TRANSITION TO MARKET ECONOMY IN THE CENTRAL AND EASTERN EUROPEAN COUNTRIES – COMPARATIVE ANALYSIS[55]

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Abstract

While in the Western Europe market economy had developed several centuries, in the Central and Eastern European countries (CEECs) the transition from centrally planned to market economy has been undertaken in a considerably shorter time. Although the long-term objectives of CEECs were similar, discrepancies arose in each country as regards the priorities, order and pace of the reforms to be undertaken. The paper starts with a brief view on the transition process in the CEECs and on the Varieties of Capitalism (VoC) theory. The main part of the paper deals with comparative analysis of economic performance of CEECs' and three benchmark Western European countries with focus on three dimensions of the economy, namely macroeconomic stability, innovation/growth/competitiveness and welfare/equality. We identify the main differences and similarities across the CEECs from the view of the three dimensions. Then we try to find which out of the two VoC ideal types the respective CEECs are closer to. The key outcomes of the analysis are summarized in conclusion.

Keywords: Transition, market economy, macroeconomic stability, welfare, Central and Eastern European countries (CEECs)

Introduction

While in the Western Europe market economy had developed several centuries, in the Central and Eastern European countries (CEECs) transition has been undertaken in a considerably shorter time. Historical, political, social and economic diversity in the CEECs at the beginning of their transition has markedly influenced the way and the extent of their transition process. This diversity has been the reason why, despite roughly the same challenges for all the post-communist countries, the concrete results of the transition process have been specific for each country.

Some of the CEECs (Poland, Hungary and Yugoslavia) started to introduce economic reforms towards a market economy, building some of its elements, already from the early 1980s. However, in other countries, no reforms were undertaken at this stage. After the fall of the Iron Curtain, some of the nations integrated into federations (Slovakia, Slovenia, Estonia, Latvia and Lithuania) used the opportunity for regaining their independent statehood (1991-1993). All these countries faced a double challenge: 1. to introduce economic reforms leading to a market economy, 2. to build the basic economic institutions needed for managing an independent state economy (e.g. central bank, own currency).

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There was a belief that it is possible to project and implement capitalist institutions in CEECs from above and in a relatively short period of time. However, reality proves to be much more complicated – transition took a longer time and it was much more difficult and complex. Instead of one universal type of capitalism, several varieties have developed in the CEECs. Given the legacy of central planning, economic transition of CEECs was path-dependent. The centrally planned economy left no institutional vacuum, so the old institutional framework could not be simply replaced by a new one, already successfully implemented in the Western countries. Hence, during transition the old institutions were combined with the new ones. At the same time, transition of formal institutions was accompanied by transition of non-formal institutions, whose importance increased at the early stage of transition when many of formal institutions ceased to exist or were isolated from the real economy. However, non-formal institutions did not improve functioning of the institutional framework as a whole (Balaz, 2006).

From the beginning of their transition, all the CEECs had a common strategic goal of joining the European Union (EU) as soon as possible. This became the key external factor of accelerating their transition. Until accession to the EU but especially in the first stage of transition, a number of fundamental economic reforms had to be implemented in all these countries. These reforms were related mainly to liberalisation, restoration of private property, capitalisation of the national economy as well as macroeconomic stabilisation and the reform of public finances.

The paper starts with a brief view on the transition process in the CEECs and on the Varieties of Capitalism (VoC) theory. Then performance of the CEECs countries and the three benchmark Western European countries is compared from the view of macroeconomic stability, innovation/growth/competitiveness and welfare/equality, using available time series and data from the Eurostat database. After mentioning the differences and similarities among the CEECs' economic performances, the outcomes of the analysis are summarized, taking into account the VoC classification.

Shock therapy versus gradualism

Although, the long-term objectives of CEECs were similar, discrepancies arose in each country as regards the priorities, order and pace of the reforms to be undertaken. In some of the CEECs (e.g. Estonia, Slovakia, Czech Republic, Poland) the supporters of more radical reforms (the so-called *shock therapy*) enforced this approach, especially in the early years of transition, despite its negative impact in the short-term (output fall, unemployment and recession). Other countries (e.g. Slovenia, Hungary, Romania) took a more *gradualist approach*, in which reformers decided to implement step-by-step macroeconomic, structural and institutional reforms at the same time, with the aim to avoid drastic changes in output, employment and welfare and to provide time for the national enterprises to adapt to the new conditions. Differences existed also in the speed of the *shock therapy* – e.g. Poland had partial experience with the functioning of the private sector already before 1989, on the other hand in Czechoslovakia the private sector was absent, which implied the need of a fast transition.

