

On Democratisation and Economic Conditions in Eastern Europe

Bernd Hayo*

ZEI
University of Bonn
Walter-Flex-Str. 3
D-53113 Bonn
Germany

Email: hayo@united.econ.uni-bonn.de
Tel.: +49-228-73-1878
Fax: +49-228-73-1809

* Special thanks to Robert MacCulloch, Jens Hölscher, participants of the Citizens in Transition Network (CITNET), and participants of a Research Seminar at the University of Bonn for helpful comments. The usual disclaimer applies.

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Abstract

The paper empirically investigates whether people's attitude towards the progress in political transformation in Eastern Europe are influenced by economic factors. Thereby it addresses the question of independence between economic and political system. Using a large panel data set, containing about 68000 observations on individuals from 19 countries over 6 years, this question is analysed in the framework of an appropriately adjusted ordered logit model. It is found that both subjective and objective personal economic experiences, such as the development of the financial situation of the household or its position in the income distribution, as well as objective aggregate data, such as inflation or the private sector share, have a significant influence on people's opinion with respect to progress in democratisation. Thus, studies on transition countries should take into account that there appear to be important spill-overs from people's economic experience to their assessment of progress in transformation of the political system.

Keywords: Eastern Europe, Political Economy, Democracy, Transformation

JEL: D72, P26, O52

1. Introduction

The economic and political transition in Eastern Europe has not been completed at this point in time. One of the debated questions is whether two core aspects of transformation – reforming the political and the economic system – are closely linked (see Rose et al. (1998)). The current paper takes up this basic argument and puts the hypothesis of a close linkage between political and economic transformation to the test. So far, most studies have concentrated on the spill-over from democratisation on the performance of the economy (see De Melo et al. (1996), Dethier et al. (1999), Fidrmuc (2000)). If we find evidence on the influence of economic factors on the way progress in democracy is perceived then these empirical approaches are potentially suffering from a simultaneous-equation bias. Contrary to these studies in the literature, endogeneity is not a big problem for the present analysis, the reason being that it uses micro data on individuals, namely the Central and Eastern Eurobarometers (CEEB). There will not be an endogeneity problem as it is unlikely that an individual person's satisfaction with democratisation affects aggregate economic variables such as inflation, openness, private sector share or employment.

There is a related study by Kunioka and Woller (1999), who build upon the work by Rose et al. (1998) and specifically look at the influence of social capital on support for democratic procedures in Eastern Europe. As part of this analysis, they also consider the effects of economic variables. However, the dependent variable is different, support versus satisfaction, as studied here, the data base is different, New Democracy Barometers versus CEEB, and they only consider a cross-section, while this paper utilises a panel data set over time and countries.

A related issue, which can be partially addressed using our results, is whether it is useful to distinguish between progress in introducing a market economy versus progress in democratisation. The finding of a linkage between the economic and political systems may support the argument that transformation in Eastern Europe is not really about introducing a market economy on the one hand and creating a democracy on the other hand: instead it is about copying the “Western model” which reflects both of these characteristics (cf. Offe (1991)). Arguably, the Western model is seen by Eastern Europeans as one whole package and not as consisting of easily separable parts. If this is true then the idea that transformation in Eastern Europe could in principle take place similar to the “Asian way”, that means keeping authoritarian structures in the political system and introducing market reforms in the economic system, is not very convincing.

In this paper a large survey data set is utilised to investigate the influence of individual and aggregate economic variables on the public's satisfaction with progress in democracy. If the hypothesis about the interconnection between economics and politics is right, then we should find that micro and macroeconomic conditions will affect people's assessment of democratic reforms. In the data set, microeconomic conditions are being measured by the relative income position of the respondent, and the relative changes in his financial situation compared to past and future. Macroeconomic influences are introduced by including national macroeconomic variables.

Along another dimension we can also categorise variables as either reflecting objective or subjective economic conditions. All of the macroeconomic variables - as well as the relative income position - can be considered as representing objective indicators. The comparison of the current financial situation with the past and the future gives us subjective indicators of people's economic situation.

