

# FROM THE COLLAPSE OF SOCIALISM TO THE CRISIS OF CAPITALISM: EXPERIENCES OF CENTRAL AND EASTERN EUROPEAN COUNTRIES

## SUMMARY

*“Back to capitalism” and “Back to Europe” were the slogans of the last decade of the twentieth century in all former socialist countries in Central and Eastern Europe (CEE); they declared uncompromising faith in capitalist market mechanisms and the full EU membership, which was considered a panacea for all current and future economic and socio-political problems.*

*Indeed, during a “golden era” CEE countries considerably outpaced the growth in the “old” EU countries and rapidly converged to the average EU level of development. However, the growth was “jobless” and “unsustainable”; it was to a great extent based on foreign savings. Large current account deficits therefore became a steady feature of CEE countries. The origin of the deficits can be traced to abrupt liberalization of foreign*

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**trade in transition while the continuation is linked to FDI. Gradually, CEE countries became fully dependent on the "old" Europe. Lisbon strategies contributed to the collapse of the manufacturing sector; while CEE countries could easily compete with the "old" Europe they could not compete with ruthless societies outside Europe.**

**Socially, CEE countries can be put into two groups; some have retained reasonable social cohesion; three Baltic countries are the extreme on the other side. Indeed, while social protection expenditures in old EU members exceed 30 percent of GDP, expenditure is less than 20 percent in seven out of ten CEE countries. Before transition, the EU was admired in former socialist countries for its political democracy and the social market model. When they joined, many features of the attractive European social market model were no longer there and the EU showed little interest to promote the model in transition countries. The emptiness was filled up with neoliberal ideas, which is shown by economic liberty indicators.**

**The global financial crisis, particularly the credit reduction, significantly hit CEE countries with large external financing needs. Foreign banks began to withdraw their capital by shrinking balance sheets in the subsidiaries. At the same time, FDI dropped to one fourth of the pre-crisis level. CEE countries thus faced net outflow rather than urgently needed inflow of capital.**

## **BACK TO CAPITALISM AND TO EUROPE**

Transition from a socialist to a market economy, a counterpart to sweeping political and ideological changes was a slogan of the last decade of the 20th century. It was to be based on four pillars: privatization, macroeconomic stabilization, microeconomic restructuring, and creation of a legal framework for a new economic system. All former socialist countries declared uncompromising faith in capitalist market mechanisms; the firmer, the fewer market institutions they possessed. Privatization was considered the cornerstone of transition. And again, every single government in Central and Eastern Europe (CEE) declared its firm commitment to full scale privatization<sup>2</sup> as it was assumed that privatization will improve efficiency in the use of the assets, enable fairness in distribution of wealth and welfare, and help the abolition of the mono-party system.

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<sup>2</sup> The notion privatization is not uniquely defined. Dictionary of Economics (Bannock, Baxter & Rees, 1986), for example, defines privatization as "the sale of government-owned equity in nationalized industries or other commercial firms to private investors, with or without the loss of government control in these organizations". After transition in CEE started, the definition widened to any form of transfer of wealth from the state sector to the private sector. Sadowski (1991: 47) distinguishes between two understandings of privatization, a full elimination of state property by transferring it into private hands, and changing the ownership structure by expanding the share of the private sector against that of the public sector, as to make the former eventually dominant.

The first assumption is taken for granted; private property rights namely provide incentives to save, to invest, to look for new products, to innovate production, to use existing resources in an optimal manner, and to bear risks of the decisions. However, privatization appears a necessary but not a sufficient condition for creating an institutional environment that assures economic efficiency. There were at least three issues or gaps that needed to be considered; technological, institutional, and behavioral. The technological gap could be overcome relatively easily. To overcome the other two gaps rapidly has been much more difficult. Formally, market institutions can be established by a decree; it is but unlikely that they would immediately function in the way they function in developed market economies. The performances of market institutions namely crucially depend on norms and patterns of social behavior; »successful operation and management of a market-type economy is, to a surprisingly large extent, a confidence trick« (Hare, 1991: 3). Agents taking part in economic transactions, adapted to changing circumstances, must believe that everyone else behaves up to the principles of the society; rather little can be governed by formal rules and contracts. The validity of the second assumption is dubious. Fairness in the distribution of wealth and welfare is an extremely ambiguous concept as illustrated, for example, by enormous variations of social protection such as pensions and health care, even among most developed capitalist welfare countries. With increased efficiency being remote and fairness ambiguous, the aim of privatization in the CEE countries was often reduced to a transparent political goal - to help abolish a mono-party system. While the dominance of private property rights seems the proper basis for a stable political democracy, the new political elites used privatization also as a tool to increase their political legitimacy. The speed of the operation therefore, understandably, became the criteria to evaluate the procedures of ownership "restructuring" and can also be only partly attributed to the faith of the new political elite in the supremacy of the market system. The responsibility aspect of ownership has been neglected both in theory and, even more so, in technical solutions<sup>3</sup>. The diversity of technical solutions namely reflected concurrent distribution of political power in a particular country, and randomly chosen western »privatizers« rather than genuine differences among

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<sup>3</sup> *Bajt (1992) distinguished between two notions of privatization. They are based on his distinction between the legal and the economic concept of ownership, with the later being related to distribution of income. While, according to the legal concept, "privatization amounts to restitution of private ownership rights in tangible capital in the form both of denationalization of the previously nationalized private capital (re-privatization) and privatization of the state accumulated capital" (Bajt, 1992: 8), privatization in the economic sense connotes the arrangements by which people earn their incomes. His distinction should have important consequences for practical solutions particularly in the countries of the former Yugoslavia as it related privatization not so much with the legal sense of ownership, but more with responsibilities for proper use and maintenance of assets. The warnings such as "to avoid the adverse effects of privatization in the process of transition, the existing property rights, particularly those of managers, ought to be strengthened rather than weakened and destroyed as is unavoidably done by the mass privatization" (Bajt, 1992: 19) appeared contrary to routines in the conventional theories of transition and were overlooked.*

countries: social environment, the existing institutional framework, the degree of monetization of the economy, industrial structure, incorporation into the world market, and macroeconomic performances<sup>4</sup>.

»Back to Europe« was another slogan of the last decade of the 20th century and the second ultimate goal of all former socialist countries in CEE; the full EU membership was considered a panacea for all current and future economic and socio-political problems. Accession enthusiasm was founded both on socio-political and economic considerations. Political democracy and the social market model with high standards of living were understandably attractive, and the EU was practically the only market left to CEE countries after the break of SEV. They could not afford to get away from it; they also expected capital in the form of direct investments, well paid jobs, and fiscal transfers. CEE countries therefore swiftly adapted their economic policies to reach the goal. The benefits were very much stressed by many studies calculating the contribution of accession to growth through adaptation to a better economic system, increased FDI, and subsidies. Opposite views were rare. A few liberal economists argued that CEE countries »would be better off by staying outside the EU and continuing improving economic freedom and the rule of law« (Prokopijević, 2005, 6). While enthusiasm for accession on the part of CEE countries was founded both on socio-political and economic grounds, enthusiasm for enlargement of the incumbents was based predominantly on political grounds<sup>5</sup>.

New member states (NMS) or CEE countries are often treated as a homogeneous group though the differences among them are substantial. They descend from initial conditions, the choice of transition model, and economic policies shaped by political developments. Despite that, common features linked to transition and to the EU accession prevail.