It needs to be pointed out that both *shock therapy* (neoclassical approach to economic transition) and *gradualism* (evolutionary approach) take into account that market will be the coordinator of economic activities in the final stage. In contrast to these two liberal approaches, the *etatist approach* sees the state as the main coordinator in the economy. An important difference between the neoclassical approach (Washington consensus) and evolutionary approach consists in the fact that while according to neoclassical economists the final system includes markets behaving in the same way as in advanced capitalist economies (only already existing types of market economies are possible), according to evolutionary

economists unique types of systems will develop that are difficult to predict (given the legacy of central planning, new types of capitalism can develop) (Morvay, 2005).

Varieties of Capitalism

As described and analyzed by the VoC approach (see e.g. Hall – Soskice, 2001), different market regimes, i.e. capitalist variations, are characterized by different institutional matrices in the economy. These institutional environments and arrangements provide incentive structures for the behavior of firms, households and also policymakers.

Concerning the economic and especially the welfare system, the literature on VoC has established two prototypes of capitalism – Liberal Market Economies (LMEs) and Coordinated Market Economies (CMEs), a categorization that already divides EU-15 in two groups (Anglo-Saxon vs. Continental).Each of these two ideal-types is characterized by a different logic of interaction and coordination between actors. In LMEs, economic actors coordinate their actions mainly through competitive markets and price signals. In contrast, CMEs are largely driven by specific non-market institutions which play critical roles and influence processes of strategic interaction. LMEs comprise the USA, the UK, Ireland, Canada, New Zealand and Australia, and CMEs include the Scandinavian countries, Continental European countries and Japan. However, the bipolar conceptualisation of competitive and coordinated contracting arrangements has been bridged to some extent by the development of additional capitalist typology in the expanding VoC literature, namely that of Mixed Market Economies (MMEs) (see e.g. Hancké et al, 2007). In this type of the VoC, represented e.g. by Italy and Spain, the state has a crucial role in compensating for an absence of institutional complementarities. Nevertheless, both CMEs and LMEs continue to be understood as essentially coherent and homogenous ideal types.

The literature on VoC has largely concentrated on leading OECD countries and on micro issues (e.g. inter-company relations, industrial relations, training/education).The discussion mainly does not consider the context of transition. As argued by Kitschelt (2006), there is a possible or impossible trinity of welfare/equality, innovation/growth and macro stability. Arguably, welfare/equality is often said to be neglected by liberal market economies, while fiscal stability is not given sufficient weight in coordinated market economies. It needs to be mentioned that EU enlargement criteria have also focused on competitiveness and stability in the first place, while welfare and equality considerations have not been high on the list of conditions for entry into the EU (Schweickert et al, 2013).

Similarly as in the OECD countries, instead of one variety of capitalism several varieties developed in CEECs. According to Balaz (2006) institutional and evolutionary economics imply also following conclusions for development of capitalism: Market economy is an economic space with a dense network of institutions. The system of institutions is path-dependent in each country. Institutions determine functioning of the market and, at the same time, market forces affect evolution of institutions. Therefore there are at least so many varieties of capitalism how many countries exist. However, it is possible to group together respective varieties of capitalism according to the common features of components of the institutional framework. Each variety of capitalism functions in its own institutional environment, which may become a source of competitive advantages as well as disadvantages. There is no perfect and universally effective model of capitalism to which all the other varieties had to converge.

Historical legacies played an important role in transition of the CEECs. The heritage of the communist pasts, lower levels of development and various informal institutions mean that there is no close fit with the ideal types used for analysing and comparing mature market economies (Lane-Myant, 2006). The Varieties of Capitalism (VoC) approach can only be

restrictively, flexibly and sensitively applied to post-communist countries, the mechanical application of the VoC can be misleading. These countries are still undergoing changes leading to a variety of capitalism with the shape that is difficult to predict now, although, some features may already be clear. In addition, institutions can be changed more easily in transition economies because of weaker enforcement compared to developed economies. Hence, more alternatives for capitalist trajectories exist in transition countries, which can develop towards LME, CME or a mixed form of both (Mendelski, 2009). It also needs to be pointed out that classification of countries depends on the level of analysis (macro/micro), the length of the period analysed, the sectors and indicators chosen and the methodology. Hence, one and the same country can be sometimes put in different clusters of countries.

