

# Evaluation of the Dynamics of Public Procurement Outsourcing in Transition Economies

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**Abstract** Outsourcing transactions has become a well-functioning mechanism in many countries all over the world. Scientific research on outsourcing transactions in public sector [3] notes competition and ownership as the main factors determining the efficiency of outsourcing transactions in public sector. The term “transition economy” refers to a country transiting from command to market economy.

**Keywords** – Outsourcing, public procurement, efficiency, transition economy, dynamic lines.

## I. INTRODUCTION

Transactions for the provision of outsourcing services have become a well-functioning mechanism in many countries all over the world. Despite the experience of the staff working in different levels of authorities, there is no single scientific opinion on whether making outsourcing contracts is always beneficial and whether the reduction of government spending is possible at all [15]. Recently, the discussions on this point have become increasingly intensive due to the fact that outsourcing transactions in public sector have started to include not only the performance of well-defined tasks (such as cleaning, garbage collection), but also more demanding activities such as military procurement or maintenance of the equipment.

The critics of outsourcing services state that using of the services provided by suppliers from outside does not ensure high service quality and low costs [7, 8] while the opponents are of the opinion that any opportunity to reduce costs is an advantage [16], and that outsourcing transactions in public sector is a powerful political tool to reduce public expenditure and improve the performance of state enterprises, although there is a risk that the quality of the services can get lower. Since a public procurement tender has to be announced before making a transaction, companies – potential service providers – compete with each other as under the conditions of capital market, staying comparatively free from political interference in their activities [14, 10].

**Scientific problem** – reduction of public companies’ operational costs is a rational solution to increase their operational efficiency since lower management costs cause smaller fiscal pressure on public institutions (as well as tax payers). Anyway, in case of outsourcing, cost reduction is not always easily substantiated because unlike the private sector, the public sector lacks of the data reflecting operational costs and capacity of institutions. What is more, the capacities are often a general result of joint activities of some institutions in the public sector. Public procurement markets show the inclination to join the needs of purchasing organizations in order to achieve the economy of scale including lower prices and transaction costs and improving purchase management. This can be achieved joining purchases by the number or sizes of purchasing organizations and the value during the time. However, joining and centralization of purchases should be carefully monitored in order to prevent concentration of too big purchase power or secret agreements and with a view to preserving transparency and competition, ensure the opportunities of small and medium enterprises to get into the market.

In EU countries, nearly 70 per cent of public procurement is performed following the criterion of economical efficiency. Respectively, only about 30 per cent of public procurement in EU is performed following the criterion of the lowest price while this criterion is dominant in the biggest part of public procurement in Lithuania: in 2012, 97 per cent of all public procurement in Lithuania was performed applying the criterion of the lowest price [6].

**The aim of this article** – after the theoretical research of the significance of transaction costs on companies and economics of the country while using outsourcing services in public sector, with reference to the data of the European Commission and The European Department of Statistics, to carry out the analysis of the average values of the main public procurement outsourcing services during the period of 2007 – 2011 and in order to research the tendencies of the dynamics of public procurement outsourcing services in the future, to perform the analysis of dynamic lines which helps to predict the future values of the dynamic lines with reference to the past values.

**The object of the article** is evaluation of the dynamics of public procurement outsourcing in transition economies.

**The methods of analysis** are as follows: logical and systematic analysis of the scientific literature based in comparative and summary methods. With

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reference to the scientific literature, the review of the internal and external environmental factors has been presented.

## II. OUTSOURCING TRANSACTIONS IN PUBLIC SECTOR

While making an outsourcing contract, both service quality and quantity are compared [9], so before and after the transaction, public sector companies have to make detailed specifications of the activities for which the outsourcing transaction is going to be made. Another problem – heterogeneity of capacities, i.e. it is difficult to compare operational costs if a company works in different regions because conditions for performance in different areas can also differ significantly. For example, as it was noted by Starr (1988), “public and private schools, hospitals and institutions of social services very occasionally work with similar students, patients or customers” [20]. That is why it is difficult to estimate whether the costs reduced due to higher efficiency of because of other reasons.

**Public procurement** refers to purchases of goods, services or works made by particular organisations (state-owned or municipal institutions and enterprises) on the basis of the contract of public procurement [17]. The regulations on public procurement are defined in the Law on Public Procurement and the related legal acts.