## **A »GOLDEN ERA« OF JOBLESS AND UNSUSTAINABLE ECONOMIC GROWTH**

On 1 May 2004, eight former socialist countries (the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Slovenia and Slovakia) joined the EU; on 1 January 2007, they were followed by Romania and Bulgaria. Three of them (Slovenia in 2007, Slovakia in 2009, and Estonia in 2011) joined the European

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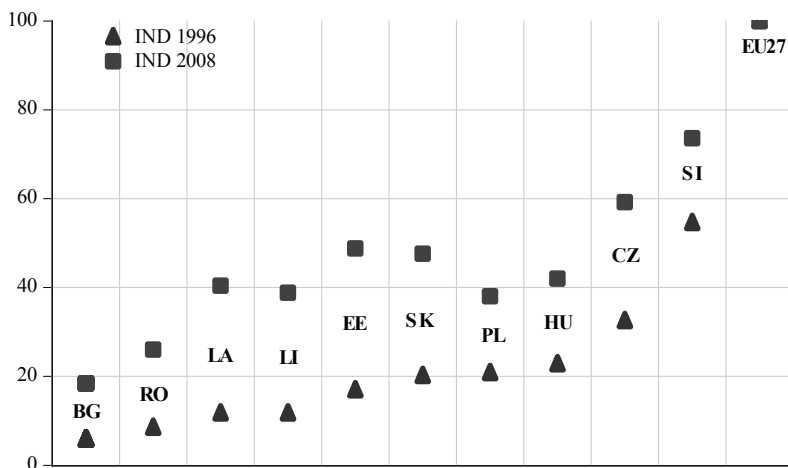
<sup>4</sup> In some CEE countries, for example, planning institutions had to be dismantled first, while in others they had been replaced by market institutions decades earlier; some countries had weak links with the world market, others had long ago developed trade relations and other forms of cooperation with Western countries.

<sup>5</sup> Namely, assumed costs and benefits which enlargement would bring to incumbents differed very much from those of newcomers. For incumbents, potential benefits of enlargement would be scanty since they could reap the benefits of transition already under arrangements which prevailed in CEE after the dissolution of socialism.

Monetary Union or euro area (EMU). Accession to the EU implied acceptance of the EU rules of the game (acquis communautaire followed by EU directives) and institutional convergence. Taking into account the relative size and the economic strength of newcomers, and flows of capital and ensuing changes in the ownership of productive assets in CEE countries one could say that enlargement of the EU with CEE countries was an acquisition rather than an accession.

Acceptance of the EU rules of the game and institutional convergence should also lead to economic (GDP/capita, GDP growth, unemployment, inflation, internal and external stability represented by the budget and the current account balance) and social (shares of the public sector in GDP, equality etc.) convergence. However, it is hard to empirically distinguish between costs and benefits which could be attributed to transition, and costs and benefits which could be attributed to joining the EU. Relatively rapid GDP/capita convergence of CEE<sup>6</sup> to the EU average began when transformational depression was overcome, i.e. far before their formal membership in the EU. Most of CEE countries reached the level of GDP before transition, i.e. in 1997, while they joined the EU in 2004 or 2007. One can nevertheless claim that the EU promised membership and preparations for the membership could also be commended for convergence.

**Graph 1** Convergence of GDP/capita in CEE countries towards the EU27 average



Source: Eurostat (<http://epp.eurostat.ec.europa.eu>), own calculations; The data indicate the position of a country compared to the EU27

<sup>6</sup> In Graph 1, GDP/capita in 1996 and in 2008 of a country is compared to the corresponding GDP/capita in the EU27. For example, GDP/capita in Bulgaria in 1996 was at the level of 29 percent of the EU27 average, in 2008, it was at the level of 40 percent, Latvia jumped from 33 percent in 1996 to 54 percent in 2008, the jumps of the Czech Republic and Slovenia were smaller; from 76 to 83 and from 79 to 88. Note that the speed of convergence is upward biased for statistical reasons; a contribution of poorer countries to lowering the average.

A kind of a »golden era« of growth lasted from 1993 to 2008. In this period, CEE fared well in comparison to the »old« EU members. Stimulated by the domestic demand and exports, the growth in CEE considerably outpaced the growth in the »old« EU countries which is in accordance with the theory of convergence. Inflation rates in CEE countries diminished gradually but persistently converging to a much lower inflation in the developed part of the EU. CEE countries were less successful considering employment and equilibrium. The average GDP growth in the »golden era« which stabilized at approximately 4 percent yearly was namely accompanied by the 12 percent unemployment rate and the 6 percent current account deficit. One could therefore talk of »jobless« and »unsustainable«<sup>7</sup> growth. Average unemployment rates exceeded double digit figures in five countries with Poland leading while unemployment in Hungary and Slovenia remained well below the EU-15 average. »Jobless growth« which is manifested in high unemployment can be easily explained by structural changes in the labor market mechanism and evident shifts of the Okun's curve (Mencinger, 2000). Relatively high double (current account and budget) deficits prevailed in most countries with the exception of Estonia (with a large current account deficit accompanied by a budget surplus), and Slovenia (with a small current account surplus and a not too large budget deficit). The development in this period led to the results at the end of the period presented in Table 1.

**Table 1** CEE countries at the end of »the golden era«

	popul- lation mill.	GDP/ capita 2008 €	unem. rate 2007	export/ GDP ratio 2007	export per capita 2008 €	current account % GDP 2007	net financial position % GDP 2007	budget balance %GDP 2007	public debt %GDP 2007	credits GDP ratio 2007
Czech R	10.3	13100	5.3	0.69	9610	-3.3	-36.6	-0.6	28.7	0.72
Estonia	1.34	10300	4.7	0.51	6310	-17.3	-75.0	2.5	3.4	-
Latvia	2.28	8200	6.0	0.30	3030	-22.9	-79.6	-0.3	9.7	1.15
Lithuania	3.38	7900	4.3	0.44	4770	-13.7	-49.9	-1.0	17.3	0.71
Hungary	10.1	9300	7.4	0.68	7340	-4.4	-109.9	-4.9	66.0	0.81
Poland	38.1	8100	9.6	0.32	3040	-3.7	-45.9	-1.9	45.2	0.59
Slovakia	5.40	11700	11.1	0.76	8950	-5.7	-49.7	-1.9	29.4	0.56

<sup>7</sup> The sustainability of growth deals with the dependency of CEE on foreign savings, demonstrated in current account deficits and growing indebtedness. In a decade, the indebtedness (net foreign asset position) of CEE quadrupled.

Nastavak tablice 1.

	popul- lation mill.	GDP/ capita 2008 €	unem. rate 2007	export/ GDP ratio 2007	export per capita 2008 €	current account % GDP 2007	net financial position % GDP 2007	budget balance %GDP 2007	public debt %GDP 2007	credits GDP ratio 2007
Slovenia	2.02	17300	4.9	0.59	11500	-4.9	-21.9	-0.1	24.1	1.09
Bulgaria	7.70	4000	6.9	0.40	1990	-21.5	-113.3	1.1	18.2	0.85
Romania	21.5	5800	6.4	0.24	1560	-14.1	-45.8	-2.5	13.0	0.53
EU15	330	27200	7.2	-	-	-	-	-0.7	66.3	-
EU27	501	23600	7.1	-	-	-	-	-0.9	59.0	-

Source: Eurostat (<http://epp.eurostat.ec.europa.eu>)

At the end of the »golden era«, GDP/capita varied between €17.3 thousand in Slovenia and €4 thousand in Bulgaria, the unemployment rate between 4.7 percent in Estonia and 11.1 percent in Slovakia. Slovakia was the most open country with exports amounting to 76 percent of GDP, while exports per capita were the highest in Slovenia. The current account deficit exceeded one fifth of GDP in two CEE countries and one tenth of GDP in three countries; the resulting negative net financial position (net foreign debt) exceeded GDP in Bulgaria and Hungary. Budget deficits as well as public debts were relatively small compared to the »old« EU states.

