TRANSITION TOWARDS NEW GLOBAL SETTING IN LITHUANIA

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Abstract. The experience gained during the transition decade and five years of the EU membership by Lithuania could be an insightful contribution to an economic policy debate on managing the transition period driven by the global rebalancing of supply and demand.

The purpose of the paper is to define the growth enhancing policy measures that have proven efficient during the transition reform period and could be relevant under the new global setting.

Findings. Regulated markets set better conditions for the growth of economy than do self-regulated markets, while the most important problem of economic strategy is to evaluate the degree of impact of each determinant on growth and to set their combination favourable for a long-term growth. The growth-enhancing public policy should be aimed to increase the total factor productivity and to ensure competitiveness in global markets.

Policy makers have to focus on facilitating an environment conducive to establishing new SMEs in new sectors of economy, instead of focusing on restructuring the old sectors. Restructuring some loss-making industries takes some time, but the efficiency of investments could be ensured if cost reduction is prioritized and leads to an increase in the total factor productivity.

Key words: *growth, transition, productivity, costs cutting, competitiveness*

Introduction

The fall of the Berlin wall, which had divided Europe into two different political and economic systems – one based on democratic values and market economy and the other relying on the state oversight over lives of ordinary citizens and centralized administrative governance of economy – had huge implications in the economic development of the whole continent. The former post-soviet countries started their transition process from centralized to market economy, and at the beginning of the 21st century this process, with some exceptions, was completed, though the results were uneven.

Approximately at the same time, the development of new information technologies, trade liberalization and expansion opened the opportunities to speed up the transition process in emerging economies, which had started some years earlier. The aim of economic

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reforms was the same – to modernize the economy and turn it into a market- based system. Not in all countries were economic reforms accompanied by democratization process and political reforms.

During the first decade of the 21st century, two new groups of countries – the EU and the so-called BRICS (Brazil, Russia, India, China, and South Africa) countries – increased their share in the global economy and became, along with the USA, systemically important for the global stability.

The new global setting was a result of the rebalancing of global supply and demand. Low costs and relatively unlimited, young labour force created a favorable environment for industrial development in Asia and Latin America, so mass production from the USA and European countries by international companies was moved there. The countries became major suppliers of goods, putting pressure on the USA and the EU economies to find new sources of growth; de facto, advanced economies also entered into the transition period. The experience gained during the transition decade and five years of the EU membership by Lithuania could be an insightful contribution to an economic policy debate on managing the transition period driven by the global reallocation of supply and demand.

The purpose of the paper is to define the growth-enhancing policy measures that have proven efficient during the reform period and that could be relevant under the new global setting. It is organized as follows: firstly, findings of the transition period from centralized to market economy are discussed and presented, recommendations of policy measures based on transition period experience are given; secondly, the results of the first five years of the EU membership are discussed, and policy measures based on this experience are suggested. This consideration allows defining the economic policy that could have a positive impact on economy during the transition period.

1. Building market economy: experience of 1990–2000

1.1. Learning by doing

Economists are in broad agreement that the main elements of transition from centralised to market economy were price liberalization, macroeconomic stabilization, restructuring and privatisation, legal and institutional reforms (IMF, 2000). Nevertheless, theoretical debates are still going on as to the constituent elements of technological progress achieved by countries in transition and the extent public policy could have influenced it.

In Lithuania, the empirical analysis of and opinion polls of the transition period showed that *the modernization of economy and ability to cope with competitive pressures were determined by the technological advancement achieved through "learning by doing", which facilitated structural changes and an increase in productivity*.

The opinion poll, conducted at 500 enterprises, unveiled the importance of learning which enterprise managers identified (86%) as a single most important determinant of growth, while investment was mentioned only by 40% of managers.

In 1990, agriculture accounted for nearly one-fifth of Lithuania's national output. By 2000, the share of agriculture in its GDP declined to 6%. The industrial sector accounted for 35–40% of total output in 1991, while by 2000, industrial output accounted for just 23% of the GDP. A rapid growth was registered in the services sector: the contribution of trade, restaurants, hotels and real estate sectors increased from 9% of GDP in 1990 to 28% in 2000. Reflecting a relatively low level of financial intermediation, the share of the financial sector declined from 7.3% of the GDP in 1993 to 2% in 2000. The Stock Exchange was launched in 1993; the same year, the national currency – litas – and a year later the currency board arrangements for monetary policy were re-established.