The analysis takes place in the framework of a non-standard ordered logit model that allows for the inclusion of variables measured at different levels of aggregation. This makes it possible to take standard errors seriously and to model within a general-to-specific strategy (see Hendry (1990)).

Section 2 summarises the empirical approach and describes the data base. The results of the regression analysis are being discussed in Section 3, and at the end of the paper, a short conclusion is put forward.

2. Empirical Approach and Data Base

The data base employed here combines several Central and Eastern Eurobarometer surveys (CEEB) conducted on behalf of the European Commission across time – from 1990 to 1996 – and countries (up to 21) in the form of a panel. Table A in the Appendix gives a summary of the countries covered by every one of the surveys and the year (usually in late Autumn) when the field work was undertaken.

Although there already exist a number of studies utilising this data base to analyse questions about political and economic aspects of transformation, so far little work has been done to investigate the spill-over of one into the other (see Rose et al. (1998), Kunioka and Waller (1999)). Probably due to the technical difficulties involved in implementing a valid econometric model, no work at all has been done using both individual and macro level

variables when studying this question. Even very recent empirical studies combining micro and macro variables rely on an inefficient two-step method (see, for instance, Di Tella et al. (2000)).

Papers using single CEEB surveys on political aspects include Juchler (1994), and Pickel and Pickel (1996), and some economic aspects are being discussed in Hayo (1997a, 1997b). Aggregating the CEEB studies over time and countries to form a panel is rather unique, and the only other paper utilising such an approach is Hayo (1999). Combining surveys gives the advantage of obtaining a very large data base in both country and time dimension. The number of valid observations is about 68000, drawn from 19 countries and 6 years. A disadvantage of this approach is that the number of variables that have been consistently recorded across all of these surveys is relatively small.

The dependent variable of this study is people's satisfaction with the development of democracy in their country (DEMO), which can be interpreted as giving information about the satisfaction with the transformation a communist-style political system into a democracy. The precise question and coding can be found in Table 1, together with the other individual-level variables employed here.

Of special interest for this study are the microeconomic indicators NEGNEG, POSPOS, POSNEG, and NEGPOS as indicators of the subjective economic situation, as well as INCOMEQ helping to describe the objective economic situation of the household.

The indicators based on changes in the financial situation reflect different personal economic experiences. Respondents collected by the variable NEGNEG are those who experienced a deterioration in their financial situation compared to the past and who expect to be even worse off in the future. They can be called subjective losers of the economic transformation process. Those respondents who feel that their financial situation has improved compared to the past and is going to improve further in the future are coded in POSPOS. Correspondingly, we can call them subjective transition winners. Under the hypothesis of a connection between economic situation and political transformation we would expect that winners view the situation much more favourably than losers.

The other two categories describe people experiencing a change in the trend of their financial situation. POSNEG captures those who did better compared to last year but who expect to be worse off next year, and NEGPOS is defined the other way around. These two categories are of interest, as they tell us something about the importance of expectations regarding a relative change in the financial situation of the household. If establishing democracy and economic

prosperity are linked then I would conjecture that those who expect a relative improvement in the future will be rather pleased with perceived progress in democracy and vice versa.

Tab. 1: Substantial Variables and Coding

| Variable name | Question | Coding |
|--------------------------------------|--|---|
| DEMO | On the whole, are you satisfied with the way democracy is developing? | 2: Very satisfied 1: Fairly satisfied -1: Not satisfied -2: Not at all satisfied |
| POSPOS POSNEG NEGPOS NEGNEG | Q1: Compare the current financial situation of your household with the one 12 months ago! Q2: Over the next 12 months, do you expect the financial situation of your household to change compared to today? | POSPOS: 1: if answer to Q1 and Q2 is "better" 0: otherwise POSNEG: 1: if answer to Q1 is "better" and Q2 "worse" 0: otherwise NEGPOS: 1: if answer to Q1 is "worse" and Q2 "better" 0: otherwise NEGNEG: 1: if answer to Q1 and Q2 is "worse" 0: otherwise |
| FEMALE | Gender | 1: Female 0: Male |
| AGE | Age in years of respondent | Years |
| AGESQ | Squared values of AGE | Years ² |
| INCOMEQ | Income quartile of respondent | 4: Highest income quartile 3: Upper middle income quartile 2: Lower middle income quartile 1: Lowest income quartile |
| EDUCL | Level of education | 4: Higher than secondary education 3: Secondary education 2: Some secondary or apprenticeship 1: Elementary education |

