

**THE FORMATION OF SOCIOTROPIC ECONOMIC  
PERCEPTIONS IN EAST CENTRAL EUROPE  
DURING THE POST-COMMUNIST  
TRANSITION**

**BY**

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## ABSTRACT

This dissertation is about the formation of economic evaluations in post-communist countries of East Central Europe over the period of transition. In the early transition phase – right after the collapse of the Berlin Wall and the dissolution of the Soviet Union – citizens' perceptions of the national economy appeared more favorable than objective economic indicators would have suggested. With triple and quadruple digit annual inflation rates and a severe economic contraction at the beginning of the 1990s, there was a substantial portion of the population in these countries who still thought that the state of the national economy had been improving. In their prospective economic evaluations, post-communist citizens expressed even higher optimism. Thus, sociotropic economic perceptions at the early stage of the democratic transformation appeared to be disconnected from the real economic situation at that time.

In my attempt to analyze the disjuncture between the objective and the subjective economy, I offer three plausible explanations. First, at the early phase of the transformation process, post-communist citizens may have lacked knowledge about the mechanisms of the new economic systems put in place of the old command economies. Second, the overall instability and uncertainty in East Central European nations should have made it even harder for people (including the most informed) to be accurate in their assessments of the economy. And third, the overestimation of the economic performance may have followed from the state of euphoria that was wide-spread in newly democratizing societies after the downfall of the old regime.

Furthermore, I posit that citizens in Central and Eastern Europe formed perceptions about the national economy in a systematic way. Drawing on the work in social and political psychology, I claim that individuals relied on cognitive and information heuristics in the process of opinion formation. In particular, information about one's personal economic situation as well as political attitudes and evaluations may have served as cues in public assessments of national economic performance. Later in the transition, despite the learning process and increased economic stability, post-communist citizens still made an extensive use of cognitive heuristics while forming sociotropic economic views.

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It has become a tradition to say that one's dissertation project would have not been completed without the help of a number of individuals. In my case, it is safe to say that I would never have even started this project without the encouragement and support of certain people.

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# CHAPTER 1

## Introduction

One of the few law-like postulates in political science is that the state of the economy matters for system support and election outcomes (Alt and Crystal 1983, Bloom and Price 1975, Frey and Schneider 1978, Hibbs 1977, Pissarides 1980, Kramer 1983, Nannestad 1989, Kuechler 1991, Norpoth 1980, Holbrook and Garand 1996, Feld and Kirchgaessner 2000, Nickelsburg and Norpoth 2000, Powell and Whitten 1993, Sanders 1991, Palmer and Whitten 1999, Anderson 1995, 2000, Pacek and Radcliff 1995a, 1995b, Buendia 1996, Remmer 1993). Articles written on this topic perhaps outnumber studies in any other sub-field in the discipline (for an overview see Nannestad and Paldam, 1994a, 2000). The most prominent theoretical claim about the link between politics and the economy is based on the Downsian model of rational voting (Downs 1957) and is usually reduced to the so-called “reward-punishment” proposition. Simply put, voters are expected to re-elect the incumbent government when the economy flourishes and elect a new government if performance of the economy is poor.

The link between the state of the economy and the actual vote is not direct, however. Information about the economy has to go through voters, because they are the

ones who cast votes - not the economy itself. In an ideal world, people would have full information about the economy and make accurate assessments about the economic performance of their government. Based on these accurate assessments, voters would then cast their votes for or against the government.

In the real world, however, people do not have full information about the economy at their disposal, nor do they seek to obtain it. Instead, information about the economy is collected as a by-product of other activities, such as a job search or interpersonal communication, and is derived from people's own economic experiences (Aidt 2000). As a result, economic perceptions of individuals are likely to be heterogeneous (Duch, Palmer, and Anderson 2000, Krause and Granato 1998, Nadeau, Niemi and Amato 2000, Duch 2001). Moreover, not only are economic evaluations formed on the basis of news reports about the economy and individuals' economic experiences, but they are also filtered through people's political affiliations, socio-economic status and other factors, which sometimes remain unaccounted for in models of economic voting and the formation of economic perceptions, especially at the aggregate level.

To date, most studies of public opinion about the economy have been conducted in Western democracies (Alvarez and Franklin 1994, Funk and García-Monet 1997, de Boef and Kellstedt 2004). Thus, limited systematic research has been conducted in new democracies developing in the place of communist regimes in Eastern and Central Europe. A most intriguing attribute of these regimes, depicted by all area study scholars, is a close interrelationship between political and economic reforms during the transition period, also called the “dual transition”. As a result, people's economic perceptions may

to a large extent be affected by changes in the political sphere of post-communist societies.

In my dissertation, I will focus on how people formed perceptions about the national economy in the new democracies of East Central Europe during the course of the transition. More specifically, I will explore the question of congruence between public perceptions of the national economy and experts' economic indicators at the beginning of the post-communist transformation as well as later in the transition. Furthermore, I will investigate the mechanisms of using cognitive and information heuristics in connection with the formation of public economic opinion in countries of the former Soviet bloc<sup>1</sup>. In addition, I will compare how much citizens relied on cognitive shortcuts when forming economic evaluations in the early and later phases of the transition. Finally, it is also my intention to find out whether individuals with various levels of economic and political sophistication exhibited any differences in their ability to form accurate economic evaluations.

In the introductory chapter, my focus will be threefold. First, I will discuss the importance of the question at hand. I will then proceed to reviewing the existing literature and identifying the gaps that need to be filled by future research. Finally, I will show how my dissertation is going to address these gaps and propose a research design for studying my question. In Chapter 2, I will provide an overview of the economic transition process in East Central Europe after the collapse of the Soviet regime, as well as of public views of the economy over the same period. The next chapter, Chapter 3, is

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<sup>1</sup> Throughout the dissertation, I will be using the terms “the former Soviet bloc”, “the communist bloc”, “the post-communist countries/nations/regimes/systems”, and “the new/emerging/newly established democracies of East Central Europe” interchangeably in reference to the former Soviet Union and East European countries that happened to be under Soviet control after World War II (refer to Appendix 1A).

devoted to establishing a link between objective economic indicators and public opinion. Chapter 4 looks at whether the link between the objective and the subjective economy is more pronounced among more politically sophisticated individuals. Chapter 5 will examine the role that cognitive and information heuristics play for the formation of national economic evaluations at the beginning of the post-Soviet transformation. In Chapter 6, I will follow the formation of sociotropic<sup>2</sup> economic evaluations across four East Central European nations at different time points of the transition. Finally, Chapter 7 will summarize the argument presented in my dissertation, as well as discuss conclusions and implications of my findings.

### **Why Study Economic Perceptions?**

The vast majority of economic voting studies start with the statement that politics and the economy are related. Few, however, provide theoretical support for why it is important to study this empirically established relationship. In what follows, I will offer several reasons for studying the link between the economy and political behavior.

First, the state of the economy is a good standard by which to hold the incumbent government accountable for its performance (Anderson and O'Connor 2000, McDonald et al. 2004, Lewis-Beck and Paldam 2000). Although all democratic societies provide for the development of free market economies, government involvement in the economic sphere is quite substantial and variable across countries. Furthermore, governments tend

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<sup>2</sup> “Sociotropic” is a term widely accepted among scholars in the field of economic voting. It is used in reference to voting or economic perceptions. Sociotropic economic perceptions are perceptions about the state of the national economy, while sociotropic voting is voting based on sociotropic economic perceptions.

to make promises about improving the national economic situation, thus assuming responsibility for economic outcomes.

Since the economy is a vital part of people's everyday lives, voters can be expected to collect a good deal of information about the economy in order to cope with the existing economic environment. Moreover, objective economic indicators are well-accepted and widely-disseminated in industrialized societies via numerous media outlets. Overall, it is in the people's interest to form evaluations about the economy that are reasonably accurate and use these evaluations as an instrument to hold governments accountable for their performance.

Second, elected officials, being aware of this instrumental function of public economic perceptions for voting behavior, seek information on people's economic sentiments in order to run an effective campaign and increase their chances for re-election. Past literature has established that party strategies depend on the relationship between economic perceptions and election outcomes (Clarke and Whiteley 1990).

Third, studying the formation of economic perceptions in countries of East Central Europe will advance our knowledge about economic voting in general (Tucker 1999a, 1999b, 2002). Before the fall of the communist bloc and the start of democratic developments in Latin America and Africa, political scientists were only able to speculate what economic voting might look like in young democracies. Now there are opportunities to put those speculations to the test. Analyzing economic perceptions in non-Western democracies will allow us to talk about the generalizability of the economic theory with much more confidence (Pacek 1994).

Fourth, economic voting is not the only field in political science where economic perceptions play a major role. Other forms of political participation, as well as trust in political institutions, may also be affected by people's evaluations of the economy. For example, economic sentiments have been found to be influential predictors of people's mobilization or withdrawal from the political process (Pacek 1994, Rosenstone 1982, Bahry and Lipsmeyer 2001, on political mobilization see also Reisinger, Miller and Hesli 1995), and researchers have found consistently that superior economic performance increases trust in government.

In sum, studying the formation of economic perceptions is important for developing a better understanding of the mechanism of government's accountability to voters in consolidated and newly established democracies, as well as advancing our knowledge of political participation in general and economic voting in particular.

### **Past Research on Economic Perceptions**

The first aggregate-level studies of economic voting took government economic accountability as a given. Voters were expected to have accurate knowledge of the economic situation, relate it to government's performance and either reward or punish the government accordingly.

On the surface, the assumption of high levels of voter political and economic sophistication in the aggregate seems reasonable. There are some people who may overestimate the economic situation and some who may underestimate it; it seems reasonable to assume that their perceptions might cancel out in the aggregate. Then, there is also a core of voters who are interested in politics and, therefore, seek out

political and economic information and, in so doing, form accurate economic evaluations. In the cleanest picture, one might expect the objective measures of the economy to fall right at the mean of voters' sociotropic perceptions about the economic situation. In this case, using either perceptions or objective economic indicators in time series statistical models should yield similar results.

Survey studies of voters, however, have repeatedly revealed rather low levels of political sophistication, raising doubts about popular economic perceptions being accurate, even when aggregated (e.g. Duch, Palmer and Anderson 2000). Thus, instead of objective economic indicators, social scientists started to use subjective measures of the economy – economic perceptions – in models of voting behavior and government popularity (e.g. Price and Sanders 1993, Clarke and Whiteley 1990, Carlsen 2000, Anderson 2000).

### *Two Debates about Types of Economic Perceptions*

Since economic perceptions became a part of voting models, a debate over which type of people's evaluations of the economy makes an impact on their vote choice has never left the scene. One side of this debate deals with whether people are backward- or forward-looking when it comes to their voting decision. The second disagreement concerns whether citizens vote based on assessments of their personal economic situation or the national economy. These controversies have grown into debates about *retrospective* versus *prospective* and *sociotropic* versus *pocketbook* (or *egocentric*) voting, respectively.

### *Retrospective versus Prospective Voting*

The retrospective voting proposition assumes that citizens cast their votes based on evaluations of the past economic situation, either personal or national. This proposition has been labeled *the reward-punishment* hypothesis and has found support in numerous empirical studies (Goodhart and Bansali 1970, Lewis-Beck 1991, Kiewiet and Rivers 1985, Kiewiet 2000).

Opponents of the retrospective voting view tend to give voters more credit in their ability to make economic assessments. Following Downs (1957), they make the assumption that voters are rational and seek full information about the economy. Thus, they are viewed as complementing information about the recent economic past with future economic forecasts and then using this information to make a voting decision that would maximize their benefits while minimizing the costs. Supporters of prospective voting believe that rewarding or punishing the incumbent government solely on the basis of past performance should not be considered rational, because such behavior cannot maximize future benefits from voting (Lockebie 1991, MacKuen, Erikson and Stimson 1992, 2000).

In empirical studies, the retrospective voting proposition has found more support than prospective voting, however. Morris Fiorina (1978), using micro-level data, found that American voters were largely retrospective, thus supporting earlier findings drawn from aggregate level analyses (e.g. Kramer 1971, Tufte 1975, Lepper 1974, Kernell 1977). This claim has been supported by a number of comparative studies (cf. Lewis-Beck 1988; Anderson 2000). To explain the dominance of retrospective voting, scholars refer to the high cost of economic information and a low interest on voters' part to collect



it. High information costs stem from seeking out relevant messages on the politico-economic situation, collecting and retaining these messages, as well as making economic forecasts based on this information. It is unlikely, however, that making all these efforts to become a sophisticated voter would in any meaningful way change one's benefits derived from voting. Overall, it has been concluded that although retrospective voting may not be the most sophisticated type of voting behavior, it certainly serves the purpose of holding the government accountable for its promises.

In spite of the fact that the retrospective voting model has found more empirical support, some researchers are still convinced that voters are forward-looking in their evaluations of government economic performance. They believe that prospective voting is more appealing theoretically than voting based entirely on past performance and see model specification and testing techniques as major problems for not finding enough evidence for prospective voting. MacKuen, Erikson and Stimson (1992, 2000), for example, developed a model of predicting presidential popularity in the United States and included both measures of retrospective and prospective economic perceptions in it. They constructed their perceptions variables from the Index of Consumer Sentiment and used them as intervening variables between objective economic conditions (inflation and unemployment) and approval ratings. Impressively, the prospective component of economic perceptions fully accounted for the presidential approval series (see also Price and Sanders, 1995; Clarke and Stewart, 1995).

In parallel research in countries of Central and Eastern Europe, Colton (1996, 2000) has found support for prospective voting in Russia. However, this does not necessarily mean that Russian voters are more "sophisticated" and knowledgeable about

the economy than voters in Western democracies. Simply, voters in transition democracies may be so dissatisfied with the current economic situation and recent economic past, but believe that things have to get worse before they get better, that they keep the government that they think would benefit them most in the long-run (Stokes, 1996, 2001; Przeworski, 1996).

Stokes (1996, 2001) provided four possible scenarios of prospective voting and government support in transition democracies. Besides '*normal*' prospective voting, which she defines as a simple extrapolation of retrospective voting, there are *intertemporal*, *antidotal*, and *distributional* voting patterns in new democracies. The idea for intertemporal voting is that the state of the economy has to get worse before it gets better. People, who follow the antidotal pattern, vote against the government when things improve, because they suspect that the reforms do not proceed 'correctly' when, at the beginning of the transition, they lead to economic improvements rather than deterioration. Lastly, distributional voting assumes that some people may still vote against the government even when they believe in the idea that 'things have to get worse before they get better'. This may happen because such people have been hurt more than others in the transition and consider it unfair.

In sum, the debate about retrospective versus prospective voting has not been resolved. Social scientists have found evidence in support for both types of voting behavior in various parts of the world. Moreover, studies of voting behavior in East Central Europe have revealed the need to modify the traditional retrospective and prospective models to explain government popularity and election outcomes in this region.

### *Sociotropic versus Egocentric Voting*

Another disagreement about which type of economic perceptions is most influential for vote choice is sociotropic versus pocketbook (or egocentric) voting. The argument in support of egocentric voting comes from the assumption that people act out of self-interest and seek to maximize their own benefits. Consequently, if people are satisfied with their personal economic situation or they think that a particular political party is most likely to make them better off in the future, they should vote for this party (Nannestad and Paldam 1994b, 1995, and 1997).

The sociotropic idea, fiercely argued by Kinder and Kiewiet (1979, 1981), presupposes that people vote based on their evaluations of the national economic situation. The underlying reasoning for this proposition is twofold. First, people realize that they cannot hold the government accountable for every misfortune that happens with their personal economic situation, thus somebody's losing a job is not necessarily the government's fault. Second, people also realize that their personal economic situation is likely to improve if the national economy performs better. Thus, voting based on sociotropic economic evaluations does not mean that people are altruistic and care for the national economy more than they care for their own financial needs, but follows from the belief that a better state of the national economy increases the likelihood of making them better off. The major criticism of the sociotropic voting view, however, is that it requires too much knowledge and effort on the part of citizens.

After Kinder and Kiewiet's (1979, 1981) strong conclusions about sociotropism of American voters, studies on this topic became increasingly popular. Weatherford (1983)

in his study of the American electorate, proceeded in several stages. First, he modeled subjective assessments of economic conditions as a function of personal economic variables, such as unemployment and change in income and other socioeconomic variables. Then, the author turned to modeling policy judgements (measured as the rating of the incumbent's economic policy performance) and, finally, he moved on to predicting the actual vote. Weatherford, unlike Kinder and Kiewiet, hypothesized that most voters use both egocentric and sociotropic referents. Most interestingly, he also predicted a possible interaction effect of economic perceptions, economic periods and characteristics of individuals. Specifically, Weatherford posed that "personal conditions will be weighted more heavily among those most vulnerable to economic dislocation during recessionary periods" (ibid. 159). He concluded that individuals put different weights on personal and national evaluations of the economy when judging the incumbent's policy performance. These conditions depend on the "likelihood and severity of the impact of macroeconomic cycles" (ibid. 171) and the ability to obtain information about the state of the national economy from the media, which is to a large extent explained by socioeconomic status.

Recently, Nagler and De Boef (2001) made an attempt to find a compromise between sociotropic and egocentric voting and put forward an argument that people look at economic conditions of their "economic reference group" when making voting decisions. This "economic reference group" can be based on geographical location, education, occupation, age, etc. Briefly, Nagler and De Boef maintain that people act out of self-interest; therefore, an individual should judge government's economic performance by whether it manages the economy in his or her interest. To form these

economic evaluations, individuals not only assess their personal situation, but they also look at how people who are close to them in some respect are doing economically.

Although the idea of “economic reference group” is rather appealing theoretically, it was not fully supported by the empirical analysis. Nagler and De Boef concluded that there is some evidence in support for 'economic reference group' voting, but sociotropic voting also appeared strong in their research. As a matter of fact, Nagler and De Boef were not the first to talk about group voting. Feldman and Conley (1991) conducted a study where they looked at causal forces of group economic perceptions, as well as national and personal perceptions, assuming that all of them could have an effect on the vote.

Summarizing the debate, it is fair to say that, to date, both sociotropic and egocentric components of economic perceptions have proven to be important in predicting government support and election outcomes, but that sociotropic perceptions have been found to be more powerful determinants of political behavior.

### *Naïveté and Sophistication of Voters*

The debates about retrospective/prospective and sociotropic/egocentric voting share some common ground. Both of them are centered around arguments about the naïveté and sophistication of voters. Traditionally, students of democracy believed that democracy could be sustained and work properly only if the public is knowledgeable and actively involved in politics. With the first survey studies, however, came a realization about a lack of political sophistication among the general public and the need to rethink democratic theory. Although mass political participation was still assigned an important

role for the normal functioning of a democratic system (Almond and Verba 1963), mass involvement of the population in political activities was viewed by some as a threat to democratic stability (Huntington 1974, Huntington and Nelson 1976). Thus, one theoretical position treats a lack of voters' knowledge of the politico-economic situation as a sign of democratic inefficiency and, in the extreme, even malfunctioning, whereas the other theoretical perspective sees no threat posed to democracy by the absence of voters' sophistication.

In the retrospective versus prospective debate, voters who base their voting decisions exclusively on information from the past are considered to be less rational and sophisticated than those who supplement all available information (past, current and future); hence, prospective voting is more sophisticated. In the pocketbook versus sociotropic controversy, pocketbook economic assessments are obviously the ones requiring less effort and knowledge from the voter. Sociotropic voting, on the other hand, assumes that people have some knowledge of the economic system and pay attention to fluctuations of the national economy. With respect to rationality, however, egocentric voters may be viewed as more rational due to the fact that they are motivated by pure self-interest when casting their votes. Since sociotropic voters base their voting decisions on evaluations of the national economy, self-interested motivation of the vote choice may not be entirely obvious.

There is a wide range of studies investigating how much voters know about the economy and how sophisticated they are when it comes to voting (Delli Carpini and Keeter 1996, Holbrook and Garand 1996, Kraus and Granato 1998, Kuechler 1991). Chappell and Keech (1985, 1991), followed by Suzuki and Chappell (1996), defined

rational voting as the utilization of full information when making a vote choice. From their analysis the authors inferred that voters appear to have an understanding of the functioning of the economic system and to distinguish between permanent and cyclical economic growth and, therefore, behave rationally. Nevertheless, the authors do not rule out less sophisticated voting.

Haller and Norpoth (1994) looked directly at how people form economic forecasts. Specifically, they intended to explore whether the formation of people's economic expectations conform to the *extrapolation*, *adaptive*, or *rational expectations* models. The extrapolation model posits that economic expectations are nothing but a function of the most recent retrospective evaluations. According to the adaptive model (Cagan 1956), future expectations are "a function of the most recent previous expectations adjusted for any errors in judgment (i.e., the discrepancy between the previous prediction and the actual outcome)" (Conover et al. 1987, 562). Finally, the rational model operates under the assumption that voters utilize all relevant information from the past, as well as possess information about the future to make economic forecasts. Their analysis of the U.S. economic series led Haller and Norpoth to believe that forecasts of inflation conform to the adaptive expectations hypothesis, while forecasts of general economic conditions are neither adaptive nor rational.

Conover, Feldman and Knight (1987), using individual level data, came to a similar conclusion that people follow the adaptive, rather than extrapolative, model when making economic predictions. Thus, neither of the discussed above studies has found overwhelming evidence in support of the rationality of voters, but has failed to reject the hypothesis of voters' rationality as well.

Overall, empirical findings show that, although few people can accurately name the unemployment, inflation, and growth rate figures, they do have a keen sense of a general direction of the economic development in their countries (e.g. Haller and Norpoth 1994, Sanders 2000, Paldam and Nannestad 2000).

Sanders (2000) conducted an investigation of British voters and showed that voters' perceptions of the salience of inflation and unemployment as public issues are strongly correlated with measures of the objective economy. The author claimed that voters do not necessarily need detailed information about economic conditions to form perceptions about the economy and make judgments about the relative merits of political parties. In an earlier study, Lupia (1994) put forward a similar idea where he argued that voters who have relatively low levels of factual knowledge about an issue could emulate the behavior of knowledgeable voters. Lupia explained this type of behavior by the availability of information cues that allows unaware voters to influence electoral outcomes in ways they would have if they had complete information about the issue.

Yet another piece of evidence in support of the idea that wide exposure to economic news is not a necessary condition of forming accurate perceptions about the economy can be found in the work of Haller and Norpoth (1997). Using Surveys of Consumers conducted in the U.S., they established that close to half of the American public admitted to not getting any economic news. However, across time, opinion of the 'no news' category of respondents were tracking closely the series of perceptions of those regularly exposed to economic news. Economic perceptions of both respondent groups could be predicted by indicators of the objective economy.



Finally, there is a group of researchers who have reexamined the notion of voter rationality altogether. They claim that it is rational to be a naive voter as opposed to be well-informed about the economy (Aidt 2000, Paldam and Nannestad 2000). This argument follows from the idea that collecting economic information is quite costly with respect to time and effort required from an individual, whereas the pay-off from having this information is miniscule. Thus, people become familiar with the economic situation in their country in the process of collecting some other information that presents more value to them or if people see economic information as valuable in social interaction (Aidt 2000).

#### *Economic Perceptions as the Dependent Variable*

Although economic voting studies are legion, the formation of economic perceptions that drive the vote has received much more modest attention from scholars. Economists were the first who felt the need to study sources of economic assessments of the public. In political science, research on the formation of economic perceptions was initiated by Weatherford (1983) and Conover, Feldman, and Knight (1986, 1987). All of these scholars put an emphasis on the ways information is processed by individuals and the potential influence of information-processing on the heterogeneity of economic perceptions.

The finding of heterogeneity of economic perceptions stimulated a string of research focusing on identifying factors that may contribute to the dispersion of sociotropic economic evaluations among individuals. One of the factors that has received most attention is exposure to mass media (Mutz 1994, Mutz and Mondak 1997,

Hetherington 1996). Furthermore, social scientists have started to explore the effects of other variables on heterogeneity of national economic perceptions, such as, for example, an individual's economic self-interest or a conscious decision to receive information only from particular sources (e.g. Alt 1991, Haller and Norpoth 1997, Krause 1997).

To date, the most comprehensive study aimed at investigating sources of heterogeneity in people's economic evaluations has been conducted by Duch, Palmer, and Anderson (2000). Their major claim is that individual-level differences among people do not necessarily cancel out in the aggregate, as is commonly believed, thus producing biased distributions of public economic perceptions. The authors identify several groups of factors that have the potential to affect economic perceptions in a systematic manner at the aggregate level.

First, informational differences among various groups of individuals may cause systematic distortions of national economic evaluations in the aggregate as was previously uncovered in the research by Bartels (1996), Althaus (1998), and Hetherington (1996). Second, as suggested elsewhere (Aidt 2000, Paldam and Nannestad 2000), collecting full information about the economy imposes high costs on individuals, whereas the benefits from having all this information are rather small. This logic has resulted in the conclusion that only those individuals who have a specific self-interest in collecting economic information should be and have been found to seek information about economic conditions. Third, personal financial experience has also been hypothesized as a distorting factor for sociotropic economic perceptions at the aggregate level. Finally, people's political attitudes and prior political predispositions may influence economic perceptions (e.g. Wlezien, Franklin, and Twiggs 1997, Anderson, Mendes, and Tverdova

2004). According to cognitive consistency theory (Festinger 1957) and its application by Zaller (1992), people “interpret new information so that it reinforces previously held attitudes, thereby augmenting rather than tempering the differences between their beliefs and those of individuals with opposing political predispositions” (Duch et al. 2000, 638). Thus, not only have Duch, Palmer, and Anderson incorporated all explanatory variables that were previously found to be important for the formation of economic perceptions, but they have also provided strong evidence that cautions us against assuming the homogeneity of aggregate economic perceptions as a given.

While research on the formation of economic perceptions in Western nations has been quite advanced, there has been very little work done exploring the sources of people’s evaluations in countries of Central and Eastern Europe. To date, the study by Anderson and O’Connor (2000) is the only systematic analysis of economic perceptions formation in that region. Specifically, the authors examined the formation of economic perceptions in East Germany under conditions of radical system change. Their findings revealed a poor match between objective economic conditions and public perceptions about the national economy during the initial stage of the transition. However, as time passed, sociotropic perceptions started tracking the objective economy more closely.

Finally, I would like to touch upon the question of the interrelationship among all four types of economic perceptions – sociotropic retrospective, sociotropic prospective, egocentric retrospective, and egocentric prospective. Recently, Nannestad and Paldam (2000) made an attempt to develop a complete model of economic voting by taking into account all possible causal relationships among the economic variables in the voting function. Surprisingly, they did not find any causal force going from economic

perceptions to government support. With respect to the causal forces operating among the economic perceptions variables, their findings showed no causal relationship going from retrospective to prospective perceptions, but rather supported the reverse relationship – from prospective to retrospective economic perceptions. In addition, according to the authors' statistical analysis, the commonly assumed causality from egocentric to sociotropic perceptions is also reversed. However, Nannestad and Paldam have cautioned against putting too much faith in their findings, because they could be a statistical artifact produced by high multicollinearity of the aggregate-level data.

In sum, economic perceptions have received much less attention as the dependent variable than as an independent one. Studies that explored sources of economic evaluations found that they were not only driven by the objective state of the economy, but also by individual differences. As a result, public economic perceptions are likely to be heterogeneous.

### **Gaps in Past Research**

Because the primary goal of economic voting research has been to explain voting behavior and election outcomes, economic perceptions have been typically used on the right-hand side of the voting function. As a result, to date we do not have a full understanding of what forces drive economic perceptions themselves. And while there is a sizeable body of literature on the formation of economic perceptions in advanced industrial societies, the sources of public economic evaluations in countries of Central and Eastern Europe have so far been overlooked. Largely, scholars who used economic perceptions as the subject of their studies did so in order to obtain a better understanding

of voting behavior. Moreover, the overall theoretical basis for understanding the formation of economic perceptions is underdeveloped. Without a good theory, however, explanations of political behavior have a descriptive character and are hardly generalizable. That is, researchers develop ad-hoc explanations to suit their evidence. While such explanations may appear plausible and accurate with regard to one particular study, they may not be generalizable for future studies. In addition, models in such studies may lack parsimony, because researchers try to predict as much variation in their dependent variable as possible, thus including a laundry list of variables to improve the fit of their models without having a good theoretical basis for doing so.

Good social research calls not only for having an accurate model, but also developing a model that is generalizable and parsimonious. Specifically, to understand how people form views about the national economy, political scientists necessarily have to draw on theories from social psychology, such as decision-making under uncertainty and information-processing theories.

Furthermore, researchers put a heavy emphasis on economic sources of sociotropic perceptions of the national economy overlooking potential non-economic factors that may also influence people's views. As previous studies showed, there are other factors that affect the way people think about the economy, such as their political attitudes and pre-dispositions, as well as individual characteristics (e.g. Conover et al. 1986, Weatherford 1983). Although factors such as past voting behavior, party identification, and ideology were not found to be as important as economic variables, they were still significant in the process of the formation of sociotropic economic perceptions.

In new democracies, economic transformations were largely intertwined with reforms of the political systems; therefore we may expect political factors to play a greater role in the formation of economic opinion compared with established democratic nations. Not only did people have to evaluate government economic performance, but they also faced an ideological dilemma of what political and economic system they would rather have – democracy or Soviet-style socialism. While Western democratic publics almost never doubt the very foundation of their politico-economic regimes, citizens in new democracies were and still are to some extent divided on this normative issue. Thus, people’s general beliefs on what kind of political and economic regime should be established in their country may bias their views of the nation’s economic performance.

In addition to the theoretical gaps in past research on economic perceptions, there are several modeling and statistical issues that have not been fully addressed. First, previous analyses used economic perceptions as a predictor of political support, such as support for democracy or vote choice, while overlooking the fact that these phenomena may not be completely exogenous to public perceptions of the national economy (Gibson 1996a, Rose and Mishler 1994, 1996). In other words, the relationship between economic perceptions, on the one hand, and political attitudes and behavior, on the other, may well be reciprocal.

Moreover, studies of economic perceptions to date have focused on a single country (e.g. Conover et al. 1987, Krause 1997, Haller and Norpoth 1994, Anderson and O'Connor 2000). This limits the ability to make comparative inferences about the formation of economic perceptions in various nations. That is, single-country studies

allow us to account for the differences in the formation of economic evaluations that can be attributed to variations among individuals within a particular country or, in case of a longitudinal analysis, to a time-varying context of this country. However, because system-specific factors contributing to the formation of economic perceptions still remain unaccounted for in single-country studies, we are unable to test the generalizability of our theories effectively.

Yet another gap in the existing research on economic perceptions is a lack of effort to integrate two levels of analysis – macro and micro – in one model. In the past, scholars chose to conduct either a time-series analysis of aggregate data on economic perceptions or to explore factors influencing the formation of economic evaluations of an individual. While longitudinal studies give researchers a chance to look at changes in the public's economic mood, they do not allow us to make direct inferences about individuals. In contrast, the purpose of an individual-level analysis is to look at how individuals form views about the economy, thus only personal characteristics get to be included in the model. Consequently, the former type of analysis misses all individual heterogeneity of economic perceptions, whereas the latter fails to account for any specific system-level explanations affecting the formation of people's assessments of the economy.

### **How Does My Dissertation Address Gaps in Past Research?**

My dissertation is about the formation of sociotropic perceptions in new democracies of East Central Europe after the collapse of the communist regime, and the purpose for writing it is fourfold. Firstly, I would like to know whether there was

congruence between the objective state of the economy and public economic evaluations at the beginning of the transition; in other words, whether the objective and the subjective economy matched up. Secondly, it is my objective to explore how post-communist citizens used alternative sources of information, to which I refer as cognitive and information heuristics, when they formed opinions about the economy. Thirdly, I am interested in whether individuals who were politically sophisticated differed systematically from less sophisticated people in their ability to form accurate evaluations of the national economy. Finally, I intend to analyze the dynamics of the formation of sociotropic economic perceptions across a limited number of Central and Eastern European democracies at different time points in the transition.

My first argument has two theoretical bases. According to democratic theory, governments must be accountable to their constituencies. Therefore, citizens ought to evaluate governments based on their performance and take political action accordingly. Among various aspects of government performance, economic performance was proved to be the one of major importance to citizens. Thus, from normative perspective, accurate economic evaluations are essential for the proper operation of democracy. However, the relationship between the objective and the subjective economy has not always shown to be strong. Despite the amount of information about the national economic situation available to people via various media sources, democratic citizens remain relatively ignorant regarding the true state of the economy.

In the post-communist region of East Central Europe, especially during the early stage of the transition, the national economic situation was rapidly deteriorating and was characterized by high instability. Moreover, citizens in the newly established



democracies were unfamiliar with the mechanisms of developing market economies. Both of these factors may have contributed to low congruence between the objective economy and public economic perceptions at the beginning of the transformation process. With time, however, this relationship may be expected to become stronger due to the potential effect of economic learning, as well as the growing stability in the economic and political spheres.

My second claim is that individuals use sources other than the state of the national economy to arrive at sociotropic economic evaluations. In particular, I argue that people employ a wide range of cognitive heuristics and information shortcuts when they form opinions about the national economy. According to the memory-based information-processing theory, people do not hold a ready set of opinions on every issue about which they may be asked (e.g. Zaller 1992, 1994). More often, individuals have to form opinions on the spot using information that is on top of their heads. This way, however, it is usually impossible to recall all relevant information stored in memory regarding the issue at hand in order to express one's most complete, truthful view on the topic. Therefore, people tend to use information that is most available to them and that is, in their view, representative of the issue. For example, information about personal economic well-being is both readily available and may be viewed as representative of the general state of the economy.

Also, political attitudes and partisan attachments may serve as cognitive and information shortcuts for the formation of economic opinion because, no matter how free a market economy is in any particular country, it is never completely void of government interference. Thus, a government supporter may be more lenient in his or her evaluation

of government economic performance to preserve the feeling of inner consistency after investing his or her vote in this government. In new democracies of East Central Europe, there is an additional factor that makes the expectation to find a relationship between political attitudes and people's evaluations of the economy even more plausible. The post-communist transition in that region, unlike in any other part of the world so far, has been characterized by a simultaneous transformation of the political and economic systems; therefore, the economy and the polity may be blended together in people's minds. When answering a survey question about the national economic state, a person may evoke information about recent political events, as well as his or her feelings toward the political system, and use this information to form his or her economic assessments.

However, heuristics may introduce systematic biases in how one forms an opinion about the economy. That is, depending on certain personal characteristics, such as political attitudes, party attachment, or perceptions of one's personal financial well-being, individuals may be systematically more or less likely to give either positive or negative assessments of the national economic situation regardless of what the true condition of the national economy is.

Furthermore, I intend to test whether a particular level of economic and political sophistication, approximated by the measures of general education and political discussion, affect the accuracy of sociotropic evaluations of the economy among post-communist citizens. In general, highly educated persons are likely to have more intellectual and financial resources to access and process economic information; hence, they may be more accurate in their sociotropic evaluations. Individuals who engage in political discussion regularly may also have more information about the general

economic and political situation in their countries. Concurrently, regular political discussants may care more about politics and thus have an easy time retrieving this information from memory.

The specificities of the post-communist transformation, however, lead me to think that this traditionally established contingent effect of economic sophistication may not work in Central and Eastern Europe at the early stage of the transition for at least two reasons. First, there existed no clear understanding of the reform processes even among well-educated citizens. And second, high economic and political instability was likely to put everybody on the same level of uncertainty regarding the future, as well as the past. Thus, I maintain that economically sophisticated individuals would be no different from the less economically knowledgeable in their ability to form accurate perceptions of the national economy. Lastly, I follow the development of the post-communist economic opinion at later phases of the transition. Consistent with the learning thesis, with time, citizens should acquire sufficient knowledge of the operation of a new system and start forming more accurate performance evaluations. Moreover, with higher economic stability during the later years of the transition, it should become easier for people to recall what happened with the national economy in the recent past, as well as make economic forecasts. Therefore, I expect to see higher correspondence between the objective economy and public economic perceptions later in the transition. Without appropriate data for longitudinal or a cross-national study, I revert to individual-level single-country analyses at several time points during the transformation reforms. In this case, in addition to the public opinion dynamics, I can analyze the change in individuals' patterns of using cognitive and information heuristics when the transition enters its

advanced stages. I argue that post-communist citizens should rely less on cognitive shortcuts once their ability to form accurate economic perceptions increased.

In the next chapter, I will introduce the reader to the economic transformations that were taking place in the post-communist nations of East Central Europe in the 1990s, as well as the development of the public economic mood during the same time. There are several important conclusions to draw from this chapter. Across all countries of the post-communist bloc, the national economies were in a dreadful state at the beginning of the transition, but these significantly improved by 1997-1998 in many of the nations in the region. Yet, sociotropic economic perceptions at that time appear to be more optimistic than would have been expected under the despairing economic conditions. Furthermore, public economic expectations were universally much more favorable than retrospective perceptions during the early transition, and they remained stable throughout the reform process, whereas perceptions about the past had noticeably improved.

Chapter 3 looks at the issue of the formation of sociotropic perceptions at the system level. That is, it explores whether individuals used information about the true state of the economy measured by expert economic indicators when making economic evaluations. Given high overall uncertainty and low public familiarity with new economic mechanisms in the post-communist societies during the early transition, I argue that congruence between the objective state of the economy and people's economic perceptions was weak. I used the 1992 Central and Eastern Eurobarometer dataset for the statistical analysis supplemented by objective economic data collected by the European Bank for Reconstruction and Development. The analysis of the data by ordered logit and an iterative generalized least squares method produced mixed results with regard to

statistical significance of the system-level economic variables. However, both estimation methods revealed very low substantive effects of the objective economic variables on sociotropic economic perceptions.

In Chapter 4, I make an assumption that not all post-communist citizens were equal in their abilities to form accurate evaluations of the national economy. Thus, political sophistication, as found in previous studies, could drive heterogeneity of public economic perceptions. However, right after the collapse of the Soviet system more sophisticated individuals should not yet be expected to have a better understanding of the economic situation in their countries and use this information when assessing the economy to a greater degree than less sophisticated people.

I found almost no substantive difference in the formation of national economic evaluations among more educated and less educated individuals. Both groups appeared to make low usage of the objective economic information in their evaluations of the national state of the economy. Similar results were found for groups with various levels of engagement in political discussion.

Chapter 5 is about developing an individual model of retrospective and prospective sociotropic economic perceptions. This model is based on the argument that people use cognitive heuristics and information shortcuts when they form evaluations about the national economy. I distinguish between two types of heuristics, which I call personal economic heuristics and political heuristics. While personal economic heuristics concern an individual's personal objective and perceived economic status, political heuristics refer to one's sentiments about the political system, such as satisfaction with democracy, party affiliation, and system support. I posit that the former heuristics are

relevant for the formation of sociotropic economic perceptions, because the most available economic information comes from one's personal experience. Therefore, when one is asked to make an evaluation about the national economy, information about personal economic experiences is most likely to be at the top of one's head. Political heuristics may play an important role for sociotropic economic assessments in general, because in capitalist societies governments still exercise relative control over the economy. In the new democracies of East Central Europe, especially during the early transition, political and economic reforms were conducted simultaneously and must have been closely associated in people's minds. As a result, individuals may have used their political sentiments in evaluations of the national economy.

In this chapter, I am using Central and Eastern Eurobarometer survey data collected in October-November 1992 in 18 countries in the region. The statistical findings point to a strong relationship between personal economic perceptions and perceptions of the national economic state, whereas unemployment status and income do not elicit much evidence of a direct relationship between any of the two variables and sociotropic economic evaluations. The impact of political attitudes, although strongly associated with the measures of retrospective and prospective national perceptions, should be interpreted with caution. Theoretically, there may exist a reciprocal relationship between political attitudes and economic perceptions, which needs to be accounted for in order to make accurate inferences about the strength of the independent effects of political attitudes, which in some instances is achieved with an instrumental variable procedure.

Chapter 6 gives a more detailed overview of the post-communist transition in four countries of the former Soviet bloc – the Czech Republic, Hungary, Poland, and Russia. In this chapter, I make an attempt to follow the dynamic of the formation of sociotropic economic perceptions in time. Due to a lack of data, I focus on a limited number of time points in the transition using several different survey datasets for this matter. While, according to the analysis, the correspondence between the actual state of the economy and public economic sentiments displayed some signs of convergence, the use of cognitive and information shortcuts by post-communist citizens was wide-spread throughout the transition.

Finally, Chapter 7 summarizes the major arguments and findings of the thesis. Moreover, in this chapter I offer conclusions and implications of the results, as well as possibilities for further research. In particular, the incongruence between objective economic indicators and public perceptions of the national economy found at the beginning of the post-communist transition, if it persists, may lead to a breach in the mechanism of democratic accountability and misuse of political power. However, the mismatch between the objective and the subjective economy remains a real threat to democracy only to the extent that economic voting plays a significant role in the voting behavior of citizens. Also, cognitive heuristics turned to be important predictors of sociotropic economic perceptions not only at the early transition period, but later in the reform process as well. This may indicate that even with relatively easy access to objective economic information people still rely on other sources when forming economic opinion. As a consequence, sociotropic economic evaluations, even in the

aggregate, may be systematically biased, which may also lead to the malfunctioning of the democratic accountability mechanism.



## Appendix 1A. Countries in East Central Europe before and after the Downfall of the Socialist Regime

### Countries before the Downfall

Albania

Bulgaria

Czechoslovakia

German Democratic Republic

Hungary

Poland

Romania

The Union of Soviet Socialist Republics

Yugoslavia

### Countries after the Downfall

Albania

Bulgaria

Czech Republic  
Slovak Republic

Germany (united)

Hungary

Poland

Romania

Azerbaijan  
Armenia  
Belarus  
Estonia  
Georgia  
Kazakhstan  
Kyrgyz Republic  
Latvia  
Lithuania  
Moldova  
Russia  
Tajikistan  
Turkmenistan  
Ukraine  
Uzbekistan

Bosnia and Herzegovina  
Croatia  
Macedonia  
Serbia and Montenegro  
Slovenia

## CHAPTER 2

### **Setting Up the Puzzle: The Objective Economy is Unrelated to Economic Perceptions**

The fall of the Berlin Wall and the Soviet empire and the transition of post-communist nations to democracy were some of the most unexpected and prominent events in the politics of the 20th Century. Not only did the collapse of the Soviet system symbolize the end of the Cold War and the defeat of the communist ideology, but it also created a unique natural laboratory in the region of East Central Europe for regime transformation. Overwhelmingly opposed to the idea of maintaining the existing communist regime with a command economy, post-authoritarian nations welcomed the idea of democracy and the market. Without prior experience and appropriate skills, new political elites in collaboration with Western expertise laid the foundation for future systems in their countries, and now, over fifteen years later, political scientists have an opportunity to assess what has grown out of that foundation. For proponents of democracy, the results of the post-communist transition are mixed, and in some instances disappointing. Of twenty-seven independent nations, created as a consequence of the post-communist nation-building, eight have already become full members of the European Union (the Czech Republic, the Slovak Republic, Poland, Hungary, Slovenia,

Estonia, Latvia, and Lithuania) after being acknowledged as free democracies with market economies. Others, such as Belarus, Turkmenistan, and Uzbekistan, discontinued democratic and market reforms completely and established new dictatorship regimes in their countries. Kazakhstan, Azerbaijan, Tajikistan, and Kyrgyz Republic are also considered authoritarian regimes, although not as strongly authoritarian the above three. Still balancing in between democracy and authoritarianism are Russia, Moldova, Bosnia and Herzegovina, Ukraine, and Georgia with the latter two undertaking decisive steps in the direction of democracy after opposition forces in these countries took over power in a series of most recent “velvet revolutions”.<sup>3</sup>

The transition from a command to a market economy was conducted concurrently with political reforms. This process was unanimously termed by political scientists the “dual transition” (Jackson et al. 2003). Some went even further in defining the post-communist transformation as the “triple transition” with the reformation of the polity, economy, and territory (Alexander 1998). In hindsight, many social scientists argue that the simultaneous implementation of democratic and market reforms was a huge mistake with severe, if not terminal, consequences for future democracy and the market in some of the post-communist nations (Intriligator 1998, Rose 1999). Opponents of the dual transition declare that the establishment of democratic institutions ought to precede the introduction of market reforms, because market reforms unsupported by democratic institutions, such as property rights laws and an independent court system, led to

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<sup>3</sup> The term “Velvet Revolution” was used in relation to the bloodless revolution in Czechoslovakia in November-December 1989, which started with student demonstrations and was quickly joined by the rest of the population. In Georgia, the overthrow of the Shevardnadze government by the opposition forces headed by Saakashvili and Burjanadze in 2003 was named the “Rose Revolution”. Finally, the “Orange Revolution” in Ukraine, which brought to power the opposition candidate Viktor Yushchenko, took place during the presidential election in November-December 2004.

corruption, organized crime, crony capitalism, and an enormous increase in income inequality. Looking back, even strong advocates of sweeping economic liberalization later admitted that early economic reforms did not work as expected due to a lack of institutional support. As a result, not all post-communist nations were able to make a successful transition to a market system. Those countries that had stronger systems of democratic institutions 1) were able to evolve into market economies, and 2) did it less painfully than nations with a weak institutional basis.

The present chapter introduces the reader to the economics of the post-communist reforms and describes the dynamic of the public economic mood during the transition process. While the early transition was characterized by a catastrophic state of the economy in almost all the nations of the post-communist bloc, the advanced transformation phase saw some extraordinary economic growth in a number of countries. It took less than a decade to bring down triple- and quadruple-digit inflation rates and stabilize them below 20 percent, and in some instances below 10 percent.<sup>4</sup> GDP contraction rates, reaching 50 percent in the early 1990s, transformed to 10 percent annual growth rate only a few years later. Along with the creation of numerous small- and medium-size business enterprises, large-scale property was transferred into private ownership for more effective management. Moreover, the ever-present deficit of consumer goods was eliminated as a result of trade liberalization. And citizens obtained the long-desired economic rights and freedoms declared in the new constitutions.

However, all these achievements came at a high cost. Unknown under socialism, unemployment became a constant problem in the post-communist countries fluctuating,

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<sup>4</sup> All economic statistics used in the dissertation are annual figures unless specified otherwise.

for the most part, in the low teens with the exceptions of mild or non-reformer states, such as the Central Asian nations, Belarus, and Moldova.<sup>5</sup> No longer well-protected by the state, most vulnerable groups of the population, including pensioners, single mothers, people with disabilities, and the unemployed, fell below the poverty line, and so did numerous public employees whose wages were both delayed or indexed under the inflation rate. Partial state withdrawal from many traditionally subsidized spheres of the economy, including transportation, health services, public housing, and education, made services produced by these spheres either inaccessible due to high market prices or of increasingly poor quality.

The question that poses itself, then, is: Given the enormous change in the economy, what was people's reaction to that change? Drawing on the evidence from public opinion polls, one may presume that, on average, post-communist citizens felt quite disappointed with the recent performance of the economy at the beginning of the transition. Yet a closer look at the numbers reveals that, despite the unimaginable severity of the economic situation in the first years of the reforms, there was still a significant portion of the population who gave favorable retrospective evaluations of the economy. Also bewildering are the results of public economic prognoses for that period. Across eighteen post-communist democracies in 1992, sociotropic economic forecasts displayed more optimism than average economic sentiments of the future national economy across the fifteen states of the European Union. Later in the transition, the public economic mood of the retrospective economy in East Central Europe became more

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<sup>5</sup> Among the vigorous economic reformers, the Czech Republic proved to be the most effective in handling unemployment, where over the whole period of the transition, the unemployment rate never exceeded 9 percent.

positive and perhaps more consonant with the actual changes in the economic state. Prospective economic perceptions, on the other hand, remained rather stable and optimistic over time.

In the present chapter, I will consider two major themes. First, I will concentrate on the economic transition in post-communist states of East Central Europe. And second, I will proceed to the discussion of the dynamic of public economic mood during the period of economic reforms.

### **Early Post-Communist Transition**

Along with the establishment of new electoral systems and the introduction of basic democratic rights and liberties, the first years of the post-communist transition were characterized by sweeping economic liberalization in at least half of the countries in East Central Europe, especially in Poland and Russia. Lacking specialists in free market economics, the democratizing nations invited experts from the largest international organizations, such as the International Monetary Fund, the World Bank, and the European Bank for Reconstruction and Development, to help develop a strategy, later labeled the “Washington Consensus”, of transforming from a command to a market economy. (Intriligator 1998, Sapir 2000, Nekipelov 2000). Western experts in collaboration with leading liberal economists from East Central Europe identified a number of objectives of economic reform, among which economic liberalization and privatization of state property were most prominent.<sup>6</sup> These two measures produced a

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<sup>6</sup> The “Washington Consensus” strategy consisted of three major policies: stabilization, liberalization, and privatization, sometimes referred to as the SLP. Another name for the “Washington Consensus” strategy frequently found in the literature is the “shock therapy” strategy or model. After Poland adopted the

domino-type effect in all segments of the economic systems in the post-communist countries and led them into a severe economic crisis.

Privatization was a complicated and in some instances a lengthy process. Before the post-communist transition a larger portion of companies belonged to the state. Under severe budget deficit produced by the inefficient command economy and exacerbated by price liberalization, the state could no longer invest the same level of resources into both the industrial and agricultural sectors. Left without vital state subsidies and suddenly facing international competition, many enterprises and collective farms were unable to survive. To attract new investments and, presumably, achieve more effective management of state companies, new governments introduced different privatization schemes across all post-communist countries. A few of the transitioning democracies adopted a mass voucher privatization program (e.g. Russia and the Czech Republic), while others considered more gradual case-by-case privatization of state assets (e.g. Hungary and Poland).

Although the privatization of state property undoubtedly was a necessary measure for the transition from a command to a market economy, the way it was conducted in many countries of East Central Europe led to severe economic, as well as political, consequences. As a result of the privatization campaign, former state property became concentrated in the hands of a small group of people who had access to money and/or connections to the new political elites. Thus, privatization that was declared as an equal opportunity for all citizens to become property owners was, in fact, an exclusive

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“shock therapy” measure on January 1, 1990, the countries that followed were Czechoslovakia (January 1991), Bulgaria (February 1991), Russia (January 1992), Albania (July 1992), Estonia (September 1992), and finally, Latvia (June 1993) (Marangos 2003).

opportunity for the rich and well-connected to grow even richer by redistributing the countries' wealth (Shleifer and Treisman 2000).<sup>7</sup> Consequently, new business owners became intimately allied with political elites, which further aggravated the already appalling situation with corruption.<sup>8</sup>

Despite a seemingly fast pace of privatization in most countries, a large portion of public property still remained in state possession (Jackson, Klich and Poznanska 2003). Mostly ineffective under the socialist system, large industrial enterprises were very slow to adjust to the new economic system. Moreover, top management of state enterprises made decisions that were in their own personal interests and oftentimes against the interest of the future development and even survival of the business.

Price liberalization essentially presumed a transition from government-fixed prices, which sometimes had been lower than the cost of production, to market-regulated prices determined by the forces of supply and demand. Under the communist regimes of East Central Europe, governments exercised full control over prices, and there were hardly any price increases year by year. This price stability allowed communist authorities to claim an absence of inflation in countries of the Soviet bloc and, therefore, the superiority of a command system of economic management vis-à-vis a capitalist system that was never able to eliminate inflation. However, the fact that there was no price growth in countries of East Central Europe did not necessarily mean zero inflation. Recall that, due to high economic inefficiency and, consequently, a decline in state

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<sup>7</sup> A few post-communist nations, however, may be viewed as successful cases of privatization. Hungary, for example, adopted an efficient strategy of handing over state-owned companies. Not only did Hungary allow extended foreign direct investments, but it also created a solid institutional foundation for privatization.

<sup>8</sup> Unfortunately, comparable cross-national data for corruption are not available for the early transition stage.



revenue, the communist governments began to suffer budget deficit. In order to reduce it, the communist leaders chose to increase the money supply, which caused so-called hidden inflation. The existence of hidden inflation suggested that the true prices of goods and services were rising, but the actual prices were artificially held at the same level by authorities.

When price liberalization was introduced, hidden inflation turned into open inflation, which was revealed by sharp price increases. In other words, higher prices reflected true or market values of products that had been restrained by government regulations under communism. Also, due to falling output in East Central Europe during the last decade of the communist rule, there was a wide-range shortage of product supply, which caused sharp price rises as soon as price liberalization was introduced (Alexeev and Leitzel 2001).

Prices were growing at unbelievable rates, and although Western advisors to the post-communist governments advocated strict control over the money supply, new volumes of money were constantly released to compensate for rising prices. According to European Bank for Reconstruction and Development statistics, the highest inflation rates in 1991 of over 300 percent per annum were witnessed in Bulgaria, Estonia, and Lithuania. Just a year later, however, in 1992, the inflation rate of 300 percent may have been considered a great economic success, when annual inflation exceeded 1,000 percent in Azerbaijan, Armenia, Belarus, Georgia, Kyrgyz Republic, and Tajikistan, and rose to around 2,000 percent in Macedonia, Kazakhstan, Moldova, Russia, and Ukraine.<sup>9</sup> The year 1993 saw even more outrageous inflation rates of over 10,000 percent per annum.

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<sup>9</sup> In fact, the inflation rates in Estonia and Latvia in 1991 were just below 1,000 percent, and in Kazakhstan in 1992, the inflation rate almost achieved 3,000 percent (2,984%).

In contrast, some of the countries of the former communist bloc were much more successful in stabilizing inflation. Already in 1992 and 1993, the Czech Republic achieved an inflation rate below 20 percent. Slovakia had the lowest rate of inflation in 1992 among all Central and Eastern European democracies (9.1%), which went up to 25.1 percent in 1993, but then remained low for the rest of the transition period. Albania, Slovenia, and Estonia had experienced significant decreases in inflation by the middle of the 1990s (especially Estonia). Finally, Hungary, which rejected “shock therapy” policies, never had a rate of inflation higher than the lower 30s.

Table 2.1 about here

The other side of hyperinflation was rapid domestic currency devaluation. In a matter of months, people found themselves living on the breadline and without savings. Money received in wages was not enough even for basic necessities. Although governments increased wages for numerous public employees almost on a monthly basis, the wage increases were still far behind the rate of inflation. For the national economy, rapid consumer impoverishment meant low purchasing power, and this perhaps was one of the main reasons for the overall output decline (Winiacki 2002).

Yet other reasons for a despairing output decline in the post-communist democracies was the inability of domestic products to compete in the international market after the introduction of trade liberalization policies, cuts in government subsidies, and low rates of investment. As a result, in 1991, all nations of the former communist bloc exhibited negative rates of GDP growth ranging from -27.7 percent in Albania to -0.7

percent in Azerbaijan.<sup>10</sup> Economic contraction continued in 1992, except for Poland, which resumed growth that year at 2.6 percent. For other transitioning democracies, the negative GDP rates ranged from –52.6 percent in Armenia to –2.9 percent in Kazakhstan. By 1993, Bulgaria had 80% of its 1989 economic wealth, whereas the Lithuanian economy had become only half its pre-transition size. However, in 1993, GDP growth resumed in several post-communist economies in addition to Poland, including the Czech Republic, Albania, Slovenia, and Romania. Most impressively, the annual growth rate in Albania had gone up from negative 7.2 percent to positive 9.6 percent between 1992 and 1993.

Table 2.2 about here

Overall, as a result of the first few years of the economic reform, economic output was dropping to dangerously low levels, inflation was rising astronomically into triple and quadruple digits, whereas the official unemployment numbers, although not as high, indicated that up to one-sixth of the working population (and even more in Albania and Macedonia) lost their jobs.

Table 2.3 about here

### **Advanced Post-Communist Transition**

A few years into the transition, the macroeconomic situation in East Central Europe started to improve. Evidently, it took some countries more time than others to emerge from the deep economic recession followed by the collapse of the socialist regime. According to some scholars, the more decentralized and liberalized the economy

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<sup>10</sup> Three countries of the post-communist bloc – Yugoslavia, Bosnia and Herzegovina, and Uzbekistan – are left out of the discussion of the GDP growth rates due to a lack of data.

used to be under the centrally planned system, the more easily and possibly faster the transition towards a market economy occurred (Kolodko 2000). However, there was another important difference among the former socialist nations, which affected the speed of economic recovery. Some nations chose not to introduce any profound reforms, such as Belarus or Uzbekistan; hence, the recession was relatively mild and the recovery was relatively fast (see Bunce 1999).

Poland was the first country in the group of the far-reaching reformers to show positive dynamics in the national economy. The economic contraction in Poland lasted approximately for three years, from mid-1989 until mid-1992 (Kolodko 2000). Already in 1996, GDP in Poland reached the level of 1989, while in most of the East European countries the pre-transition output level was achieved approximately two years later. In the Commonwealth of Independent States (CIS), the situation at that time was much worse, with the average GDP for the whole group in 1996 at 53 percent of the socialist level.

The degree of the initial economic contraction and subsequent recovery was not only a function of the socialist legacy and the depth of post-socialist reforms, but also economic policies implemented over the period of transition (Kolodko 2000, Intriligator 1998, Crawford and Lijphart 1995). Kolodko maintains that it was primarily due to early policy mistakes that the post-socialist systemic crisis was so severe (Kolodko 2000, 76; Keane and Prasad 2002). The implementation of the right policies later on in the transition allowed countries like Poland and Hungary to set out on the path of economic improvement fairly soon. According to Kolodko, Poland achieved success not because of the “shock therapy” policy at the beginning of the transition, as many tend to think, but

despite it (ibid., 111). In fact, only because Poland abandoned the policies it had introduced right after the collapse of the socialist regime early enough and adopted a new set of policies did it emerge from the recession fairly fast. A similar critical view of the shock therapy measures is shared by a number of students of Russian transitional politics who claim that Russia could not transform itself into a democracy with a market economy because of the adoption of “Washington Consensus” policies (Nekipelov 2000, Intriligator 1998, Sapir 2000). Even the founding fathers of the shock therapy model admit a certain failure of the SLP model, although they believe it happened not because the model was inherently wrong, but because of the faulty implementation (Aslund 1997a, 1997b, Thomas and Wang 1997, Balcerowicz 1994, 1995, Dabrowski 1993, Sachs 1993).

Along with Poland, Croatia, Estonia, and Slovenia were also among the most successful reformers, whereas Bulgaria, Romania, Russia, and Ukraine lagged far behind. Note, however, that the countries in the avant-garde of market reforms were not only the ones that implemented good policies during the transition, but also the ones that had introduced some elements of the market before the collapse of the communist regime, such as Hungary and Estonia.

Another factor associated with the severity of economic recession and the speed of recovery was the shock from trade liberalization. The more competitive domestic commodities turned out to be vis-à-vis foreign imports, the less dramatic a decline in production output was. Moreover, countries that had traded outside of the communist camp prior to the transition had an easier time to absorb external shocks from trade liberalization. For example, while Estonia and Moldova (as well as almost all other

Soviet Republics) had exported almost 90 percent of their export goods to other communist countries, Hungary and Poland had traded approximately 50 percent of their export goods with non-socialist economies (Kolodko 2000, 93).

Along with the drastic economic contraction, one of the most distinctive characteristics of the transition economies of East Central Europe and especially of the CIS states was the size of the so-called shadow economy. Although unregistered economic activity also existed under the centrally planned system, its scale had been much more modest than during the transition.<sup>11</sup> Thus, the estimated size of the shadow economy in Russia in 1994 was 40 percent. In Georgia, this estimate was as high as 64 percent, while the share of the untaxed and criminal activities in Poland constituted only 15 percent (Kaufmann and Siegelbaum 1997). The Polish figure is directly comparable to the corresponding numbers in Western democracies. In the European Union, the estimated share of the shadow economy accounts for 15 percent of the overall economy, whereas in the United States this figure is less than 10 percent. A substantial share of the shadow economy suggests that, in fact, the transitional economies were larger than evaluated by the official statistics. However, unregistered economic activities were tightly connected with organized crime and corruption (Morawska 1999). Moreover, governments were not able to collect taxes from these activities, which led, among other things, to cuts for social programs, wage delays, and low funding of education, research,

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<sup>11</sup> Under the socialist system, the shadow economy was mostly represented by illegal trade of hard currency as well as deficit goods, especially imports (speculation). Underground production companies, on the other hand, were rarely organized. In the post-communist times, speculation of goods actually became legal, while hard currency exchange by private persons, first unregulated in some countries, was soon outlawed. Moreover, underground firms were multiplying at dangerous rates, which led to significant budget losses due to tax evasion, yet helped create new jobs. Besides stealing from the state in the form of tax non-payments, underground companies produced goods of poor quality and provided no social benefits or protection to their employees.

and health services. On the macroeconomic level, high tax evasion contributed to the current account deficit and, as a consequence, low inflows of foreign investments.

Table 2.4 about here

There was a widely shared opinion that post-communist nations had to conduct a full-scale privatization as one of the first vital steps to a market economy. What was not taken into consideration, however, was the absence of a legal basis for the transference of property rights to private owners. In other words, there were no institutions in place to make privatization fair and effective.

Although in many respects the consequences of privatization were considered detrimental to the economies and societies in East Central Europe, some positive outcomes of the ownership transference should not be underestimated (Roberts and Zhou 2000). In a number of the post-socialist countries, such as Hungary, Poland, Slovenia, Estonia, Lithuania, and Albania, the new private sector made a significant contribution to the overall economic growth and recovery later in the transition (Kolodko 2000, Rondinelli and Yurkiewicz 1996). Not only did small and medium-sized companies supply a significant portion of GDP, but they also were the largest source of new jobs.

Many private companies were organized as joint ventures between foreign investors and local entrepreneurs. It is worth noting that a great number of such joint ventures were created with partners from the former socialist bloc. For example, in 1998 in Poland, there were approximately 2,500 joint ventures with Polish partners, whereas in Ukraine there were reported about 800 such ventures (Kolodko 2000, 155). The importance of joint ventures for the development of trade and gradual integration into the context of international competition in East Central Europe should not be underestimated.

One of the factors necessary for economic growth is a sufficient level of consumption and savings. Savings turned into investments boost production, and so does consumption. However, the level of consumption during the early and mid phases of the transition dropped dramatically compared to the pre-crisis level. Moreover, savings were lost overnight and were hard to regain due to hyperinflation. In general, the propensity to save is instigated by three things: sufficient income, a wish to save, and a positive return on savings. During the first half of the post-communist transformations, most people could hardly make ends meet, let alone set some money aside. Many of those who had a wish to save invested their savings in financial pyramid schemes and in numerous cases incurred high losses.<sup>12</sup> This became possible because of the deficiency of financial and legal mechanisms. In general, the inadequacy of financial institutions, particularly, banks, stock exchanges, and investment funds in East Central Europe, as well as the defective tax system with inefficient mechanisms of tax collection and unreliable fiscal policies significantly slowed down economic recovery.

The collapse of the centrally planned system led to the destruction of the social protection system (Fajth 1999). The first to suffer were pensioners. Thus, in 1996, the ratio of the number of pensioners to the number of people employed (the dependency ratio) was 53.8 percent in Russia and 65.3 percent in the Ukraine. The highest dependency ratio was found in Hungary – 76.9 percent followed by Bulgaria and Belarus with 74.4 and 71.0 percent respectively. The lowest dependency ratio was found in the post-communist states of Central Asia (Turkmenistan, Tajikistan, and Uzbekistan), which, however, was attributed to a lack of social security coverage for some social

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<sup>12</sup> Examples of the most harmful financial pyramid schemes have been found in Russia and Albania.



groups (Kolodko 2000, 178). Meanwhile, the average replacement rate (average pension relative to the average wage) rarely exceeded 40 percent. In 1996, the highest rate was recorded in Poland (61.3%), whereas the lowest rate was found in Armenia (24.3%). High dependency ratios in countries of East Central Europe were not only a function of an aging population, but mainly resulted from high unemployment rates and poor collection of payroll taxes.

Right at the beginning of the transition, with the introduction of trade and price liberalization and private property, the gap in the income distribution became rather pronounced. Under the communist system, the distribution of income had been more equitable, although the level of equitability had differed among the countries in the communist bloc (Kolodko 2000, 197). In political science and economics, a widely-used measure of income dispersion is the Gini index.<sup>13</sup> Theoretically, it can vary from 0 (perfectly equal distribution of income) to 100 (one person gets all the money in the country). Before the collapse of the Soviet system, all the countries in East Central Europe belonged to the group with low (24-26) or very low (20-22) levels of income inequality (for the group categorizing see Atkinson et al., 1994). By the mid 1990s, the

<sup>13</sup> The Gini coefficient is a measure of inequality that is usually used to measure income inequality (Gini 1912). It is a number between 0 and 1, where 0 corresponds to perfect equality (where everyone has the same income) and 1 corresponds to perfect inequality (where one person has all the income, and everyone else has zero income). The Gini index is the Gini coefficient expressed in percentage form. Thus, it can range from 0 to 100 percent.

The Gini coefficient is calculated as a ratio of areas on the Lorenz curve diagram. The Lorenz curve is a graph that shows, for the bottom x% of households, the percentage y% of the total income they have. The percentage of households is plotted on the x-axis, the percentage of income on the y-axis. The Gini coefficient is the area between the line of perfect equality and the Lorenz curve.

Also, the Gini coefficient can be calculated using the Brown formula:

$$G = \left| 1 - \sum (X_{k+1} - X_k)(Y_{k+1} + Y_k) \right|, \quad k = 0 \dots n-1$$

X: cumulated proportion of the population income

Y: cumulated proportion of the income variable

Gini index in most of the post-communist nations grew to over 30. Since the late 1980s, the index has doubled in Russia (a jump from 24 to 48) and Ukraine (an increase from 23 to 47). Yet, in some countries of East Central Europe, such as Slovakia, Hungary and Slovenia, the Gini index remained in the low range (19, 23, and 25 respectively), which had been an insignificant increase since the late 1980s and Slovakia even saw a decrease of 1 point. The most disturbing feature of this change was that the biggest income loss occurred among the poorest groups of citizens in all of those nations. One last point worth mentioning in relation to the income distribution has to do with the size of the shadow economy. Paradoxically, along with all the destructive consequences produced by unregistered and illegal economic activity, it supplied people with additional jobs and, therefore, additional income. Nonetheless, according to rough estimates, the shadow economy benefited the rich more than the poor (Kolodko 2000).