The main driver of growth was small and medium enterprises; in 1995–1997, value added at constant prices, produced by small-sized companies (those with up to 10 employees) increased by 203%, while in large corporations (those with more than 200 employees) it fell by 7.3%. Medium-sized enterprises (10–49 employees) also saw a rapid growth in 1995–1997: their value added rose by 71%.

In 1999, a simple neo-classical growth model, proposed by Prof. A. Harberger, was estimated to assess the contribution of labor, capital and the "residual" to the growth during Lithuania's 1995–1998 economic recovery. This model was chosen because Harberger proposed "a vision of the growth process that differs. The key points of the focus are: a) the economic rate of return to capital as an important element in the breakdown of growth and b) the interpretation of the total factor productivity (TFP) "Residual" in the growth breakdown as representing real cost reductions of all kinds". This approach allowed defining the growth process through knowledge-driven cost cutting and productivity growth as well as an efficient use of investments – key elements in market-oriented reforms during transition.

Given that labour force and wage bill have not changed significantly, the growth equations were re-estimated, with the change in quality-adjusted labour set to zero. Following Harberger (1998), the structural model was as follows:

$$p\Delta y = w\Delta L + (\rho + \delta)\Delta K + R, \quad (1)$$

where Δy is change in value added, ΔL is change in labor input, ΔK is change in capital, p is the initial price level, ρ is the real return on capital, δ is the real depreciation of capital, w is the initial wage, and R is the residual unexplained by traditional inputs (total factor productivity).

Using least-square regression, the growth equation was estimated in first differences to reduce autocorrelation. The equation that was estimated was as follows:

$$\frac{Y(t)-Y(t-1)}{Y(t-1)} = a \cdot \frac{L(t)-L(t-1)}{L(t-1)} + b \cdot \frac{K(t)-K(t-1)}{K(t-1)} + c\,,\ t = 95, 96, 97, 98. \quad (2)$$

Results by fields of economic activity are reported in Table 1.

TABLE 1. **Growth, return on capital and productivity increase by sectors, 1995–1998**

Sectors	Real growth of value added (average, %)	Return on capital (average, %)	Capital contribution to growth (%)	Total factor productivity (average, %)
Agriculture	3.6	5.9	2.7	3.0
Manufacture	3.2	5.4	4.0	2.2
Electricity, gas, and water supply	-1.3	1.9	4.4	-2.5
Construction	15.8	6.2	4.2	14.7
Trade	14.3	5.4	4.7	13.1
Hotels and restaurants	2.5	16.6	10.3	-0.1
Transport	-1.5	2.3	3.9	-2.6
Mean	5.2	6.2	4.9	4.0

The results based on the official national accounts data show that the improvement of total factor productivity was the key determinant (90%) of the return to growth in Lithuania in 1994–1998, and *the change in total factor productivity was not evenly distributed across all sectors of the economy:* nearly two-thirds of the cost-reduction in the economy came from the construction and trade sectors.

Transport and public utilities accounted for almost all of the negative total factor productivity growth. In other words, these sectors generated less value-added per unit of capital and labour than they employed.

The growth equations that were estimated from the biggest companies' financial reports showed that capital accounted for almost half of economic growth; the rest of the growth was explained by the increase in total factor productivity. However, investments were used inefficiently: costs were growing, and return on capital was low. In transport and energy sectors, there was a large number of long-gestating, high-cost investments into Government-owned firms that augmented capacity rather than restructure operations.

Restructuring of some loss-making industries, indeed, takes some time, but the *efficiency of investments could be ensured if cost reduction were prioritized and lead to an increase in total factor productivity*.

An empirical analysis of the transition period data confirmed the neoclassical theory findings that poorer market economies would tend to grow faster than the richer ones as they have a natural comparative competitive advantage – lower costs of production, so trade was a major source of their growth. In other words, income levels converge amongst nations, because the rate of return on capital investment is higher in poorer countries than in richer ones.

The analysis also confirmed the endogenous theory findings that technological change (defined broadly to include management improvement) was the most important determinant of economic growth. Technological change was the result of applying new

knowledge and led to the improving competitiveness as the outcome of the rational resource allocation process.