The aim of public procurement is to ensure that all enterprises or individuals have equal opportunities to sell their goods and services for the state [13]. In order to use the budget for rational purchase of necessary goods/services/works, ensuring their quality and aiming at making contracts with reliable suppliers, the participants of public procurement tenders as well as their goods, services or works must meet particular requirements. These requirements are usually presented in the documents of a particular tender.

Advanced transition economy is a country that in some conditions of business environment has met the market economy standards of developed countries, and evaluation of its particular sphere is 4.33 points, for example, in the spheres of price liberalization and foreign currency system. However, the level of developed countries has not still been reached in other business environment describing spheres (company restructuring, competition policy, market protection and others). The definition has been presented considering the evaluations of the European Bank for Reconstruction and Development, 2012 [4]. The common characteristic of all transition economies is the process of transition from centrally planned economy to market economy [19]. Although more advanced in transition period, unlike developed countries, transition economies still face more difficult conditions of business environment. Mainly, scientific

research is based on the evaluation of the environment in transition economies, annually presented by EBRD.

Public procurement tender is announced by a purchasing organisation which forms the commission to observe the procedures of public procurement. Depending on the quantity of goods and services to be purchased, different procedures can be applied. Procurement can be announced publically or just by sending invitations to participate for chosen potential suppliers.

Purchase is an economic activity which both uses the supply and demand in the market and at the same time forms these two market powers. Purchasing organisations work in the markets in which they can be either the only subjects to form the demand as, for instance, procurement in national defence system, or operate basically under the same conditions with other market subjects when buying standardized objects such as fuel or construction works. Therefore, on one hand, purchasing organisations themselves are influenced by market laws when they need particular goods, services or works. However, at the same time they make influence on the market by forming demand, especially considering road building – the sphere mostly dependent on state orders.

What is more, some of the biggest problems impeding and delaying the procedures of public procurement are as follows:

- the biggest part of purchases, including complicated intellectual, creative or high-technology services, are made applying the criterion of the lowest price;
- the results of public procurement tenders can be appealed.

The cheapest service is hardly qualitative and, in most cases, does not meet customer’s needs.

At present, majority of the problems in public procurement order in Lithuania are caused by insufficient competence of public sector organisations to choose suitable services and evaluate the proposed ones. Usually applied principle of the lowest price determines poor quality of the services, so public sector is offered to consider the application of the criterion of economical efficiency, i.e. value for money. It is agreed that the criterion of the lowest price is suitable to apply purchasing typical goods and services such as fuel, connection, stationery. In addition, this practice contributes to black economy: the lowest price can be offered by the companies operating with lowest costs.

The process of public procurement in Lithuania is regulated by the Law on Public Procurement which defines procurement order and principles. However, each purchasing organisation can differently arrange the procedures of public procurement. That is why different organisations can make the same purchase during different time for different costs with different resources and so forth. Therefore, the process of public procurement is dynamic and individual, in spite

of the regular standards and related conditions applied. Efficient organising of the process of public procurement is the aim to use the public procurement funds as rationally as possible [18]. Lithuanian Business Confederation supports the expansion of the value for low-value purchases because such purchases are made simpler and faster, this way reducing administrative burden and enabling to use sticking EU funds [11]. It should be noted that in the countries of the EU, the volumes of low value purchases are much bigger than in Lithuania. Undoubtedly, it is necessary to apply all the protectors, established in the Law of Public Procurement, so that low-value purchases would not be abused. For instance, it is necessary to ensure that purchasing organisation would not be splitting a high-value purchase to avoid the public purchase regulations [2]. Solution of the problems with the legal regulation of Lithuanian public procurement system and practical organisation of procurement determines the efficiency, transparency of public procurement and makes influence on economic and social welfare of the country.

For ensuring transparency, confidentiality of tenders should be reduced. At present, the bidders can mark all the information in tenders as confidential, i.e. unavailable to competitors. However, it is obvious that the information on whether a bidder meets the qualification requirements – has necessary turnover, the experience in similar projects, permissions, certificates, professional staff and so forth - can not be considered as confidential. Bidders must have an access to the documents proving competitors' qualifications.