Table 2.5 about here

Judging by economic statistics, 1997 was probably the best year for post-communist democracies, with a few exceptions.<sup>14</sup> The last few years of the twentieth century and the beginning of the new century witnessed steady progress in the transition toward the market system and democracy in many of the East and Central European countries. However, several nations of the post-communist bloc chose to limit or even discontinue democratization reforms and settled on various forms of totalitarian regimes. These countries include Belarus and the states of Central Asia (Kazakhstan, Turkmenistan, etc.). In the economy, Russia experienced the most severe financial crisis

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<sup>14</sup> For the Czech Republic, 1997 was the year of financial crisis and the beginning of a deep economic recession. Bulgaria, Romania, and Albania – the countries that demonstrated significant economic volatility throughout the 1990s going from highly positive to highly negative rates of GDP growth, went into another round of economic recession.

in the region in 1998 caused in part by the developments in the global economy and in part by the deficiency of the financial institutions. Evidently, other countries of East Central Europe also suffered from the Russian financial crisis, especially those with closer ties to the Russian economy. As stated in the 1998 transition report prepared by the European Bank for Reconstruction and Development, the “financial crisis has underlined that the region’s remarkable achievements in liberalization and privatization must be accompanied by progress in institutional reforms” (EBRD Transition Report, 1998).<sup>15</sup>

In the late 1990s, countries that used to be the laggards in the region achieved the greatest progress in reforms. Bosnia and Herzegovina, Bulgaria, Romania, and Tajikistan showed impressive results in privatization and banking reform. Partially, it was the prospect of joining international organizations and institutions, such as the EU and the World Trade Organization that instigated democratization and market reforms in Bulgaria and Romania, as well as Latvia, Lithuania, and Slovak Republic. The rest of the EU candidates in the region demonstrated gradual, although more incremental, development of reforms. In 2000, all post-communist nations sustained a positive rate of economic growth, and this trend continued into 2001 with the rare exception of Macedonia. Despite the severe financial crisis in Russia in 1998, the Kosovo conflict, and the economic crisis in the Czech Republic in the late 1990s, all of the countries displayed remarkable signs of economic recovery by the end of the century with steady growth and relatively low levels of inflation and unemployment. Institution building still remained

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<sup>15</sup> Institutional backwardness in the post-communist nations of East Central Europe has been pointed out as a slow-down factor in the transitional reforms by numerous scholars in the field (Winiecki 2000, Smithey and Ishiyama 2000, Kolodko 2000, Hendley 1997, Berkowitz and Li 2000, Dykir 2000, Ishiyama and Velten 1998, Ross 2000).

the greatest problem in the region, with Central European and Baltic countries more advanced than the CIS nations.

### **Leaders and Laggards of the Transition**

It is hard to distinguish among obvious leaders and laggards during the initial stage of the transformation process. Evidently, some countries experienced less severe contractions of their economies and lower levels of inflation and unemployment than others, but that was mostly determined by the extent of economic liberalization policies that they adopted at the beginning of the transition, as well as their communist legacies. Overall, all the nations of the former communist bloc saw a collapse of their economies and fell into a deep economic and political crisis. In fact, political scientists started to talk about transitional leaders and laggards much later when they could develop standards upon which to judge whether a country was in the avant-garde of the democratic transformation or lagging behind.

In the literature on the post-communist transition, I found at least two well-grounded criteria used to distinguish among the leaders and laggards of the transition. One was based on economic performance of the CEE nations, in particular, their growth patterns (Kolodko 2001). The basis for the other criterion developed by Bunce (1999) was the joint outcome of political and economic reforms. According to Kolodko, the Central and Eastern European nations can be categorized into four groups: *frontrunners*, *gainers*, *even-runners* and *laggards*. The placement of a certain country in one of those groups depends on the country's average growth rate from 2000 until 2003-2004. Thus, the frontrunners turned out to be Albania, Serbia and Montenegro (Yugoslavia),

Azerbaijan, and Georgia with growth rates ranging from 6.2 to 10.7 percent. The largest group appeared to be the gainers, which included Slovakia, Armenia, Hungary, Poland, Romania, FYR Macedonia, Bulgaria, Lithuania, Turkmenistan, Bosnia-Herzegovina, Slovenia, Tajikistan, Estonia, and Latvia with GDP growth rate in the range between 4.1 and 5.5 percent. Furthermore, the even-runners were the Czech Republic, Moldova, Croatia, Kazakhstan, Kyrgyzstan, Ukraine and Russia with the growth rate ranging from 2.1 to 4.0 percent, leaving Uzbekistan and Belarus is the laggards group.

The point of Kolodko's category building is to determine when a particular post-communist nation is likely to reach the end of the transition, which he defines as catching up with the developed countries in output. Specifically, he calculated the benchmark for the moment of catching up as the GDP per capita of 30,000 \$PPP.<sup>16</sup> Because the author's classification is based on estimated future economic performance, nations may move from one category to another depending on their future growth patterns. At the moment, the country that is the closest to the developed nations in production output is Slovenia. It needs to double its GDP to become as wealthy as mature EU democracies (on average), whereas both Estonia and the Czech Republic have to more than triple their 2000 per capita output. In accordance with Kolodko's estimates, while Slovenia could do it by 2014, the Czech Republic and Estonia would need another decade along with Slovakia, Hungary and Croatia to achieve this benchmark. As for the current frontrunners in terms

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<sup>16</sup> PPP – Purchasing Power Parity – is a measure of standard of living across countries. On the most basic level PPP states that identical goods should have the same price regardless of location. This is called the “law of one price”. Absolute PPP compares the price of a basket of similar goods between countries. It asks whether the law is correct “on average”. While absolute PPP depends on the ratio of the level of prices in two countries, relative PPP depends on the ratio of the growth rates of prices (rate of inflation) in two countries. GDP – Gross Domestic Product – is defined as the total value of all goods and services produced within a territory during a specific period of time. GDPs of different countries can be compared by converting their value in national currency according to PPP exchange rates.

of GDP growth rates – Albania, Serbia and Montenegro, Azerbaijan and Georgia – even in the best-case scenario, they will not be able to catch up with the developed democracies until 2037. To summarize what seems to be a complicated classification of transition leaders and laggards, Slovenia unequivocally comes in first ahead of all the reformers, followed by the Czech Republic, Slovakia, Estonia, Hungary, Croatia, Poland and, perhaps, Latvia. On the other end of the economic spectrum are such countries as Serbia and Montenegro, Azerbaijan, Georgia, Moldova, Albania, and Tajikistan; the latter far behind everybody else even in the laggards group with the GDP per capita 39 times as small as that of mature European democracies. Somewhere in between the economic leaders and laggards, stand all the other nations of East Central Europe.

Bunce (1999) does not explicitly talk about leaders and laggards; rather she considers three pathways of post-socialism. The first one is “where democracy and capitalism coexist in relative and, indeed mutually-supportive harmony, and where political stability and sustained economic growth are the results” (Bunce 1999, 761). The second pathway is “where authoritarian politics co-exist with semi-socialist economics” resulting in “stable politics and relatively reasonable economic performance” (ibid.). And finally, “a middle group [is] poised between democracy and dictatorship and between socialist and capitalist economics” (ibid.). According to Bunce, the first group is undoubtedly exemplified by such states as Poland, the second by Uzbekistan, and the latter by Russia. In the same article, however, the author also suggests a few more possible classifications: 1) based on the extent of economic reform with Poland representing countries that implemented considerable economic reforms and Belarus and Uzbekistan having adopted minimal reforms, and most of the countries in the region

falling in between; 2) based on political stability, that is state consolidation and government effectiveness, with Poland, Hungary, the Czech Republic, Slovenia, Lithuania, Estonia, Latvia, Kazakhstan, Turkmenistan, and Belarus being examples of highly stable countries, and Albania, Bosnia and Herzegovina, Armenia, Georgia, and Tajikistan typifying the most unstable countries; and finally, 3) based on democratization with Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovenia, and I would argue Slovakia at this point exemplifying the most liberal nations according to the Freedom House ranking (see also Bunce 2001).

Table 2.6 about here

Along the lines of Bunce's classification, Robinson (2001) suggests dividing the post-communist nations into three groups based on the extent and continuity of reforms (see also Popov 2000). On the one end of the reform spectrum are the countries, "in which the emergence of new economic actors and relative economic success encourage the continuation of reform" (Robinson 2001, 424). On the opposite end of the spectrum are the nations where minor or practically no reforms have been undertaken; yet their systems largely remain in a situation of status quo. Finally, the third group consists of the states that only allowed partial reforms, therefore enjoyed neither benefits of reforms nor benefits of stability.

A much simpler gradation of the post-communist nations of East Central Europe is proposed by Berend (2001). Without further refinement, he suggests considering the new EU members as the leaders, while all the rest of the countries as the laggards of the transition. As a matter of fact, Lavigne (2000) in a review article claims that this classification of Eastern and Central European nations is the most common among post-

communist scholars. She specifies that the first group of countries consisting of the 8 new members of the EU, as well as the two applicants – Bulgaria and Romania – have achieved macro-economic stabilization and resumed economic growth, yet the process of institution building in those countries is still incomplete. The second group comprises the former Soviet Union states, Albania, and the states of the former Yugoslavia (minus Slovenia). In this group, the transition has been complicated by heavy communist legacies, wars, and corruption.

Despite a variety of criteria used for categorization of the transitional leaders and laggards, they all yield similar results. In particular, the Czech Republic, Hungary, Poland, Slovenia, Slovakia, Estonia, Lithuania, and Latvia with some variation comprise a group of transitional leaders, usually followed by Romania and Bulgaria, whereas Belarus, Uzbekistan, Moldova, and Tajikistan are unanimously defined as the laggards (see also Korasteleva 2000). All the rest of the countries are situated somewhere in between the two groups with Albania, Georgia, Azerbaijan, Serbia and Herzegovina, Ukraine, Kazakhstan, Turkmenistan and Kyrgyzstan closer to the laggards group than Macedonia, Russia, and Armenia.

Aside from attempts to divide the post-communist nations of Central and Eastern Europe into leaders and laggards, political scientists tried to identify stages of the transition. Apparently, there is no undisputed point of view on this issue either. Welsh (1994), for instance, relies on the classical gradation of transition phases developed by Rustow (1970) who distinguished three stages. In fact, the first phase, called preparatory phase, takes place even before a transition itself starts with the polarization of the main political actors. Then follows the decision phase with the introduction and



institutionalization of crucial democratic procedures. Finally, the transition enters its last phase when both political actors and the electorate are “habituated” to the new political system (Welsh 1994, 380). As applied to post-communist European nations, Welsh suggests an unusual way of defining the preparatory phase of the transition as the “round table negotiations” that took place between the old communist elites and the new democratic political forces.<sup>17</sup> It was a tedious process of bargaining and conflict resolution resulting in the peaceful transfer of power to the new elites at the beginning of 1990s. Already in 1991, most of the post-communist transitions entered the second transformation phase by conducting the first free election and creating a competitive multi-party system.

Haynes and Husan (2002), as well as Kolodko (2000, 2001), do not identify clear-cut stages of the transition, yet agree that the end of the post-communist transformation should be marked by convergence with advanced Western democracies. Kolodko, in turn, elaborates a little further on the issue and calls the time right after the collapse of the

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<sup>17</sup> In Poland, in 1989, the Communist government conducted round table negotiations with the umbrella union organization – Solidarity – on further reforms and organizing a new partially free parliamentary election, which was lost by the Communists. By the late 1980s, a substantial number of opposition groups had also established or re-established themselves in the Hungarian society, and in March-June of 1989 six of them took part in the Opposition Round Table, similar to the one organized in Poland. Like the Polish Communist party, HSWP negotiated itself out of power with an expectation to win a substantial number of parliamentary seats at the first free national election (Ziblatt 1998). However, the opposition forces managed to attract more popular votes and the Hungarian Communist party only gathered 11 percent of the votes. Still it remained active in the parliament and enjoyed the largest membership among the Hungarian parties (Ziblatt 1998). After the execution of Nicolae Ceaușescu and his wife Elena, the Romanian Communist Party was banned and the opposition forces gathered for a round table negotiations at the end of January of 1990. The objective of the negotiations was the replacement of the old system, but the bargaining process was impaired by the unwillingness of the opposition forces to compromise and share power. The limited role of bargaining among the new political elite may have been a result of an extensive period of the Ceaușescu dictatorship (Welsh 1994). The Bulgarian Communist Party by the end of the 1980s still seemed to be strong and resistant to negotiations with the emerging political groups. Moreover, the opposition forces were still weak and disorganized (Welsh 1994). Only the threat of nation-wide strikes and demonstrations made the Communist elites finally agree to collaborate with the opposition on the creation of a new transitional government in Bulgaria. As a consequence, the first post-communist government ironically consisted of the communists exclusively, and only in December 1990 did the opposition forces enter into a power-sharing government (Welsh 1994).

command economic system “transition recession”. Transition recession can be viewed as the initial stage of the transition lasting until the end of economic contraction and the beginning of economic growth. It took some countries more time than the others to overcome economic recession, from 3 years in the case of Poland to 10 years in the case of Ukraine. The period after the turning point, which was denoted by a positive annual rate of GDP growth, is still considered by the author as transitional depression persisting until a transitioning nation exhibits “growth along the business cycle patterns distinctive to a market system” (Kolodko 2001, 302).

### **Public Opinion During the Early Transition**

Given the profound, novel, and tumultuous changes described above, what was the reaction of the public in Central and Eastern Europe toward the transformation process during the first, most challenging, years of the transition? In particular, how did citizens of the newly democratizing nations evaluate the state of the national economies in their respective countries? Unfortunately, cross-national survey studies, which tap into the issue of public economic evaluations, are hard to find. In the early 1990s, the most comprehensive survey study covering a significant number of post-communist countries was the Central and Eastern Eurobarometer project. Two questions, found in the 1991 and 1992 surveys, most closely describe the phenomenon of interest for the purposes of this dissertation: public evaluations of the national economy. The first question asks respondents to rate the change in the economic situation of their respective countries over

the past twelve months.<sup>18</sup> Respondents are given five substantive choices (the economy has become much worse, worse, has remained the same, has become better and much better) and a choice to say “don’t know”. Similar to the “retrospective” question, there is a question that asks respondents to make a forecast of the national economic situation for the next year.<sup>19</sup> The list of the possible answers is the same as for the “retrospective” question. On the five-category scale, a 1 denotes the most unfavorable evaluations; whereas a 5 means that a respondent assessed the state of the national economy over the past year as having “become much better”.

### *Economic Evaluations in 1991*

According to the Central and Eastern Eurobarometer data collected in 1991 in eleven countries of the post-communist bloc, mean evaluation scores for retrospective perceptions range from 1.634 in Russia to 2.460 in Bulgaria.<sup>20</sup> Moreover, prospective economic perceptions are higher than retrospective ones for each country in the data set. Albanians are the ones who have the most positive expectations about their economic future for the following year (the mean score is 3.816). Russians, on the contrary, do not express too much hope for a quick recovery of their national economy (the mean score is 2.473). Romanians and Bulgarians are the other two publics with a mean score of

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<sup>18</sup> The survey question reads: “Compared to 12 months ago, do you think the general economic situation in (COUNTRY) has: 1) Got a lot better; 2) Got a little better; 3) Stayed the same; 4) Got a little worse; 5) Got a lot worse.”

<sup>19</sup> The survey question reads: “And over the next 12 months, do you think the general economic situation in (COUNTRY) will: 1) Get a lot better; 2) Get a little better; 3) Stay the same; 4) Get a little worse; 5) Get a lot worse.”

<sup>20</sup> A complete list of countries in the 1991 Central and Eastern Eurobarometer Study include: Albania, Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Russia, and Slovakia.

prospective economic perceptions higher than 3 (3.370 and 3.343 respectively). All the other nations in the data set have mean prospective evaluation scores between 2.687 and 2.922).

Figure 2.1.1 about here

Interestingly, the biggest difference between the retrospective and prospective scores is found for Albania (1.63).<sup>21</sup> Conversely, Czechs, Slovaks, Hungarians, Poles, and Lithuanians demonstrate much more similarity between their evaluations of the past economy and prognoses for the future (between 0.483 in Lithuania and 0.642 in Poland). This may mean that citizens in these Central European nations make forecasts of the future economic state using their assessments of the economic past with some adjustment. Albanians, on the other hand, are likely to form prospective perceptions mostly based on some other factors, such as politicians' promises for a quick economic recovery or mass public euphoria caused by the end of a most severe dictatorship in East Central Europe (Tarifa 1995). Although the difference scores for all other countries are much lower than the score for Albania (between 0.7 in Latvia and 0.91 in Bulgaria), extrapolation from the past economic evaluations onto the future predictions is most evident in the Czech Republic, Slovakia, Hungary, Poland and Lithuania.

Retrospective and prospective egocentric perceptions form a pattern similar to evaluations of the national economy. Specifically, future prognoses of one's well-being on average are higher than past evaluations of personal economic situation. In all the Baltic States and Russia, prospective egocentric evaluations are only slightly different from the assessments of their most recent personal economic state. Conversely,

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<sup>21</sup> The difference between retrospective and prospective scores is calculated by subtracting a mean retrospective score from a mean prospective score.

Albanians and Bulgarians on average anticipate a substantial improvement in their future personal finances. Poles, Czechs, Slovaks, Hungarians and Romanians remain somewhere in the middle, still expecting their personal economic situation to become better, but not as considerably so as Albanians and Bulgarians.

Figure 2.1.2 about here

Surprisingly, citizens in only four of the eleven countries thought that their personal economic situation had worsened compared to the state of the national economy in the previous year, whereas in all countries except Estonia people predicted the national economy to become better than their own financial state. It would be reasonable to infer from these facts that in 1991 citizens in East Central Europe did not see their personal economic conditions as bad as the state of the national economies. Yet, they were more reserved in making favorable forecasts of their own future finances than predicting a brighter future for their national economies.

Figure 2.2 about here

### *Economic Evaluations in 1992*

In comparison to the 1991 survey, the 1992 CEEB study revealed a greater dispersion of the average perception scores among Central and Eastern European publics, both retrospective and prospective. Most of it, however, is explained by the introduction of seven countries that were not surveyed in 1991.<sup>22</sup> Citizens who are the least satisfied with the state of the national economy were found in Armenia (1.394). Belarus, Georgia, Macedonia and Ukraine are also among the newly introduced countries whose publics

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<sup>22</sup> The new seven countries in the 1992 survey in comparison to 1991 are: Armenia, Belarus, Georgia, Macedonia, Moldova, Slovenia, and Ukraine.

expressed highly negative economic perceptions (less than 2 on the five-category scale). In contrast, Albanians became even happier with the state of their national economy over the past year (2.935). Slovenians scored a little lower (2.894) than Albanians, but substantially higher than most of the other nationals. Retrospective sociotropic perceptions in the countries from the 1991 sample are little, if at all, different from the previous year. Yet in Hungary, Latvia and Lithuania, citizens became considerably more negative in their economic assessments compared to 1991, whereas Poles and Russians thought their countries were doing better than a year before.

Figure 2.3.1 about here

As in the previous year, citizens in all 18 nations surveyed in 1992 demonstrated high optimism about their countries' economic future, despite the fact that the economic situation had only worsened over the previous year, contrary to their expectations. Absolutely speaking, in 1992 Albanians made the most favorable prognoses about their country's economy (3.767), whereas Armenians were the most cautious (2.024). However, Macedonians are the ones whose forecast of the economic future was hardly based on the evaluations of the past economic performance. Specifically, the difference between retrospective and prospective sociotropic perceptions in Macedonia was greater than 1. Albanians, Georgians, Latvians and Lithuanians were also relatively dispersed in their economic views of the past and the future. Prospective economic opinions of Czechs, Slovaks, Hungarians and Poles were most closely connected to their retrospective evaluations of the economy (the difference scores of 0.375, 0.301, 0.393 and 0.357 respectively).

Comparing retrospective sociotropic and egocentric perceptions in 1992, it becomes evident that, on average, citizens in 15 out of 18 surveyed countries felt better about their own finances relative to their country's economic conditions. Only Bulgarians and Slovenians thought that they personally were doing more poorly than the national economies of their nations. Estonians on average evaluated their personal and the national economic conditions about the same. Thus, despite horrible economic conditions in the post-communist nations and dreadful deterioration of the standard of living reported by experts and mass media at the beginning of the transition period, average citizens did not think their own economic conditions were as bad as the state of the national economy. In other words, people somehow managed to survive and show optimism under conditions of growing unemployment, unprecedented hyperinflation, absence or deficit of consumer products and overnight devaluation or loss of personal savings.

Figure 2.3.2 about here

Even more optimism was demonstrated in people's assessments of the economic future, both individual and national. In 14 countries included in the 1992 CEEB study, citizens evaluated their future personal economic state as high or higher than the future state of their national economies. Recall that mean scores for prospective sociotropic evaluations across all the nations were higher than the retrospective mean; and so were mean prospective egocentric evaluations. Only Bulgarians, Slovenians, Czechs and Poles thought that their personal economic future would not be as bright as the general state of their national economies. However, the difference between prospective sociotropic and egocentric perceptions in those countries was not substantial.

Figure 2.4 about here

### **Public Opinion During Advanced Stages of the Transition**

Cross-national economic opinion data for later phases of the transition were surprisingly hard to find. Given that the purpose of this chapter is to paint a broad picture of the economic transformations in the post-communist societies and summarize citizens' reaction on subsequent economic changes, I draw on a variety of data sources for aggregate economic perceptions. Unfortunately, the pool of countries for which relevant data were available has substantially shrunk compared to 1991 and 1992.

The major coherent source for public economic perceptions in the later phases of the post-communist transition is provided by the European Union Consumer Confidence surveys. Inconveniently though, the Consumer Confidence data are not directly comparable to the CEEB mean scores, which I used for the previous years. They are constructed as percent differences between aggregate positive and negative economic evaluations.<sup>23</sup> Because neither mean scores for retrospective and prospective economic perceptions, nor aggregate percentage figures for economic optimists and pessimists are available in the Consumer Confidence surveys, the only option for me to draw a parallel between the two sets of data (the CEEB surveys and the Consumer Confidence surveys)

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<sup>23</sup> The difference scores, also called the balances, can theoretically range from -100, when 100 percent of the population in a particular country feel most pessimistic about the national economy, to +100, when every citizen expresses much satisfaction with the economic performance. A negative score indicates that a proportion of economic pessimists is larger than a proportion of optimists, although the actual proportions of the optimists and the pessimists in the country is impossible to infer due to the infinite number of possible combinations of two continuous numbers between 0 and 100 percent resulting in the same difference score, given that the number of people who expressed the neutral view ("the economy has stayed the same") are unknown.



is to convert the CEEB scores into the CC measurement units.<sup>24</sup> To do this, I first calculated aggregate percentage figures for favorable and pessimistic economic evaluations by country for 1992, and then found a difference between them by subtracting the negative perceptions from the positive ones.<sup>25</sup> Based on the difference scores for 1992, Armenians (-72.6) still expressed the most pessimism regarding their country's recent economic past, whereas Albanians (-3.2) showed the most satisfaction with the performance of the national economy. Significantly larger proportions of both Lithuanian and Latvian publics also displayed more negative retrospective evaluations than positive (-64.3 and -69.7 respectively), as did Macedonians, Belorussians, Ukrainians, and Hungarians. If highly negative perceptions of the national economy should not come as a surprise given terrible economic conditions in East Central Europe, optimistic economic evaluations, such as in Albania, present more of a puzzle. Along with Albanians, Slovenians expressed a lot of satisfaction with how their economy was doing (-5.3). Slovenian economic optimists were outnumbered only by 4.9 percent by the pessimists. Compared with the average balance score for retrospective evaluations calculated across the 15 European Union members in 1992 (-41.4), citizens in Bulgaria, the Czech Republic, Poland, and Romania also had more favorable perceptions of the recent past of their national economies than publics in developed European democracies. More perplexing, the average balance score for the 18 post-communist democracies in

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<sup>24</sup> Without a doubt, I would prefer it the other way around, since by obtaining one difference score instead of having two scores for aggregate positive and negative economic perceptions causes inevitable information loss, which in turn, leads to lower inference reliability.

<sup>25</sup> The precise formula for calculating the difference scores or the balances is as follows:  $(PP+1/2P)-(MM+1/2M)$ , where PP is the percentage of strong positive answers, P is the percentage of positive answers, M is the percentage of negative answers, and MM is the percentage of strong negative answers.

the 1992 sample was -45.4, which is only 4 percentage points lower than the average in the EU.

Table 2.7.1 about here

According to the EU Consumer Confidence (CC) surveys, in 1993 Hungarians expressed more pessimism regarding recent changes in the national economy (the difference score of and -62.2 compared to -56.1 in 1992), whereas Estonians and Latvians evaluated their national economies more favorably than in 1992 and yielded almost identical difference scores of the economic past (-54.4 in 1992 versus -49.3 in 1993, and -69.7 versus -49.3 for the respective countries). Finally, in comparison to 1992, Polish retrospective perceptions did not change much in 1993 (-29.1 versus -32.9). Relative to all other post-communist nations for which I have data for both 1992 and 1993, Poland places the highest in its public's assessments of the recent economy in 1993.<sup>26</sup>

In 1994, despite substantial positive changes in the economic situation of Estonia, Hungary, Latvia, the Czech Republic, and Slovakia, especially in terms of resumed output growth, but also lower rates of inflation, meaningful shifts in public economic opinion reflecting this tendency only emerged in two of the five nations – in the Czech Republic and Estonia. In Estonia, the balance score for retrospective economic perceptions had increased from -49.3 to -16.7 since 1993, whereas in the Czech Republic, for which I only have data back for 1992, it had grown from -32.8 up to 12.8.<sup>27</sup> However, in Hungary, Latvia, and Slovak Republic public opinion about the recent economic past

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<sup>26</sup> The 1993 data for Poland come from the survey study “The Transformation Processes, 1993-1995”.

<sup>27</sup> The data for the Czech Republic for 1994 come from The Transformation Processes data set. The calculated difference score for retrospective economic perceptions based on an alternative source appears more conservative – the pessimists outnumbered the optimists by 9 percent (Jitka Brátková. Unpublished Manuscript. “Economic Situation: How Does It Look Like in the Mirror of Public Opinion?” Presented at STEM Press Conference on March 26, 2001).

still remained highly pessimistic (the difference scores of and -42.5, -38.4, and -48.2 respectively) regardless of the fact that the rate of GDP in Latvia, for example, had gone up from -14.9 to 0.6 over the year, whereas in Slovakia it had increased from -3.7 to 4.9.<sup>28</sup>

In 1995, post-communist countries remained sharply divided in their publics' assessments of the recent economic past. Thus, Hungarians and Latvians maintained a high level of skepticism in their retrospective evaluations (-60.6 and -47.8 respectively), while Estonians and Czechs felt much more satisfied with the past performance of the national economy, with respective difference scores of -7.8 and -4. The same pattern of retrospective economic opinion persisted through 1996 with Hungary and Latvia scoring low (-45.4 and -50) under conditions of a small downturn in the economy, and Estonia and the Czech Republic averaging much higher (-2.5 and 7.1 respectively) under similar economic circumstances.

It was only by 1997 that economic opinion in Hungary and Latvia had finally improved (-32.1 and -30.1) with GDP growing at the rates of 4.3 and 6 percent for the respective countries. While Estonians again proved relative stability in their retrospective economic mood (-7.4), Czechs had become significantly more dissatisfied (-25.2) perhaps due to the political and financial crises that struck the country at the beginning of the year. Among the post-communist publics for which I have data for 1997, Poles expressed the most satisfaction with the performance of their national economy (-2.9), and Russians were the least happy (-44.23). Finally, Slovenians, who had an extremely high difference score in 1992 (-4.9) seem to have become much more disappointed with

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<sup>28</sup> The rate of economic growth in Hungary had also improved in 1994 relative to 1993 and had gone up from -0.6 to 2.9.

the performance of their national economy by 1997 (-30.3) despite the improvement in the objective state of the economy, although not as remarkable as in most other countries of the post-communist bloc.

In 1998, Hungary and the Czech Republic changed places with Hungarians finally warming up in their retrospective economic sentiments (-7.8), as well as Latvians (-16.7), while Czechs were expressing more frustration with the consequences of the financial crisis that occurred in the previous year (-30). Estonians, by tradition, expressed high satisfaction with their national economy (-2.4), and Slovenians kept their pessimism (-32.4) in the situation of having, by far, the best economy of all post-communist nations in the region.

Sharp changes in retrospective economic opinion occurred in 1999, when a number of post-communist countries experienced an economic slowdown and even a recession. Thus, Estonia, whose GDP had dropped from 4.7 to -1.2 between 1998 and 1999, also witnessed a huge change in public economic mood going down from -2.4 to -37.5 and going back up again in 2000 (-20) and 2001 (-7.7), when national economic conditions improved. At the turn of the century, Czechs were still not able to overcome the shock from the economic crisis and expressed negative economic views throughout 1999, 2000, and 2001 (the respective difference scores of -33.6, -32, and -28.3). Without any obvious reason, Hungarian public economic opinion in 1999-2000 became more negative again (-20 and -22.1), whereas Latvian and Slovak publics reacted more or less as expected to a considerable rise in unemployment along with a decline in output in both countries. In Slovenia, at the turn of the century, retrospective perceptions of the national

economy were still unexpectedly negative given the favorable economic situation. For comparison, the difference score for the 15 EU members in 2000 averaged -6.3.

As mentioned earlier, public economic perceptions of the near future tended to be more optimistic than evaluations of the recent economic past. After converting prospective aggregate numbers from the 1992 CEEB surveys into difference scores comparable to the EU Consumer Survey Index scores, the mean difference score for the eighteen transitioning countries was just -14.4 percent. Interestingly, the mean difference score for the fifteen EU members in 1993 was below -20 percent. Thus, during the worst year of the post-communist transition, Central and Eastern European citizens were on average more optimistic about their economic future than citizens of the established European democracies. Of the eighteen new democracies, four – Albania, Bulgaria, Romania, and Slovenia – had positive prospective difference scores in 1992, which indicates that more people in these countries formed optimistic rather than pessimistic economic forecasts.

Table 2.7.2 about here

In 1993, consistent with the pattern of retrospective economic evaluations, Hungarians were the least optimistic about their future (with a difference score of -32.6), followed by Estonians (-28.1), and Latvians (-21.4). In contrast, Poles had very favorable prognoses for their national economy for the year ahead with a greater portion of the population predicting that the economy would improve (the difference score was 11.08). Strongly positive perceptions of the future economy were expressed by Czechs in 1994 (21.17), whereas Hungarians and Latvians were still among the most pessimistic publics (the difference scores of -16.7 and -16.8 respectively). Slovaks, whose economy had

progressed immensely since the beginning of the transition, on average, felt more negatively than positively about their economic future (-16).

In 1995, Czechs lost some of their optimism, but were still favorable in their prognoses (3.2), similar to Estonians (1.3). Conversely, Hungarians, being in the middle of a minor economic recession (a decrease in the GDP growth rate from 2.9 to 1.5 percent, and an increase in the inflation rate from 21 to 28 percent compared to 1994) immediately felt insecure about their future (-43.25). Also sensitive to a slight slowdown in their economy in 1995 were Latvians (-21.8). This pattern remained through 1996 with the exception of Hungary, which displayed significantly more optimistic perceptions about the future economy (-27.8) compared to the previous year, although relatively lower than in all other post-communist nations in the sample.

The year of 1997 is sometimes considered to be overall the most successful year of the post-communist transition. For Estonia and Latvia this statement, certainly, holds true; however, aggregate economic forecasts in Estonia had decreased compared to the two preceding years (-2.6), although they remained relatively high, whereas Latvians still felt pessimistic about their future (-13.3). Hungarians, whose economy was, then, on the rise, adopted a more optimistic view of the future than they had done before (-11.4). Notably, Russians and Poles were among the most optimistic publics in 1997 (the difference scores of 11.23 and 12.24 respectively), with Russia just having resumed growth for the first year at 0.4 percent. Czechs, on the contrary, started to feel even more pessimistic about their economic future (-8.9) probably due to a major financial crisis that they had in the spring of 1997. In 1998, there were no big changes in public economic

forecasts, with the exception of Hungary. Hungarians, finally, believed they would live better in the future, and optimists outweighed pessimists by 6.4 percent.

Toward the end of the decade, Latvians also acquired more optimism for the future (the balance score of -2.4 for 1999). Czechs remained relatively negative at the turn of the century similar to Slovenians. The most pessimistic were Slovaks with the difference scores of -30.8 and -33.1 for 2000 and 2001 respectively. Hungarians lost some of their optimism after 1998 and went back to more negative economic prognoses (-9.3, -11.8, and -3.4 for 1999, 2000, and 2001 respectively). Finally, Estonians had unexpectedly negative future perceptions in 1999 and 2000, but resumed their optimism in 2001.

The above description of the economic transition in East Central Europe and public economic mood reveals a number of interesting things. To begin with, the first few years of the transition were economically the roughest across all countries in the region; yet, a significant portion of the population had favorable evaluations of the recent economic past, especially in Bulgaria, Albania, and Slovenia. Assessments of short-term economic prospects during the same period in the public's eyes looked even brighter. In fact, prospective perceptions of the national economy across Central and Eastern European countries in 1992 were more optimistic than those of Western European publics at approximately the same time. Later in the transition, retrospective economic perceptions seemed to follow fluctuations in the national economies more closely, but some divergences still occurred. The discrepancy between the poor economic situation and citizens' economic optimism presents the puzzle that I set out to solve in the next chapters of my dissertation.

**Table 2.1. Inflation in East Central Europe over the Period of the Post-Communist Transition**

| Countries       | 1991  | 1992   | 1993    | 1994   | 1995   | 1996  | 1997  | 1998* | 1999* | 2000* |
|-----------------|-------|--------|---------|--------|--------|-------|-------|-------|-------|-------|
| Albania         | 104.0 | 236.6  | 30.9    | 15.8   | 6.0    | 17.4  | 42.0  | 20.6  | 0.4   | 0.05  |
| Azerbaijan      | 126.0 | 1395.0 | 1293.8  | 1788.0 | 84.5   | 6.7   | 0.5   |       |       |       |
| Armenia         | 25.0  | 1341.0 | 10896.0 | 1885.0 | 32.0   | 5.8   | 21.9  | 8.7   | 0.7   | -0.8  |
| Belarus         | 93.0  | 1159.0 | 1996.0  | 1960.0 | 244.0  | 39.2  | 63.1  | 72.9  | 293.7 | 168.6 |
| Bulgaria        | 339.0 | 79.4   | 63.8    | 121.9  | 32.8   | 310.8 | 578.6 | 18.7  | 2.5   | 10.3  |
| Croatia         | 250.0 | 938.2  | 1149.0  | -3.0   | 3.8    | 3.4   | 3.8   | 6.4   | 3.7   | 5.4   |
| Czech Republic  | 52.0  | 12.7   | 18.2    | 9.7    | 7.9    | 8.6   | 10.0  | 10.6  | 2.1   | 3.9   |
| Estonia         | 304.0 | 953.5  | 35.6    | 42.0   | 29.0   | 15.0  | 12.0  | 8.2   | 3.3   | 4.0   |
| Georgia         | 131.0 | 1177.0 | 7488.0  | 6474.4 | 57.4   | 13.8  | 8.1   | 3.6   | 19.2  | 4.1   |
| Hungary         | 32.0  | 21.6   | 21.1    | 21.2   | 28.3   | 19.8  | 18.4  | 14.1  | 10.0  | 9.8   |
| Kazakhstan      | 137.0 | 2984.1 | 2169.0  | 1160.0 | 60.4   | 28.6  | 11.3  | 7.1   | 8.3   | 13.2  |
| Kyrgyz Republic | 170.0 | 1259.0 | 1363.0  | 95.7   | 31.9   | 35.0  | 14.8  |       |       |       |
| Latvia          | 262.0 | 959.0  | 35.0    | 26.0   | 23.0   | 13.1  | 7.0   | 4.7   | 2.4   | 2.6   |
| Lithuania       | 345.0 | 1161.1 | 1188.8  | 45.0   | 35.5   | 13.1  | 8.5   | 5.1   | 0.8   | 1.0   |
| Macedonia       | 230.0 | 1925.2 | 229.6   | 55.4   | 9.3    | 0.2   | 4.6   | 0.5   | -1.3  |       |
| Moldova         | 151.0 | 2198.0 | 837.0   | 116.0  | 23.8   | 15.1  | 11.2  | 6.6   | 45.9  | 31.2  |
| Poland          | 60.0  | 44.3   | 37.6    | 29.4   | 21.6   | 18.5  | 13.2  | 11.7  | 7.3   | 10.1  |
| Romania         | 223.0 | 199.2  | 295.5   | 61.7   | 27.8   | 56.9  | 151.6 | 59.1  | 45.8  | 45.7  |
| Russia          | 144.0 | 2508.8 | 840.1   | 204.7  | 131.3  | 21.8  | 11.1  | 27.7  | 85.7  | 20.8  |
| Slovak Republic | 58.0  | 9.1    | 25.1    | 11.7   | 7.2    | 5.4   | 6.4   | 6.7   | 10.6  | 12.0  |
| Slovenia        | 247.0 | 92.9   | 22.9    | 18.3   | 8.6    | 8.8   | 9.4   | 8.6   | 6.6   | 10.8  |
| Tajikistan      | 204.0 | 1364.0 | 7344.0  | 1.1    | 2133.0 | 40.5  | 165.0 |       |       |       |
| Turkmenistan    | 155.0 | 644.0  | 9750.0  | 1328.0 | 1262.0 | 446.0 | 21.5  |       |       |       |
| Ukraine         | 161.1 | 2730.0 | 10155.0 | 401.0  | 182.0  | 39.7  | 10.1  | 10.6  | 22.7  |       |

Source: European Bank for Reconstruction and Development (cited in Kolodko, "From Shock to Therapy", 2000).

Source\*: World Bank, World Bank Development Indicators, 2000.



**Table 2.3. Unemployment in East Central Europe over the Period of the Post-Communist Transition**

| Countries       | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998* | 1999* | 2000* |
|-----------------|------|------|------|------|------|------|------|------|-------|-------|-------|
| Albania         | 9.5  | 9.5  | 27.0 | 22.0 | 18.5 | 13.1 | 12.1 | 14.0 | 17.8  | 18.0  |       |
| Azerbaijan      |      |      | 0.2  | 0.7  | 0.9  | 1.1  | 1.1  | 1.2  |       |       |       |
| Armenia         |      |      | 3.5  | 6.2  | 5.6  | 8.1  | 9.7  | 11.0 | 9.3   |       |       |
| Belarus         |      | 0.0  | 0.5  | 1.4  | 2.1  | 2.7  | 3.9  | 2.3  | 2.3   | 2.0   |       |
| Bulgaria        | 1.6  | 10.5 | 13.2 | 16.3 | 14.1 | 11.4 | 11.1 | 14.2 | 12.2  | 14.1  | 16.3  |
| Croatia         | 9.3  | 14.9 | 17.2 | 16.8 | 16.7 | 16.7 | 18.2 | 17.0 | 11.4  | 13.5  | 16.1  |
| Czech Republic  | 0.8  | 4.1  | 2.6  | 3.5  | 3.2  | 2.9  | 3.5  | 5.2  | 6.5   | 8.7   | 8.8   |
| Estonia         |      |      |      | 5.0  | 5.1  | 5.1  | 5.6  | 5.4  | 9.9   | 11.7  | 14.8  |
| Georgia         |      |      | 0.9  | 1.4  | 3.6  | 3.4  | 2.3  | 2.6  | 14.5  | 13.8  |       |
| Hungary         | 1.9  | 7.8  | 13.2 | 12.1 | 10.4 | 10.4 | 10.7 | 10.4 | 7.8   | 7.0   | 6.5   |
| Kazakhstan      | 0.0  | 0.0  | 0.5  | 0.5  | 8.0  | 11.0 | 13.0 | 13.5 | 13.7  |       |       |
| Kyrgyz Republic |      | 0.0  | 0.1  | 0.2  | 4.1  | 5.7  | 7.8  | 7.5  |       |       |       |
| Latvia          |      |      | 2.3  | 4.7  | 6.4  | 6.3  | 7.2  | 6.7  | 13.8  | 14.5  | 8.4   |
| Lithuania       |      | 0.3  | 1.3  | 4.2  | 3.8  | 6.1  | 7.1  | 5.9  | 13.3  | 14.1  | 11.1  |
| Macedonia       |      | 19.2 | 19.8 | 18.7 | 20.7 | 23.7 | 24.9 | 30.0 | 34.5  |       |       |
| Moldova         |      |      | 0.1  | 0.7  | 1.1  | 1.4  | 1.4  | 1.7  |       | 1.1   |       |
| Poland          | 6.3  | 12.2 | 14.3 | 16.4 | 16.0 | 14.9 | 13.6 | 10.5 | 10.7  | 12.5  | 16.7  |
| Romania         |      |      | 8.2  | 10.4 | 10.9 | 9.5  | 6.4  | 8.8  | 6.3   | 6.8   | 10.8  |
| Russia          | 0.0  | 0.0  | 4.8  | 5.7  | 7.5  | 8.8  | 9.3  | 9.0  | 13.3  | 13.4  | 11.4  |
| Slovak Republic |      | 11.8 | 11.4 | 12.2 | 13.7 | 13.8 | 12.6 | 13.0 | 12.5  | 16.2  | 18.9  |
| Slovenia        | 4.7  | 8.2  | 11.6 | 14.6 | 14.5 | 14.0 | 13.9 | 14.4 | 7.7   | 7.4   | 7.5   |
| Tajikistan      |      |      | 0.3  | 1.1  | 1.7  | 1.8  | 2.8  | 4.7  |       |       |       |
| Turkmenistan    | 2.0  | 2.0  |      |      |      | 3.0  |      |      |       |       |       |
| Ukraine         | 0.0  | 0.0  | 0.3  | 0.4  | 0.4  | 0.5  | 1.6  | 2.9  | 11.3  | 11.9  |       |
| Uzbekistan      | 0.0  | 0.0  | 0.1  | 0.3  | 0.4  | 0.4  | 0.4  | 0.5  |       |       |       |

Source: European Bank for Reconstruction and Development (cited in Kolodko, "From Shock to Therapy", 2000).

Source\*: World Bank, World Bank Development Indicators, 2000.

**Table 2.2. GDP Growth in East Central Europe over the Period of the Post-Communist Transition**

| Countries       | 1990  | 1991  | 1992  | 1993  | 1994  | 1995  | 1996  | 1997  | 1998* | 1999* | 2000* |
|-----------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Albania         | -10.0 | -27.7 | -7.2  | 9.6   | 9.4   | 8.9   | 9.1   | -8.0  | 7.9   | 7.3   | 7.8   |
| Azerbaijan      | -11.7 | -0.7  | -22.6 | -23.1 | -18.1 | -11.0 | 1.3   | 5.0   |       |       |       |
| Armenia         | -7.4  | -10.8 | -52.6 | -14.8 | 5.4   | 6.9   | 5.8   | 3.3   | 7.3   | 3.3   | 6.0   |
| Belarus         | -3.0  | -1.2  | -9.6  | -7.6  | -12.6 | -10.4 | -2.6  | 10.0  | 8.4   | 3.4   | 5.8   |
| Bulgaria        | -9.1  | -11.7 | -7.3  | -1.5  | 1.8   | 2.1   | -10.9 | -7.4  | 3.5   | 2.4   | 5.8   |
| Croatia         | -6.9  | -20.0 | -11.7 | -0.9  | 0.6   | 1.6   | 4.3   | 5.5   | 2.5   | -0.4  | 3.7   |
| Czech Republic  | -0.4  | -14.2 | -3.3  | 0.6   | 3.2   | 6.4   | 3.9   | 1.0   | -1.2  | -0.4  | 2.9   |
| Estonia         | -8.1  | -7.9  | -14.2 | -8.5  | -1.8  | 4.3   | 4.0   | 10.0  | 4.7   | -1.2  | 6.4   |
| Georgia         | -12.4 | -13.8 | -44.8 | -25.4 | -11.4 | 2.4   | 10.5  | 10.0  | 2.9   | 3.0   | 1.9   |
| Hungary         | -3.5  | -11.9 | -3.1  | -0.6  | 2.9   | 1.5   | 1.3   | 4.3   | 4.9   | 4.2   | 5.2   |
| Kazakhstan      | -0.4  | -13.0 | -2.9  | -10.4 | -17.8 | -8.9  | 1.1   | 1.8   | -1.9  | 2.7   | 9.6   |
| Kyrgyz Republic | 3.0   | -5.0  | -19.0 | -16.0 | -20.0 | -5.4  | 5.6   | 10.4  |       |       |       |
| Latvia          | 2.9   | -8.3  | -34.9 | -14.9 | 0.6   | -0.8  | 2.8   | 6.0   | 3.9   | 1.1   | 6.6   |
| Lithuania       | -5.0  | -13.4 | -37.7 | -17.1 | -11.3 | 2.3   | 5.1   | 5.7   | 5.1   | -3.9  | 3.9   |
| Macedonia       | -9.9  | -12.1 | -21.1 | -8.4  | -4.0  | -1.4  | 1.1   | 1.0   | 3.4   | 4.3   | 4.3   |
| Moldova         | -2.4  | -17.5 | -29.1 | -1.2  | -31.2 | -3.0  | -8.0  | 1.3   | -6.5  | -3.4  | 1.9   |
| Poland          | -11.6 | -7.0  | 2.6   | 3.8   | 5.2   | 7.0   | 6.1   | 6.9   | 4.8   | 4.1   | 4.0   |
| Romania         | -5.6  | -12.9 | -8.7  | 1.5   | 3.9   | 7.1   | 4.1   | -6.6  | -4.8  | -2.3  | 1.6   |
| Russia          | -4.0  | -13.0 | -14.5 | -8.7  | -12.6 | -4.0  | -4.9  | 0.4   | -4.9  | 5.4   | 8.3   |
| Slovak Republic | -2.5  | -14.6 | -6.5  | -3.7  | 4.9   | 6.8   | 6.9   | 6.5   | 4.1   | 1.9   | 2.2   |
| Slovenia        | -4.7  | -8.1  | -5.5  | 2.8   | 5.3   | 4.1   | 3.1   | 3.3   | 3.8   | 5.2   | 4.6   |
| Tajikistan      | -1.6  | -7.1  | -29.0 | -11.0 | -18.9 | -12.5 | -4.4  | 2.2   |       |       |       |
| Turkmenistan    | 2.0   | -4.7  | -5.3  | -10.0 | -18.8 | -8.2  | -8.0  | -15.0 |       |       |       |
| Ukraine         | -3.4  | -9.0  | -13.7 | -14.2 | -23.0 | -12.2 | -10.0 | -3.2  | -1.9  | -0.2  | 5.8   |

Source: European Bank for Reconstruction and Development (cited in Kolodko, "From Shock to Therapy", 2000).

Source\*: World Bank, World Bank Development Indicators, 2000.

**Table 2.4. Corruption in East Central Europe over the Period of the Post-Communist Transition**

| Countries          | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
|--------------------|------|------|------|------|------|------|------|------|------|------|
| Albania            |      |      |      |      | 2.30 |      |      | 2.50 | 2.50 | 2.50 |
| Azerbaijan         |      |      |      |      | 1.70 | 1.50 | 2.00 | 2.00 | 1.80 | 1.80 |
| Armenia            |      |      |      |      | 2.50 | 2.50 |      |      | 3.00 | 3.10 |
| Belarus            |      |      |      | 3.90 | 3.40 | 4.10 |      | 4.80 | 4.20 | 3.30 |
| Bosnia-Herzegovina |      |      |      |      |      |      |      |      | 3.30 | 3.10 |
| Bulgaria           |      |      |      | 2.90 | 3.30 | 3.50 | 3.90 | 4.00 | 3.90 | 4.10 |
| Croatia            |      |      |      |      | 2.70 | 3.70 | 3.90 | 3.80 | 3.70 | 3.50 |
| Czech Republic     |      | 5.37 | 5.20 | 4.80 |      | 4.30 | 3.90 | 3.70 | 3.90 | 4.20 |
| Estonia            |      |      |      | 5.70 | 5.70 | 5.70 | 5.60 | 5.60 | 5.50 | 6.00 |
| Georgia            |      |      |      |      | 2.30 |      |      | 2.40 | 1.80 | 2.00 |
| Hungary            | 4.12 | 4.86 | 5.18 | 5.00 | 5.20 | 5.20 | 5.30 | 4.90 | 4.80 | 4.80 |
| Kazakhstan         |      |      |      |      | 2.30 | 3.00 | 2.70 | 2.30 | 2.40 | 2.20 |
| Kyrgyz Republic    |      |      |      |      | 2.20 |      |      |      | 2.10 | 2.20 |
| Latvia             |      |      |      | 2.70 | 3.40 | 3.40 | 3.40 | 3.70 | 3.80 | 4.00 |
| Lithuania          |      |      |      |      | 3.80 | 4.10 | 4.80 | 4.80 | 4.70 | 4.60 |
| Macedonia          |      |      |      |      | 3.30 |      |      |      | 2.30 | 2.70 |
| Moldova            |      |      |      |      | 2.60 | 2.60 | 3.10 | 2.10 | 2.40 | 2.30 |
| Poland             |      | 5.57 | 5.08 | 4.60 | 4.20 | 4.10 | 4.10 | 4.00 | 3.60 | 3.50 |
| Romania            |      |      | 3.44 | 3.00 | 3.30 | 2.90 | 2.80 | 2.60 | 2.80 | 2.90 |
| Russia             |      | 2.58 | 2.27 | 2.40 | 2.40 | 2.10 | 2.30 | 2.70 | 2.70 | 2.80 |
| Slovak Republic    |      |      |      | 3.90 | 3.70 | 3.50 | 3.70 | 3.70 |      | 4.00 |
| Slovenia           |      |      |      |      | 6.00 | 5.50 | 5.20 | 6.00 | 5.90 | 6.00 |
| Tajikistan         |      |      |      |      |      |      |      |      | 1.80 | 2.00 |
| Turkmenistan       |      |      |      |      |      |      |      |      |      | 2.00 |
| Ukraine            |      |      |      | 2.80 | 2.60 | 1.50 | 2.10 | 2.40 | 2.30 | 2.20 |
| Uzbekistan         |      |      |      |      | 1.80 | 2.40 | 2.70 | 2.90 | 2.40 | 2.30 |

**Source:** Transparency International.

**Note:** Entries are Transparency International Corruption Perception Index (CPI) Scores. CPI Score relates to perceptions of degree of corruption as seen by business people and country analysts and ranges between 10 (highly clean) and 0 (highly corrupt).

**Table 2.5. Gini Index in East Central Europe over the Period of the Post-Communist Transition**

| Countries          | 1989  | 1992 | 1993  | 1994 | 1995 | 1996  | 1997  | 1998  | 1999  | 2000  | 2001  |
|--------------------|-------|------|-------|------|------|-------|-------|-------|-------|-------|-------|
| Azerbaijan         | 27.5  | 36.1 |       | 42.8 | 45.9 | 45.8  | 46.2  | 46.2  |       | 50.6  | 50.1  |
| Armenia            | 25.8  | 35.5 | 36.6  | 32.1 | 38.1 | *44.4 |       | *37.9 |       | 48.6  |       |
| Belarus            | 23.4  | 34.1 | 39.9  |      | 37.4 | 35.6  | 35.4  | 35.1  | 33.7  | 33.7  | 34.3  |
| Bosnia-Herzegovina |       |      |       |      |      |       |       |       |       |       | *26.2 |
| Bulgaria           |       |      |       |      |      |       |       |       |       |       | *31.9 |
| Croatia            |       |      |       |      |      |       |       |       |       |       | *29.0 |
| Czech Republic     | 20.4  | 21.4 | 25.8  | 26.0 | 28.2 | 25.4  | 25.9  | 25.8  | 25.7  | 27.0  | 27.3  |
| Estonia            | 25.3  |      |       |      |      |       | 33.6  | 38.4  | 40.1  | 37.6  |       |
| Georgia            | 30.1  | 36.9 | 40.0  |      |      | *37.1 | *36.1 | *36.0 | *38.1 | *38.9 | *36.9 |
| Hungary            | 26.8  | 30.5 | 32.0  | 32.4 |      |       | 35.0  | *24.4 |       |       | 38.6  |
| Kazakhstan         | *25.7 |      | *32.7 |      |      | *35.3 |       |       |       |       | *31.3 |
| Kyrgyz Republic    | 26.0  | 30.0 | 44.5  | 44.3 | 39.5 | 42.8  | 43.1  | 42.9  | 46.6  | 47.0  | 51.2  |
| Latvia             | 24.4  | 33.3 | 28.3  | 32.5 | 34.6 | 34.9  | 33.6  | 33.2  | 33.3  | 33.7  | 32.2  |
| Lithuania          | 26.0  | 37.2 |       | 39.0 | 37.4 | 35.0  | 34.5  | 35.7  | 36.8  | *36.3 | 38.2  |
| Macedonia          |       |      |       |      |      |       |       | *28.2 |       |       |       |
| Moldova            | 25.0  | 41.1 | 43.7  | 37.9 | 39.0 | 41.4  |       | 42.6  | 44.1  | 39.2  | 39.1  |
| Poland             | 20.7  | 24.7 | 25.6  | 28.1 | 29.0 | 30.2  | 30.0  | 29.4  | 30.5  |       |       |
| Romania            | 15.5  |      | 22.6  | 27.7 | 28.7 | 30.5  | 35.2  | 35.8  | 37.2  | 40.6  | 38.8  |
| Russia             | 27.1  | 37.1 | 46.1  | 44.6 | 47.1 | 48.3  |       |       |       | *45.6 | 52.1  |
| Slovak Republic    |       |      |       |      |      | *25.8 |       |       |       |       |       |
| Slovenia           | 21.9  | 26.0 | 27.6  | 27.5 | 35.8 | 29.8  | 30.7  | 30.6  | 30.5  | 30.6  | 31.0  |
| Tajikistan         |       |      |       |      |      |       |       | *34.7 |       |       |       |
| Turkmenistan       | *26.4 |      | *35.8 |      |      |       |       | *40.8 |       |       |       |
| Ukraine            | 24.4  | 25.1 | 36.4  |      |      | 41.3  | 40.6  | 39.1  | 42.7  | 46.2  | 45.2  |
| Uzbekistan         | *25.0 |      | *33.3 |      |      |       |       | *45.4 |       | *27.0 |       |

Source: UNICEF, TransMONEE Database, 2003 edition.

Source\*: World Bank, Global Poverty Monitoring website.

**Table 2.6. Political Rights and Civil Liberties in East Central Europe over the Period of the Post-Communist Transition**

| Countries          | 1989  | 1990  | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 |
|--------------------|-------|-------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| Albania            | 7/7   | 7/6   | 4/4  | 4/3  | 2/4  | 3/4  | 3/4  | 4/4  | 4/4  | 4/5  | 4/5  | 4/5  | 3/4  | 3/3  | 3/3  |
| Azerbaijan         |       |       | 5/5  | 5/5  | 6/6  | 6/6  | 6/6  | 6/5  | 6/4  | 6/4  | 6/4  | 6/5  | 6/5  | 6/5  | 6/5  |
| Armenia            |       |       | 5/5  | 4/3  | 3/4  | 3/4  | 4/4  | 5/4  | 5/4  | 4/4  | 4/4  | 4/4  | 4/4  | 4/4  | 4/4  |
| Belarus            |       |       | 4/4  | 4/3  | 5/4  | 4/4  | 5/5  | 6/6  | 6/6  | 6/6  | 6/6  | 6/6  | 6/6  | 6/6  | 6/6  |
| Bosnia-Herzegovina |       |       |      | 6/6  | 6/6  | 6/6  | 6/6  | 5/5  | 5/5  | 5/5  | 5/5  | 5/4  | 5/4  | 4/4  | 4/4  |
| Bulgaria           | 7/7   | 3/4   | 2/3  | 2/3  | 2/2  | 2/2  | 2/2  | 2/3  | 2/3  | 2/3  | 2/3  | 2/3  | 1/3  | 1/2  | 1/2  |
| Croatia            |       |       | 3/4  | 4/4  | 4/4  | 4/4  | 4/4  | 4/4  | 4/4  | 4/4  | 4/4  | 2/3  | 2/2  | 2/2  | 2/2  |
| Czech Republic     | *6/6  | *2/2  | *2/2 | *2/2 | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  |
| Estonia            |       |       | 2/3  | 3/3  | 3/2  | 3/2  | 2/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  |
| Georgia            |       |       | 6/5  | 4/5  | 5/5  | 5/5  | 4/5  | 4/4  | 3/4  | 3/4  | 3/4  | 4/4  | 4/4  | 4/4  | 4/4  |
| Hungary            | 4/3   | 2/2   | 2/2  | 2/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  |
| Kazakhstan         |       |       | 5/4  | 5/5  | 6/4  | 6/5  | 6/5  | 6/5  | 6/5  | 6/5  | 6/5  | 6/5  | 6/5  | 6/5  | 6/5  |
| Kyrgyz Republic    |       |       | 5/4  | 4/2  | 5/3  | 4/3  | 4/4  | 4/4  | 4/4  | 5/5  | 5/5  | 6/5  | 6/5  | 6/5  | 6/5  |
| Latvia             |       |       | 2/3  | 3/3  | 3/3  | 3/2  | 2/2  | 2/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  |
| Lithuania          |       |       | 2/3  | 2/3  | 1/3  | 1/3  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  |
| Macedonia          |       |       |      | ¾    | 3/3  | 4/3  | 4/3  | 4/3  | 4/3  | 3/3  | 3/3  | 4/3  | 4/4  | 3/3  | 3/3  |
| Moldova            |       |       | 5/4  | 5/5  | 5/5  | 4/4  | 4/4  | 3/4  | 3/4  | 2/4  | 2/4  | 2/4  | 2/4  | 3/4  | 3/4  |
| Poland             |       |       | 4/3  | 2/2  | 2/2  | 2/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  |
| Romania            | 7/7   | 6/5   | 5/5  | 4/4  | 4/4  | 4/3  | 4/3  | 2/3  | 2/2  | 2/2  | 2/2  | 2/2  | 2/2  | 2/2  | 2/2  |
| Russia             | **6/5 | **5/4 | 3/3  | 3/4  | 3/4  | 3/4  | 3/4  | 3/4  | 3/4  | 4/4  | 4/5  | 5/5  | 5/5  | 5/5  | 5/5  |
| Slovak Republic    | *6/6  | *2/2  | *2/2 | *2/2 | 3/4  | 2/3  | 2/3  | 2/4  | 2/4  | 2/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  |
| Slovenia           |       |       | 2/3  | 2/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/1  | 1/1  |
| Tajikistan         |       |       | 3/3  | 6/6  | 7/7  | 7/7  | 7/7  | 7/7  | 6/6  | 6/6  | 6/6  | 6/6  | 6/6  | 6/5  | 6/5  |
| Turkmenistan       |       |       | 6/5  | 7/6  | 7/7  | 7/7  | 7/7  | 7/7  | 7/7  | 7/7  | 7/7  | 7/7  | 7/7  | 7/7  | 7/7  |
| Ukraine            |       |       | 3/3  | 3/3  | 4/4  | 3/4  | 3/4  | 3/4  | 3/4  | 3/4  | 3/4  | 4/4  | 4/4  | 4/4  | 4/4  |
| Uzbekistan         |       |       | 6/5  | 6/6  | 7/7  | 7/7  | 7/7  | 7/6  | 7/6  | 7/6  | 7/6  | 7/6  | 7/6  | 7/6  | 7/6  |

Source: Freedom House.

Notes: The first figure stands for political rights (PR) and the second figure indicates civil liberties (CL). Political rights and civil liberties are measures on a one-to-seven scale, where one indicates the highest degree of freedom and seven the lowest.

\* The ratings are given for Czechoslovakia.

\*\* The ratings are given for the USSR.

**Table 2.7.1. Aggregate Retrospective Evaluations of the National Economy over the Period of the Post-Communist Transition**

| Countries       | 1992 <sup>a</sup> | 1993                | 1994                | 1995   | 1996   | 1997                | 1998   | 1999   | 2000   | 2001   |
|-----------------|-------------------|---------------------|---------------------|--------|--------|---------------------|--------|--------|--------|--------|
| Albania         | -3.22             |                     |                     |        |        |                     |        |        |        |        |
| Armenia         | -72.63            |                     |                     |        |        |                     |        |        |        |        |
| Belarus         | -57.88            |                     |                     |        |        |                     |        |        |        |        |
| Bulgaria        | -22.88            |                     |                     |        |        |                     |        |        |        |        |
| Czech Republic  | -25.91            |                     | 12.76 <sup>b</sup>  | -4.00  | -7.09  | -25.22              | -29.90 | -33.60 | -32.01 | -28.30 |
| Estonia         | -54.41            | -49.33              | -16.67              | -7.75  | -2.50  | -7.42               | -2.42  | -37.50 | -20.75 | -7.67  |
| Georgia         | -58.37            |                     |                     |        |        |                     |        |        |        |        |
| Hungary         | -56.11            | -62.50              | -49.83              | -60.58 | -45.42 | -32.08              | -7.75  | -19.92 | -22.08 | -15.17 |
| Latvia          | -69.66            | -49.25              | -40.25              | -47.75 | -49.58 | -30.83              | -16.67 | -26.33 |        |        |
| Lithuania       | -64.29            |                     |                     |        |        |                     |        |        |        |        |
| Macedonia       | -61.42            |                     |                     |        |        |                     |        |        |        |        |
| Moldova         | -44.67            |                     |                     |        |        |                     |        |        |        |        |
| Poland          | -29.06            | -32.86 <sup>b</sup> |                     |        |        | -2.92 <sup>c</sup>  |        |        |        |        |
| Romania         | -29.62            |                     |                     |        |        |                     |        |        |        |        |
| Russia          | -57.03            |                     |                     |        |        | -44.23 <sup>c</sup> |        |        |        |        |
| Slovak Republic | -44.43            |                     | -48.20 <sup>b</sup> |        |        |                     |        |        | -48.33 | -46.75 |
| Slovenia        | -5.29             |                     |                     |        |        | -30.33              | -32.42 | -27.08 | -24.17 | -23.75 |
| Ukraine         | -61.04            |                     |                     |        |        |                     |        |        |        |        |

**Source:** The EU Consumer Confidence Surveys.

**Source<sup>a</sup>:** Central and Eastern Eurobarometer No. 3.

**Source<sup>b</sup>:** The Transformation Processes 1993-1995.

**Source<sup>c</sup>:** The East Transformations Barometer 1997.

**Notes:** Entries are aggregate percentage differences between positive and negative evaluations of the general economic situation in respondents' respective countries.

**Table 2.7.2. Aggregate Prospective Evaluations of the National Economy over the Period of the Post-Communist Transition**

| Countries       | 1992 <sup>a</sup> | 1993               | 1994                | 1995   | 1996   | 1997               | 1998   | 1999   | 2000   | 2001   |
|-----------------|-------------------|--------------------|---------------------|--------|--------|--------------------|--------|--------|--------|--------|
| Albania         | 37.36             |                    |                     |        |        |                    |        |        |        |        |
| Armenia         | -48.80            |                    |                     |        |        |                    |        |        |        |        |
| Belarus         | -32.97            |                    |                     |        |        |                    |        |        |        |        |
| Bulgaria        | 5.57              |                    |                     |        |        |                    |        |        |        |        |
| Czech Republic  | -7.16             |                    | 21.17 <sup>b</sup>  | 3.17   | 1.53   | -8.90              | -12.83 | -16.30 | -16.25 | -14.07 |
| Estonia         | -19.42            | -28.08             | -8.42               | 1.33   | 0.08   | -2.58              | -2.58  | -18.17 | -12.42 | -0.92  |
| Georgia         | -10.28            |                    |                     |        |        |                    |        |        |        |        |
| Hungary         | -33.33            | -32.58             | -16.67              | -43.25 | -27.75 | -11.42             | 6.42   | -9.33  | -11.83 | -3.58  |
| Latvia          | -29.26            | -21.42             | -16.75              | -21.75 | -19.50 | -13.33             | -4.08  | -2.42  |        |        |
| Lithuania       | -16.21            |                    |                     |        |        |                    |        |        |        |        |
| Macedonia       | -9.73             |                    |                     |        |        |                    |        |        |        |        |
| Moldova         | -22.16            |                    |                     |        |        |                    |        |        |        |        |
| Poland          | -11.18            | 11.08 <sup>b</sup> |                     |        |        | 12.24 <sup>c</sup> |        |        |        |        |
| Romania         | -4.87             |                    |                     |        |        |                    |        |        |        |        |
| Russia          | -25.58            |                    |                     |        |        | 11.23 <sup>c</sup> |        |        |        |        |
| Slovak Republic | -29.37            |                    | -15.96 <sup>b</sup> |        |        |                    |        |        | -30.83 | -33.08 |
| Slovenia        | 18.45             |                    |                     |        |        | -9.42              | -12.83 | -9.42  | -6.17  | -6.75  |
| Ukraine         | -19.62            |                    |                     |        |        |                    |        |        |        |        |

**Source:** The EU Consumer Confidence Surveys.

**Source<sup>a</sup>:** Central and Eastern Eurobarometer No. 3.

**Source<sup>b</sup>:** The Transformation Processes 1993-1995.

**Source<sup>c</sup>:** The East Transformations Barometer 1997.

**Notes:** Entries are aggregate percentage differences between positive and negative evaluations of the general economic situation in respondents' respective countries.