As the new EU members lagged behind the EU average much more than the countries which had joined the EU during previous enlargements, the newcomers expected to be assisted in their catching-up process. However, hopes of large transfers from the EU budget to national budgets have proven to be illusions; the newcomers were from the very beginning in a much worse position than old cohesion countries (Greece, Spain, Portugal, Ireland). The »Big bang« enlargement in 2004 was namely based on political rather than economic considerations and the economic situation in the EU in 2004 was worse than the economic situation during previous enlargements. The new members were to contribute to the EU budget in well known forms (traditional own resources, a part of VAT revenues, a share of GNP, and a share for the UK rebate) and to introduce many costly »acquis« requested by the EU membership which increased their budget expenditures. Furthermore, while the flows from national budgets to the EU budget are certain, the flows in the opposite direction are conditional and uncertain; they in most cases request co-financing and fulfillment of cumbersome administrative requests. The estimates of

net effects of accession on public finance therefore differ considerably, depending also on the place from where they come<sup>8</sup>.

Large current account deficits and the corresponding escalation of indebtedness became a steady feature of CEE. Their origin can be traced to the beginning of transition and stabilization policy which was based on Washington Consensus promoting abrupt liberalization of foreign trade. A predictable result of such abrupt liberalization of imports in the early nineties was a destruction of the manufacturing sector, large trade account deficits, and the sale of the best productive assets to foreign multinationals. Sales of state-owned companies to multinationals were also an important component of privatisation and restructuring; a significant part of FDI was cheap cash purchases of productive assets. FDI net inflows gradually calmed down as the »family silver« was more or less sold during hasty privatization, with Slovenia being an exception<sup>9</sup>. Though literature reveals mixed evidence on the spill-over effects of FDI for a host country<sup>10</sup>, positive spill-over effects of FDI have acquired the status of unquestionable truth, and FDI has remained a pillar of the development strategies in the CEE countries. Indeed, to attract FDI, the CEE countries have been willing to use various forms of subsidies: tax vacations, adaptation of the legal system or even direct financial assistance to multinationals<sup>11</sup>. By them, the CEE countries have replaced

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<sup>8</sup> Thus, Dabrowski, Antzak and Gorzelak (2004) from Poland are very skeptical about net inflows to CEE and stress the costs involved by acceptance of the EU regulation and standards. Hallet and Keermean (2005) from EU directorates estimated that new countries could, due to the Copenhagen package-related appropriations for commitments, reckon on total budgetary envelope of €40.9 billions in the 2004-2006 period. They however admitted that the amount actually paid will be much lower and will together with the running out pre-accession assistance amount to €31.4 billion or 2 percent of GDP per year. Including €14.6 billion contributions to the EU budget, which is 0.9 percent of their GDP, net inflows amount to €16.9 billion. This implies that in the 2004-2006 period the new member countries would be as a group a net beneficiary receiving 1.1 percent of their GDP. This is far less than what was given to Ireland, Spain, Portugal and Greece in 2003, taking into account their relative levels of development. In 2003, Spain received 1.2 percent, Greece 2.2 percent, Portugal 2.7 percent and Ireland 1.4 percent of their GDP. These estimates do not include changes in the expenditure side of the budgets. Namely, most EU transfers are "additional" rather than substitutes of domestic expenditures.

<sup>9</sup> Indeed, Slovenian outward FDI (mainly to former Yugoslav republics) over-passed inward FDI.

<sup>10</sup> See Carkovic and Ross (2005), Lipsey (2006), Mencinger (2003).

<sup>11</sup> Economic policy makers and development strategists in the EU new member states (CEE) often consider FDI the pillar of their development, and indeed, CEE have been recipients of substantial net capital inflows. The policy makers overlook three issues: future outflows of capital and structural current account deficits which are more and more shaped by the income account, the resulting vulnerability to financial shocks, and social effects of domestic versus foreign ownership. The growing gap between the gross national product and the gross domestic product is an inevitable result of FDI. The outflow of capital in the form of dividends is speeded up by the opportunities to relocate production to the countries with even cheaper labor. Most new FDI in the CEE are therefore investments in service and real estate sectors which weakens potential positive spillover effects of FDI. If outflow of capital exceeds FDI inflows, sudden interruption of FDI inflows could result in an exchange rate crisis. Furthermore, the difference in normal behavior of domestic and foreign owners should also be considered; the domestically-owned companies are more likely to support social and other activities in their country than foreign-owned companies. In theory, FDI is supposed to bring technology and know-how, contribute to enterprise development and restructuring, increase international trade integration, bolster competition, and support human capital formation. The reality can differ. First, many FDI in CEE were cheap cash sales of assets. They were therefore not investments in the macroeconomic sense of the word, and the



contemptible sales of their assets in the period of speedy, ideologically and politically inspired privatisations during which the »family silver« in most of the CEE countries was sold. Within a decade, foreign ownership of productive assets became a major and in some sectors (financial services, telecommunications, retail trade) the predominant or even exclusive ownership. Though, average inflows of FDI in the 1996-2008 period exceeded average outflows of profits, the situation was rapidly changing; outflows were growing faster than inflows<sup>12</sup>. A structural current account deficit first caused by the trade deficit used to be more and more fueled by the income account deficit which in 2005 surpassed the total current account deficit of CEE; the growth based on foreign rather than domestic savings led to a huge negative net foreign financial position.

**Table 2** Balance of payments, 2001–2010 average % BDP

	Current account					Financial account Investments		
	Total	goods	services	incomes	transfers	direct	portfolio	Other
Bulgaria	-10.74	-15.77	3.52	-1.65	3.17	12.38	-1.39	4.78
Czech Republic	-3.64	-0.16	1.45	-5.17	0.25	4.57	0.34	0.67
Estonia	-8.20	-12.59	8.34	-4.87	1.04	5.69	-2.73	4.83
Latvia	-9.45	-17.11	4.83	-0.28	3.11	3.34	-0.33	8.46

*proceeds from sales did not necessarily enhance productive assets of the countries. On the contrary, they were spent on consumption and imports. Second, a large portion of FDI in the CEE was concentrated in three activities: financial services, retail trade, and telecommunications. This implies that FDI does not contribute much to the horizontal or vertical transfer of technology and know-how of the host country, and also, that FDI might increase imports more than exports creating a trade deficit rather than a trade surplus. Third, there is no doubt that an acquisition of a local company by a multinational corporation increases efficiency of the company and that foreign multinationals are generally more productive than domestic firms. However, the resulting specialization and purchases of raw materials within a multinational chain can nevertheless have a negative impact on the national economy if the links between the acquired company and the rest of the local companies are cut or reduced. In this case, the benefits of the enhanced efficiency accrue to a multinational corporation only rather than to the host country. In addition, the use of transfer prices etc. enables avoiding or lowering taxes on profits. Fourth, FDI can enhance competition but it is equally likely that FDI reduces competition. Indeed, a multinational can, particularly in a small country, establish a powerful monopoly which destroys and/or prevents creation of potential domestic competitors. Finally, multinationals often nominate foreign managers to head the acquired companies and they often transfer existing research activity of the companies abroad which hinders rather than spurs human capital creation in the host country. The consequences of this transfer are clearly visible by the number of patents per million of population shown in Table 3, which, with the exception of Slovenia, lag enormously behind the EU average.*

