for economic reforms, increased prosperity, to put an end to corruption and for integration to Europe, promised by Victor Yanukovych, a candidate from Eastern Ukraine, backed by Russia. Soon after he won election by a small margin to his archrival, Yulia Timoshenko, whom he put in jail later on for alleged "abuse of power", the new President became trapped by his own promises to transform Ukraine into an "economic tiger" and one of the world richest twenty countries. Instead, his authoritarian and incompetent policy succeeded to transform the Parliament – Ukrainian Rada, into a rubber-stamp machine, controlled by his own Party of Regions; subordinate the courts to the "oligarchic rule"; neglect badly needed economic reforms, and realign his foreign policy to Russia. In April 2010 he signed the Russian-Ukrainian pact, which extended the Russian Black Sea Fleets rights in Crimean Peninsula until 2047 [19, p.137-148]. V.Yanukovich U-turn from Europe, was marked by his refusal to sign the Association Agreement with European Union with visa free regime and the following Free Trade Agreement just before EU Vilnius Summit (November 28-29, 2013). This was the last drop in people's patience and a spark of massive protests in Kiev's central square – *Euromaidan* [3]. This awakening of people was much stronger this time, as Oleh Shamshur, former Ukrainian Ambassador to the U.S. observed.

The situation in which Ukraine found itself today, after less than four years of the corrupted presidency of V.Yanukovych is an eloquent example of conditions under which politics and economics run into conflict at the price of democracy and economic reforms. As Anders Aslund, a Georgetown University professor mentioned, the president Yanukovych and his family embezzled between $8 billion and $10 billion a year, an amount of about $35 billion desperately needed by the new democratic government today to avoid economic abyss [27, p.21-23], [30, p.15-16]. The Ukrainian crisis is far from being solved, especially after Russia's military intervention into Crimean peninsula to "protect the Russian minority human rights". The real and ill camouflaged Russia's intention is to re-capture this territory that the former Soviet Leader Nikita Khrushchev transferred in 1954 to the then Soviet Republic of Ukraine.

"We should learn lessons from the crisis in Ukraine. And the first such lesson is: once you have set yourself a goal you should realize it", the Moldovan Prime Minister Iurie Leanca stated at a meeting of the Atlantic Council in Washington DC on Monday, March 3d. In his address to the Council, he said that Ukraine's refusal to sign its Association Agreement with the European Union was "a decision that changed everything"; the second lesson is: one should not focus on negotiations only: "In parallel, we should be preparing the country and the national economy to availing ourselves of the Association Agreement provisions". "The 3rd lesson is that we must better communicate with citizens, and a final lesson, according to Moldovan Prime Minister, is that the Eastern Partnership Program needs to be revised so that all the countries involved should be given clear perspectives of integration into Europe" (*Infotag*, 04 March 2014).

The "Eastern Partnership" has been initiated by the EU to forge closer relations and cooperation with Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine, all former Soviet Union republics that have not very much in common today except three things, as Edward Lucas, well known expert on this region, said: "Their abilities to make deep reforms range from weak to nil. The EU does not want them in its orbit as full members. And the Kremlin wants to keep them in its orbit" [17].

I would add to this just one important detail: all these independent countries with exception of Belarus are facing threats of protracted conflicts and separatists movements, backed by Russia and this undermines their national security as well as regional peace and security, and prospects for economic and democratic reforms. The Transnistria's separatists, a Moldovan territory overtly supported by Kremlin, recently voted for adoption of the legislation of the Russian Federation. This is one of the five frozen and forgotten conflicts in the former Soviet Union, along with Georgia's Abkhazia and South Ossetia, statelets captured by Russia during its five days war against Georgia in 2008; Nagorno-Karabakh, a disputed territory between Armenia and Azerbaijan and now Ukraine's Crimea, occupied by Russian troops [33, 18].

On May 25 2014 Ukraine elected a new president, Petro Poroshenko, a tycoon, whose nickname is "Chocolate King" (he made his fortunes by privatizing Ukraine's chocolate factories and I know him since my career of the Moldovan Minister of Privatization in early 90s). As Mikheil Saakashvili, former President of Georgia, stressed: "Petro Poroshenko was the best choice among all the candidates, considering the challenges of the moment" [23]. The new Ukrainian President promised to sign the Association Agreement with

EU, to revive the unitary Ukrainian state by promoting reforms and democratization, to end "the terror" in the eastern part of Ukraine and to start direct negotiation with Russia [22]. This is another chance for Ukraine to solve the dilemma "Quo Vadis?"

Emerging markets and rebalancing growth model

During the last five years after the Great Recession (2007-08), emerging markets beginning to submerge. Their average annual growth decreased to 4% in 2013, more than twice from the all-time high 8.7% in 2007, deconverging farther from the advanced markets [24, p.55]. Although many emerging market economies remain the world's fastest growing, their market purchasing managers indexes, a proxy for GDP growth, hits their lowest level. Economic growth of BRICS decelerates simultaneously and much more than was expected due to underappreciated cyclical and structural factors. Three of these big "five fragile" – Brazil, Russia and South Africa, are growing now at a pace slower than that of the U.S. The IMF experts consider that exceptionally large monetary and fiscal stimulus, which contributed to the global economy recover (these factors led to lift of growth, rebounded export, fall of the global interest rates and increases commodity prices), began to fade starting with 2011.

To recover and rebalance the economic growth policymakers could increase the economic resilience of their emerging markets by implementing important reforms, swinging in capital inflows and stabilizing financial adjustment, strengthening the institutional frameworks. More resilient economies have more credible fiscal and monetary policies. They are characterized by improved prudential regulation and supervision, limiting excessive risk without preventing the development of financial sector. Stabilizing financial adjustment and rebalancing the growth requires also relatively open capital account to allow their residents to accumulate stocks of foreign assets and to move money in and out of the country as necessary [15, p.127].

Conclusions: regaining the growth momentum

How emerging markets could regain their growth momentum, keep their economies humming?

First, identification of the engines of growth and prosperity. Daron Acemoglu and James Robinson in their book *Why Nations Fail* pointed out to inclusive economic institutions that create "inclusive markets, which not only give people freedom to pursue the vocations in life that best suit their talents but also provide a level playing field that gives them the opportunity to do so" [1, p.76-77].

Second, successful development, according to Timothy Besley and Torsten Persson, "depends upon the state's capacity to raise revenue, enforce the rule of law and to avoid political conflict" [2].

Third, the role of political leadership. As Ruchir Sharma wrote in a recent article, the leaders "need to make sure the growth across national accounts (not too dependent on borrowing), social classes (not concentrated in the hands of a few billionaires), geographic regions (not hoarded in the capital), and productive industries (not focused in corruption-prone industries, such as oil" [24, p.55].

Fourth, imperative necessity to develop their human capital – health, education, and skills. Robert Zoellick, former president of the World Bank Group, consider that to capitalize on this potential, the emerging markets need "to invest in solutions to overcome transport, energy, telecom and water bottlenecks", to eradicate, or at least to diminish impediments to starting new businesses, to reduce the cost and increase efficiency of public services, to solve the problems of inefficient state-owned enterprises by privatizing them [31].

Fifth, there is a strong positive correlation between democracy and reforms, being robust to the variables that are usually associated with reforms and not necessarily with democracy, such as crises, neighboring country effects, compensation schemes; but there is no evidence that economic reforms "pave the way for political reforms", wrote Paola Giuliano, Parachi Mishra, and Antonio Spilimbergo, calling for an effort "to study the precise mechanisms through which democracy has an impact on economic reforms" [5, p.179-204).

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