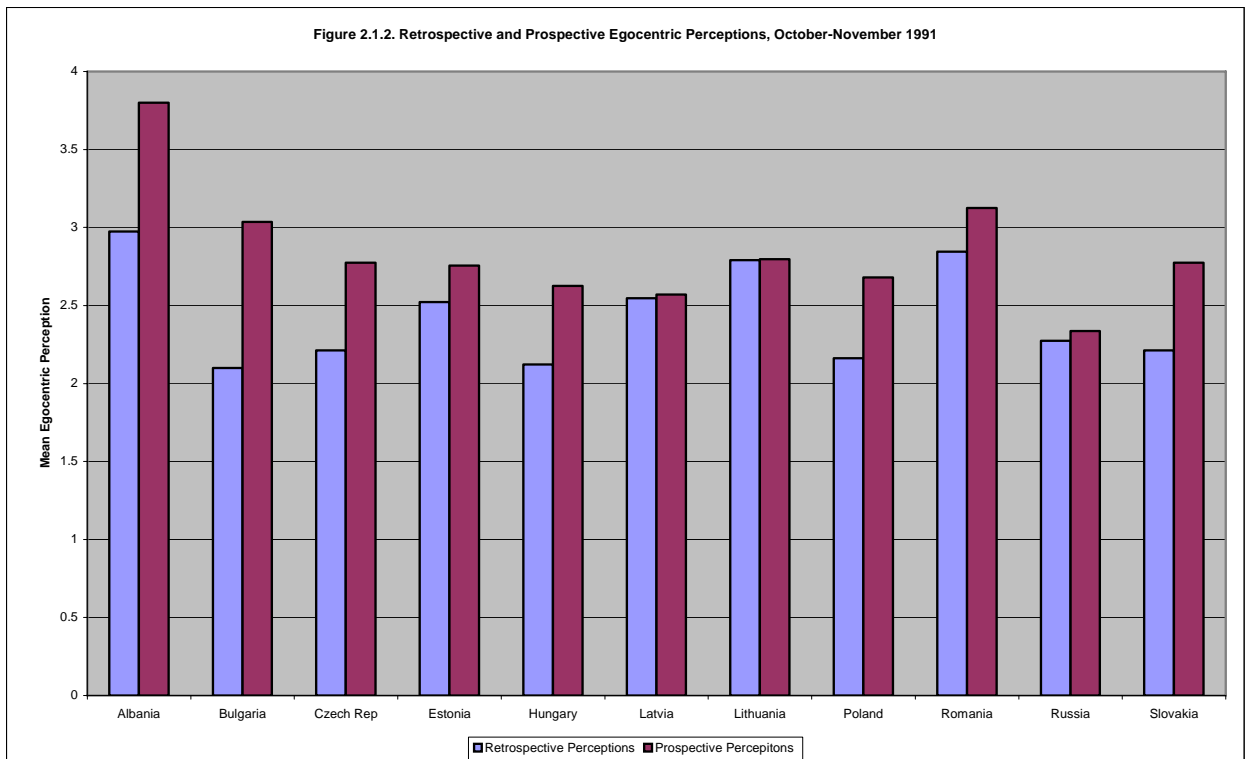
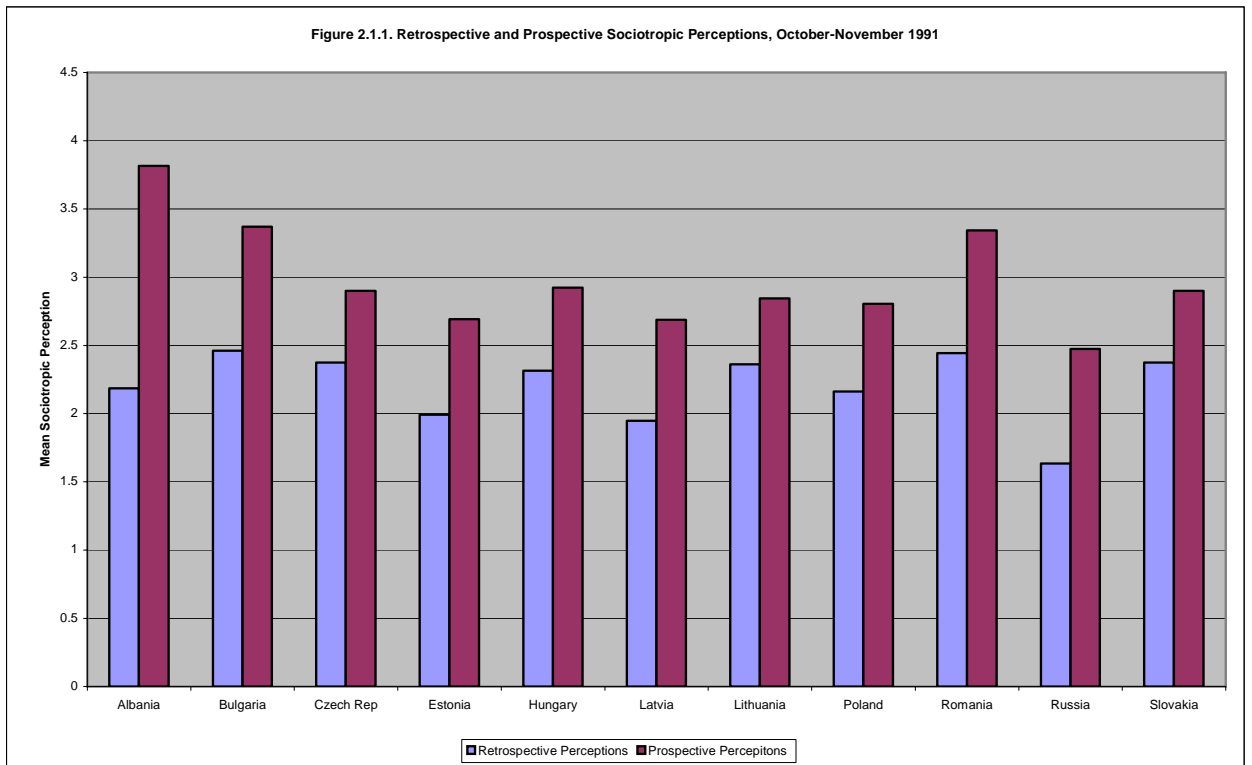
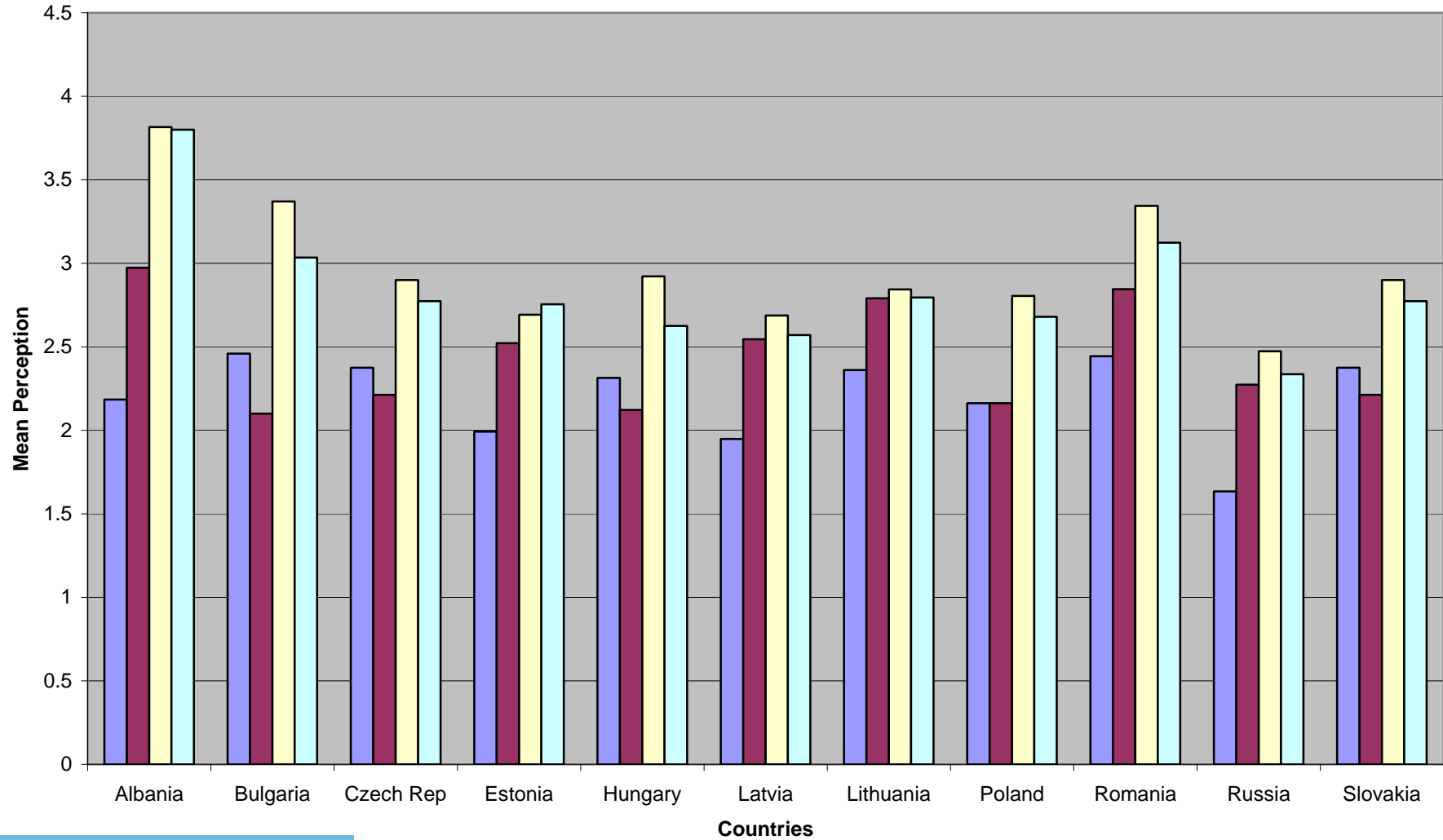




Figure 2.2. Aggregate Sociotropic and Egocentric Economic Perceptions in East Central Europe in 1991



■ Retrospective Sociotropic 
 ■ Retrospective Egocentric 
 ■ Prospective Sociotropic 
 ■ Prospective Egocentric

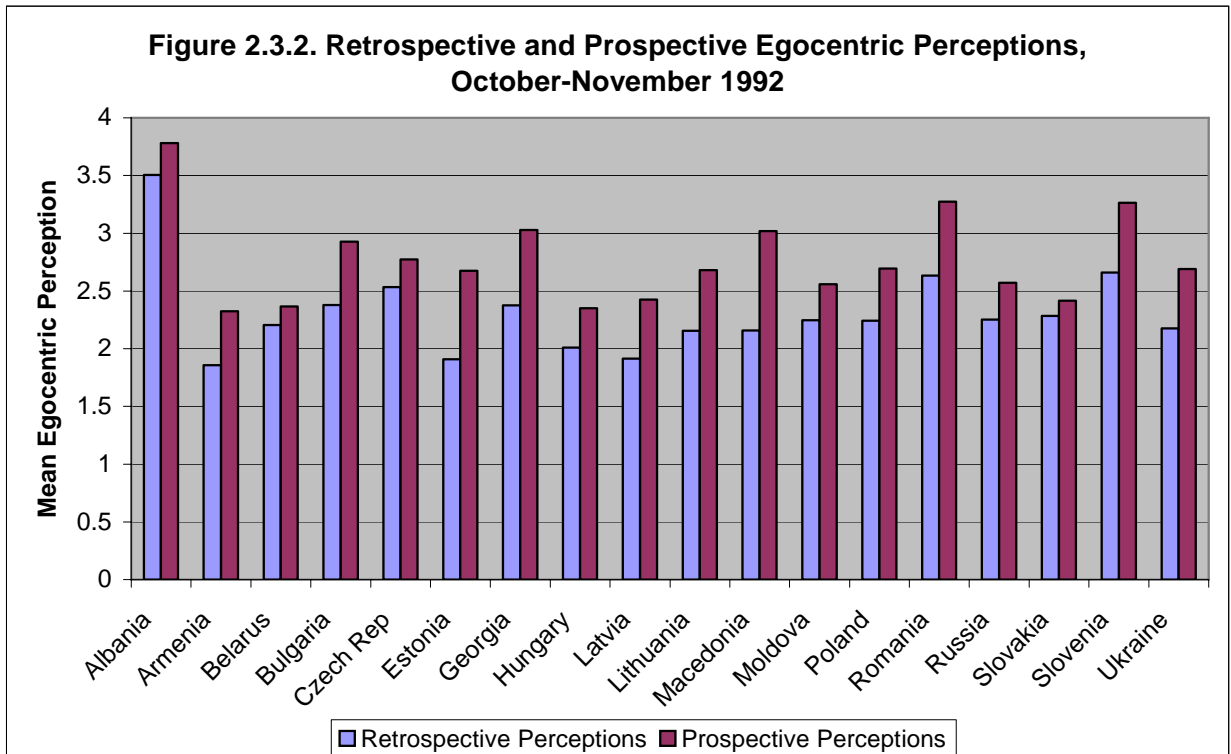
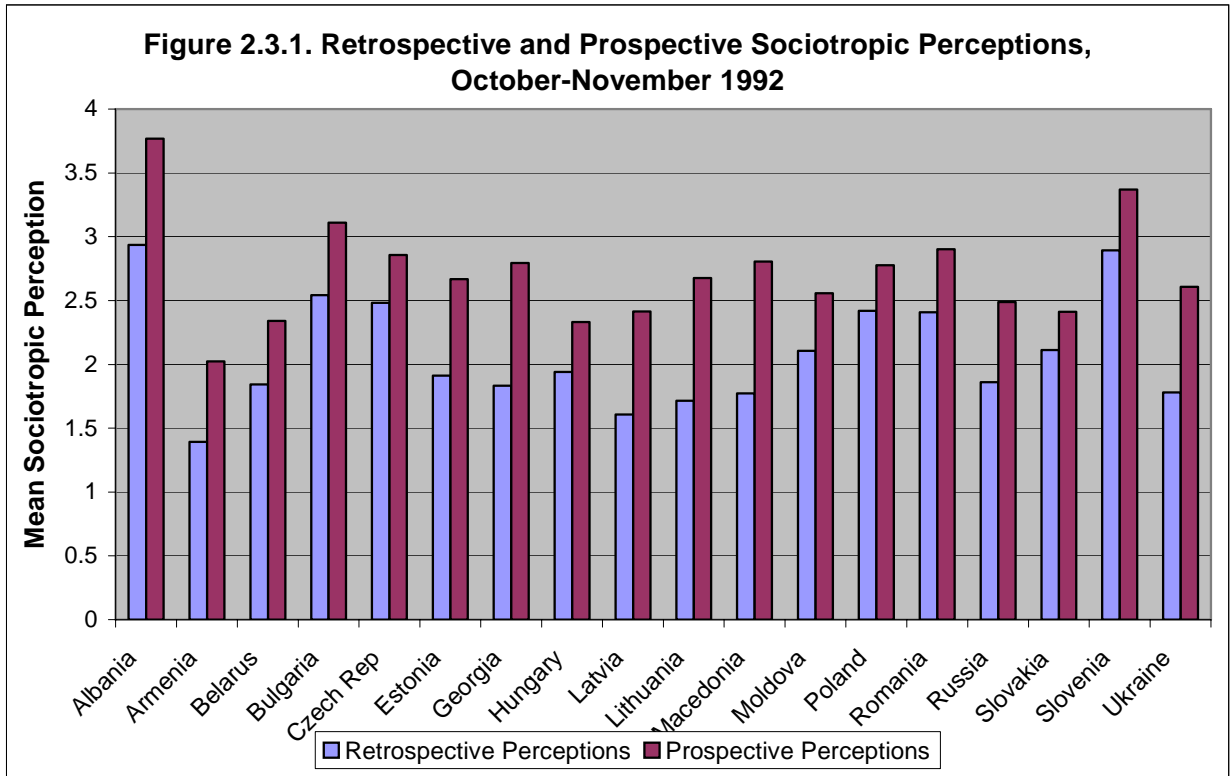
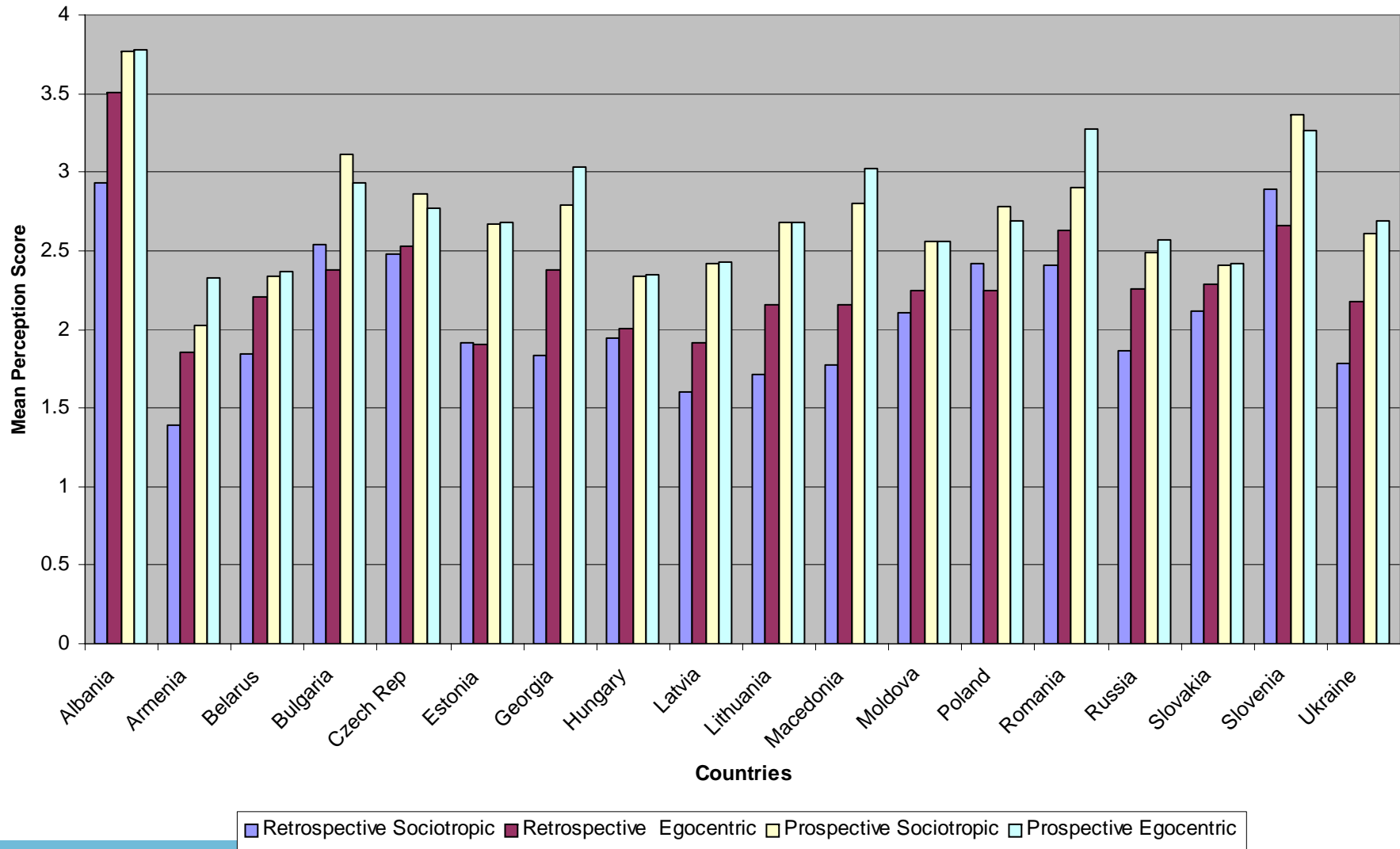


Figure 2.4. Aggregate Sociotropic and Egocentric Economic Perceptions in East Central Europe in 1992



## CHAPTER 3

### **The Puzzle of Economic Perceptions in Post-Communist Transition Countries**

One of the grounding postulates of democratic theory is the principle of accountability. The theoretical operation of the accountability mechanism is quite simple: elected officials bear responsibility for their performance and receive reward or punishment from their constituency accordingly in the form of re-election or denial of a future political mandate. In reference to economic accountability, the mechanism presumes government responsibility for the state of the national economy, also known as economic voting (Monroe 1984, Lewis-Beck 1988, Alvarez and Nagler 1998). As noted by Nannestad and Paldam (2000), the link between the state of the national economy, or “objective” economy, and the act of voting proceeds through several phases. First, objective economic information has to be perceived by potential voters. Ideally, voters’ economic opinion ought to reflect experts’ evaluations of the national economy or the “objective” economy. In this case, public economic opinion is considered to be accurate. Then public perceptions of the national economy must be connected to evaluations of government economic competence and, finally, lead to a decision to support or not support the government.

The focus of my dissertation is on the relationship between the “objective” economy and public economic perceptions, namely sociotropic economic evaluations. For a long time, this link had been simply assumed to exist, but later it was empirically established in mature democracies (Page and Shapiro 1992; Nannestad, Paldam, and Rosholm 2003). Thus, public economic perceptions in mature democracies bear a certain degree of accuracy, although not as considerable as was previously expected. It should be noted, however, that some scholars argue that the very notion of the “objective” economy to be perceived and evaluated by citizens is problematic (Keech 1995, Lohmann 1999). Keech believes that while there may be economic facts, their interpretation is frequently contested. Thus, when a consensus on what economic facts mean does not exist, accountability is difficult if not impossible to judge. Yet a vast majority of voting scholars acknowledge the existence of the “objective” economy measured by macroeconomic indicators and maintain that congruence between the “objective” and “subjective” economies endorses government accountability.

With regard to the post-communist nations of East Central Europe, the relationship between the state of the national economy and public economic perceptions remains completely uninvestigated. With the collapse of the command economy, the general economic state in all the countries in the region hit rock bottom, and most people found themselves in deep poverty. Thus, economic health must have become a top of the list concern for citizens and politicians alike (Ahl 1999). While the former fought for everyday economic survival, the latter fought for staying in office by making promises of a prosperous economic future. Yet a closer look at public economic perceptions alongside indicators of the macro economy during the early transition in the previous

chapters revealed a noticeable discrepancy between a poor national economic state and unusually high sociotropic evaluations (comparable to public economic assessments in developed democracies for the corresponding period of time), especially regarding the near-term economic future. A question, then, arises: Did the “objective” state of the national economy drive sociotropic economic perceptions in the emerging democracies of East Central Europe at the beginning of the post-communist transition? While the evidence assembled so far is suggestive, this chapter seeks to establish this potential link more conclusively.

### **Economic Voting in Central and Eastern Europe**

The study of economic voting, indisputably is the area of political science that employed the notion of economic perceptions more often than all other sub-fields combined. Recall that according to the democratic accountability mechanism, voters ought to form economic evaluations based on the actual performance of the macro-economy and punish or reward elected officials respectively. From past literature on voting in developed democracies, we know that the state of the national economy more often than not affects electoral outcomes. After the collapse of the Soviet socialist bloc, quite naturally, many students of voting behavior turned to the study of economic effects on the vote in East Central Europe. The whole region comprised of 27 emerging electoral democracies became an attractive new zone for the application of the old voting theories.

Recently, Tucker (2002) published an excellent survey of the existing literature on economic voting in the post-communist nations of Central and Eastern Europe. I will

rely on his review amended by some new work and articles published elsewhere in order to summarize the current findings on the topic in the region.

During over a decade of the existence of economic voting studies in the post-communist nations, the scope of the research in this area of the world has reached that of Western democracies. Along with aggregate-level studies using both objective economic indicators and economic perceptions (Pacek 1994, Fidrmuc 2000a, 2000b, Hesli and Bashkirova 2001, Tucker 1999a, 2001), the majority of analyses utilize individual-level data (e.g. Colton 1996, Harper 2000). The studies also range from single-country (Bell 1997, Gibson and Cielecka 1995, Colton 1996, Roper 2003, Duch and Palmer 2002) to multi-nation comparative analyses (Harper 2000, Tucker 2001).

One of the founding studies on economic voting in East Central Europe was a study by Pacek (1994) who used aggregate-level cross-national data along with an objective measure of the unemployment rate. In the best tradition of the reward-punishment mechanism, Pacek found support for retrospective economic voting in the newly established democracies. Somewhat later, Fidrmuc (2000a, 2000b) confirmed Pacek's results in two studies of regional data on the Czech Republic, Slovakia, Hungary, and Poland. Again, unemployment was used along with a measure of real wages. Yet, his were findings of prospective economic voting. Subjective economic forecasts also mattered in the single-country analysis of Russia conducted by Hesli and Bashkirova (2001). Consonant with Hesli and Beshkirova's results, Kim and Sidorenko-Stephenson (1999) found perceptions of the national future important for the intended vote for Yeltsin in 1996. Intriguingly, Cohen (2004) put forward a new hypothesis about the difference in the voting pattern in old versus new democracies. Specifically, he

maintained, and later found empirical evidence for his claim, that in developed democracies with established economies, people should employ prospective perceptions, whereas in emerging democratic systems, citizens would employ retrospective reasoning. The underlying logic for his argument is the degree of uncertainty present in both types of democratic systems. Because in newly established democracies uncertainty about the future is too high for people to make reliable prospective judgments, it is unreasonable for them to vote prospectively.

An advocate of micro-level analyses in the study of vote choice, Colton (1996) explored voting behavior of Russians at the micro-level and found evidence for the reward-punishment mechanism. Continuing on the investigation of the Russian voting function, Gerber (2000) looked at the 1996 presidential election and concluded that normative economic views (pro- or anti-market) rather than evaluations of how the economy worked influenced voters' decisions.

In contrast, Powers and Cox (1997) in their study of voting outcomes in Poland argued for the relative importance of political factors over economic ones. Economic effects, although present in the Polish voting function, turned to be less strong than expected. Likewise, Harper (2000) found very modest sociotropic and pocketbook economic effects in an individual-level investigation of Russian voters, yet substantial effects of satisfaction with how democracy worked and normative economic attitudes. In full agreement with these findings, Evans and Whitefield (1995) and Whitefield and Evans (1999) also emphasized the political element of voting in the post-communist democracies, as well as defined a mechanism of the effect of economic factors on the vote through attitudes toward the market (see also Mateju and Vláchová 1998). In



particular, Whitefield and Evans (1999) posited that pocketbook effects, which were found to be much less significant for a voting decision than sociotropic factors in the CEE nations (e.g. Hesli and Bashkirova 2001), acted indirectly through normative economic attitudes, such as feelings toward a market economy.

Overall, studies of voting behavior in new democracies of East Central Europe showed consistent evidence that the economy matters for voting behavior to a greater or lesser extent. Moving beyond this straightforward question, researchers started to ask the question of how the economy influences voting for various types of parties (Tucker 2002). All the post-communist nations are multi-party political systems with an expanded array of political parties, including reformist, left-wing, nationalist, opposition, government, post-communist, and extremist parties. In general, economic “winners” of the transition tend to vote for right-wing/reformist parties, while economic “losers” support left-wing or anti-reform parties. For instance, in a recent study of Poland, Bielasiak and Blunck (2002) presented their findings of the retrospective economic effects on the post-communist and post-Solidarity votes, which validated the idea that not only economic and social variables, but also pre-transition organizational affiliation influenced electoral behavior of voters during the transition. A most comprehensive study of economic voting in East Central Europe was performed by Tucker (2001). It covered a range of 14 parliamentary and presidential elections in Hungary, Russia, Poland, the Czech Republic, and Slovakia from 1990 to 1996. With consistency, the author found evidence for voting patterns that reflected support for particular types of parties, such as pro-reform, anti-reform, nationalist, etc., rather than the classical reward-punishment pro- or anti-incumbent voting. Elsewhere, Tucker (2004) developed a set of

arguments aimed at testing The Referendum and The Transition models. Under The Referendum Model, the author implied the traditional reward-punishment model, whereas The Transition Model is a modified partisan model in which the vote for ex-communist parties (Old-Regime parties) is driven by poor economic conditions and support for pro-reform (New-Regime parties) is determined by good economic conditions.

### **Economic Perceptions and System Support in East Central Europe**

In behavioral political studies, evaluations of the national economy also play an important role for determining different forms of political participation other than voting, as well as political attitudes and system support (Weatherford and Sergeyev 2000). Mishler and Rose, among the first, consistently explored issues of regime support in East Central Europe after the collapse of communism (1994a, 1994b, 1996, 1997, 2001, 2002). Every time, the authors found evidence confirming economic effects on system support and political trust. At the beginning of the transition and throughout the 1990s, public support for the new regime was higher than one would have expected given the poor conditions of the objective economies in the post-communist nations. Yet, econometric analyses consistently pointed to a link between perceived economy and political support. According to Mishler and Rose (1994), support for the legislature and regime support was affected by macro economic perceptions to a greater extent than by evaluations of personal financial conditions. In addition, the authors noted that political support was high even among the most economically dissatisfied groups (see also Rose 1992, Gibson 1996a). The major reason for elevated system support over the first several

years of the transition was formulated by Mishler and Rose (1996) as support for “what they [the new regimes] are not and what they do not do” (557), as opposed to the usual support for what regimes are and do (see also Przeworski 1991, Duch 1993, Rose 1997).

Duch (1993) conducted a study of support for a market economy in Russia in the early 1990s. In contrast to the traditional view, he argued, and later found support for his hypothesis, that negative assessments of recent economic performance were a catalyst for public support for market reforms. This idea is based on the fact that at the beginning of the post-communist transition people were likely to feel excitement about the new regime and blame the old one for all the economic misfortunes of the past, present, and near future (see also Stokes 2001). Almost a decade before the collapse of the socialist regime in East Central Europe, Hirschman (1981) concisely termed the phenomenon of high support under poor economic conditions “political economy of patience”. In their later work, Mishler and Rose focused on the importance of political performance and institutional arrangement as primary explanations for system support contrary to the economic voting thesis.

The main framework uniting all work on post-communist democracies and other emerging democracies is regime consolidation and survival (Reisinger et al. 1994, Weyland 1998a, 1998b, Seleny 1999, Bielasiak 1997, Comisso 1997, Duch 1998, Gibson 2001). Will democracy be sustained or will it slide back into authoritarianism? Sufficient regime support along with the presence of democratic values in newly established democracies were considered among the key factors necessary to build and maintain democracy (Letki 2004, Kurtz and Barnes 2002, Ishiyama and Velten 1998, Bunce 2001). Thus, besides components of system support, researchers pursued the

question of what constituted democracy in the post-communist states and what democratic values citizens possessed (Miller, Reisinger and Hesli 1996, 1997; Miller, Hesli and Reisinger 1994, Gibson 1996a, Wyman et al. 1998). In their study of the meaning of democracy, Miller, Reisinger and Hesli (1997) distinguished between elites' perceptions of democracy and what democracy meant for the masses. While in the opinion of the masses, democracy in the first place constituted freedom, the elites viewed democracy as the rule of law. Interestingly, according to a factor analysis, the loading of economic components into the meaning of democracy was insignificant, thus, the authors claimed that very few citizens thought about democracy in economic terms.

Evans and Whitefield (1995) found similar results in their cross-national study of the post-communist nations in the middle of the 1990s. They concluded that normative commitment to democracy was hardly driven by economic experiences. Yet they maintained that attitudes toward a market economy directly affected sentiments about democracy.

The relationships between economic evaluations on the one hand and ideology (Tworzecki 2003), party identification (Miller, Erb, Reisinger and Hesli 2000), voting turnout (Pacek 1994), and protest behavior (Bahry and Lipsmeyer 2001) on the other have received much less attention in the study of public opinion and political behavior in East Central Europe so far. In all of the analyses, the connection between economic judgments and various types of political participation and political affiliations was established in the expected direction. That is, more optimistic views of the economy produced attachments to reformist or incumbent parties and pro-market ideology.

## **The Relationship between the Objective and the Subjective Economy: Preliminary Evidence**

The above discussion of economic voting and political support in East Central Europe has revealed a significant role of national economic evaluations for election outcomes and regime popularity. However, all the previous studies using subjective measures of economic perceptions overlooked the issue of potential bias and inaccuracy of sociotropic evaluations. This is especially surprising after political scientists already saw the discrepancy between their earlier assumption of high congruence between the objective and the subjective economy in established democracies and the empirical evidence of a much weaker link. Moreover, all the tribulations through which the post-communist nations were going paired with high democratic support, particularly at the beginning of the transition, should have alerted scholars that newly democratic citizens may have had overly optimistic economic evaluations in comparison to the actual state of the national economy. Contrary to the assumption of congruence between the national economic state and public sociotropic evaluations, I expect to find no meaningful correlation between the two at the early phase of the transformation, because of high economic instability and uncertainty, low public knowledge and experience with the new economic system, and the general optimism among the public regarding the establishment of democracy in the post-communist countries.

I start by considering simple bivariate relationships between objective economic indicators, namely inflation, unemployment, and GDP growth, and public assessments of the economy to illustrate my point. Table 3.1 shows objective economic data for 18 new democracies in the region for 1991-1992 collected by the European Bank for Reconstruction and Development and aggregate retrospective and prospective

perceptions of the national economy for 1992 taken from the respective Central and Eastern Eurobarometer study. In addition, Table 3.1 provides numbers of the proportion of the population in those countries who thought that the national economic situation had gotten better or much better over the previous year.

Table 3.1 about here

A first look at the inflation, unemployment, and GDP growth rates in the 18 nations for 1991-1992 would probably make us think that there should be no one in those countries who would think that the national economic situation had improved. How can a triple-digit inflation rate be considered an improvement? However, as can be clearly seen from Table 3.1, a significant portion of the population in post-communist countries in 1992 thought that the national economy had gotten better in spite of the dreadful numbers for the inflation, unemployment and economic growth rates for that year. In one third of the countries over 20% of the citizens evaluated the national economy as improving. In another third of the countries more than 10% thought that the economy had performed better than 12 months before.

Looking ahead, post-communist citizens tended to be even more optimistic. In all 18 countries in the 1992 survey, future economic forecasts for the following year were much more favorable than evaluations of past performance. Thus, almost three quarters of Albanians felt positively about the economic future of their country. In Slovenia and Bulgaria, economic optimists constituted a majority, whereas over 80 percent of Armenians and Hungarians did not envision any improvement in their national economies for the year ahead. In the rest of the countries, the figure for those who believed in the economy getting better ranges approximately from 20 to 40 percent.

Figures 3.1.1 through 3.1.3 demonstrate a series of bivariate relationships between the levels of the inflation, unemployment, and growth rates and sociotropic retrospective economic perceptions by country. As the graphs suggest, the relationships between the dependent variable and any one of the objective economic indicators are heteroskedastic and not substantively significant, although they may appear to be. The results of bivariate OLS regressions point in the same direction. In fact, these results are in sync with those of Anderson and O'Connor (2000) in East Germany. They explained this lack of a relationship with a lack of familiarity about the new economic system and also with an overall euphoria about the transition (see also Tóka 1995). Anderson and O'Connor posited that people in new democracies had to “learn” before they would begin to form more accurate perceptions of the economy, i.e. congruent with objective economic indicators. Also, once the early stage of transition - the “honeymoon” - passed, people became more critical of the conditions in the country and started to hold the current government, not the past regime as during the “honeymoon” period, accountable for the state of the economy.

Figures 3.1.1 through 3.1.3 about here

The results of bivariate regression analyses between the objective economic indicators and sociotropic prospective perceptions aggregated by country paint a similar picture (Figures 3.2.1-3.2.3). The recent state of the economy did not seem to have much of an effect on citizens' economic forecasts in the new democracies of Central and Eastern Europe. It should not come as a surprise that economic expectations were even more detached from the real state of the economy than past economic evaluations. While the economic past is already determined, the economic future is uncertain and may be a

projection of people's high hopes for a quick recovery of the national economy. As argued by Stokes and others (e.g. Stokes 1996, 2001; Przeworski 1996), in new democracies, people may believe that things have to become worse before they get better; therefore, the drastic economic situation in East Central Europe may have been perceived by the citizens as a good sign. This can explain a slightly significant direct relationship between the rate of unemployment and national economic forecasts.

Figure 3.2 about here

Overall, the preliminary analysis of the relationship between sociotropic economic perceptions and objective economic indicators during the first years of the post-communist transition revealed no substantively significant link between the two regardless of statistical significance found in a few cases. However, these results cannot be considered final and a full-scale multivariate analysis is needed in order to draw more reliable conclusions. Later in this chapter, I intend to test more systematically whether there is a link between measures of the objective economic state and individuals' perceptions of the national economy.

## **Multivariate Analyses**

### *Data and Measures*

Individual level data for my analysis come from the Central and Eastern Eurobarometer Study No. 3 conducted in October-November of 1992. Unfortunately, the 1992 surveys were the last ones in the Central and Eastern Eurobarometer series that asked questions about sociotropic economic perceptions. Studies that followed only included questions about people's personal financial situation. However, the year of



1992 may be ideal as a starting point in modeling sociotropic economic perceptions in newly established democracies. We may expect that in 1992 memories of the old regime were still fresh, but also that, after a few years of democratic reforms, people had formed firm attitudes towards the new system. Thus, questions about sociotropic economic perceptions would most likely prompt people to make a comparison between the old and the new regimes. There are seventeen nations included in the surveys, for which I have complete data: Albania, Armenia, Belarus, Bulgaria, the Czech Republic, Slovakia, Georgia, Hungary, Latvia, Lithuania, Macedonia, Moldova, Poland, Romania, Russia, Slovenia, and the Ukraine.

#### *Dependent Variable*

Previous studies of economic voting have posed the question of whether voters are forward-looking or retrospective (MacKuen et al. 1992, Erikson et al. 2000, Suzuki and Cappell Jr. 1996, Suzuki 1991, Fiorina 1978). Although the rationality assumption prescribes voters to use prospective evaluations of the national economy, empirical analyses so far have shown more evidence supporting the reward-punishment hypothesis or retrospective voting across a wide range of countries (e.g. Fiorina 1981; Lewis-Beck 1988; see also Hesli and Bashkirova 2001).

From the point of view of democratic accountability, the reward-punishment mechanism is fairly straightforward. Citizens evaluate their government based on the past state of the national economy and reward or punish the government accordingly by voting for or against it in the next election, thus holding elected officials accountable for their past economic performance. Prospective economic evaluations may also be treated

as an accountability check if they contain an extrapolative component from the past; that is, if prospective perceptions are a function of retrospective economic perceptions adjusted for the future.

Past studies of economic voting in post-communist countries have produced mixed and at times contradictory results with the respect to the retrospective-prospective voting hypotheses.<sup>29</sup> Thus some new democratic governments in those countries achieved reelection under economic conditions that would have been fatal for any government in Western democracies.

Harper (2000) found only modest economic effects on party choice in Lithuania, Hungary, and Bulgaria. Fidrmuc (2000a, 2000b), on the other hand, argued that those who economically benefited from the reforms voted for the right-wing parties, whereas economic losers supported left-wing parties. He also found evidence for prospective economic voting (similar to Great Britain) in his analysis of the Czech Republic, Hungary, Poland, and Slovakia (Fidrmuc 2000b). In an earlier study, Mishler and Rose (1996) also found support for prospective economic voting in a similar sample of countries.) In this chapter, and throughout the dissertation, I examine both retrospective and prospective sociotropic perceptions as my dependent variables. The retrospective perceptions variable is based on the survey question where respondents are asked whether over the past twelve months the national economy in their countries has gotten much better, better, stayed the same, has gotten worse, or much worse. The original question has five categories, which I reversed to make them range from the most negative (1=the

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<sup>29</sup> Pacek (1994) found support for the reward-punishment hypothesis in an analysis of vote choice in Bulgaria, the Czech Republic, Slovakia, and Poland. Przeworski (1996), in a single-country analysis of Poland, found evidence against the simple reward-punishment mechanism and suggested that post-communist public (at least in Poland) was aware of the fact that things should become worse before they could become better (also see Stokes 1996).

economy has gotten much worse) to the most positive (5=the economy has gotten much better). Similar to the retrospective question, the survey question about national economic forecasts asks for an evaluation of the economic situation a year ahead from the date of the interview. Because the answer choices in the original prospective question were identical to those in the retrospective question, I also inverted the scale. For the summary statistics on these and all other variables refer to Appendix 3B at the end of this chapter.

### *Objective Economic Indicators*

For measures of the objective state of the national economy in countries of East Central Europe, I relied on the statistics collected by the European Bank for Reconstruction and Development. I chose three economic indicators that have been most-widely used in the past studies of economic voting – the annual inflation, unemployment, and GDP growth rates. Since the survey data for the analysis were collected at the end of 1992, I considered it most appropriate to employ the measures of the inflation and unemployment rates for 1992. Moreover, those measures seemed to be more relevant than the less recent ones, say for instance 1991, because the retrospective survey question asked the respondents to consider the change in the economy within the period of one year. Finally, utilizing earlier economic measures would lead to a significant case loss due to scarcity of economic data for the first years of the post-communist transition. It would be more desirable to obtain more refined measures of inflation, unemployment and growth to combine with the survey data, such as the rates of inflation and unemployment for a year back since the month of the interview for each

particular country in the data set. However, no consistent sources for monthly economic series in East Central Europe for that time period were found for all countries examined here.

In previous analyses, some scholars used changes in the rates of unemployment and inflation from one year to another (e.g. Anderson 1995). The underlying logic for using change measures is that people may react differently to the same level of unemployment and inflation in any given year depending on what the levels of unemployment and inflation had been in the previous year or even further back in history. For example, if the unemployment rate is running high in a certain year, but it is still a decrease compared to the recent history, people may perceive it as an improvement in the economic state. Theoretically, accounting for the recent economic history may be a better way to tap into public perceptions of the economy. However, there are at least two reasons why I would still prefer to use levels instead of change measures of the economy in this particular study. First, there are less economic data available for 1991 than for 1992; thus, I would need to exclude a number of countries from the analysis. Second, in 1992 citizens in the nations of Central and Eastern Europe may still associate current conditions with the communist era when both the inflation and unemployment rates were virtually zero. And although the survey question about people's past economic evaluations specifies a reference point of one-year back, people may still compare the whole transition period with the situation before the communist collapse. One of the reasons the base rate for comparison may still be the economic situation under communism is the ease with which people can retrieve this information from their memories. For decades people in the communist nations of East Central Europe had

known there was neither inflation nor unemployment in their countries before the situation radically changed with the abolishment of the command economy. Since then, the state of the economy had been changing so rapidly that recalling the unemployment rate 12 months back in time even for those following the economy may have presented a serious challenge.

Due to the potential complications associated with using change measures of the economy in the present study, I used level measures of the annual inflation, unemployment, and GDP growth rates for 1992. I used natural logarithms of the inflation indicator to level down the distribution of the extreme values. For detailed definitions and variable codes refer to Appendix 3A.

### **Effects of Objective Economic Indicators on Sociotropic Perceptions**

Given the ordered nature of my dependent variables, I performed an ordered logit analysis of my models of sociotropic retrospective and prospective perceptions.<sup>30</sup> The models consist of the individual-level explanatory variables described in detail in the next

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<sup>30</sup> The ordered logit model is a natural extension of the binary logit model. Ordered logit is an aggregate estimation technique when the outcome variable is a non-interval categorical variable with ordered categories. Because the spacing of the outcome variable cannot be assumed uniform, OLS becomes an inefficient, although still consistent, estimator of models with ordered dependent variables. The Ordered Logit Model is given by the following formula:

$$\log \left[ \frac{P(y \leq j | x)}{1 - P(y \leq j | x)} \right] = \mu_j - \sum_{k=1}^K \beta_k x_k, \quad j = 1, 2, \dots, J-1.$$

The above formula can also be expressed in probability terms:

$$\Pr(y \leq j) = \Pr(y^* \leq \mu_j) = \frac{e^{\mu_j - \sum_{k=1}^K \beta_k x_k}}{1 - e^{\mu_j - \sum_{k=1}^K \beta_k x_k}}$$

chapter and the three measures of the objective economic state, the rates of inflation, unemployment, and economic growth for 1992:

$$\text{Retrospective Perceptions} = f(\text{Objective Economy, Personal Economic Variables, Political Attitudes, Controls})$$

$$\text{Prospective Perceptions} = f(\text{Objective Economy, Retrospective Sociotropic, Prospective Personal Expectation, Personal Economic Variables, Political Attitudes, Controls})$$

### *Retrospective Evaluations*

The first column of Table 3.2 presents the results for the retrospective model. Contrary to the expectation of finding no significant effects of the objective economic indicators on the formation of public retrospective economic evaluations, the macro-variable estimates of the individual-level ordered logit analysis achieved the conventional levels of statistical significance, except for unemployment. Note also that, increases in the inflation rate are negatively associated with past economic assessments, although the relationship is statistically significant. This implies that post-communist citizens were relatively sensitive to changes in the inflation rate in 1992, which should not come as a big surprise, given the horrendous rates of price increases that year across all newly established democracies in the region. What remains unexpected, however, is that the magnitude of this negative effect on the retrospective perceptions is extremely small, as indicated by the calculated shifts in the probability of forming favorable assessments of the past economy. In fact, moving along the inflation rate scale from over 2,700 percent down to below 10 percent increases the probability of positive retrospective perceptions only by 4 percent. The explanation offered earlier in this chapter is a lack of economic knowledge and overall instability that precluded people from making a connection between the objective state of the national economy and their economic perception.

Figure 3.3.1 about here

Finally, the estimate of the GDP growth slope coefficient, despite my supposition of a zero effect, also reached statistical significance and indicates a direct relationship with retrospective economic perceptions. Substantively the effect of GDP growth appears to be stronger than the inflation effect. Specifically, the probability having positive retrospective perceptions goes up from 5 percent to 20 percent as a function of the increase in the GDP growth from -53 to 2.6 percent per annum.

Figure 3.3.3 about here

The findings call for an explanation that takes an account of the specificity of the economic situation in East Central Europe at that time. First, consumer prices during the early stage of the transition were going up beyond any comprehensible level, and this growth affected every citizen in the post-communist countries. Not everybody, however, suffered job loss; although the risk of becoming unemployed dramatically increased for almost all occupational groups on the labor market. Furthermore, individuals who had been laid off from their jobs did not necessarily find themselves in a worse situation than those who remained employed. For one, many of the newly unemployed became self-employed and earned some income, but did not register officially as private entrepreneurs. Secondly, most of the public employees, who constituted the majority of the labor force in post-communist countries, experienced severe wage payment delays and were not better off financially than the unemployed. Thus, it should not come as a surprise that the inflation rate had more of a negative effect on public perceptions of the national economy than the level of unemployment.

The positive effect of economic growth on public economic evaluations falls into the traditional reward-punishment framework. In fact, the question on which the dependent variable is based is phrased in such a way that it does not point to any specific segment of economic performance, but rather the state of the economy in general. GDP growth, in turn, is considered to be the most general economic indicator. Thus, its superior statistical performance compared to the other two objective indicators in the equation (inflation and unemployment) is as expected. It is also an important economic indicator for the population, because GDP growth directly influences quite tangible benefits received by people, such as wages and social payments.

#### *Prospective Evaluations*

The results for the simple prospective model are presented in the last column of Table 3.2. All three economic indicators achieved statistical significance and are positively associated with national perceptions of the economy. This means that not only higher economic growth, but also higher levels of inflation and unemployment led people to form more favorable expectations about the economic future. Although not directly intuitive, finding positive evaluations to be associated with a poor state of the national economy is not new in the sub-field of transition democracies. In the past, scholars showed empirical evidence of incumbent government support in East Central Europe and Latin America while deteriorating economic conditions persevered in those countries (e.g. Anderson and Tverdova 2001; Echegaray and Elordi 2001). The general idea behind positive performance evaluations in new democracies despite a poor economy is that transitions do not happen overnight, and things may get worse before they get better,



this has been termed in the literature *intertemporal* support (Stokes 1996). Thus, with respect to unemployment, which stayed within reasonable limits, East Central European citizens at the early state of post-communist transformation may have developed positive economic evaluations, because a growth in unemployment was expected and was perceived as a sign of moving in the right direction. In contrast, inflation did not produce the same positive effect on public economic opinion because of its deplorable size. Moreover, due to the overall euphoric mood about the collapse of the totalitarian system, the drastic economic conditions in East Central Europe did not distort people's high hopes for the national economic future.

Despite the fact that the macro-variable coefficients in the prospective model reached statistical significance, the actual magnitude of the effect of the "true" economy on public sociotropic forecasts was small. Figures 3.3.1 through 3.3.3 illustrate the shifts in the probability of forming favorable perceptions of the national economy as a function of the inflation, unemployment and growth rates. With the annual inflation rate moving from 10 to 2,700 percent across countries, the probability of assessing the future economy positively also goes up from 25 to 35 percent. The increase in the probability of having positive prospective perceptions with respect to unemployment appears more meaningful; going from the minimum (0.1%) to the maximum (30%) rate of unemployment across the countries in the sample raises the probability of favorable economic evaluations by almost 17 percent.

Figure 3.3.2 about here

GDP growth in the prospective model had a more modest effect than in the retrospective model, and did not seem to produce very powerful effects on the formation

of economic forecasts at the early stage of the post-communist transformation either. Thus, when going from -53 to 2.6 percent on the growth rate scale (the full variation range across the countries in the sample), the likelihood of evaluating the future economy positively increases from 27 percent to 34 percent. Unlike the case of inflation and unemployment, however, the relationship between the growth rate and evaluations of the national economy followed the traditional reward-punishment mechanism.

### **Hierarchical Analysis of the Models**

Methodologically, I have to overcome another potential problem imbedded in the very nature of the data that I am using. My dependent variables and the independent variables measuring the objective economic situation are, in fact, different units of analysis. The unit of analysis of the sociotropic economic perceptions (the dependent variables) is an individual, whereas the unit of analysis of the objective economic indicators is a country. A common way of controlling for country-specific effects in survey analysis is to introduce a series of dummy variables for each specific nation, but one. While country dummies take care of a potential estimation bias due to omitted relevant effects measured at the level of a nation, they contribute little substantive information to the model. Once other country-level variables are introduced into an individual-level analysis, it is no longer possible to keep nation dummy variables in the same model due to perfect collinearity. Yet, it is desirable to control for country-level effects not captured by the substantive variables or at least be able to make a judgment about a potential threat of obtaining biased estimates due to omitted relevant country-level variables.

Another problem with using multilevel data is that traditional estimation methods, such as OLS, logit and probit, do not produce the most efficient standard errors. In fact, they underestimate standard errors, which may lead to a higher risk of Type I error (rejecting the null hypothesis when there is no systematic relationship between the variables).

Steenbergen and Jones (2002), drawing on education research, presented political scientists with one plausible solution of estimating models that incorporate multilevel data. A multilevel model is estimated by a maximum likelihood estimator using an iterative generalized least squares (IGLS) algorithm (for a detailed discussion on IGLS see Goldstein 1986, Longford 1987, and Goldstein 1995), which provides for "correct" estimation of standard errors and conveniently furnishes the researcher with the estimates of variance both at the individual and country level.<sup>31</sup>

I estimated my models using MLwiN 1.1 (Rasbash et al. 2000) statistical software specifically developed for analyzing hierarchical data. The first model in Tables 3.3.1 and 3.3.2 is an ANOVA model that estimates two types of variances: variation in the dependent variable produced by differences among the countries in the analysis and

<sup>31</sup> A two-level linear multilevel sub-model used in my dissertation can be given by the following notation:

$$y_{ij} = \beta_0 + \sum_{q=1}^Q \beta_{0q} z_{qj} + \sum_{p=1}^P \beta_{p0} x_{prij} + u_{0j} + e_{ij} ,$$

where  $\beta_0$  is the intercept or constant,

$\sum_{q=1}^Q \beta_{0q} z_{qj}$  is a set of Q level-2 predictors  $z_{qj}$  ( $q = 1, \dots, Q$ ),

$\sum_{p=1}^P \beta_{p0} x_{prij}$  is a set of P level-1 predictors  $x_{prij}$  ( $p = 1, \dots, P$ ),

$u_{0j}$  is the residual level-2 variation in the level-1 intercept, and  $e_{ij}$  is the disturbance capturing omitted level-1 predictors.

variation attributed to differences among the individuals.<sup>32</sup> The sum of these two variances produces the total variance in sociotropic economic perceptions. Thus, the total variance in the retrospective case is 1.37, of which 14.7 percent comes from country-level variation and 85.3 percent is the result of individual differences. With regard to the prospective model, these figures are 12.8 and 87.2 percent respectively with the total variance of 1.48.<sup>33</sup>

Tables 3.3.1 and 3.3.2 about here

The variance estimates for the full multivariate model with country dummy variables (column two) indicate that the country dummies, as must be the case, completely account for all the country-level variation that exists in the data, whereas the individual-level variables explain 25.9 and 38.6 percent of the individual-level variance, in the retrospective and prospective cases respectively.

The last columns in Tables 3.3.1 and 3.3.2 show the results from the models, in which substantively meaningful macro-level variables (inflation, unemployment, and GDP growth) were used instead of the country dummies. The results produced by the hierarchical estimator to a large extent differ from the ordered logit estimates. Unlike in the logit model, the coefficients of the inflation rate did not achieve statistical significance at any conventional level of statistical significance in the retrospective case.

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<sup>32</sup> ANOVA stands for Analysis of Variance. The random effects ANOVA decomposes the variance in the dependent variable across all levels of analysis; in my case there are two levels – the individual level (level 1), and the country level (level 2). The random effects ANOVA model is given by the following formula:

$$y_{ij} = \beta_0 + u_{0j} + e_{ij},$$

where  $\beta_0$  is the overall intercept for the dependent variable,  
 $u_{0j}$  is the total variance attributable to differences at the country level,  
 $e_{ij}$  is the total variance attributable to differences among individuals.

<sup>33</sup> The total variance is calculated as a sum of variance estimates at different levels. Total variance =  $u_{0j} + e_{ij}$

Prospectively, the effects of the objective economic indicators all remained positive, but less statistically significant. In fact, the coefficient of the growth rate variable was not at all significant. Despite lower statistical significance of the macro-level variables, their presence in the models reduced the total unexplained country-level variance by 83.7 percent in the retrospective case and 95.8 percent in the prospective one.<sup>34</sup> In other words, the country-level variance that remains unexplained after including the three objective economic indicators drops to 16.3 percent in the retrospective case and 4.2 percent in the prospective case. Therefore, one should look at the individual level to explain the remaining variation in the dependent variable.<sup>35</sup>

## Discussion and Conclusions

This chapter had one major objective in mind. I proposed to explore the congruence between the state of the national economy, as measured by rates of inflation, unemployment, and GDP growth and sociotropic economic perceptions at the beginning of the post-communist transition in East Central Europe. In particular, I hypothesized to

<sup>34</sup> Since the total unexplained variance attributed to differences across the nations is relatively small (14.7% in the retrospective case and 12.8% in the prospective case), and it is substantially reduced as a result of the inclusion of the three country-level economic indicators, I believe the potential bias coming from omitting relevant nation-specific independent variables is low.

<sup>35</sup> The total variance in the retrospective model:  $0.202 + 1.168 = 1.37$  Percent of the total variance in the retrospective model coming from country-level differences:  $(0.202/1.37) * 100\% = 14.7\%$  Percent of the total variance in the retrospective model coming from differences among individuals:  $100\% - 14.7\% = 85.3\%$  Country-level variance in the retrospective model left unexplained after the inclusion of the country-specific predictors:  $(0.033/0.202) * 100\% = 16.3\%$  Individual-level variance in the retrospective model left unexplained after the inclusion of the individual-level predictors:  $(0.865/1.168) * 100\% = 74.1\%$  The total variance in the prospective model:  $0.19 + 1.29 = 1.48$  Percent of the total variance in the prospective model coming from country-level differences:  $(0.19 / 1.48) * 100\% = 12.8\%$  Percent of the total variance in the prospective model coming from differences among individuals:  $100\% - 12.8\% = 87.2\%$  Country-level variance in the prospective model left unexplained after the inclusion of the country-specific predictors:  $(0.008/0.19) * 100\% = 4.2\%$  Individual-level variance in the prospective model left unexplained after the inclusion of the individual-level predictors:  $(0.792 / 1.29) * 100\% = 61.4\%$

find insignificant substantive effects of the objective conditions on people's evaluations of the past economy, as well as economic expectations. This argument was based on two assumptions. At the early phase of the transformation process, post-communist citizens may have lacked knowledge about the mechanisms of the new economic systems put in place of the old command economies. This lack of knowledge may have resulted in a general misconception of the national economic situation and an inability to form accurate evaluative judgments about it. Furthermore, the overall instability and uncertainty in East Central European nations should have made it even harder for people to be accurate in their assessments of the economy. With regard to retrospective evaluations, the main challenge may have been remembering the economic situation a year back from the date of the interview due to rapid changes in the economy. Prospectively, the challenge was to predict the future economy for the year ahead in a situation of high instability.

The overall findings support the proposition that people's retrospective and prospective views of the national economy at the beginning of the post-communist transition significantly diverged from indicators of the actual economic situation. Among the three objective economic indicators, none had a really significant substantive effect on the formation of public perceptions of the national economy, despite statistically significant estimates obtained with the ordered logit estimator. Although it may appear that a positive shift of 15 percent in the probability of forming positive retrospective economic evaluations as a function of growing GDP is substantively meaningful, this shift occurs along the whole range of the GDP growth in 1992 (from -53 to 2.6 percent – the range of over 55 percent). If one considers a difference in GDP growth of, for

instance, 5 percent (a large difference in economic growth under the standard of established democracies), a positive shift in the probability, then, only becomes 2.5 percent.

The direction of the coefficients of the inflation and unemployment variables in the prospective case requires an explanation. Recall that both the inflation and the unemployment rates were positive and statistically significant with relation sociotropic economic expectations. The positive relationship between higher unemployment and inflation rates and optimistic economic prognoses, may be due to the “honeymoon” phase of the transition characterized by general euphoria and an upbeat mood about the changes that were taking place (Bernhard, Reenock, and Nordstrom 2003). Although the economy was doing horribly, people may have still perceived it as a good sign, because things were supposed to get worse before they would get better. Such a phenomenon, labeled “intertemporal” support, was described by Stokes (1996) with regard to countries in transition across East Central Europe and Latin America. Yet, Stokes and her collaborators also found evidence for the traditional reward-punishment mechanism operating in transitioning nations in their studies of popular voting and regime support. Therefore, they drew the conclusion that various types of support may have coexisted in transitioning countries. Consistent with this proposition, I found evidence for the intertemporal pattern of support in relation to inflation and unemployment in the prospective case and the reward-punishment pattern with regard to economic growth measured as the annual change in GDP and inflation in the retrospective case. Furthermore, the coefficient for output growth turned out to be positive and statistically significant in both retrospective and prospective models. The negative effect of inflation

was not surprising given the dreadful economic conditions in which people found themselves due to skyrocketing price increases during 1992.

However, all of the significant relationships between the objective indicators and economic perceptions may have been an artifact of the estimation method (ordered logit). According to the results obtained with the multilevel model estimator, some of the macro-level variables both in the retrospective and prospective models became insignificant. Specifically, the negative inflation coefficient in the retrospective case dropped to zero, as did the growth coefficient in the prospective case. Also, the degree of statistical significance is less strong in the multilevel models than in the logit models. Given that statistical significance of the findings is sensitive to the estimation method, and their minor substantive effects, I am convinced that there was only very limited congruence between the true state of the economy and public economic opinion at the beginning of the post-communist transition.

The results of this study provide a new outlook on the early stage of the transition to democracy in the countries of East Central Europe. One of the most important characteristics of a democratic regime is the government's accountability to its citizens; in other words, governments are to be held responsible for their performance. Economic performance of democratic governments has been a focus of numerous studies due to its essential role for predicting voting behavior and regime support. Many previous studies of economic voting in post-communist societies revealed a solid connection between people's economic perceptions of the national economy and vote choice. In this study, I took one step back and explored whether public economic perceptions were, in fact, driven by government's economic performance, thereby suggesting an orderly operation



of the accountability mechanism. As my analysis reveals, there was, at best, a weak link between the actual economy and national economic perceptions among citizens in new democracies of East Central Europe in 1992. Thus, economic voting at the beginning of the democratic transition in post-communist nations was not a reflection of the country's economic performance, but was most likely driven by people's individual characteristics, personal financial situation and political attitudes, as the subsequent chapters of this dissertation will show. Although such a distortion of the democratic accountability mechanism may be expected in the early stage of a democratic transition, it may pose a threat to further consolidation of democracy, if incongruence between the subjective and the objective economies perseveres. However, it is possible that, even if economic perceptions had been accurate, people would not have held governments accountable, as predicted by the pattern of intertemporal support. Despite a terrible state of the national economy, citizens in East Central Europe were ready to put up with governments of the reformists for a while believing that things should go bad before they turn for the better.

In the next chapter, I will make the first step toward solving the puzzle of weak correspondence between economic reality and public economic perceptions. Particularly, I will consider public heterogeneity of political and economic awareness as a source of economic accuracy.

### Appendix 3A. Variables Measures and Coding.

1. *Inflation Rate.* Inflation as defined by the CPI reflects the annual percentage change in the cost of the average consumer of acquiring a fixed basket of goods and services that may be fixed or changed at specified intervals, such as yearly. The Laspeyres formula is used.
2. *Unemployment Rate.* The share of the labor force that is without work but available for and seeking employment, measured in percent of total labor force.
3. *Growth Rate.* Annual change of the GDP from the previous year.
4. *Sociotropic Retrospective Perceptions.* A five-category variable ranging from 1 (the general economic situation in the (RESPONDENT'S) country has become much worse, compared to 12 months ago) to 5 (the general economic situation has become much better).
5. *Sociotropic Prospective Perceptions.* A five-category variable ranging from 1 (the general economic situation in the (RESPONDENT'S) country in the next 12 months will become much worse) to 5 (the general economic situation will become much better).
6. *Egocentric Retrospective Evaluations.* A five-category variable, which ranges from 1 (personal financial situation has got much worse over the past year) to 5 (personal financial situation has got much better over the past year).
7. *Egocentric Prospective Evaluations.* A five-category variable, which ranges from 1 (personal financial situation is expected to become much worse in the next 12 months) to 5 (personal financial situation is expected to become much better in the next 12 months).
8. *Income.* For the convenience of comparing individual incomes from 16 different countries of Central and Eastern Europe, the income variable has been standardized into 20 categories, where 1 is the lowest income bracket and 20 is the highest income bracket.
9. *Unemployment Status.* Coded 1 for those who reported themselves as being unemployed.
10. *System Support.* A three-category variable scored 1 if the respondent likes the past political system better than the new one, 2 if he likes neither of the systems, and 3 if he decides that the new system is better.
11. *Democracy Satisfaction.* Varies from 1, meaning complete dissatisfaction with how democracy is working in the respondent's country, to 4, which corresponds to the respondent's complete satisfaction with democracy.
12. *Opinion about the market economy.* Coded as a dummy variable, where 1 indicates positive feelings for a market economy, and 0 means that the respondent thinks that market is a bad thing in general.
13. *Feelings towards the speed of economic reforms.* Coded such that 0 corresponds to the respondents' answers that there are no reforms in their countries, 1 indicates that the speed of the reforms is either too slow or too fast, and 2 is the right speed. People who have received a score of 2 on this question are expected to be the ones who develop the most favorable attitudes toward the national economic situation.