<sup>12</sup> *Within a decade, foreign ownership of productive assets became a major and in some sectors (financial services, telecommunications, retail trade) the predominant or even exclusive ownership. Average yearly FDI inflow into CEE in the period 1996–2008 was approximately €20 billion, with the exception of 2003, when it halved. The FDI inflows therefore resulted in the growth of foreign-owned productive assets and correspondingly in enhanced investment income outflows. Though average inflows of FDI in the 1996-2008 period exceeded average outflows of investment income amounting to €16 billion yearly the situation was rapidly changing. Outflows of capital were namely growing from €2.5 billion in 1996 to €42 billion in 2008. The crisis changed the situation abruptly; while inflows of FDI to CEE dropped to €10 billion yearly, outflow of profits continued to remain at the level of €40 billion yearly.*

## Nastavak tablice 2.

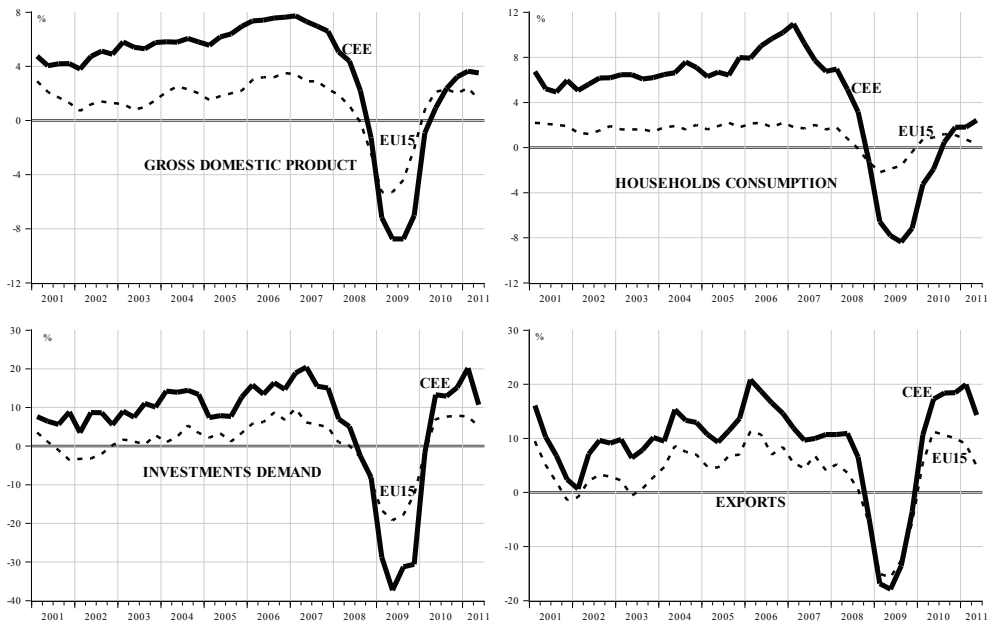
	Current account					Financial account Investments		
	Total	goods	services	incomes	transfers	direct	portfolio	Other
Lithuania	-6.32	-9.86	3.04	-2.15	2.65	2.77	0.95	2.73
Hungary	-5.77	-1.59	1.51	-5.82	0.13	2.54	1.70	3.60
Poland	-4.13	-3.04	0.52	-2.41	0.79	2.59	1.69	1.35
Romania	-7.58	-9.10	0.00	-2.24	3.81	4.94	0.45	5.59
Slovenia	-2.02	-3.45	2.97	-1.37	-0.18	0.64	0.13	2.78
Slovakia	-6.39	-3.47	0.47	-3.31	-0.08	5.59	-0.30	3.12

Source: Eurostat (<http://epp.eurostat.ec.europa.eu>), own calculations

There was another price to be paid for the successful convergence of GDP/capita. By entering the EU and the EMU (Slovenia, Slovakia and Estonia) CEE have indeed ceased to exist as proper economic entities; they have given up most of the attributes which characterize a country as an economic entity (control of money, taxes, flows of goods, services, capital and labor over the borders, and its own economic system). Monetary policy (in three countries completely and in the other partially) was shifted to ECB, fiscal policy became more and more restricted by EU regulations, countries could not control flows of goods and capital, EU directives form the economic system. More important, flows of goods and capital are linked to the old EU member states and CEE countries became EU regions rather than states. This dependence is normal as they are small economies (except Poland) with export demand higher than 50% of GDP, which is very much concentrated on exports to the EU15.

The dependence of CEE countries on the old EU countries is shown in Graph 2 with quarterly rates of change of GDP and the three final demand components: household consumption, gross fixed investments, and exports of goods and services in the new and the old EU member states. The growth of GDP in CEE in the "golden era" was twice the growth in the old EU member states. The differences in the growth of household consumption were even larger particularly in the years preceding the crisis.

**Graph 2** The dependence of CEE on the EU15



Source: Eurostat (<http://epp.eurostat.ec.europa.eu>)

## EU LONG-RUN STRATEGIES AND CEE COUNTRIES

The Lisbon Strategy signed in March 2000 should have ensured the EU becoming the most efficient knowledge based economy by 2010. After some years of mantras on the strategy, the actual development brought admittance that the EU was not only far from the goals but also heading in the opposite direction. The European Commission reluctantly admitted that the strategy failed; in February 2005, it was replaced by »Partnership for Growth and Jobs – New Beginning of the Lisbon Strategy«. In it, the ending year 2010 was abandoned, the number of goals was reduced, and responsibilities were turned to the governments of member states. The new strategy was said to be simple, pragmatic, and tangible<sup>13</sup>. It should be based on the partnership between the Commission and member states, which should create their own »Lisbons« and become responsible for efficiency, an increase of productivity, and employment which was to be attained by the assistance of »healthy« macroeconomic policy supporting structural reforms. There were no provisions for the turning point. Instead, the new strategy surprised

<sup>13</sup> Communication to the spring European Council (2005). *Working together for growth and jobs, A new start for the Lisbon Strategy*, COM (2005) 24.

with an abundance of empty talks, newly invented phraseology and concepts, action plans and programs, priorities, mobilizations, new institutions and similar claptraps<sup>14</sup>. In short, if the economic growth in the EU had depended on rhetoric, it would have been high. Since it did not, the new strategy soon turned into a worthless political document.

In CEE, which just entered the EU, the new strategy was met with similar enthusiasm by politicians but much less so by common people accustomed to many similar claptrap talks during the former regimes. One could nevertheless maintain that the two strategies contributed to the collapse of the manufacturing sector in CEE, already badly affected by the rapid liberalization of imports. CEE countries could namely easily compete with the old EU states if labor costs and productivity were the only determinants of the costs of production; average hourly labor costs (defined as the total labor costs divided by the corresponding number of hours worked) in CEE compared to average hourly labor costs in the EU-15, remained much lower than labor productivity in CEE compared to labor productivity in the EU-15.

