

*Review*

# Redefining economic theory: Lessons from post-industrial Poland

Ignacy H. Chrzanowski

Maritime University, Szczecin, Poland; the Szczecin School of European Integration  
Corresponding author E-mail: [hranow54@yahoo.com](mailto:hranow54@yahoo.com)

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The transformation process of the national economies of the former Communist states in Central and Eastern Europe that started in the late 1980s and early 1990s, has created new challenges for the educational system of economics departments of universities and other academic institutions. New programmes were introduced, sometimes hastily, and economics teachers had to re-orientate their educational methodology. This paper is looking at some challenges that arose in the course of these reforms.

**Keywords:** Economics, socialist states, challenges, post-industrialism, new institutional economics.

## INTRODUCTION

Twenty or so years after the demise of the Soviet-style "real socialism" many questions still remain unanswered: how was it possible in the first place, was it unavoidable, were the peoples of the communist countries prepared for such dramatic a change ?

When back in 1970 a young Russian dissident Andrei Amalrik wrote his famous book "Will the Soviet Union survive until 1984?"<sup>1</sup> many thought him to be a utopian romantic at best, insane at worst. What is more surprising, his book was dismissed by the majority of American "Sovietologists" and "Kremlinologists" as sheer nonsense. Not surprisingly, however, it was taken seriously by the Soviet authorities who rightly considered

the book as a threat to the status quo and promptly sent its author to exile.

Yet Amalrik, who ten years later died in a suspicious car accident near the Franco-Spanish border on his way to a conference in Madrid, was wrong only by 7 years, an acceptable margin of error for a forecasting exercise of such a magnitude.

Many mistakes have been committed during the transition period from the centrally-planned to a market economy in these countries, and Poland was probably the most spectacular case of this transition which happened almost overnight. Yet despite this transition now mostly completed, the countries in question are still looking for the "right" economic model to adopt. Should it be the model borrowed from the mature capitalist countries or should these countries seek their own version of capitalism, particularly at this time of crisis and

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<sup>1</sup> Initially Amalrik put that date at 1980 but inspired by the Orwellian 1984 changed the year accordingly.

uncertainty when it has become all too obvious that the "traditional" model of capitalism is not working? Is it possible to adjust these countries' economic, political and social model to the requirement of the hard-core market economy without compromising their economic future and what role should economic theory play to prepare a smooth passage of these nations to the post industrial age?

These are just a few questions this paper will focus upon. While it is primarily based on Poland's experience over the past two decades, it is relevant to practically all the post-communist nations, with some specifics for each and every one of them.

The primary aim of this paper is not to provide ready-made answers since there are *no* such answers. It is aimed at triggering off some debate about these issues. Why are these countries still at grips with wavering economies, high unemployment, inflation, high deficits and other calamities of a market economy? Why is it so difficult for them to reach consensus in the most fundamental things as far as strategic economic plans are concerned? Why cannot they learn lessons from the bad experience of the market economies and why do they blindly get into the traps of the vagaries offered by the free market economies?

A part of the answer lies in the fact that people in the post-communist states want them both: *freedom* and *security*. They want the freedom of a market economy and democracy; they want the freedom to travel, settle and work in another city or country, as it is now the case in the European Union, freedom of choice how to spend their money. At the same time they want the security of the previous system: free education and health care, job-security, subsidized vacation and the like. They tend to forget, all too easily, that under the market economy you have first to create wealth before you start to distribute it. Under the market economy if something is too good to be true it probably is. "Too good" that is.

The biggest problem seems to be with the young generation who does not remember the hardship under the "real socialism". Finding no or few jobs they get extremely frustrated, increasingly impatient and anxious to "make it". Raised on the American-style of life they are unaware that it has its darker side, as well. But it does not seem to matter to them.

### **What causes this dichotomy?**

To a certain extent people in the newly franchised countries can be understood. They have been exploited and abused far too long. So once the band wagon stopped they jumped on it and enjoyed it fully. They had learned the hard way in the past that the band wagon may not stop again. It happened all too often in the past; their savings often proved worthless with hyperinflation

and change of currency which, in fact, had nothing to do with real money. So once the opportunity knocked at their door they grabbed it without too much thought whether this would last or not.