14. *Gender* is coded 1 for female and 0 for male.
15. *Education*. The education variable has four categories, where 1=up to elementary, 2=secondary, but not completed, 3=completed secondary, and 4=higher education.
16. *Political Discussion*. A 3-category variable coded 1 for individuals who never discuss politics with their friends, 2 if they discuss politics occasionally, and 3 if political matters are discussed on a regular basis.
17. *Age* indicates the actual age of the respondent

### Appendix 3B. Descriptive Statistics.

| Variable                                       | N     | Mean   | Std.Dev. | Min    | Max  |
|--|-------|--------|----------|--------|------|
| <b>Retrospective Model</b>                     |       |        |          |        |      |
| <b>MACRO-Level</b>                             |       |        |          |        |      |
| Annual inflation rate (logged)                 | 11118 | 5.77   | 1.86     | 2.21   | 7.91 |
| Annual unemployment rate                       | 11118 | 8.08   | 7.94     | 0.10   | 27   |
| Annual GDP growth rate                         | 11118 | -17.20 | 15.33    | -52.60 | 2.60 |
| <b>MACRO-Level</b>                             |       |        |          |        |      |
| Sociotropic retrospective economic evaluations | 11118 | 2.16   | 1.17     | 1      | 5    |
| Egocentric retrospective economic evaluations  | 11118 | 2.41   | 1.16     | 1      | 5    |
| Income   | 11118 | 6.41   | 4.64     | 1      | 20   |
| Unemployment status                            | 11118 | 0.07   | 0.26     | 0      | 1    |
| Satisfaction with democracy                    | 11118 | 2.15   | 0.82     | 1      | 4    |
| Attitudes toward the system                    | 11118 | 2.00   | 0.93     | 1      | 3    |
| Attitudes toward the speed of the reforms      | 11118 | 1.05   | 0.53     | 0      | 2    |
| Attitudes toward market economy                | 11118 | 0.60   | 0.49     | 0      | 1    |
| Political Discussion                           | 11118 | 2.27   | 0.67     | 1      | 3    |
| Education                                      | 11118 | 2.65   | 0.97     | 1      | 4    |
| Gender   | 11118 | 0.49   | 0.50     | 0      | 1    |
| Age  | 11118 | 41.15  | 15.81    | 14     | 98   |
| <b>Prospective Model</b>                       |       |        |          |        |      |
| <b>MACRO-Level</b>                             |       |        |          |        |      |
| Annual inflation rate (logged)                 | 9767  | 5.71   | 1.88     | 2.21   | 7.91 |
| Annual unemployment rate                       | 9767  | 8.32   | 8.06     | 0.10   | 27   |
| Annual GDP growth rate                         | 9767  | -16.82 | 15.18    | -52.60 | 2.60 |
| <b>MACRO-Level</b>                             |       |        |          |        |      |
| Sociotropic retrospective economic evaluations | 9767  | 2.19   | 1.17     | 1      | 5    |
| Sociotropic prospective economic evaluations   | 9767  | 2.82   | 1.22     | 1      | 5    |
| Egocentric retrospective economic evaluations  | 9767  | 2.43   | 1.17     | 1      | 5    |
| Egocentric prospective economic evaluations    | 9767  | 2.88   | 1.17     | 1      | 5    |
| Income   | 9767  | 6.57   | 4.69     | 1      | 20   |
| Unemployment status                            | 9767  | 0.07   | 0.26     | 0      | 1    |
| Satisfaction with democracy                    | 9767  | 2.17   | 0.82     | 1      | 4    |
| Attitudes toward the system                    | 9767  | 2.02   | 0.93     | 1      | 3    |
| Attitudes toward the speed of the reforms      | 9767  | 1.07   | 0.53     | 0      | 2    |
| Attitudes toward market economy                | 9767  | 0.61   | 0.49     | 0      | 1    |
| Political Discussion                           | 9767  | 2.29   | 0.66     | 1      | 3    |
| Education                                      | 9767  | 2.65   | 0.98     | 1      | 4    |
| Gender   | 9767  | 0.49   | 0.50     | 0      | 1    |
| Age  | 9767  | 41.05  | 15.76    | 14     | 98   |

**Table 3.1. Mean Level of Sociotropic Perceptions and National Economic Indicators by Country**

| Country    | Mean Score of Retrospective Economic Perceptions |          | Mean Score of Prospective Economic Perceptions |          | Inflation |        | Unemployment |      | Growth |       |
|------------|--|----------|--|----------|-----------|--------|--------------|------|--------|-------|
|            |  | % Better |  | % Better | 1991      | 1992   | 1991         | 1992 | 1991   | 1992  |
| Albania    | 2.94   | 46.53    | 3.77   | 74.72    | 104.0     | 236.6  | 9.5          | 27.0 | -27.7  | -7.2  |
| Armenia    | 1.39   | 3.71     | 2.02   | 16.81    | 25.0      | 1341.0 |              | 3.5  | -10.8  | -52.6 |
| Belorussia | 1.84   | 9.42     | 2.34   | 20.24    | 93.0      | 1159.0 | 0.0          | 0.5  | -1.2   | -9.6  |
| Bulgaria   | 2.54   | 30.55    | 3.11   | 50.61    | 339.0     | 79.4   | 10.5         | 13.2 | -11.7  | -7.3  |
| Czech      | 2.48   | 23.81    | 2.86   | 37.66    | 52.0      | 12.7   | 4.1          | 2.6  | -14.2  | -3.3  |
| Slovakia   | 2.11   | 13.50    | 2.41   | 24.06    | 58.0      | 9.1    | 11.8         | 11.4 | -14.6  | -6.5  |
| Estonia    | 1.91   | 13.80    | 2.67   | 29.84    | 304.0     | 953.5  |              |      | -7.9   | -14.2 |
| Georgia    | 1.83   | 12.40    | 2.79   | 42.46    | 131.0     | 1177.0 |              | 0.9  | -13.8  | -44.8 |
| Hungary    | 1.94   | 9.21     | 2.33   | 18.43    | 32.0      | 21.6   | 7.8          | 13.2 | -11.9  | -3.1  |
| Latvia     | 1.61   | 7.25     | 2.41   | 25.03    | 262.0     | 959.0  |              | 2.3  | -8.3   | -34.9 |
| Lithuania  | 1.71   | 4.06     | 2.68   | 28.92    | 345.0     | 1161.1 | 0.3          | 1.3  | -13.4  | -37.7 |
| Macedonia  | 1.77   | 7.72     | 2.81   | 39.82    | 230.0     | 1925.2 | 19.2         | 19.8 | -12.1  | -21.1 |
| Moldova    | 2.11   | 14.83    | 2.56   | 22.15    | 151.0     | 2198.0 |              | 0.1  | -17.5  | -29.1 |
| Poland     | 2.42   | 20.68    | 2.78   | 28.52    | 60.0      | 44.3   | 12.2         | 14.3 | -7.0   | 2.6   |
| Romania    | 2.41   | 26.39    | 2.90   | 39.56    | 223.0     | 199.2  |              | 8.2  | -12.9  | -8.7  |
| Russia     | 1.86   | 13.95    | 2.49   | 28.06    | 144.0     | 2508.8 | 0.0          | 4.8  | -13.0  | -14.5 |
| Slovenia   | 2.89   | 35.75    | 3.37   | 55.66    | 247.0     | 92.9   | 8.2          | 11.6 | -8.1   | -5.5  |
| Ukraine    | 1.78   | 10.61    | 2.61   | 29.72    | 161.1     | 2730.0 | 0.0          | 0.3  | -9.0   | -13.7 |

**Table 3.2. Determinants of Sociotropic RETROSPECTIVE and PROSPECTIVE Economic Perceptions**  
(Standard errors in parentheses)

| Independent Variable                                 | RETROSPECTIVE<br>Ordered Logit | PROSPECTIVE<br>Ordered Logit |
|--|--------------------------------|------------------------------|
| Inflation Rate (logged)                              | -.044**<br>(.015)              | .085***<br>(.016)            |
| Unemployment Rate                                    | .0007<br>(.003)                | .025***<br>(.003)            |
| Growth Rate  | .028***<br>(.002)              | .006**<br>(.002)             |
| Sociotropic <i>retrospective</i> evaluations         |                                | .485***<br>(.021)            |
| Egocentric <i>retrospective</i> economic evaluations | .771***<br>(.019)              | .098***<br>(.022)            |
| Egocentric <i>prospective</i> economic evaluations   |                                | .954***<br>(.023)            |
| Income   | -.008<br>(.005)                | -.017**<br>(.005)            |
| Unemployment Status                                  | .076<br>(.073)                 | -.030<br>(.079)              |
| Satisfaction with democracy                          | .480***<br>(.026)              | .361***<br>(.028)            |
| Attitudes toward political system                    | .167***<br>(.023)              | .116***<br>(.024)            |
| Attitudes toward the Market                          | .217***<br>(.042)              | .214***<br>(.044)            |
| Attitudes toward the speed of the reforms            | .452***<br>(.039)              | .275***<br>(.041)            |
| Education  | -.006<br>(.020)                | .018<br>(.022)               |
| Political Discussion                                 | -.130***<br>(.029)             | -.008<br>(.030)              |
| Age  | -.003*<br>(.001)               | .005***<br>(.001)            |
| Gender   | .071<br>(.037)                 | .176***<br>(.029)            |
| N  | 11118                          | 9767                         |
| -2Log Likelihood                                     | 25747.01                       | 22939.73                     |
| Pseudo R <sup>2</sup>                                | .16                            | .21                          |

\* p < 0.05 \*\* p < 0.01 \*\*\* p < 0.001 (two-tailed).

**Table 3.3.1. Multilevel Analysis: Determinants of Sociotropic RETROSPECTIVE Economic Perceptions**  
(Standard errors in parentheses)

| <b>Independent Variable</b>                   | <b>ANOVA</b>       | <b>Model with<br/>Country Dummies</b> | <b>Model with<br/>Macro Variables</b> |
|---|--------------------|---------------------------------------|---------------------------------------|
| <b>Inflation Rate (logged)</b>                |                    |                                       | -.025<br>(0.032)                      |
| <b>Unemployment Rate</b>                      |                    |                                       | 0.003<br>(0.007)                      |
| <b>Growth Rate</b>                            |                    |                                       | .011**<br>(0.004)                     |
| Egocentric retrospective economic evaluations |                    | .366***<br>(.009)                     | .367***<br>(.009)                     |
| Income  |                    | -.007*<br>(.003)                      | -.007*<br>(.003)                      |
| Unemployment Status                           |                    | .031<br>(.035)                        | .031<br>(.035)                        |
| Satisfaction with democracy                   |                    | .203***<br>(.013)                     | .204***<br>(.013)                     |
| Attitudes toward political system             |                    | .087***<br>(.011)                     | .087***<br>(.011)                     |
| Attitudes toward market                       |                    | .059**<br>(.021)                      | .060**<br>(.021)                      |
| Attitudes toward the speed of the reforms     |                    | .223***<br>(.019)                     | .222***<br>(.019)                     |
| Education                                     |                    | -.007<br>(.010)                       | -.007<br>(.010)                       |
| Political Discussion                          |                    | -.034*<br>(.014)                      | -.034*<br>(.014)                      |
| Gender  |                    | .038*<br>(.018)                       | 0.039*<br>(.018)                      |
| Age   |                    | -.002<br>(.001)                       | -.002<br>(.001)                       |
| <b>Constant</b>                               | 2.132***<br>(.109) | .360***<br>(.067)                     | .885***<br>(.195)                     |
| <b>Country-Level Variance</b>                 | .202***<br>(.069)  | .000<br>(.000)                        | .033**<br>(.012)                      |
| <b>Individual-Level Variance</b>              | 1.168***<br>(.016) | .864***<br>(.012)                     | .865***<br>(.012)                     |
| N   | 11118              | 11118                                 | 11118                                 |
| -2Log Likelihood                              | 33360.29           | 29923.58                              | 29995.92                              |

\* p < 0.05 \*\* p < 0.01 \*\*\* p < 0.001 (two-tailed)

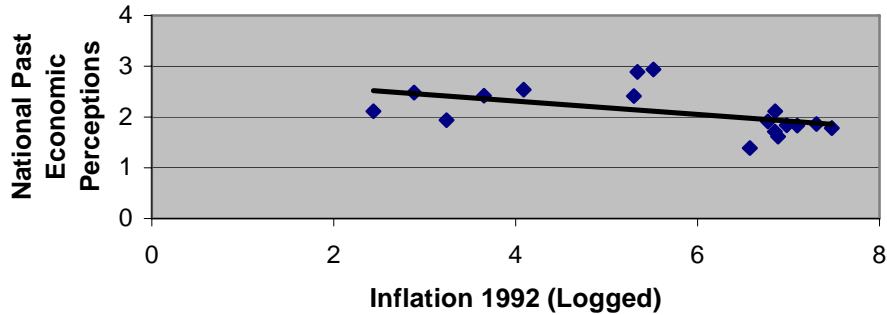
**Table 3.3.2. Multilevel Analysis Determinants of Sociotropic PROSPECTIVE Economic Perceptions**  
(Standard errors in parentheses)

| Independent Variable                                 | ANOVA              | Model with<br>Country Dummies | Model with<br>Macro Variables |
|--|--------------------|-------------------------------|-------------------------------|
| <b>Inflation Rate (logged)</b>                       |                    |                               | .039*<br>(.017)               |
| <b>Unemployment Rate</b>                             |                    |                               | .011**<br>(.004)              |
| <b>Growth Rate</b>                                   |                    |                               | .003<br>(.002)                |
| Sociotropic <i>retrospective</i> evaluations         |                    | .218***<br>(.010)             | .219***<br>(.010)             |
| Egocentric <i>retrospective</i> economic evaluations |                    | .043***<br>(.010)             | .042***<br>(.010)             |
| Egocentric <i>prospective</i> economic evaluations   |                    | .420***<br>(.010)             | .421***<br>(.010)             |
| Income   |                    | -.007*<br>(.003)              | -.007*<br>(.003)              |
| Unemployment Status                                  |                    | -.011<br>(.036)               | -.010<br>(.036)               |
| Satisfaction with democracy                          |                    | .143***<br>(.013)             | .145***<br>(.013)             |
| Attitudes toward political system                    |                    | .064***<br>(.012)             | .065***<br>(.012)             |
| Attitudes toward market                              |                    | .099***<br>(.021)             | .100***<br>(.021)             |
| Attitudes toward the speed of the reforms            |                    | .137***<br>(.019)             | .137***<br>(.019)             |
| Education  |                    | .005<br>(.010)                | .006<br>(.010)                |
| Political Discussion                                 |                    | -.019<br>(.014)               | -.019<br>(.014)               |
| Gender   |                    | .080***<br>(.018)             | .080***<br>(.018)             |
| Age  |                    | .002*<br>(.001)               | .003***<br>(.001)             |
| <b>Constant</b>                                      | 2.767***<br>(.106) | .337***<br>(.072)             | .038<br>(.121)                |
| <b>Country-Level Variance</b>                        | .190**<br>(.066)   | .000<br>(.000)                | .008**<br>(.003)              |
| <b>Individual-Level Variance</b>                     | 1.290***<br>(.018) | .791***<br>(.011)             | .792***<br>(.011)             |
| N  | 9767               | 9767                          | 9767                          |
| -2Log Likelihood                                     | 30283.66           | 25423.34                      | 25473.37                      |

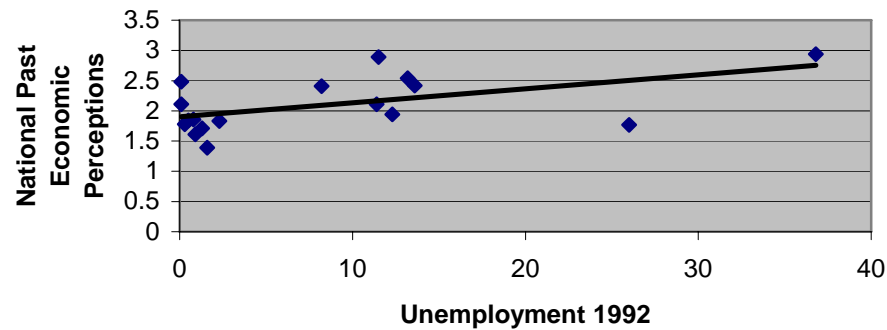
\* p < 0.05 \*\* p < 0.01 \*\*\* p < 0.001 (two-tailed)



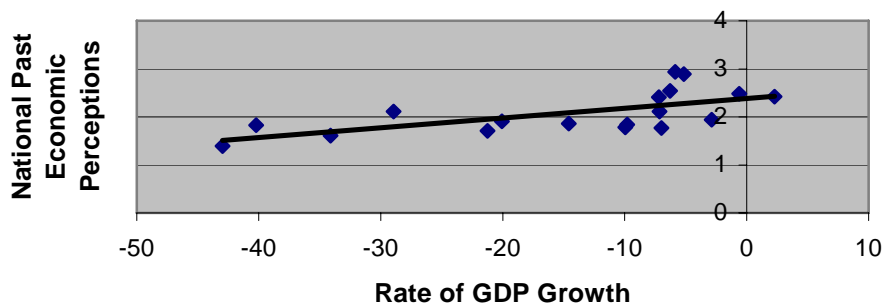
**Figure 3.1.1. Relationship Between the Rate of Inflation in 1992 and Public RETROSPECTIVE Perceptions of the Economy in 1992 in Countries of Central and Eastern Europe**



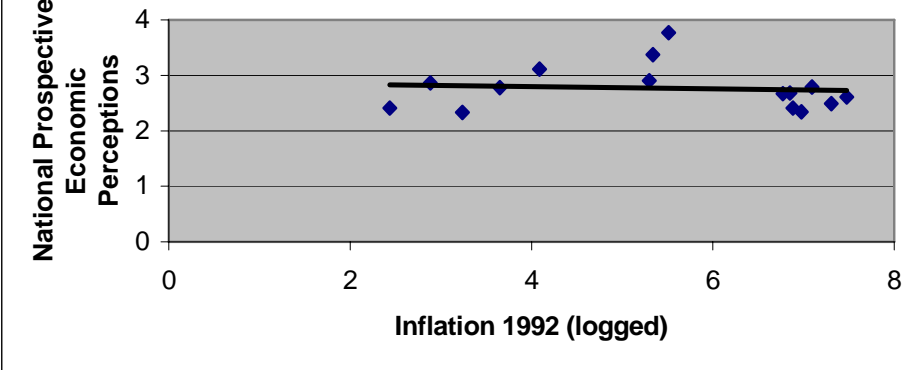
**Figure 3.1.2. Relationship Between the Rate of Unemployment in 1992 and Public RETROSPECTIVE Perceptions of the Economy in 1992 in Countries of Central and Eastern Europe**



**Figure 3.1.3. Relationship Between the Rate of GDP Growth in 1992 and Public RETROSPECTIVE Economic Perceptions in 1992 in Countries of Central and Eastern Europe**



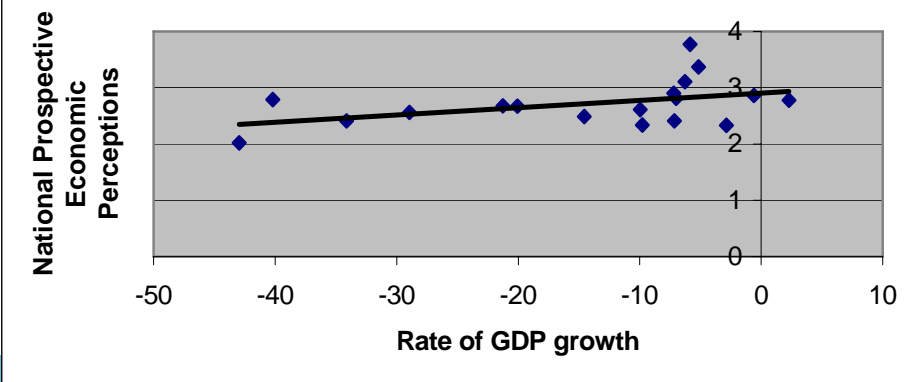
**Figure 3.2.1. Relationship Between the Rate of Inflation in 1992 and Public EXPECTATIONS of the National Economy in 1992 in Countries of Central and Eastern Europe**



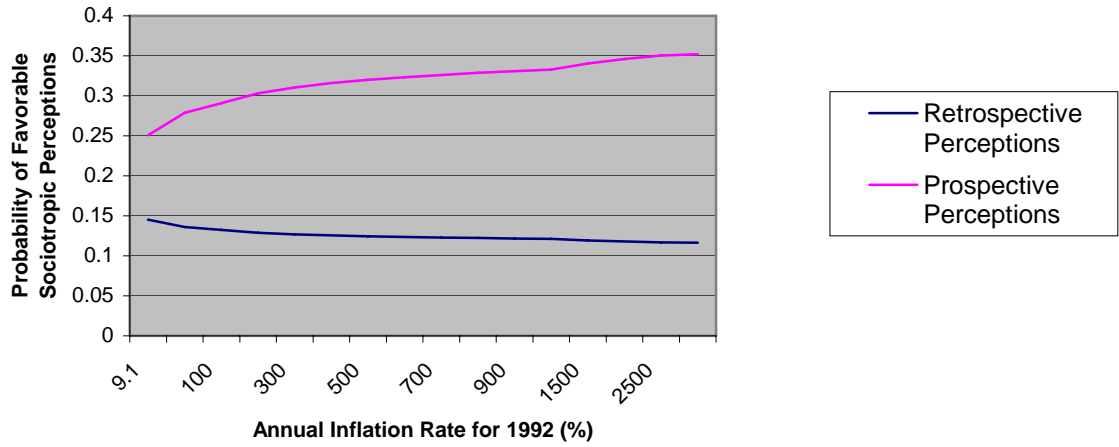
**Figure 3.2.2. Relationship Between the Rate of Unemployment in 1992 and Public EXPECTATIONS of the National Economy in 1992 in Countries of Central and Eastern Europe**



**Figure 3.2.3. Relationship Between the Rate of GDP Growth in 1992 and Public EXPECTATIONS of the National Economy in 1992 in Countries of Central and Eastern Europe**



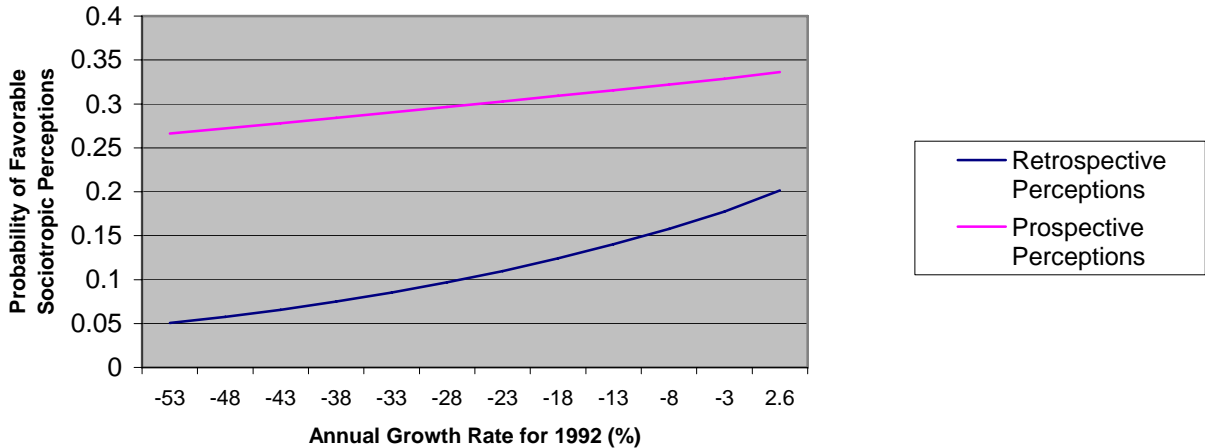
**Figure 3.3.1. Probability of Favorable Retrospective and Prospective Perceptions of the National Economy as a Function of Inflation Rate**



**Figure 3.3.2. Probability of Favorable Prospective Perceptions of the National Economy as a Function of Unemployment Rate**



**Figure 3.3.3. Probability of Favorable Retrospective and Prospective Perceptions of the National Economy as a Function of GDP Growth Rate**



## CHAPTER 4

### **Unraveling the Puzzle: Is Political Sophistication a Key to Economic Accuracy?**

In the previous chapter, I established no substantive connection between the “objective” economic state and public perceptions of the national economy in the post-communist countries of East Central Europe at the initial stage of the transition. Unsurprisingly, with the introduction of a new politico-economic system, citizens might have been insufficiently familiar with it to make accurate economic judgments. However, one may argue that even in a newly established system, some people have higher levels of knowledge and political sophistication, and therefore should be able to form more accurate economic evaluations than the rest of the population.

There is a substantial body of literature in political science that considers differences in political behavior and opinion formation conditional on political sophistication and the level of information. While the majority of such studies have found variation in political opinion and behavior of individuals with different levels of knowledge and information (Weatherford 1983, Zaller 1992, Alvarez 1998, Gidengil et al. 2001, Baum 2002), others have found similar patterns of behavior across all sophistication groups (Pierce 1993, Goren 2004, Kumlin 2001).

Generally, political sophistication is viewed as knowledge of political facts and phenomena (e.g. Cassel and Lo 1997), but oftentimes researchers use a wider range of measures, such as political discussion frequency, education, media consumption, etc. in order to capture the same notion. Factual knowledge of politics is hard to capture without a long battery of survey questions. And then, however, the validity of such a measure is arguable: knowing the name of the president does not necessarily mean that the respondent has a full understanding of the president's responsibilities and, which is even more important, has an ability of making causal attributions (Iyengar 1989, Gomez and Wilson 2001, Rudolph 2003). In a recent study of the influence of political knowledge on policy preferences, Gilens (2001) maintains that general political sophistication does not unequivocally lead to policy-specific knowledge. According to his analysis, policy-ignorant citizens revealed considerable divergence in their policy preferences from policy-sophisticated individuals despite the fact that all of the respondents were considered fully informed on a general political knowledge scale. Thus, the validity of a political sophistication measure based on factual political knowledge is likely to be conditioned on the research question at hand. At the same time, the assumption that somebody who knows more political facts also follows politics more closely and is more likely to be able to employ political reasoning than somebody who does not even know the president's name, is certainly plausible.

Alternatively, measures of sophistication, such as education and media consumption, are more general, but indirect. Precisely, they are viewed as possible sources or correlates of political sophistication. Without a doubt, advanced formal education may or may not mean higher political sophistication, but it is sensible to

assume that it does, and this has oftentimes been confirmed by empirical evidence (Mondak 1995, Haller and Norpoth 1997). High media consumption, depending on the media source, of course, also increases the probability of having more political knowledge, and, one may argue, so does political interest and political discussion (Haller and Norpoth 1997, Eveland and Scheufele 2000, Milburn and McGrail 1992). The latter was empirically shown to increase levels of political sophistication through deliberation (Gastil and Dillard 1999, Dutwin 2003).

To date, political scientists have used all of the above measures more or less interchangeably, sometimes simply based on availability. For the purpose of my study, I will employ a measure of education and a measure of political discussion to approximate a person's level of political and economic sophistication. In the context of East Central Europe, these two measures may be the most appropriate for capturing the scope of political awareness.

It is common to think that higher education gives people more intellectual, as well as material, resources to enhance political knowledge (Berggren 2001). These assumptions, however, may not have held in the post-communist nations during the initial stage of the transformation for at least two reasons. Firstly, at the beginning of the transition reforms, the highly educated were unlikely to have better knowledge on democracy and the market than the less educated, because these topics were not covered during the course of formal schooling in the socialist times. Information on the Western democratic system was also unavailable from other sources except underground publications. Thus, the more educated were not privileged, save a few, in having a better

understanding on how democracy and markets work, although they may have had higher learning capabilities.

Secondly, judging by the literature on income structure in the post-communist nations, positive returns to education were negligible (Jensen 2003). Put differently, persons with higher formal education were not likely to have better pay. Consequently, it would not be fair to say that the more educated could enjoy better opportunities, financially speaking, to access information. Having said that, however, it is unreasonable to deny that education contributes to the development of better logical skills and hence advanced information processing skills in general.

In contrast, interpersonal communication is a cheap way to acquire economic and political information. Essentially, all it takes is a willingness to engage in a political conversation, and sometimes even less – simply listening to what other people say. Thus, political discussion may become a primary source of economic and political information leading to the formation of public opinion. Bearing on past research, many individuals do not form political judgments from media reports before they discuss them with someone they trust on political matters. Conveniently, such a trustworthy person is normally not hard to find, since individuals, on average, tend to think that people around them are more politically sophisticated than they are.

Again, in the context of newly emerging democracies, when information was scattered and confusing, interpersonal discussion may have become the most influential source of knowledge on the economy and politics. Yet, political discussion is likely to lead to biased economic judgments, because one's conversation partners are inclined to express evaluative statements during discussion, thus potentially affecting the person's

own assessments. On top of that, discussion networks tend to be homogeneous, thereby re-introducing the same bias every time a conversation takes place. In the post-communist nations of East Central Europe, similar to other countries in this regard, discussion networks were traditionally comprised of relatives, friends, and colleagues, thus providing anecdotal evidence in support of the homogeneity assumption. Moreover, the tone of political discourse was person-centered with a prevailing pessimistic connotation (Shevchenko 2001, Ries 1997). In other words, people often complained when communicating with others, thus possibly contributing to the creation of a negative image of the general situation in the country.

What follows from the above is that the more educated and those more versed in politics may, in fact, have not been more politically sophisticated in the sense of possessing accurate information regarding the political and economic state of their nation at the initial stage of the post-communist transition. While persons with higher education were as limited in their access to political and economic information, as well as knowledge-deprived because of the socialist system of education, people who eagerly discussed politics may have talked about their own economic problems and problems of their friends and relatives rather than the national economic situation. And even when they discussed national news, people's interpretation of what they heard in the media may have been biased by their own attitudinal pre-dispositions.

### **Political Sophistication as a Mediator of Political Behavior and Attitudes**

Few would disagree with the statement that the most important act of political participation is the act of voting. My own research question regarding the formation of



sociotropic economic perceptions analyzed in the present thesis is indeed a building bloc in the voting function (Nannestad and Paldam 2000, Paldam and Nannestad 2000). Is political sophistication important for voting? What are the consequences of political ignorance? Are there differences in the voting patterns of more politically sophisticated individuals and less sophisticated ones?

The overall debate about different patterns of voting among highly and less sophisticated citizens is driven by the general issues of government accountability and voter rationality. Some scholars argue that voters' ignorance may be damaging for democracy (Iyengar 1989). Political ignorance may lead to voters' inability to make causal attributions of responsibility, thus undermining the proper operation of the accountability mechanism (Lau and Sears 1981). For instance, if voters are incapable of connecting governments' economic policies and national economic outcomes, they cannot be expected to hold governments responsible for the state of the national economy. Alternatively, if voters form inaccurate perceptions of the national economy, but are inclined to assign blame for the national economic performance to the government, they may make an inadequate decision to reward or punish it based on biased economic evaluations. In this case, the accountability mechanism would be formally at work but malfunctioning. Instead of holding the government accountable for its actual performance, citizens would hold their government responsible for what they incorrectly perceive to be the government's performance.

Potential consequences of the malfunctioning of the accountability mechanism give rise to scholarly debates about the possible success and failure of democracy. Whereas for some mass political ignorance, especially along with political apathy, may

signal the potential future collapse of democracy, for others there is no threat to democracy as long as voters in the aggregate can display signs of rational behavior. In reference to economic voting, the latter give several reasons for their optimism. First, the optimists posit that in each democracy, there is a group of “elitist” voters who are well-informed, thus capable of making rational vote choices (Aidt 2000). All other voters evaluate government performance with some error. As long as such errors are equally spread around a core of unbiased evaluations of sophisticated citizens, they cancel out in the aggregate, and the accountability mechanism works (Bartels 1996). That is, the incumbent government gets reelected or thrown out of office based on its actual performance, because of the accurate perceptions of a relatively small number of highly informed citizens.

Yet another point of view is that precise knowledge of economic indicators is not essential for the democratic accountability mechanism to work properly as long as voters have a sense of the direction in which the economy is going (Sanders 2000), because this information is enough for voters to make “reasoned choices”. Finally, some scholars argue that even unsophisticated voters can behave as if they are “enlightened” (Lupia 1994, Lupia and McCubbins 1998, see also Nannestad, Paldam and Rosholm 2003). Put differently, there are no significant differences between politically sophisticated vis-à-vis the politically ignorant in their voting behavior.

Most studies, however, find systematic variation in the voting behavior of low and high sophisticates; yet they do not necessarily go as far as making an inference about the failure of democracy. Gomez and Wilson (2003), for example, considered economic voting in U.S. congressional elections. According to their findings, less sophisticated

voters attribute responsibility of economic outcomes to the President, ignoring the influence of Congress, whereas more sophisticated citizens are capable of dividing the blame or the credit between the two. In an earlier article, Gomez and Wilson (2001) posited what might be a somewhat counterintuitive argument that more sophisticated voters tend to use pocketbook evaluations to a greater extent than less sophisticated individuals, because sophisticates are able to make a connection between their own finances and government's policies (for a competing argument see Weatherford 1983, Mutz 1992). Drawing on information-processing theories from psychology, the authors maintained that low sophisticates attempted to maximize proximal consistency, which implies "bringing closely related political information into congruence" (Gomez and Wilson 2001, 902). In contrast, highly aware persons are able to connect more distant notions, such as their own financial situation and president's economic performance; that is, high sophisticates seek distal consistency or congruence between distant and abstract referents (see also Sniderman, Brody, and Tetlock 1991).

Besides economic voting, scholars have looked at heterogeneity of issue voting conditional on the level of political sophistication. For example, MacDonald et al. (1995) explored the predictive power of directional and traditional spatial (proximity-based) models controlling for political sophistication, and, contrary to their predictions that more educated and politically involved individuals should use the cognitively more demanding traditional model, find that voters at various levels of sophistication tend to use directional models.<sup>36</sup> However, they also found that sophisticates are more capable of

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<sup>36</sup> Under the traditional proximity spatial model, a voter's utility for a candidate is assumed to increase with proximity to his ideal point (set of political preferences). In the most basic of such models, vote-maximizing party locations for two-party competition converge toward the median voter location of the

relying on issue voting in general because of their superior ability to comprehend political issues (for contrasting results see Maddens and Hajnal, 2001). In a study of a Hungarian parliamentary election, Todosijevic (2005) also compared proximity and directional models of issue voting. He hypothesizes and later confirms his proposition that, in newly established democracies, voters rely on directional models to a greater extent due to a lack of information on parties' exact positions. Moreover, the reliance on a directional model of issue voting is larger among less sophisticated individuals than among their more sophisticated counterparts. Alternately, Bartle (2000) cautioned against applying issue-voting models to uninformed voters in the same manner as to highly aware citizens, because of significant instability and low ideological constraint of their issue positions.

In addition to specific types of voting models, scholars have also explored the question of whether citizens are likely to turn up to vote conditional on their political sophistication. Jackson (1995) established a causal relationship between education, political sophistication and turnout. Specifically, according to the author's results, education has a positive influence on political awareness, which in turn enhances voter turnout. In a later study, Gidengil et al. (2001) concluded that more politically informed

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overall electorate. In general, in the traditional model, voter's choices and preferences exert a centrist influence on the strategy of candidates seeking the voters' preferences. In contrast, alternative spatial models suggest that some or all candidates may benefit by moving outward from the ideological center in the direction of the preferences of particular constituencies. There are two basic spatial models based on directionality that can be seen as alternatives to the standard proximity model. The first compares the direction of policy movement desired by a voter – from a status quo point or a policy neutral point with the direction of policy movement taken by a candidate. Direction of policy movement entails both desired or proposed policy changes on each of several issues as well as relative salience to the voter or candidate among these issues. The second accounts not only for direction but also for the overall intensity of the voter's preferences on the issues as well as the overall intensity with which each contender advocates issue positions.

and involved citizens holding negative views about a particular party are more likely to go and vote against this party than abstain.

There is also a growing body of literature considering the role of political sophistication in the formation of public opinion (Zaller 1992, Babad 1995, Kumlin 2001, Baum 2002). Similar to voting studies, analyses of the effects of information and political knowledge on public attitudes yield mixed results. Karp et al. (2003) found that more and less politically aware persons base their evaluations of the EU on different factors. In particular, more sophisticated individuals incorporate assessments of EU institutions, while their less informed counterparts do not. In contrast, Goren (2004) claimed that people at various levels of sophistication had more or less uniform core values and beliefs and relied equally on them when forming political judgments.

Directly related to my research question regarding the formation of economic perceptions are studies on the accuracy of specific political judgments. Dolan and Holbrook (2001) analyzed predictions of U.S. presidential elections and inferred that political knowledge had a positive influence on the accuracy of individuals' predictions. In addition, political judgments are also shaped by "wishful thinking", which is attenuated by political sophistication. Somewhat contradictory results have been obtained in an earlier study by Babad (1995). The author concludes that the effect of wishful thinking on predictions of the 1992 general election in Israel was not reduced among individuals with full information compared to individuals with partial information. Koch (2001) claimed that politicians, armed with the knowledge about a higher ability of political sophisticates to identify candidates' issue positions accurately,

adjusted their issue standing depending of the average level of education and political awareness in a district.

Lastly, I would like to touch upon the issue of political sophistication and attitude stability. The dynamic component of political judgments has attracted scholarly attention in relation to the study of persuasion and information reception and acceptance. In other words, political scientists have been fascinated by the question of who is likely to be affected by what kind of political messages. Without this knowledge, political campaigns are deemed to be nothing else but a stroll in the dark. Some scholars are inclined to think that the more politically aware hold more stable and cognitively constrained views, which are hard to influence, unlike low sophisticates who are considerably unstable and inconsistent in their opinions (Converse 1964, Bartle 2000). Others maintain that the relationship between political sophistication and attitude stability is likely to be non-monotonic (Zaller 1992, Kinder 1998, Druckman and Lupia 2000). In accordance with this proposition, the unsteadyest in their views are persons in the middle education or awareness group. This observation is explained by the fact that high sophisticates are already knowledgeable enough to be able to generate internal counterarguments upon receiving new information, whereas the least aware are likely to receive little information to begin with, thus their existing opinion is less prone to change.

### **Economic Perceptions and Political Sophistication**

As follows from the above review, political awareness may well cause heterogeneity in political participation and attitudes. Evidently, of particular interest to me is the question of whether political sophistication can lead to higher accuracy of

national economic evaluations in East Central Europe. Previous research in established democracies has produced consistent evidence that it does, although some counterarguments have also been voiced (e.g. Haller and Norpoth 1997). Rather straightforwardly, the argument asserts that highly informed or sophisticated individuals should be more accurate in their perceptions of the national economy than people with lower information levels. The underlying logic for this claim is built on the assumption that sophisticates simply know more about the economy, as well as have more cognitive resources to understand and correctly interpret economic information. Should we assume that the only sources of economic information are mass media and official government reports, this statement will probably arouse no heated debates. Yet it has been well established that personal economic experiences and interpersonal communication are also significant contributors of information later utilized by individuals to form economic judgments (Kiewiet 1983, Norpoth 1996, Mutz 1992). In light of this finding, the mediating role of political awareness may be somewhat attenuated, since it does not require a whole lot of political sophistication to interpret one's own economic situation.

In an effort to understand the origins of economic evaluations, political scientists initially searched for potential sources of economic information. Apparently, the most obvious first choice was mass media (e.g. Haight and Brody 1977, Kiewiet 1983). However, in early studies, direct media effects were hard to find, and scholars had to develop more complex models of economic information processing. For example, Kiewiet (1983) recognizes that economic perceptions may be formed as a result of political conversation, particularly, a third party reporting news read in the paper or heard on TV. Weatherford (1983) compared the process of the formation of economic

judgments among heavy media users and poorly informed individuals, and found distinctly different patterns of opinion formation and voting behavior between the two groups. While the former rely on their evaluations of the national economy when casting a vote, the latter use the only source of economic information of which they could be certain, namely their personal experiences.

In a widely known study of retrospective economic evaluations, Conover, Feldman and Knight (1986) asked the specific question of where assessments of inflation and unemployment come from. Suggestively, their findings show that people learn about inflation from political elites and mass media, whereas the unemployment situation is most likely to be learned through personal and impersonal experience, as well as interpersonal communication, which is consistent with the view of Behr and Iyengar (1985). Individuals who exhibit accurate knowledge of the actual inflation rate are also more accurate in their retrospective perceptions of inflation than their less knowledgeable counterparts. In contrast, public evaluations of unemployment do not depend on their knowledge of the actual unemployment rate, but turn out accurate regardless. Later, Paldam and Nannestad (2000) attested to the finding that people were much more knowledgeable about unemployment than inflation, thus advocating the idea that economic accuracy may be issue-specific.

Consistent with the above results, but not mimicking them, Mutz (1992) has inferred the significance of mass media effects for the formation of sociotropic retrospective economic perceptions. Furthermore, interpersonally mediated communication or interpersonal discussion has a distinctive effect on the accuracy of national economic evaluation, which is no less important than the influence of mass



media. As for the study of prospective economic evaluations, Krause (1997) found no media effects on public perceptions of the future national economy except for the most educated group of voters. Elsewhere, Conover et al. (1987) also considered the formation of economic forecasts and concluded that the accuracy of economic predictions is in fact contingent on the level of political sophistication.

Haller and Norpoth (1997), along with verifying an earlier finding that individual-level heterogeneity in economic perceptions is a function of political sophistication, also promoted the idea of badly informed individuals being less clueless about the state of the national economy as it may seem. Although economically ignorant respondents in the analysis are significantly less accurate about the general economic direction, in the aggregate, more than half of them are correct in their estimation of past economic performance. In fact, these results are consistent with the earlier findings of Conover et al. (1986) regarding unemployment evaluations, as well as research by Lupia (1994) and Sanders (2000) who maintain that even uninformed citizens are capable of making reasoned judgments. In addition, it is worth noting that the authors found that the sources of people's perceptions of the national economy were not only media news, but also objective economic indicators (see also Goidel and Langley 1995). However, Sanders and Gavin (2004) did not find support for the hypothesis that both media news and the objective economy together form the basis of sociotropic economic evaluations; rather, they conclude, people count on television news when forming judgments about the economy.

Overall, the mass media is a powerful influence on public economic assessments, despite earlier failures to establish this connection empirically. Interestingly, some

scholars have made the claim that media news may be subject to a negative bias. In particular, negative news reports outnumber optimistic economic stories, thus biasing public opinion about the national economy (Harrington 1989, Hetherington 1996). While Harrington (1989) maintains that economic news is more balanced during election years, Hetherington (1996) found evidence that the 1992 U.S. presidential campaign was dominated by negative economic news. Not only were the news reports unrepresentative of the true economic situation, but they also affected the presidential election outcome. With the help of content analysis, Goidel and Langley (1995) also come to the conclusion that negative economic news is prevalent in the media; yet they have nevertheless established a connection between the objective state of the economy and media reports. Consistent with the above results, Hester and Gibson (2003) concluded that economic news is negatively framed more often than positively and hence drive public economic expectations.<sup>37</sup> Obviously, if media news is biased, it may bear serious consequences for sociotropic economic sentiments and for political behavior.

### **Preliminary Evidence from East Central Europe**

This chapter examines the question of whether the accuracy of public economic evaluations in Central and Eastern Europe, that is the agreement between economic perceptions and objective economic indicators, was dependent on the level of political sophistication. Specifically, did individuals with higher levels of education and attentiveness to political matters tend to utilize information about the objective state of

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<sup>37</sup> Lau et al. (1999) studied the effect of negative political advertisement on public opinion and attitudes about the political system in general. Contrary to the conventional wisdom of the detrimental consequences of negative political ads, a sophisticated econometric analysis did not reveal evidence of such effects in the United States.

the economy in their economic evaluations to a greater degree than people with lower educational levels and interest in politics?

Drawing on the evidence from Chapter 3 of this thesis, the difference between public economic perceptions and experts' ratings of the economy at the beginning of the democratic transition may have existed due to people's unfamiliarity with the laws of a market economy and a general lack of experience with the new systems. In other words, it could have taken citizens in the post-communist region some time to learn the new economic rules before they started making more accurate judgments of the national economic state.

Yet, in post-communist nations, like in established democracies, there were citizens with various levels of education and political awareness. Moreover, it is reasonable to assume that well-educated persons were numerous due to the high-quality free education up to university level available in the socialist societies and during the first years after the communist collapse. The downside of the socialist educational system, however, was its taboo on teaching students about the "enemy" system of the economy, namely market economics or capitalism. Consequently, even the most intelligent individuals (save a tiny number of specialists) were likely to be ignorant about the operation of a market economy. Nonetheless, the more educated in the post-communist nations still should be expected to have better analytical skills, hence the likelihood to be more politically and economically aware vis-à-vis less educated individuals. Not only do more educated people have greater intellectual resources to embrace new economic knowledge, but they oftentimes use superior information sources than those who are less educated.

However, education by itself, also an acceptable proxy for an individual's level of economic and political sophistication (Kinder 1998), is not a necessary condition for successful economic learning. Another source of information, as well as a means of political learning, is political discussion or interpersonal communication. Political discussion is a cheap way of collecting information, although it may lead to biased economic perceptions, because an individual's discussion networks tend to be homogeneous.

However, the conditions of the transformation process in East Central Europe at the beginning of 1990s may have prevented even most sophisticated from forming accurate perceptions of the national economy for at least two reasons. First, even though the more educated and politically interested undoubtedly had more potential (if only cognitive) to learn, it may have been too soon in 1992 to talk about clear understanding of economic and political events by anyone in the post-communist nations, but a very small number of people in political elites. Second, even with full understanding of the reform processes, it would have been quite challenging to give accurate evaluations both of the past economic situation and the future, because of rapid changes in the economy, i.e. high economic instability. In the former case, high instability could have prevented people from remembering even the recent economic past, whereas in the latter, it is likely to have made it difficult to make economic predictions. Moreover, with regard to the future, people may have been overly optimistic due to promises made by political elites in the media about things getting worse before they would get better. Thus, I hypothesize to find no substantive differences in the use of objective economic information among

less sophisticated and highly sophisticated citizens at the beginning of the post-communist transition.

Figures 4.1.1-4.1.4 depict the distribution of sociotropic retrospective and prospective perceptions by level of education, as well as frequency of political discussion, aggregated from the 1992 Central and Eastern Eurobarometer Survey.<sup>38</sup> In the case of national retrospective perceptions, the proportion of those who evaluated the general economy as favorable remained equal across all four levels of education. With regard to the percentage of the population who formed negative perceptions of the national economy, it was slightly higher for the two advanced levels of education (somewhat over 70%) as opposed to the two lower educational categories (somewhat below 70%). A more detailed depiction of the relationship between education and retrospective sociotropic evaluations is presented in Table 4.1.1, which can be described as a monotonic decline in the proportion of those who evaluated the past economy as highly unfavorable to those who thought that the national situation had gotten a lot better. This pattern remained for all four levels of education; that is, across all the educational groups, approximately the same proportion of people fell into each perception category. For example, about 30 percent in the lowest education group thought that the state of the national economy had gotten worse over the previous year, whereas in the other three education categories these figures were 32, 31, and 29 percent respectively. The only difference that education appears to make concerns those who evaluated the economic

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<sup>38</sup> Education is a four-category variable based on the following question: “What is the highest level of education you have received?” It is coded from 1 to 4, where 1 means the lowest level of education, and 4 indicates that a respondent has completed higher education. Frequency of political discussion is a three-category variable constructed from the following survey question: “When you get together with friends, would you say you discuss political matters frequently, occasionally or never?” It takes integer values from 1 to 3, where 1 means that a respondent never discusses politics, and 3 indicates that s/he engages in political discussion on a regular basis.

situations as *much* worse compared to the previous year. In this category, individuals with the highest level of education outnumbered those in the lowest education category by almost 6 percent, while the remaining education groups were “behind” by over 8 and 4 percent. Overall, however, these differences are not large.<sup>39</sup>

Table 4.1.1 and Figure 4.1.1 about here

Sociotropic prospective assessments display a very different pattern of the public economic mood compared to sociotropic retrospective perceptions (Table 4.1.2). While the proportion of persons giving more favorable assessments of the past economy was ever decreasing, the majority of individuals felt optimistic about economic future. Thus, people who thought that the future economy would be much worse, worse, or stay the same as compared to the present economic state fluctuate within the range of 64.13-66.63 percent across all four educational categories. Meanwhile, those who believed that the national economy would improve are evenly distributed and constitute approximately 30 per cent in each education group. Yet, the proportion of citizens who had favorable or highly favorable economic expectations never exceeded the proportion of people who formed negative or highly negative forecasts of the national economy for any of the four educational groups (Figure 4.1.2). As in the case of retrospective assessments, levels of education did not seem to have much explanatory power in accounting for the differences in economic evaluations.

Table 4.1.2 and Figure 4.1.2 about here

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<sup>39</sup> Ahl (1999) finds similar results in his analysis of public evaluations of the national economic state in Russia in the mid 1990s. He posits that national economic perceptions are uniformly distributed across educational strata.

Frequency of political discussion divided the sample more noticeably than level of education with respect to national economic evaluations. Individuals who engaged in political discussions more often tended to have more negative opinions about their country's economic past than their fellow citizens who discussed politics less frequently (Table 4.1.3). For example, about 68 percent of people who never discussed politics or did so occasionally formed negative retrospective perceptions about the national economy, whereas about 75 percent of regular discussants of politics thought that the economic situation had gotten worse over the previous year. Among those who evaluated the state of the national economy as favorable, the differences across various political discussion categories were miniscule (Figure 4.1.3). This pattern was repeated with regard to prospective perceptions. A little over 40 percent of citizens who never engaged in political discussions or did so occasionally formed pessimistic opinion about the past state of the national economy, while about 48 percent of those who discussed politics regularly expressed similar views (Figure 4.1.4). People who liked to get involved in a political conversation were also more numerous in the *highly* pessimistic category than those who discussed politics less (Table 4.1.4).

Tables 4.1.3 and 4.1.4 about here

These aggregate results are only preliminary; and although they point to a lack of an interaction effect between the objective economic state and the measures of education and political discussion, a more thorough individual level analysis is necessary for drawing more reliable conclusions. That is, we need to test explicitly whether more educated individuals rely on objective economic indicators to a greater degree than less educated people when making judgments about the state of the national economy. Also,

in subsequent analyses, I will explore whether the same hypothesis holds for individuals who engage in political discussion on a regular basis.

Figures 4.1.3 and 4.1.4 about here

## **Analysis and Results**

For more comprehensive empirical tests of my propositions, I employed the same data set that I used in Chapter 3. To remind, the data set has a hierarchical structure compiled of individual- and nation-level variables. The individual-level survey data come from Central and Eastern Eurobarometer No.3, collected in the fall of 1992, and are supplemented with unemployment, inflation and GDP growth data gathered by the European Bank for Reconstruction and Development for the corresponding period of time.

To test the hypotheses of mediating effects of political sophistication on the way people formed evaluations about the national economy, I constructed a series of multiplicative interaction terms between the objective economic indicators and both the education variable and the political discussion variable. In particular, I posited that highly educated individuals should not be more likely to have based their sociotropic economic evaluations on the actual state of the economy. I also hypothesized that people who frequently conversed about politics relied on indicators of the objective economy to the same extent when they formed judgments about the economic situation in their countries than those who did not regularly engage in political discussion. The underlying logic leading to these hypotheses is twofold: high economic instability resulting in high uncertainty even among most sophisticated individuals, as well as a lack of economic



understanding at the beginning of the transition even among most educated and politically interested citizens.

It should be noted that there might be a significant statistical concern in the way I initially constructed the interaction terms. Greene (2000) argues that, by creating a multiplicative interaction term between a multinomial ordered variable and a continuous variable one imposes the assumption of equal effects of moving from one category of the ordered variable to the next one on the slope of the continuous variable. In order to test whether the assumption of equal effects is right and as a potential remedy, I have expanded my ordered education and political discussion variables into a series of dummy variables. Then, I created multiplicative interaction terms between each of the dummy variables, except for the base category, and each of the objective economic measures. As it turned out, the results for the interaction models with the collapsed education and political discussion variables were not much different from the ones obtained with the ordinal scales, yet I was not able to accept the assumption of equal intervals. As a possible solution, and for the purpose of simplicity, I collapsed the multi-category education and political discussion variables into two dummies.<sup>40</sup>

Table 4.2 about here

Due to the ordered nature of my dependent variable, I analyzed the models with ordered logit. In addition, taking into account the hierarchical nature of the data, I also used the iterative generalized least squares procedure especially created for multilevel data, in the manner I did in Chapter 3. Consistent with the results of ordered logit, the

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<sup>40</sup> I collapsed the four-category education variable into a dummy by coding categories 1 (elementary) and 2 (secondary incomplete) as zero and categories 3 (secondary) and 4 (higher) as one. I also created a dummy variable out of the three-category political discussion variable by merging together categories 1 (never discuss politics) and 2 (occasionally discuss politics) and coding them as zero, whereas leaving category 3 (discuss politics regularly) as a separate category coded as one.

interaction terms between education and the measures of the objective economy achieved statistical significance (with the exception of the growth interaction term) only in the retrospective model (Table 4.2, column 1). With regard to inflation, the probability of forming optimistic perceptions of the past national economy decreased from 10.9 to 10.6 percent among less educated along the total range of the actual price increases in the region (from 9.6 to 2,700 percent) – a completely unnoticeable change. More educated individuals, on the other hand, were also less likely to view the past economic situations as positive when inflation was growing (Figure 4.2.1), but this effect was a little bigger (the probability shift of 6.5 percent over the whole range of the inflation rate). As for unemployment, the mediating effect seems almost inconsequential. While less educated citizens do not seem to have formed their perceptions consistent with the reward-punishment mechanism, their more educated counterparts followed the intertemporal pattern of support – that is, they were more likely to form favorable economic evaluations alongside with increasing unemployment (Figure 4.2.2). However, the substantive effects of the interaction terms, measured by probability shifts in the effects of inflation and unemployment on positive retrospective perceptions across various levels of education, were minimal (3.8 percent for the less educated and 1.2 percent for high sophisticates). As for prospective perceptions, education does not seem to have had any mediating effect on the relationship between the actual state of the economy and individuals' economic expectations (Table 4.2, column 2).

Similarly to the effect of education and consistent with my hypotheses, frequency of political discussion in the retrospective model only made a difference for the way individuals used information on GDP growth to form sociotropic economic evaluations.

Yet, the mediating effect of political discussion, although statistically significant, was substantively small for the formation of retrospective economic perceptions with regard to economic growth. The probability of seeing the country's economic past positively increased from 5 to 17 percent among occasional discussants of politics and from 3 to 17 percent among those who discussed politics frequently over the entire range on GDP growth figures (-52.6 to 2.6 percent) in the sample of countries (Figure 4.3.1).

Figure 4.3.1 about here

Prospectively, people who engaged in political discussion on a regular basis appear to have used information on inflation and GDP growth differently than individuals who talked about politics less often when they evaluated the national economy. In particular, the shift in the probability of forming optimistic economic forecasts based on economic growth among individuals who discussed politics often was less pronounced than among people who did it only occasionally or never (Figures 4.3.2 and 4.3.3). In fact, the probability curve in the growth case for those discussing politics frequently looks almost flat (Figure 4.3.3). Nonetheless, a careful visual inspection of the probability curves points to relatively small substantive differences between the two categories of political discussants regarding the use of this objective indicator of the economy in national economic forecasts. The actual probability shifts with regard to GDP growth was an increase of 12.5 percent in the probability of forming favorable economic expectations among those who never discussed politics or did it only occasionally. Among regular political discussants this probability only went up by 2.5 percent. Finally, for those who scored low on the political discussion variable the shift in the probability of giving optimistic predictions increased from 23 to 36.7 percent,

whereas among those who discussed politics regularly the probability shift was from 30 to 33 percent along the whole range of the inflation rates.

Figures 4.3.2 and 4.3.3 about here

### **Multilevel Analysis and Results**

Due to the multilevel structure of my data, however, “traditional” statistical methods, such as, for example, ordered logit may lead to erroneous inferences regarding analyzed relationships. Specifically, the failure to account for the hierarchical data format may result not only in miscalculation of the standard errors, but also in biased slope estimates. Goldstein (1995) proposed a more appropriate statistical procedure for estimating multilevel models, which was first applied in political science by Steenbergen and Jones (2002). Based on the maximum likelihood principle, this estimator takes the hierarchical data structure into consideration and conveniently calculates variances by data level, by way of which we can judge the performance of the model at each structural level.<sup>41</sup>

Overall, the estimates of the multilevel model both in the retrospective and prospective cases remain consistent with the findings obtained by ordered logit (Tables 4.3.1 and Table 4.3.2). In particular, regarding contingent effects of education on perceptions of the past economy, the interaction terms with inflation and unemployment achieved statistical significance. While the more educated were likely to form more pessimistic economic evaluations based on the actual levels of inflation, they were also more likely to form more favorable retrospective views based on the objective state of

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<sup>41</sup> A more detailed description of the model is presented in Chapter 3.

unemployment. Recall that both objective indicators had worsened during the year preceding the CEEB surveys, but the situation with price rises was especially terrifying. Although the better educated may have more cognitive abilities to realize it (Mutz 1992), the magnitude of the difference between the two educational groups was hardly noticeable. The differentials of the unemployment effects among individuals with higher and lower education levels were also miniscule. Finally, the relationship between economic growth and the formation of sociotropic retrospective perceptions was insensitive to education levels.

The mediating effect of the frequency of political discussion was always positive. In other words, persons who engaged in political discussions on a regular basis were likely to perceive the national economy more optimistically based on the inflation and growth statistics. However, whereas increasing growth rates should promote more favorable economic assessments in light of the traditional reward-punishment view, skyrocketing inflation, to the contrary, should be associated with negative perceptions of the economy. My results paint a different picture when the more politically versed appear to have associated higher inflation rates with positive changes in the economy, following the framework of intertemporal support. Importantly though, those who discussed politics on a regular basis, on average, had substantially more negative perceptions of the national economy.

Table 4.3.1 about here

In the prospective model, the multilevel estimates also converge with the ordered logit results. The mediating role of education was statistically indistinguishable from zero, whereas political discussion had a completely opposite effect on the relationship

between objective indicators and the formation of economic forecasts compared to the retrospective case. Specifically, positive GDP growth was viewed by active political discussants as a slightly negative factor contrary to the favorable effect it produced on less politically versed individuals. Furthermore, among people who often talked about politics inflation had a negative effect on forecasts of the national economy compared to persons unaccustomed to regular political talks. As discussed earlier, it may be the case that, at the beginning of the transition, many people perceived negative economic changes as something to be expected before the economy would improve. Such a logic (intertemporal support) may have had its reverse side when citizens would see positive changes in the national economy as anomalous and would expect bad economic times as a result; therefore people's evaluations of positive developments in the economy may have been pessimistic. In fact, this pattern of performance evaluations was named "antidotal support" (Stokes 1996, 2001).

Table 4.3.2 about here

## **Discussion and Conclusions**

In this chapter I intended to investigate contingent effects of education and political discussion on sociotropic perceptions of the economy during the initial phase of the post-communist transformation. Contrary to the most common assumption found in the literature, I hypothesized that more highly educated individuals or individuals who regularly engage in a political conversation would be as likely to have evaluated the national economy accurately as their less informed counterparts due to high economic instability and a lack of experience with a market economy. According to my statistical

results, however, more educated persons formed more negative perceptions of the past economy when inflation levels were increasing, but more favorable retrospective perceptions under the condition of growing unemployment. In line with the findings obtained in Chapter 3, the present estimates may indicate a mixture of various patterns of political support, such as traditional (reward-punishment) and intertemporal support, not uncommon during transition periods. Furthermore, individuals who engaged in active political discussions were likely to form less critical evaluations of the past economy than those who stayed away from political talk. With regard to economic forecasts, no mediating effect of education was established, yet a habit to discuss politics was conducive to greater pessimism in prospective perceptions when inflation was growing. More surprising is that those who talked about politics more frequently also formed more negative forecasts when GDP growth was favorable. This finding may also be attributed to an intertemporal posture when an improving economic situation is perceived as unnatural at an early stage of transition and receives negative public evaluations, especially among those who actively discuss politics.

Visually, statistically significant findings seem to refute my proposition of no difference between the more and less politically sophisticated in their reliance on objective economic indicators when making judgments about the national economy. Nevertheless, further inspection of the results makes my point clearer and, hopefully, more convincing. Statistical significance, although a good standard for hypothesis testing, may be deceiving. With over 11,000 cases even small slope coefficients can become statistically significant. Yet, statistical significance does not automatically equate to substantive significance of the estimated effects. As seen in the previous

chapter, the statistically significant effects of the objective indicators made no or only small differences for the formation of sociotropic economic perceptions. Similarly, the magnitude of the mediating effect of education on the relationship between the objective economy and public economic assessments was very limited.

Noteworthy, however, is the result that people who frequently conversed about politics were on average less likely to view the past economic situation as favorable compared to those who did not engage in political discussion on a regular basis. What this may suggest is that the general tone of political discussions at the beginning of the post-communist transition was negative, something that has also been noticed by ethnographic studies. Thus, persons who regularly participated in political conversations perceived the situation in the country more pessimistically, whereas people who chose to isolate themselves from other people's stories and political evaluations formed more favorable views of the national economy. Conversely, with regard to economic forecasts, active political discussants felt more optimistically than those who were not involved in interpersonal communication on political matters. Apparently, favorable economic prognoses may have been driven by elevated hopes typical at the initial phase of the transformation concerning their own economic future and economic perspectives for their nation.



**Table 4.1.1. National RETROSPECTIVE Economic Perceptions by Level of Education**

| <i>National Retrospective Perceptions</i> | <i>Level of Education</i> |                      |           |        |
|---|---------------------------|----------------------|-----------|--------|
|   | Elementary                | Secondary Incomplete | Secondary | Higher |
| Much Worse                                | 38.22                     | 35.7                 | 40.53     | 43.91  |
| Worse                                     | 29.97                     | 31.97                | 31.27     | 29.16  |
| Same                                      | 14.1                      | 14.68                | 11.24     | 10.59  |
| Better                                    | 15                        | 15.83                | 14.92     | 13.93  |
| Much Better                               | 2.72                      | 1.83                 | 2.05      | 2.41   |

**Table 4.1.2. National PROSPECTIVE Economic Perceptions by Level of Education**

| <i>National Prospective Perceptions</i> | <i>Level of Education</i> |                      |           |        |
|---|---------------------------|----------------------|-----------|--------|
|   | Elementary                | Secondary Incomplete | Secondary | Higher |
| Much Worse                              | 22.32                     | 19.91                | 20.72     | 21.82  |
| Worse                                   | 22.55                     | 23.21                | 23.15     | 21.93  |
| Same                                    | 19.36                     | 23.51                | 21.84     | 20.38  |
| Better                                  | 31                        | 29.60                | 30.41     | 31.78  |
| Much Better                             | 4.77                      | 3.77                 | 3.88      | 4.1    |

**Table 4.1.3. National RETROSPECTIVE Economic Perceptions by Frequency of Political Discussion**

| <i>National Prospective Perceptions</i> | <i>Frequency of Political Discussion</i> |              |           |
|---|--|--------------|-----------|
|   | Never                                    | Occasionally | Regularly |
| Much Worse                              | 36.78                                    | 34.62        | 47.79     |
| Worse                                   | 30.57                                    | 33.79        | 26.89     |
| Same                                    | 15.65                                    | 13.19        | 9.66      |
| Better                                  | 15.02                                    | 16.46        | 12.96     |
| Much Better                             | 1.97                                     | 1.93         | 2.7       |

**Table 4.1.4. National PROSPECTIVE Economic Perceptions by Frequency of Political Discussion**

| <i>National Prospective Perceptions</i> | <i>Frequency of Political Discussion</i> |              |           |
|---|--|--------------|-----------|
|   | Never                                    | Occasionally | Regularly |
| Much Worse                              | 20.75                                    | 18.05        | 25.13     |
| Worse                                   | 21.44                                    | 23.59        | 22.16     |
| Same                                    | 23.3                                     | 23.13        | 18.19     |
| Better                                  | 30.87                                    | 31.45        | 29.57     |
| Much Better                             | 3.64                                     | 3.78         | 4.95      |

**Table 4.2. Mediating Effects of Education and Frequency of Political Discussion of the Formation of Sociotropic RETROSPECTIVE and PROSPECTIVE Economic Perceptions**

(Standard errors in parentheses)

| Independent Variable                                 | Ordered Logit with<br>Interactions<br>(retrospective) | Ordered Logit with<br>Interactions<br>(prospective) |
|--|---|---|
| <b>Inflation Rate (logged)</b>                       | -.004<br>(.025)                                       | .115***<br>(.026)                                   |
| <b>Unemployment Rate</b>                             | -.014**<br>(.005)                                     | .023***<br>(.005)                                   |
| <b>Growth Rate</b>                                   | .025***<br>(.004)                                     | .011**<br>(.004)                                    |
| Sociotropic <i>retrospective</i> evaluations         |   | .486***<br>(.021)                                   |
| Egocentric <i>retrospective</i> economic evaluations | .769***<br>(.019)                                     | .098***<br>(.022)                                   |
| Egocentric <i>prospective</i> economic evaluations   |   | .953***<br>(.023)                                   |
| Income   | -.012*<br>(.005)                                      | -.017**<br>(.005)                                   |
| Unemployment Status                                  | .081<br>(.074)  | -.036<br>(.079)                                     |
| Satisfaction with democracy                          | .479***<br>(.026)                                     | .360***<br>(.028)                                   |
| Attitudes toward political system                    | .165***<br>(.023)                                     | .117***<br>(.024)                                   |
| Attitudes toward the market                          | .224***<br>(.042)                                     | .219***<br>(.044)                                   |
| Education  | .361*<br>(.145)                                       | -.040<br>(.154)                                     |
| Political Discussion                                 | -.369*<br>(.151)                                      | .220<br>(.160)                                      |
| <b>Inflation*Education Dummy</b>                     | -1.108***<br>(.028)                                   | -.002<br>(.030)                                     |
| <b>Unemployment*Education Dummy</b>                  | .019***<br>(.005)                                     | .004<br>(.006)                                      |
| <b>Growth*Education Dummy</b>                        | -.003<br>(.004)                                       | -.001<br>(.004)                                     |
| <b>Inflation*Political Discussion Dummy</b>          | .049<br>(.027)  | -.064*<br>(.028)                                    |
| <b>Unemployment*Political Discussion Dummy</b>       | .005<br>(.005)  | -.002<br>(.006)                                     |
| <b>Growth*Political Discussion Dummy</b>             | .011**<br>(.004)                                      | -.009*<br>(.004)                                    |
| N  | 11118   | 9767  |
| -2Log Likelihood                                     | 25677.06  | 22931.49  |
| Pseudo R <sup>2</sup>                                | .16   | .21   |

\* p < 0.05 \*\* p < 0.01 \*\*\* p < 0.001 (two-tailed). Note: Gender, Age, and Attitudes towards the speed of reforms are included as controls.