**Table 3** Competitiveness of CEE countries

	Labor costs/ hour €	Yearly earnings in € 2010			Tax wedge 2010	Patents/ million people	Exports/ capita € 2009
		Total	Gross	Net			
European Union <sup>27</sup>		18,455	15,445	11,977	39.3	108.6	
European Union <sup>15</sup>		21,350	17,948	13,945	39.8	135.1	
Bulgaria	1.89	2,275	1,941	1,536	32.5	1.6	1350
Czech Republic	7.88	7,613	5,681	4,897	38.9	25.5	7730
Estonia	6.60	6,438	4,790	4,040	38.6	38.1	4840
Latvia	4.41	5,095	4,106	2,919	43.5	10.7	2440
Lithuania	5.09	4,439	3,383	2,798	38.8	6.5	3520
Hungary	7.13	5,858	4,559	3,457	43.6	20.2	5930
Poland	6.73	5,189	4,521	3,514	33.4	8.0	2560
Romania	3.40	3,567	2,786	2,068	43.1	1.7	1350
Slovenia	12.09	9,818	8,457	6,513	38.5	81.7	9230
Slovakia	6.41	5,883	4,662	4,035	34.5	6.0	7430

Source: Eurostat (<http://epp.eurostat.ec.europa.eu>), own calculations

<sup>14</sup> See for example: EU (2005). *Delivering on growth and jobs: A new and integrated economic and employment co-ordination cycle in the EU*. Brussels: European Council.

However, competing with much more ruthless societies, China, particularly, was simply impossible<sup>15</sup>. Some multinational corporations which had in the early nineties located production in CEE countries, began relocating a part of it to new poorer candidate countries and much more to poorer countries in Asia. This did not affect only production of many traditional industries with low value added jobs (textiles) but also industries with high value added jobs. By their relocation to the countries with miserable wages, nil social security, and disregard of externalities (which all contribute to high initial profits) these industries also swiftly turned to industries with low value added<sup>16</sup> jobs. The relocation of production therefore also weakened the ability of CEE countries for creating more jobs in services. While it is true that by a higher economic growth and an increase in the standard of living in the rest of the world, new markets will emerge, their emergence will lag behind the disappearance of jobs in CEE due to the production being shifted from CEE. The number of patents per million of inhabitants clearly points out to one of the consequences of the destruction of the manufacturing sector during transition and selling its remnants to foreign multinationals: an absence of research and development. Indeed, by the number of patent applications per million of inhabitants, CEE countries belong to the third world countries.

In 2010, the EU launched Europe 2020: EU's growth strategy for the decade. The collapses of the two previous strategies made European »planners« a little bit more cautious and the third strategy a little bit more realistic. For example, the former pillar of economic progress – globalization is now put among long-run problems together with the scarcity of natural resources and the aging of the population. The strategy should deliver growth which is to be: smart (based on more effective investments in education, research and innovation); sustainable (thanks to a move towards a low-carbon economy), and inclusive (with a strong emphasis on job creation and poverty reduction). The strategy is focused on five goals in the areas of **employment** (75% of the 20-64-year-olds to be employed), **innovation** (3% of the EU's GDP to be invested in R&D), **education** (reducing school drop-out rates below 10% and at least 40% of 30-34-year-olds completing third level education), **poverty reduction** (at least 20 million fewer people in or at risk of poverty and social exclusion), and **climate change** (lowering energy greenhouse gas emissions by 20%, increasing energy production from renewable sources by 20% and increasing energy efficiency by 20%). The goals are particularly ambitious

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<sup>15</sup> Globalization occurred when the American model of capitalism prevailed not only over socialism but also over other models of capitalism which led to the globalization of market fundamentalism.

<sup>16</sup> Value added at market prices is a sum of wages, profits and net indirect taxes, i.e. taxes-subsidies. One can therefore increase profits if wages are miserable and net taxes low.

for the CEE countries which lag behind the five strategic goals<sup>17</sup> considerably. What will happen to Europe 2020 remains uncertain. Though the strategy is slightly more realistic than the predecessors it nevertheless appears to be a kind of pre-election program with a lot of promises, newly invented expressions, and empty slogans; the demand side is again ignored. Therefore, Europe 2020 might soon turn to a worthless political document providing speech-making and jobs for the EU bureaucracy responsible for its "implementation". Recent developments do not even assure that the EU will exist in 2020.

## SOCIAL COHESION AND IDEOLOGY

The transition has proven to be a painful process with many setbacks, and social and political tensions emerging from the redistribution of income, wealth, and power. This could have been expected; the transition began without a clear picture of the actual situation, without a fully worked-out scheme of a new economic system, and without a suitable economic and social arrangement in place. They were replaced by assumptions that the elimination of deformed non-market institutions, restoration of private ownership together with a laissez-faire free market mechanism would instantly transform socialist countries into welfare states. New, mostly inexperienced governments were assisted by international financial institutions; many domestic politicians and foreign advisers were ideologically and politically motivated - their major goal being abolition of socialism and existing institutions rather than a gradual creation of a viable economic system and an increased economic prosperity for everybody. In short, previous prevention of »capitalist exploitation ideology« was replaced by what George Soros called »market fundamentalism«.

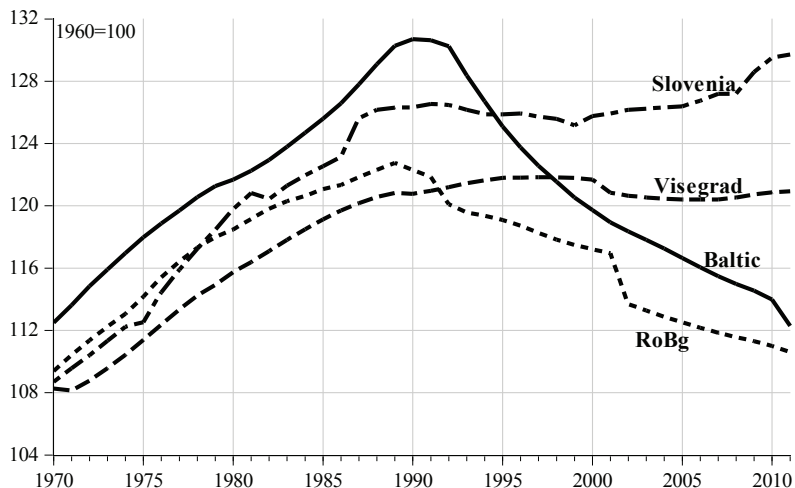
Unwarranted expectations did not materialize; many people suffered substantial reductions in their standards of living, production declined, unemployment increased, and distribution of income worsened (Ellman, 2000). The enthusiasm of Western countries over political freedoms and economic transition in Eastern Europe diminished as well when they realized that the amount of money needed

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<sup>17</sup> *The first goal of Europe 2020 (75 percent employment rate) indicates an important shift in philosophy or awareness that the basic problem of contemporary world is a lack of jobs and that economic, social, and political developments in the near future will be determined by employment and unemployment and their social consequences. Unemployment is far the most severe social problem also in CEE countries; out of the three kinds of economic growth: »smart, sustainable and inclusive«, CEE will therefore have to care for the inclusive growth: creation of new jobs. Most jobs in the decade before the crisis were lost in manufacturing, partly because of "smart" growth or technological change, and partly because of moving production to »China«; a part of manufacturing and employment in it can only be brought back by actually holding back imports to the EU while repeating a free trade rhetoric. The ability to request »fair« trade and competition which would request that competitors comply with minimal social norms and rights of workers has been missed by greed of multinationals and the EU thoughtlessness.*

to cope with a nostalgia for communism's cradle-to-grave social benefits would exceed available financial resources.