Finally, looking at IMCOMEQ gives a measure of the relative income situation of the household in his national economy. This can be considered an objective indicator on the individual level, as it is based on actual (reported) income. Again I would expect that those respondents who are relatively better off to be more satisfied with progress in democracy.

The variables used to describe the macroeconomic conditions – which should be seen as providing information on the objective economic situation – are summarised in Table 2. INFLATION, GDPCAP, and EMP are key macroeconomic indicators, while OPENNESS is a proxy for the integration of the country into the world economy. Since unemployment data on Eastern European countries are unreliable for cross-country comparisons (United Nations (1997, p. 114f)), I use employment data measured as an index instead. Although employment is neither measured with great precision, it seems to be somewhat less distorted.

Tab. 2: Aggregate Level Variables and Coding

| Variable name | Definition |
|---------------|---|
| GDPCAP | GDP per capita in constant US Dollars, expressed as index (base: 1996) |
| EMP | Employment expressed as an index (base: 1989) |
| INFLATION | Inflation rate in % p.a. |
| OPENNESS | Ratio of exports plus imports divided by 2 to GDP in US Dollars |
| GOVGDP | Ratio of government expenditure to GDP in % |
| GOVDEF | Ratio of government surplus to GDP in % (a deficit implies a negative value) |
| PRIVSHAR | Private sector share in percent of GDP |
| INTPRICE | Chained de Melo et al. (1996) and EBRD transition indicator (simple sum of index for price liberalisation and competition) |
| EXTMARK | Chained de Melo et al. (1996) and EBRD transition indicator (index for trade and foreign exchange rate system) |
| PRIVATE | Chained de Melo et al. (1996) and EBRD transition indicator (simple sum of index for large-scale and small-scale privatisation, and banking reform) |

Source: de Melo et al. (1996), EBRD Transition Report (1994, 1995, 1996, 1997, 1998), UN Economic Survey of Europe (1997, 1998), Berg et al. (1999), own calculations.