**Table 4.3.1. Multilevel Analysis: Mediating Effects of Education and Frequency of Political Discussion on the Formation of Sociotropic RETROSPECTIVE Economic Perceptions**

(Standard errors in parentheses)

| Independent Variable                           | ANOVA | Model with Country Dummies | Model with Macro Variables and Interactions |
|--|-------|----------------------------|---|
| <b>Inflation Rate (logged)</b>                 |       |                            | -.022<br>(0.032)                            |
| <b>Unemployment Rate</b>                       |       |                            | -0.002<br>(0.007)                           |
| <b>Growth Rate</b>                             |       |                            | .008*<br>(0.004)                            |
| Egocentric retrospective economic evaluations  |       | .366***<br>(.009)          | .365***<br>(.009)                           |
| Income   |       | -.007*<br>(.003)           | -.008**<br>(.003)                           |
| Unemployment Status                            |       | .031<br>(.035)             | .034<br>(.035)                              |
| Satisfaction with democracy                    |       | .203***<br>(.013)          | .204***<br>(.013)                           |
| Attitudes toward political system              |       | .087***<br>(.011)          | .087***<br>(.011)                           |
| Attitudes toward market                        |       | .059**<br>(.021)           | .062**<br>(.021)                            |
| Attitudes toward the speed of the reforms      |       | .223***<br>(.019)          | .219***<br>(.019)                           |
| Education                                      |       | -.007<br>(.010)            | .103<br>(.074)                              |
| Political Discussion                           |       | -.034*<br>(.014)           | -.149*<br>(.075)                            |
| Gender   |       | .038*<br>(.018)            | 0.039*<br>(.018)                            |
| Age  |       | -.002<br>(.001)            | -.002<br>(.001)                             |
| <b>Inflation*Education Dummy</b>               |       |                            | -.031*<br>(.014)                            |
| <b>Unemployment*Education Dummy</b>            |       |                            | .007*<br>(.003)                             |
| <b>Growth*Education Dummy</b>                  |       |                            | .0004<br>(.002)                             |
| <b>Inflation*Political Discussion Dummy</b>    |       |                            | .029*<br>(.013)                             |
| <b>Unemployment*Political Discussion Dummy</b> |       |                            | .001<br>(.003)                              |

|  |          |          |          |
|--|----------|----------|----------|
| <b>Growth*Political Discussion<br/>Dummy</b> |          |          | .005*    |
|  |          |          | (.002)   |
| Constant                                     | 2.132*** | .360***  | .839***  |
|  | (.109)   | (.067)   | (.194)   |
| <b>Country-Level Variance</b>                | .202***  | .000     | .033**   |
|  | (.069)   | (.000)   | (.011)   |
| <b>Individual-Level Variance</b>             | 1.168*** | .864***  | .862***  |
|  | (.016)   | (.012)   | (.012)   |
| N  | 11118    | 11118    | 11118    |
| -2Log Likelihood                             | 33360.29 | 29923.58 | 29957.12 |

\* p < 0.05 \*\* p < 0.01 \*\*\* p < 0.001 (two-tailed)

**Table 4.3.2. Multilevel Analysis: Mediating Effects of Education and Frequency of Political Discussion on the Formation of Sociotropic PROSPECTIVE Economic Perceptions**

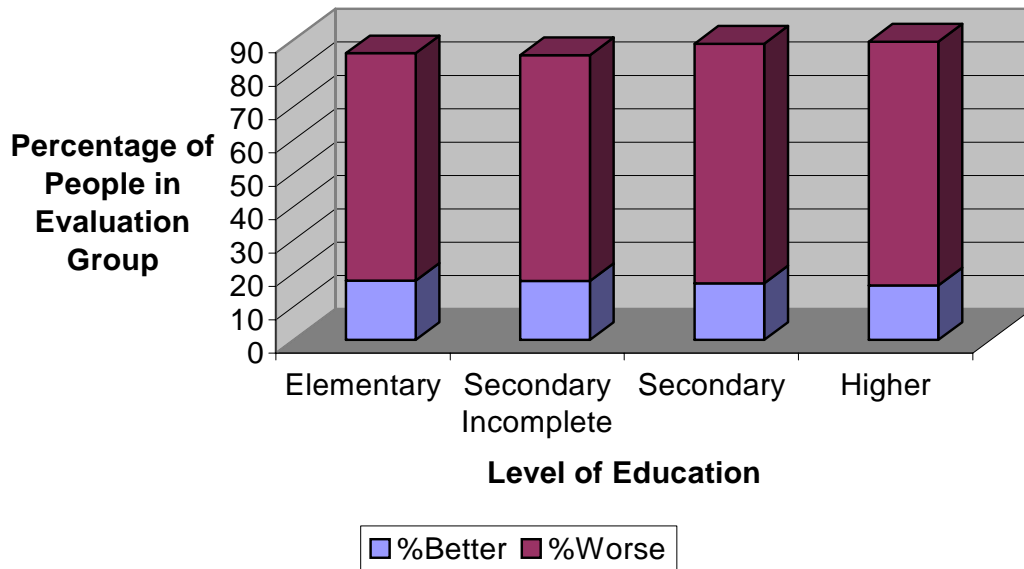
(Standard errors in parentheses)

| Independent Variable                                 | ANOVA | Model with Country Dummies | Model with Macro Variables and Interactions |
|--|-------|----------------------------|---|
| <b>Inflation Rate (logged)</b>                       |       |                            | .053*<br>(.020)                             |
| <b>Unemployment Rate</b>                             |       |                            | .010*<br>(.004)                             |
| <b>Growth Rate</b>                                   |       |                            | .005<br>(.003)                              |
| Sociotropic <i>retrospective</i> evaluations         |       | .218***<br>(.010)          | .221***<br>(.010)                           |
| Egocentric <i>retrospective</i> economic evaluations |       | .043***<br>(.010)          | .042***<br>(.010)                           |
| Egocentric <i>prospective</i> economic evaluations   |       | .420***<br>(.010)          | .421***<br>(.010)                           |
| Income   |       | -.007*<br>(.003)           | -.007*<br>(.003)                            |
| Unemployment Status                                  |       | -.011<br>(.036)            | -.013<br>(.036)                             |
| Satisfaction with democracy                          |       | .143***<br>(.013)          | .144***<br>(.013)                           |
| Attitudes toward political system                    |       | .064***<br>(.012)          | .064***<br>(.012)                           |
| Attitudes toward market                              |       | .099***<br>(.021)          | .102***<br>(.021)                           |
| Attitudes toward the speed of the reforms            |       | .137***<br>(.019)          | .137***<br>(.019)                           |
| Education  |       | .005<br>(.010)             | -.041<br>(.073)                             |
| Political Discussion                                 |       | -.019<br>(.014)            | -.098<br>(.074)                             |
| Gender   |       | .080***<br>(.018)          | .079***<br>(.018)                           |
| Age  |       | .002*<br>(.001)            | .002***<br>(.001)                           |
| <b>Inflation*Education Dummy</b>                     |       |                            | .005<br>(.014)                              |
| <b>Unemployment*Education Dummy</b>                  |       |                            | .002<br>(.003)                              |
| <b>Growth*Education Dummy</b>                        |       |                            | .0005<br>(.002)                             |

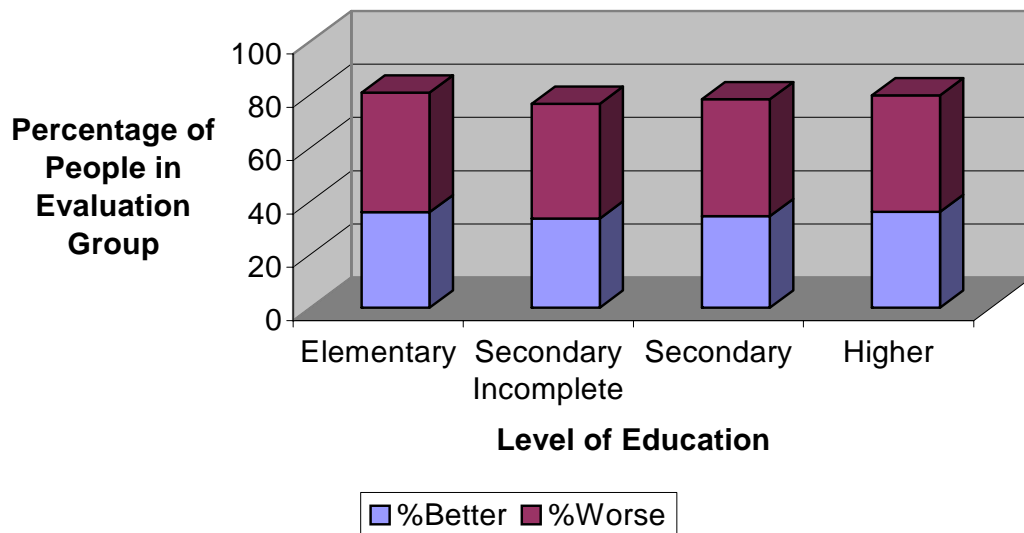
|  |                    |                   |                    |
|--|--------------------|-------------------|--------------------|
| <b>Inflation*Political Discussion<br/>Dummy</b>    |                    |                   | -.037**<br>(.013)  |
| <b>Unemployment*Political<br/>Discussion Dummy</b> |                    |                   | -.0004<br>(.003)   |
| <b>Growth*Political Discussion<br/>Dummy</b>       |                    |                   | -.006***<br>(.002) |
| Constant   | 2.767***<br>(.106) | .337***<br>(.072) | -.007<br>(.125)    |
| <b>Country-Level Variance</b>                      | .190**<br>(.066)   | .000<br>(.000)    | .009*<br>(.003)    |
| <b>Individual-Level Variance</b>                   | 1.290***<br>(.018) | .791***<br>(.011) | .791***<br>(.011)  |
| N  | 9767               | 9767              | 9767               |
| -2Log Likelihood                                   | 30283.66           | 25423.34          | 25459.32           |

\* p < 0.05 \*\* p < 0.01 \*\*\* p < 0.001 (two-tailed)

**Figure 4.1.1. National RETROSPECTIVE Economic Evaluations by Level of Education**

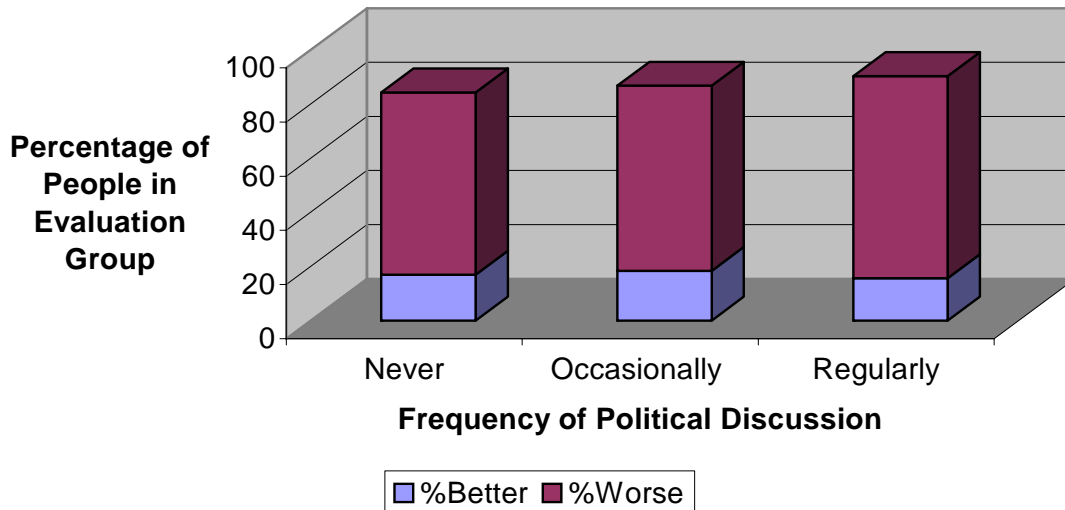


**Figure 4.1.2. National PROSPECTIVE Economic Evaluations by Level of Education**

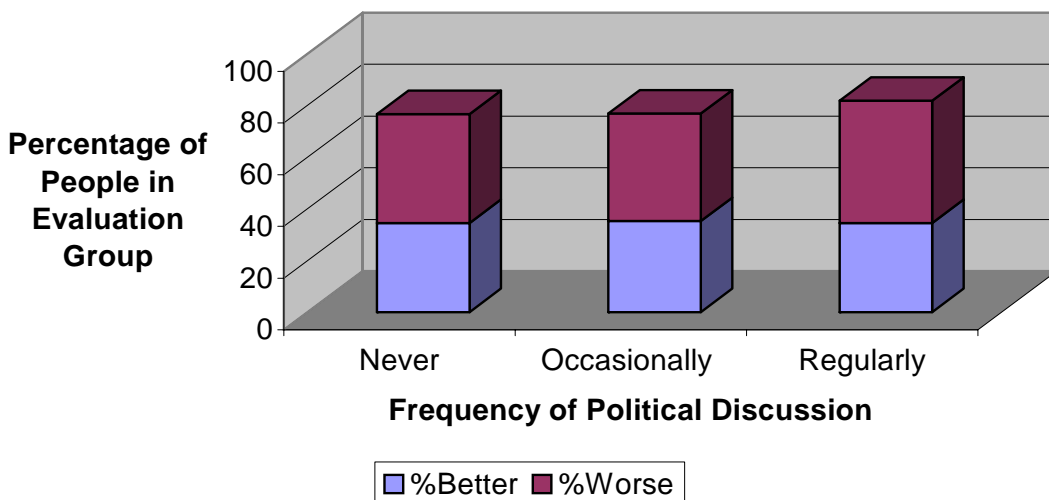




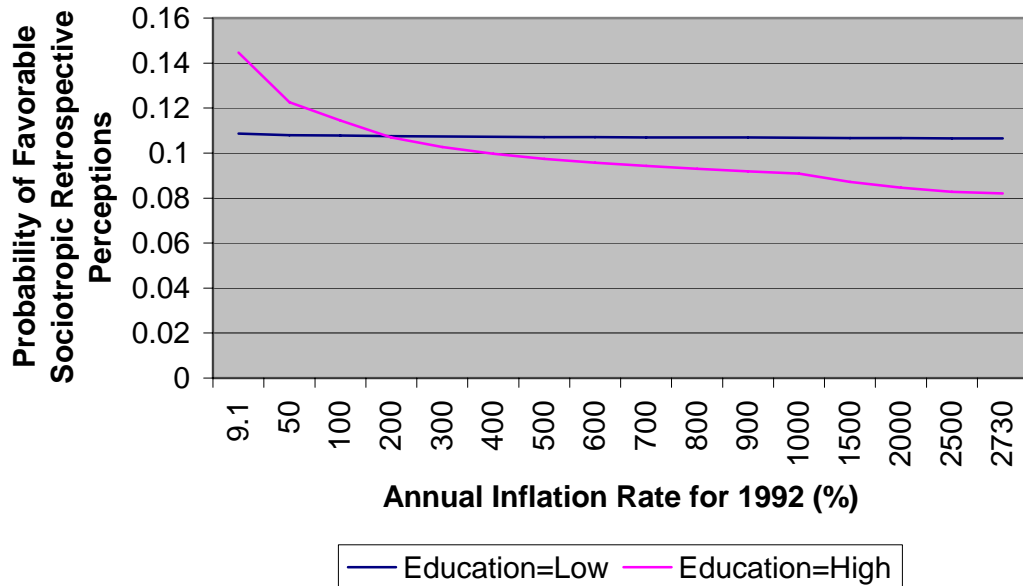
**Figure 4.1.3. National RETROSPECTIVE Economic Evaluations by Frequency of Political Discussion**



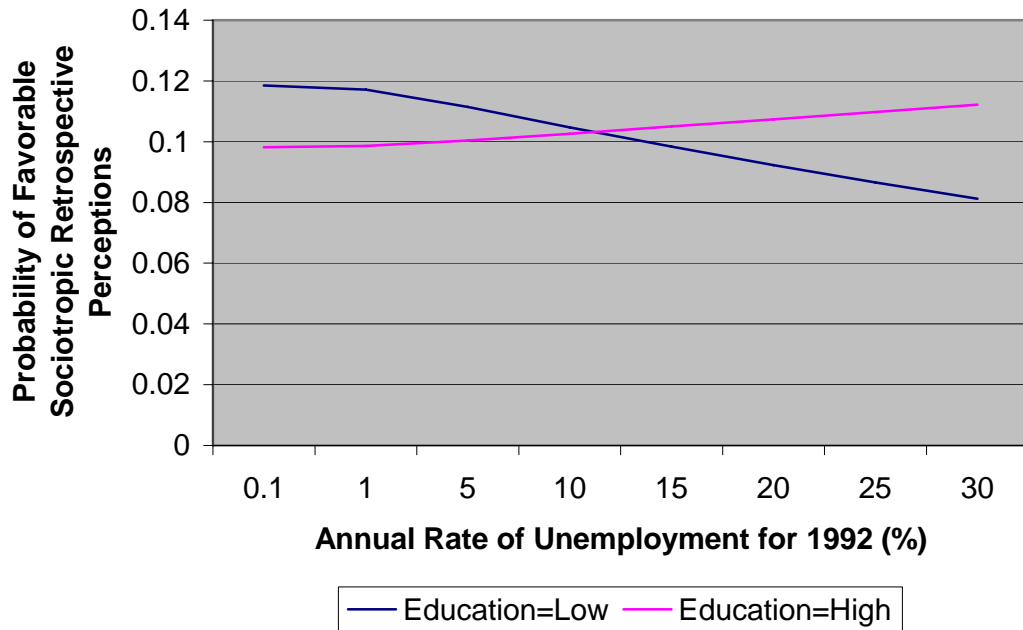
**Figure 4.1.4. National PROSPECTIVE Economic Evaluations by Frequency of Political Discussion**



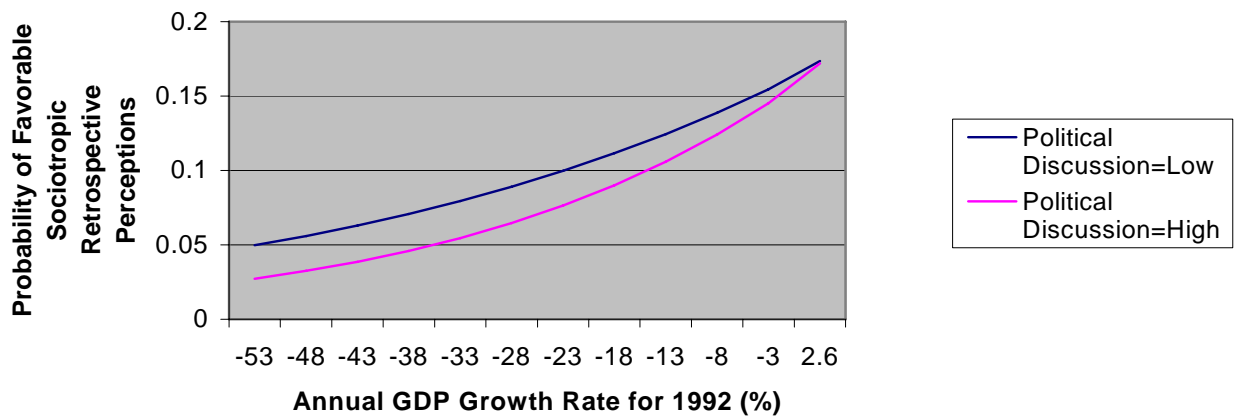
**Figure 4.2.1. Probability of Favorable Retrospective Perceptions of the National Economy as a Function of the Inflation Rate by Level of Education**



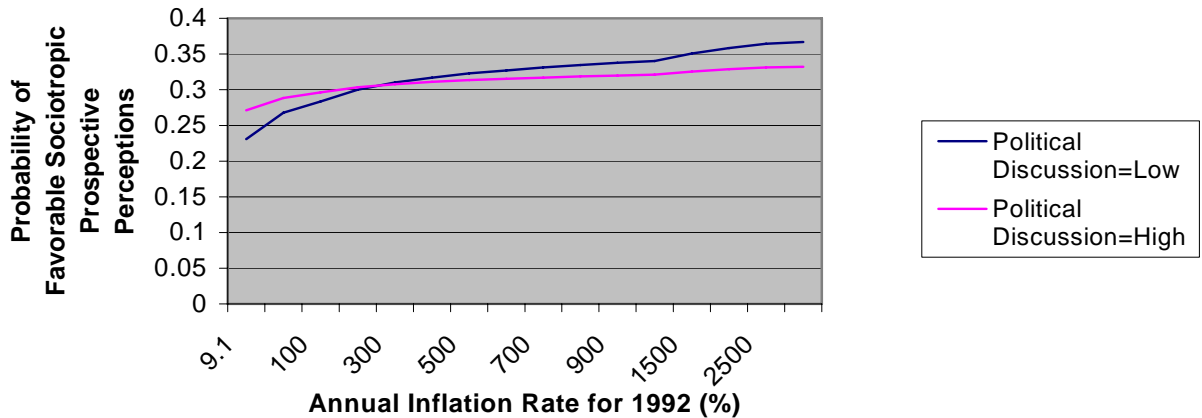
**Figure 4.2.2. Probability of Favorable Retrospective Perceptions of the National Economy as a Function of the Unemployment Rate by Level of Education**



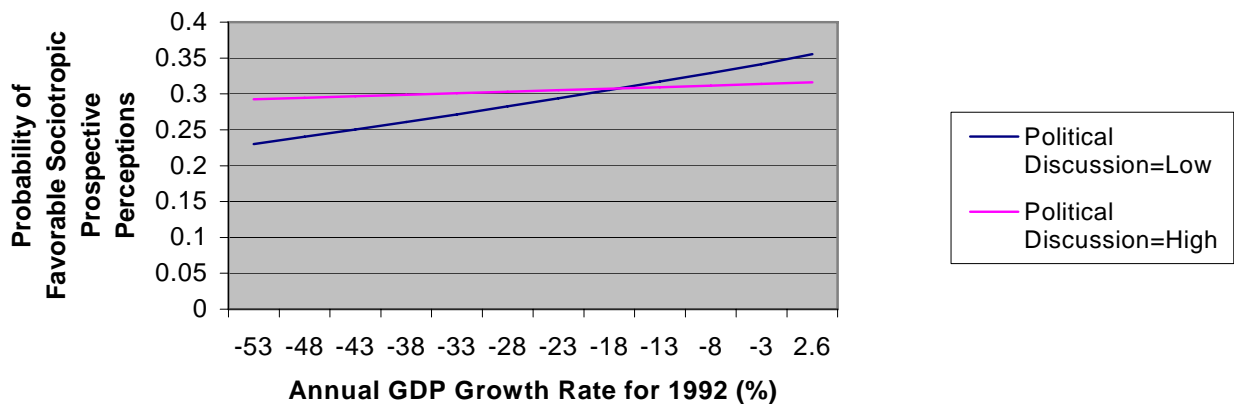
**Figure 4.3.1. Probability of Favorable Retrospective Perceptions of the National Economy as a Function of the GDP Growth Rate by Degree of Political Discussion**



**Figure 4.3.2. Probability of Favorable Prospective Perceptions of the National Economy as a Function of the Inflation Rate by Degree of Political Discussion**



**Figure 4.3.3. Probability of Favorable Prospective Perceptions of the National Economy as a Function of the GDP Growth Rate by Degree of Political Discussion**



## CHAPTER 5

### **Cognitive and Information Heuristics as a Source of Sociotropic Economic Evaluations**

The puzzle of incongruence between the objective state of the national economy and public economic opinion in the post-communist countries of East Central Europe did not find its solution in the heterogeneity of people's political knowledge. When even the most educated and versed in politics were inaccurate in their evaluations of the general economic situation, what was the source of the bias in people's economic views? With this question in mind, I propose to look closely at theories of information processing and opinion formation.

Contrary to our belief that citizens, especially the well informed ones, should have accurate perceptions of the objective state of the world, social psychologists tell us why exactly it should be improbable. Simple as it is, the explanation stems from the notion of memory. Remembering and forgetting are the two keys to understanding why persons' evaluations of various events, including changes in the national economy, are imprecise.

In this chapter, I will discuss cognitive and information heuristic mechanisms, which play a significant role for our understanding of public opinion.<sup>42</sup> My intention is also to find out how two distinctive features of systems in transition – system instability and its novelty to the population – affect the process of the formation of national economic evaluations.

The major focus of this dissertation is on the mechanism of people’s formation of national economic evaluations in East Central Europe after the collapse of the communist regime. In particular, my interest rests with two issues: 1) how public perceptions of the economy correspond to objective economic indicators, and 2) how people use cognitive heuristic mechanisms in their assessments of the national economy. Although these two issues may seem separate, they are, in fact, closely interrelated.

In theory, people should be politically informed and actively participate in the democratic process for democracy to function properly. One of the aspects of this process is for citizens to hold governments accountable for their performance, including economic performance. In order to be able to give adequate evaluations of governments’ economic performance, however, people need to form accurate assessments of the national economic state; that is, public opinion should correspond to objective economic indicators.

In reality, people are quite ignorant on political matters; nonetheless, established democracies are quite stable. Although democratic citizens in mature democratic societies use objective economic information to some extent in their evaluations of the national economic situation, it accounts for a small part in the variation of public

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<sup>42</sup> A dictionary definition of “heuristic” is “revealing” or “leading to discovery”, as well as such argument or process. I use “shortcuts” and “cues” as synonyms for “heuristics”.

economic opinion. It turns out that the remaining variation can be explained by a number of systematic factors upon which people rely to make evaluations of the national economy. Generally speaking, these are sources of economic information that individuals use when they lack information on the objective economy or simply do not want to go to the trouble to retrieve it from memory when asked about their economic opinion. I refer to those alternative sources as cognitive and information heuristics or shortcuts (Lau and Redlawsk 2001, Kuklinski et al. 2001, Neuwirth et al. 2002).

In assessing the probability of an uncertain event, such as the state of the national economy or the likelihood of rain, people use a limited number of heuristic principles rather than statistical norms (Kahneman et al. 1982, 3).<sup>43</sup> An uncertain event may refer both to the past and to the future. Uncertainty related to the past is simply ignorance of an event or vagueness due to memory shortage. Judgment heuristics or cognitive shortcuts are mechanisms that help people ease the task of forming evaluations and assessing probabilities in situations of uncertainty. In general heuristics are quite useful, since they reduce complexity of prediction; but this simplification may lead to potential systematic errors in probability judgment, which sometimes could be grave.

There are several heuristics helping people form perceptions about uncertain events and phenomena. When probability of A is evaluated by the degree to which A is representative of B, that is, by the degree to which A resembles B, we may say that A is evaluated based on *representativeness* heuristic. Although experimental and anecdotal

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<sup>43</sup> An uncertain event may refer to any event or phenomenon that a person can describe or evaluate with less than 100% certainty. Peterson (2004) gives a simple definition of certainty as “how sure a person is about the attitude they hold” (513). An uncertain event can equally be the name of another person or the inflation rate provided the respondent has any degree of doubt of giving the right answer. Any future event should automatically be considered as uncertain.

evidence reveals that the representativeness heuristic is widely used in everyday life, a number of studies in psychology showed that this approach to probability judgment could result in serious biases. These biases emerge because several factors that should influence the calculation of probability, such as the base-rate or prior probabilities and the sample size, are ignored when the representativeness heuristic comes into play (ibid., 4). On the brighter side, similarity or representativeness oftentimes retrieves a valid association between A and B, which leads to an accurate assessment of probability of A given knowledge of B.

*Availability* is another cognitive shortcut used by people when forming assessments about uncertain events. The availability heuristic is such a mechanism of assessing the likelihood of a phenomenon that revokes familiar, vivid, salient, and emotional matters related to this phenomenon in people's minds. In other words, it is simply the ease with which occurrences of the same or related events can be brought to mind (ibid., 11). Reliance on availability, similar to representativeness, may cause biased inferences in estimation procedures. Things that are more familiar or of greater salience seem more probable; and so do more recent occurrences of events. Also, if two events co-occur or co-exist in people's minds, then the incidence of one of them may make the other one appear more likely. More often than not, however, easy recall from memory is in fact associated with a higher probability of an event; hence availability, like representativeness, is a useful cognitive tool in forming assessments under uncertainty.<sup>44</sup>

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<sup>44</sup> Besides *representativeness* and *availability*, Kahneman et al. consider a third heuristic termed *adjustments and anchoring*. What it means is that "people make estimates by starting from an initial value that is adjusted to yield the final answer... Different starting points yield different estimates, which are biased toward the initial value" (Kahneman et al. 1982, 14). As follows from the studies of choice conducted in experimental psychology, the most significant systematic error produced by imperfect adjustment is overestimation of probability of conjunctive events and underestimation of occurrence of

Despite the fact that cognitive heuristics occasionally lead to biased judgments, they persevere as evaluative mechanisms not only among laymen, but also among experienced researchers thinking intuitively (ibid., 18). In contrast, normative statistical rules, oftentimes counterintuitive, demonstrate much lower utility in everyday situations of decision-making.

### **Inaccuracy of Economic Evaluations and Utilization of Heuristic Mechanisms**

By convention, sociotropic economic perceptions are said to be accurate when they match experts' assessments of the national economic state or objective economic indicators. However, this agreement between experts' and public economic evaluations could only exist if people closely follow all media reports on objective economic indicators and have perfect memory of this information. To most of us such an assumption sounds completely unrealistic and the reasons for that are obvious.

First, one needs to be motivated to follow economic news in general (Gordon and Segura 1997). This statement looks relatively reasonable because people are social beings interacting with the economic system on a daily basis. Yet, daily activities do not require citizens to be fully aware of all economic news in the nation. It is sufficient for people to know only as much about the national economy as it takes them to sustain themselves in everyday life.

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disjunctive events (ibid., 15). Put differently, contrary to normative rules of formal probability theory, people evaluate the probability of two joint events as greater than each of them separately. With regard to my dependent variable, a respondent's evaluation of the economic situation 12 months prior to the interview (in the retrospective case) and at the moment of the interview (in the prospective case) can be viewed as initial values from which the respondent makes his or her estimation of the present (compared to the past) and the future (compared to the present) economy. However, these initial values remain unknown given the data, thus the adjustment and anchoring heuristic is not applicable in my study of the formation of economic judgments.



Second, experts' economic indicators do not appear in every economic news report broadcast by the media. Along with the accounts of government economic performance, many of which are void of statistical data on the national economy, journalists are keen on making reports from various localities and communities within the country. Local conditions, therefore, may become viewed as representative for the whole country and, consequently, may lead to incorrect inferences about the national economic situation. Thus, both the relative infrequency of media reports containing objective economic indicators and potentially faulty generalizations from regional economic news are likely to cause inaccurate economic views in the populace.

Finally, even if people obtain credible information on objective economic indicators, there is no guarantee that they retain it in memory until the moment when a pollster asks them to evaluate the state of the national economy. In other words, national economic figures are not something that people would normally remember for a long time, unless this information is necessary for people's everyday activities.

Overall, public ignorance of the objective state of the national economy was found by a number of studies on economic perceptions and economic voting. Yet respondents of public opinion polls more often than not offer their opinion on their country's economic situation even when the option 'don't know' is made available by the list of possible answers. It could mean one of the two things: either people give random responses or they use some sources other than objective economic indicators to assess the past economic situation and to predict the economic future. If people answer non-randomly, there ought to be systematic factors on which respondents base their economic perceptions. Following Kahneman et al. (1982), I posit that people use heuristics or

cognitive shortcuts, such as representativeness and availability, when making evaluations of the national economy.

### **The Individual Nature of Sociotropic Economic Perceptions**

To understand how people process information about the economy and which heuristics they are likely to use when forming sociotropic economic opinion, I rely on the Receive-Accept-Sample (RAS) Model developed by John Zaller (1992). Zaller's definition of an opinion includes two components: information and predisposition. One needs information "to form a mental picture of the given issue...and predispositions to motivate some conclusions about it" (Zaller 1992, 6).

The cornerstone of Zaller's theory is a series of four assertions or axioms. Axiom 1 (A1), called the reception axiom, states that greater attentiveness to an issue leads to a greater likelihood of receiving messages regarding this issue. The second axiom (A2) declares that, "people tend to resist arguments that are inconsistent with their political predispositions, but they do so only to the extent that they possess the contextual information necessary to perceive a relationship between the message and their predispositions" (ibid., 44). In other words, people possess a set of certain values and beliefs and tend to accept arguments that are consistent with their prior beliefs and reject dissonant messages. In the third axiom (A3), titled the accessibility axiom, Zaller proposes that more recent information is brought to the top of the head more easily than information that has been stored and not activated for a long time. This does not necessarily mean that information has to be something that one sees or hears, it also includes information about which one thinks. Finally, the response axiom (A4) states

that, when approached by an interviewer, people answer questions by “averaging across the considerations that are immediately salient or accessible to them” (ibid., 49). Considerations are defined by the author as reasons pro or against an issue. Thus, Zaller posits that people do not hold pre-determined attitudes on each and every issue about which a pollster may ask them. Instead, they form their opinions on the go by recalling relevant considerations from memory. In the situation of a questionnaire interview, considerations that get recalled are the ones that are easily available.

According to the RAS model, a person must first receive some information related to an issue, in my case opinion about the state of the national economy. One of the major sources of economic information is mass media. In addition, one way or another, people have to act and interact within a given economic system on a daily basis. By going grocery shopping, for instance, they become familiar with current prices, while by looking for a new job, individuals get an idea about the state of the labor market.

In the process of acquiring new information about an issue, people may react critically to it, and either accept or reject it. These types of reaction to new information should depend on people’s previous cognitive predispositions. If the new message does not fit into a person’s system of beliefs, then, the person will, in all likelihood, reject such a message. If, on the other hand, the message appears consistent with the person’s previous predisposition on the issue, he or she can be expected to accept it. This process, however, can only take place when the person is able to relate the new information to the old information on the same issue stored in his or her memory.

Surprisingly, reception and critical evaluation of new information does not conclude the formation of an opinion. According to Zaller, people do not “carry around

in their heads fixed attitudes on every issue on which a pollster may happen to inquire” (Zaller 1992, 1). Instead, people form opinions on the fly using considerations that are on top of their heads.

It was mentioned earlier in this chapter that numerous studies on economic voting and perceptions have concluded that the general public knows little about the state of the national economy. Furthermore, it would be naïve to suppose that each and every individual within an economic system forms the same set of evaluations about it. This statement follows to some extent from all four axioms proposed by Zaller as the components of his RAS information-processing model. Information about the national economy comes from various sources. Along with mass media, personal experience and interpersonal communication have been acknowledged as important sources in forming sociotropic perceptions (Mutz 1992, Conover et al. 1986). Diana Mutz (1992) even claimed that, “economic issues are precisely the type least likely to be influenced by mass media” (Mutz 1992, 484). Because personal experiences and interpersonal communication patterns vary by individual, perceptions derived from these experiences are also likely to be individually determined. On top of that, following on the topic of Chapter 4, information received through interpersonal communication is likely to be biased due to subjective representation of messages by participants of a political conversation, as well as the homogeneous nature of discussion networks. Moreover, mass media sources in democratic societies are allowed to offer their own evaluative commentaries and analyses on the national economic situation along with objective numbers. Thus by choosing different mass media sources, people may become exposed to different interpretations of seemingly identical economic information. Finally,

individuals have diverse interests in economic and political matters and may simply choose not to receive any information of the national state of the economy; therefore, the disparity of sociotropic perceptions can also be caused by the amount of information received.

The second axiom, the acceptance axiom, points to potential discrepancies in national economic evaluations among individuals more directly. It states that individuals filter new information through the prism of their earlier predispositions on related issues. Social psychologists maintain that what people strive for is consistency within their value and belief systems (Mattila 1998, Vláchová 2001). This prompts individuals not only to accept considerations that fall within the framework of their value system, but also to seek out information that is compatible with their previous attitudinal predispositions. Conversely, statements that contradict people's personal systems of beliefs tend to be rejected.<sup>45</sup>

Let me now consider a general set of values and beliefs that may affect an individual's decision to accept or reject a certain piece of information about the national economy. First, as indicated by numerous studies on attitudes, most people have ideological predispositions that scale along a socio-economic dimension. Depending on whether a person is on the left or on the right of the ideological scale, he or she would evaluate certain economic reports differently. For example, news about lowering unemployment by means of creating more public jobs may be evaluated positively by somebody on the economic left, whereas somebody on the right may view it as government interference in the economy, which distorts free market operation.

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<sup>45</sup> Such a tendency to preserve stability within one's system of values, beliefs, and even behavioral patterns has been referred to as *cognitive consistency* (Festinger 1957).

Second, previous political behavior and predispositions may also serve as a filter for the stream of economic information (Conover et al. 1986). It is a well-documented fact in past research that citizens hold their government accountable for national economic performance (for a review see Nannestad and Paldam 1994a, 2000). Although in a free market economy government has a limited role in managing the economy, still this role should not be underestimated. Not only does the government develop national economic policies, but it is also one of the biggest investors and customers in the national market.

Now consider an individual who voted for the governing party during the latest election and another one who voted for a party in opposition. According to the thesis about a person's propensity for cognitive consistency with previously made considerations, a government supporter would tend to evaluate the state of the national economy more positively than a person who is in opposition to the government. It happens because a pro-government voter presumably supported the winners' economic program by giving them his or her vote. Thus, during the winners' term in office the government supporter would seek out information that would allow him or her to form a more favorable opinion about the national economy to preserve inner consistency. A government opponent would tend to do the opposite (Anderson, Mendes, and Tverdova 2004).

From past public opinion research, we know that people receive information about the national economy from three main sources: mass media reports, interpersonal communication, and personal experiences. Of the three sources, mass media reports are presumed to be the most objective and impartial. Yet the evaluative comments offered

by journalist reporters and analysts cannot be completely void of their personal vision of reported issues. In turn, people tend to choose mass media sources that most closely represent their own ideological views. As a result, objective economic information disseminated by various media sources may have dissimilar effects for the formation of sociotropic economic perceptions among individuals – messages that work in dissonance with the previous predispositions get rejected while congruent messages are accepted (Novosel 1995).<sup>46</sup>

Interpersonal communication and personal economic experience can both serve as sources and filters of information on the national economy (Sanders and Gavin 2004). Personal economic well-being or the economic state of their relatives, friends, colleagues and neighbors oftentimes prompt people to be critical of what they hear on the radio and TV or read in the newspaper regarding the economic situation in their country. The mechanism here is very simple: personal experience (whether a person's own experience or experience of somebody from his or her environment) is difficult to deny and can be used as a powerful base for critical evaluation of economic information coming from

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<sup>46</sup> Even before the collapse of the communist system in East Central Europe, mass media in those countries started to show noticeable signs of liberalization. In Poland, opposition press was particularly strong and had a well-developed organization within the framework of Solidarity. During Gorbachev's perestroika in the Soviet Union (1985-1991), both print and electronic media dramatically changed the style of the news presentation introducing political debates, critical analyses of current events, live broadcasting, and dissidents' opinions in their reports if only to the extent that would not threaten the foundation of the existing regime and Communist Party hegemony. With the downfall of communist, new media titles emerged rapidly addressing a wide range of groups and interests in the society (Frybes 2000). Many newspapers were closely identified with a concrete political opinion (ibid.). To develop a pluralistic press system, newly emerging parties were allowed to buy or were allotted media outlets (Jakubowicz 1995). Consequently, many media sources were highly biased. For example, Czechoslovakian media at the beginning of the transition was very politicized and full of anti-communist ideology. Polish and Hungarian media, on the contrary, was much more objective and independent (Urban 2001). This, however, changed in the Hungarian case when later in the transition the new government tried to resume its control of electronic media (Molnár 2001). In Russia and Romania, journalism was also politically affiliated (Jakubowicz 2001). As for the major focus of mainstream media outlets at the early stage of the post-communist transformation, it was mainly concern with the economy, as compared to largely political reports during the early phase of *perestroika* (Rantanen 2002).

other sources. Diana Mutz (1992) posits that personal experience is “superior” to all other sources of sociotropic economic perceptions. Thus depending on whether a particular economic message acquired from a mass media source or via interpersonal communication is consistent with a person’s own economic experience, the person may accept or reject it. Elsewhere, Schmitt-Beck (2003) makes a claim that media reports get accepted or rejected by many individuals only after somebody trustworthy from their surrounding sends a signal of how the media message should be interpreted.

The third axiom, which talks about the availability and accessibility of issue considerations, also suggests the importance of a micro-foundation in the formation of national economic attitudes. In the first place, people possess sets of individually determined considerations regarding a certain issue, for example the economy. Therefore considerations available to one individual may differ from considerations available to another one on the same issue. Moreover, according to numerous psychological studies, availability of a consideration stored in a person’s memory depends on the salience of this particular consideration to this particular individual. For instance, the same survey question could be of different importance for various individuals. One individual, for whom the question touches upon a salient issue, is likely to know more about the issue and take the question more seriously. Another individual, who feels that the issue is of less importance, is also likely to be less knowledgeable about it and may not make enough effort to give a thoughtful answer to the survey question.

Imagine now a very unlikely situation when two individuals have the same set of considerations about a particular issue. Even if we found such individuals, they would, in



all likelihood, place various degrees of salience (or weight) on at least one of these considerations and, therefore, in the end, their opinions on the issue could differ.

Besides salience, another important factor influencing availability is time passed since a certain consideration has been encountered by a person. According to Bousfield and Sedgewick (1944), availability is a negatively accelerated exponential function of time. In other words, the fresher a certain consideration is in one's memory, the more accessible it is. Furthermore, considerations that an individual encounters more often also tend to be easier to retrieve from memory than those encountered once or twice, all else equal (Kahneman et al. 1982). Finally, availability depends on the strength of the associative connection between a survey question and each particular consideration stored in a person's mind, which is related to the issue brought up by the question (Kahneman et al. 1982).

The last axiom, the response axiom, concludes the model of the formation of a public attitude. According to Zaller (1992), once a person has completed surveying for all considerations relevant to the issue question, he gives a final answer by averaging across these considerations. This final step of the opinion formation is the only one that pollsters observe. There are three possible outcomes of the underlying process of the opinion formation: 1) a person may say the truth, 2) he or she may lie, or 3) he or she may choose not to answer the question at all by either refusing to answer or saying he or she does not know. Naturally, we as researchers would only want to analyze truthful answers; yet, we are deprived this privilege. We have no means of telling the truth from the lie in questionnaire responses; therefore we have no choice but to assume that they are all truthful. Should we decide to assume the opposite, survey research would lose all

its meaning. As a rule, pollsters get a wide range of evaluative answers to questions about the state of the national economy in the respondents' countries, which reflects the individual nature of the opinion formation process assumed by the RAS model.

Having made all the above statements about the potential heterogeneity of public views on an issue, by no means do I intend to claim complete idiosyncrasy of a person's opinion that cannot be modeled. Instead, I hypothesize that, an individual's economic attitudes, as probably any other type of attitudes, includes a systematic component driven by generalizable cognitive and information shortcuts. Upon request people survey their memory for instances or consideration related to the question and form an opinion on the go by aggregating the consideration that are immediately available to them.

### **Alternative Models of Information Processing and Opinion Formation**

It is fair to note that Zaller's is not the only model describing the internal process of converting information into political judgments and preferences. In fact, there has been a long-standing debate in social psychology already exported to political science about the underlying mechanism of opinion formation. Social psychologists have divided along the line of when exactly judgment formation takes place – right at the moment of receiving information or at the moment of retrieving it from memory. To specify, the former argue that an individual evaluates a message at the time of receiving information and stores the evaluation, not the information itself, in long-term memory. When encountering new information on the same issue, the person updates the existing evaluations, again without remembering all details of the message. As soon as there is a need to express an opinion on the subject, the individual simply retrieves a readily

available evaluation from memory. This mechanism of information processing is termed *on-line* (Vanknippenberg and Vanknippenberg 1994, Moser 1992, McConnell et al. 1994).

Recall that Zaller maintains that people do not walk around with readily made issue opinions and instead, form them on the fly using messages that are on top of their heads. Thus, Zaller stands on the opposite end of the information-processing continuum and his model refers to the so-called *memory-based* models.<sup>47</sup> What it means is that individuals do not form evaluations in the moment of receiving information; rather they store raw messages in memory. Later, when the time comes to make an evaluation, they retrieve relevant and accessible considerations from memory and form a judgment by averaging across these considerations.

At first sight, and some scholars support this view, memory-based information processing appears to be more cognitively engaging. In particular, it requires individuals to store issue considerations in memory, retrieve the relevant ones when necessary, and weigh the positive and the negative messages or, some say, average across the messages for a final evaluation. Oftentimes, however, researchers observe survey respondents or subjects of experiments unable to recall specific contents of information messages that they received in the past, yet capable of forming a general opinion on the issue. For example, a respondent may say whether she likes or dislikes a presidential candidate, but not necessarily remember why. Such on-line information processing is considered by some scholars as less cognitively demanding, because it only requires recalling an

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<sup>47</sup> Druckman and Lupia (2000) refer to Zaller's model of opinion formation as an accessibility model.

already made general impression of a target without remembering any specific content about it.

On the flip side of the seeming cognitive simplicity of an on-line model, however, lies the necessity to form and update the evaluation upon encountering new information about the issue. Thus, some scholars believe that on-line opinion formation may involve even more effort on the part of an individual than memory-based models. First, a person has to be motivated to evaluate information when it comes along rather than simply absorb it. Second, the initial evaluation has to be updated every time new relevant information about the issue appears. Finally, the evaluation needs to be stored in memory and retrieved upon request.

Because both memory-based and on-line models of information processing are internal cognitive routines, they can be hard to tell apart. In addition, one person can very well engage in both on-line and memory-based reasoning depending on the situation. This, by all means, complicates the modeling process, but scholars nevertheless derived some commonalities of information processing.

According to Tormala and Petty (2001), an important determinant of memory-based versus on-line information processing is a person's prior motivation to evaluate a target or, to use the authors' words, "the need to evaluate" (also see Bargh and Thein 1985). Quite logically, high need to evaluate leads to forming perceptions on-line; thus, each piece of relevant incoming information updates a previously held issue position. Conversely, low need to evaluate prevents a perceiver from making an intellectual effort to take notice of relevant information and assessing it every time upon receipt. This leads

to the formation of an issue evaluation by memory-based fashion, if such a need ever arises.

Furthermore, the same person may engage in both memory-based and on-line information processing depending on target *entitativity* (i.e. possessing unity and coherence). When perceivers expect high entitativity of a target – that is, they see the target's characteristics as stable – they tend to use an on-line mode of thinking. On the other hand, when a target is perceived as malleable and changeable, people switch to memory-based information processing (McConnell et al. 1997).

Curiously, the concept of entitativity may be applied not only in reference to a target, but a perceiver herself. Although McConnell and his colleagues, as psychologists, were mostly concerned with personal traits as potential targets for evaluation, the same idea should be applicable to targets other than people, for example, government policies or the economy. McConnell (2001) maintains that people themselves can be seen as entity theorists or incremental theorists. Whereas entity theorists who consider traits of other people as fixed and stable engage in on-line thinking, incremental theorists with their views of changeable personal traits make memory-based judgments.

In political science, the debate about on-line versus memory-based information processing has been particularly sizzling in the study of election campaigns. Perhaps the best known work on the topic has been produced by a group of Stony Brook scholars (Lodge et al. 1989, Lodge, Steenbergen, and Brau 1995) who argue that during election campaigns voters develop evaluations of candidates on-line. Thus, when the time comes to vote, all that citizens can remember are their general impressions of contenders, rather than specific messages they received over the course of the campaign. Recently,

Torgovnik (2000) replicated the findings of Lodge et al. (1995) in application to the 1996 Israeli election. The author took the argument even further by inferring that on-line candidate assessments formed during the election campaign overshadowed retrospective memory-based evaluations of candidates' prior performance.

Finally, Rahn, Aldrich, and Borgida (1994) drew a distinction between person-centered (newspaper profiles, candidates' stump speeches, "infomercials", etc.) and dimension-centered (political debates) campaigns. Moreover, the authors distinguished among voters with various levels of political sophistication, and analyzed the relationship between campaign type and information processing mode contingent on the level of political awareness. As it turned out, an on-line type of candidate evaluation was predominant among all types of voters in a cognitively less demanding information environment, namely a person-centered campaign. However, the debate format was not conducive to an on-line mode of thinking among non-sophisticates, which confirms earlier findings that on-line processing is prevalent among high sophisticates who possess more efficient processing capacities (McGraw, Lodge, and Stroh 1990).

Yet, the purpose of the present study is not to resolve the scholarly debate about the effectiveness of on-line models versus memory-based models in general. Instead, my objective is to develop a model that helps me solve the puzzle of incongruence between the objective state of the economy and public economic evaluations at the early stage of the post-communist transition in East Central Europe. If post-communist citizens formed economic perceptions on-line, they should have been highly accurate in their sociotropic evaluations of the economy. Because the objective economic state in the newly established democracies was, to put it kindly, poor, information in the media, at least

about the past economy, was conducive to forming highly negative economic assessments. Moreover, the wording of the survey question that I used for my dependent variable did not require an accurate recall of economic statistics, but a simple evaluation of the direction of the national economy. Thus, every time people would encounter economic news, they should have updated their perceptions of the national economy as negative and later recall them during the survey interview, provided they had formed retrospective perceptions on-line.

With regard to prospective evaluations, telling whether post-communist citizens used on-line or memory-based information processing may be more difficult. Arguably, it could be both, because in their attempt to secure power, new political elites continually promised economic prosperity after only a few short years of tremendous economic hardships. Possibly, this explains overly optimistic economic forecasts of the public, but with the data at my disposal, it is unrealistic to determine reliably when these evaluations were formed – at the time of the interview (memory-based) or whether they were updated on-line at the time a politician repeated the message in his or her speech.

I will, then, for the purpose of my investigation, assume that the formation of both retrospective and prospective economic evaluations at the beginning of the transformation process in Central and Eastern Europe followed the RAS model developed by Zaller. Not only is it a well-respected and highly successful model of opinion formation in political science, but it better fits my own logic and observation of how people formed perceptions of the national economy soon after the collapse of the communist system than the on-line mode of reasoning, at least in the retrospective case. Moreover, Zaller's model has performed much better than any other model with survey

data, whereas on-line models have proved to be successful mostly in an experimental set up (Druckman and Lupia 2000, Kinder 1998). Finally, borrowing the logic of stable versus unstable targets and exporting it to the context of public economic judgments, the state of the economy is more likely to be judged based on memory due to the high instability of the target, especially in the early post-communist environment of (for a contrasting view see Haller and Norpoth 1997).

### **Micro Foundations for Economic Opinion in Post-Communist Nations during the Early Transition Years**

The first few years after the collapse of the communist regimes in East Central Europe were the most severe for the economy of the post-communist nations. More importantly, they had a life-changing impact on the lives of each citizen in those countries. Almost overnight, a guaranteed job, a stable monthly salary, steady prices, and a long-term deposit in the bank, which were a part of many individuals' personal economy, had turned into an everyday fear of losing a job, months of salary delays, skyrocketing prices, and highly depreciated bank accounts. Despite a low standard of living under the communist regime, one's personal economic status was stable and predictable. For most post-communist citizens, the standard of living after the demolition of the command economy fell even lower in addition to all the instability associated with the market reforms.

The economic instability was characterized by two features: radical changes in objective economic indicators and the transformation of formal economic institutions. In turn, economic instability was causing uncertainty about the economic situation; that is, it was hard for people to make sense of the current situation and develop economic



forecasts. The former task of forming accurate economic evaluations was complicated by the fact that citizens in the newly democratizing nations of East Central Europe had neither enough knowledge about nor sufficient experience with the new economic systems. Moreover, persistent fluctuations in the economy made it difficult to keep track of what was going on even for those individuals who had some understanding of the economic reforms.

In the previous chapters, I showed that under conditions of economic instability and low economic expertise at the beginning of the post-communist transformation, public opinion about the national economy diverged from the true economic state. Recall that the true state of the economy was measured by objective economic indicators. Yet, a vast majority of the Central and Eastern Eurobarometer survey respondents did offer their opinion about the national economy. One possibility is that individuals' perceptions of the economy were random. However, my argument is that people resorted to heuristic principles or information shortcuts when they formed opinions about the general economic situation, and those heuristic principles were predictable and generalizable across individuals. Specifically, to form evaluations of the national economy people should have thought about something, in their minds, representative of the general economic situation. In addition, this information had to be easily accessible – that is, salient and fresh in their memories.

In the early period of the post-communist transition, the most available and familiar information about the economy was information about one's personal economic situation. Also, according to the representativeness heuristic, people may have drawn conclusions about the state of the national economy based on how they, personally, were

doing. That is, individuals whose personal economic state had gotten better over a specified period of time should have had a more favorable opinion about the national economy. Conversely, people who felt they had lost financially should also have thought more negatively about the general economic situation. Such factors as individuals' subjective sentiments about their personal economies, their unemployment status, or income may all have influenced how a person evaluated the state of the economy in his or her country.

***Hypothesis 5.1.*** Individuals with higher levels of personal economic well-being, either actual or perceived, should be more likely to assess the national economy favorably than individuals with lower personal economic levels.

Recent history of the post-communist transformations leads us to believe that transition to a market economy occurs in close relationship with democratic reforms (duality of the transition); in other words, political changes are intertwined with economic changes (e.g. Colton 2000, Duch 1993, Tóka 1995, Przeworski 1991)<sup>48</sup>. Consistent with this, I posit that political and economic considerations were closely connected in people's minds; contrary to common assumptions in the literature, politics helped shape people's understandings of the economy, rather than the other way around. Equipped with this simple postulate, we can derive a series of testable hypotheses

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<sup>48</sup> A connection between the polity and the economy is obvious to the extent that political decisions and government politics affect economic behavior and business performance. Concurrently, economic outcomes prompt politicians either to modify the current economic policies, develop new ones, or to continue with the old policies. In Western democracies, public evaluations of the national economy have been found to be affected by assessments of government performance, but the magnitude of this relationship is modest. The effect of political evaluations on mass opinion of the national economic state in the post-communist nations is expected to be of higher substantive value, because democratic reforms were interwoven into economic reforms.

regarding the possible effects of political factors on public opinion about the national economy.

Since political and economic transformations in countries of East Central Europe were so closely related, one may also expect the outputs produced by these transformations to be correlated. Furthermore, people's evaluations of these outputs may be connected as well. This argument is supported by Kahnemann's and Tversky's idea of representativeness. Recall that if A is associated in one's mind with B, then B may be used in assessments of A. In accordance with this statement, provided that democratic performance is representative of economic performance, evaluations of the democratic reforms may be used to make sociotropic economic judgments. Thus, if people express satisfaction with the democratic performance, they may also express satisfaction with the performance of the economy, although in actuality national economic indicators signaled a severe crisis.

***Hypothesis 5.2.*** Individuals who are more satisfied with the performance of democracy in their country are also likely to have more favorable perceptions of the national economy.

The major problem with testing this hypothesis is the dubious nature of the causal relationship between assessments of democracy and assessments of the economic situation. A great number of previous studies theorized the causal force going from evaluations of economic performance to satisfaction with democracy (Clarke, Dutt, and Kornberg 1993; Finkel, Muller, and Seligson 1989; Listhaug and Wiberg 1995). The underlying logic for this claim is that people *first* make their evaluations of the economy

and *then* assess performance of democracy. Yet nobody has provided a strong theoretical reason why this should be the sequence of people's evaluative steps or the only possible sequence of steps. My claim is that it is equally plausible that people form perceptions about the national state of the economy depending on whether they like or dislike how the democratic system performs in their country. Hence, the relationship may well be simultaneous or reciprocal.

A specific feature of the transforming societies in East Central Europe was a lower level of diffuse political support than in consolidated democracies (e.g. Tóka 1995). The notion of diffuse political support was first introduced by Easton (1965, 1975) and was conceptualized as support for a particular political regime rather than political actors. Whereas support for the idea of democracy is overwhelming in Western democracies (Fuchs et al. 1995), citizens in new democratic societies are slightly more divided on the issue of a regime ideal, although support for democracy is uniformly high across all nations of East Central Europe (Klingemann 1999). Moreover, support for a democratic ideal in consolidating democracies may be described as fragile or unstable, because during pre-adult socialization, citizens in the post-communist countries were not exposed to an ideal of democracy. The only source of people's support for democracy was likely to come from their own experience with some attributes of a democratic regime introduced in their countries. Since this experience was short and in many aspects painful, diffuse political support in nations of East Central Europe may have been first,

low, and second, indistinguishable from specific support for political performance (for an alternative view see Mishler and Rose 1994).<sup>49</sup>

However, mass media and new political elites were very active in disseminating information about democratic ideas. Thus, we cannot entirely reject the possibility of the existence of diffuse support for democracy even at the early stages of democratization. Besides, the notion of democracy is likely to represent a political system different or even opposite to the past Soviet system.<sup>50</sup> People who expressed support for a certain political regime may be also expected to be more tolerant of the hardships associated with establishing and maintaining this regime, including economic shortcomings. Thus citizens who supported a democratic regime and whose country had embarked on the path of democratic transition may have expressed more positive views about the state of the national economy.

The causality mechanism in this case is also debatable. What comes first: support for the regime, which operates as a predisposition for national economic evaluations, or satisfaction with economic performance, which leads to increased support for the new regime? Although this question is hard to resolve without a sophisticated statistical

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<sup>49</sup> Mishler and Rose (1994), using data from six Eastern European countries confirm that public support for the legislature is remarkably wide-spread. Among attentive publics and those most satisfied with the performance of the economy, support is the highest. However, given the extent of support even among the most dissatisfied, Mishler and Rose claim it to be symbolic or diffuse, rather than specific, in nature.

<sup>50</sup> It is noteworthy that Russia displays substantially lower public support for the ideal of democracy than all the other post-communist countries. For example, according to Political Indicators compiled by Fessel-GfK (Austria), only 32 percent of respondents in Russia expressed full support for democracy in 2001 compared to at least 45 percent in the next lowest case (Bulgaria). The highest support for democracy that Russia ever displayed was in 1994 (50 percent), and in all other years before and after 1994 it never rose higher than 40 percent, which is substantially lower than in other post-communist countries. This may be partially determined by the exclusive role that the Russian Federation played in the Union of the Soviet Socialist Republics, as well as on the whole territory of the communist space. Consequently, after losing the hegemonic power over the rest of the communist states, some Russians may have felt nostalgic about the Soviet Union, hence, they express lower support for a democratic system.

procedure, some evidence from past research points in the direction of the former mechanism. In fact, Gibson (1996a, 1996b) in his studies on democratic support in Russia and Ukraine in 1990 and 1992, found that support for the system was very weakly linked to satisfaction with economic performance, particularly in Ukraine. In other words, dreadful economic conditions, in contrast to the previous predictions, did not undermine high support for either democracy or a market economy. Accordingly, in the presence of a significant correlation between sociotropic economic evaluations and system support, it would be reasonable to assume that the causal flow runs from support of the system (market or democracy) toward satisfaction with economic performance rather than the other way around. Drawing on the Polish case, Rose (1999) also asserts that economic assessments affected political assessments only weakly at the beginning of the transition. This finding may serve as an indirect indication of the causal relationship going from political evaluations to economic evaluations rather than the other way around.

***Hypothesis 5.3.*** Supporters of the past regime in transitioning democracies are expected to form more negative perceptions about the national economy than supporters of the new democratic regime.

The economic transformations undertaken in countries of Central and Eastern Europe were targeted at converting the command economies of those nations into market economies (Hellman 1998). People who believed that a market economy was generally a good thing were likely to be the ones who were willing to be more patient regarding economic difficulties that occurred before the situation improved (Duch 1993, Tóka

1995). In contrast, those in opposition to a market economy could be expected to have had more negative attitudes towards what was happening in their countries with respect to economic changes. However, this proposition should only hold true if market reforms were actually taking place in those countries. If a person who was in favor of a market economy lived in a country where market reforms were frozen or had never been initiated, he or she would have been more likely to develop negative assessments of the national economy.

***Hypothesis 5.4.*** Attitudes towards the economic transition are expected to influence prospective sociotropic economic perceptions. In transitioning democracies, individuals who hold favorable views about the market economy are more likely to form positive perceptions of the national economy, given that their countries are undertaking market reforms.

### **Data and Measures**

As in the previous two chapters, survey data for this study come from Central and Eastern Eurobarometer Study No.3 conducted in October-November 1992. Fortunately, a simple cross-national individual-level design allows me to keep all 18 nations from the original surveys: Albania, Armenia, Belarus, Bulgaria, the Czech Republic, Slovakia, Estonia, Georgia, Hungary, Latvia, Lithuania, Macedonia, Moldova, Poland, Romania, Russia, Slovenia, and the Ukraine.

The dependent variables also remain the same as in Chapters 2 and 3 – retrospective and prospective evaluations of the national economy (sociotropic economic evaluations). The retrospective variable is based on the following survey question: Compared to 12 months ago, do you think the general economic situation in (OUR

COUNTRY) has got a lot worse, got a little worse, stayed the same, got a little better, and got a lot better? Similarly, the survey question from which the prospective variable was derived reads like this: And over the next 12 months, do you think the general economic situation in (OUR COUNTRY) will get a lot worse, get a little worse, stay the same, get a little better, get a lot better?

### *Independent Variables*

In accordance with Hypothesis 5.1 about the effects of personal economic situation on perceptions of the national economy, I included two measures of objective individual well-being as well as a measure of subjective egocentric economic evaluations in the model. The two objective measures are individual income and unemployment status. The *Income* variable was standardized into twenty categories for the purpose of generalizability across nations. The *Unemployment* variable is a dummy with 1 indicating that the respondent is presently out of work. Similar to sociotropic retrospective evaluations, the measure of the *Evaluation of Personal Economic Past* is a five-category variable. In order to make the original scale more intuitive, I reversed it to range from the most negative (1=personal economy has gotten much worse) to the most positive (5=has gotten much better). The *Personal Economic Forecast* variable is based on the respondent's prognosis of his or her personal financial situation a year ahead, and also has five categories identical to the retrospective question.

Hypotheses 5.2 and 5.3 were developed to test the connection between political and economic attitudes in the early stage of the post-communist transformation. In the



analysis, political attitudes are captured by two variables: satisfaction with the performance of democracy and system support.

*System Support* is a three-category variable scored 1 if the respondent likes the past political system better than the new one, 2 if one likes neither of the systems, and 3 if he believes that the new system is better.

*Democracy Satisfaction* varies from 0, meaning complete dissatisfaction with how democracy is working in the respondent's country, to 3, which corresponds to the respondent's complete satisfaction with democracy (Linde and Ekman 2003).

Finally, a measure of people's sentiments regarding the economic reforms undertaken in post-communist countries in the early 1990s is attitudes toward the market economy. *Opinion About the Market Economy* is measured as a dummy variable, where 1 indicates positive feelings for market and 0 means that the respondent thinks that market is a bad thing in general.

In addition to the core independent variables, I used a number of control variables and a series of country dummies to eliminate potential bias and inefficiency in the parameter estimates attributable to unspecified country-level effects. Along with traditional demographic variables used as controls, such as gender and age, I included a variable measuring attitudes toward the speed of the reforms, which deserves particular notice (Appendix 5A).<sup>51</sup> To my knowledge, this variable has not been used before in studies of economic opinion. Yet, I am convinced that the speed of the reforms variable

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<sup>51</sup> The speed of the reforms variable is a three-category variable, where 1 indicates that there are no reforms implemented in a respondent's country, 2 means that the reforms are going too slow or too fast, and, finally, 3 indicates a respondent's content with the speed of the reforms. Yet, such coding may be contested on the ground of the variable categories being, in fact, ordinal rather than nominal. For example, one may argue that the category of "no reforms" stands aside from the other two categories rather than stands along the same continuum.

belongs in my models if only as a control. In the first years of the post-communist transformation, the question of how to conduct democratic reforms – gradually or radically – was at the top on the agenda of the new governments and extensively reported in the media. The pace and the extent of the reforms were the factors, along with many others, that citizens were likely to blame for the deteriorating state of the national economy, as well as their poor personal financial situations.

### **Analysis and Results**

Due to the ordered nature of the dependent variables, I performed an ordered logit analysis to test my propositions.<sup>52</sup> In addition, I also analyzed my models using ordinary least squares regression both for robustness purposes and easier interpretability of the parameter estimates. Moreover, I converted the estimates of the ordered logit procedure into probability figures at various levels of the independent variables and present them graphically (Figures 5.1 through 5.3).

In general, my argument that people relied on cognitive heuristics when forming retrospective evaluations of the national economic situation is supported by the analysis (Table 5.1). In particular, people's sentiments about their personal economic conditions are correlated positively with individuals' feelings about the general state of the economy in their countries. Both the OLS and ordered logit coefficients were not only statistically significant, but also meaningful in magnitude. Thus, moving from being highly dissatisfied with one's personal finances (personal economic situation has got much worse over the past year) to highly satisfied (personal economic situation has got much

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<sup>52</sup> A concise technical description of ordered logit is presented in Chapter 3.

better) made an individual 45 percent more likely to give a favorable retrospective evaluation of the national economy.

Table 5.1 and Figure 5.1 about here

Contrary to my expectation, however, an individual's employment status does not appear to have produced much of a difference for retrospective sociotropic economic perceptions. In neither retrospective model – OLS or ordered logit – did unemployment status reach statistical significance. Also to my surprise, personal income has a consistent negative effect on people's views of the performance of the national economy, although this effect was substantively not particularly meaningful. One of the plausible explanations may be that there is an indirect relationship of the objective indicators of the personal economy – unemployment status and income – and national economic evaluations through subjective feelings about one's own economic situation. In other words, individuals' income and unemployment status may well have affected how they felt about their personal economic state, which, in turn, was an important factor in determining their sociotropic economic evaluations.

Both measures of political evaluations have performed as expected; that is, the more satisfied a respondent was with how democracy was working in his or her country, the more favorably respondents assessed the national economy. Similarly, being in favor of the new political system rather than the old one also increased the probability of forming more positive perceptions of the national economic state. Specifically, moving up on the scale of democracy satisfaction changes the probability of favorable perceptions of the past economic performance from 7.7 to 23.5 percent. Liking the new political system more than the old one has a more modest effect on the formation of

retrospective evaluations of the national economy. This effect shifts the probability of positive evaluations from 10.2 percent to 14.4 percent when moving from the minimum to the maximum on the political system scale.

Figures 5.2 and 5.3 about here

As for the relationship between attitudes toward the market economy and evaluations of the macroeconomic performance, it is consistently positive and significant, but not as strong as the link between political and economic evaluations. Support for the market made an individual 2.4 percent more likely to have positive perceptions of the national economy than being anti-market.

Curiously enough, people's assessments of the speed of the reforms produced a rather strong positive effect on macroeconomic evaluations. To remind, the speed variable is measured so that those who were satisfied with the pace of the transition reforms were given a score of 2, whereas those who thought the speed of the reforms was either too slow or too fast were scored 1. Finally, the ones who claimed that no reforms were being implemented received a score of zero. It turned out that individuals who approved of the speed of the transition were 8 percent more likely to evaluate the general economic situation positively than individuals who were dissatisfied with the pace of the reforms.