**Graph 3** Population in CEE countries



**Table 4** Social cohesion indicators

	Public expenditure/GDP 2001-2010 average	Inequality coefficient 2010	Population change 2011/1991 Index	Empl. rate 2010	Unempl. rate 2011	Social Protection Expenditure 2010		
						in GDP	% old age	%health
EU27	47.6	4.83	106.6	64.1	9,7	29.4	45.0	37.4
EU15	48.1	4.89		65.4	9,7			
Bulgaria	38.3	5.84	92.3	59.7	11,3	18.1	51.5	32.2
Czech R.	43.8	3.48	102.2	65.0	6,7	20.1	47.2	40.1
Estonia	36.7	5.03	85.5	61.0	12,5	18.1	44.2	37.7
Latvia	38.0	6.97	83.9	59.3	16,2	17.8	53.4	28.4
Lithuania	36.2	7.25	87.6	57.8	15,4	19.1	44.0	35.8
Hungary	49.9	3.42	96.3	56.4	10,9	23.1	45.4	33.7
Poland	43.8	4.96	100.0	59.3	9,7	18.9	60.9	31.6
Romania	36.7	6.05	86.6	58.8	7,4	17.6	50.7	34.7
Slovenia	46.6	3.40	102.5	66.2	8,2	24.8	46.3	39.6
Slovakia	39.1	3.80	102.3	58.8	13,6	18.6	43.0	39.5

Source: Eurostat (<http://epp.eurostat.ec.europa.eu>)

Social cohesion can be measured by indicators of equality or inequality (the inequality coefficient, the Gini coefficient, the risk of poverty rate) and their determinants such as the share of the public sector in GDP, the employment rate, the unemployment rate, public expenditures for health, education and social security etc. According to indicators presented in Table 4, CEE countries can be put into two groups; four countries (Slovenia, the Czech Republic, Hungary and Slovakia) have retained reasonable social cohesion; their inequality coefficients being lower than the EU average. Three Baltic countries are the extreme on the other side. Their poor social state is to some extent reflected in large emigration<sup>18</sup>. Population of CEE countries which amounts to one fifth of the EU population, has since 1991 decreased from 106 million to 102 million; the Czech Republic, Poland, Slovenia and Slovakia have retained population unaltered, while population in other CEE countries has decreased; in three Baltic states by 15 percent, in Bulgaria by 13, in Romania by 8, and in Hungary by 4 percent. The employment rate in the Czech Republic and Slovenia is above the EU average, other countries lag behind in this (most likely decisive) pillar of social cohesion. By the share of public expenditure in GDP, CEE countries lag behind the EU average (except Hungary), they are however divided into two groups in this aspect as well; the Baltic countries, Romania, and Slovakia with less than forty percent of public expenditure in GDP, and other CEE countries with more than forty percent. CEE countries lag considerably behind the EU average in social protection expenditures as a percentage of GDP. Indeed, social protection expenditures in developed old member states exceed 30 percent in France, Denmark, the Netherlands, Germany, Finland and Sweden, while it is less than 20 percent in seven CEE countries, with the exception of Slovenia, Hungary and the Czech Republic. The share of old age benefits in the total social protection expenditures was the highest in Poland, and the lowest in Slovakia, while the share of health was the highest in Slovakia and the lowest in Latvia.

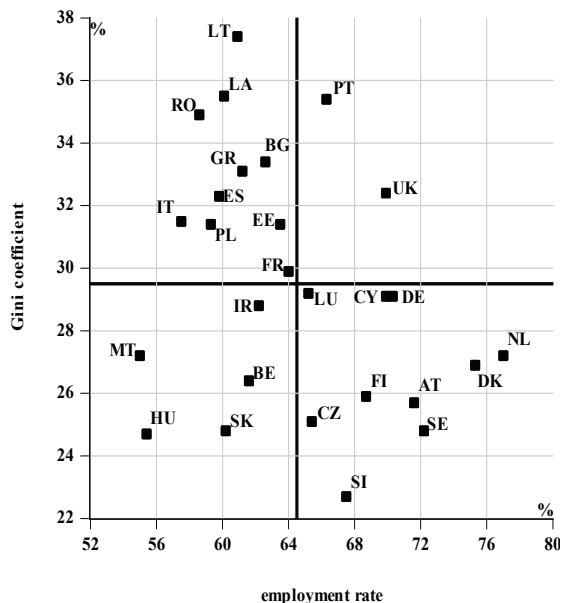
The employment rate might be considered the major indicator of economic performance; it also determines social cohesion of the country. The relationship between it and the Gini coefficient is depicted by a scatter diagram in Graph 4 with the employment rate on the horizontal axis and the Gini coefficient on the vertical. Average values create four quadrants called Scandinavian, Anglo-Saxon, Central European, and Mediterranean. Six (Lithuania, Latvia, Romania, Bulgaria, Estonia, Poland) out of ten CEE countries fall in the Mediterranean quadrant with less than an average economic and social performance (less than the average employment rate and higher than the average Gini coefficient) together with Greece, Spain, Italy and France. Slovenia and the Czech Republic are in the "Scandinavian" quadrant, Slovakia and Hungary in the "Central European" quadrant.

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<sup>18</sup> Besides political reasons related to Russian population.



**Graph 4** Economic performance and social cohesion of EU countries



Source: Eurostat (<http://epp.eurostat.ec.europa.eu>)

Before transition, Western Europe was admired in all former socialist countries for its political democracy and social market model. However, when former socialist countries joined the EU, many features of the attractive European social market model were no longer there. Furthermore, the EU showed very little interest to promote the model in transition countries. The emptiness created by the fall of socialism was therefore filled up by American advisers promoting the pure »shareholders value« type capitalism. They were immediately followed by many domestic preachers and politicians; very often former »Marxists« who quickly turned to »Hayekians«, while the governments (»left« and »right«) accepted neoliberal beliefs in market institutions much more than the governments in the old EU countries. Indeed, CEE countries are quite high on different scales of economic liberty calculated by the Heritage Foundation or the Fraser Institute, and slightly worse on the scales of competitiveness calculated by WEB. Estonia, which is clearly leading on the scales of the first two institutions, is considered more liberal than most EU countries; it is followed by Latvia, Lithuania and the Czech Republic which are close to the EU-15 average. Slovenia is on the bottom not only among the ten newcomers but also among the 27 EU members. The situation is very much reversed on the Economic Complexity Index or the Human Development Index where the Czech Republic and Slovenia are leading, and Baltic countries lagging.