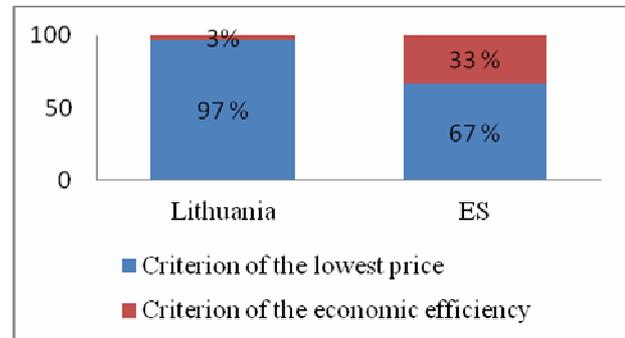
With reference to Lithuanian Business Confederation, the changes of the Law of Public Procurement must be aimed at bureaucracy reduction. The Confederation supports the suggestion to stop announcing the declaration of supplier's integrity because its conditions can be defined in the documents provided together with the tender. The changes of the Law of Public Procurement must ensure the efficiency and transparency of public procurement procedures and their implementation within the shortest term [11]. It is obvious that the present Law does not ensure the conditions explicated above and leaves much space for process delays which often becomes an obstacle for the timely use of EU funds and impedes project executions.

### III. EVALUATION CRITERIONS AND THEIR IMPACT ON THE EFFICIENCY OF THE USE OF EU FUNDS

Purchasing organizations are often not competent enough and do not possess special knowledge for proper evaluation of the importance of the criterions of economical efficiency and interrelations of these criterions. This is vividly revealed while purchasing

services, when the terms of a purchase define that tenders are evaluated following the criterions of quality, understanding of needs, efficiency and others, but the order of criterion evaluation is not detailed. This leaves many opportunities to misapply and favour particular suppliers.

What is more, in Lithuania, the criterion of the lowest price is widely applied (Fig. 1).



Source: prepared in accordance with the data of LR Ministry of Finance, 2012

Fig. 1. Comparison of public procurement evaluation criterions in Lithuania and ES (by the number of tenders)

As it can be seen from Fig. 1, in Lithuania, 97 per cent of all procurement is made applying the criterion of economic efficiency while EU average is 33 per cent.

It should be noted that the use of the criterion of the lowest price often determines purchasing the cheapest service but not the one that a customer really needs. Even more problems rise due to the bankruptcies of the bidders who have offered the lowest price or their inability to provide the purchased services. The criterion of economical efficiency is superior since it enables to ensure rational distribution of funds: a purchasing organisation gets the purchase object by the best value of money; application of this criterion also enables to choose the product which best meets the needs of the purchasing organization not only from economical but also from environmental or social point of view, ensures a long-term saving effect because acquisition of the object of better quality reduces maintenance costs, encourages economic development and innovations. Reduction of public companies' operational costs is a rational solution to increase operational efficiency since with lower management costs government institutions (as well as tax payers) experience smaller fiscal pressure. Anyway, in case of outsourcing, cost reduction is not always easily substantiated because unlike the private sector, the public sector lacks of the data reflecting operational costs and capacity of institutions. What is more, the capacities are often a general result of joint activities of some institutions in the public sector.

Considering the fact that evaluation of tenders by the criterion of the lowest price is a much simpler procedure in comparison with the criterion of

economical efficiency, such way of tender evaluation is also considered to be a faster way to make a purchase [5]. Respectively, in the cases, when a purchase object (works, goods or services) is clearly and comprehensively defined, it is simple or its characteristics are not important for the performance of the contract, evaluation of tenders by the lowest price is the most suitable and efficient method. In practice, evaluation of tenders by the criterion of the lowest price is usually chosen not only considering the little impact of the quantitative parameters of the purchase object on evaluation, but also as the evaluation method requiring little effort. Such practice is defective when the purchase object is complicated or its qualitative or financial parameters are important [1].

The criteria of the lowest price and economical efficiency are not the only ones that can be applied for the selection of a procurement winner. In some cases, the price can be not considered at all [12].

Different tendencies of criterion choice in different EU countries are possibly determined by the proportions of purchase objects. In Lithuania, goods' purchases make about half of international purchases while in EU this proportion is much smaller – 25 per cent of all purchases. The goods, which in Lithuania make a significantly bigger part than EU average, are usually standardized, so application of the criterion of economical efficiency is unnecessary. However, the limited practice of the application of this criterion can be determined by other reasons: more complicated application, necessity of more resources and effort, higher risks of litigation and so forth.

