

# THE CHALLENGES OF REAL AND SUBJECTIVE POVERTY AND THE GROWTH OF INEQUALITY IN THE ECONOMIES OF SOUTHEAST EUROPE IN TRANSITION<sup>1</sup>

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Summary\*  
UDC 365.65(4-11)  
JEL I32, P36

## *Abstract*

*From the beginning it was clear that during the transformation, all aspects of economic inequality were likely to be exacerbated and that poverty was likely to emerge. This paper discusses the size and consequences of transformation-generated changes in economic inequality and poverty, both “real” and “subjective”, for future economic growth and the legitimacy of continued transformation in the Mediterranean economies in transformation (Bosnia and Herzegovina, Croatia, Macedonia, Serbia and Montenegro and Slovenia), which have been expanded to include Romania and Bulgaria. This area is referred to as the “region”.*

## **1. Transformation-generated inequality and poverty**

In spite of the differences in initial conditions with respect to economic inequality and poverty, the similarities among the transformation economies are striking. Transformation is a process that aims fundamentally to change a society’s notions of equity and unavoidably, significantly and lastingly to increase its inequality and introduce visible poverty and extend social exclusion.

Admittedly, only the former is an overt goal of transformation-led social engineering, while the latter two are not primary goals rather derived consequences or goals.

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\* Received: December 17, 2004  
Accepted: January 25, 2005

<sup>1</sup> Summary of the paper printed in Croatian at *Financijska teorija i praksa* [[http://www.ijf.hr/financijska\\_praksa/PDF-2005/1-05/bicanic-franicevic.pdf](http://www.ijf.hr/financijska_praksa/PDF-2005/1-05/bicanic-franicevic.pdf)].

The conscious and policy-generated increase in inequality can be seen by looking at the main policy paradigm applied in some form in all transformation economies. All three policy pillars of the dominant "grand" policy paradigm (i.e. the "holy trinity" of transformation: liberalization, privatization and multiparty democracy with the attendant macroeconomic stabilization) and the main supporting policy referred to as the Washington consensus policies generate a change in economic inequality and everything related to it in a fundamental and lasting way (i.e. over the long term).

In spite of the variety of transformation policies, the generated economic inequality and poverty and their evolution during the process have some striking similarities, sufficiently marked to allow the identification of the following "stylized" facts (derived from various sources in the relevant literature):

- inequalities during the transition should have initially increased significantly and probably later decreased or at least stagnated;
- some of the changes were desirable while others may have been the result of transition pathologies;
- the pattern of change was determined by the various social deficits, their size and speed and way they were "filled in";
- sources of inequality should have changed, initial changes being influenced by labour incomes and later by income from assets;
- changes may have led to poverty increases, some social groups being excluded from the benefits of transition, both in the short term and the long term;
- the effect of the pathologies can vary and lead to a 'winners curse' blocking later reform;
- the initial increase in inequality is a result of polarization and major changes in the middle of the distribution and implies a change of shape.

Of course, in any given economy or group of economies these stylized facts may have been differently reflected.

## **2. Transformation generated inequality and poverty in the region**

In the economies of the region, in spite of important initial differences in starting positions, there were many similarities that became clearer as the transformation unfolded, the region's economies having become increasingly grouped into the 'Southern transformation tier'. In comparison to the benchmark values of Slovenia (which is the transformation frontrunner) all the economies of the region had a more unstable (inflation, government deficit), more costly (fall of production, level of recovery, years of rising unemployment) and longer (crises lasting longer and upswing starting later and being slower) transformation experience. The higher transformation costs were attended with relatively higher inequality and poverty levels. This is shown both by direct measurement of changes in inequality and poverty levels and indirectly from aggregate statistics reflecting the quality of life.

In addition to the initial conditions the region has one specific and very important feature which distinguishes it from other transformation economies (except some CIS economies). These are the international military conflicts (Wars of the Yugoslav Succession) spawned by the violent break-up of Yugoslavia in 1991. The Yugoslav successor states were obviously affected but so were Romania and Bulgaria, which had to contend with a closed Danube waterway and the indirect effects of the embargo on Serbia. These wars certainly contributed to increased inequality both through their influence on the bottom of the distribution (loss of life, displaced persons, refugees, property destruction) and the top (war profiteers at many levels, of the usual kind and those generated by state-related embargoes).