It was very instructive to watch the final weeks and days of the former GDR; happy crowds dancing in the streets, proudly waiving their "real deutschmarks". Quickly, though, they realised that it took a lot of those marks to make a living leading some to disenchantment. Many started longing for the old good days of the lazy communist security. They still do<sup>2</sup>.

Now, all this has changed. Money is no longer to be found in the street. Money has to be earned the hard way. And that was the shock therapy. Not always easy to accept.

The young generation, born after the collapse of the communist order of things, completely rejects their parents' concerns and nostalgia. They are citizens of the new Europe. They want immediate results, without waiting too long. They want their countries to be on the same footing as the "old" democracies. And they get frustrated when they realize that this is not going to happen immediately. Their frustration translates into their attitudes, towards education for example. Students are not interested in learning *per se*. They are interested in getting their diplomas as quickly and effortlessly as possible. Finding that enrolling into one programme may not be enough as the private sector often finds their education inadequate for the jobs that are available, they get into more than one programme naively thinking that this will enhance their chances of landing a better job. And this becomes a vicious circle as far as the post-secondary education is concerned.

However, it is not only higher education that is in crisis. Most of what used to be good vocational schools are now dismantled and it is becoming more and more difficult to find a real professional in many trades<sup>3</sup>. Combined these trends create a surplus of university graduates while there is a lack of intermediate level specialists.

At the same time university graduates, particularly those from more general programmes, such as humanities, find it extremely difficult to land a job. Because it is easy to travel and seek employment elsewhere, many young and brilliant people emigrate, only to increase the army of those who accept any type of job, well below their qualifications. The vicious circle does not seem to have an end.

But worse is yet to come. As the economies of these newly democratised countries are increasingly moving

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<sup>2</sup> Some estimates put at some 20% the number of East Germans who would welcome the return of the old system, despite the limitations on individual freedom.

<sup>3</sup> Poland, like other industrial nations, is facing a serious shortage of manpower, particularly in engineering, IT, transport and other domains.

Table 1. Share of the tertiary sector (service industries) in GDP of selected countries

Country	% share in GDP of the service industries
United States	77.8
United Kingdom	76.3
Australia	75.0
Canada	70.0
Singapore	69.6
Germany	67.8
Japan	66.4
Italy	65.1
South Korea	65.1
Russia	60.0
China	31.4
<b>Hong Kong</b>	<b>90.0</b>

Source: China Statistical Yearbook 2008. NBS

towards the post-industrial era, this intellectual unemployment will only gain in importance. In this respect Poland does not differ very much from some developing nations where many universities produce unemployed B.S., M.A. and even PhD graduates.

As a result an army of well-educated people who are unable to find suitable employment is ever increasing and their frustration is growing.

The reasons for that are numerous; from misconceptions about the real nature of the market economy, old habits of those who were used to the advantages of a welfare state to the lack of correlation between the contents of the university curricula and the requirements of the job markets. The end result of all these factors remains the same: high expectations with respect to the state which bears responsibility for all the citizens' problems.

However, the main reason for that dichotomy between expectations and reality is that these countries were ill-prepared for such a dramatic turn around<sup>4</sup>. Once communism fell Poland, as well as other ex-communist states, had to create market economies almost from scratch. And they should be commended for their results in such a short period of time (20 years or less), despite all the mistakes committed. But the road to really successful market economies is still long and bumpy.

To some it may appear ironic. The former communist states who were among the world's leaders in terms of education, have now found themselves in a situation whereby a strong, adequate educational system

<sup>4</sup> When the delegation of the Polish independent trade union "Solidarity" visited in 1988 Jerzy Gedroyc, the director of the Paris-based anti-communist Polish institute "Kultura, they were embarrassed by his first question about the programme for the after-communism Poland. The embarrassment was explicable; there was no such a programme.

becomes a barrier to further economic advancement and the challenges offered by post-industrialism may prove difficult to overcome. It is not so much for the lack of possibilities to study but chiefly because the educational system is ill-adapted to the requirements of the contemporary societies. And the field of economics does not escape this rule.

#### Post- industrialism: is Poland already there?

A post-industrial economy relates to that stage of economic development of a given nation that is characterised by a steady decrease of the relative importance of manufacturing and an increase of the service sector, and in particular of IT technology, innovation and R and D.