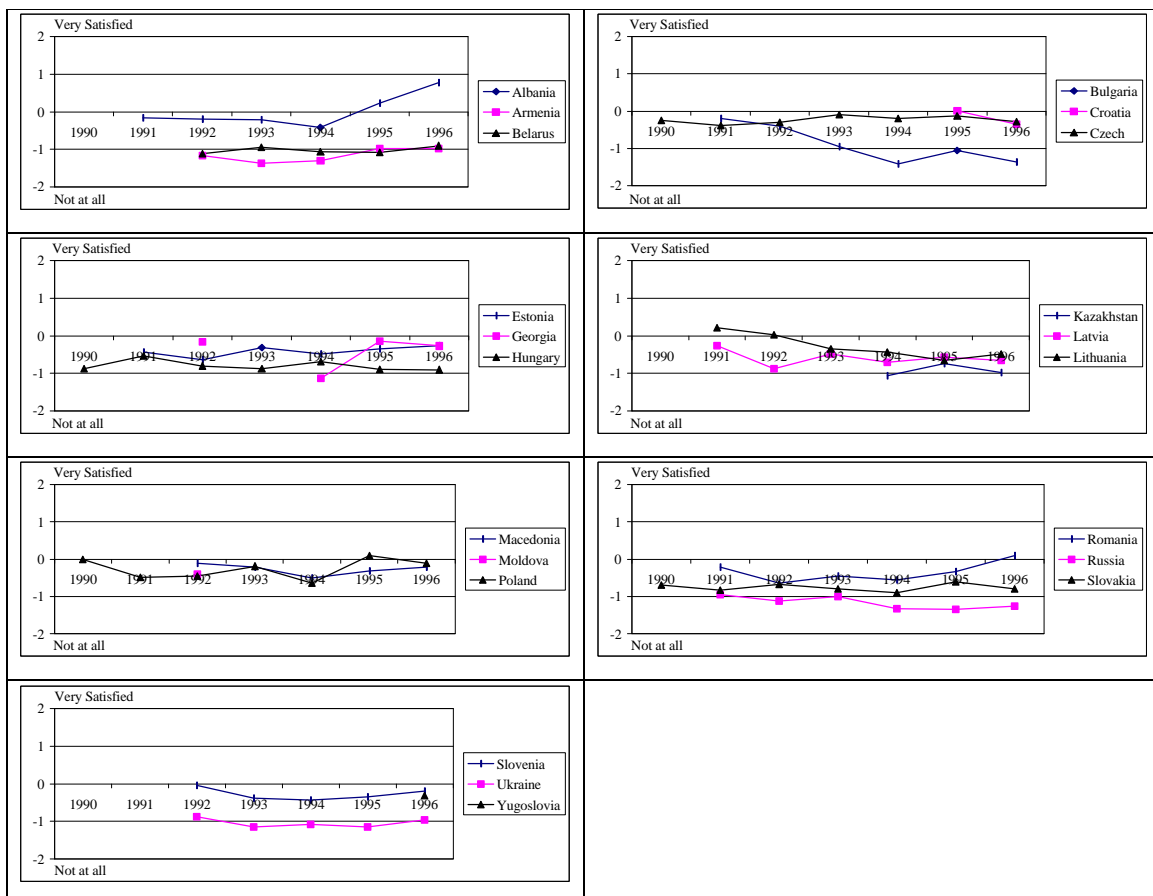
Fiscal policy is described by GOVGDP, PRIVSHARE, and GOVDEF. The first two variables are proxies for the involvement of the state in the economy. The further market reforms have progressed, the smaller will those ratios be. The last variable indicates the extent to which the

government tries to smooth the burden of transformation over time. This can be either seen as positive – future generations will benefit from introducing a market economy, hence they should bear a part of the burden – or negative, as it is unclear whether this money is in fact used to compensate transition losers and to prevent economic hardship.

Finally, indicators for the progress achieved in economic transition as recorded by the EBRD, namely INTPRICE, PRIVATE and EXTMARK, are utilised in the analysis. Again, I would expect that the further a country has come in terms of economic transition, the more benevolent the political situation will be evaluated by its citizens.

Before we come to the actual estimation of the model, a description of the dependent variable in the time dimension for all available countries is presented in Figure 1.

Fig. 1: Satisfaction with the development of democracy (DEMO)



We can be brief in summarising the trends, as the general tendency for most series is to stay relatively close to the ‘not satisfied’ category. Some interesting points are: There is a strong

increase in satisfaction in Albania after 1994.¹ The Czechs are relatively indeterminate about the development of democracy in their country and this position is quite stable over time. In Hungary, we also find that answers do not fluctuate a lot on average but people are rather dissatisfied with democracy. For Poland, the variations are larger, but in general the level of satisfaction is higher than in Hungary and – taking the average over time – close to that of the Czech Republic. The Baltic states show some variation in the development of satisfaction with democratisation over time, with Estonians being the least dissatisfied. Although we see similar average values for Latvia and Lithuania in 1996, the time dimension shows that people in Lithuania were quite satisfied in 1991 and then became less and less satisfied, while for Latvia we do not observe a notable trend.

The most dissatisfied countries with the way democracy is developing are Bulgaria and Russia. Worrisome is the strong rise in dissatisfaction and that there is not much social disagreement on this issue, as indicated by a relatively small standard deviation. Belarus and Armenia are also countries where people do not view the development of democracy as very promising.