Legacy of central planning constituted different starting points and different challenges for CEECs compared to countries in the Western Europe. According to Esping-Andersen's (1990) typology, development in CEECs is often described as a gradual change towards the liberal welfare state, characterized by the minimal state, i.e. minimum government interventions in social area and in labour market, and by the shift of responsibility for social welfare from the state to individuals and their families. There are also attempts to identify elements of the corporatist welfare state, emphasizing merit principle, and social-democratic welfare state, promoting universalism and a high degree of redistribution, in respective CEECs countries. According to Farkas (2011), CEECs cannot be put into one single welfare system. Social protection in Poland, Hungary and Slovenia fits the Continental model; the others have the characteristics of the Anglo-Saxon model. According to other authors, welfare state in CEECs is rather a combination of more types of welfare states, depending on the sector examined. However, legacy of central planning and the so called path-dependency should be also taken into account when explaining formation of welfare states in CEECs.

Analysis of selected indicators

Analysis of selected indicators based on available time series and data from the Eurostat database has been conducted in the ten CEECs (Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia) and three benchmark countries (Germany as the case of CME, UK as LME and Italy as MME) to provide a broader picture of performance of CEECs. The indicators represent the trinity of macroeconomic stability, innovation/growth/competitiveness and welfare/equality (see Annex).

For the analysis a scoring model has been developed, based on the average values of the respective indicators for all countries. The model has the following specifications: The average values of individual indicators have been statistically distributed into 10 percentiles, which provided the necessary intervals for assigning points to countries. The points have been assigned to countries in descending order from 10 to 1 (i.e. the country with best performance in the respective indicator receiving 10 points and the worst receiving 1 point). The total score for each country for individual dimensions of the trinity has been calculated as the sum of the points assigned to the country for indicators in the respective dimension of the trinity.

The summary table with the performance indicators used in the analysis and average values for all countries analysed is in Annex (table 1). The scores for each indicator and each country can be seen in the table 2 (in Annex) and the results are also shown in figure 1 and 2.

Based on the data and methodology used, the following conditions and trends could be identified in CEECs:

- when we look at respective dimensions of the trinity in CEECs, the worst results in macroeconomic stability were registered in Hungary; the worst results in

innovation/growth/competitiveness were clearly reached in Bulgaria and Romania; and in welfare/equality in Latvia and Poland (figure 1 and 2),

- on the other hand, the three Baltic states, Slovenia and the Czech Republic performed best among the CEECs in macroeconomic stability; Slovenia followed by Estonia and the Czech Republic in innovation/growth/competitiveness; and again Slovenia followed by the Czech Republic in welfare/equality.
- among the benchmark countries, Germany and the UK represent more developed economies compared with Italy,[56]
- the results for Slovenia mostly fit those of Germany and the UK; in less extent, the same is the case of the Czech Republic (with the most evident difference in dimension of innovation and competiveness) and Estonia (with worse performance in welfare dimension),
- at the same time, Estonia seems to have caught up with Italy's performance in the analysed period (with better results in macroeconomic stability) and Slovakia is also rather close to Italy with deficit in the innovation/growth/competitiveness dimension.

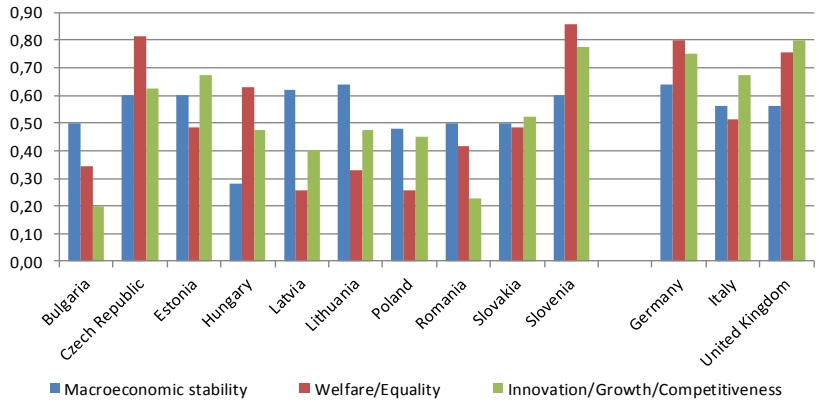
Slovenia and the Czech Republic, followed by Estonia are the most successful countries among the CEECs in reaching objectives of all three dimensions of the trinity, with Estonia lagging in terms of welfare. In general, the Baltic States are rather unequal and socially exclusive, Slovenia and the Czech Republic represent the opposite extreme. As regards research and development (R&D), Slovenia, Estonia and the Czech Republic represent slight exceptions from underfinanced R&D systems in the CEECs.