Structural characteristics of the economy, including the strength of domestic institutions and the appropriateness of the government's role in the economy, were influencing the incentives for generating and acquiring new knowledge. Therefore, institutional thinking that the rational use of financial resources can only be undertaken where the foundation for institutional and legal order is well developed also found confirmation.

The vulnerability of economy revealed that the influence of structural factors and economic setting on long-term growth is not automatic. The enabling public policy environment and the development of market-responsive institutions will determine whether or not the economy is able to realize its structural growth potential. *During the decade of reforms, Lithuania faced a couple of shocks triggered by external and internal factors.* In 1995, the weak supervision of the banking sector led to accumulation of non-performing loans and a solvency crisis of two major banks and some of non-banking institutions. The government was forced to take over the banks and start a long restructuring process by the specially established Asset Management Bank; experts put the total cost of the banking restructuring at 3% of GDP. The supervision system of the banking sector was strengthened and the legal basis was updated as the implications of crisis on public policy.

In 1998, the currency crisis in neighbouring Russia halted almost a third of Lithuania's export with a negative impact on budget revenues and GDP, approximately at 5%. These factors contributed to the renewal of macroeconomic instability and the economic growth slowdown. The government had to take rapid and austere measures to ensure the stability of the financial system and support programs to assist the re-orientation of export to the EU markets. This *crisis has revealed the necessity to build up reserves for dealing with external shocks*.

The relatively rapid reform process was costly in human development as in 1995–1999 the number of industrial workers in industrial regions fell by 30%. This was the unavoidable outcome of a radical economic transformation, during which the outdated economic system and management structure were dismantled; therefore, *the government had an important role to play in providing and managing the social capital.*

A shift in the structure of economy from agriculture and industry to the service sector also increased regional differences as the growth rate in regions favourable for service sector expansion, i.e. capital, port city, major cities, was outpacing the growth rate in other regions. When defining growth enhancing policy measures, attention should be focused on supporting the regions with a structural disadvantage.

It should be noted that economic reforms themselves do not ensure a long-term growth of economy; behavioural factors also matter. *When new windows of opportunity are open up, it takes some time for people and companies to learn how to use them.*

1.2. Growth-enhancing policy measures

During transition from centralized to market economy, the debates on public policy fostering economic growth mostly concentrated on what sort of mixture of government planning and control versus free market was conducive to the growth and competitiveness of economy.

Economists have enough empirical evidence "that just about every case of sustained growth over long periods of time has benefited from a sound institutional and legal environment" (Harberger, 1998). *Even integrated economies differ substantially as regards the structure of economy, available resources, geographical position and neighbourhood as well as behavioural patterns.*

A full assessment of a country's fiscal and debt (including public and private) situation must be carried out taking into account the overall macroeconomic situation and balance of payment prospects. The debt sustainability indicator, especially of short-term debt sustainability, reflects the real state of economy more accurately. This indicator allows assessing financing needs and the ability to generate revenues important for remembering that fiscal sustainability is closely linked to external sustainability.

And, last but not least, the problems of one country spreading to another tend to accumulate so that a tidal wave floods everyone; therefore, an appropriate emergency reserve fund to manage external shocks has to be laid aside.

Given that development arises from internal dynamics, every crisis has to be used to shore up cost-cutting and productivity-enhancing programs bringing a substantial improvement in competitiveness on the global stage.

In the rapidly changing environment, priority has to be given to setting up a direct linkage between fiscal consolidation measures and productivity gains and putting economic policy into a real economy framework.

The economic upturn was mainly the result of improvements in total factor productivity, which itself encompasses a wide range of factors. Exploiting economies of scale, scope, urban agglomeration, networks and positive reputation are the factors that are bound to play a more important role in the decades to come. Public and private investment itself will not ensure that these important sources of growth are exploited. In fact, the policies that favor capital accumulation, at the expense of improvements in labor productivity and social overhead capital, may crowd out the innovations aimed at improving total factor productivity and competitiveness.

An excessive reliance on foreign savings can lead to the danger that capital flows will reverse and that the economy will be, for some period of time, illiquid at the prevailing exchange rate. *Well-developed financial markets with established institutional investors and long-term investment products are needed to encourage domestic savings.* Excessive reliance on foreign savings can lead to a repayment burden that stifles new private initiative.