Although there are many definitions of post-industrial economies some elements are common for most of them, viz.:

(i) A declining manufacturing sector which leads to *de-industrialization*. In certain post-industrial countries, such as the U.K., Canada or Italy, the manufacturing sector represents only slightly more than 20 per cent of GDP;

(ii) Predominance of the service sector which may contribute in excess of 3/4 of GDP;

(iii) Information technology, innovation, RandD, etc. are now the true engines of economic growth (see data in table 1).

Most post-industrial economies have gone through a typical development pattern; from agriculture to industry and on to services.

However, the increase in labour productivity in the service sector lagged behind that of agriculture or industry. The reason for that stems from the fact that in the service sector labour cannot be replaced by machines to the same extent as it had been in the two

previous sectors where mechanization and automation easily and quickly replaced human labour. Consequently, employment grew faster in the service sector compared to agriculture and industry. But eventually that increase will come to a saturation point as the surpluses of relatively unskilled labour will have been absorbed into the service sector, principally into the basic services. Further growth of the sector, its sophistication and refinement, would require skilled labour. That would put an extra onus on the educational system of the former communist states which, as of now, is hardly ready to meet that challenge.

Meanwhile the majority of the post-industrial nations increasingly outsource the bulk of their manufacturing activities to the developing nations. The latter are now capable of producing basic industrial goods at substantially lower costs compared to the post-industrial world. All this causes the industrial map of the world change rapidly.

One of the main albeit not exclusive reasons for this are lower labour costs in the developing countries. Labour costs represent a fraction of what the costs to make basic goods such as shoes, clothes, household goods, and even electronics compared with the developed world. There are hardly any practical ways for the post-industrial nations to curb these trends. These nations have practically no choice but to maintain their technological competitive edge in selected industries to secure decent economic growth; or indeed any long-term growth.

### **Post-industrial economy and the post-industrial society**

Similarly to capitalism which transformed the feudal society into an industrial one, the post-industrial economy has created a new type of society, usually referred to as the post-industrial society. D. Bell, one of the classical writers on the subject<sup>5</sup>, speaks of six stages of this process. These stages are:

(i) A transition from the production of goods to the production of services. A post-industrial society no longer depends for its survival exclusively on the production of goods such as steel, machinery, house appliances or clothes but increasingly evolves towards such an economic structure which is based predominantly on a great variety of services: from selling of hamburgers and hot dogs to financial advice, consultancy and high technology. And although there is a wide spectrum of services provided by the private sector, government-provided services constitute the core of the service sector in a post-industrial society.

(ii) Manual work ( including assembly line workers) declines in importance and that of professionals such as health professionals, consultants, chartered accountants, financial advisers, lawyers and the like becomes dominant. New areas of expertise, such as genetic engineering, family counselling, immigration services etc. become of special importance. Traditional manufacturing centres decline, creating what is known as “ghost towns” with hardly any inhabitants. Large armies of unemployed are created as a result of what is now known as “structural unemployment”.

(iii) There is a growing importance of theoretical knowledge over the practical know-how which has now become a standard. Some trades such as shoe-making or baking are now vanishing giving way to new ones. Advances in such specialized knowledge create enormous needs for innovative solutions. Ethical aspects of such issues as cloning, transplant of human organs and the ensuing trade thereof, euthanasia or adoption of children by same sex couples urgently await solutions. There is the ever pending issue of the deteriorating environment, refugees, terrorism, etc., which have definite impact on the economy.

(iv) Post-industrial societies increasingly seek dominance over technologies and efficient control over them. This relates particularly to nuclear technology which, despite its well-known deficiencies, is still perceived as the viable source of energy for the future.

(v) To deliver all this, new intellectual technologies are being developed with the continuous drive for the search of innovative solutions which invariably change the way of our life.

(vi) All these developments lead toward a greater interaction between scientists and the technologies they create. Post-industrial societies are more and more dependent on the quality education. This creates an ever-growing need for specialized university knowledge as lower levels of education no longer make this interaction workable.

These are just a few aspects of the technological revolution that occurs daily, and the technological revolution creates an intellectual revolution. These societies which are unable to cope with the new levels of education and systemic change are the most certain losers in that race towards excellence.