By many authors, Slovenia and Estonia are considered the most successful transition countries with two diverse but coherent institutional systems. While Slovenia is the case that is very similar to pure CME, Estonia is most similar to pure LME. One of the factors of the success of Slovenia is its exceptional legacy, as the country inherited from the former Yugoslavia a unique enterprise ownership structure based on self-management and a unique institutional setting.

Estonia and other two Baltic States belong to the few CEECs with rather satisfactory results in macroeconomic stability (figure 1), Latvia and Lithuania only before the crisis. The goal of national independence can explain why macroeconomic stability became a priority for these states. They have enjoyed strong political support for reforms towards the market economy in contrast with many other countries, as radical economic reforms were crucial for the defence of national independence. However, in these countries the domestic demand as a growth driver was so dominant that it led to very large deficits on current accounts before the crisis. At the same time, the results of the Baltic States in the welfare/equality dimension are weaker.

[56] Similar results of Germany and the UK in welfare/equality dimension result from the fact that while Germany reached a higher score in expenditure on social protection, in-work at-risk-of-poverty rate and in Gini coefficient in the analysed period, the UK was performing better in unemployment rates(see Annex).

Figure 1The trinity in the CEECs and benchmark countries (relative values calculated as shares in the maximum values for each dimension of the trinity)



Source: Eurostat (2014), own calculations.

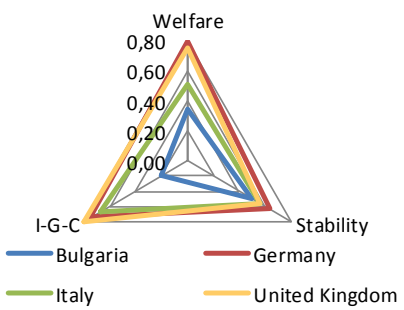
The Czech Republic is also often considered one of the most successful socialist countries to have transited to capitalism, which has been confirmed by the results of our analysis. The results of the trinity in the Czech Republic are closer to those of Slovenia (CME) than those of Estonia (LME). The Czech Republic and Slovenia reached the highest score in welfare/equality dimension among the analysed countries and, at the same time, both performed relatively well in terms of macroeconomic stability.

Also the results of Hungary fit more those of Slovenia, with a stronger emphasis on welfare/equality dimension. However, as regards the trinity, the overall results of Hungary are significantly worse than those of Slovenia. While the case of Hungary confirms that fiscal stability is often not given sufficient weight in coordinated market economies, this is not so evident in the case of the Czech Republic or Slovenia (see Annex).

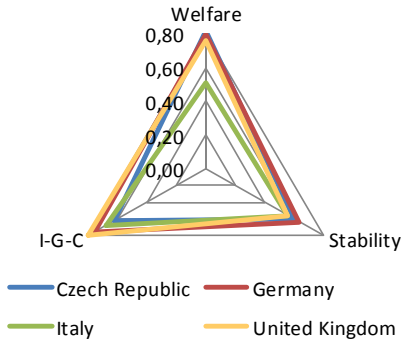
Slovakia is around the middle within the CEEC countries. As can be seen from figure 1, the results of the trinity in Slovakia are closer to those of Estonia (LME) than those of Slovenia (CME), since Slovakia and Estonia have focused less on welfare/equality than on other two dimensions of the trinity. The same is the case of Poland which, however, in comparison with the two mentioned countries, performed even worse, in particular in welfare/equality. The most problematic cases among the CEECs are represented by Bulgaria and Romania with a very weak performance in innovation/growth/competitiveness. In these countries, macroeconomic stabilization proves to be focused more than welfare or innovation.