Prospectively, according to the results of both OLS and ordered logit, people also relied on information heuristics when making forecasts of the national economy (Table 5.2). The largest effect on how people assessed their country's economic future was produced by personal prospective economic evaluations. That is, citizens tended to project their personal economic well-being onto the future success or failure of the

national economy. However, this result should be interpreted with much caution. It is not entirely clear whether the causal force necessarily goes only in one direction – from egocentric perceptions to sociotropic evaluations of the economy. Theoretically, it is completely logical to assume that the relationship between prospective personal and national economic assessments is reciprocal.<sup>53</sup> Consequently, the parameter estimate for the effect of prospective personal evaluations may be biased. How is this relationship different from the link between personal and national retrospective economic perceptions, which I assumed to be unidirectional, at least in theory?

Table 5.2 about here

In the case of retrospective perceptions, the personal economic past is something of which a respondent has first-hand knowledge. Evaluation of one's economic past, thus becomes a representation or projection of how the country is doing economically. In other words, something that is known is used to make an assessment of something uncertain rather than the other way around. With regard to prospective personal and sociotropic evaluations, both refer to the future and thus, both are uncertain. In this case, it is hard to say about what people think about first when forming economic perceptions – about their personal economy or about the national economic state.<sup>54</sup>

Personal economic past also has a statistically significant effect on national economic forecasts. Substantively, however, this effect does not appear to be very sizeable. Moving from the minimum (1) to the maximum (5) on the personal evaluation

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<sup>53</sup> Influenced by optimistic media reports about fast economic recovery, post-communist citizens may have formed bright perceptions of the national economic future, which, in turn, led them to believe that they personally would also do better.

<sup>54</sup> Due to a potential bias of the slope coefficient on the future personal economic perceptions variable in the prospective equation, I have decided not to make any probability statements for this relationship.

scale increases the probability of having positive national economic forecasts from 20.5 to 28.6 percent. Other personal economic variables, such as income and unemployment status, do not reach conventional levels of statistical significance, except for income in the OLS model. However, when estimated with ordered logit, which is a more efficient method in this case, the coefficient for the income variable is no longer statistically significant.

Similar to the retrospective perceptions, political sentiments, such as satisfaction with democracy and attitudes toward the political system played an important role in the formation of future economic evaluations. Both variables have positive and significant coefficients. In particular, individuals who were somewhat or very satisfied with the way democracy was working in their country were respectively 19 and 11 percent more likely to give positive economic prognoses than those who were very unhappy. Similarly, those who liked the present political system better than the old one were 4 percent more likely to evaluate the national economic future favorably than those who preferred the old political system.

Consistent with Hypothesis 5.4, attitudes toward the market system were positively correlated with economic forecasts. That is, individuals who were in favor of the market economy were 3.5 percent more likely to form positive expectations about their country's economic future. Interestingly, gender has a relatively strong positive effect on how people viewed national economic future. Women were 3 percent more likely to form favorable economic forecasts than men.

Using ordered logit for my model estimation implicitly assumes that my model is *recursive*.<sup>55</sup> This means that the causal flow is assumed to run in one direction – from independent variables to dependent variables. However, on a number of occasions I had strong reason to believe that the causal flow was not unidirectional. Following on previous findings in the literature, national economic perceptions may just as well operate as a driving force of political support and attitudes toward the market economy and not the other way around as I have modeled so far. With several cases of potential simultaneity between the dependent variable and several independent variables discussed earlier in this paper, ordered logit may not be fully appropriate. The ordered procedure, as well as Ordinary Least Squares, which is a consistent but inefficient estimator with an ordered dependent variable, produces inconsistent results in the presence of simultaneity.

One way to estimate a nonrecursive model is to revert to an Instrumental Variable (IV) procedure, such as Two Stage Least Squares (2SLS). Two Stage Least Squares allows one to overcome the simultaneity bias<sup>56</sup> by using an estimate for the endogenous

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<sup>55</sup> *Recursive* models are such models that satisfy a set of conditions “that together ensure that all causal effects specified in the model are “unidirectional” in nature, i.e., that no two variables in the model are reciprocally related, with each affecting the other”. (Berry 1984, 8). The truth is that with complex relationships that political scientists study, recursive models are rarely found. Yet, researchers more often than not are willing to relax some assumptions of a recursive model, at least with regard to no reciprocal effects among independent variables. Correlations among independent variables in a model lead to inefficient, but still unbiased estimates, provided all other assumptions necessary for unbiased parameter estimates are fulfilled. When, however, a reciprocal relationship occurs between the dependent variable and an independent variable(s) in the model, then the consequences are bias and inconsistency of the parameter estimator on the independent variable(s). Models that do not satisfy the assumption of “unidirectionality” are called *nonrecursive*. Nonrecursive models can be expressed through a series of structural equations. In nonrecursive models, variables “the causes of which are explicitly represented in the model” are termed *endogenous*. In contrast, variables that are not determined by the model are called *predetermined*. There are two types of predetermined variables: *lagged endogenous* variables and *exogenous* variables. Whereas the former are the same endogenous variables only at previous points in time, the latter are assumed to be determined completely outside of the model.

<sup>56</sup> The simultaneity bias implies that the endogenous independent variable is correlated with the error term. A non-zero correlation between an independent variable and the error term leads to biased and inconsistent estimates.

independent variable. Technically, 2SLS proceeds in the following manner. In the first stage, one obtains an estimate of the endogenous independent variable by running a regression analysis on it including all the exogenous variables in the system in addition to at least one instrumental variable. An instrumental variable is a variable that is not directly related to the endogenous dependent variable. What happens in the first stage is that the endogenous independent variable becomes "freed" from the correlation with the error term. Thus 2SLS estimates are proved to be consistent.<sup>57</sup>

Although an instrumental variable estimator is an appropriate method for estimating a nonrecursive model, 2SLS may not be most efficient when both the dependent variable and the endogenous independent variables are ordered-level. Econometricians suggest using a Limited Information Maximum Likelihood (LIML) estimator instead of Two Stage Least Squares. However, LIML is computationally very intensive and would require programming skills. At this point, I have decided to employ the Two Stage Least Squares estimator for the sake of simplicity. While not the most

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<sup>57</sup> In case of a non-recursive model, common estimation techniques, such as OLS or ordered logit, are inappropriate, since they produce biased and inconsistent estimates due to a non-zero correlation between the error term and the endogenous variable. For this reason, other procedures have been developed that produce at least consistent, if not unbiased, estimates. Two-stage least squares (2SLS) is one of the appropriate approaches to take in the presence of simultaneity. It is referred to the class of limited-information techniques (as opposed to full-information ones), which means that parameters are estimated for each equation separately and based exclusively on assumptions imposed on the certain equation under estimation (Berry 1984). The idea behind 2SLS is simply finding a modified variable for the endogenous X variable, which is uncorrelated (in theory) with the error term. Then the modified variable is used instead of the endogenous variable in the initial equation. In order to construct a modified endogenous X variable, one must find such exogenous variables (at least one) that are correlated with the endogenous X, but are uncorrelated with Y. As follows from the name of the procedure, the estimation proceeds in two stages. In the first stage, the endogenous X variable is regressed on all the variables in the system plus the exogenous variables. Then a vector of the predicted values is used as a modified endogenous X variable as a new independent variable – also called an *instrumental variable* – in the second stage. The the OLS parameter estimator of the instrumental variable in the second stage may still produce biased estimates, but it is consistent.



efficient, this estimator should produce consistent results. Along with the coefficients estimated by ordered logit, I present the results obtained with 2SLS.

Due to unavailability of an appropriate instrument to test and account for potential endogeneity between sociotropic economic perceptions and attitudes toward a market economy and between sociotropic economic perceptions and evaluations of the speed of the reforms, these reciprocal relationships were not estimated by 2SLS. Thus the only reciprocal relationship estimated by 2SLS is the link between sociotropic economic perceptions and satisfaction with democratic performance.

The instruments for predicting satisfaction with democracy are a person's perceptions about individual human rights and liberties, as well the general level of respect for human rights in his or her country (Hofferbert and Klingemann 1999, Pammett 1999).<sup>58</sup> Note that the questions about individual human rights and liberties were asked as follow-up questions after the general questions about the level of respect for human rights. Part of the follow-up questions were two concerning economic opportunities and economic hardships. What may be problematic with the general human rights variable in this case is that it is not completely void of an economic component, which theoretically makes it an inappropriate instrument in the estimation of democracy satisfaction. Put differently, the potential presence of an economic component in the human rights variable potentially makes it a direct correlate of sociotropic economic

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<sup>58</sup> The exogenous variables used in the first stage of the Hausman endogeneity test and the two stage least squares model include evaluations of respect for human rights in the respondent's country (a 4-category variable, where a 1 indicates the lowest respect) and a series of follow-up questions about respect of human rights: respect for human rights because of 1) good ethnic relations (a dummy variable coded 1 if the respondent says "yes" and zero otherwise), 2) restored democracy (1=yes), 3) freedom (1=yes), 4) gaining independence (1=yes), and 5) ability to travel abroad (1=yes); no respect for human rights because of 1) ethnic tensions (1=yes), 2) ethnic riots (1=yes), 3) right-wing extremism (1=yes), 4) political problems (1=yes), and 5) rising crime and violence (1=yes).

perceptions, hence endogenous in the system. To tackle this problem, I have taken out all individuals who indicated that economic considerations were important for their assessments of the general human rights situation and estimated the models without those respondents.

Before rejecting the ordered logit estimator as biased, however, one ought to perform a test for endogeneity. A theoretically hypothesized reciprocal relation between an independent and the dependent variable may turn out to be unidirectional with regard to a particular database. Commonly, Hausman's specification test is used for this purpose.<sup>59</sup> To achieve a more exhaustive model estimation, I performed the Hausman test for the full sample of individuals, as well as the sub-sample of the respondents excluding those who made a post-hoc connection between their perceptions of human rights and economic sentiments. Both tests pointed to the existence of a reciprocal relationship between satisfaction with democracy and retrospective economic perceptions; therefore I have reverted to 2SLS.<sup>60</sup>

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<sup>59</sup> The Durbin-Wu-Hausman test, also referred to as the Hausman test, computes a test for endogeneity in a regression estimated via instrumental variables (IV), the null hypothesis for which states that an ordinary least squares (OLS) estimator of the same equation would yield consistent estimates: that is, any endogeneity among the regressors would not have deleterious effects on OLS estimates. A rejection of the null indicates that endogenous regressors' effects on the estimates are meaningful, and instrumental variables techniques are required. The test was first proposed by Durbin (1954) and separately by Wu (1973), and Hausman (1978). This "Durbin-Wu-Hausman" (DWH) test is numerically equivalent to the standard "Hausman test". Under the null, it is distributed Chi-squared with  $m$  degrees of freedom, where  $m$  is the number of regressors specified as endogenous in the original instrumental variables regression. If endogeneity exists then only IV (such as two stage least squares) is consistent.

<sup>60</sup> The results for the Durbin-Wu-Hausman test for the endogeneity of the *democracy satisfaction* variable are given first for the full sample of the respondents and then for those respondent who did not give economic reasons for their evaluations of respect for human rights:

$$H_0: \beta_e = 0$$

$$H_1: \beta_e \neq 0, \text{ where } \beta_e \text{ is a parameter estimate of the vector of predicted residuals from the first stage}$$

The results for the Hausman endogeneity test of the *democracy satisfaction* variable (full sample):

$$F(1, 11164) = 57.99$$

$$\text{Prob} > F = 0.0000$$

Table 5.1 (columns 1 and 3) displays the estimates obtained with OLS, ordered logit, and 2SLS. First, let me consider the coefficients of the democracy satisfaction variable, which was suspected to be endogenous. In both the OLS and 2SLS models, slope estimates achieve high statistical significance; yet they differ in magnitude. This should be unsurprising given the significance of the Hausman test. What is unexpected, however, is that the slope estimate on the satisfaction with democracy variable has increased instead of going down. Oddly enough, it indicates that those who were satisfied with democracy were also more likely to be satisfied with economic performance, whereas those who expressed favorable retrospective evaluations of the national economy were likely to be more skeptical about performance of democracy. In other words, more satisfaction with democracy bred more satisfaction with economic performance, while more satisfaction with the economy led to lower satisfaction with the democratic performance. To rephrase it, lower economic evaluations caused higher satisfaction with democracy. Stated this way, the relationship between economic evaluations and system support falls right within the framework of intertemporal support (Stokes 1996, 2001). This result is also consistent with findings of Duch (1993) and Mishler and Rose (1994) who observed high democratic support even among citizens who had negative evaluations of the economy.

With regard to the rest of the variables in the models, there are some discrepancies between the OLS and 2SLS results. Due to substantial similarities between the full and truncated datasets, I will discuss them simultaneously. Most consistently,

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The results for the Hausman endogeneity test of the *democracy satisfaction* variable (reduced sample):  
 $F(1, 7217) = 31.93$   
 $\text{Prob} > F = 0.0000$

throughout all the models, the estimate of the personal retrospective economy variable has stayed within a close range. Attitudes toward the speed of reforms and present versus past political system, although they dropped in magnitude under 2SLS estimation, remain statistically significant and in the expected direction. The slope coefficient on the attitudes toward the market variable, however, has suffered the biggest change across the two least squares estimators considerably, decreasing both in magnitude and statistical significance.

## **Discussion and Conclusions**

The major objective of this chapter was to explore the micro foundations of sociotropic economic evaluations at the beginning of the post-communist transformations in East Central Europe. Specifically, I intended to delve into the question of whether individuals use cognitive heuristic mechanisms in the formation of economic opinions. I found that, under conditions of high economic instability and low levels of knowledge and experience with new economic institutions and market outcomes, people tended to resort to heuristic mechanisms, which helped them make judgments about the economy.

The process of the formation of economic perceptions is complex: it is both multistage and unobservable. According to John Zaller, people do not walk around with readily available opinions on various issues. Instead, they form opinions on the fly, when faced with the necessity of doing so. As demonstrated by previous research on public opinion, survey respondents do not have accurate knowledge of the national economic state, yet most of them offer their economic evaluations. Without precise information on the economy, how do respondents make judgments about the economic situation in their

countries? Obviously, those few who follow economic news closely may remember news reports and form accurate evaluations. However, even well-informed individuals may find it challenging to retrieve precise economic information from their memory if it is not at the top of their heads. As a consequence, they have to resort to other sources of economic information, which I call information shortcuts, along with those persons who have no accurate knowledge about the economy to begin with, but who are still willing to express an opinion. When asked a question about the state of the national economy, respondents search their memory for considerations related to the question at hand – that is, representative considerations. Such considerations also have to be readily available to respondents, because they do not have much time to think in the interview situation.

I hypothesized that at the early stage of the transition, citizens in East Central Europe should have systematically relied on a number of cognitive shortcuts to form sociotropic evaluations of the economy. First and foremost, these are considerations related to personal economic situation. Not only is information about one's economic state immediately available, but it is also salient and emotionally colored (availability heuristic). Besides, one's perception of the personal economy sometimes becomes the only piece of economic information the respondent knows or can remember during an interview, thus operating as a representative heuristic. Both in the retrospective and prospective models, evaluations of the personal economy were a good predictor of national economic perceptions. However, objective indicators of the personal economic state, such as employment status and income, did not perform as expected. The most plausible explanation of the consistently insignificant effects of unemployment and personal income on sociotropic economic evaluations is their indirect operation through

subjective assessments of the personal economy. In other words, people's view of their personal well-being were influenced by whether they were employed or not, as well as how much they earned, which, in turn, affected their evaluation of the national economic situation. Thus, statistically, the indirect effects of income and unemployment on sociotropic economic perceptions may have been captured by the parameter estimate of the effect of egocentric economic assessments.

Second, owing to the duality of the post-communist transformation, I hypothesized that evaluations of the political system should be linked to economic sentiments. This expectation found support in the statistical analysis. More specifically, satisfaction with how democracy worked in one's country may have operated as availability heuristic and led to positive feelings about the national economy. Furthermore, positive feelings about democracy and the market as better systems than the Soviet regime motivated people to be more patient in their wait for positive performance outcomes. Also in light of post-communist propaganda, citizens may have seen positive signs even in the complete collapse of the economy because they believed things needed to get worse before they would get better.

Lastly, although no specific hypothesis about the speed of the reforms was developed, I included it as a control variable. At the early stage of the post-communist transition, new political elites together with Western advisors had a debate about the general policy of reforms: gradualism versus "shock therapy".<sup>61</sup> The issue was actively

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<sup>61</sup> Social scientists refer to "shock therapy" in the context of the post-communist East Central Europe as a set of economic measures introduced shortly after the collapse of the communist system and aimed at the transformation of the command economies in the region to market economies in the fastest possible way. "Gradualism" also implies transition to a market economy, but at a more guarded slow-moving pace. While the strongest argument in favor of the former was the speed of the transformation – that is, the completion of major market reforms within 2 or 3 years – the strongest argument in favor of the latter was

publicized. As it turned out later, radical reforms or “shock therapy” with full price and trade liberalization resulted in the immediate collapse to the economy, but led to faster recovery, although some scholars think that it was not “shock therapy” per se that prompted recovery, but successful reforms that followed (Kolodko 2000). Evidently, satisfaction with the pace of reforms had to have some influence on national economic sentiments, regardless of the policy chosen by the elites (Marangos 2002).

Overall, the findings of this chapter demonstrate that in the face of uncertainty, whether it is related to the past or future, people still make judgments on various issues. These judgments are based on cognitive heuristics or information shortcuts, such as representativeness and/or availability. In the countries of East Central Europe at the beginning of the post-communist transition, uncertainty about new political and economic systems was especially high due to the volatile economy, radical institutional changes, and low public knowledge about the systems. In their evaluation of the national economic situation, citizens relied on their personal economic experience and attitudinal assessments of political and economic phenomena associated, in their minds, with the state of the economy, such as democracy and the market. Consequently, post-communist citizens may have voted based on their biased economic perceptions rather than accurate evaluations of the government economic performance, if we believe that economic voting existed during the early transformation phase, as some scholars argue (Pacek 1994, Fidrmuc 2000a, 2000b, Colton 1996). It is important to explore whether the tendency to rely on information heuristics, especially personal economic well-being was preserved in

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the intention to cushion the shock from the transition by taking slow well-measured steps. The weakest point of shock therapy was a lack of institutional basis to support the reforms. In countries that adopted a gradualist approach institutions were set up in a more timely fashion, yet it took those countries more time to come out of the recession.

East Central Europe overtime, or whether people became more “objective” later in the transition. Not only is this information essential for explaining voting behavior, but it is also relevant for understanding citizens’ expectations of their governments – in other words, public demand for government policies. If all people care about is their personal economic situation, they should oppose each and every policy that did not or will not benefit them personally. In this case, there is a potential risk that economic minorities would never be heard, because governments would have to pass policies personally benefiting more numerous groups of the population in their attempt to stay in office.



## Appendix 5A. Variables Measures and Coding.

1. *Sociotropic Retrospective Perceptions.* A five-category variable ranging from 1 (the general economic situation in the (RESPONDENT'S) country has become much worse, compared to 12 months ago) to 5 (the general economic situation has become much better).
2. *Sociotropic Prospective Perceptions.* A five-category variable ranging from 1 (the general economic situation in the (RESPONDENT'S) country in the next 12 months will become much worse) to 5 (the general economic situation will become much better).
3. *Egocentric Retrospective Evaluations.* A five-category variable, which ranges from 1 (personal financial situation has got much worse over the past year) to 5 (personal financial situation has got much better over the past year).
4. *Egocentric Prospective Evaluations.* A five-category variable, which ranges from 1 (personal financial situation is expected to become much worse in the next 12 months) to 5 (personal financial situation is expected to become much better in the next 12 months).
5. *Income.* For the convenience of comparing individual incomes from 16 different countries of Central and Eastern Europe, the income variable has been standardized into 20 categories, where 1 is the lowest income bracket and 20 is the highest income bracket.
6. *Unemployment Status.* Coded 1 for those who reported themselves as being unemployed.
7. *System Support.* A three-category variable scored 1 if the respondent likes the past political system better than the new one, 2 if he likes neither of the systems, and 3 if he decides that the new system is better.
8. *Democracy Satisfaction.* Varies from 0, meaning complete dissatisfaction with how democracy is working in the respondent's country, to 3, which corresponds to the respondent's complete satisfaction with democracy.
9. *Opinion about a market economy.* Coded as a dummy variable, where 1 indicates positive feelings for a market economy, and 0 means that the respondent thinks that market is a bad thing in general.
10. *Feelings towards the speed of economic reforms.* Coded such that 0 corresponds to the respondents' answers that there are no reforms in their countries, 1 indicates that the speed of the reforms is either too slow or too fast, and 2 is the right speed. People who have received a score of 2 on this question are expected to be the ones who develop the most favorable attitudes toward the national economic situation.

11. *Gender* is coded 1 for female and 0 for male.
12. *Political Discussion*. A 3-category variable coded 1 for individuals who never discuss politics with their friends, 2 if they discuss politics occasionally, and 3 if political matters are discussed on a regular basis.
13. *Age* indicates the actual age of the respondent.
14. *Political Discussion Dummy*. Created from the Political Discussion 3-category variable by collapsing it into two categories. Respondents who report that they never discuss politics or do it occasionally are coded as 0, whereas respondents who do it on a regular basis are assigned the score of 1.
15. *Education Dummy*. Created from the Education 4-category variable. Respondents who have elementary or secondary incomplete education are coded as 0, while respondents who have completed secondary or higher education are coded as 1.

## Appendix 5B. Descriptive Statistics.

| Variable                                       | N     | Mean  | Std. Dev. | Min | Max |
|--|-------|-------|-----------|-----|-----|
| <i>Retrospective Model</i>                     |       |       |           |     |     |
| Sociotropic retrospective economic evaluations | 11725 | 2.15  | 1.17      | 1   | 5   |
| Egocentric retrospective economic evaluations  | 11725 | 2.39  | 1.16      | 1   | 5   |
| Income   | 11725 | 6.37  | 4.55      | 1   | 20  |
| Unemployment status                            | 11725 | 0.07  | 0.26      | 0   | 1   |
| Satisfaction with democracy                    | 11725 | 2.15  | 0.82      | 1   | 4   |
| Attitudes toward the system                    | 11725 | 1.99  | 0.92      | 1   | 3   |
| Attitudes toward the speed of the reforms      | 11725 | 1.05  | 0.53      | 0   | 2   |
| Attitudes toward market economy                | 11725 | 0.61  | 0.49      | 0   | 1   |
| Political Discussion                           | 11725 | 2.28  | 0.67      | 1   | 3   |
| Education                                      | 11725 | 2.65  | 0.97      | 1   | 4   |
| Gender   | 11725 | 0.49  | 0.50      | 0   | 1   |
| Age  | 11725 | 41.22 | 15.85     | 14  | 98  |
| <i>Prospective Model</i>                       |       |       |           |     |     |
| Sociotropic retrospective economic evaluations | 10276 | 2.18  | 1.17      | 1   | 5   |
| Sociotropic prospective economic evaluations   | 10276 | 2.81  | 1.22      | 1   | 5   |
| Egocentric retrospective economic evaluations  | 10276 | 2.41  | 1.16      | 1   | 5   |
| Egocentric prospective economic evaluations    | 10276 | 2.88  | 1.17      | 1   | 5   |
| Income   | 10276 | 6.53  | 4.60      | 1   | 20  |
| Unemployment status                            | 10276 | 0.07  | 0.25      | 0   | 1   |
| Satisfaction with democracy                    | 10276 | 1.17  | 0.82      | 0   | 3   |
| Attitudes toward the system                    | 10276 | 2.01  | 0.93      | 1   | 3   |
| Attitudes toward the speed of the reforms      | 10276 | 1.07  | 0.53      | 0   | 2   |
| Attitudes toward market economy                | 10276 | 0.61  | 0.49      | 0   | 1   |
| Political Discussion                           | 10276 | 1.29  | 0.66      | 0   | 2   |
| Education                                      | 10276 | 2.65  | 0.97      | 1   | 4   |
| Gender   | 10276 | 0.49  | 0.50      | 0   | 1   |
| Age  | 10276 | 41.12 | 15.81     | 14  | 98  |

**Table 5.1. Determinants of Sociotropic RETROSPECTIVE Economic Perceptions in 1992**

(Standard errors in parentheses)

| Independent Variable                            | OLS<br>Regression | Ordered<br>Logit   | 2SLS               |
|---|-------------------|--------------------|--------------------|
| Egocentric retrospective economic evaluations   | .363***<br>(.009) | .755***<br>(.019)  | .302***<br>(.010)  |
| Income  | -.007*<br>(.003)  | -.015*<br>(.007)   | -.006<br>(.003)    |
| Unemployment Status                             | .023<br>(.034)    | .046<br>(.072)     | .016<br>(.036)     |
| Satisfaction with democracy                     | .196***<br>(.012) | .435***<br>(.026)  | .502***<br>(.042)  |
| Attitudes toward political system               | .094***<br>(.011) | .198***<br>(.023)  | .046**<br>(.013)   |
| Attitudes toward market                         | .061**<br>(.020)  | .172***<br>(.042)  | -.000<br>(.022)    |
| Attitudes toward the speed of the reforms       | .225***<br>(.018) | .509***<br>(.038)  | .136***<br>(.023)  |
| Education                                       | -.015<br>(.010)   | -.033<br>(.020)    | -.013<br>(.010)    |
| Political Discussion                            | -.042**<br>(.013) | -.126***<br>(.028) | -.038**<br>(.014)  |
| Gender  | .034<br>(.017)    | .049<br>(.036)     | .046*<br>(.018)    |
| Age   | -.002**<br>(.001) | -.005***<br>(.001) | -.002***<br>(.001) |
| N   | 11725             | 11725              | 11194              |
| -2Log Likelihood                                |                   | 26778.87           |                    |
| Pseudo R <sup>2</sup> / Adjusted R <sup>2</sup> | .36               | .17                | .33                |

\* p < 0.05 \*\* p < 0.01 \*\*\* p < 0.001 (two-tailed)

**Note:** All the analyses include a series of country dummy variable (the base category is XX).

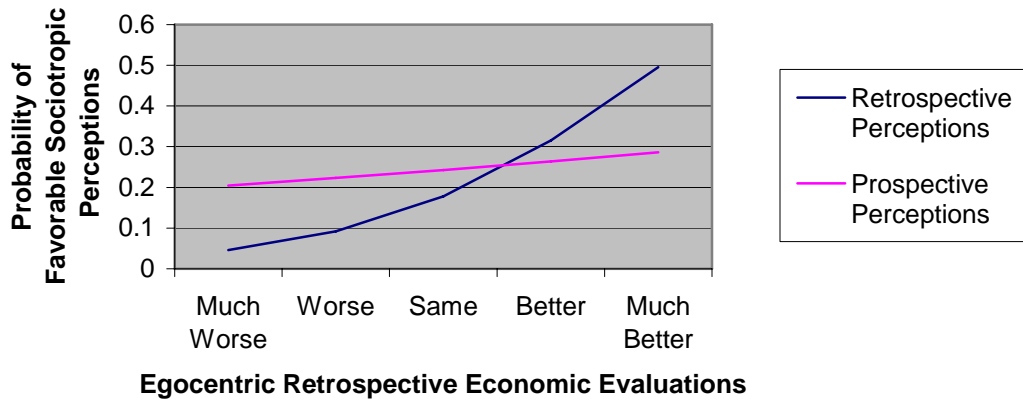
**Table 5.2. Determinants of Sociotropic PROSPECTIVE Economic Perceptions**  
(Standard errors in parentheses)

| Independent Variable                                 | OLS Regression    | Ordered Logit     |
|--|-------------------|-------------------|
| Sociotropic <i>retrospective</i> evaluations         | .217***<br>(.009) | .467***<br>(.021) |
| Egocentric <i>retrospective</i> economic evaluations | .045***<br>(.010) | .111***<br>(.022) |
| Egocentric <i>prospective</i> economic evaluations   | .416***<br>(.009) | .931***<br>(.023) |
| Income   | -.007*<br>(.003)  | -.012<br>(.007)   |
| Unemployment Status                                  | .004<br>(.036)    | -.004<br>(.078)   |
| Satisfaction with democracy                          | .144***<br>(.013) | .332***<br>(.028) |
| Attitudes toward political system                    | .067***<br>(.011) | .108***<br>(.024) |
| Attitudes toward market                              | .099***<br>(.021) | .201***<br>(.044) |
| Attitudes toward the speed of the reforms            | .137***<br>(.019) | .269***<br>(.041) |
| Education  | .007<br>(.010)    | .011<br>(.021)    |
| Political Discussion                                 | -.021<br>(.014)   | -.014<br>(.030)   |
| Gender   | .075***<br>(.018) | .167***<br>(.038) |
| Age  | .002**<br>(.001)  | .005***<br>(.001) |
| N  | 10276             | 10276             |
| -2Log Likelihood                                     |                   | 24101.28          |
| Pseudo R <sup>2</sup> / Adjusted R <sup>2</sup>      | .46               | .21               |

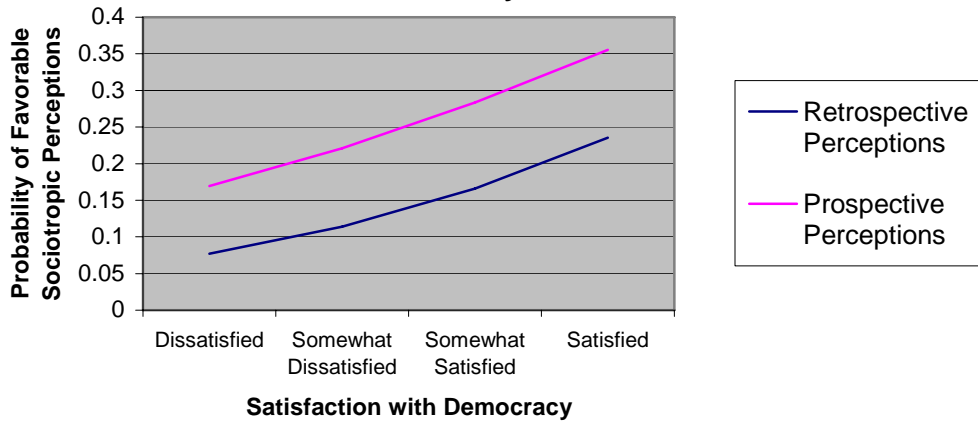
\* p < 0.05 \*\* p < 0.01 \*\*\* p < 0.001 (two-tailed)

**Note:** All the analyses include a series of country dummy variable (the base category is XX).

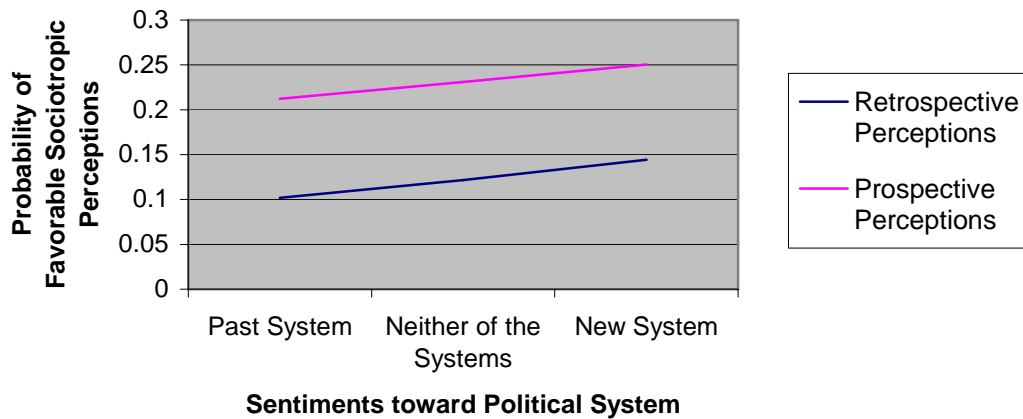
**Figure 5.1. Probability of Favorable Retrospective and Prospective Perceptions of the National Economy as a Function of Egocentric Retrospective Economic Evaluations**



**Figure 5.2. Probability of Favorable Retrospective and Prospective Perceptions of the National Economy as a Function of Democracy Satisfaction**



**Figure 5.3. Probability of Favorable Retrospective and Prospective Perceptions of the National Economy as a Function of Sentiments toward Political System**



## CHAPTER 6

### **Dynamics of Transition: Snapshots of the Formation of Economic Perceptions in the Czech Republic, Hungary, Poland, and Russia**

In the previous chapters, I made an attempt to analyze the formation of sociotropic economic perceptions in the post-communist nations of East Central Europe at the beginning of the transition. However, over ten years have passed since then, and the next logical question that arises is about the change in the formation of public views of the national economy. In particular, there are two major issues that remain: the first issue has to do with congruence between people's perceptions of the economic situation in their country and experts' assessments of the economy, namely objective economic indicators. And second, I intend to pursue the question of whether cognitive and information heuristics still act as important sources of public economic opinion during mature stages of the transition.

At the early stage of the post-Soviet reforms, the substantive relationship between the objective economic indicators and public perceptions was negligible, although some statistically significant estimates emerged in the analysis in Chapter 3. Put differently, the actual state of the economy did not have any noticeable influence on the probability

of forming positive or negative economic evaluations in the post-communist societies. It would be plausible to hypothesize that, with time and greater economic stabilization, the correspondence between public opinion of the national economy and objective economic indicators would become more pronounced, or in other words, significant in magnitude. Unfortunately, due to data limitations, I will not be able to conduct a full-scale estimation to explore the dynamics of the relationship between the objective economy and public economic perceptions, such as a time-series or a cross-country time-series analysis. Neither will I be able to conduct a multi-level cross-sectional analysis of the above relationship at individual time points later in the transition. Instead, I will perform a more qualitative comparative analysis for a sample of four countries – Hungary, the Czech Republic, Poland, and Russia at three selected time periods in the transformation.

Furthermore, I propose to investigate the issue of reliance on cognitive and information heuristics at the more advanced stages of the post-communist reforms. Specifically, I will use the same sub-sample of four East and Central European nations in a series of individual-level single-country analyses at various phases of the transition. The objective of the analysis is to find out whether people continue to rely on personal economic and political heuristics later in the transition as they did shortly after the collapse of the Soviet regime. On the one hand, with increased access to information, time to learn, and relative economic stabilization, individuals should be able to use objective information about the national economy to a greater extent in their sociotropic economic evaluations; thus the need to rely on cognitive and information heuristics would be reduced. In contrast, based on the findings of Kahneman and Tversky, people, including the most sophisticated, may still utilize heuristics, provided they are salient and



readily available, when making judgments under uncertainty. Recall that by “uncertain event” in this dissertation I mean the state of the past and future national economy.

Aside from the question about the dynamics of public economic opinion in East Central Europe over the period of the post-communist transformation, another question that has not received much attention in this work has to do with the development of personal judgments about the national economy in individual countries of the post-Soviet bloc. Despite a general cross-national focus of my dissertation announced at the beginning of the study, I have also acknowledged the importance of looking at each country in greater detail in order to paint a full picture of the processes in the region. Although such an analysis falls short of presenting a complete story of the formation of sociotropic economic perceptions in each individual country of Central and Eastern Europe over the period of the post-communist reforms, I will look at four separate nations in the region – Hungary, the Czech Republic, Poland, and Russia – at various points of the transition.

The particular choice of the four countries was dictated by the availability of appropriate data more so than by any other reason. At the same time, these particular countries represent both Central Europe (the first three nations) as well as the former Soviet Union (Russia). In addition to some historic differences stemming from the socialist period, the sample is also diverse with regard to economic and political reforms and policies adopted by these nations during the post-communist transformation and, consequently, outcomes of those policies. To summarize, the purpose of the micro-level single-country analysis is twofold: 1) to determine to which extent cognitive shortcuts are still utilized in opinion formation during the later stages of the transition; and 2) to

acquire insights into the dynamics of public economic opinion in individual nations of the post-communist bloc.

What follows is a concise description of the politico-economic situation in each of the four countries before and after the collapse of the communist system until about the late 1990s, alongside public economic opinion data at various time points over the transition. After that, I will undertake a qualitative comparative analysis of the relationship between subjective economic perceptions and the state of the national economies over the period from 1992 to 1997 – the time span for which I have survey data. Then, I will proceed to individual country analyses and conclude with a discussion of the results and implications.

## **Political and Economic Conditions in the Czech Republic, Hungary, Poland, and Russia**

### *The Czech Republic*

After the repressed revolution of 1968, the new Czechoslovakian government took a non-reformist political stand keenly adhering to the Soviet doctrine of communism.<sup>62</sup> Alongside, Czechoslovakian society seemed to be one of the most politically apathetic in East Central Europe during the 1970s and 80s. It should be noted that the standard of living in Czechoslovakia was somewhat higher than in other communist countries, although the general economic decline in the late 1970s-early 1980s was similar to that experienced in other states of the Soviet bloc. Unlike Poland

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<sup>62</sup> Twelve years after the 1956 Hungarian revolution attempt, Czechoslovakia declared its intention to build 'socialism with a human face'. The short period of liberalization known as "Prague Spring" was ended when Soviet tanks appeared in the streets of Prague in August 1968. Unlike Hungary and Poland, though, Czechoslovakia got a new Soviet-fixed government, which keenly adhered to the Moscow approach to communism.

and Hungary, however, the Czechoslovakian leadership did not try to open up its economy or pursue limited market reforms, but focused on modernizing its extensive industrial sector (Wolchik 1999). Along with technological development, the government also concentrated its efforts on raising employee morale, conserving resources, improving the efficiency of investments, and increasing incentives for managers. The Húsak government (1969-1989), fearful of the repetition of the 1968 events, tried to minimize public participation in the political process by providing greater material benefits and extending the social welfare program (Wolchik 1999). For over twenty years, the Czechoslovakian leadership had been successful in keeping its populace in compliance with the regime.

The Gorbachev reforms in the Soviet Union were received with no enthusiasm by the Húsak government. The whole process bore a strong resemblance to the Prague Spring, when the Dubcék leadership attempted to implement reforms from above. Remembering the consequences of the 1968 revolution, the Czechoslovakian government decided to stay away from perestroika, and, in contrast to Poland, Hungary, and the Soviet Union, initiated only modest reforms.<sup>63</sup> Yet between November 17 and December 10, 1989, Czechoslovakia suddenly moved to the forefront of the transformation process in the region. The so-called Velvet Revolution started with student demonstrations and was quickly joined by the rest of the population (Wolchik 1999). In a matter of days the government resigned, and the revolution was completed by electing a long-time dissident

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<sup>63</sup> *Perestroika*, which can be translated into English as *re-construction*, was a general term to denote a set of economic and political reforms implemented by Mikhail Gorbachev and his government in the Soviet Union between 1985 and 1991.

and leader of the opposition Václav Havel as the President of Czechoslovakia (Wolchik 1999).

Unlike, for example, Hungary and Russia, by the time of the communist collapse, Czechoslovakia had managed to keep its macroeconomy under steady control (McDermott 2004). Without excessive foreign debt, the fall of output was insignificant and the standard of living was high compared to other countries of the Soviet bloc. Thus, the ground for market reforms was more secure, which resulted in a relatively mild economic recession. Similar to most of the post-communist nations, Czechoslovakia adopted a package of economic reforms directed at privatization of state-owned property, price and trade liberalization in conjunction with stabilization of inflation and interest rates (Horowitz and Petráš 2003).

Along with Russia, Czechoslovakia conducted a sweeping two-round voucher privatization program, transferring a significant portion of state-owned enterprises into private hands (Katz and Owen 2002). The first round of privatization was launched in May 1992 and was completed by 1993, shortly before the break-up of Czechoslovakia. The second round of the privatization program was undertaken between April 1994 and November 1994 (Palda 1997, Horowitz and Petráš 2003).

With tamed inflation, moderate output decline, and well-controlled and relatively low unemployment, the Czech Republic had been justly considered a leader in the transformation process (Blanchflower 2001). What happened a few years later, in the mid 1990s, was therefore probably unexpected, although logical. The country had been sliding into a crisis climaxing in 1997 in the banking sector. Unarguably, the reason for the crisis lay in undeveloped financial institutions and economic regulations (Barnes

2003). Mass privatization of state-owned enterprises at the beginning of the 1990s resulted not only in the transfer of the owner rights from the state to private proprietors, but also in the transfer of financial responsibilities, including finding new sources of investments. Naturally newly privatized enterprises turned to banks for funding. However, lagging behind in reforms and still under state ownership, banks mostly engaged in lending, oftentimes pressured by the state to give loans to particular enterprises without background checks and further monitoring of the loan use (Horowitz and Petráš 2003). As a result, the share of bad loans had increased dramatically already by 1994, which inevitably led to a financial crisis a few years later. In turn, poor control of loan use gave a tempting opportunity for top management of newly privatized firms for misallocation of the funds, asset stripping, and channeling profits outside of the country (Barnes 2003, McDermott 2004). The consequences of such activities were reflected in output decline from 6.4 in 1995 to 1.0 in the crisis year of 1997 continuing down to -1.2 in 1998, as well as an increase in unemployment from 3.2 percent in 1994 – the last year of the privatization campaign – to 5.2 in 1997 and further up to 8.7 in 1999.

Table 6.1 about here

The Czech financial crisis of 1997, as well as the Russian crisis of 1998, exemplified the high economic instability of the newly established democracies even after several years of intense reforms. Impressively though, both countries were able to stabilize rather quickly, and already by 2000 were displaying a pattern and relatively low inflation (especially the Czech Republic). However, the Czech unemployment rate had almost tripled since the pre-crisis period (from 3.2 in 1994 to 8.7 in 1999), yet staying lower than in the most of the post-communist nations (Horowitz and Petráš 2003). Still,

by the end of the 1990s, the Czech Republic was losing to other nations in the leading group, Poland in particular. For example, in 1998 industrial production in the Czech Republic only achieved three-fourths of the pre-transition level compared 145 percent in Poland (McDermott 2004).

The population of the Czech Republic, similar to all other transition economies, incurred significant losses from the transformation, especially at the beginning of the reform processes and during the crisis. As everywhere else across the post-communist nations, income inequalities rose compared to the socialist period (Večerník 2004). Wages were higher in the private sector, which by late 1994 provided almost 60 percent of the nation's employment (35% under alternative statistics), than in the state sector, with a pay in the private sector being on average 11.7% higher than in the state sector; but returns to schooling and years of experience had become lower than under central planning and much lower than in market economies (Flanagan 1995, Domanski 1997).<sup>64</sup>

### *Hungary*

Notwithstanding permanent economic reforms throughout the whole period of the communist rule in Hungary, the country found itself in a deep crisis by the mid-1980s.<sup>65</sup> Janos Kadar, the leader of the regime at that time, refused to take responsibility for the deteriorating situation in the country, thus losing all the public support he had (Barany

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<sup>64</sup> By "returns to schooling and years of experience", the authors mean systematic increases of wages contingent on the level of education and years of work experience.

<sup>65</sup> Already in 1956 Hungary challenged the hegemony of Moscow's rule with a popular uprising, which was suppressed by the Soviet troops. Since the 1960s, over the course of the communist rule, Hungary succeeded in introducing gradual market reforms followed by the development of various political opposition groups in the 1980s (Verdery 1993, Barany 1999).

1999). The general mood in the society was that of detachment from the Marxist philosophy and communist dogma.

The reform-oriented members of the Hungarian Socialist Workers' Party (HSWP) called for a reorganization of the party and a more democratic form of elections. As a result, the leadership role of the HSWP was transferred to the reform-minded group who recognized the need for a new political strategy (Barany 1999). Hungary became the first among East and Central European countries to allow a multi-party system in the late 1980s, although with some limitations. By that time a substantial number of opposition groups had already established or re-established themselves in the Hungarian society, and in March-June of 1989 six of them took part in the Opposition Round Table, similar to the one organized in Poland. And also like the Polish Communist party, HSWP negotiated itself out of power with the expectation to win a substantial number of parliamentary seats in the first free national election (Ziblatt 1998). However, the opposition forces managed to attract more popular votes and the Hungarian Communist party only gathered 11 percent of the votes. Still it remained active in parliament and enjoyed the largest membership among the Hungarian parties (Ziblatt 1998); moreover, it regained power, winning the subsequent parliamentary election in 1994.

Hungary, unlike Poland and Russia, rejected the Washington Consensus program of reforms and adopted a gradualist approach to transformation (Kornai 1996). Although one of the most successful socialist systems, which introduced elements of a free market back in the 1960s, Hungary on the edge of the communist collapse was burdened by substantial foreign debt (Vanhuysse 1999). Unwilling to borrow massively from international organizations, Hungary chose to put a stake on creating an auspicious

climate for foreign direct investments (King and Váradi 2002, Li and Reuveny 2003). Also, rejecting high-speed privatization, Hungary engaged in careful case-by-case transferring of state-owned enterprises into private ownership by welcoming foreign capital for share buy-outs. Alongside, favorable conditions were organized for creating small- and medium-scale firms and restructuring large-scale enterprises with the help of reformed financial institutions (King 1997, 2001). In contrast to most other countries of the post-communist bloc, Hungary took the risk of privatizing its banks to foreigners, thus bringing high expertise and investments into reforming of its financial system (Barnes 2003). As a result, Hungarian banks adopted a policy of financing newly established or privatized firms through investments rather than loans or direct shareholding. Close monitoring of investments on the part of banks promoted high efficiency of enterprise restructuring and low levels of money laundering, unlike in the Czech Republic.

The gradualist approach adopted in Hungary was critiqued at first as leading to prolonged reforms (Vanhuysse 1999). In contrast, the shock therapy program was expected to produce positive returns within a shorter time limit and of larger magnitude. However, unlike all other transitioning nations of East Central Europe (with the exception of the Czech Republic), Hungary avoided a dreadful economic collapse and experienced only a relatively mild recession. To offer an example, the annual inflation rate in Hungary never exceeded 35 percent over the whole period of the transition and economic growth already resumed in 1994 and steadily increased thereafter.

Table 6.2 about here



The weak points of the Hungarian transformation were its high unemployment rate (over 10 percent) up until 1998 and the decline in real income relative to the pre-transition period common to all post-communist democracies (Ferge and Tausz 2002). In real terms, however, the mean total income in Hungary in 1993-1994 stood at \$194, which was higher than elsewhere in the region (Domanski 1997). Nonetheless, the low-income headcount more than doubled. In turn, the 1993 Gini coefficient increased only by 1.6 points compared to 1989 indicating a very modest increase in income inequality, unlike in many other nations of East Central Europe (Vanhuysse 1999). Moreover, the net gender gap in Hungary was also much smaller indicating, in 1993-1994, 16 percent in favor of men (Domanski 1997). With regard to sector employment and pay, the Hungarian private sector accounted for 12.2% of the totally employed with a pay differential of 14.8% between the state sector and the private sector in favor of the latter (Domanski 1997).

### *Poland*

Poland witnessed a rather powerful workers' movement already back in the 1970s, which culminated in the emergence of Solidarity in 1980 (Korbonski 1999). Moreover, Poland managed to develop a sizeable (under the communist regime) private sector. During socialist times, eighty-five percent of all the agricultural land in Poland was in private hands, and in 1980, over eleven percent of GNP was produced by private agriculture (Kozminski 1997). In addition, Poles had an opportunity to own homes and apartments as well as organize and work at small private enterprises in retailing, crafts, and small industry (Kozminski 1997).

In late 1980s Poland, the government was so weak that it had to negotiate with the opposition forces, gathered under the umbrella of Solidarity, the further reforms in the country (Zubek 1997). The Polish government even agreed to conduct a partially free parliament election in 1989, assuming it would still win the majority of the seats. Yet to the great surprise of the communist elite, as well as to the Solidarity leadership, Solidarity swept to a solid victory in the parliamentary election and thus were granted an opportunity to guide the country out of the political and economic crises.

In its attempt to reform the economy, Poland was the first to introduce a package of the Washington Consensus policies directed at radical price and trade liberalization, stabilization of inflation and interest rates, as well as transfer of state assets to private owners (Balcerowicz 1995, King 2002, Vanhuysse 1999). Whereas the former two sets of policy prescriptions were immediately implemented in Poland already in 1989, privatization of state-owned enterprises and banks was delayed (King 2002, McDermott 2004). For example, “the Polish version of voucher privatization was not implemented until 1995-1996, concerned only 512 firms (10% of industry and construction sales), and allowed for the state to maintain 25% ownership” (ibid., 192). Banks were privatized even later, toward the end of the 1990s. Although lingering, the transfer of the ownership in Poland represented a careful case-by-case approach with close monitoring by the government at both national and local levels (Shleifer 1997, see also Rondenelli and Yurkiewicz 1996).

As the evidence shows, Poland was the first to fall into a recession, as well as the first to emerge from it (Kolodko 2000, 2001; Slay 2000). Moreover, it took Poland the shortest period of time to recover from the economic crisis compared to the rest of the

post-communist states, thus proving the effectiveness of “shock therapy” (Vanhuysse 1999; for a different view refer to Kolodko 2000). Already in 1992 economic growth resumed in Poland and never again over the transition period dropped below 3.5 percent. As a consequence, the pre-transition level of GDP was achieved in 1996, when the rest of the post-communist bloc averaged at two thirds of the 1989 output (Trzeciak-Duval 1999, Vanhuysse 1999). The inflation rate in Poland stayed in double digits during the whole period of the transformation dropping into single digits after 1998, and never exceeded 60 percent, when most of the nations in East Central Europe, especially in the former Soviet Union, witnessed four-digit hyperinflation. Successful as they were in managing inflation and boosting economic growth, Polish reformers could not assume the same degree of control over unemployment. As a result, Poland had one of the highest unemployment rates among the countries of the post-communist bloc averaging above 13 percent between 1990 and 2000.

Table 6.3 about here

The wage structure in Poland was somewhat different compared, for instance, to the Czech Republic and Russia. Unlike in the latter two countries, private sector wages in Poland did not exceed state sector wages, except at the very beginning of the transition (Newell and Socha 1998, but see Adamchik and Bedi 2000). Yet compared to the rest of the countries considered in the present chapter, Polish women lost the most to men in total incomes (Adamchik et al. 2003). In 1993-1994, the total incomes of women in Poland were calculated at 56.7 percent of the incomes of men (Domanski 1997). Private sector employment accounted for about 22% (including farmers), paying on average

19.7% more than the public sector before pay in the two sectors converged, approximately in 1996 (Domanski 1997).

### *Russia*

After Gorbachev was elected the leader of the Soviet state in 1985, he announced that the country had to settle on the path of *perestroika* and *glasnost*.<sup>66</sup> What Gorbachev had in mind was restructuring the Communist party from within, slightly lifting information censorship and introducing some mild economic reforms, which were supposed to be non-threatening to the regime. Yet, for a Soviet system suffering from profound stagnation at that time, the modest modifications in the economy and polity introduced by Gorbachev seemed revolutionary. Very quickly, the seeds of freedom sprouted on the fertile soil of public dissatisfaction and government crisis.

Starting with the proclamation of the need to accelerate growth and technological development of an economy that was falling behind, the new leader of the USSR soon realized that no actual economic changes were possible without transformation of the Soviet polity (White et al. 1997). The electoral system reformed under Gorbachev provided for the first semi-free election. Instead of a single candidate competing, or rather assigned, for each parliamentary seat, the reformed election system foresaw multiple candidates with different policy positions running for each seat, thus for the first time in the history of Soviet socialism giving voters an electoral choice (White et al. 1997). All the candidates running for the Congress of People's Deputies were still,

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<sup>66</sup> The Russian word *glasnost* could be most closely translated into English as *publicity* or *openness*.

however, members of the Communist Party, since Gorbachev did not dare contest the party's political monopoly.

During the Gorbachev era numerous secret archives were made public, which unveiled disgraceful and abusive practices of the top echelon of the Communist Party members throughout Soviet history. The cult of Stalin was brought down, and dissident writers, scientists, musicians, public activists and other representatives of the Soviet intelligentsia earlier persecuted by the Communist Party were rehabilitated and received an opportunity to come out from the underground and return from prisons and exiles. Clearly realizing that their power was quickly vanishing, several members of the conservative wing of the Communist Party undertook a desperate attempt to stage a *coup d'état* in August 1991, which was crushed three days later by newly emerging political forces under Boris Yeltsin's leadership. The transformation of the Soviet society had already gone too far to be reversed, and so had the reform processes in most other communist countries of East Central Europe.

After the Soviet Union was dissolved in December 1991, Yeltsin together with a team of liberal reformers implemented a package of "shock therapy" measures similar to the one introduced in Poland (Sachs 1993, 1994; Murrell 1993, Aslund 1995; Aslund, Boone, and Johnson 1996, Popov 2000). On January 2, 1992 the Russian government freed prices, which immediately multiplied. What happened within the following year was an escalation of prices resulting in an annual inflation rate of 2,500 percent. It is fair to say that other post-communist nations experienced even higher inflation rates

exceeding 10,000 percent per annum.<sup>67</sup> Yet the consequences of the shock therapy policies in Russia were undoubtedly more destructive for the economy than in Poland and the Czech Republic. From the beginning, Russia went into a wage-price spiral, which resulted in hyperinflation accompanied by a drastic fall in demand instantaneously followed by a considerable output decline. Unlike Poland, Russia failed to achieve timely stabilization and fell into an economic slump (Brainerd 1998). It is also worth noting that Russia is a huge country and regional economic diversity has been striking over the whole period of the transformation (as well as during the Soviet time). To offer an example, annual average growth rates in real per capita income in 48 regions of Russia ranged from -9.0 to 15.7% between 1993 and 1997 (Berkowitz and DeJong 2003).

Table 6.4 about here

Concurrently with price liberalization, Russia was also undertaking massive voucher privatization comparable to that in the Czech Republic (Blasi et al. 1997, King 2002, Brainerd 2002). “By the end of 1994, more than two-thirds of all industrial enterprises were out of state hands and overall employment in state enterprises had fallen to 45% of total employment” (Brainerd 2002, 164). Without a doubt, the idea of privatization of state-owned enterprises was right; the realization of it, however, proved detrimental to the Russian economy (Braguinsky 1999, Berkowitz and DeJong 2003). Many middle- and large-scale enterprises were privatized by “insiders” through the voucher program. This, however, did not change either the management style or the style of business operations leading to omnipresent asset stripping and theft of borrowed funds (Shleifer and Vishny 1994, Barnes 2003). Resisting restructuring and cuts of state

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<sup>67</sup> According to the EBRD data, Ukraine and Armenia had inflation rates over 10,000 percent per annum in 1993.

subsidies, some newly privatized enterprises tried to adjust to the unfriendly market environment by barter trading and downgrading their production line. Others simply went out of business. Barter payments, extensive as they were in the post-communist Russia, struck a serious blow to tax collection and led to demonetization of the market (Goorha 2001).

The other privatization scheme in Russia was named “loans-for-shares” (Blasi et al. 1997, Roberts and Sherlock 1999). Driven by the need for capital, the government decided to sell its biggest enterprises to domestic and foreign banks in 1995. In reality, foreign bids were frozen, and the organizer of the auction, a Russian bank previously approved by the government, won with a previously negotiated offer. The trick, however, was not in making potential buyers full owners of the companies, but virtually lending companies to them with the option for the government to repay the loan. As a result of the “loan-for-shares” deals, auction winners, who were later labeled “oligarchs”, gained extensive power to influence state policies (Blasi et al. 1997). In turn, state officials secured their opportunity for rent collection by prohibiting new owners to re-sell the acquired shares. What this merger between big business and the state led to was across-the-board corruption, large-scale asset stripping, massive tax evasion, profit tunneling outside of the country, and weakening of the Russian state (Holmes 1997, Frye and Shleifer 1997, Roberts and Sherlock 1999, Shlapentokh 1996, Hale 2003). Moreover, owing his re-election in 1996 to oligarchs, president Yeltsin became even more dependent on big business (McFaul 1997, Roberts and Sherlock 1999, Brudny 1997). It is fair to notice, however, that some of these businesses have eventually become successful enterprises directed by effective management, which, had they not been

privatized in the mid 1990s, would have most likely gone bankrupt or, at least, remained less efficient.

Deficient monetary and fiscal policies, among other factors, resulted in a severe financial crisis and default in 1998, fuelling a new spiral of inflation (up to 86% in 1999), GDP contraction (-4.9% in 1998), and a rise of unemployment from 9 percent in 1998 to over 13 percent in 1999. Unexpectedly though, Russia managed to resume growth a year later (5.4% and 8.3% in 1999 and 2000 respectively, yet due mostly to high oil prices), reduced the inflation rate to 21 percent in 2000, and brought the unemployment rate down to 11.4 percent in 2000.

Most sadly, from the beginning of the post-communist transition, citizens of Russia have been in dire straits losing incomes, jobs, savings, and hopes. By the end of 1995, a record 35 percent of the population had been living below the official poverty line, which traditionally had been set very low (Klugman and Braithwaite 1998).<sup>68</sup> The poor were primarily families with children, the unemployed, and the elderly. The gap between the rich and the poor, as measured by the Gini coefficient, in Russia was larger than in Eastern Europe, but in the same range as in other nations of the former Soviet Union. Although mixed, most of the evidence points in the direction of positive income returns to education, yet returns to years of experience were negligible (Klugman and Braithwaite 1998, Brainerd 1998). Women, indisputably, on average suffered higher income losses than men (Brainerd 1998). According to some data, the income gap in 1993-1994 reached as high as 43.8% in favor of men (Domanski 1997). As for the mean

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<sup>68</sup> However, the existing data on poverty in countries of the former Soviet states are contradictory and should be treated with caution. For instance, Jensen (2003) reports the poverty rate in Russia during 1993-1995 as exceeding 50 percent. Christinsen (1998), on the other hand, quotes the Russian Ministry of Labor official statistics, according to which the proportion of the Russian citizens living below poverty line by March 1996 was 25 percent.



average income at the same period, it stood at \$23 per month and one of the lowest in the region (Domanski 1997).

Of the four cases considered in the present chapter, Russia was the least successful example of democratic transition (Shleifer 1997). Actually, whether Russia is in fact a democracy has been a topic of heated debates. Economically speaking, the Russian Federation has not been viewed unequivocally as a market system either. Forceful interference of the state in the economy and underdevelopment, as well as inefficiency, of market institutions in addition to relative instability of macroeconomic indicators places Russia somewhere inbetween a state-regulated and a market system.

### **Public Economic Opinion in the Czech Republic, Hungary, Poland and Russia**

The present chapter gives several snapshots of public economic evaluations in the Czech Republic, Hungary, Poland, and Russia over the period of the post-communist transition. The first is based on a sub-sample of the four countries selected from Central and Eastern Eurobarometer No.3 – the survey I used for empirical analyses in the previous chapters of this thesis. To paint the dynamics of popular economic views in newly established democracies, I draw on three additional survey studies conducted between 1993 and 1997.

In 1993-1995, a study called The Transformation Processes was conducted in four countries of Central Europe: the Czech Republic, Hungary, Poland, and Slovakia. Administrators of the survey asked respondents about their sociotropic economic perceptions, a year prior to the day of the survey and a year ahead. Therefore, the answers obtained in The Transformation Processes study are comparable to the data

collected by the Central and Eastern Eurobarometer project. While the survey data collected across the four nations were united into one project, the actual field studies were undertaken within a wide time-span far apart from each other.<sup>69</sup>

A 1997 study of public opinion in East Central Europe, The East Transformation Barometer, also contains data on four nations: the Czech Republic, Hungary, Poland and Russia. Conveniently, the wording of the questionnaire items asking about the national economic state precisely matched the sociotropic questions from the other two studies, thus making the data comparable across time.

Along with the three multi-national survey studies, I also used an additional single-country data set on Hungary. Being a panel survey, this study allows me to control for potential endogenous effects of political and personal economic heuristics. The last post-election wave of the questionnaire was administered in May 1994 with three pre-election waves conducted in December 1992, December 1993, and April 1994.

A quick look at the distribution of the mean scores for retrospective perceptions across the four nations in 1992 allows distinguishing between two pairs of countries. While citizens of the Czech Republic and Poland are relatively satisfied with the past performance of their national economies (the mean scores of 2.48 and 2.42), people in Hungary and Russia feel pessimistically about the recent change in the national economic conditions (the scores of 1.94 and 1.86 respectively). Mapping these numbers against objective economic indicators of inflation, unemployment, and GDP growth does not explain the relative position of Hungary. Aside from high unemployment (13.2%), which was even higher in Poland (14.3%), the overall state of the Hungarian economy was

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<sup>69</sup> The fieldwork was conducted in Poland in September 1993, in the Czech Republic and Slovakia in June-July 1994, and in Hungary in July 1995.

closer to those of the Czech Republic and Poland than to that of Russia. In contrast, given the absolute figures of the national economic conditions in East Central Europe, public opinion scores in the Czech Republic and Poland were probably too high. To offer a comparison, mean retrospective economic evaluations for the corresponding period in Belgium, France, the Netherlands, West Germany, to name just a few, were lower than in Poland and the Czech Republic.<sup>70</sup> Concerning economic forecasts, citizens of all four East Central European nations displayed relative optimism within a close range of scores. Czechs were, again, the most optimistic with a mean prospective score of 2.86, whereas Hungarians were the most pessimistic with a mean perception of 2.33 on the five-point scale.

Figure 6.1 about here

This tendency was preserved later in the transition, and in 1994 Czechs on average scored 3.12 in evaluating the previous year of the economic transformation, while Hungarians in 1994 and in 1995 still demonstrated greater pessimism in their assessments of the past economic state (2.21 and 1.94 for the respective years). Poles in 1993 were somewhere in between the two, with a retrospective score of 2.47. Justly, citizens of the Czech Republic displayed elevated spirits aligned with their country's impressive economic achievements. With unemployment running at slightly above 3 percent, annual inflation below 10 percent, and economic growth at 3.2 percent, the Czech Republic was indisputably the leader of the transition. Even Poland, where in 1993 the growth rate had been positive for the second year in a row, still suffered from one of the highest unemployment rates in the post-communist region, and an inflation

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<sup>70</sup> The mean economic perceptions scores for the nations of Western Europe were calculated based on Eurobarometer No. 40.0 conducted in October-November 1993.

rate of 37.6 percent per annum. Hungarians, at first sight also displayed sensitivity to the change in the national economy from 1993 to 1994 and then from 1994 to 1995. Having resumed economic growth in 1994, bringing down unemployment and demonstrating steady control over inflation, Hungary seemed to have improved its macroeconomy significantly compared to 1993. In contrast, 1995 was less economically thriving. While the unemployment level remained unchanged, the inflation rate had gone up 7 percentage points, and GDP growth had slowed from 2.9 to 1.5 percent. As for economic forecasts, they had become more favorable in comparison to 1992 turning above 3 in all the countries, except for Hungary in 1995 (mean score of 2.32).

Figure 6.2 about here

According to the 1997 data, Poles were still the most satisfied with the past performance of the national economy (2.93), and Hungarians were most critical (2.21). Furthermore, Czech retrospective evaluations had fallen significantly compared to 1994 (from 3.12 to 2.19). However, this result is quite expected, because the survey was taken right after the financial crisis and government resignation in April of 1997. For Russia, 1997 was the best year with regard to the national economy, thus relatively high retrospective economic perceptions (2.36) are reasonably justified. Still, in comparison to the other three nations, Russia was indisputably lagging behind.

Figure 6.3 about here

Presumably following on their retrospective evaluations, Poles also formed the most optimistic forecasts of their economic future for the following year 1998 (3.10). Czechs, Hungarians and Russians had almost identical predictions of their countries' future economies (the average prospective scores are 2.56, 2.581 and 2.541 respectively).

Note, though, that only in Poland did economic forecasts remain in the ballpark of the previous years. Evidently, citizens of the other post-communist democracies started feeling less optimistic about their economic future. Also, perceptions of the future were not too removed from past evaluations. This may indicate that people did not perceive radical changes to happen in one year, which, in turn, may have been a sign of relative economic stability. In contrast, it may also mean that post-communist citizens learned to make more realistic predictions of the future economy based on past economic performance rather than their own wishful thinking.

Overall, aggregate retrospective evaluations for the four countries combined became somewhat higher by the mid and late 1990s than they were at the beginning of the transition period. Predictions of the future, surprisingly, remained almost unchanged across all the studies. To conclude, despite enormous changes in the objective economies of East Central European countries over the 1990s, people's perceptions, at least in the aggregate, revealed very modest changes.

### **The Objective State of the National Economies and Sociotropic Economic Opinion in the Czech Republic, Hungary and Poland**

Due to the small N problem with regard to the number of nations included in the survey, I did not conduct a multi-level study (containing both macro- and micro-level units of analysis), in which I would be able to test directly whether the link between the objective and the subjective economy in East Central Europe became stronger. Instead, I conducted a largely qualitative comparative analysis, with the introduction of some basic statistics, of the change in aggregated economic evaluations for three out of the four selected nations of the post-communist bloc – the Czech Republic, Poland, and Hungary.

The reason I excluded Russia from this analysis was because I had survey data for only two time points, which could make my potential inferences highly unreliable.

Because objective economic indicators are measured at the country level, the unit of analysis has to be determined as an individual country. Thus, the appropriate analytical strategy was to aggregate individual-level sociotropic economic perceptions taken from the three survey studies to the level of the country. I did this by calculating the mean for retrospective and prospective economic evaluations across all the respondents within a particular country for each survey study. Consequently, I obtained three means (four in the case of Hungary) for retrospective and three for prospective economic perceptions for each individual country for three different time points, which I then compared to the dynamics of the development in the objective economy for the corresponding time periods. For measures of the objective economy, I used the same indicators that I used in the other empirical chapters of this dissertation – the rate of inflation, unemployment, and GDP growth.