To conclude, there seems to be a general feeling of dissatisfaction with the progress made in creating democratic political systems in Eastern Europe. Moreover, there appear to be considerable differences across countries and some variation across time. In the following section, the influence of economic variables on people's attitudes towards progress in democracy will be analysed.

3. Economic determinants of satisfaction with progress in democracy

In Table 4, the results of a non-standard ordered logit model are presented; satisfaction with progress in democratisation is the dependent variable. The adjustment of the standard logit model is necessary in this context to account for different aggregation levels of the regressors, which is crucial for making valid inferences (see Moulton (1990)). The distribution assumption in the model is that observations across individuals within one country are not independently distributed (see Binder (1983), Skinner (1989)), which implies that we cannot use standard maximum likelihood techniques. However, to gain some additional degrees of freedom, the available information across time is taken into account when computing the standard errors for the statistical tests.

¹ Note that there seems to be a general upward bias in the values for Albania (see Hayo (1997b)).

The left part of Table 4 gives the unrestricted estimates containing all variables utilised in this study. Note that the coefficients give the influence of variables on the probability that an answer falls into one of the four categories. As it is apparent from the table, not all variables are statistically significant. We continue in a general-to-specific modelling procedure and eliminate those variables that are not jointly significant at a 5% significance level ($F(10,67) = 1.68$). Operating with large-scale samples implies that we do not have to worry about marginally significant variables (see Leamer (1978)). The remaining variables are displayed in the right part of Table 4, and their effects on the attitude towards progress with respect to democracy will be discussed below.

Tab. 4: Satisfaction with Democracy (1991-1996, adjusted ordered logit, 68372 cases)

| Independent Variables | General model | | | Simplified model | | |
|------------------------------|---------------|----|-----------|------------------|----|-----------|
| Financial situation | | | | | | |
| NEGNEG | -0.93 | ** | (0.04) | -0.94 | ** | (0.03) |
| POSNEG | -0.06 | | (0.08) | | | |
| NEGPOS | 0.05 | | (0.04) | | | |
| POSPOS | 1.02 | ** | (0.07) | 1.0 | ** | (0.07) |
| INCOMEQ | 0.09 | ** | (0.01) | 0.09 | ** | (0.01) |
| Macro variables | | | | | | |
| INFLATION | -0.0001 | ** | (0.00003) | -0.00004 | * | (0.00002) |
| GDPCAP | -0.003 | * | (0.001) | -0.002 | * | (0.001) |
| EMP | -0.02 | | (0.01) | | | |
| OPENNESS | 0.04 | | (0.53) | | | |
| Fiscal policy | | | | | | |
| GOVGDP | 0.02 | | (0.02) | | | |
| GOVDEF | 0.05 | * | (0.02) | | | |
| PRIVSHARE | 0.02 | * | (0.01) | -0.02 | * | (0.01) |
| Transition indicators | | | | | | |
| INTPRICE | 0.07 | | (0.62) | | | |
| PRIVATE | 0.93 | | (0.90) | | | |
| EXTMARK | -0.81 | | (0.43) | | | |

| | | | | | | |
|---------------------------|-------------------|----|----------|--------------------|----|----------|
| Socio-demographics | | | | | | |
| FEMALE | -0.05 | ** | (0.02) | -0.05 | ** | (0.02) |
| AGE | -0.03 | ** | (0.003) | -0.03 | ** | (0.003) |
| AGESQ | 0.0003 | ** | (0.0003) | 0.0003 | ** | (0.0003) |
| EDUCL | -0.0001 | | (0.01) | | | |
| Time fixed effects | | | | | | |
| D92 | -0.60 | * | (0.23) | -0.62 | * | (0.25) |
| D93 | -0.84 | ** | (0.24) | -0.72 | * | (0.28) |
| D94 | -1.48 | ** | (0.32) | -1.35 | ** | (0.34) |
| D95 | -1.64 | ** | (0.35) | -1.48 | ** | (0.37) |
| D96 | -1.40 | ** | (0.36) | -1.28 | ** | (0.39) |
| F-test | F(42,35) = 61.2** | | | F(32,45) = 107.6** | | |
| Pseudo-R ² | 0.092 | | | 0.091 | | |

Notes: Country dummies are always included. Moldova and Yugoslavia are excluded due to limited observations. Cut values have been omitted. Standard errors are given in brackets after coefficients. * (**) indicates significance at a level of 5% (1%).