Figure 2 The trinity of macroeconomic stability – welfare/equality – innovation/growth/ competitiveness in individual CEEC countries compared with the benchmark countries (relative values calculated as shares in the maximum values for each dimension of the trinity)

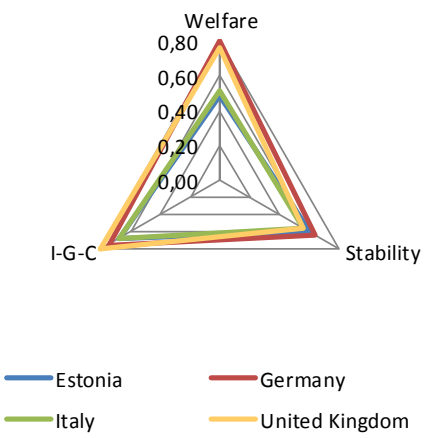
Bulgaria



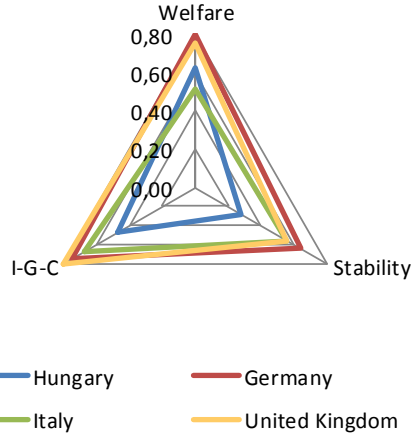
Czech Republic



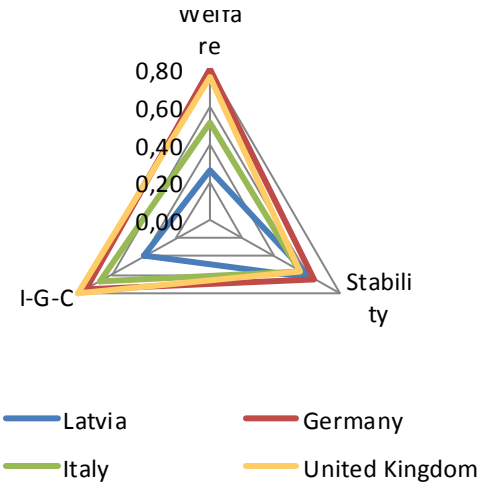
Estonia



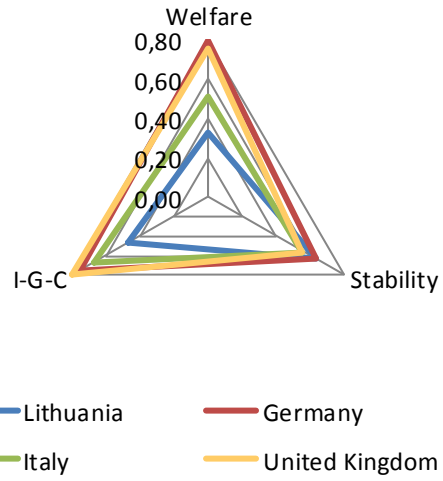
Hungary



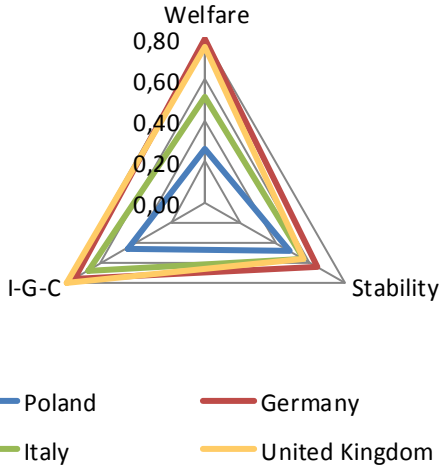
Latvia



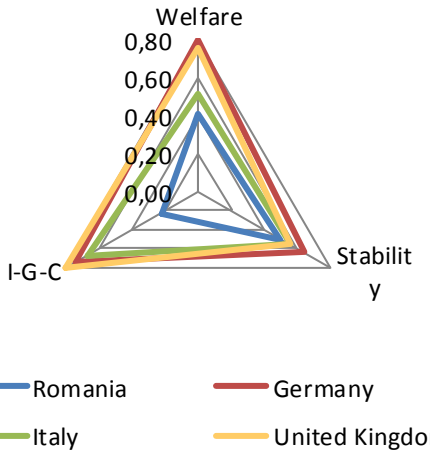
Lithuania



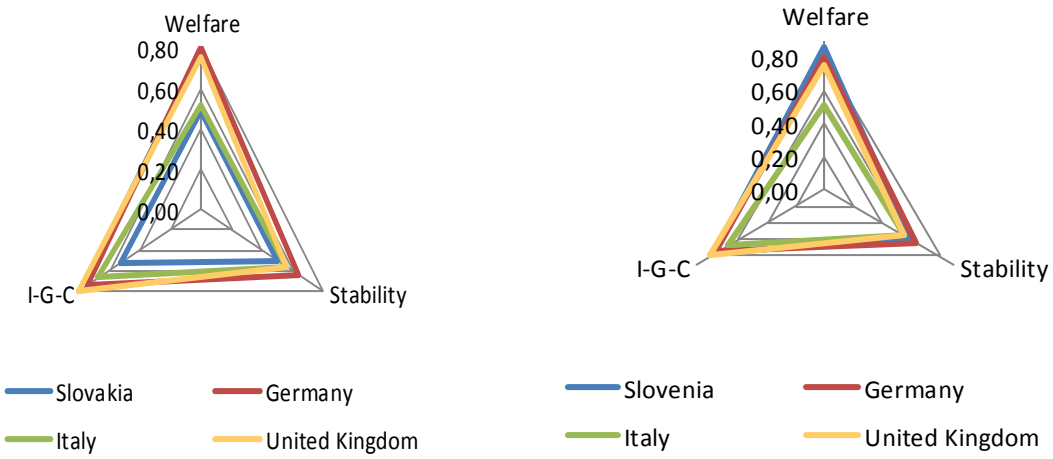
Poland



Romania



Slovakia **Slovenia**



Source: Eurostat (2014), own calculations.

Conclusion

The authors are aware of the fact that the classification of countries depends much on the indicators chosen, the methodology, as well as on the length of the period and the sample of countries analysed. Indeed, the outcomes of the analysis should be interpreted cautiously. Based on the data and methodology used in the paper, we assume that Slovenia can be considered the CME model and Estonia the LME model. At the same time, the results of the Hungary and also those of the Czech Republic are closer to the CME type, while the other two Baltic States, Poland and Slovakia fit more with the LME type. We can also assume that the results of Romania and Bulgaria, with a lower emphasis on the welfare/equality dimension than on macroeconomic stability, are closer to the LME than to the CME model.

Taking into account path-dependence, the choice between the shock therapy (e.g. Estonia, the Czech Republic, Slovakia, Poland) and the gradualist approach (e.g. Slovenia, Hungary, Romania), and the results of our analysis, we can suppose that the way of conducting transition from the centrally planned to the market economy by itself does not predetermine successfulness of the whole transition process in terms of economic performance. Neither does the type of the market economy, as there are relatively successful economies among the CEECs, which fit more to the LME model and also those closer to the CME type.