Figures 6.4.1 through 6.6.2 represent the relationship between public assessments of the national economy and objective economic indicators by country. I will focus almost exclusively on interpreting the charts for retrospective economic perceptions, because the dynamic pattern for economic forecasts mirrors the one for past evaluations (only running a little higher) with the exception of Poland in 1993. Visually, there are some signs of congruence between objective economic indicators and changes in public opinion of the national economy. To specify, in the Czech Republic retrospective economic evaluations closely follow the dynamics of GDP growth, yet display little sensitivity with regard to inflation, except in 1994, and even less connection to changes in

the unemployment rate. Indisputably, the highest correspondence between the objective and the subjective economy is achieved in the Polish case. Retrospectively, Poles seem to have reacted to changes in all three economic indicators. However, this may only be true because the resumption of GDP growth in Poland was accompanied by both decreasing inflation and unemployment rate: that is, the economy was unequivocally improving. In other emerging democracies, falling inflation was occurring along with, say, rising unemployment and further contractions of the economy, thus sending mixed signals to citizens about the state of the country's economy. Had the Polish economy produced mixed results, congruence between economic changes and public opinion might have been less evident. With regard to prospective economic evaluations, public reaction to the first positive signs in the economy was remarkably optimistic. Whereas both average retrospective and prospective perceptions in 1993 had increased, the differential between the two had become .6 compared to .35 in the previous year. Finally, a link between the objective economic indicators and public perceptions also seemed to exist in Hungary, especially after the initial phase of the transition. Hungarians were most sensitive to changes in inflation and GDP growth, while changes in unemployment were not accompanied with correspondent shifts in popular economic opinion.

Figures 6.4.1 through 6.6.2 about here

For two countries of the four – the Czech Republic and Hungary – I also had additional aggregate public opinion data from the EU Consumer Confidence Surveys. Similar to the above, I matched the economic perceptions data with the annual economic series of the inflation, unemployment, and GDP growth rates. I present the relationships graphically on Figures 6.7.1 and 6.7.2. First, it is notable how sociotropic economic

expectations track sociotropic retrospective evaluations over time. As for congruence between the objective and subjective economy, there seems to be a fairly close correspondence between public economic mood and GDP growth, as well as the inflation rate. The unemployment series remains disjoint from sociotropic economic perceptions in the Czech Republic. Similarly, in Hungary, public economic evaluations appear to be sensitive to changes in unemployment. Beginning with 1997 and continuing through the 1990s, Hungarians became more pessimistic about their national economy despite moderate macroeconomic improvements.

Figures 6.7.1 and 6.7.2 about here

### **Cognitive Heuristics as Sources of Sociotropic Economic Perceptions in the Czech Republic, Hungary, Poland, and Russia**

The main focus of this chapter is to explore the micro-foundation of the formation of sociotropic economic evaluations in the four countries at different time points of the post-communist reform process. In particular, I examine whether the reliance on personal economic and political heuristics further down the path of transition was as strong as at the beginning of the transition. For this, I will compare magnitudes of the probability shifts in favorable assessments of the national economy. Following on the learning proposition, I maintain that the effect of cognitive heuristics on the formation of economic perceptions at more advanced phases of the post-communist transformation should become less pronounced than at the beginning of the transformation process. The logic behind this hypothesis is that with time newly democratic citizens became more knowledgeable about the new economic systems and should have been more able form economic evaluations independent of political heuristics. In addition, the national



economies, especially by 1997, had shown more stability than early in the transition. Thus, the need to use personal economic and political heuristics would have ceased to be as strong as at the beginning of the transition when high economic instability and a lack of economic knowledge prevented people from making accurate judgments about the national economy. The rival proposition is based on the findings of Kahneman, Tversky and their collaborators who inferred from their experimental work that, whenever people need to make judgments under uncertainty, they tend to rely on cognitive heuristics if they are salient and readily available to them regardless of their level of knowledge.

At my disposal, I have data for the Czech Republic for 1992, 1994, and 1997, Hungary for 1992, 1994, 1995, and 1997, Poland for 1992, 1993, and 1997, and finally data for Russia collected in 1992 and 1997. Overall, I used survey data collected by three major international survey projects in the region: Central and Eastern Eurobarometer No.3 (1992), The Transformation Processes Surveys (1993-1995), The Transformations Barometer East (1997), and the 1992-1994 Hungarian Panel Election Studies.

The choice of the latter dataset was motivated by two purposes. Not only does a panel study allow me to follow the evolution of economic opinion more closely, but it also gives me an opportunity to tackle the endogeneity problem. Throughout this thesis, I have acknowledged a potential threat of reciprocity in my model. Specifically, a number of my independent variables, such as attitudes toward political system and the market, as well as evaluations of democratic performance in the respondent's country, may be endogenous to the system; that is, the dependent variable may instantaneously be a causal force for all of these variables.

In present day political science, aside from specifying the nature of relationships theoretically, there are two statistical ways to solve the simultaneity problem. The first is an instrumental variable (IV) approach, such as two stage least squares. And the other one prescribes using lagged independent variables that are suspected to be endogenous.<sup>71</sup> Both methods have their drawbacks and may pose certain challenges with regard to application owing to a set of requirements necessary to be fulfilled. Evidently, utilizing a lagged independent variable requires time-series or panel data. In turn, an instrumental variable method entails the use of variables exogenous to the system, which may be both hard to find and justified.

Earlier in this work, I made an attempt to solve the endogeneity issue by applying an instrumental variable technique – two stage least squares. Here I will use a lagged endogenous variable approach using a four-wave panel Hungarian election study. The three pre-election waves of the questionnaire were conducted in December 1992, December 1993, and April 1994 (within a month of the election date), while the post-election wave took place shortly after the election in May 1994. Focusing on the post-election study, which supplied most of the variables for my analysis, I selected a series of potentially endogenous variables and replaced them with the ones from the two most recent pre-election surveys. The reason I chose the second and the third pre-election waves was to minimize the effect of time on survey responses. In fact, the time effect may be revealed in two ways: 1) a true change of a respondent's opinion, and 2) response instability due to increased noise. The former is undesirable because a lagged variable

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<sup>71</sup> A lagged independent variable approach prescribes using a lagged version of the endogenous independent variable ( $X_{t-1}$ ) in the equation at time  $t$ . Thus, the lagged endogenous independent variable automatically becomes exogenous to the system because the dependent variable at time  $t$  cannot possibly influence the endogenous independent variable at time  $(t-1)$ .

should approximate the replaced endogenous variable to a high degree; otherwise we would have two different variables, while our goal is to make reliable inferences about the present relationship between the dependent and the endogenous independent variable based on the estimated effect of the lagged independent variable. The latter should be avoided for the same reason, but the divergence between the original and the lagged independent variables occurs due to randomness in survey responses. What this means is that a person may give different answers to the same question at consecutive survey interviews without any systematic basis. Although response instability due to randomness can be found in interviews conducted even within a short period of time, it is likely to increase with time owing to true changes in opinion (Converse 1964, 2000, Converse and Pierce 1986, Markus 1979).

Sadly, despite a relatively short time span in between the pre-election and post-election waves of the Hungarian panel study, I encountered the problem of response instability to a noticeable degree. In particular, the Pearson's correlation between the original (post-election) variable denoting satisfaction with how democracy works in the respondent's country and the lagged version of it only amounts to .37, although the relationship is highly statistically significant. The correlation between the two measures of personal prospective economic perceptions is even lower – .23. One possible explanation for the low cross-panel correlation may lie in potential effects of the election campaign. As discussed in Chapter 4, some scholars have argued that over a period of election campaigns people form political views and preferences *on-line* – that is, by updating their judgments every time they hear relevant information, but immediately discarding the substantive component of the message. Moreover, people's views may

change during a campaign depending on messages they encounter. It has also been claimed that retrospective judgments formed as a result of memory-based information processing may be overshadowed by the most recent on-line preferences. By using lagged explanatory variables only moderately correlated with the original ones, I was running the risk of arriving at unreliable or even invalid conclusions about the effect of the independent variable on sociotropic economic perceptions due to the unaccounted for effect of the election campaign or for any other potential intervening effect in this regard. Therefore, I also decided to revert to two stage least squares to assure the robustness of my inferences.

Because it would be cumbersome to describe variables from four databases in the body of the chapter, a detailed explanation of the measures is presented in Appendix 6A at the end of the chapter. Although the series of independent variables slightly alternates from one dataset to the other, the wording and the scale of the dependent variables remain unchanged. Moreover, all of the categories of cognitive and information heuristics used as the key explanatory factors (personal economic situation, political evaluations and attitudes, as well as normative economic sentiments) are preserved across the databases.

## **Sociotropic Economic Perceptions in 1992**

### *The Czech Republic*

The results of the simple retrospective model in the Czech case matched those estimated by the cross-country model in Chapter 3. Individuals with more positive evaluations of personal finances were more likely to have favorable retrospective perceptions of the national economy, and so were citizens approving of the new political

system and those who were satisfied with how democracy worked in the Czech Republic. Particularly, Czechs who were strongly dissatisfied with their personal economic situation had a probability of only 7.5 percent to hold favorable views of the past national economy compared to 33.5 percent for those who thought their personal financial situation had improved over the previous year and 48 percent of those whose financial situation had very much improved. The results of the Hausman endogeneity test indicated no reciprocal relationship between satisfaction with democracy and sociotropic retrospective economic evaluations in the Czech case; therefore I calculated the probability shifts of forming favorable perceptions of the national economy from the ordered logit results. As it turned out, citizens who were highly dissatisfied with how democracy worked in the Czech Republic had only a 10 percent likelihood of evaluating the national economy positively versus almost 32 percent among highly satisfied individuals.

Attitudes toward the market economy, as well as satisfaction with the speed of the reforms also preserved their positive relations with retrospective sociotropic evaluations. Interestingly, women tended to see the recent past of the national economy more optimistically than men, whereas individuals who liked to engage in political discussion, to the contrary, viewed the economy less favorably.

For the formation of sociotropic economic forecasts, Czechs used their own evaluations of the past economy and expectations of their personal financial situation in the following year. In addition, sociotropic retrospective perceptions seem to have played the most significant role in the prediction of the country's economic forecasts. Thus, there was a 30 percent probability gap in forming optimistic economic expectations

between those who evaluated the past economy negatively and positively. Of the two political heuristics, only satisfaction with democracy achieved statistical significance with a probability shift of forming favorable economic forecasts of 20 percent over the whole range of the democracy satisfaction variable. Finally, attitudes toward the market economy were the only other factor that influenced public perceptions of the country's economic future.

Tables 6.5.1 and 6.5.2 about here

### *Hungary*

Hungarians, early on during the post-communist transition used assessments of their personal economic situation to form retrospective evaluations to a greater extent than any other factor. Whereas those who saw their financial situation as having gotten worse or much worse had only a 2 and a 5 percent chance of assessing the national economic past favorably, those who evaluated their personal economy positively or strongly positively had a 27 and a 50 percent likelihood of forming an optimistic retrospective view of the national economy, all else equal. Moreover, satisfaction with democracy and attitudes toward the political system also played a significant role for the formation of retrospective economic evaluations (the shifts in the probability of favorable retrospective evaluations were a more modest 12 and 2 percentage points respectively). Finally, the speed of the reforms significantly influenced how Hungarians viewed the recent economic past of their country.

Prospectively, Hungarians tended to rely on a number of personal economic heuristics when forming evaluations of the national economy, such as egocentric future

and past economic perceptions, as well as personal unemployment status. Retrospective sociotropic perceptions also played an important role for the formation of economic expectations. Specifically, compared to those most dissatisfied with the national economy, those who were satisfied were 28 percent more likely to form favorable economic forecasts. Moreover, attitudes toward the political system achieved statistical significance. Individuals who liked the present political system more than the past were likely to view the economic future in a brighter light than those who felt nostalgic about the Soviet system, but this estimate produced a gap in the probability of forming optimistic future perceptions of only 4.5 percent between Hungarians who liked the old regime and the new regime, all else equal. Finally, the gender variable reached statistical significance, which suggests that women were more optimistic about the national economic future than men.

Figures 6.8.1 and 6.8.2 about here

### *Poland*

In Poland, people relied on perceptions of the past personal economy to a large extent when forming retrospective economic evaluations. In fact, Poles who were highly dissatisfied or dissatisfied with their personal economy had a 9 and a 16 percent likelihood of having a favorable outlook of the past national economy, while the economically satisfied and highly satisfied had a probability of forming positive retrospective perceptions of 40 and 56 percent respectively, all else equal. Alongside, political heuristics also affected the formation of past assessments of the national economy. Surprisingly, attitudes toward the speed of the reforms, a truly painful issue

for Poles at the beginning of the post-communist transition, did not play a significant role in the retrospective model. Finally, women felt less happy with the past national economy than men.

As far as sociotropic expectations are concerned, Polish citizens took perceptions of their personal future finances and retrospective sociotropic perceptions into account (the overall shift in the probability of forming favorable forecasts was 51 percent) when they thought prospectively about their country's economy. Also, satisfaction with democracy was statistically significant in the prospective model. While Poles who were not at all satisfied with democracy in 1992 had only a 15 percent likelihood of forming optimistic economic expectations, those who were satisfied or very satisfied had a 35 and a 48 percent probability of having favorable forecasts, all else equal.

### *Russia*

Russians, similar to everybody else, paid attention to their personal economic situation when forming perceptions of the past national economy. Among other cognitive heuristics, satisfaction with democracy, attitudes toward the market, and the speed with the reforms achieved statistical significance. However, the effect of satisfaction of democracy on the formation of sociotropic economic perceptions in 1992 was less strong than in the other three countries (the overall shift in the probability of favorable retrospective assessments calculated from the ordered logit coefficient was 11 percent). Moreover, the results of the Hausman tests suggested that there might have been no causal effect of the democracy satisfaction variable on sociotropic economic perceptions, but that the relationship was reverse. Yet, the standard error for the residual



variable in the Hausman tests was too large, and the slope estimate did not reach statistical significance, which may be due to the inefficiency of OLS (used for the Hausman tests) with an ordered dependent variable.

In the prospective model, perceptions of the past economy as well as personal economic expectations achieved statistical significance. Similar to the other three countries my sub-sample, the shift in the probability of forming favorable economic forecasts among those who had highly negative and highly positive evaluations of the past economy was about 37 percent. Both political heuristics, democracy satisfaction and attitudes toward political system, were also significantly associated with public prospective evaluations, but given the results of the Hausman test in the retrospective model, I would refrain from making any causal inferences. Finally, attitudes toward the market economy and the speed of the reforms were statistically significant as well.

### **Sociotropic Economic Perceptions in 1993-1995**

#### *The Czech Republic 1994*

Retrospective perceptions in the Czech Republic in the middle of 1994 were based to a large extent on evaluations of respondents' past personal financial situation, although even those citizens who evaluated their personal economy highly negatively or negatively had a 24 and a 33 percent likelihood of forming favorable retrospective evaluations of the national economy compared to only 7 and 13 percent in 1992. Citizens who had positive feelings about their personal well-being had a 54 and a 65 percent likelihood of favoring the national economic past, all else equal. Other personal economic heuristics, such as income and personal unemployment status, did not have a

direct effect on the formation of public views about the past national economy. Political heuristics also played a significant role. Both satisfaction with the direction of the reforms and the speed of the reforms were estimated as positive and significant.

For future economic predictions, again, evaluations of the past economic situation played the most significant role (with an impressive shift of almost 80 percent in the probability of forming optimistic economic forecasts). Perceptions of current prices were also significant, whereas the expected unemployment rate in the next year was not. Among all personal economic heuristics, egocentric prospective perceptions were the only ones that achieved statistical significance, while satisfaction with the direction of the reforms seem to have been the only political heuristic in the model on which people relied when making predictions about the future economy.

Tables 6.6.1 and 6.6.2 about here

#### *Hungary 1994*

To remind the reader, I used two different methods – a lagged independent variable approach and two stage least squares – to test my hypotheses in the case of 1994 Hungary. One of the suspected endogenous variables was satisfaction with democracy. I started with logit estimation of the retrospective model using the original (post-election) variable for satisfaction with democracy. The estimate of the effect of satisfaction with democracy on evaluations of the past economy turned out both statistically significant and of meaningful magnitude, leading to a change in the probability of forming favorable retrospective perceptions of 11 percent over the whole range of the independent variable. Furthermore, to avoid potential simultaneity between evaluations of past democratic

performance and the dependent variable, I estimated the same model with the lagged democracy satisfaction measure. Owing to a weak correlation between the original and the lagged variables, the slope estimate failed to reach statistical significance and lost more than a half in magnitude.

My expectation would be that the true effect of democracy satisfaction lies somewhere in between the two coefficients (.41 and .16), but, unfortunately, it is impossible to make a more precise estimate. Building on the Hausman test for endogeneity, I was able to reject the hypothesis of a simultaneous relationship between evaluations of the democratic performance and retrospective economic perceptions.<sup>72</sup> Consequently, there is no need to apply two stage least squares, and a simple ordered logit model with the post-election democracy satisfaction variable can be used instead.

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<sup>72</sup> The instrumental variables used for Hausman's endogeneity test include: evaluations of freedom under the communist system (a five-category variable where a 1 indicates the lowest level of freedom), evaluations of freedom in the present system (five categories, 1=the lowest level of freedom), evaluations of personal importance of freedom of expression (a 4-category variable, 1=rank-ordered first among the four political goals specified by Inglehard as determinants of a person's political value system (maintain order, have influence over the government, struggle with price rises, and have freedom of expression), evaluations of the statement, "government has no touch with people" (4 categories, 1=completely agree, this variable was only used in the Hausman test for the democracy satisfaction variable), evaluations of the statement "people have no say in what the government does" (4 categories, 1=completely agree), and evaluations of the statement "the left bloc has ruled since 1945 up until now" (4 categories, 1=completely agree; this variable was only used in the Hausman test for the political system variable).

The Hausman endogeneity test proceeds in two stages. In the first stage, one regresses a suspected endogenous variable on all the variables in the system plus at least one exogenous variable, which is assumed to have values determined completely outside of the system (for a more detailed description of the Hausman tests and the related two-stage least squares procedure refer to Chapter 3.). One then obtains a vector of predicted residuals used as an independent variable in the second stage. A significant parameter estimate for the residual variable based on the F-distribution indicates the presence of simultaneity.

$$H_0: \beta_e = 0$$

$$H_1: \beta_e \neq 0, \text{ where } \beta_e \text{ is a parameter estimate of the vector of predicted residuals from the first stage}$$

The results for the Hausman endogeneity test for the *democracy satisfaction* variable were:

$$F(1, 623) = 0.84$$

$$\text{Prob} > F = 0.3592$$

With higher reliability at this point, I can accept the initial estimate for the satisfaction with democracy variable (.41) as true.

Besides satisfaction with democracy, another measure of political assessments has been suspected and tested for endogeneity. People's evaluations of the pre-1989 versus the present political system can theoretically be involved in a reciprocal relationship with retrospective economic evaluations. Short on a lagged version of the system variable (the question was only asked in the post-election survey), I had no other choice but revert to two stage least squares. The Hausman test after the first stage revealed no simultaneous relationship, thus I put the original system variable into the logit model.<sup>73</sup> Similar to satisfaction with democracy, the effect of the political system variable is both large and statistically significant.

Finally, I included an extra measure of political evaluations, namely assessments of government performance, which in my case serves as a cognitive heuristic for the formation of sociotropic economic opinion. In contrast to the system variable, the measure of government performance evaluations was not available in the post-election wave; therefore I could only use the lagged measure right from the beginning. Although lagged, perceptions of government performance were statistically significant and substantial in magnitude.

Table 6.7. about here

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<sup>73</sup> The results for the Hausman endogeneity test for the *political system* variable were:  
F (1, 557) = 0.67  
Prob > F = 0.4133

Among other explanatory factors, perceptions of personal economic situation produced the strongest effect on the formation of retrospective evaluations of the national economy (with a shift in the probability of 30 percent). Consistent with the results obtained in almost all the previous analyses, objective indicators of personal economic well-being had no direct relationship with national economic evaluations. While the coefficient for reported family income reached statistical significance, it was miniscule in magnitude and had a negative sign. Finally, a dummy variable denoting pre-1990 membership in the former ruling party (Hungarian Socialist Workers' Party) was estimated with a relatively large negative coefficient suggesting that being a member of the communist party in the past made a person much more likely to form pessimistic assessments of the national economic state. This finding can serve as additional evidence in support of the argument that political predispositions and attitudes act as causal forces rather than effects in the process of the formation of sociotropic economic evaluations.

Regarding prospective economic perceptions, the model is also potentially complicated by endogeneity. It concerns the causality between personal financial expectations and national economic forecasts. While individuals who look with optimism at their personal economic future may project this optimism to the national economy, bright prospects of the national economic situation may elevate hopes for improvements in the personal economy. Having been unable to find an appropriate set of instrumental variables to test and, if needed, correct for endogeneity between prospective egocentric and prospective sociotropic perceptions, I so far could only talk about an association between the two. Owing to the panel data, I can offer a remedy to solve for

potential reciprocity between the two variables, although still being unable to test for its presence or absence.

One by one, I used both the original (post-election) variable indicating personal economic expectations and the lagged endogenous variable (from the two most recent pre-election surveys) in the model of prospective perceptions of the national economy. Due to a low correlation between the two measures (.23), though, the effects of personal economic expectations – the original and the lagged – substantially diverged. Specifically, the coefficient for the former was estimated at 1.34, while the coefficient for the latter has only reached .24. Nonetheless, both achieved statistical significance. With high reliability, the only thing possible to infer based on these estimates is that egocentric prospective perceptions act as a causal force on the formation of national economic forecasts. The true magnitude of this effect, however, is difficult to determine with higher precision than the range between the estimate of the lagged endogenous and the original variables.

Among the other cognitive heuristics used to explain national economic predictions, retrospective sociotropic evaluations of the economy played a significant role (with a probability shift of 26 percent across the scale of the independent variable), with favorable perceptions of the past economy associated with optimistic prognoses. The estimate for personal wealth also achieved statistical significance, although its substantive effect turned out to be modest. Most intriguing, however, are the negative estimates of some political heuristics, which were positive in the retrospective model. Recall that the last wave of the panel study was conducted shortly after the 1994 parliamentary election in Hungary. The winner of the election was the former communist

party – the Hungarian Socialist Workers’ Party. Evidently, the return of the communist party to power was inspiration for some portion of society and distress for another. Individuals who favored the pre-transition system over the present one vested their hopes in the new government and were more likely to expect a bright economic future for Hungary, while those who supported the democratic system expressed economic pessimism. Satisfaction with democracy and evaluations of government performance were also estimated with reversed signs, but did not reach conventional levels of statistical significance.

Figures 6.9.1 and 6.9.2 about here

### *Hungary 1995*

The formation of retrospective evaluations of the national economy in Hungary in 1995 was determined by people’s assessments of current price levels and egocentric retrospective perceptions. In particular, Hungarians who were highly dissatisfied with their personal economic situation had a 92 percent chance of forming negative evaluations of the retrospective economy and only a 1 percent chance of having positive economic evaluations. In contrast, citizens who thought they had experienced a significant improvement in their personal economy over the previous year had only a 16.5 percent chance of evaluating the past economy positively, whereas they had almost a 37 percent chance of evaluating it negatively. Moreover, satisfaction with democracy turned out significant, but its substantive effect was inconsequential (the shift in the probability of forming positive retrospective perceptions was 4 percent). Interestingly,

the gender variable also achieved statistical significance with a positive sign, which means that Hungarian women looked at the past economy more optimistically than men.

Prospectively, Hungarians used perceptions of current prices, the past general economic situation (with a shift in the probability of forming optimistic expectations of 33 percent), and expectations of the future unemployment rate. Among personal economic heuristics, egocentric economic predictions were the only factor affecting the formation of economic forecasts.

### *Poland 1993*

For the formation of retrospective economic evaluations in Poland in 1993, personal economic heuristics and political attitudes prevailed. Specifically, subjective evaluations of one's personal economic situation, as well as personal income, were both statistically significant in the model of sociotropic retrospective perceptions. Poles who evaluated their personal well-being positively were twice as likely to form favorable perceptions of the nation's past economic performance. Moreover, satisfaction with the direction and speed of the reforms were also significant and almost equal in magnitude. These same variables remained significant in the interactive model with the exception of personal income.

Due to a missing key variable in the prospective case, evaluations of future personal finances, I decided not to analyze the formation of economic forecasts in Poland. I arrived at this decision after analyzing the effect of this variable in all other three cases and inferred that excluding this variable from the model would probably lead to biased results.



## **Sociotropic Economic Perceptions in 1997**

### *The Czech Republic*

The results for the retrospective model in the Czech Republic were in line with the findings from Poland, with three variables – egocentric economic perceptions, satisfaction with the direction of the reforms and satisfaction with the speed of the reforms – affecting the formation of past economic evaluations. However, the substantive effect of personal economic perceptions on the probability of forming favorable sociotropic evaluations of the recent economic past was not particularly large (the overall shift in the probability was 17 percent). Also, in comparison to the Polish case, the coefficient for the direction variable seems much stronger (the overall change in the probability was 42 percent), whereas the coefficient for personal economic evaluations seems weaker.

Prospectively, the effect of past evaluations of the national economy in the Czech case was much smaller than in the Polish case. Precisely, the magnitude of the coefficient estimate was half as big, producing the shift in the probability of forming optimistic economic expectations of less than 30 percent between the most dissatisfied and satisfied with the national economic past. Expectations of the future unemployment rate also had a significant effect on future evaluations of the economic situation in general. Both perceptions of personal economic past and future influenced the formation of national economic forecasts in conjunction with household income and fear of losing one's job. The only political heuristic that mattered in the prospective case was satisfaction with the direction of the reforms.

Tables 6.8.1 and 6.8.2 about here

### *Hungary*

In the retrospective model, the findings for the Hungarian case were similar to all other countries in terms of the direction and statistical significance, but the magnitudes of the coefficients for all the three factors were larger than in both the Czech and Polish cases. To specify, Hungarians who evaluated their personal economic well-being strongly negatively or negatively had a 2 and a 6 percent chance of forming favorable retrospective evaluations. Conversely, citizens who felt positive and strongly positive about their personal economic situation had a 37 and a 64 percent likelihood of assessing the national retrospective economy favorably.

In their forecasts, Hungarians to a large extent relied on past perceptions of the national economy and estimations of future personal finances. Thus, the overall change in the probability of forming positive economic expectation was almost 83 percent when moving along the scale of retrospective sociotropic evaluations. The expected level of prices was another factor affecting the formation of prospective evaluations of the national economic state, as were unemployment expectations, which turned out to be marginally significant using a one-tailed test. Finally, age achieved conventional levels of statistical significance with a positive sign, which points to the fact that older people were more optimistic about the economic future. At first sight, however, the magnitude of the effect does not seem to be substantial.

Figures 6.10.1 and 6.10.2 about here

### *Poland*

In Poland, satisfaction with the direction and the speed of the reforms and personal economic assessments were the three factors influencing public perceptions about the past of the national economy. While the estimate for personal economic perceptions produced an overall shift in the probability of 57 percent, satisfaction with the direction of the reforms had an overall probability effect of 50 percent. That is, those who were mostly satisfied with either of their personal economy or the direction of the reforms were 57 and 50 percent more likely to form positive retrospective evaluations of the national economy respectively, all else equal.

In the prospective model, evaluations of the past national economy were a significant determinant of economic forecasts, along with assessments of the unemployment rate a year ahead. Poles who formed favorable or strongly favorable evaluations of the past economy had a 52 and a 76 percent likelihood of forming optimistic economic forecasts versus respective probabilities of 11 and 4 percent for the dissatisfied and the strongly dissatisfied with the national retrospective. Personal aspects influencing future economic evaluations included egocentric prospective perceptions, household income, and fear of becoming unemployed in the next year. Between the two political heuristics in the model, satisfaction with the direction of the reforms was the only one that achieved statistical significance.

### *Russia*

In Russia, the magnitudes of the estimates of personal financial situation, satisfaction with the direction and the speed of the reforms in the retrospective model

were close to those in the Czech case. For example, the overall shift in the probability of forming favorable retrospective perceptions of the national economy as a function of personal economic well-being was only 25 percent. However, along with the same three factors statistically significant in all countries, there was one more variable that achieved statistical significance only in Russia, namely age. According to the results, older people were less likely to form positive perceptions of the national economy in Russia than younger citizens. Substantively, though, the effect of age was hardly noticeable.

The estimation of the prospective model in Russia produced four significant factors. Similar to all other cases, sociotropic retrospective perceptions, were positive and significant, as were prognoses of personal financial situation. Specifically, Russians who believed that the national economy had been improving during the previous year were over 36 percent more likely to form optimistic economic expectations (the respective probabilities were 6 and 42 percent). Moreover, those who had highly favorable perceptions of the past economy were 71 percent likely to be optimistic about the country's economic future. The expected behavior of prices was insignificant, as foreseen by Russians, unlike the expected level of unemployment, which was negatively associated with public economic forecasts.

## **Discussion and Conclusions**

Bearing on the overall goal of the thesis to analyze the formation of sociotropic economic perceptions in the post-communist nations of East Central Europe, I identified the purpose of this chapter as threefold. First, after establishing no obvious correspondence between the objective state of the economy at the beginning of the

transformation, it was only natural to follow the dynamic of this relationship over time. Under conditions of data limitations and a short time span since the start of reforms, I had no other choice but try to look at the change in public opinion at individual time points later in the transition. Even then, though, a full-scale econometric analysis of congruence between the objective and the subjective economy was infeasible, and I settled on providing a qualitative comparison of the dynamic pattern. This analysis revealed reasonable sensitivity of public opinion to changes in the three objective economic indicators – inflation, unemployment, and GDP growth. Suggestively, the highest correspondence was achieved with economic growth measured in annual percent change of GDP. Changes in the unemployment rate seem to have affected sociotropic evaluations of the economy to the least degree. Unfortunately, Russia had to be excluded from this analysis since I could only obtain comparable Russian survey data for two time points. Any inferences regarding tendencies based on two data points, however, are hazardous. Thus, my conclusion about visible correspondence between the objective economy and public economic perceptions in a dynamic perspective only concerns the three leading nations in the region, where the national economic situation had been relatively reasonable even right after the collapse of the post-communist regime in comparison to other countries within the former Soviet bloc. Furthermore, the Czech Republic, Hungary, and Poland had quickly stabilized, and their economies soon started to approximate market economies of established democracies (but see Kolodko 2001). As a consequence, it would be hazardous to generalize from the evidence I have found with regard to the three nations onto the rest of the post-communist region.

Second, also following on my earlier finding concerning people's reliance on cognitive and information shortcuts while forming perceptions about the national economy, I intended to test this proposition for mature phases of the reform process in East Central Europe. I hypothesized that, with time, owing to economic learning and increased stability in the transitioning democracies, citizens in those countries should stop relying on cognitive heuristics to the extent they used to at the beginning of the transformation. However, the evidence from the Czech Republic, Hungary, Poland, and Russia strongly suggests that this expectation does not seem to hold.

While, individuals based their sociotropic economic evaluations at the early stage of the transition on perceptions of their personal financial situation, sentiments toward a market economy, the speed of the reforms, and a number of political attitudes, such as satisfaction with democracy and evaluations of the present versus the pre-transition political system, the same relationship was revealed during the more advanced phases of the post-communist reforms. Overall, citizens of the Czech Republic, Hungary, and Poland displayed reliance on personal economic perceptions, evaluations of the speed and direction of reforms, and their attitudes to a market economy. It is important to note, however, that the causal flow with regard to the political heuristics and attitudes toward the market and retrospective assessments of the national economy can be posited to be reciprocal. Yet, the two-stage analysis of the 1994 Hungarian model, as well as the estimation of the same model using a lagged endogenous variable approach points to a reasonable validity of the inferences made for other leading nations in the region. In addition, my findings suggest that post-communist citizens used perceptions of the price

level and unemployment in making both retrospective and prospective judgments about the national economy.

As for 1997, which is the most recent year for which I have relevant survey data, the same pattern emerges with egotropic economic perceptions being a major factor for public evaluations of the national economy both retrospectively and prospectively. Similarly, feelings about the speed and the direction of reforms still play a significant role for the formation of sociotropic economic assessments, along with expectations of future inflation and unemployment rates. To summarize, at the mature stages of the democratic transition, as at the very beginning, post-communist citizens still relied on cognitive and information heuristics to a significant extent for making judgments about the state of the national economy.

Finally, in this chapter I sought to go into greater detail on the transition processes in the Czech Republic, Hungary, Poland, and Russia, and shed some light on the dynamics of public economic opinion in these nations. It should be noted that there were no striking differences in the formation of sociotropic economic opinion among the publics of the four countries. While Czech citizens consistently relied on evaluations of their personal financial situation and satisfaction with the reform process (direction and speed) when judging the national economy retrospectively, Poles were only concerned with the speed of the reforms later in the transition, but not at the earlier stage of it. Still, Polish citizens also based their evaluations of their nation's economic past on their personal financial situation and satisfaction with the direction of reforms. In Hungary, personal economic perceptions, satisfaction with democracy and the speed of the reforms constituted the basis for the formation of retrospective economic evaluations. Similarly,

Russians relied on their personal financial situation and satisfaction with democracy and the reform process when forming opinion about the country's economic past. With regard to prospective evaluations, the reliance on economic and political heuristics remained consistently high in all the four post-communist nations. This similarity in the formation of economic opinion across the analyzed countries lends support to the generalizability of my model in application to a wider range of transitioning societies, unstable economies, as well as nations where politics and economics are perceived as tightly intertwined. In addition, the persistent reliance on cognitive heuristics over time allows me to establish support for Zaller's model and support for the general proposition put forward by Kahneman, Tversky and their collaborators about the importance of accessibility (availability) and representativeness of issue considerations for opinion formation. Notwithstanding easy access to objective economic information, people tend to rely on other considerations if they are representative and readily available to them at the time of an interview. Provided such information shortcuts do not lead to a heavy systematic bias in public evaluations of the national economy, voters should still be able to hold their governments accountable for its economic performance and make reasoned vote choices.



## Appendix 6A. Countries by Studies

### Central and Eastern European Barometer #3

| <i>Country</i>         | <i>Period of Data Collection</i> |
|------------------------|----------------------------------|
| Czech Republic         | October –November 1992           |
| Slovak Republic        | October –November 1992           |
| Hungary                | October –November 1992           |
| Poland                 | October –November 1992           |
| Russia (European Part) | October –November 1992           |

### The Transformation Processes in Hungary, Poland, the Czech and Slovak Republics

|                 |                                  |
|-----------------|----------------------------------|
| Poland          | September 21 – September 28 1993 |
| Czech Republic  | June 20 – June 21 1994           |
| Slovak Republic | June 20 – June 21 1994           |
| Hungary         | July 10 – July 24 1995           |

### The Hungarian Pre-Post-Election Panel Study, 1992-1994

|         |   |
|---------|---|
| Hungary | December 1993 (2 <sup>nd</sup> Pre-Election Wave) |
|         | April 1994 (3 <sup>rd</sup> Pre-Election Wave)    |
|         | May 1994 (Post-Election Wave)                     |

### Transformations Barometer East

|                |          |
|----------------|----------|
| Poland         | May 1997 |
| Czech Republic | May 1997 |
| Hungary        | May 1997 |
| Russia         | May 1997 |

## Appendix 6B. Variables Measures and Coding

### Central and Eastern European Barometer #3 (1992)

1. *Sociotropic Retrospective Perceptions.* A five-category variable ranging from 1 (the general economic situation in the (RESPONDENT'S) country has become much worse, compared to 12 months ago) to 5 (the general economic situation has become much better).
2. *Sociotropic Prospective Perceptions.* A five-category variable ranging from 1 (the general economic situation in the (RESPONDENT'S) country in the next 12 months will become much worse) to 5 (the general economic situation will become much better).
3. *Egocentric Retrospective Evaluations.* A five-category variable, which ranges from 1 (personal financial situation has got much worse over the past year) to 5 (personal financial situation has got much better over the past year).
4. *Egocentric Prospective Evaluations.* A five-category variable, which ranges from 1 (personal financial situation is expected to become much worse in the next 12 months) to 5 (personal financial situation is expected to become much better in the next 12 months).
5. *Income.* For the convenience of comparing individual incomes from 16 different countries of Central and Eastern Europe, the income variable has been standardized into 20 categories, where 1 is the lowest income bracket and 20 is the highest income bracket.
6. *Unemployment Status.* Coded 1 for those who reported themselves as being unemployed.
7. *System Support.* A three-category variable scored 1 if the respondent likes the past political system better than the new one, 2 if he likes neither of the systems, and 3 if he decides that the new system is better.
8. *Democracy Satisfaction.* Varies from 0, meaning complete dissatisfaction with how democracy is working in the respondent's country, to 3, which corresponds to the respondent's complete satisfaction with democracy.
9. *Opinion about a market economy.* Coded as a dummy variable, where 1 indicates positive feelings for a market economy, and 0 means that the respondent thinks that market is a bad thing in general.
10. *Feelings towards the speed of economic reforms.* Coded such that 0 corresponds to the respondents' answers that there are no reforms in their countries, 1 indicates that the speed of the reforms is either too slow or too fast, and 2 is the right speed. People

who have received a score of 2 on this question are expected to be the ones who develop the most favorable attitudes toward the national economic situation.

11. *Gender* is coded 1 for female and 0 for male.
12. *Political Discussion*. A 3-category variable coded 1 for individuals who never discuss politics with their friends, 2 if they discuss politics occasionally, and 3 if political matters are discussed on a regular basis.
13. *Age* indicates the actual age of the respondent.
14. *Political Discussion Dummy*. Created from the Political Discussion 3-category variable by collapsing it into two categories. Respondents who report that they never discuss politics or do it occasionally are coded as 0, whereas respondents who do it on a regular basis are assigned the score of 1.
15. *Education Dummy*. Created from the Education 4-category variable. Respondents who have elementary or secondary incomplete education are coded as 0, while respondents who have completed secondary or higher education are coded as 1.

### **The Transformation Processes in Hungary, Poland, the Czech and Slovak Republics (1993-1995)**

1. *Sociotropic Retrospective Perceptions*. A five-category variable ranging from 1 (the general economic situation in the (RESPONDENT'S) country has become much worse, compared to 12 months ago) to 5 (the general economic situation has become much better).
2. *Sociotropic Prospective Perceptions*. A five-category variable ranging from 1 (the general economic situation in the (RESPONDENT'S) country in the next 12 months will become much worse) to 5 (the general economic situation will become much better).
3. *Egocentric Retrospective Evaluations*. A five-category variable, which ranges from 1 (personal financial situation has got much worse over the past year) to 5 (personal financial situation has got much better over the past year).
4. *Egocentric Prospective Evaluations*. A five-category variable, which ranges from 1 (personal financial situation is expected to become much worse in the next 12 months) to 5 (personal financial situation is expected to become much better in the next 12 months).
5. *Income*. For the convenience of comparing individual incomes from 4 different countries of Central and Eastern Europe, the income variable has been standardized into 6 categories, where 1 is the lowest income bracket and 6 is the highest income bracket.

6. *Unemployment Status.* Coded 1 for those who reported themselves as being unemployed.
7. *Direction of Reforms.* A three-category variable scored 1 if the respondent thinks that the reforms need to be seized, 2 if he thinks they need to be continued, but with some changes, and 3 if he thinks the reforms need to be continued without as before.
8. *Democracy Satisfaction (Hungary).* Varies from 1, meaning complete dissatisfaction with how democracy is working in the respondent's country, to 4, which corresponds to the respondent's complete satisfaction with democracy.
9. *Opinion about a market economy.* Coded as a dummy variable, where 1 indicates that the respondent thinks that market will benefit everybody in the long run, and 0 means that the respondent disagrees with this statement.
10. *Feelings towards the speed of reforms.* Coded such that 0 indicates that the speed of the reforms is either too slow or too fast, and 1 is the right speed.
11. *Prices this year.* This is a 6-category variable coded 1 if the respondent thinks that prices will go much down during this year, 2 if prices will go somewhat down, 3 if prices will stay the same, 4 if prices will go a little up, 5 if prices will go somewhat up, and 6 if prices will go much up.
12. *Unemployment next year.* A 5-category variable coded 1 if the respondent predicts next year's national unemployment rate to go substantially down, 2 if it goes somewhat down, 3 if unemployment stays the same, 4 if it goes somewhat up, and 5 if the respondent envisions a sharp increase in unemployment.
13. *Job security.* Coded 1 if the respondent is currently unemployed, 2 if the respondent envisions losing his job within the following two years with a high probability, 3 if there is some probability of the respondent's losing his job, 4 if the respondent thinks that he is more likely to keep the job than lose it, and 5 if the respondent is almost sure he is not going to lose his job.
14. *Gender* is coded 1 for female and 0 for male.
15. *Age* indicates the actual age of the respondent.
16. *Education Dummy.* Created from the education variables for each individual country and then collapsed into two categories where 0 indicates lower education and 1 means high education.

### Transformations Barometer East (1997)

1. *Sociotropic Retrospective Perceptions.* A five-category variable ranging from 1 (the general economic situation in the (RESPONDENT'S) country has become much worse, compared to 12 months ago) to 5 (the general economic situation has become much better).
2. *Sociotropic Prospective Perceptions.* A five-category variable ranging from 1 (the general economic situation in the (RESPONDENT'S) country in the next 12 months will become much worse) to 5 (the general economic situation will become much better).
3. *Egocentric Retrospective Evaluations.* A five-category variable, which ranges from 1 (personal financial situation has got much worse over the past year) to 5 (personal financial situation has got much better over the past year).
4. *Egocentric Prospective Evaluations.* A five-category variable, which ranges from 1 (personal financial situation is expected to become much worse in the next 12 months) to 5 (personal financial situation is expected to become much better in the next 12 months).
5. *Income.* For the convenience of comparing individual incomes from 4 different countries of Central and Eastern Europe, the income variable has been standardized into 3 categories, where 1 indicates low income, 2 means middle income, and 3 indicates high income.
6. *Direction of reforms.* A 4-category variable scored 1 if the respondent not at all satisfied with the direction of the reforms, 2 if she is somewhat dissatisfied, 3 if the respondent is somewhat satisfied, and 4 if she is fully satisfied with the direction of the reforms.
7. *Feelings towards the speed of reforms.* Coded such that 0 indicates that the speed of the reforms is either too slow or too fast, and 1 is the right speed.
8. *Education Dummy.* Created from the 4-category education variable by collapsing it into two categories where 0 indicates lower education and 1 means high education.
9. *Prices next year.* This is a 6-category variable coded 1 if the respondent thinks that prices will go much down during this year, 2 if prices will go somewhat down, 3 if prices will stay the same, 4 if prices will go a little up, 5 if prices will go somewhat up, and 6 if prices will go much up.
10. *Unemployment next year.* A 5-category variable coded 1 if the respondent predicts next year's national unemployment rate to go substantially down, 2 if it goes somewhat down, 3 if unemployment stays the same, 4 if it goes somewhat up, and 5 if the respondent envisions a sharp increase in unemployment.

11. *Job security*. Coded 1 if the respondent is currently unemployed, 2 if the respondent envisions losing his job within the following two years with a high probability, 3 if there is some probability of the respondent's losing his job, 4 if the respondent thinks that he is more likely to keep the job than lose it, and 5 if the respondent is almost sure he is not going to lose his job.
12. *Gender* is coded 1 for female and 0 for male.
13. *Age* indicates the actual age of the respondent.

**Table 6.1. Development Indicators in Czech Republic**

| Indicators              | 1990 | 1991  | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998  | 1999  | 2000 |
|-------------------------|------|-------|------|------|------|------|------|------|-------|-------|------|
| <b>Inflation</b>        |      | 52.0  | 12.7 | 18.2 | 9.7  | 7.9  | 8.6  | 10.0 | *10.6 | *2.1  | *3.9 |
| <b>Unemployment</b>     | 0.8  | 4.1   | 2.6  | 3.5  | 3.2  | 2.9  | 3.5  | 5.2  | *6.5  | *8.7  | *8.8 |
| <b>GDP Growth</b>       | -0.4 | -14.2 | -3.3 | 0.6  | 3.2  | 6.4  | 3.9  | 1.0  | *-1.2 | *-0.4 | *2.9 |
| <b>Gini Index</b>       |      |       | 21.4 | 25.8 | 26.0 | 28.2 | 25.4 | 25.9 | 25.8  | 25.7  | 27.0 |
| <b>Political Rights</b> | *2/2 | *2/2  | *2/2 | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2   | 1/2   | 1/2  |
| <b>Corruption</b>       |      |       |      |      |      |      | 5.37 | 5.20 | 4.80  |       | 4.30 |

**Source<sup>a</sup>**: European Bank for Reconstruction and Development (cited in Kolodko, "From Shock to Therapy", 2000).

**Source<sup>a\*</sup>**: World Bank, World Bank Development Indicators, 2000.

**Source<sup>b</sup>**: UNICEF, TransMONEE Database, 2003 edition.

**Source<sup>b\*</sup>**: World Bank, Global Poverty Monitoring website.

**Source<sup>c</sup>**: Freedom House.

**Source<sup>d</sup>**: Transparency International.

**Table 6.2. Development Indicators in Hungary**

| Indicators              | 1990 | 1991  | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998  | 1999  | 2000 |
|-------------------------|------|-------|------|------|------|------|------|------|-------|-------|------|
| <b>Inflation</b>        |      | 32.0  | 21.6 | 21.1 | 21.2 | 28.3 | 19.8 | 18.4 | *14.1 | *10.0 | *9.8 |
| <b>Unemployment</b>     | 1.9  | 7.8   | 13.2 | 12.1 | 10.4 | 10.4 | 10.7 | 10.4 | *7.8  | *7.0  | *6.5 |
| <b>GDP Growth</b>       | -3.5 | -11.9 | -3.1 | -0.6 | 2.9  | 1.5  | 1.3  | 4.3  | *4.9  | *4.2  | *5.2 |
| <b>Gini Index</b>       |      |       | 30.5 | 32.0 | 32.4 |      |      | 35.0 | *24.4 |       |      |
| <b>Political Rights</b> | 2/2  | 2/2   | 2/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2  | 1/2   | 1/2   | 1/2  |
| <b>Corruption</b>       |      |       |      |      |      | 4.12 | 4.86 | 5.18 | 5.00  | 5.20  | 5.20 |

**Source<sup>a</sup>**: European Bank for Reconstruction and Development (cited in Kolodko, "From Shock to Therapy", 2000).

**Source<sup>a\*</sup>**: World Bank, World Bank Development Indicators, 2000.

**Source<sup>b</sup>**: UNICEF, TransMONEE Database, 2003 edition.

**Source<sup>b\*</sup>**: World Bank, Global Poverty Monitoring website.

**Source<sup>c</sup>**: Freedom House.

**Source<sup>d</sup>**: Transparency International.

**Table 6.3. Development Indicators in Poland**

| Indicators              | 1990  | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998  | 1999  | 2000  |
|-------------------------|-------|------|------|------|------|------|------|------|-------|-------|-------|
| <b>Inflation</b>        |       | 60.0 | 44.3 | 37.6 | 29.4 | 21.6 | 18.5 | 13.2 | *11.7 | *7.3  | *10.1 |
| <b>Unemployment</b>     | 6.3   | 12.2 | 14.3 | 16.4 | 16.0 | 14.9 | 13.6 | 10.5 | *10.7 | *12.5 | *16.7 |
| <b>GDP Growth</b>       | -11.6 | -7.0 | 2.6  | 3.8  | 5.2  | 7.0  | 6.1  | 6.9  | *4.8  | *4.1  | *4.0  |
| <b>Gini Index</b>       |       |      | 24.7 | 25.6 | 28.1 | 29.0 | 30.2 | 30.0 | 29.4  | 30.5  |       |
| <b>Political Rights</b> |       | 4/3  | 2/2  | 2/2  | 2/2  | 1/2  | 1/2  | 1/2  | 1/2   | 1/2   | 1/2   |
| <b>Corruption</b>       |       |      |      |      |      |      | 5.57 | 5.08 | 4.60  | 4.20  | 4.10  |

**Source<sup>a</sup>**: European Bank for Reconstruction and Development (cited in Kolodko, “From Shock to Therapy”, 2000).

**Source<sup>a\*</sup>**: World Bank, World Bank Development Indicators, 2000.

**Source<sup>b</sup>**: UNICEF, TransMONEE Database, 2003 edition.

**Source<sup>b\*</sup>**: World Bank, Global Poverty Monitoring website.

**Source<sup>c</sup>**: Freedom House.

**Source<sup>d</sup>**: Transparency International.

**Table 6.4. Development Indicators in Russia**

| Indicators                          | 1990 | 1991  | 1992   | 1993  | 1994  | 1995  | 1996 | 1997 | 1998  | 1999  | 2000  |
|-------------------------------------|------|-------|--------|-------|-------|-------|------|------|-------|-------|-------|
| <b>Inflation<sup>a</sup></b>        |      | 144.0 | 2508.8 | 840.1 | 204.7 | 131.3 | 21.8 | 11.1 | *27.7 | *85.7 | *20.8 |
| <b>Unemployment<sup>a</sup></b>     | 0.0  | 0.0   | 4.8    | 5.7   | 7.5   | 8.8   | 9.3  | 9.0  | *13.3 | *13.4 | *11.4 |
| <b>GDP Growth<sup>a</sup></b>       | -4.0 | -13.0 | -14.5  | -8.7  | -12.6 | -4.0  | -4.9 | 0.4  | *-4.9 | *5.4  | *8.3  |
| <b>Gini Index<sup>b</sup></b>       |      |       | 37.1   | 46.1  | 44.6  | 47.1  | 48.3 |      |       |       | *45.6 |
| <b>Political Rights<sup>c</sup></b> | 5/4  | 3/3   | 3/4    | 3/4   | 3/4   | 3/4   | 3/4  | 3/4  | 4/4   | 4/5   | 5/5   |
| <b>Corruption<sup>d</sup></b>       |      |       |        |       |       |       | 2.58 | 2.27 | 2.40  | 2.40  | 2.10  |

**Source<sup>a</sup>**: European Bank for Reconstruction and Development (cited in Kolodko, “From Shock to Therapy”, 2000).

**Source<sup>a\*</sup>**: World Bank, World Bank Development Indicators, 2000.

**Source<sup>b</sup>**: UNICEF, TransMONEE Database, 2003 edition.

**Source<sup>b\*</sup>**: World Bank, Global Poverty Monitoring website.

**Source<sup>c</sup>**: Freedom House.

**Source<sup>d</sup>**: Transparency International.



**Table 6.5.1. Determinants of Sociotropic Retrospective Perceptions by Country in 1992**

(Standard errors in parentheses)

| Independent Variable                          | Czech Republic    | Hungary            | Poland            | Russia            |
|---|-------------------|--------------------|-------------------|-------------------|
| Egocentric retrospective economic evaluations | .606***<br>(.081) | 1.006***<br>(.112) | .638***<br>(.094) | .568***<br>(.082) |
| Income  | -.027<br>(.031)   | -.025<br>(.028)    | .005<br>(.025)    | .039<br>(.041)    |
| Unemployment Status                           | .354<br>(.461)    | -.215<br>(.295)    | -.072<br>(.282)   | -.002<br>(.417)   |
| Satisfaction with democracy                   | .471***<br>(.125) | .619***<br>(.122)  | .550***<br>(.124) | .285*<br>(.134)   |
| Attitudes toward political system             | .461***<br>(.105) | .223*<br>(.112)    | .375***<br>(.108) | .143<br>(.109)    |
| Attitudes toward market                       | .757***<br>(.179) | .251<br>(.204)     | .168<br>(.207)    | .580*<br>(.200)   |
| Attitudes toward the speed of the reforms     | .375*<br>(.148)   | .520*<br>(.185)    | .293<br>(.189)    | .376*<br>(.177)   |
| Education                                     | -.006<br>(.087)   | .034<br>(.092)     | .155<br>(.097)    | -.171<br>(.105)   |
| Political Discussion                          | -.316*<br>(.120)  | -.198<br>(.130)    | -.118<br>(.124)   | -.031<br>(.137)   |
| Gender  | .288<br>(.148)    | .018<br>(.172)     | -.333*<br>(.169)  | .252<br>(.170)    |
| Age   | -.008<br>(.005)   | -.003<br>(.005)    | -.0001<br>(.006)  | -.004<br>(.006)   |
| N   | 672               | 558                | 532               | 576               |
| -2Log Likelihood                              | 1637.61           | 1119.62            | 1364.68           | 1310.87           |
| Pseudo R <sup>2</sup>                         | .14               | .17                | .12               | .11               |

\* p < 0.05 \*\* p < 0.01 \*\*\* p < 0.001 (two-tailed)

**Note:** Entries are ordered logit estimates.

**Table 6.5.2. Determinants of Sociotropic Prospective Perceptions by Country in 1992**

(Standard errors in parentheses)

| Independent Variable                                  | Czech Republic    | Hungary           | Poland             | Russia            |
|---|-------------------|-------------------|--------------------|-------------------|
| Sociotropic <i>retrospective</i> economic evaluations | .623***<br>(.087) | .774***<br>(.116) | .642***<br>(.103)  | .483***<br>(.092) |
| Egocentric <i>retrospective</i> economic evaluations  | -.132<br>(.088)   | .227<br>(.120)    | .048<br>(.108)     | .113<br>(.099)    |
| Egocentric <i>prospective</i> economic evaluations    | .852***<br>(.096) | .611***<br>(.107) | 1.119***<br>(.120) | .910***<br>(.113) |
| Income  | .033<br>(.033)    | .012<br>(.028)    | .001<br>(.028)     | .036<br>(.045)    |
| Unemployment Status                                   | -.221<br>(.471)   | -.700*<br>(.315)  | .585<br>(.326)     | .081<br>(.440)    |
| Satisfaction with democracy                           | .448***<br>(.128) | .154<br>(.124)    | .558***<br>(.140)  | .375*<br>(.154)   |
| Attitudes toward political system                     | .127<br>(.106)    | .255*<br>(.116)   | -.004<br>(.123)    | .297*<br>(.125)   |
| Attitudes toward market                               | .603**<br>(.185)  | .264<br>(.200)    | .361<br>(.226)     | .618*<br>(.225)   |
| Attitudes toward the speed of the reforms             | .147<br>(.152)    | .252<br>(.184)    | .302<br>(.208)     | .587*<br>(.207)   |
| Education   | -.127<br>(.091)   | -.025<br>(.093)   | .022<br>(.107)     | .147<br>(.117)    |
| Political Discussion                                  | -.236<br>(.125)   | -.031<br>(.134)   | .136<br>(.138)     | -.302<br>(.155)   |
| Gender  | .176<br>(.153)    | .430*<br>(.174)   | .325<br>(.188)     | -.217<br>(.192)   |
| Age   | .007<br>(.005)    | .002<br>(.006)    | .007<br>(.007)     | .005<br>(.007)    |
| N   | 653               | 516               | 462                | 443               |
| -2Log Likelihood                                      | 1546.57           | 1144.43           | 1019.40            | 968.42            |
| Pseudo R <sup>2</sup>                                 | .17               | .18               | .23                | .26               |

\* p < 0.05 \*\* p < 0.01 \*\*\* p < 0.001 (two-tailed)

**Note:** Entries are ordered logit estimates.

**Table 6.6.1. Determinants of Sociotropic Retrospective Perceptions by Country in 1993-1995**

(Standard errors in parentheses)

| <b>Independent Variable</b>                    | <b>Czech Republic</b> | <b>Hungary</b>     | <b>Poland</b>     |
|--|-----------------------|--------------------|-------------------|
| Egocentric retrospective economic evaluations  | .442***<br>(.096)     | .795***<br>(.096)  | .491***<br>(.065) |
| Income   | .077<br>(.067)        | .016<br>(.046)     | .166*<br>(.069)   |
| Unemployment Status                            | .115<br>(.217)        | .106<br>(.178)     | .320<br>(.247)    |
| Prices this year                               | -.133<br>(.087)       | -.473***<br>(.086) | -.034<br>(.057)   |
| Job Security                                   | .156<br>(.085)        | -.060<br>(.066)    | .087<br>(.061)    |
| Satisfaction with democracy                    |                       | .446***<br>(.109)  |                   |
| Satisfaction with the direction of the reforms | .621***<br>(.174)     | .247<br>(.193)     | .453**<br>(.136)  |
| Attitudes toward market                        | .330***<br>(.054)     | .046<br>(.041)     | .189***<br>(.039) |
| Attitudes toward the speed of the reforms      | .412*<br>(.156)       | .269<br>(.168)     | .469**<br>(.144)  |
| Education                                      | -.067<br>(.155)       | .066<br>(.148)     | .135<br>(.130)    |
| Gender   | .120<br>(.151)        | .525***<br>(.141)  | -.111<br>(.121)   |
| Age  | -.017*<br>(.006)      | -.006<br>(.006)    | -.001<br>(.004)   |
| N  | 684                   | 808                | 936               |
| -2Log Likelihood                               | 1525.43               | 1584.55            | 2509.50           |
| Pseudo R <sup>2</sup>                          | .12                   | .13                | .07               |

\* p < 0.05 \*\* p < 0.01 \*\*\* p < 0.001 (two-tailed)

**Note:** Entries are ordered logit estimates.

**Table 6.6.2. Determinants of Sociotropic Prospective Perceptions by Country in 1993-1995**

(Standard errors in parentheses)

| Independent Variable                                  | Czech<br>Republic  | Hungary            |
|---|--------------------|--------------------|
| Sociotropic <i>retrospective</i> economic evaluations | 1.151***<br>(.121) | 1.118***<br>(.112) |
| Egocentric <i>retrospective</i> economic evaluations  | .050<br>(.109)     | -.012<br>(.104)    |
| Egocentric <i>prospective</i> economic evaluations    | .386***<br>(.111)  | .860***<br>(.105)  |
| Income  | -.019<br>(.077)    | .020<br>(.046)     |
| Unemployment Status                                   | .217<br>(.253)     | .076<br>(.176)     |
| Prices this year                                      | -.218*<br>(.104)   | -.369***<br>(.090) |
| Unemployment next year                                | -.075<br>(.105)    | -.245*<br>(.092)   |
| Job Security  | .010<br>(.097)     | .033<br>(.065)     |
| Satisfaction with democracy                           |                    | .098<br>(.110)     |
| Satisfaction with the direction of the reforms        | .543*<br>(.189)    | .043<br>(.200)     |
| Attitudes toward market                               | .101<br>(.060)     | .002<br>(.041)     |
| Attitudes toward the speed of the reforms             | .157<br>(.173)     | -.183<br>(.163)    |
| Education   | .174<br>(.173)     | .204<br>(.145)     |
| Gender  | .043<br>(.169)     | -.124<br>(.140)    |
| Age   | -.001<br>(.007)    | .004<br>(.006)     |
| N   | 608                | 807                |
| -2Log Likelihood                                      | 1155.58            | 1682.86            |
| Pseudo R <sup>2</sup>                                 | .19                | .20                |

\* p < 0.05 \*\* p < 0.01 \*\*\* p < 0.001 (two-tailed)

**Note:** Entries are ordered logit estimates.

**Table 6.7. Determinants of Sociotropic Retrospective and Prospective Perceptions in Hungary in 1994**

(Standard errors in parentheses)

| Independent Variable                                  | Retrospective     | Retrospective (Satisfaction with democracy lagged) | Prospective        | Prospective (Egocentric prospective lagged) |
|---|-------------------|--|--------------------|---|
| Sociotropic <i>retrospective</i> economic evaluations |                   |  | .325***<br>(.087)  | .348***<br>(.083)                           |
| Egocentric <i>retrospective</i> economic evaluations  | .617***<br>(.088) | .612***<br>(.088)                                  | -.300**<br>(.098)  | -.064<br>(.091)                             |
| Egocentric <i>prospective</i> economic evaluations    |                   |  | 1.343***<br>(.101) | .239**<br>(.079)                            |
| Unemployment Status                                   | .186<br>(.304)    | .184<br>(.305)                                     | -.068<br>(.314)    | -.192<br>(.300)                             |
| Retired   | -.236<br>(.219)   | -.267<br>(.217)                                    | .141<br>(.229)     | .202<br>(.224)                              |
| Income  | -.0003<br>(.001)  | -.0002<br>(.001)                                   | .0001<br>(.001)    | -.001<br>(.001)                             |
| Income Change   | .063<br>(.055)    | .081<br>(.054)                                     | -.012<br>(.057)    | -.015<br>(.056)                             |
| Family Income   | -.001*<br>(.0004) | -.001*<br>(.0004)                                  | .0004<br>(.0004)   | .0005<br>(.0004)                            |
| Wealth (subjective)                                   | -.012<br>(.050)   | -.003<br>(.050)                                    | .069<br>(.054)     | .104*<br>(.051)                             |
| Satisfaction with democracy                           | .409***<br>(.107) | .156<br>(.099)                                     | -.123<br>(.112)    | -.112<br>(.111)                             |
| Attitudes toward political system                     | .371***<br>(.076) | .437***<br>(.074)                                  | -.161<br>(.083)    | -.167*<br>(.081)                            |
| Evaluation of the government performance (lagged)     | .343**<br>(.102)  | .323**<br>(.106)                                   | -.028<br>(.108)    | -.108<br>(.106)                             |
| Vote in 1990  | .135<br>(.161)    | .115<br>(.162)                                     | .147<br>(.172)     | .061<br>(.165)                              |
| MSZMP past membership                                 | -.450*<br>(.203)  | -.435*<br>(.201)                                   | -.005<br>(.213)    | .129<br>(.209)                              |
| Education   | .086<br>(.102)    | .069<br>(.103)                                     | -.105<br>(.109)    | -.163<br>(.106)                             |
| Political Discussion                                  | -.047<br>(.122)   | -.020<br>(.122)                                    | -.230<br>(.131)    | -.213<br>(.126)                             |
| Political Interest                                    | -.028<br>(.091)   | -.0001<br>(.091)                                   | .107<br>(.099)     | .081<br>(.095)                              |

|                       |                 |                 |                |                 |
|-----------------------|-----------------|-----------------|----------------|-----------------|
| Gender                | -.095<br>(.148) | -.071<br>(.148) | .224<br>(.157) | .054<br>(.155)  |
| Age (categories)      | .144<br>(.100)  | .145<br>(.098)  | .007<br>(.105) | -.130<br>(.101) |
| N                     | 735             | 732             | 669            | 653             |
| -2Log Likelihood      | 1749.50         | 1752.36         | 1490.05        | 1637.89         |
| Pseudo R <sup>2</sup> | .11             | .11             | .14            | .03             |

\* p < 0.05 \*\* p < 0.01 \*\*\* p < 0.001 (two-tailed)

**Note:** Entries are ordered logit estimates.

**Table 6.8.1. Determinants of Sociotropic Retrospective Perceptions by Country in 1997**

(Standard errors in parentheses)

| Independent Variable                           | Czech Republic     | Hungary            | Poland            | Russia            |
|--|--------------------|--------------------|-------------------|-------------------|
| Egocentric retrospective economic evaluations  | .527***<br>(.098)  | 1.109***<br>(.126) | .755***<br>(.092) | .566***<br>(.072) |
| Income   | .176<br>(.095)     | .054<br>(.126)     | -.131<br>(.102)   | .043<br>(.077)    |
| Satisfaction with the direction of the reforms | 1.142***<br>(.132) | .922***<br>(.193)  | .852***<br>(.137) | .914***<br>(.098) |
| Attitudes toward the speed of the reforms      | .450*<br>(.171)    | .928***<br>(.266)  | .456*<br>(.179)   | .445*<br>(.187)   |
| Education                                      | .009<br>(.148)     | .111<br>(.208)     | .077<br>(.150)    | -.083<br>(.128)   |
| Gender   | -.132<br>(.145)    | -.340<br>(.188)    | -.224<br>(.143)   | .029<br>(.116)    |
| Age  | -.002<br>(.005)    | .009<br>(.007)     | -.003<br>(.005)   | -.008*<br>(.004)  |
| N  | 704                | 426                | 724               | 1082              |
| -2Log Likelihood                               | 1626.67            | 935.14             | 1678.84           | 2599.43           |
| Pseudo R <sup>2</sup>                          | .12                | .18                | .11               | .10               |

\* p < 0.05 \*\* p < 0.01 \*\*\* p < 0.001 (two-tailed)

**Note:** Entries are ordered logit estimates.

**Table 6.8.2. Determinants of Sociotropic Prospective Perceptions by Country in 1997**

(Standard errors in parentheses)

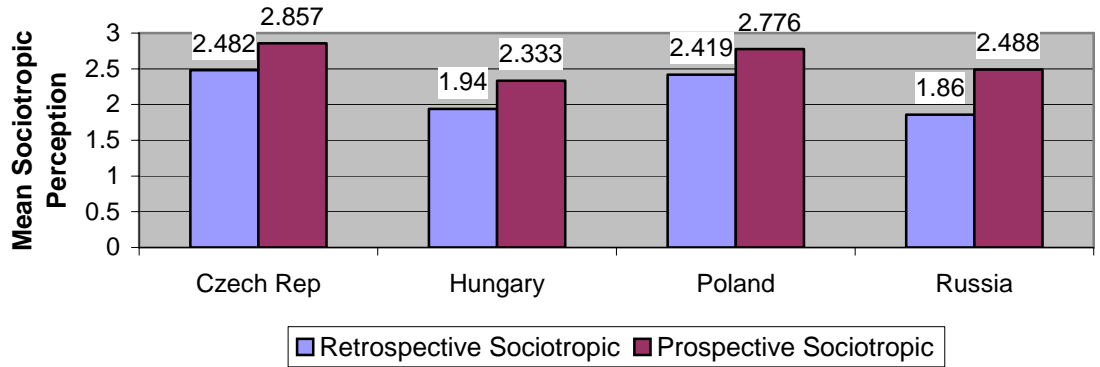
| Independent Variable                           | Czech Republic     | Hungary            | Poland             | Russia             |
|--|--------------------|--------------------|--------------------|--------------------|
| Sociotropic retrospective economic evaluations | .501***<br>(.111)  | 1.284***<br>(.172) | 1.083***<br>(.123) | 1.208***<br>(.167) |
| Egocentric retrospective economic evaluations  | .214<br>(.124)     | -.008<br>(.161)    | .046<br>(.120)     | .075<br>(.156)     |
| Egocentric prospective economic evaluations    | .617***<br>(.128)  | .783***<br>(.169)  | .718***<br>(.121)  | .509*<br>(.165)    |
| Income   | .275*<br>(.118)    | -.063<br>(.164)    | -.238<br>(.123)    | .127<br>(.172)     |
| Prices next year                               | -.075<br>(.108)    | -.296*<br>(.134)   | -.164<br>(.102)    | .250<br>(.150)     |
| Unemployment next year                         | -.308*<br>(.126)   | -.260<br>(.158)    | -.363**<br>(.110)  | -.419*<br>(.147)   |
| Job security                                   | -.247*<br>(.107)   | .173<br>(.134)     | -.181<br>(.099)    | .048<br>(.125)     |
| Satisfaction with the direction of the reforms | 1.005***<br>(.181) | .100<br>(.235)     | .470*<br>(.167)    | .641*<br>(.211)    |
| Attitudes toward the speed of the reforms      | .013<br>(.204)     | .136<br>(.315)     | .138<br>(.213)     | -.012<br>(.379)    |
| Education                                      | .053<br>(.182)     | .229<br>(.248)     | .040<br>(.186)     | .157<br>(.301)     |
| Gender   | -.077<br>(.178)    | -.176<br>(.226)    | -.009<br>(.174)    | -.251<br>(.235)    |
| Age  | .002<br>(.006)     | .018*<br>(.009)    | -.010<br>(.006)    | .012<br>(.011)     |
| N  | 491                | 316                | 551                | 287                |
| -2Log Likelihood                               | 1071.43            | 666.41             | 1081.04            | 538.90             |
| Pseudo R <sup>2</sup>                          | .21                | .25                | .21                | .23                |

\* p < 0.05 \*\* p < 0.01 \*\*\* p < 0.001 (two-tailed)

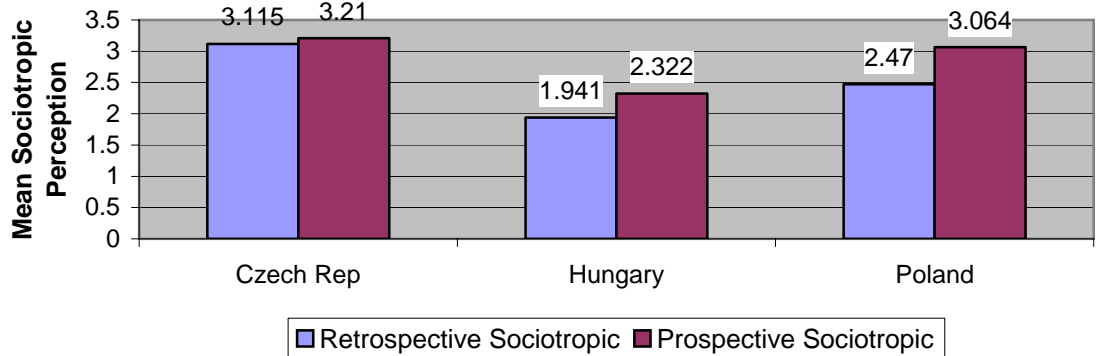
**Note:** Entries are ordered logit estimates.