The government can clearly play a positive role by expanding the supply and improving the quality of the public goods and services that, over time, can help to augment the total factor productivity growth and differential competitive advantage. Public expenditure reviews can help identify opportunities for improving the efficiency of government outlays in each of these areas and for modernization in the social sector.

SMEs tend to be more labor-intensive than larger enterprises, partly because they are more concentrated in the services sector and part by because new start-up enterprises tend to make greater use of abundant factors (and labor remains far more abundant than capital). *The degree to which SMEs can expand productive employment and the profitability of SME operations are directly related to the tax wedge on labor and cost of bureaucracy.* Public policy should build on the steady progress registered by small enterprises.

2. EU membership – five years on

2.1. New economic setting

The coordination of economic policy at the EU level has been done through three channels: the Growth and Stability Pact, the Broad Economic Police Guidelines, and the Lisbon strategy. The Growth and Stability Pact was signed in 1996 to ensure fiscal sustainability and foresees convergence criteria determining the readiness of Members States to join the euro-zone; the Broad Economic Policy Guidelines are being prepared since 1996 and focus on general recommendations to Member States with regard to economic policy direction, meanwhile the Lisbon Strategy, launched in 2000, was dedicated to promote innovation and knowledge-driven economy. However, all these policy tools lacked enforcement procedures, except the excessive deficit procedure, and it was up to Member States to decide to what extent to follow the common guidelines.

Lithuania, after years of the highly focused economic policy with the goal to fulfil the EU membership criteria, which was guided and partly funded by the IMF and the World Bank and later by the EU Commission, after accession to the EU in May 2004 *had to define the new priorities of its economic policy.*

The government had to choose between two policy options – to follow the investment-driven or the innovation-driven integration process. *Recommendations based on the transition period experience,* adjusted to new realities, could have served as benchmarks to support a long-term growth and ensure the country's competitiveness *required a policy focused on innovation and knowledge accumulation.* Meanwhile, *expectations of the inflow of the EU funds* and the conviction that public policy will be fixed on stimulating private investments *have encouraged choosing the investment-driven integration policy option.*

The key feature of the EU membership period was that a relative shortage of investments during the transition decade was replaced by a flood of public and private money into the economy. The easy availability of credits due to low interest rates,

perception of the macroeconomic environment as stable and a need to co-finance the EU budget payments were building internal imbalances, and the economic policy had to be adjusted to manage the excessive liquidity. Gross fixed capital investments in 2005–2008 increased by 3.4% of GDP – from 22.8% to 25.4% (Lithuania in Figures, 2011). Bank credit to the private sector as the GDP percentage doubled in Lithuania in 2004–2008 (Herzberg, 2010).

The most important tool for liquidity management was the public investment program, especially given a substantial support from the EU budget: during the first five years of EU membership Lithuania received financial support at around 12% of GDP. Though payments from the EU structural funds for the period 2007–2014 by the end of 2010 made only LTL 12 bn / EUR 4 bn (including 2004–2007), the total appropriations could reach almost LTL 26 bn / EUR 8 bn (Ministry of Finance, 2011).

The experience of the transition decade suggests that the long-term results and effectiveness of using investments depend on the appropriately prioritized spending – the changing economic targets and the role of the government in modern society have made it necessary to review the state expenditure structure and to determine the new guidelines. Unfortunately, *accumulation of internal and external imbalances has revealed the lack of coherent policy and of clearly defined growth-enhancing priorities*.

As one can see in Fig. 1, investments went mainly to the construction sector, creating bubble which, under the pressure of the 2008 financial crisis, burst and triggered in 2009 a severe contraction (by 14.8%) and a rise in unemployment. In 2008, the share of the construction sector in the value added made 10%, while in 2010 it fell to 6% (Lithuania in Figures, 2011).