First, the results for the control variables are briefly noted but not commented upon (see Hayo (1999) for a more detailed analysis and the references therein). Regarding the time dummies, we find that compared to the base year 1991 all other years show less satisfaction with the progress made in democratisation. The minimum satisfaction occurred in 1995, and in 1996 a slight recovery has taken place. Education does not appear to have any explanatory power with respect to the question at hand.² Age has a significantly negative influence on people's opinion towards progress in democracy. However, the non-linear term implies that minimum satisfaction occurs at an age of about 50 years. Regarding the gender dummy, women are more dissatisfied than men.

Next, we come to the interpretation of the individual-level variables describing the respondents economic situation. The variables capturing the subjective evaluation of the financial situation in a comparison across time show slight evidence for an expectation effect

² The education variable is not recorded in a metric scale and one may be concerned that this is distorting results. An alternative is to split the variable up into dummy variables. A major disadvantage of such a procedure is that information about the ordering of categories is not used. However, I have re-estimated the model employing dummies for education, the coefficients of which are neither significant. Results are available upon request.

in the general model. People who expect to be better off in the future are also more satisfied with the political transformation even if they had to suffer income losses compared with the past and vice versa. However, the influence of the mixed financial situation variables is not significant, and we have to conclude that there is not much evidence in favour of a strong effect of expectations regarding changes in a household's financial situation.

What we find as a strong significant effect is that if people are better off compared to the past and expect to be even better off in the future, they will typically be more pleased with progress in democracy and vice versa. Thus subjective personal economic success (failure) has a positive (negative) impact on the attitude towards the democratisation process.

Finally, the income quartile variable shows that relatively rich people are more satisfied with progress in political transformation.³ This can be interpreted as an example of an objective economic variable having an effect at the individual level. As in the case of aggregate variables, I do not think there is a simultaneity problem, the reason being that it is unlikely that a person's relative income position will be very much affected by his view on progress in democratisation.

Regarding the variables collected at a macro level, the following conclusions can be drawn: First, employment has no significant effect. This may be due to the mentioned problems of adequately measuring the conditions in the labour markets. The transformation and openness indicators neither show robust effects. This negative finding applies also to the fiscal policy variables except the private sector share. If it were possible to disaggregate fiscal policy, for example by extracting transfer payments, results may have been different.

Turning to the significant macroeconomic variables, we can see that inflation has a negative effect on satisfaction. The higher the inflation rate, the less satisfied are people with democratisation. Thus, inflation does not only reduce support for market reforms (see Hayo (1999)), it also decreases satisfaction with progress in reforming the political system. Thus low inflation rates can be seen as contributing towards stabilising public satisfaction with economic as well as political reforms.

The GDP per capita index displays a negative sign. Respondents in countries that are characterised by a higher GDP index are less satisfied with the political transformation progress. An interpretation of this finding is that it may reflect a value change towards more post-materialistic values in a relatively more affluent society (see Inglehart (1977)). In other

³ A similar point applies as mentioned in the previous footnote. Again I have checked that results are robust with respect to a split-up of the variable into dummies.

words, if living conditions have improved, people demand a similar amount of progress in political transformation.

Finally, the higher the private sector share in GDP, the more satisfied people are with democratisation, and one can argue that democratisation is strengthened by privatisation. However, no influence was found when examining the effects of EBRD transition indicators.⁴ Hence, objective economic indicators measured at an aggregate level have a significant influence on the respondent's assessment of progress in developing a more democratic political system.