### **The role of the economic science in the post-industrial societies**

All these ideas take us back to the title of this paper. The major issues that emerge are captured in the following questions: *does the classical way of economic thinking prepare a society such as the Polish nation for this new level of economic reality? Are we adequately equipped, in terms of economic expertise that is necessary to*

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<sup>5</sup> D. Bell: The Coming of the Post-Industrial Society. New York. Harper Colophon Books 1974.

**Table 2.** Distribution of world GDP 1989

Quintile of world population		% of world income
Richest	20%	82.7
Second	20%	11.7
Third	20%	2.3
Fourth	20%	2.4
Poorest	20%	0.2

Source: UNDP 1992 . Human Development Report

*confront the challenges that are brought to us by the post-industrial society? Do we transfer the right type of economic skills to the next generation of managers and entrepreneurs? Do we teach our students at various levels of academic hierarchy the ability to think and act with the needed economic perspective? Do we equip them with the right analytical tools to distinguish between what is important for decision-making and what is irrelevant? For the advance of computer technology does not solve all the problems related to decision-making. On the contrary, sometimes it even blurs and obscures it.*

The above are just some questions economists in Poland and elsewhere should be asking themselves. Because as teachers and educators we are professionally and morally responsible for the kind of knowledge the graduates of economic faculties of our universities will carry with them into their professional lives.

### **Economic science today**

If the mission of the science of economics is to maximise the effects from the use of scarce resources to the benefit of the whole society, then it has bitterly failed in the course of human history. The question is, however, whether it is just the economic theory that failed us or whether it was the ill-advised politicians who were.

That relates particularly to the distribution of the wealth we create through the act of economic activity. Just a glance at the figures in table 2 will tell us the whole story. And while the data in the table may be somewhat obsolete it is very instructive.

More recent statistics only confirm this trend. The richest 1% of adults in the world own 40% of global wealth<sup>6</sup>. In the USA at the end of 2007, the top 1% of households (the upper class) owned 34.6% of all privately held wealth, and the next 19% (managers, professionals and small businesses) owned 50.5%. Combined, these two groups, representing 20% of the

population controlled 85% of wealth. The remaining 15% were owned by 80% of wage and salary workers<sup>7</sup>. More shocking statistics of this nature could be quoted but it is a subject of its own and should be covered in a separate contribution.

These facts notwithstanding, a critical observer will be quick to point out that the issue of income and wealth distribution is not directly related to the very act of producing goods and services. Fair enough, but can we really disassociate the production and distribution? After all we produce goods and service to sell them, viz. to distribute them. The more equitable this distribution, the better the system than does it. Otherwise we will never attain economic peace.

One of the main challenges to the traditional economic theory is the discrepancy between what the theory says and the everyday economic reality. An average person in the street of our cities today no longer trusts economist to the same extent as he or she no longer trusts politicians. In this respect there indeed is very little, if any, difference between a Mr. Smith, Mrs. Ling Woo or Mr. Kowalski.

The chief reason for this distrust is that virtually no aspiring politician dares telling his constituency the harsh economic truth during an election campaign. He would rather succumb to the syndrome of lying to the electorate; making promises and forgetting them the very moment he gets elected. Do the economists follow that path?

If one gets into the shoes of an average pensioner who lost his lifetime savings through the dealings of a Mr. Mallof or Mr. Black one should not expect him to trust the economists, managers and entrepreneurs, bankers and the like.

But an average Mr. Smith is not himself without sin. He shows little interest in the economic science which he often considers a complete waste of time. Not the least because this science becomes increasingly complex and vague. Had he shown even a slightest interest in what whistle-blowers were saying about the forthcoming credit crunch, he would have taken some precautions. Because

<sup>6</sup> See: J. Randerson: World's richest 1% own 40% of all wealth, UN report discovers. The Guardian, 6December 2006.

<sup>7</sup> G.William Domhoff: Wealth, Income and Power. <http://www.2ucsc.edu/whorulesamerica/power/wealth.html>

he omitted to do so, millions like him have been badly hurt.