**Table 5** Rankings of CEE countries by some performance indicators\*

	<b>Heritage Freedom Ranking 178 countries</b>	<b>Fraser Freedom Index 141 countries</b>	<b>WEF index 139 countries</b>	<b>ECI index CID 128 countries</b>	<b>HDI index UNDP 179 countries</b>
Czech R.	70.4 (28/3)	7.13 (46/6)	4.57 (36/2)	1.63 (8/1)	0.865 (27/2)
Estonia	75.2 (14/1)	7.52 (15/2)	4.61 (33/1)	0.79(32/7)	0.835 (34/3)
Latvia	65.8 (56/6)	6.92 (60/9)	4.14 (70/9)	0.59(39/9)	0.805 (43/8)
Lithuania	71.3 (24/2)	7.40 (24/4)	4.38 (47/5)	0.68(36/8)	0.810 (40/7)
Hungary	66.6 (51/5)	7.52 (15/3)	4.33 (52/6)	1.43(14/3)	0.816 (38/5)
Poland	64.1 (68/10)	7.00 (54/8)	4.51 (39/3)	1.02(25/5)	0.813 (39/6)
Slovakia	69.5 (37/4)	7.56 (13/1)	4.25 (60/7)	1.38(15/4)	0.834 (35/4)
Slovenia	64.6 (66/9)	6.78 (74/10)	4.42 (45/4)	1.52(10/2)	0.884 (21/1)
Bulgaria	64.9 (60/7)	7.34 (28/5)	4.13 (71/10)	0.59(40/10)	0.771 (55/10)
Romania	64.7 (63/8)	7.08 (48/7)	4.16 (67/8)	0.94(27/6)	0.781 (50/9)

\* values of the Heritage Foundation index are between 89.7 (Hongkong) and 22.1 (Zimbabwe); values of the Fraser freedom index are between 9.01 (Hongkong) and 4.06 (Zimbabwe); values of the WEF index are between 5.63 (Switzerland) and 2.73 (Chad); values of the ECI (economic complexity index) are between 2.313 for Japan and -1.907 for Mauretania; values of the HDI (human development index) are between 0.943 (Norway) and 0.343 (Central African Republic); The first number in parenthesis shows the position of a country among all countries evaluated, while the second number shows the position among the ten CEE countries.

Source: home pages of relevant institutions

## CRISIS IN CEE COUNTRIES

Financial crisis rapidly infected Europe. It was brought about by European banks, central banks included, as they had purchased new financial products with AAA+ ratings from US banks. The reason was similar to that in the United States, an unlimited belief in the market mechanism combined with greed. Namely, Europe was increasingly replacing its own economic order – »social market capitalism« with the American version of »shareholder value capitalism« and increasingly accepted the lessons of neoliberalism, although not without frequently adding completely pointless bureaucratic rules. The financial sector expanded far beyond rational limits in the EU as well, and the profits from generating virtual wealth were also mind boggling in European banks and other financial institutions.

At the outbreak of the crisis, EU institutions were confused; their initial response was to wish the crisis away by repeating mantras from documents such as the Lisbon Strategy or the Stability Pact. Following initial confusion, the EU continued

to prevent the collapse of the financial system; government guarantees for deposits prevented the flight of money from deposit accounts into cash, pumping large quantities of primary money into the banking system prevented the collapse of even more banks. This has not yet strengthened mutual trust between banks and has not encouraged them to put more loans into circulation. The so-called credit crunch persisted, though one should not overlook that the crunch followed the previous credit addiction.

**Table 6** Exposure of CEE countries at the beginning of the crisis

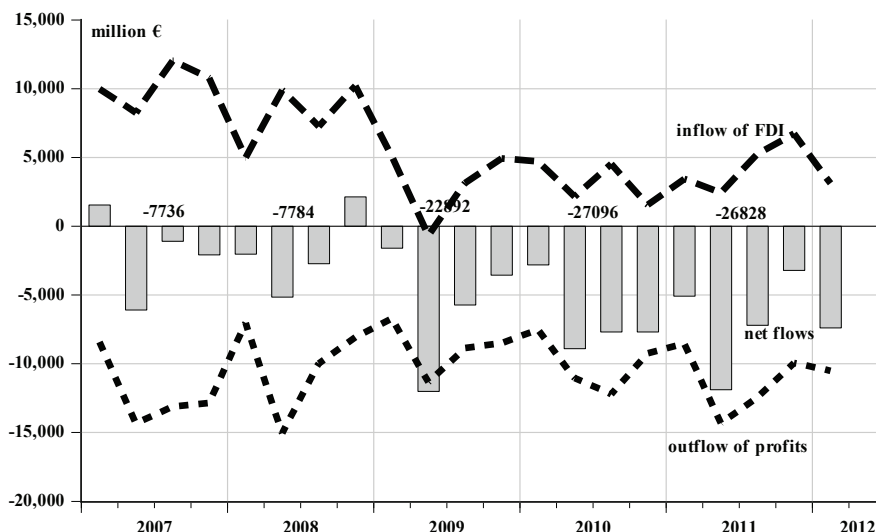
	<b>GDP to GDP27 average 2007</b>	<b>export/GDP ratio 2007</b>	<b>foreign banks % of assets</b>	<b>ROE of banks 2007</b>	<b>loan/deposit ratio July 08</b>	<b>current account/GDP 2007</b>	<b>net financial position/GDP 2007</b>
Czech Republic	81.3	0.69	83	25	0.77	-3.3	-36.6
Estonia	70.6	0.51	99	29	1.62	-17.3	-75.0
Latvia	58.0	0.30	63	26	2.90	-22.9	-79.6
Lithuania	61.0	0.44	92	29	1.53	-13.7	-49.9
Hungary	63.5	0.68	83	20	1.32	-4.4	-109.9
Poland	53.8	0.32	70	23	1.15	-3.7	-45.9
Slovakia	68.6	0.76	97	19	0.86	-5.7	-49.7
Slovenia	90.9	0.59	36	15	1.60	-4.9	-21.9
Bulgaria	38.1	0.40	80	24	1.29	-21.5	-113.3
Romania	40.6	0.24	88	26	1.27	-14.1	-45.8

Source: Eurostat (<http://epp.eurostat.ec.europa.eu>), ECB

The global financial crisis, particularly the credit reduction hit CEE countries with large external financing needs exceptionally hard. Foreign banks, very much involved in banking in CEE and until 2008 enjoying rates of returns on equity which were twice the rates of returns on equity in their home countries<sup>19</sup>, began to withdraw their capital from CEE countries by shrinking balance sheets in the subsidiaries. At the same time FDI dropped to one fourth of the pre-crisis level. CEE countries thus faced net outflow rather than inflow of capital. Indeed, as seen in Graph 5 the net outflow of capital (the difference between inflow of FDI and outflow of profits from CEE countries) in the crisis years tripled.

<sup>19</sup> In 2007, the average share of profits of five major players (Erste Group, Unicredit, Raiffeisen, KBC, Intensa Sanpaolo) in CEE amounted to 30.5% of profits while the asset share was 22.5%. At the end of 2007, 42 % of the total assets of the Austrian banking sector were in CEE countries.

**Graph 6** Flows of capital during the crisis



Source: Eurostat (<http://epp.eurostat.ec.europa.eu>), own calculations

While the EU was attempting to deal with the financial crisis, it turned into a recession or even a depression. The drop of the economic activity affected CEE countries linked to the rest of the EU even harder than the development in the financial sector. Namely, their manufacturing sector does not depend only on the general economic situation in the old EU but much more on production of durable consumer goods for which they produce spare parts.

In the crisis, CEE countries faced two issues: how to secure external financing during the crisis and how to deal with the downturn in the real sector. While GDP in the EU27 dropped from growth of +2.9 percent to -4 percent, shrinkage of GDP in small Baltic countries reached or exceeded 15 percent and in other more than 5 percent, the only exemption being a relatively large Polish economy which because of its size depends on the economic activity in the EU less. The link between the drop of GDP and exports is confirmed by similar drops of exports. The crisis was accompanied by an expansion of unemployment and an increase of the budget deficit and a corresponding increase of the public debt. However, increases of budget deficits are similar to the increases of deficits in the rest of the EU, while public debts in CEE countries are lower than in the most EU member countries, which is due to »youth« of the countries<sup>20</sup>.