Another important aspect influencing the top end of the distribution must be noted. In all the economies (except Bosnia and Herzegovina) the wars ran concurrently with the transformation. Croatia may provide the clearest example of developments present in different forms and at different times in all the region's economies. In the example of Croatia, liberalization took place amid an institutional deficit and a war, privatization designed to be state-managed ran concurrently to the war and the extensive military mobilization of large sections of the population and displaced persons in Croatia. Of course a few were well placed to personally while many were simply excluded from the process.

### **3. Subjective poverty and expectations**

In addition to 'real' increases in inequality and poverty there were major changes in subjective inequality and poverty evaluations. These are very important. Subjective poverty seems to be the missing critical link between economic and social reforms and their political legitimacy. The actors perceive distributional changes not as a static simple framework of redistribution obtaining over the short term, when changes can go either way, but rather as something dynamic and more substantial, entailing deep-seated and long-term changes that takes in at least their children. The underlying process is, of course, a deep social restructuring, a process which is unfortunately not well and systematically researched, when individuals and families are defining not only their position on the emerging new social ladder, but also their chances of ascending it in the future. In spite of many measurement problems it seems that subjective perceptions of inequality and poverty levels have been markedly exacerbated.

An interesting aspect of subjective poverty is what relationship it bears to changes in the real economy. If correct, then the data on these subjective perceptions should have some foundation in more robust data, if not they may indicate a paradox. In spite of the lack of research throughout the region, subjective poverty levels seem much higher than the 'objective' calculation seems to warrant. Furthermore, the proportion of those who consider themselves 'losers' in the transformation process is greater than one could possibly expect from the real data (on growth, real wage etc.). By drawing attention to this paradox we are far from denying the extent of true poverty and are certainly not denying the need and value for pro-poor social and economic policies. However,

framing the issue of poverty in the context of actors' perceptions and normative judgements indicates only that much more may be at stake, and that the issue of subjective poverty might be indicative of much deeper changes and concerns.

#### **4. Two critical policy implications of subjective inequality and poverty**

The region (with the exception of Slovenia) is still in many aspects unsettled (even when security, political and boundary issues are omitted). It still faces two major all-encompassing and ongoing restructuring processes. The first is the still unfinished transformation with respect to which in spite of differences the region is considered a comparative laggard. The second concerns convergence to the EU, which is only starting. Given this double pressure for future changes, and the feedback, it seems justified to take a forward-looking view and see how poverty, exclusion and inequality, both actual and subjective, can influence these vital processes and whether they can act as an accelerator or a barrier.

It is important to realize that the dynamics of poverty and inequality levels, actual and subjective, in transformation economies are deeply influenced by the dynamics and nature of reforms. And vice versa. No less importantly, reforms may be strongly influenced by both the impact of real social trends and the various actors' perceptions and interpretations of these trends, that is, by their moral economies. The moral economy is about social norms and perceptions, values and judgements which the actors have about their individual participation and roles in the economic processes, as well as about the nature of the economic system and its outcomes at large. It is particularly about equity and justice, fairness and deserts, acceptable and unacceptable. Its central role is in providing the economic system, processes and outcomes with legitimacy.

The legitimacy of reforms in the region is closely linked democratic consolidation. In the region only in Romania and Bulgaria and probably in Croatia does the democratization process seem to have reached an advanced and/or sustainable level. In some countries or territories in the region this has not yet been achieved. They are either at the start of the process (Albania, Serbia and Montenegro), in a state of political crisis (Macedonia) or are quasi- or de facto international protectorates (Bosnia and Herzegovina and Kosovo). Democratic consolidation and legitimacy of democratic regimes and ongoing reforms relies not only on the economic and social output, but on people's perceptions and (moral and equity) interpretations of it. The poverty paradox likely has a central place in this. Importantly, the paradox indicates that economic growth is not enough for legitimacy and consolidation and the continuation of the transformation. With respect to each of them, major reasons for concerns remain, as well as major challenges. These challenges stem from serious institutional and democratic deficits, uncompensated losers and undeserving winners, a continuing strong base for fundamentalist nationalism, inequalities and uncertainties concerning personal and interregional developments which are all coupled with widespread pessimism and too many with pessimistic expectations. They may easily lead to a questioning of the post-socialist reform agenda, particularly if economic growth is not sustained and modern economic growth is.