Ironically we have found ourselves in a peculiar *cul-de-sac*. On the one hand we are being served increasingly complex economic theories for which Nobel Prizes are granted, and on the other hand people are losing millions if not billions in the most irrational way. No one seems to have a quick solution to this dead end.

This paper does not pretend to provide answers. Neither do we believe that such readily available answers exist. All that is certain is that very few people are immune to this syndrome. Is the responsibility for that exclusively the economists'?

A possible explanation of this state of affairs may lie in the very nature of the economic science and the way it interacts with our everyday lives. Because economics is very complex, on top of being an inexact science, it is difficult to absorb, even by an educated person. Since it is highly abstractive, the conclusions proposed by economic models cannot be verified the same way mathematical theorems, biological or chemical experiments can. All too often a practical verification of economic theories comes months or even years later, only after the actual damage has been done.

So what the science of economics could and should do to change all this? The answer is as simple as it is impractical. Economics must occupy more space in our everyday lives and economic theories must be put more straightforwardly for the ordinary people to understand. And here comes our cherished subject of how the faculties of economics of our universities should answer this challenge.

### **Why do economic theories fail us at the most critical moments?**

We have known them all: Leon Walras, John M. Keynes, Kenneth Arrow and Gerard Debreu, Milton Friedman, Robert Lucas and Thomas Sargent, to name just a few. They are not just names in the economic literature. They are icons. But as Professor Mark Blaug bluntly puts it: "... we now understand almost less of how actual markets work than did Adam Smith or even Leon Walras"<sup>8</sup>.

So why cannot economic theory help us avoid severe economic crisis that periodically put the whole world economy on the brink of collapse, if not altogether then at least to mitigate their consequences that destroy lives of millions?

Professor Blaug has his answer: "... because most if not all the economic theories that are labelled *modern* are nothing less than pouring old wine into new bottles"<sup>9</sup>.

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<sup>8</sup> M.Blaug: Ugly Currents in Modern Economics. "Policy Options'. September 1997, p.4

<sup>9</sup> Idem, p. 5

Professor Blaug is critical, very critical, of the so called mathematical economics, which he calls " a sort of social mathematics in which analytical rigour is everything and practical relevance is nothing"<sup>10</sup>. He further claims that " much of modern microeconomics might be fairly described as a kind of geography that consists entirely of images of cities but providing no maps of how to reach a city either from another city or from the countryside"<sup>11</sup>.

Some readers can legitimately ask what all the above discussion has to do with Poland, or for that matter, with any other post-communist state. Is it not the concern of Western economies only?

Western economists, who have been instrumental for the transition from the command to market economy in these countries, have, according to Professor Blaug, been less than useful as a profession in advising the governments of Eastern Europe on the transformation issue. And although he stops short of saying that straightforwardly, they might in fact have misled these governments on a good deal of crucial issues. As some recipient countries frequently put it "the Western consultants come, stir confusion, recommend the constitutions be amended and.... leave " <sup>12</sup>.

This paper is not, however, about the assistance to development. It is about economics. Many of us remember the epic struggle Poland and other ex-socialist states had led in the early 1990s, not only to ensure the transition, but first and foremost to curb hyperinflation and fill the empty shop shelves up. The author of this paper had the privilege to be in Poland in the early 1990s and participate in the transformation process, although in a very modest way.

He sincerely believes that as economists we failed in helping Poland make this transition as smooth as possible and avoid some painful mistakes. And although Poland has made a spectacular progress in her effort to transform the ailing economy and make it move forward, few would disagree with the fact that much better progress would have been made had a programme of deep reforms been prepared *before* the actual transformation of the economy took place.

In the waning years of the old *regime* Polish economists were split into two groups: those who tried to defend the old system that was crumbling all over, and those (a vast majority in fact) who were keeping a low profile and simply trying to survive. Very few were

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<sup>10</sup> Idem, p. 3

<sup>11</sup> op.cit., p.4

<sup>12</sup> The author of this paper has, in his quality of a development consultant, frequently been confronted with deep frustration of the recipient countries' politicians with irrelevance of certain projects. Nevertheless he strongly believes the vast majority of such projects, particularly those which directly involve local staff, generate positive results and advance these countries' economies.

genuinely thinking of what was lying ahead of the communist system once it has been dealt its *coup de grâce*.