#### IV. THE RESEARCH OF THE DYNAMIC LINES FOR PUBLIC SECTOR OUTSOURCING SERVICES IN TRANSITION ECONOMIES

In order to research the tendencies of the dynamics of public procurement outsourcing services in the future, the method of dynamic lines has been chosen. This method enables to prognosticate the future values of dynamic lines with reference to the past values. Making prognostications, methods of long-term tendencies' calculations are usually substantiated on the presumption that the present scale of changes of the target size will not change in the future. With reference to the data of the European Commission, 2012 [6], in transition economies, the value of public procurement tenders as percentage of GDP raised: in Estonia, it raised from 2.68 per cent to 16.40 per cent, in Latvia – from 1.79 per cent to 17.60 per cent, in Poland – from 2.57 per cent to 7.70 per cent during the period of 2004 – 2011. Similar tendencies can be seen in other transition economies (TE) (see Table I).

TABLE I  
THE VALUE OF PUBLIC PROCUREMENT TENDERS AS PERCENTAGE OF GDP

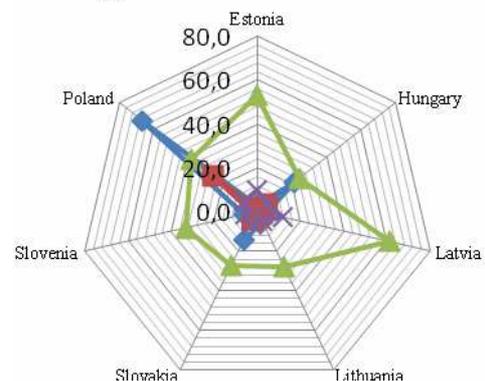
TE	'04	'05	'06	'07	'08	'09	'10	'11
EE	2.68	7.1	7.20	7.00	8.10	8.4	10.5	16.4
LV	1.79	9.8	13.9	12.4	9.70	8.6	11.4	17.6
LT	2.42	3.5	4.80	4.20	3.60	4.8	4.80	5.60
H	1.27	6.8	6.80	4.60	5.20	6.4	5.70	5.10
U								
PL	2.57	7.6	5.20	5.80	7.10	8.2	8.70	7.70
SI	1.58	3.2	5.00	6.50	5.10	6.0	4.60	5.40
SK	2.71	6.3	3.10	3.60	3.70	6.9	11.6	5.80

Source: the European Commission report data, 2012

This indicator is also called public procurement transparency indicator because it shows which part of procurement in EU countries is public. As it can be seen from Table I, public procurement transparency level is very different in transition economies: from 5.1 per cent in Hungary and 5.4 per cent in Slovenia to 17.6 per cent in Latvia and 16.4 per cent in Estonia.

In order to compare the main indicators of public procurement tenders in transition economies, the average values of the period 2007 – 2011 were calculated (see Fig. 2).

- Average total expenditure by general government and utilities on works, goods and services"
- Average value of tenders published in TED"
- Average value of tenders published in TED as % total expenditure"
- Average value of tenders published in TED as a % of GDP"



Source: prepared in accordance with the calculations performed by the authors with reference to the European Commission report data, 2012

Fig. 2. The map of the main indicators of public procurement tenders (average values of the period 2007 – 2011)

As it can be seen from Fig. 2, by the calculated average value of tenders published in TED as percentage of total expenditure and the average value of tenders published in TED as a percentage of GDP

during the researched period, the leading countries were Estonia and Latvia while Poland was significantly ahead of other countries by the average value of tenders in billion EUR. The average value of this indicator in Poland reached 25 billion EUR while the values of the same indicator in other transition economies varied in the interval from 1.34 billion EUR (Lithuania) to 5.3 billion EUR (Hungary). Also, Poland remains an obvious leader by the average total expenditure by general government and utilities on works, goods and services (the average value of this indicator is 66.4 billion EUR).

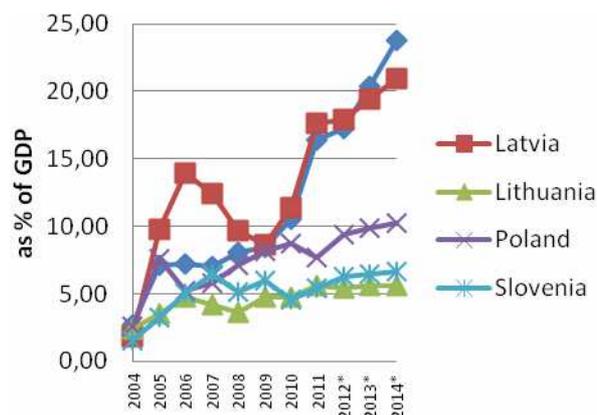
Since the data of public procurement tenders is at present available only up to 2011, it is purposeful to prognosticate the values of public procurement tenders as percentage of GDP during the period of 2012 – 2014. In the first stage of the research, determination coefficients ( $R^2$ ) were calculated following the data presented in Table I. For prognostication of the three years, only those values of  $R^2$ , which are higher than 0.5 were selected. Prognostication was based on the regression model – considering the highest value of  $R^2$  (see Table II and Fig. 3).