Note

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ANNEX

Table 1

Average values of selected indicators in CEECs and the three benchmark countries

Indicator/Country	Bulgaria	Czech Republic	Germany	Estonia	Italy	Latvia	Lithuania	Hungary	Poland	Romania	Slovenia	Slovakia	United Kingdom
Innovation/Growth/Competitiveness													
GDP growth rate - Y-o-Y change (95-13)	2,6	2,6	1,3	4,9	0,7	4,3	4,6	2,0	4,1	2,9	2,8	4,2	2,2
Gross domestic expenditure on R&D in % of GDP (95-12)	0,5	1,2	2,5	1,1	1,1	0,5	0,7	0,9	0,6	0,5	1,6	0,7	1,8
Labour productivity per hour worked vs. EU average (00-12)	37,3	72,4	107,2	60,7	115,0	51,4	57,8	67,4	63,2	39,5	80,4	71,8	109,9
Patent applications to the European Patent Office per million inhabitants (95-11)	1,8	10,7	258,2	13,6	69,4	5,3	2,0	12,9	3,5	0,8	39,6	4,2	88,3
Macroeconomic Stability													
Current account balance in % of GDP - (95-13)	-5,8	-3,5	3,2	-6,7	-0,2	-7,0	-6,5	-4,6	-3,9	-6,2	-0,6	-5,2	-2,0
General government deficit/surplus (95-13)	-0,2	-4,3	-2,4	0,2	-3,6	-2,3	-3,5	-5,1	-4,6	-3,6	-3,9	-5,4	-3,8
General government gross debt (95-13)	41,2	27,1	66,9	6,2	113,3	20,3	23,3	68,2	46,6	21,2	31,1	39,3	53,9
HICP 2005=100 - annual data (97-13)	6,1	3,2	1,6	4,7	2,2	4,6	3,39	7,1	4,76	26,0	4,8	5,04	2,1
Private debt in % of GDP - non consolidated - annual data (95 - 12)	101,6	68,1	125,6	104,8	98,6	76,8	48,4	96,9	61,8	61,1	98,6	61,1	165,0
Welfare/Equality													
Employment rate 20 -64 years (98-13)	62,4	71,4	71,6	71,2	60,2	68,4	68,4	61,5	61,9	65,1	69,8	65,3	74,4
Unemployment rate, annual average % (98-13)	11,8	7,2	8,3	10,3	8,8	12,6	12,3	8,0	13,3	6,9	6,8	15,1	6,1
Long-term unemployment - annual average (98-13)	6,9	3,3	4,2	4,7	4,8	5,8	5,7	3,7	6,4	3,3	3,3	9,6	1,7
Gini coefficient (05-13)	32,8	25,1	28,7	32,3	31,8	36,4	34,6	26,9	35,8	34,1	23,5	25,5	33,1
COFOG - Social protection % GDP (02-12)	12,2	13,2	20,5	11,4	19,0	11,0	11,8	17,1	16,8	12,2	17,3	12,2	16,2
In-work at-risk-of-poverty rate (Source SILC) (05-13)	7,1	3,7	6,8	7,6	9,8	9,6	9,7	6,3	11,7	18,1	5,2	6,2	7,9
Expenditure on social protection per inhabitant (03-11)	1587	3641	7907	2200	6358	1234	2201	3469	2613	1464	4568	2748	6909