The main public investment management problem was *the difficulties in finding a systematic way to assess the efficiency of investment and employment guarantees after allocation of the EU funds.* The other problem was of the European level: the EU budget funding system and its requirement to meet the mechanically set deadlines for funds

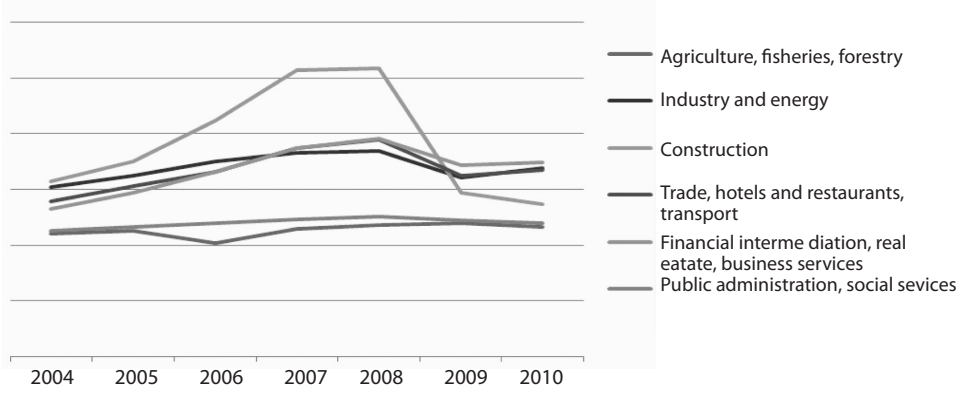

FIG.1. **Value added by economic activity (2000 = 100)**

Source: Lithuanian Statistics Database.

consumption were favourable for large-scale projects, which are usually related to the construction sector.

The excessively generous capital investment did little to stimulate efficient investment and, in fact, discouraged investment in human capital and TFP-enhancing innovations. Despite the strong growth of economy in 2005–2007, allocations to social services were modest, and Lithuania was lagging behind the other EU countries in the innovation scoreboard. Meanwhile, the administrative burden for small projects was high. The share of the ICT sector in the total output in 2008 decreased to 3.6% versus 5% in 2005 (Lithuania in Figures, 2011). It should be noted that special programmes for SME also were available, but it took time to raise the awareness of different opportunities given the lack of substance and coordination of the training programs.

In the first two years when the plans to introduce euro were much alive, *the euro zone convergence criteria were serving as benchmarks for the country's economic policy*, but later, when this plan was abandoned, no new long-term targets were introduced and the economic policy was based on vague terms, the so-called Lithuania's development strategies.

The transition period experience says that investments are efficient when producing cost cutting and positive changes in productivity. Labour productivity in all new EU Member States was growing at a more rapid pace than in the mature core EU countries (see table 2).

TABLE 2. **Real labour productivity growth per hour worked, % change over previous year (2000 = 100)**

Country	2000	2004	2010
EU-27	92.8	98.9	103.3
Italy	99.5	99.5	99.3
France	93.2	98.5	100.0
Portugal	95.9	98.9	104.8
Germany	93.5	98.8	104.0
Spain	96.3	99.2	106.0
Greece	86.3	98.7	100.2
Sweden	86.6	97.2	101.8
Ireland	88.2	99.8	110.5
Slovenia	84.5	93.5	107.4
Hungary	79.1	96.7	104.8
Poland	83.2	98.5	112.3
Czech Republic	80.4	95.6	113.0
Slovakia	78.8	97.0	122.8
Lithuania	**72.7**	**98.3**	**113.9**
Estonia	73.0	94.4	117.3
Latvia	71.3	93.8	118.1

Source: Euorostat, Dataset, 22.09.2011.

The differences in productivity growth rate could be explained by the fact that the Member States that joined the EU in 2010 were economically at a lower stage of development and had a lot of unexploited sources of growth. In Lithuania, labour productivity per hour worked accounted only for 55% of the EU-27 average.

There are three stages of economic development from a resource-based economy to an innovation-based economy with the growth driven by different factors: at the low level of income, the growth is driven by primary factors of production, at the middle income level it is driven by investment and at the high level by innovation (Porter, Sachs, McArthur, 2002).

Although the EU as a whole is definitely a high-income region, internally, especially during the first years, there were some noticeable differences in development. Lithuania and some other EU countries were in the catch-up phase from a middle-income to a high-income country with the GDP per capita at PPP accounting for around 50% of the EU-27 average in 2004 (see Table 3).

