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Former Soviet Union as the World champion in cheapness ☆

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Abstract

The paper assesses the relationship between income and price levels in the Former Soviet Union (FSU) republics relative to remaining countries during the period 1991–2000. The basic idea of the paper is that the price levels of FSU republics were in the 1990s remarkably lower not only vis-à-vis the non-transitional economies with income levels similar to those of the FSU republics but also vis-à-vis non-FSU transitional countries. The author finds out the cross-country relationship between income and price levels among non-transitional economies and derives from this equation the income-predicted price levels for the FSU republics both at the very beginning, in the middle and at the end of the 1990s. Based on his calculations, the author assesses the differences between the FSU republics' income-predicted and actual price levels and compares the results with those of the non-FSU transitional countries.

JEL classification: E31; P22; P52

Keywords: Former Soviet Union; Price level; Price convergence; Real exchange rate; Purchasing power parity

☆ The Russian and Polish managers were asked in the survey whether they would invest US$ 100 today if they expected to receive US$ 200 in 2 years. Ninety-nine percent of the Russian managers said they would not, compared with 22% of the Polish managers [J. McMillan and C. Woodruff, *Journal of Economic Perspectives—Summer 2002*].

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1. Introduction

The phenomenon of very low price levels of the FSU economies in the 1990s vis-à-vis the non-transitional economies with similar GDP per capita levels is usually investigated only qualitatively (as transitional countries' initial temporary undervaluation and proceeding price convergence) or with independent estimates from only one or two time points. There is much less debate about the quantity of the initial undervaluation and the path of its decrease in the FSU republics as well as about the important differences between the FSU and non-FSU transitional countries. The aim of this paper is to show quantitatively that (and how much) the price levels of FSU republics were in the 1990s lower both vis-à-vis non-transitional economies with income levels similar to those of the FSU republics and vis-à-vis non-FSU transitional countries. This paper focuses on the quantitative assessment of the difference between actual and income-predicted ("equilibrium") price levels of the FSU republics in the 1990s and compares the results with those of the non-FSU transitional economies. Both the actual price levels and actual price levels relative to income-predicted price levels ("relative price levels") are arranged to the world-wide "cheapness rankings" and "country-group (FSU, non-FSU transitional, non-transitional) results," which indicate clearly the FSU republics' cheapness in comparison with other countries. Therefore, the price levels of the FSU republics are assessed both in the dimensions of space (in comparison with non-transitional and non-FSU transitional economies) and time (changes in the years 1991–2000). The results show that the FSU republics were not only much cheaper vis-à-vis the remaining countries with income levels similar to those of the FSU republics in the 1990s, and that the price levels of non-FSU transitional countries were much more similar to the non-transitional countries' price levels than the FSU republics' price levels at the beginning of 1990s—but also that both the actual and relative price levels of FSU republics (excluded Baltics) were ca. three times lower compared to non-transitional countries and ca. two times lower compared to non-FSU transitional countries in 2000, 9 years after the dissolution of the Soviet Union.

The paper is organized as follows. After this introduction, the second part gives the overview about the existing investigations about a cross-country relationship between income and price levels. The third part is devoted to the data, and the fourth part to the methodology. The analysis of results is presented in the fifth part. The sixth part concludes.

2. The literature overview

The cross-country relationship between income and price levels exists because of the barriers to the international arbitrage. Both the formal (custom barriers) and informal (transportation costs, differences in languages, legal systems and currencies; the costs of hunting information about prices, risks and trade conditions, etc.) arbitrage barriers make products and production factors more or less immobile ("non-tradable"). And due to this international immobility, the differences in the countries' local supply and/or demand transform into the price differences between these countries.

Most of the domestic supply and demand side factors are reflected in the country's income level (GDP per capita PPP-adjusted). The most important supply-side factors, the