<sup>20</sup> The notions of budget deficit and public debt were practically unknown in the so-called centrally planned »shortage« economies or in Yugoslavia where the gap between budget revenue and expenditure was covered by the central bank.

**Table 6** The effects of the crisis on performance of CEE

	GDP growth		exports per capita		unemployment rate		budget balance		public debt	
	2007	2009	2008	2009	2007	2010	2007	2009	2007	2010
EU27	2.9	-4.0			7.1	9.8	-0.8	-6.8	58.7	80.1
Czech R.	6.8	-4.7	9610	7730	5.3	6.7	-0.6	-5.8	28.7	37.6
Estonia	7.5	-14.3	6310	4840	4.7	11.3	2.5	-1.8	3.4	6.7
Latvia	9.6	-17.7	3030	2440	6.0	15.1	-0.3	-9.6	9.7	44.7
Lithuania	9.8	-14.8	4770	3520	4.3	16.2	-1.0	-9.5	17.3	30.0
Hungary	0.1	-6.8	7340	5930	7.4	9.8	-4.9	-4.5	66.0	81.3
Poland	6.8	1.6	3040	2560	9.6	9.9	-1.9	-7.3	45.2	54.9
Slovakia	10.5	-4.9	8950	7430	11.1	13.6	-1.9	-8.0	29.4	41.0
Slovenia	6.9	-8.0	11500	9230	4.9	7.9	-0.1	-6.0	24.1	38.8
Bulgaria	6.4	-5.5	1990	1530	6.9	12.1	1.1	-4.7	18.2	16.3
Romania	6.3	-6.6	1560	1350	6.4	7.3	-2.5	-8.5	13.0	31.0

Source: Eurostat (<http://epp.eurostat.ec.europa.eu>)

What can we say after twenty years of transition in CEE countries? Was it a success or was it a failure? Was a high speed of transition bound to the so-called Washington consensus a major error as suggested by Joseph Stiglitz (1999)? Can economic and social problems in CEE countries, created by the crisis, be linked to socialist heritage as often suggested by younger economists in CEE countries? The answers to the questions depend on the goal. If the major goal was the destruction of the old political regime and of socialism, the transition can be considered a success, if, however, the goal of the transition was the creation of general economic and social prosperity, the transition cannot be so clearly regarded a success story.

The problems in CEE countries have been to a great extent overshadowed by the problems of the EU periphery (Greece, Spain, Portugal) which represent a much more dangerous threat for the future of the EU than the problems in CEE countries. This can be to some extent explained by CEE countries being accustomed to the hardships and their reliance on »welfare family« economy. Furthermore, the CEE countries have not performed so badly; Poland is the only EU country which has not faced depression, GDP in Slovakia recovered quickly and surpassed its level before the crisis, while GDP in other countries in 2011 remained approximately 5 percent lower than it had been before the crisis. Some major social difficulties (unemployment, income disparities, etc.) worsened. It is premature to assert that the crisis will create opportunity for a break with the present, and the search for a new capitalism, or a return to the European social market economy. Institutional

changes in CEE depend on the future of the EU which is not promising. The EU economy cannot be kick-started by increasing the competitiveness on the global market, but by the increased demand which could only be generated by the governments. Unfortunately, this appears to be impossible having in mind hysteric affection for savings and reduction of the public sector. The recession in the EU might therefore persist; the extension of the crisis is but much more dangerous to the future of the EU than the depth of the crisis<sup>21</sup>. A lengthy recession could namely lead to a "Yugoslav" syndrome: i.e. to endless discussions of who is to be blamed, who is exploiting whom, and who should be rescued and who should not. It is not very likely that CEE countries would be winners in such a development.

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<sup>21</sup> *There seems to be four major pillars of the EU firmness: (1) stalemate caused by formation of distributional coalitions (Olson, 1982); (2) ability and readiness of the EU to ignore or to bend its own rules, when needed, (3) democratic deficit, and (4) ability to constantly create new institutions and corresponding bureaucracy. Can these four "fragile" pillars suffice to gradually create European identity and social cohesion which is necessary for a long lasting association? They might. However, dissolution of the EU, though seemingly unrealistic at present, cannot be completely ruled out if actual or imaginary benefits of dissolution become attractive (Matzner, 2000). Such a scenario could only become realistic after a rather long economic depression during which actual redistribution of income or perceived exploitation would be used by nationalists in a large member country.*

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## OD PADA SOCIJALIZMA DO KRIZE KAPITALIZMA: ISKUSTVA ZEMALJA SREDNJE I ISTOČNE EUROPE

### SAŽETAK

„Povratak kapitalizmu“ i „Povratak Europi“ slogani su koji su obilježili posljednje desetljeće 20. stoljeća u svim bivšim socijalističkim zemljama srednje i istočne Europe; oni si izražavali bezuvjetnu vjeru u mehanizme kapitalističkog tržišta i punopravno članstvo u Europskoj uniji, što se smatralo rješenjem svih sadašnjih i budućih ekonomskih i socio-političkih problema.

Tijekom tzv. zlatnog doba, zemlje srednje i istočne Europe značajno su nadmašile rast u „starim“ zemljama Europske unije te se brzo uskladile s prosječnom razinom razvoja EU-a. Međutim, rast nije bio temeljen na zapošljavanju i nije bio održiv; u velikoj mjeri temeljio se na stranoj štednji. Veliki deficiti na tekućim računima stoga su postali trajna značajka zemalja srednje i istočne Europe. Izvor deficita može se pronaći u nagloj liberalizaciji strane trgovine tijekom tranzicije dok se nastavak trenda deficita povezuje s inozemnim izravnim ulaganjima. Zemlje srednje i istočne Europe postupno su postale potpuno ovisne o »staroj« Europi. Lisabonska strategija pridonijela je propasti proizvodnog sektora; iako su se zemlje srednje i istočne Europe mogle lako nositi sa »starom Europom« nisu se mogle natjecati s nemilosrdnom društvima izvan Europe.

U društvenom smislu, zemlje srednje i istočne Europe mogu se podijeliti u dvije skupine; one koje su zadržale razumnu društvenu koheziju, te tri baltičke zemlje koje su otišle u drugu krajnost. I dok izdatak za socijalnu skrb u starim zemljama članicama prelazi 30% BDP-a, isti izdatak u sedam od 10 zemalja srednje i istočne Europe iznosi manje od 20% BDP-a. Prije tranzicije, u bivšim socijalističkim državama divili su se Europskoj uniji zbog njene demokracije i modela socijalnog tržišnog gospodarstva. U trenutku kada su se pridružile Europskoj uniji, mnoge značajke privlačnog europskog modela socijalnog tržišnog gospodarstva više nisu bile prisutne i EU nije pokazivala interes da taj model promovira u tranzicijskim zemljama. Praznina je popunjena neoliberalnim idejama, što se vidi po indikatorima ekonomske slobode.

Globalna financijska kriza, osobito smanjenje kreditiranja, značajno je pogodila zemlje srednje i istočne Europe s velikim potrebama vanjskog financiranja. Strane banke počele su povlačiti svoj kapital smanjenjem bilanci u podružnicama. Istovremeno, inozemna izravna financiranja pala su na četvrtinu u odnosu na razdoblje prije krize. Zemlje srednje i istočne Europe na taj način suočile su se s neto odljevom umjesto s nužno potrebnim priljevom kapitala.

**Ključne riječi:** zemlje srednje i istočne Europe, tranzicija, ekonomski rast, socijalna kohezija, ekonomska kriza.