TABLE II  
PROGNOSTICATION OF THE VALUE OF PUBLIC PROCUREMENT TENDERS AS PERCENTAGE OF GDP BY THE METHOD OF DYNAMIC LINES DURING THE PERIOD OF 2012 - 2014

TE	Equation	$R^2$	2012*	2013*	2014*
EE	$y=0.171x^2-0.144x+4.691$	0.822	17.25	20.35	23.80
LV	$y=3.317x^{0.768}$	0.597	17.93	19.44	20.92
LT	$y=2.654x^{0.327}$	0.754	5.44	5.64	5.62
PL	$y=3.360x^{0.466}$	0.679	9.35	9.83	10.27
SI	$y=-1.888\ln(x)+2.257$	0.651	6.63	6.63	6.63

Source: prepared by the authors with reference to performed calculations

As it can be seen from the calculations presented in Table II and the graphs in Fig. 3, public procurement outsourcing as well as its generated part of GDP has a tendency to rise. The biggest rise is prognosticated for Estonia, Latvia and Poland. In Lithuania and Slovenia, the value of public procurement tenders as percentage of GDP during the period of 2012 – 2014 should stay steady, i.e. it can be expected to exceed respectively 5 per cent and 6 per cent. In Poland, the value of public procurement tenders as percentage of GDP can be expected to make 10.27 per cent in 2014.



Source: prepared by the authors with reference to performed calculations

Fig. 3. Prognostications of public procurement tender as percentage of GDP for transition economies during the period of 2012 - 2014

Prognostications for Slovakia and Hungary failed to be made due to statistically insignificant values of  $R^2$  ( $R_{Slovakia}^2 = 0.419$ ;  $R_{Hungary}^2 = 0.423$ ).

Summarizing the results of prognostication, the following conclusions can be made:

1) Leading transition economies by the value of public procurement tenders remain Estonia, Latvia and Poland. It has been estimated that the prognosticated value of public procurement tenders as percentage of GDP should rise up to 23.80 per cent in Estonia, 20.92 per cent - in Latvia and 10.27 per cent - in Poland in 2014. It can be concluded that the transition economies mentioned above show the highest level of transparency in the field of public procurement.

2) The prognostications made following the method of dynamic lines revealed that Lithuania and Slovenia can be attributed to the other group of transition economies which show low level of public procurement transparency. Until 2014, the value of public procurement in Lithuania should not change significantly while Slovenia is prognosticated to show a steady growth of the value of public procurement (6.63 per cent of GDP during the period of 2012 – 2014).

## V. CONCLUSIONS

1. The volumes of public procurement made by purchasing organizations in both regional and EU level are growing every year, so public and private sectors are interested in the efficiency of public procurement system.

2. In most EU countries, the markets of public procurement make about 17 per cent of GDP. In Lithuania, it made about 12.2 per cent of country's GDP in 2011.



3. Evaluation of tenders by the criterion of economical efficiency is more complicated and less objective. There is the tendency to apply safer methods in order to prevent litigations, pretensions and avoid controversies.

4. By the calculated average value of tenders published in TED as percentage of total expenditure and the average value of tenders published in TED as a percentage of GDP during the researched period, the leading countries were Estonia and Latvia while Poland was significantly ahead of other countries by the average value of tenders in billion EUR. Also, Poland remains a leader by the average total expenditure by general government and utilities on works, goods and services with the average value of 66.4 billion EUR.

5. The prognosticated value of public procurement tenders as percentage of GDP should rise up to 23.80 per cent in Estonia, 20.92 per cent - in Latvia and 10.27 per cent - in Poland in 2014 with these transition economies showing the highest level of transparency in public procurement. Lithuania and Slovenia can be attributed to transition economies with low level of public procurement transparency. Until 2014, the value of public procurement in Lithuania should not change significantly while Slovenia is prognosticated to show a steady growth of the value of public procurement - 6.63 per cent of GDP annually.

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