TABLE 3. **GDP per capita at PPP in selected countries, 2000–2010 (index, EU-27 = 100)**

Country	2000	2004	2010
EU-27	100	100	100
Latvia	37	46	52
Lithuania	**39**	**50**	**58**
Poland	48	51	62
Hungary	55	63	64
Estonia	45	57	65
Slovakia	50	57	74
Czech Republic	68	75	80
Portugal	81	77	81
Slovenia	80	87	87
Greece	84	94	89
Italy	117	107	100
Spain	97	101	101
France	115	110	107
Germany	118	116	118
Sweden	128	126	123
Ireland	131	142	125

Source: Eurostat, Dataset, 12.08.2011.

In Poland and Slovakia, convergence processes were more rapid than in Hungary, Latvia and Lithuania, although during the transition period the structure of Lithuania's economy changed to become similar to the other market economies. *The substantial*

structural flows in the energy and transport sector as well as difficulties in securing a position in the EU manufacturing value chain weighted heavily on the country's business capacity to cut costs and to compete in the internal EU and global markets.

The energy sector dependence on one source of supply (Russia) pushed energy prices higher than the average in the EU. By the end of 2010, energy prices for consumers in Lithuania (HICP energy) were by 70% higher than in 2005, versus 32% of the EU-27 average. This was the steepest rise in energy prices in the EU, and only prices in Latvia outpaced it. Moreover, in the middle of 2011, energy prices rose again, and the rise reached 84% as compared with the 2005 level (Eurostat, Dataset, 2011). Meanwhile, real wages grew only by 26%, so the increase in had a negative impact on domestic demand. Energy prices higher than in the other EU Member States energy prices put pressure on the competitive position of industry, and the enterprises willing not to lose their market share were slow to raise wages; this in turn pressed down the budget revenues and the intakes of the social security fund and, as a result widened the fiscal gap.

For maintaining the budget deficit in check, the government set *a relatively high tax wedge on labour which, as known from the transition decade experience, contradicts the policy of supporting small and medium enterprises as the major source of new jobs* (see Table 4).

TABLE 4. **Tax wedge, minimum monthly wage and net migration in 2010**

Country	Tax wedge on labour (%)	Minimum monthly wage (EUR/month)	Net immigration (1000 population)
EU-27	39.3	-	854.0
Ireland	23.4	1468.9	-33.7
Portugal	32.8	554.2	3.8
Poland	33.4	320.9	-2.1
Greece	34.4	862.8	15.0
Slovakia	34.5	307.7	3.4
Spain	36.4	738.9	63.2
Slovenia	38.5	597.4	0.1
Estonia	38.6	278.0	0
Lithuania	**38.9**	**231.7**	**-82.4**
Czech Republic	38.9	302.2	15.6
Sweden	40.6	-	49.7
Latvia	41.5	253.8	-7.9
Hungary	43.6	271.8	11.8
Italy	43.6	-	311.7
Germany	44.9	-	130.2
France	45.5	1343.8	75.0

Source: Eurostat, Dataset, 21.09.2011.

As is seen in Table 4, Lithuania's net immigration was the highest in the EU, while the minimum wage was one of the lowest, and the tax wedge on low-earners was noticeable. *The main economic political concern for Lithuania had to be to find the ways and means that would allow as many people as possible to take advantage of the newly created opportunities in their own country.*

It should be noted that the liberalization of world trade had given an equal access to new technologies and markets to all countries, not only the EU Member States, so low-cost Asian countries were putting a deflationary pressure on the prices of products, thus triggering structural changes in the global economy, which will be addressed by introducing new policy measures.

The new EU, after accession of post-communist countries, was a unique mixture of advanced old Member States and the converging low-cost new members and was in position to make necessary adjustments to the new global settings by cutting costs, employing economy of a scale allowing to contain the deflationary pressure of the third world.

However, *after accession to the EU the convergence of unit labour costs was speeding up in all new Member States, and this was a reason for diminishing the competiveness of the new Europe in global markets.* The average EU-27 unit labour costs went up by 5.6 % in 2009 as compared with 2005, while in Lithuania the costs were rising in double digits – by 25.8%.