No wonder that the economic science in Poland had been overtaken by events. There were hardly any theoretical foundations for the economic experiment Professor L. Balczerowicz and his advisors embarked upon at the turn of 1989/1990. That historic experiment involving the whole nation, braking up with one system and taking on a completely new one, had practically no pattern to take inspiration from.

That the experiment was painful every citizen of this country who lived through this period knows all too well. But experiments of such a magnitude are seldom painless.

Neither was it faultless. Scores of people paid, and are still paying, a heavy price for the almost overnight reversal of the economic system and mistakes that ensued. But while this sacrifice was painful it was also worthwhile. In the course of less than one generation the country was completely transformed and found itself on the right path.

It is highly arguable whether the transition would have been easier and less painful had the economic science in Poland prepared the ground for the transformation ahead of time. The answer is probably yes although there are quite a few people who would disagree. But they represent a minority.

### Where do we go from here?

Now, with the transition period almost completed and Poland trying to catch up with the leading industrial nations, the *ugly question* (to paraphrase Professor Blaug's article quoted earlier in this paper) returns: "*have the economists done their homework and come up with economic models that are adequate for the post-industrial society which this country is already or which it will soon be?*"

This paper does not intend to repeat its main arguments and admit that we do not have yet the answer. What is more, this question cannot be answered right now. It is asked, maybe in a somewhat provocative spirit. That economists have a very important role to play in this process is nobody's secret, and both the traditional and mathematical schools have an equal opportunity to contribute to this discussion provided they learn how to listen to each other first and constructively criticise one another later.

One of the likely areas where consensus could be sought is the concept of the **NEW INSTITUTIONAL ECONOMICS (NIE)**. The main reason for that is that the "traditional economics", both microeconomics and macroeconomics, struggles to provide answers to some urging questions such as, for instance, how to provide an

efficient way of internalization of externalities and make it workable.

Ironically this problem was very simple under the command economy whereby the State was not only an undisputed decision-maker but it also was the sole provider of almost all investment funds. But the State of that era hardly did any economic analysis; maybe only to prove to the public that its policies were right.

However, under the capitalist system things have got a bit complicated. If external costs, such as pollution, noise, damage to environment, etc. are to be internalized, who is going to pay them? The very nice principle "let the polluter pay" is commendable but hardly practicable. What if the polluter is your powerful neighbour to the South (or East for that matter)? How are smaller nations, such as Poland<sup>13</sup>, for instance, going to implement that principle?

**NIE** addresses such issues. Amongst many issues/concepts<sup>14</sup> that form the scope of **NIE** one should point, although not exclusively, to: organizational arrangements, transaction costs, credible commitments, types of governance, persuasive abilities, social norms, ideological and cultural values, decisive perceptions, gained control, enforcement mechanisms, specificity of assets, human assets, social capital, asymmetric information, strategic behaviour, bounded rationality, opportunism, adverse selection, moral hazard, contractual safeguards, surrounding uncertainty, monitoring costs, incentives for collusion, hierarchical structures, bargaining strength.

**NIE** does not have all the answers to the most urgent questions that the traditional economics is confronted with today. But it helps move things forward. That is why the traditional approach to economic science and the way it is taught today is no longer relevant and needs an overhaul.

### CONCLUSION

The financial crisis of 2008 which at the time of this writing, is far from over, prompts us to rethink the whole system of economics and its role in the post-industrial societies. Especially in the former communist states which just started to apply the capitalist system, this is one the most important issues. Should these countries blindly follow the path of the traditional capitalist nations

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<sup>13</sup> Poland herself is a heavy polluter with 90% of electricity generated by coal-fired plants. This will have to be soon changed and there are few alternatives to coal that would be economically justifiable.

<sup>14</sup> See: O. Williamson: The New Institutional Economics. "Journal of Economic Literature". Vol38 no.2, 2000. P.595 and subseq.

or should they develop their own methods of doing things? How far are these countries compelled to doing things the same way the leading post-industrial societies do and to what extent the mistakes they commit are of their own making?

Economists not only should be but are morally responsible for helping to resolve these questions. They must stimulate a public discussion of what the economic education at all levels should be. They must propose workable and implementable changes. And these are the main challenges for economic theory in the post-industrial societies.

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