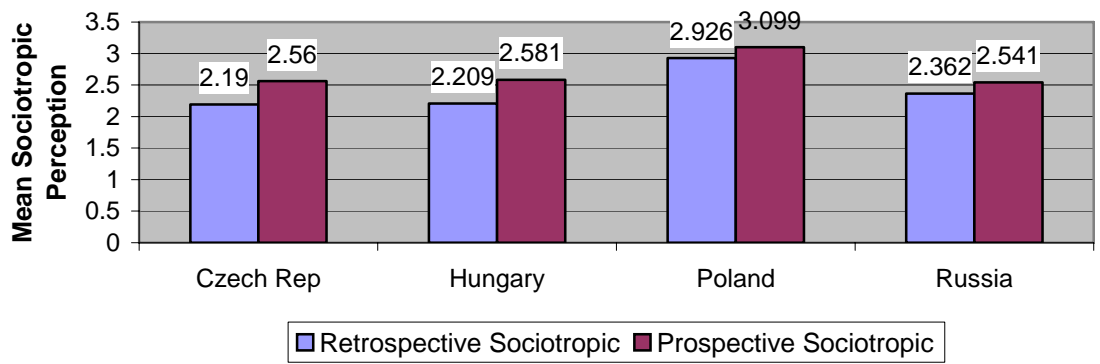
**Figure 6.1. Sociotropic Retrospective and Prospective Economic Perceptions by Country in 1992**



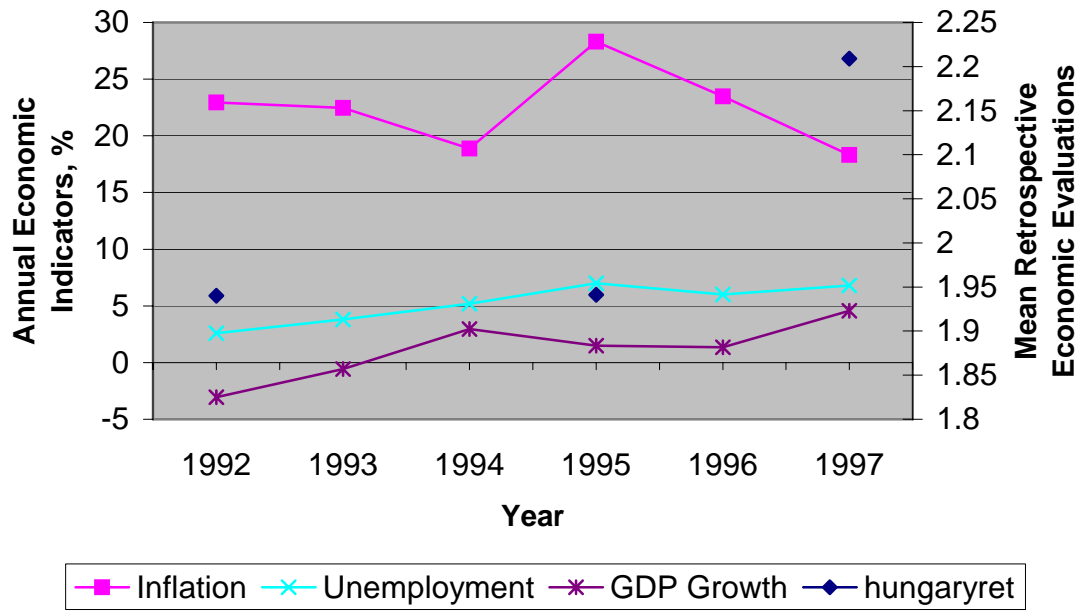
**Figure 6.2. Sociotropic Retrospective and Prospective Economic Perceptions by Country in 1993-1995**



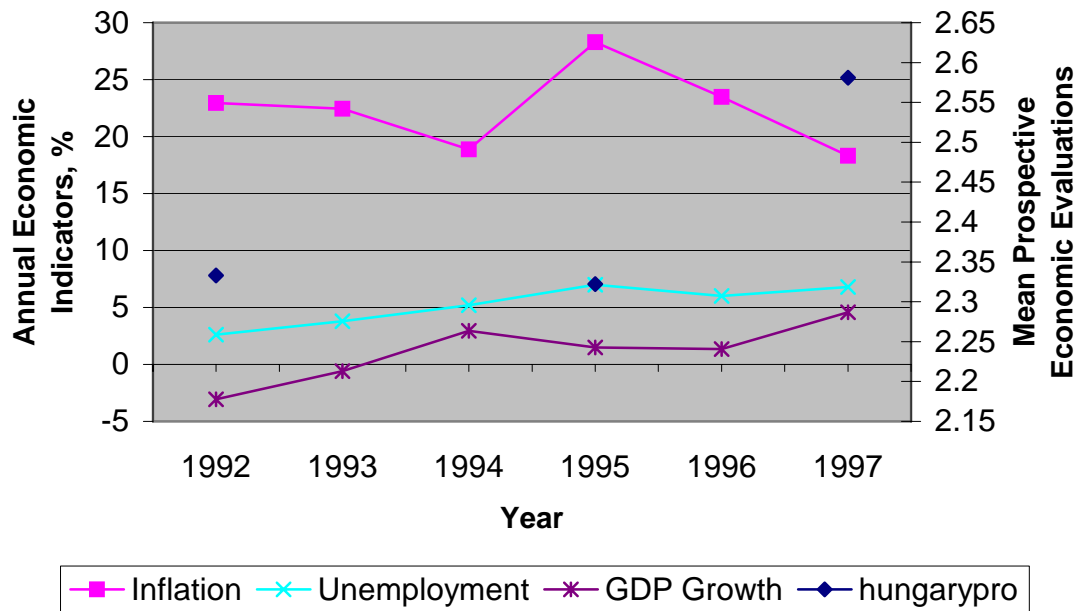
**Figure 6.3. Sociotropic Retrospective and Prospective Economic Perceptions by Country in 1997**



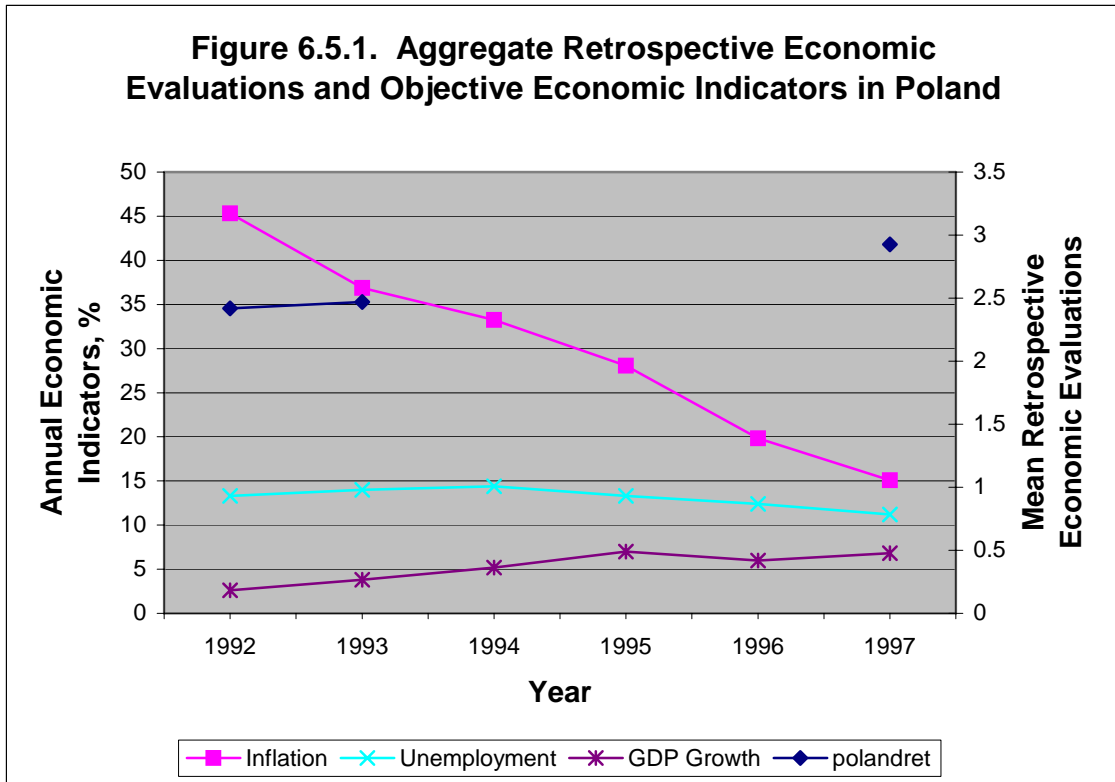
**Figure 6.4.1. Aggregate Retrospective Evaluations and Objective Economic Indicators in Hungary**



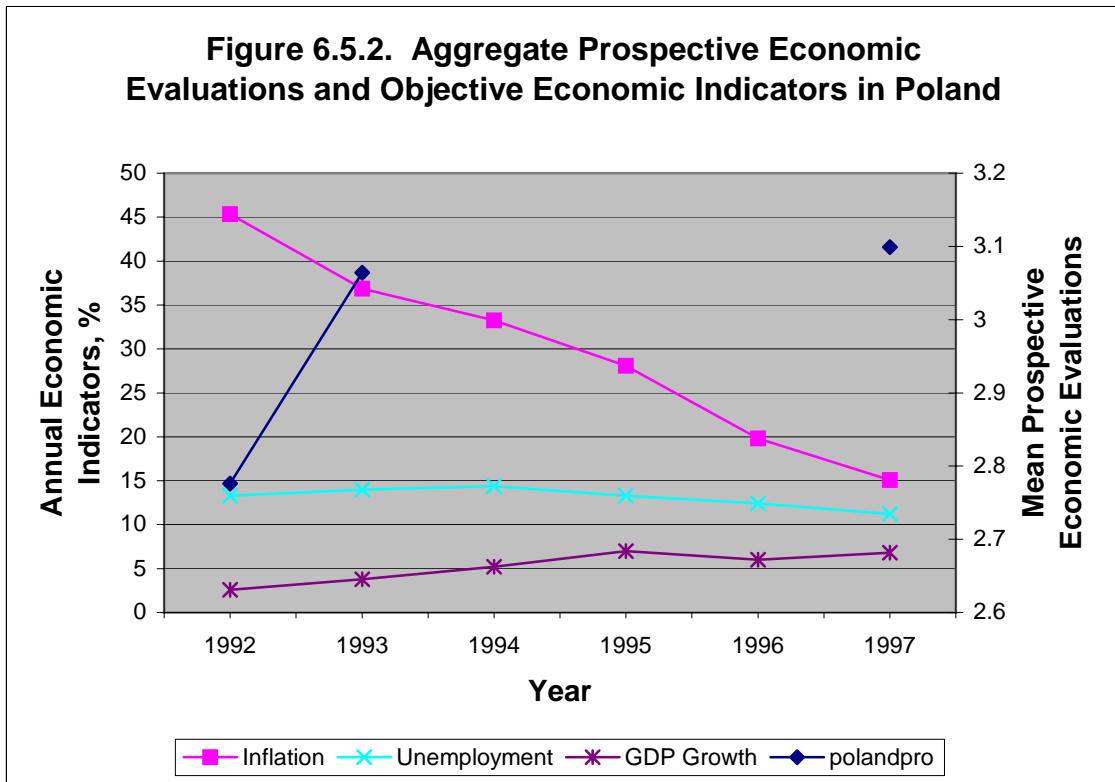
**Figure 6.4.2. Aggregate Prospective Evaluations and Objective Economic Indicators in Hungary**



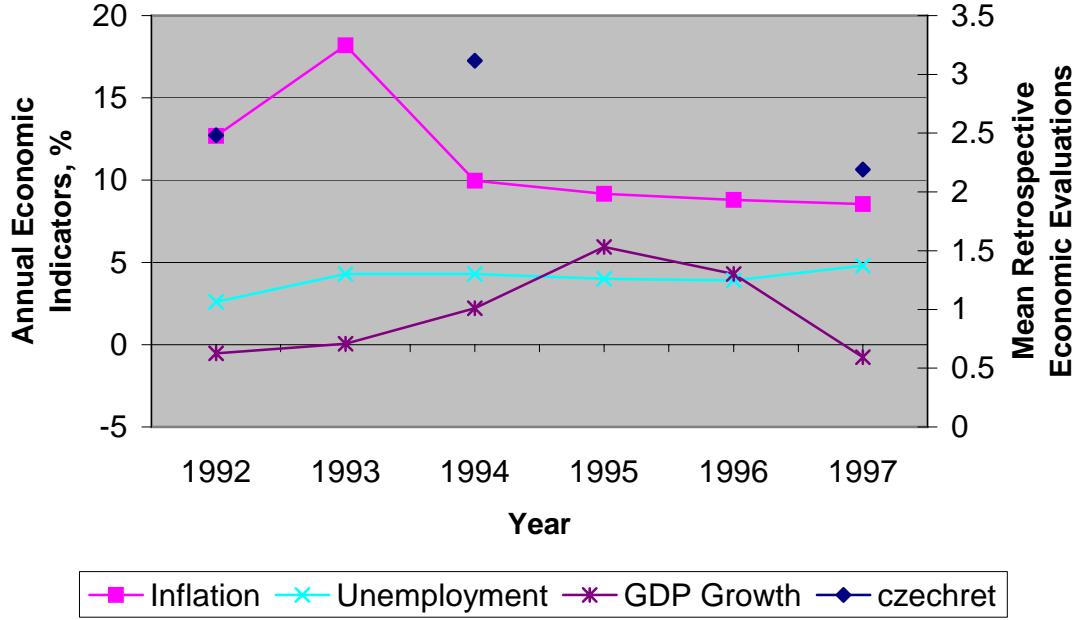
**Figure 6.5.1. Aggregate Retrospective Economic Evaluations and Objective Economic Indicators in Poland**



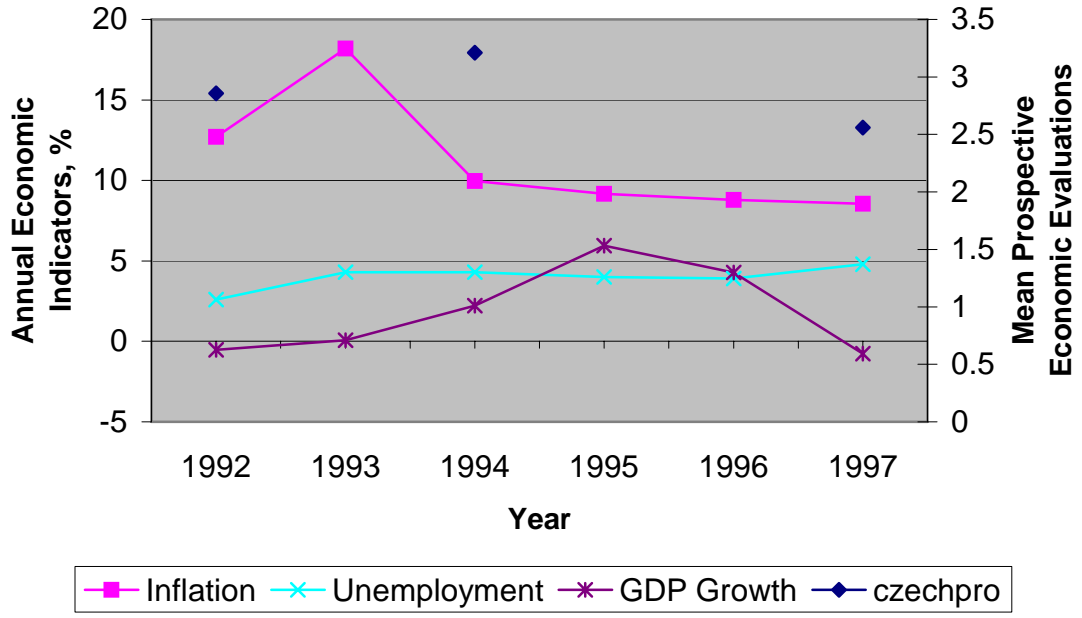
**Figure 6.5.2. Aggregate Prospective Economic Evaluations and Objective Economic Indicators in Poland**



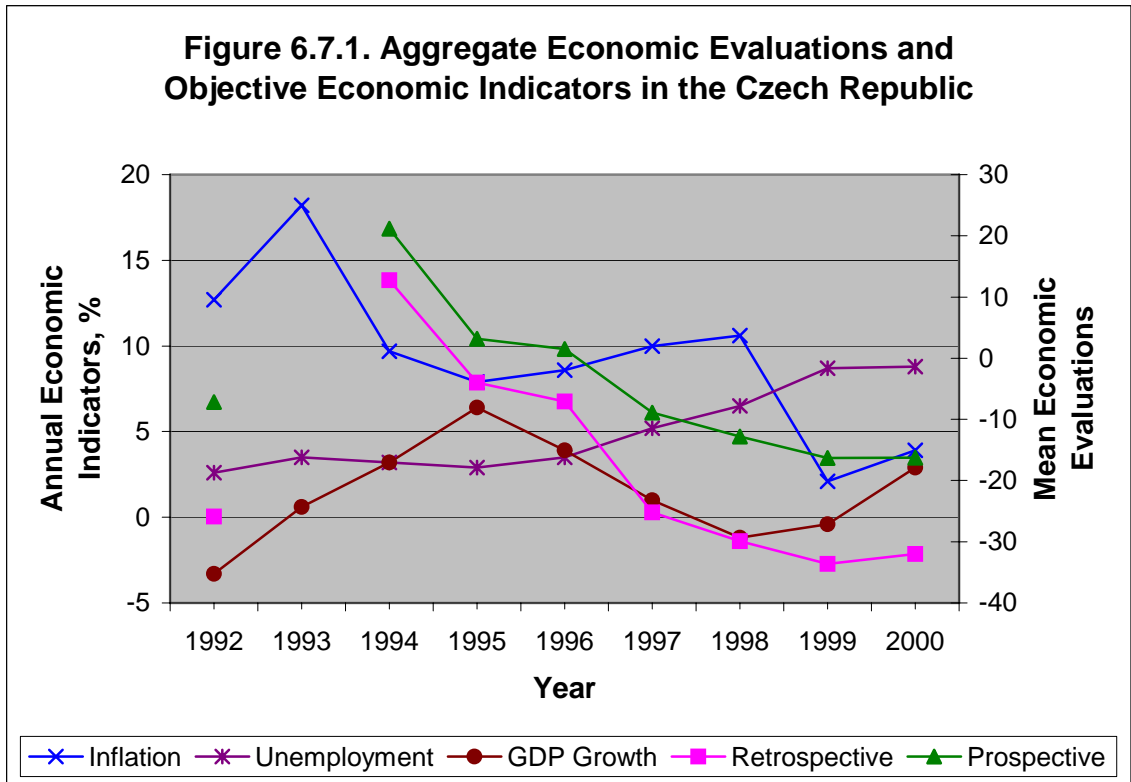
**Figure 6.6.1. Aggregate Retrospective Evaluations and Objective Economic Indicators in the Czech Republic**



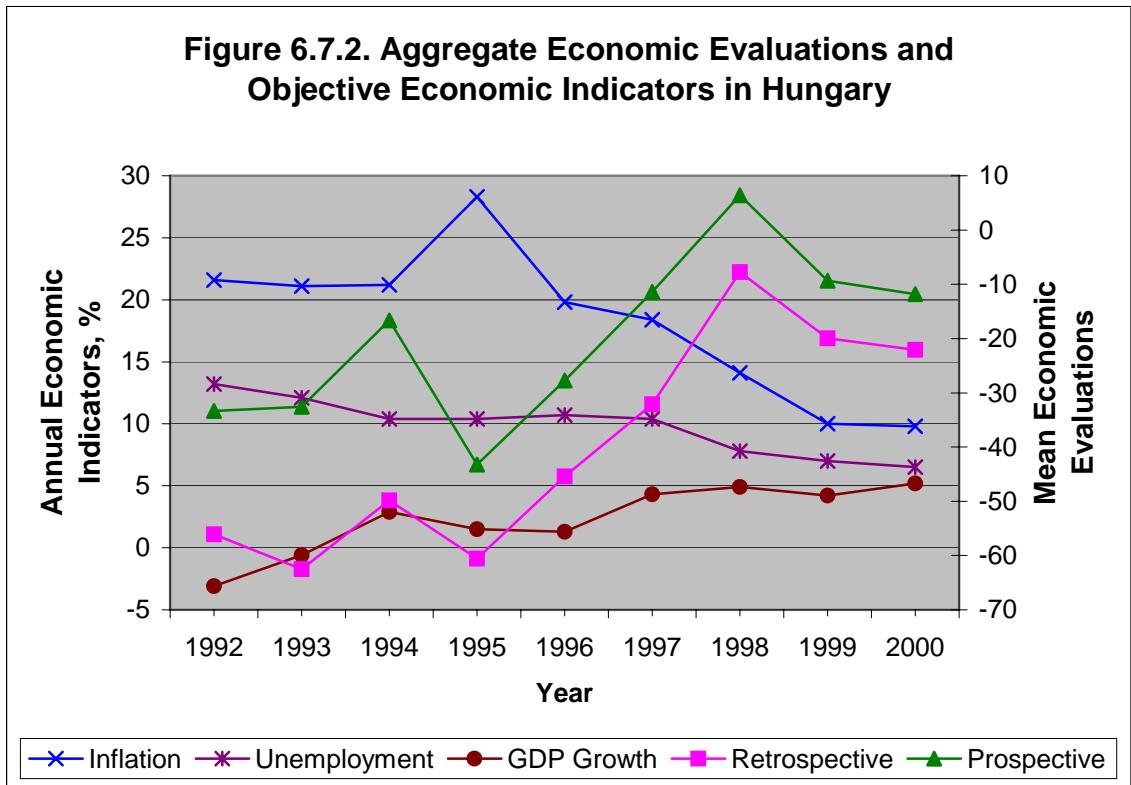
**Figure 6.6.2. Aggregate Prospective Evaluations and Objective Economic Indicators in the Czech Republic**



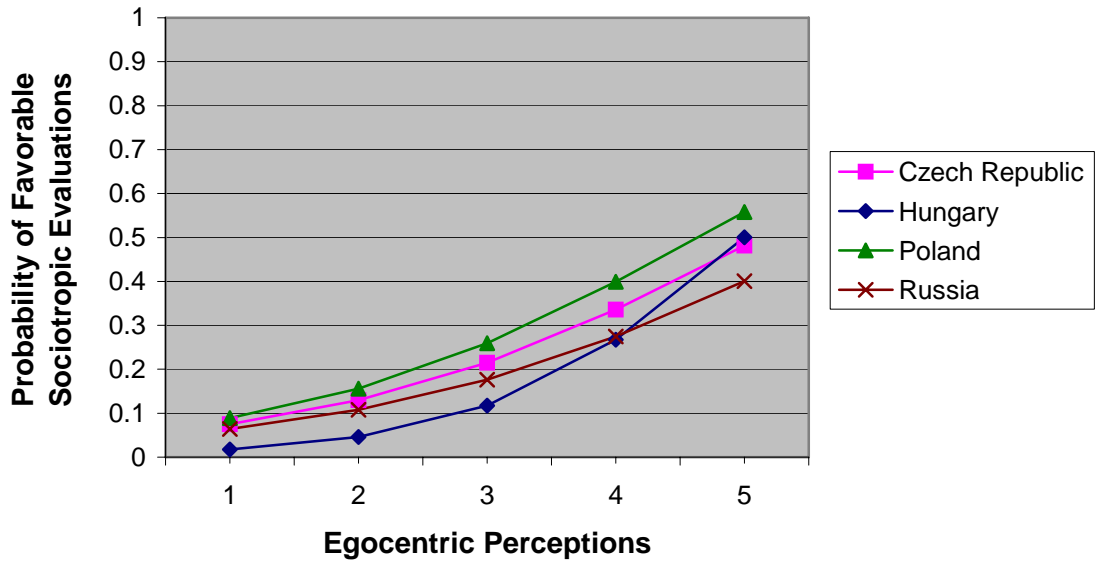
**Figure 6.7.1. Aggregate Economic Evaluations and Objective Economic Indicators in the Czech Republic**



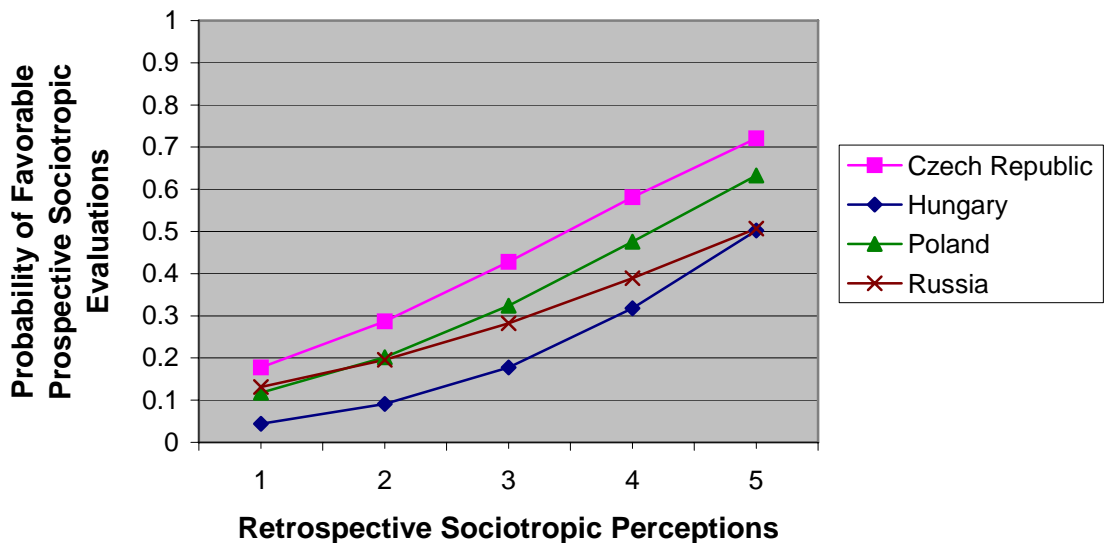
**Figure 6.7.2. Aggregate Economic Evaluations and Objective Economic Indicators in Hungary**



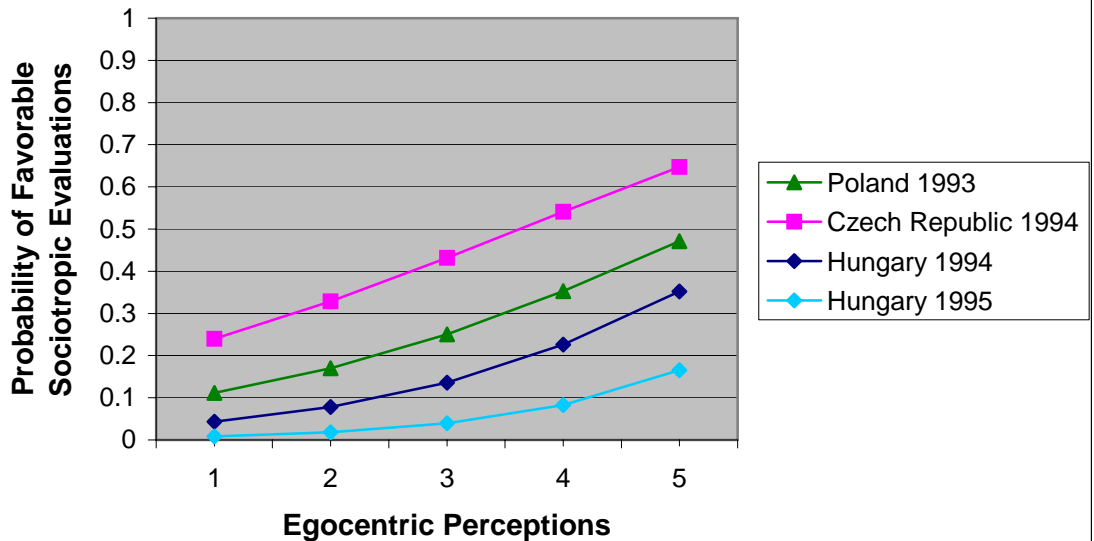
**Figure 6.8.1. Probability of Favorable Retrospective Sociotropic Economic Evaluations as a Function of Egocentric Economic Retrospective Perceptions in 1992**



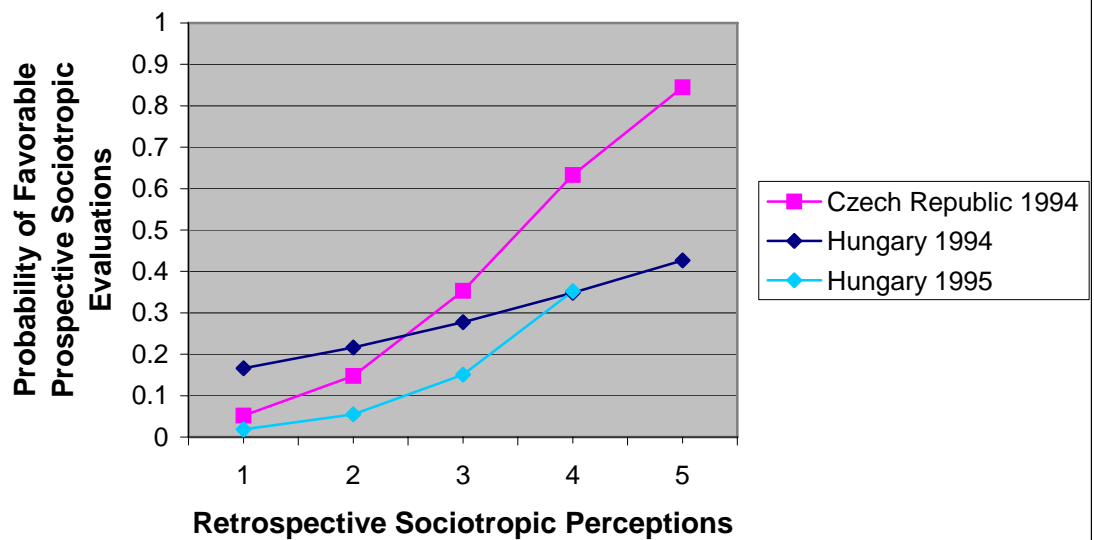
**Figure 6.8.2. Probability of Favorable Prospective Sociotropic Economic Evaluations as a Function of Retrospective Sociotropic Economic Perceptions in 1992**



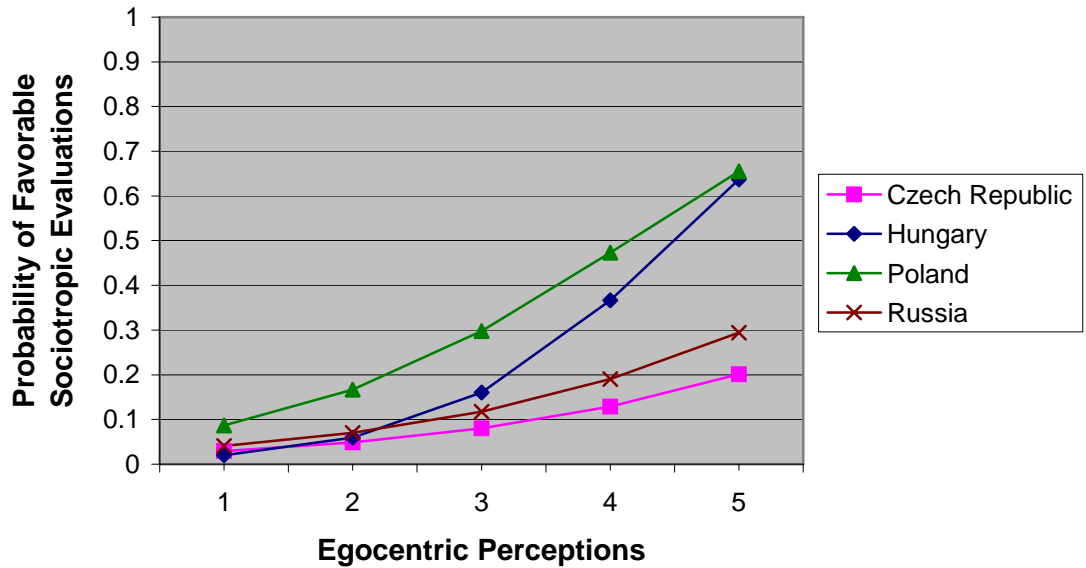
**Figure 6.9.1. Probability of Favorable Retrospective Sociotropic Economic Evaluations as a Function of Egocentric Retrospective Economic Perceptions in 1993-1995**



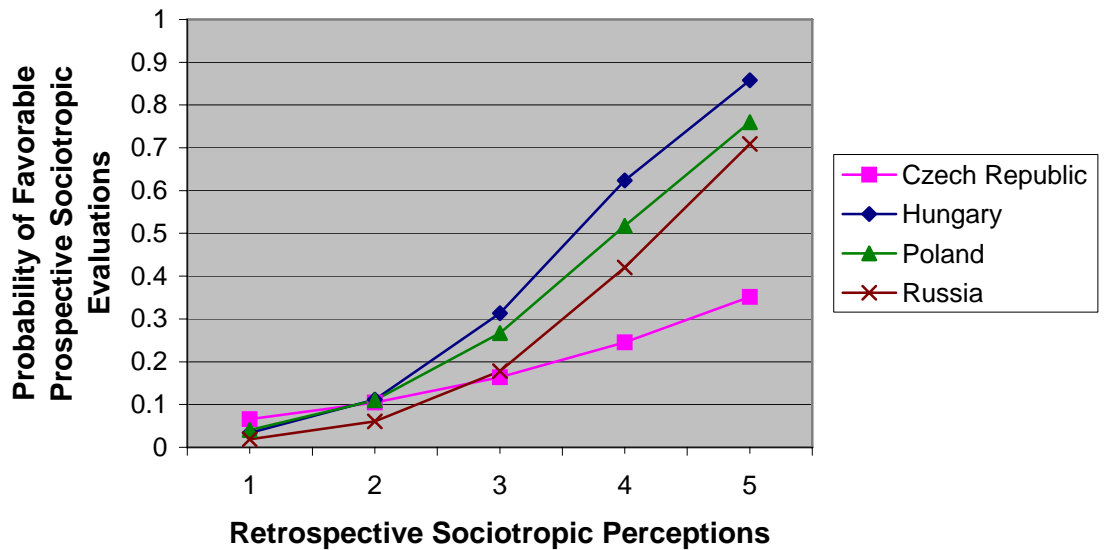
**Figure 6.9.2. Probability of Favorable Prospective Sociotropic Economic Evaluations as a Function of Retrospective Sociotropic Economic Perceptions in 1993-1995**



**Figure 6.10.1. Probability of Favorable Retrospective Sociotropic Economic Evaluations as a Function of Egocentric Retrospective Economic Perceptions in 1997**



**Figure 6.10.2. Probability of Favorable Prospective Sociotropic Economic Evaluations as a Function of Retrospective Sociotropic Economic Perceptions in 1997**





## CHAPTER 7

### Conclusion

#### Research Question

The major purpose of my thesis was to explore the formation of sociotropic economic evaluations, i.e. assessments of the national economy, in countries of East Central Europe after the collapse of the Soviet regime. In particular, I was interested in whether public economic perceptions of the national economic state corresponded to experts' evaluations of the economy, which I refer to as objective economic indicators. Alongside, I wanted to see if persons with higher levels of political sophistication were able to achieve higher accuracy in their sociotropic economic evaluations. In addition, I intended to investigate the role of cognitive or information heuristics in the formation of public economic opinion in post-communist countries.

The choice of the question for my dissertation was motivated by several reasons. First, previous research established a strong connection between public economic evaluations and voting behavior. To explore this argument, a whole separate branch of voting studies emerged, called economic voting (Nannestad and Paldam 1994a, Lewis-Beck and Stegmaier 2000). Over thirty years since the first studies on this topic appeared, this branch of voting behavior research has produced an enormous number of

publications, yet the main question whether and how the economy matters for election outcomes still remains on the table. The majority of economic voting studies in the field acknowledge an important role of the macroeconomic state for voting behavior, although the findings show that it is not always the objective economy that affects the vote, but mostly public economic perceptions (MacKuen, Erikson, and Stimson 1992, 2000).

With this realization came the need to focus on the formation of economic evaluations as a separate research question. If public perceptions of the economy are different from objective economic indicators, what drives economic perceptions? Aside from scholarly curiosity, though, why would political scientists (and hopefully not only they, but citizens and political elites alike) need to know possible sources of public economic perceptions? The answer lies in one of the very fundamental principles of democracy, namely democratic accountability. In short, democratic governments have to be accountable to their constituencies, and performance of the national economy is one of the criteria for which citizens can hold their elected officials responsible. Not only does the economic state of a nation affect everyone living in this nation, but it is also a good standard of government accountability, because there exist readily available and widely accepted economic measures familiar to the majority of the population. Furthermore, the need to study the formation of economic perceptions has become more pronounced since public evaluations of the economy were found to be significant predictors of people's decisions to participate in politics and of government trust. Together with the democratic accountability concern, issues of declining political trust and political participation feed into the discussion of democratic stability and regime survival.

Apart from the normative perspective of studying economic evaluations – that is, in order to see whether the democratic accountability mechanism operates “properly”, there is the more practical purpose of exploring the sources of economic assessments. Knowledge about the origins of economic opinion would allow politicians running for office communicate in a more effective way.

My research question concerned a specific geo-political region, East Central Europe, at a particular state – the transition from the Soviet system to democracy. The choice of the region and the time was important for the objectives of my study. First, I wanted to contribute to the literature on the post-communist processes in East Central Europe in general, and public opinion studies in particular. And second, my research was intended to enhance our knowledge of periods of economic instability, such as transitions from one regime or economic system to another.

### **Prior Research**

Past research on sociotropic economic evaluations was mostly related to voting behavior studies (Fiorina 1981, Kinder and Kiewiet 1979). Yet another stream of studies, if not so numerous, where economic perceptions played the role of explanatory force, were dedicated to political mobilization and withdrawal, political trust, and system support (Levi and Stoker 2000). Beginning in the mid 1980s, political scientists became interested in the sources of public economic evaluations themselves, thus beginning to use perceptions about the national economy as the dependent variable in their research (Weatherford 1983, Conover et al. 1986, 1987). In this latter context, my dissertation was driven by two major questions: Did public economic evaluations correspond to the

state of objective economy in East Central Europe? And if they did not, what drove them? A majority of findings in previous studies found a divergence between people's perceptions of the national economy and experts' economic evaluations. Survey respondents on average displayed an inability to recall recent economic figures; and they did not do much better in their economic forecasts (Haller and Norpoth 1994). Such findings called for worrisome inferences about the possible failure of democratic accountability, yet stable democracies did not seem to fall apart. Further research on the subject suggested that exact knowledge about the economy was not a necessary condition for making reasonable judgments about the national economic state. Some scholars argued that not knowing the precise rate of unemployment does not prevent citizens from having a sense of the general direction of economic change or performance; that is, a sense of whether the economy has been doing better or worse in relation to the past. Moreover, any particular individual does not have to be right on the mark even about the direction of the economy, as long as the public in the aggregate has the right feeling (Lupia 1994). In this case, the democratic accountability mechanism should not suffer.

In general, the economic direction proposition had been accepted in the scholarly community and taken for granted before some contradictory findings were published (Duch, Palmer, and Anderson 2000, Anderson, Mendes, and Tverdova 2004, Tverdova and Anderson 2004). The essence of these latter publications was that people, even in the aggregate, may have the wrong sense about the national economic state and cast their votes according to their biased views. If this happens on a regular basis, such a situation may lead to a serious breach in the democratic accountability mechanism, at least, with regard to government economic performance.

Recent findings about the divergence between sociotropic economic evaluations and the objective state of the economy in the aggregate in addition to the earlier evidence of inaccuracy in individual economic perceptions make a search for the sources of national economic assessments even more essential. Fortunately for us as social scientists, despite the random component or possibly unidentifiable idiosyncratic sources of economic perceptions, we can still point out a number of systematic components that drive evaluations of the national economy.

First, these are differences in information consumption among individuals that cause heterogeneity in economic evaluations. People have to be motivated to consume and retain certain types of information; in this study this is information about the national state of the economy. Thus the greater motivation is, regardless of whether it is professional interest or mere curiosity to learn about the economy, the higher the chance that a person will be more accurate in his or her economic assessments. Consequently, many people, when faced with the need to form an evaluation about the national economic situation, would have to turn to sources other than their knowledge of the objective economy because this information is lacking or difficult to recall.

The second systematic component of sociotropic economic evaluations concerns one's personal economic experience and perceptions of well-being. This information is always available to any individual and has a logical connection to the general economic situation in the country. For example, mass lay-offs at a person's enterprise may lead him or her to believe that the unemployment situation in the nation is worsening. Similarly, increased prices at a local grocery store and one's need to reduce the amount or quality of goods consumed may be associated with growing inflation and decreasing real

wages. Although personal economic experiences sometimes directly relate to the economic well-being of the whole nation, at other times they are just a reflection of the state of the local economy or one's personal financial situation. In the latter case, if their evaluations are exclusively based on their personal economic experiences, people are likely to form biased perceptions of the general economy.

Finally, people's attitudes and prior political predispositions play a significant role in the formation of sociotropic economic evaluations. Prior political predispositions may be party affiliation or vote in the previous election. According to cognitive consistency theory, individuals tend to make judgments or behave consistently with their past decisions in order to have inner peace with themselves (Anderson, Mendes, and Tverdova 2004). Likewise, previously formed attitudes and beliefs operate as certain filters in the process of economic opinion formation. For instance, if a person believes that the government must be responsible for providing people with jobs, then this person's evaluation of the economy may be negative even if the unemployment rate is relatively low. In the extreme, a person's opinion of the economy may be influenced by his or her personal feelings toward particular members of the government, if in any way in this person's mind they are associated with economic decisions.

To date, studies on the sources of economic perceptions in East Central Europe have been virtually non-existent. Much more attention has been devoted to economic voting, where subjective economic evaluations of one's personal financial situation, as well as the national economy, are used as predictors in the vote or popularity function (Tucker 2002). Inferences drawn at the end of such studies bear a strong resemblance to the inferences from parallel studies conducted in Western democracies. In particular,

based on the results of their statistical analyses, scholars typically draw a conclusion about the presence or absence of economic voting, and, in case of the former, its type – sociotropic versus egocentric and retrospective versus prospective. In the presence of sociotropic voting, a logical conclusion that follows is that the state of the national economy matters for the vote choice. However, there has been little or no attempt of systematically studying economic perceptions in the context of East Central Europe, with the exception of the piece by Anderson and O'Connor (2000), to find out whether the economy *really* matters – that is, to determine whether there is congruence between public economic perceptions and the objective economic situation, or that sociotropic perceptions of the economy are driven by other factors instead.

### **Cognitive and Information Heuristics**

Sources other than official economic reports, such as political attitudes and predispositions or one's personal economic situation, can be categorized under the rubric of cognitive or information heuristics. Cognitive heuristics or shortcuts are such mechanisms that simplify the task of making a decision under uncertainty. With regard to sociotropic economic evaluations, they allow a respondent to make economic judgments without precise knowledge about the national economy. The term cognitive heuristic was widely discussed in the socio-psychological literature by Kahnemann, Tversky and their collaborators (1982), and later popularized in political science by John Zaller (1992). According to Kahnemann and Tversky, there are three general heuristic mechanisms: representativeness, availability, and adjustment and anchoring.

I used cognitive heuristics or shortcuts in my dissertation along with Zaller's Receive-Accept Sample (RAS) model to theorize about the formation of sociotropic economic perceptions in general, and in post-communist nations of East Central Europe in particular. In relation to my major research question, only two heuristic principles, representativeness and availability, have relevance. In a nutshell, the process of the formation of economic opinion undergoes several stages. First, an individual has to receive economic information from various sources. The effectiveness of the reception is determined by the attentiveness to this type of information. In other words, a greater interest in the issue leads to a greater likelihood of receiving messages about the issue. Second, in light of former dispositions on the issue, the person either rejects or accepts the message – that is, evaluates it positively or negatively. Third, when needed, the message, along with other pieces of economic information, is retrieved from memory. Commonly, the more recent the information is, the easier it is to recall. However, emotions may be no less significant than the time factor for the recollection process. Finally, all the recalled messages on the issue are reevaluated in accordance with the individual's set of attitudes and beliefs, and an opinion is formed. Thus, the first two steps of the opinion formation process have to do with receiving information, giving it preliminary evaluation, and storing it in memory, whereas the latter two stages refer to retrieving relevant information from memory and giving it a final evaluation before announcing an opinion.

Cognitive shortcuts come into play when a person is stimulated to give an opinion on a certain issue and needs to recall relevant information stored in memory. The representativeness heuristic helps the individual to remember as much information as



possible relevant to the issue at hand. It has to be said, though, that what is considered to be relevant information for one person may not be considered as such by another one. It is individual-specific how pieces of information are associated with one another in one's mind. The very process of recalling relevant considerations depends on how available these messages are, which usually has a direct relation to the emotional aspect of a consideration and an inverse relation to the time this consideration has been stored in memory. As pointed out earlier, in case of sociotropic economic evaluations, such factors as personal economic status, political attitudes and beliefs, along with political predispositions operate as cognitive heuristics in the formation of economic opinion.

## **Hypotheses**

After 1989, the fall of the Berlin Wall and the end of the Soviet Union meant that, for the first time in world history a whole geo-political region was transforming from an authoritarian political regime with a command economy to a market democracy. The major problem, of course, was that there existed no expertise or prior experience of how to do it most effectively. An international group of experts developed an economic strategy, named the "Washington Consensus" or "shock therapy", which was offered to the transitioning countries (Marangos 2003). Without many alternative options, post-communist elites took the risk of introducing shock therapy reforms in their nations shortly after they seized power.

The "Washington Consensus" plan entailed instantaneous privatization of state property as well as price and trade liberalization. Unsupported by the necessary political and economic institutions, however, the implementation of the reforms led to unplanned,

and for the most part uncontrollable consequences, including hyperinflation, a sharp fall in production output, mass impoverishment of the population, corruption, and weakening of the state. It should be noted, though, that despite a lack of alternative economic policies other than shock therapy policies, some countries, such as Hungary and Slovenia, still rejected the “Washington Consensus” package and implemented market reforms gradually at a much slower pace. Still incurring high social costs during the transition, those countries experienced smaller economic shocks and milder recessions.

Surprisingly, despite despairing performance of the economy in the early transition, a sizeable portion of post-communist citizens expressed positive evaluations of their country’s economic performance. National public opinion polls registered over 20 percent of the population in one third of Central and Eastern European countries approving of the past performance of the national economy in 1991-1992. These numbers stood in striking contrast to official economic statistics that suggested that, given the state of the economy, there should have been virtually no one in the former communist nations evaluating the national economic performance favorably. Public prognoses of the economy for the near future seemed even more perplexing. In 14 out of 18 new democracies that I had in the 1992 sample, over one fourth of the population expressed optimistic economic forecasts. And in Slovenia, Bulgaria, and Albania, the number was as high as 50 percent or more. The paradox of overly optimistic public perceptions along with poor economic performance indicated a significant disjuncture between the objective and the subjective economy.

A few years after the collapse of the communist regimes, Central and Eastern European nations started to show signs of economic recovery. Starting with Poland as

early as 1992, the Czech Republic, Slovenia, Albania, and Romania resumed economic growth in 1993, followed by Hungary, Slovakia, Armenia, Croatia, and Latvia in 1994. Annual inflation rates had been brought down to single and double digits by 1995 in most of the post-communist nations. Yet, not all countries of the former Soviet bloc were recovering at the same rate of success. In fact, the disparity among Central and Eastern European societies had become more pronounced later in the transition than right after the collapse of the communist system. Whereas Central European countries, such as Poland, Hungary, Slovenia, the Czech Republic, and Slovakia had achieved impressive economic results already by the mid 1990s, nations of the former Soviet Union, with the exception the of Baltic States were lagging behind. Besides the differences in economic standing at the start of the transformation and certain modifications of economic policies, post-communist countries also differed in policy implementation. A vital step in the success of economic policy implementation was the creation of a solid institutional basis for market reforms. More often than not, however, the development of institutions succeeded rather than preceded the introduction of certain market reforms in an ad-hoc manner. Consequently, instead of helping with the implementation of economic policies, such improvised institutions worked as obstacles rather than solutions in the economic transition. Aside from the institutional weaknesses, post-communist economies at the mature transition stages were still economically unstable. That is, after a period of steep economic growth, nations would yet again go in a deep recession.

How had the public view of the economy changed since the beginning of the transition? Judging by public opinion polls, the change in aggregated prospective perceptions of the economy across post-communist nations was hardly noticeable. In

contrast, consistent with the changes in the actual economy, sociotropic retrospective perceptions had become more favorable. However, considering each country separately, one can still find discrepancies between the objective and the subjective economy.

Thus, there are several questions arising from such observations. First, how congruent were public economic perceptions with the objective state of the economy in the early transition? Second, if they were not congruent, what were the sources of sociotropic economic evaluations? And third, what were the driving forces behind the formation of public economic opinion during the mature stages of the post-communist transition?

With the above questions in mind, I developed a series of hypotheses drawing on previous theoretical and empirical work in the fields of voting behavior, system support, and information-processing. Based on previous research of the situation in East Central Europe after the downfall of the communist regimes, I hypothesized a potential disjuncture between the actual state of the national economies and public economic assessments. The mismatch between the objective economy and public economic assessments may have existed for a variety of reasons. By definition, transition from one system to another is characterized by high instability. Instability, in turn, brings about a certain degree of uncertainty not only about the future, but also about the past. To conclude, high uncertainty is likely to breed inaccuracy of judgments, thus leading to potential incongruence between reality and perception. Another reason for it may follow from the state of euphoria that was wide-spread in newly democratizing societies after the downfall of the old regime. In this case, the general optimism associated with the new regime may be projected onto the future economy; hence favorable economic forecasts

developed. With relation to the past, the overall happiness may lead to high tolerance of the distress associated with transition from the old to a new regime. Consequently, at the beginning of transition, evaluations of past economic performance may be not as harsh as expected, because citizens are willing to give the new regime some buffer time to proceed with reforms before their patience expires.

Furthermore, contrary to the common assumption that differences in information consumption should cause heterogeneity in the accuracy of sociotropic economic evaluations, I maintained that, if it exists at all, the accuracy differential between the more political sophisticated and the less politically sophisticated was not substantively significant. The logic leading to this hypothesis also follows from the instability thesis. Under conditions of high instability, the most sophisticated may be equally challenged compared to their less sophisticated counterparts in recalling the recent past of the national economy. In addition, due to the general novelty of the new system, citizens with different levels of education may have been uniformly ignorant concerning its operation. Alternatively, people who discussed politics on a regular basis vis-à-vis the ones who tended to stay away from political discussion may have had more economic information, but this information may have been biased due to the likely homogeneity of interpersonal communication networks.

Judging by the first two hypotheses, one may wonder whether there were any systematic factors that drove sociotropic economic evaluations, or whether they were totally random or idiosyncratic. I hypothesized that a large portion of the variation in sociotropic economic perceptions could be attributed to people's use of cognitive and information heuristics, including political attitudes and predispositions, and one's

personal economic situation. Undoubtedly, information about one's personal financial situation is most available to an individual, and may be treated as representative of the national economic state. Political attitudes, similarly, may have acted as representativeness and availability heuristics, because of the duality of the post-communist transition. In other words, due to the close interrelationship between politics and economics in the post-communist states, citizens may have formed strong associations between political and economic outcomes.

Finally, looking at the formation of sociotropic economic perceptions over time, I expected to see a closer match between the objective and the subjective economy. Also, I hypothesized that the effect of cognitive and information heuristics should decline once post-communist citizens acquired a better understanding of the new economic systems and market processes due to learning. With this knowledge, people should be able to use objective economic information rather than cognitive cues when evaluating the economy.

### **Findings and Implications**

Overall, the empirical findings proved supportive of my arguments. First, at the early stage of the post-communist transition, the correspondence between public economic judgments and objective economic indicators in countries of East Central Europe was almost non-existent – that is, statistically not different from zero. Although by design, it was impossible to determine the precise causal force of the disjuncture between subjective and objective economies, I could offer three plausible reasons. First, the initial period of the transformation processes was characterized by unprecedented economic, political, and social instability, which contributed to the general confusion in

society and led to high uncertainty among citizens regarding both the future of the national economy, as well as its recent past, because it was difficult to follow and remember even the most recent changes in the national economic situation. Under such conditions of high instability, and hence high citizens' uncertainty, sociotropic economic evaluations should not be expected to have been accurate.

Furthermore, post-communist publics were quite ignorant with regard to the principles of democracy and the market economy. As a result, it was difficult for people to make accurate economic judgments when they were unfamiliar with market mechanisms. Yet unquestionably, East and Central European citizens should be granted enough common sense to realize that galloping prices, enterprise closeouts, and mass layoffs, as well as pervasive poverty were not signs of a healthy economy.

Lastly, for some time after the collapse of the Soviet system, post-communist citizens were carried away by the euphoria about the long-awaited freedom from the totalitarian regime. Without a clear vision what a new regime would be, people were ready to believe it would be better than the old one. At first, democracy as an alternative to the Soviet regime was eagerly welcomed in the post-communist bloc, particularly in Central Europe and the Baltic States, and was buffered by high public support. On the individual level, people who supported the new regime and the market economy certainly believed that life overall would be better for them in the future. Moreover, if citizens had a belief that the new regime was better than the old one, they may have been less willing to admit that the new regime was delivering poorer economic performance than the old one, hence overestimated retrospective evaluations.

However, not everybody in the post-Soviet space shared the joy of freedom. For a substantial portion of the population, especially in Russia, Belarus, Ukraine, and the Central Asian states, the collapse of the Soviet system signaled the demolition of a powerful world empire and the depreciation of the communist principles in the superiority of which those people believed all their lives. Besides the ideological defeat, however, the collapse of the Soviet socialist system brought about high economic insecurity. If not for anything else, the Soviet regime should be granted the creation of a strong social benefits and welfare system available to virtually everyone in the former communist countries. Although compared to some developed Western democracies, welfare provisions in the former communist states of East Central Europe were substantially more modest in absolute terms, welfare payments allowed people to sustain themselves in their home countries. In addition, social benefits provided everybody with an opportunity for free education, health services, and guaranteed employment. Under the Soviet system, all these benefits gave citizens a sense of security and stability, if not satisfaction, and not everyone was ready to give them up for freedom.

Second, as expected, the inaccuracy of sociotropic economic assessments could not be attributed to heterogeneity in information levels or political sophistications. I examined two indicators of political sophistication, namely level of education and frequency of political discussion; and with both measures I obtained mixed results. Statistically, some of the coefficients achieved significance. Substantially, however, the mediating effects of political sophistication on sociotropic economic perceptions was small. When I mentioned that the results were mixed, I did not only mean statistical significance, but also the direction of the effects. Consistent with the reward-punishment



hypothesis, one would expect that individuals with high levels of education or those who frequently engage in political discussions would be more accurate in their economic evaluations. In other words, their perceptions would bear more correspondence to the actual changes in the economy. Yet, the findings show that in some instances high sophisticates formed evaluations contradictory to the reward-punishment pattern; that is, they had more positive sociotropic assessments under worse economic conditions. This pattern of performance evaluation, however, falls into the framework of intertemporal regime support characteristic to countries in transition (Stokes 1996).

Third, I was able to establish a tight connection between various heuristic factors and sociotropic economic perceptions. Put differently, people based their assessments of the national economy on information that they considered representative of or associative with the general economic situation in their countries, as well as information that was readily available for them. Contrary to the proper operation of the relevant principle of democratic accountability, those heuristic factors differed from objective economic evaluations and led to biased perceptions of national economic performance in East Central Europe. Specific cognitive and information heuristics on which people relied when making judgments about the national economic situation included one's personal economic state, evaluations of democratic performance, and support for the political and economic regimes. Among all the heuristic principles, evaluations of one's personal economic situation appeared to have the strongest effect on sociotropic assessments. This result was not unexpected, though, since perceptions of personal economic well-being were not only readily available for respondents, but also carried a powerful emotive component.

Evaluations of democratic performance measured as democracy satisfaction, support for the market, and sentiments toward the present political system vis-à-vis the past one were also confirmed as significant predictors of sociotropic economic evaluations at the early stage of the post-communist transition. The major obstacle for testing the effects of the attitudinal variables on sociotropic economic evaluations was a potential threat of reciprocity. That is, while economic perceptions may be caused by political attitudes and evaluations, they may also act as a driving force for political sentiments. Fortunately, in some instances I was able to offer a test and a solution for the endogeneity problem, whereas in the case of the market support variable, the direction of the relationship still remains an open question. Intriguingly, my analysis suggests that whereas individuals who were dissatisfied with democratic performance were also more likely to assess national economic performance negatively, those who had pessimistic economic perceptions were more likely to form favorable evaluations of democratic performance. The most plausible explanation, which speaks to other research in the field (Gibson 1996b, Duch 1993), is that political factors played the primary role for people's support, not the economy. Those who were dissatisfied with political performance were also intolerant regarding poor economic performance. Conversely, those who realized that the economy was doing badly still evaluated democratic performance favorably because they knew that things should get worse before it would get better and were therefore hopeful about the future.

Finally, based on very limited data on sociotropic economic perceptions over time, I made an observation that the disjuncture between the objective and the subjective economy in the advanced phases of the post-communist transition became smaller. In

particular, I inferred that public economic perceptions, at least in the aggregate, began to respond adequately to changes in the national economy. As for the use of cognitive and information heuristics, citizens still relied on political attitudes and perceptions of their personal economic state to form sociotropic economic evaluations. This result accords with experimental findings from social psychology that point to the fact that even experts, when making judgments, rely on heuristic factors if they are immediately available to them.

Recall that my main theoretical argument for the importance of studying sociotropic economic evaluations was related to democratic theory in general and the democratic accountability mechanism in particular. According to the empirical results, at the early stage of the post-communist transformations in Central and Eastern Europe, the accountability mechanism did not function properly. That is, instead of relying on objective economic information when forming judgments about the national economy, people based their evaluations on more readily available, although potentially biased, factors. On its own, bias in public economic perceptions does not pose a threat to democracy. However, political decisions, such as a voting decision, made on the basis of biased perceptions may lead to malfunctioning of the democratic accountability mechanism. Any democratic system has provisions for holding governments responsible for their performance. The most powerful accountability mechanism is an election, but a variety of alternative means, such as participation in demonstrations, meetings, strikes, and political organizations among others are available in democratic systems for expressing public opinion and influencing the government. Yet, the accountability mechanism can only work properly when people reward or punish elected officials based

on their actual performance, i.e. accurate evaluations of government performance. Then, governments get reelected or thrown out of the office according to their actual performance. In case of biased perceptions, reward or punishment may be unfair, which, in turn, may lead to misuse of power by politicians, especially in the long run if this tendency perseveres. Imagine that citizens' economic perceptions are systematically biased in the long run. Then, once the source(s) of this bias is known, politicians can start manipulating public opinion in their own interest. If the accountability mechanism is broken, elections can also be manipulated, thus undermining the very foundation of democracy and posing the risk for regime change. This situation is hardly ever possible in established democracies without a number of other factors coming together at the same time. However, in new democracies, which are unstable and fragile, this scenario seems much more plausible.

From past voting literature we know that national economic performance is one of the important criteria by which citizens evaluate governments' performance and cast their votes. The first free elections in East Central Europe did not make an exception in this sense – newly democratic citizens voted based on their perceptions of the state of the national economy among other things. My findings suggest, however, that those perceptions were not a fair reflection of the economic reality. Therefore, the first post-communist governments were rewarded or punished, to some extent, on the basis of what they had not done. Has the incongruence between the objective economic situation and people's perceptions of the economy disappeared in the process of democratic reforms in the post-communist nations? Unfortunately, I only have suggestive evidence to answer this question. This preliminary evidence, however, is encouraging, because it appears

that over time post-communist citizens developed greater sensitivity for economic changes. Put differently, during later phases of the transition people's economic mood seems to have been following the dynamic of the objective economy. Yet, this pattern is not fully consistent either across countries or over time for individual countries. Moreover, because the sample of countries for which I had data for later time points in the transition is limited, it is difficult to generalize for the whole region of Eastern and Central Europe.

Imagine that still, after fifteen years of the post communist transformations, there may be little reality in people's reflections of the national economic state in some new democracies. If citizens' economic perceptions remain predominantly egocentric – that is, if people, to a large extent, associate their personal economic state with the national economic situation and vote accordingly, then, all that governments need to do to maximize their chance for reelection is to give their citizens a pre-election economic bonus to increase their immediate material well-being and care less the rest of the time. Evidence of such practices has been found in various regions of the Russian Federation in the middle and late 1990s, when incumbent governors paid off wage arrears before local elections. Thus, I argue that although as an occasional instance biased economic evaluations do not pose a threat to democracy, recurrent biased perceptions may, especially in new fragile systems.

Democracy, defined as governance of people for people through a system of democratic institutions, calls for making people's lives better. A better life, of course, implies different things for different individuals. Yet, few people would deny the importance of the economic aspect for their overall happiness and satisfaction with the

regime. Understanding what specific factors affect citizens' economic evaluations could throw light on questions about the level of political efficacy or government trust in addition to voting behavior, and help us understand what makes people happy or unhappy in a democracy and what governments should do to increase the level of satisfaction and support for the system. In newly established democracies, the issue of popular system support is of vital importance for democracy consolidation and survival. If citizens feel dissatisfied with system performance, including the state of the economy, they may finally form a strong aversion toward the system itself. In the extreme, this may lead to regime overthrow.

Lastly, my research contributes to the literature on opinion formation in general, and the use of heuristic mechanisms in particular. Previously scholars have argued that people are not perfect information processors. Thus, they are not able to store every single bit of information in memory that they encounter and retrieve it at the earliest request. Individuals do not have an unlimited memory capacity, nor do they have full control over it. With some divergence, people remember the best information that is salient for them, emotionally colored, and recent. When asked to express an opinion on an issue, people search their memory for the most available considerations that are representative of the issue and form a judgment. While the above description is perhaps an oversimplification of a very complex opinion formation process, it serves to make my point, which is twofold. First, under certain conditions, individuals draw on considerations stored in memory to form an opinion that may not seem immediately relevant to other people who are unaware of those conditions. For example, citizens of the post-communist nations of East Central Europe relied extensively on their feelings

about the new political regime when making evaluations of the national economy. Without knowledge of the “dual transition”, this relationship would not be most apparent. Thus, I urge social scientists to be sensitive to specific conditions when they develop their theories. Second, the reliance on cognitive heuristics and information shortcuts is high even when objective information is relatively easily accessible. Accurate economic evaluations even among experts, let alone laymen, will always remain in the realm of wishful thinking.

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