TABLE 5. **Unit labour costs (2005 = 100)**

Country	2005	2009	2011f
EU 27	100	105.6	107.4
Germany	100	104.8	104.7
Poland	100	111.5	120.3
Sweden	100	111.8	110.6
France	100	110.2	112.1
Portugal	100	109.1	108.1
Lithuania	**100**	**125.8**	**116.9**
Ireland	100	112.0	103.3
Latvia	100	165.3	148.0
Spain	100	113.4	111.2
Italy	100	112.9	113.7
Slovakia	100	113.7	111.7
Czech Republic	100	113.1	114.4
Greece	100	117.5	116.0
Slovenia	100	119.7	119.1
Hungary	100	115.2	114.3
Estonia	100	148.0	145.1

Source: Eurostat, Dataset, 22.09.2011.

The growth in unit labour costs was driven by income growth stimulated by integration and the free movement of labour. New solutions were needed to maintain the rising costs in check and to boost a comparative competitive advantage of goods in the low-cost global markets. The global rebalancing when the emerging economies became major suppliers in the world market, especially of mass production goods, resulted in a shift of industrial capacities outside the EU and the USA, which meant less jobs and revenues, while the demand for sophisticated quality goods and services from the EU was not broad-based. The new middle class of the emerging economies was not in position to buy these products which were accessible only to a small fraction of rich population. *The supply-and-demand gap, which has manifested itself in the global economy, is known from the transition decade experience. The essence of this economic phenomenon is that, although structural reforms bring a growth in supply, the pickup in demand lags behind as some time is needed to accumulate incomes*. In Lithuania, this gap made approximately five years given the size of the emerging market economies and inertia, it is possible to expect that the gap would make more than 5 years.

Meanwhile, the social and political stability needed for the successful implementation of new reforms could not come a without rapid growth of living standards. *The transition lesson is that the restructuring of loss-making industries has to be very selective and based on the long-term horizon.*

Identification of policy-making problems during the EU membership period could be a precondition for the economic strategy allowing to address imbalances in economy. A painful *internal devaluation process could help to restore competitiveness, but only in a short run as it triggers loss in human capital; for a long run sustainability, new policy tools are needed*.

To sum up the EU membership experience, the following findings could be presented (Table 6).

TABLE 6. **EU membership economic policy lessons**

New factors	Implications	Policy tools
Accelerating investment rate	Growing internal imbalances	Review of tax policy and state expenditure priorities, new quality of financial markets supervision
Convergence of costs	Diminishing comparative competitive advantage	Framework conducive to creativity and innovation
Increased labour mobility	Shrinking labour force due to ageing and immigration	Wage policy and incentives for resource productivity growth
Increased extent of the market	Difficulties in raising FDI	Focus on private / public partnership
Increased human capital per worker	Higher requirements to quality and accessibility of public services	Social sector modernization program

Source: compiled by author.

The majority of economic policy measures suggested in Table 6 fall into the framework of recommendations based on findings concerning the determinants of long-term growth from the transition period.

Conclusions

Upon summarizing the macroeconomic results of transition, it is possible to say that *regulated markets set better conditions for the growth of economy other than self-regulated markets*, while the most important problem of the economic growth strategy is to evaluate the degree of impact of each determinant on growth and to set their mixture ensuring the cutting of costs and the efficiency of investments.

Policy makers have to focus on facilitating an environment conducive to establishing new SMEs in new sectors of economy instead of fixing the focus on restructuring the old sectors.

Economic governance during transition *is an innovative process: it is impossible to follow a uniform approach or to use the same growth model in order to achieve the same results.*

Sound institutions and macroeconomic sustainability are needed for capital and labour mobility management to avoid accumulation of significant internal and external imbalances. The fiscal policy has to incorporate the so-called "golden rule", while the supervision of the financial sector has to impose prudential requirements.

The growth-enhancing public policy should be based on the necessity to increase the total factor productivity to ensure competitiveness in the global market. Therefore, a review of tax policy and state expenditure priorities has to be carried out continuously. Promotion of domestic savings instead of mining foreign savings has to focus on stimulating the private / public partnership and financial market development; incentives for resource productivity growth should be offered. A social sector modernization program and a state governance reform have to be implemented to ensure efficient investments in TFP augmenting public goods and services. It is most important to create a framework to support SMEs by removing obstacles to their operation and cutting the red tape, setting a lighter tax wedge on labour income and ensuring the macroeconomic environment conducive to creativity and innovation.

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