4. Conclusion

The aim of this paper was to empirically investigate possible interactions between economic variables and the satisfaction people express regarding the progress that has been made in democratisation. After documenting the development of satisfaction with political transformation over time and countries, we have analysed a combination of micro and macro variables reflecting economic conditions in an appropriately adjusted ordered logit regression model. We found that both subjective and objective micro influences, specifically relative income position, development and expectation of financial situation, and objective macro influences, namely inflation, GDP per capita index and private sector share, have a robust and significant influence.

The main general conclusion which can be drawn from these results is that people's opinion towards political transformation is influenced by economic conditions, both at an individual and an aggregate level. This immediately raises the concern that those studies in the literature that focus on the analysis of the effects of the political system on economic performance are subject to an endogeneity bias, which may invalidate those results. Hence a proper analysis of the interaction between democratisation and economic performance should take the simultaneity into account, either by using instruments or by specifying a full-fledged simultaneous equation model.

Moreover, the distinction between political and economic transformation may not be very helpful in practice, as people in Eastern Europe evaluate political transformation conditional on the developments in the economic system. So the choice of an "Asian way" to transition appears to be not very realistic, and transformation countries in Eastern Europe have little

choice but to meet the challenge of having to transform their economic and political systems at the same time. What clearly comes out in this paper is that transition countries, if they want to keep satisfaction with democratisation reasonably high, have to make progress in their economic development. Perhaps the situation in Russia is a good example to make that point. The election of Vladimir Putin as President in Spring 2000 may be viewed as a return to more authoritarian political structures and as an outcome of widespread dissatisfaction with the performance of the democratic political system as implemented so far. In the light of our results it is tempting to interpret the loss in satisfaction in democratisation as mirroring the difficulties of the Russian economy. If that was true then the recovery of the Russian economy will be crucial in sustaining support for the creation of a democratic political system.

Finally, I would interpret the findings in this study as empirical evidence suggesting that the treatment of the economic and political systems as separate entities is unlikely to be very useful when it comes to developing practical policy conclusions. But the importance of deriving useful policy prescriptions for a successful transformation process warrants further research on the interactions of economics and politics in the phase of transition.

⁴ The insignificance of PRIVATE is not due to a high degree of collinearity with PRIVSHARE.

Appendix

Tab. A: Surveys Across Time and Countries

| Surveys | CEEB1 | CEEB2 | CEEB3 | CEEB4 | CEEB5 | CEEB6 | CEEB7 |
|------------|---------------------|-------|-------|-------|-------|-------|-------|
| ZA-No. | 2253, 2256, 2257 | 2251 | 2321 | 2474 | 2577 | 2802 | 2924 |
| Year | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 |
| Albania | | X | X | X | X | X | X |
| Armenia | | | X | X | X | X | X |
| Belarus | | | X | X | X | X | X |
| Bulgaria | | X | X | X | X | X | X |
| Croatia | | | | | | X | X |
| Czech | X | X | X | X | X | X | X |
| Estonia | | X | X | X | X | X | X |
| Georgia | | | X | | X | X | X |
| Hungary | X | X | X | X | X | X | X |
| Kazakhstan | | | | | X | X | X |
| Latvia | | X | X | X | X | X | X |
| Lithuania | | X | X | X | X | X | X |
| Macedonia | | | X | X | X | X | X |
| Moldova | | | X | | | | |
| Poland | X | X | X | X | X | X | X |
| Romania | | X | X | X | X | X | X |
| Russia | | X | X | X | X | X | X |
| Slovakia | X | X | X | X | X | X | X |
| Slovenia | | | X | X | X | X | X |
| Ukraine | | | X | X | X | X | X |
| Yugoslavia | | | | | | | X |

Note: The primary data are available, for example, from the “Zentralarchiv für Empirische Sozialforschung” (ZA) in Cologne, and as additional information ZA-classification codes are listed in the second line. The data for Czechs and Slovaks over the period 1990-92 are based on filtering the respondents in Czechoslovakia according to the region where they live. Yugoslavia stands for Serbia and Montenegro.

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