Source: Eurostat (2014), own calculations.

T a b l e 2

Scores and relative scores for selected indicators in CEECs and the three benchmark countries

	Bulgaria	Czech Republic	Germany	Estonia	Italy	Latvia	Lithuania	Hungary	Poland	Romania	Slovenia	Slovakia	United Kingdom
Macroeconomic stability													
Current account balance in % of GDP - (95-13)	3	6	10	1	9	1	2	4	5	3	8	4	7
General government deficit/surplus (95-13)	9	2	7	10	4	8	5	1	2	3	6	1	6
General government gross debt (95-13)	6	7	3	10	1	10	8	2	5	9	6	6	4
HICP 2005=100 - annual data (97-13)	3	8	10	6	9	6	7	2	4	1	5	5	10
Private debt in % of GDP - non consolidated -(95 - 12)	4	7	2	3	5	6	10	5	8	9	5	9	1
Relative score (% of maximum 50 points)	0,50	0,60	0,64	0,60	0,56	0,62	0,64	0,28	0,48	0,50	0,60	0,50	0,56
Innovation/Growth/Competitiveness													
GDP growth rate - Y-o-Y change (95-13)	4	5	1	10	1	8	9	2	7	6	6	7	3
Gross domestic expenditure on R&D in % of GDP (95-12)	2	8	10	6	7	1	5	5	3	1	9	4	10
Labour productivity per hour worked vs. EU average (00-12)	1	7	9	4	10	2	3	6	5	1	8	6	10
Patent applications to the European Patent Office per million inhabitants (95-11)	1	5	10	7	9	5	2	6	3	1	8	4	9
Relative score (% of maximum 40 points)	0,20	0,63	0,75	0,68	0,68	0,40	0,48	0,48	0,45	0,23	0,78	0,53	0,80
Welfare/Equality													
Employment rate 20 -64 years (98-13)	3	9	10	8	1	6	6	1	2	4	7	5	10
Unemployment rate, annual average % (98-13)	4	8	6	5	5	2	3	7	1	9	9	1	10
Long-term unemployment - annual average (98-13)	1	10	6	6	5	3	4	7	2	8	9	1	10
Gini coefficient (05-13)	5	10	7	5	6	1	2	8	1	3	10	9	4
COFOG - Social protection % GDP (02-12)	3	4	10	1	9	1	2	7	6	3	8	4	5
In-work at-risk-of-poverty rate (Source SILC) (05-13)	6	10	7	5	2	4	3	8	2	1	10	9	5
Expenditure on social protection per inhabitant (03-11)	2	6	10	4	8	1	3	6	4	1	7	5	9
Relative score (% of maximum 70 points)	0,34	0,81	0,80	0,49	0,51	0,26	0,33	0,63	0,26	0,41	0,86	0,49	0,76

Source: Eurostat (2014), own calculations.