The Origin of the Global Economic Crisis and Characteristics of the Economic Crisis in Central and Eastern Europe

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Introduction

The financial crisis in the US spread rapidly in the autumn of 2008 to the largest European countries, which caused a significant credit shrinking and a sharp economic downturn in those countries. The severe recession in the US and core European countries also resulted in a decline of exports from Japan and China to those countries. Japan experienced a huge decline in GDP and industrial production from the last quarter of 2008 to the first quarter of 2009. China's pace of growth also slowed to 9 percent in 2008, which was low compared to its previous years' double-digit growth. Both advanced and emerging economies faced a severe recession or a slow down in economic growth.

Although a shrinking of the world market hit the economies of Asia's emerging countries including China, India, Indonesia and Vietnam, their economic losses have been relatively small compared to the damage suffered in the emerging European economies, namely the Central and Eastern European countries (CEE).

This paper focuses on two issues. First, it examines the current global crisis and argues that the failure of finance-led capitalism (or finance-led growth regime) in the US brought about the current global crisis. Second, it examines the current crisis in the CEE and argues that the heavy dependency of the CEE economies on the old EU members in both export and banking sectors caused a serious economic crisis in

almost all of CEE countries. The crux of this paper will focus on the severe recession in the CEE.

Although the term "CEE"(Central and Eastern Europe) is usually used for the region including not only new EU member states (the three Baltic states, four Visegrad countries, Slovenia, Bulgaria and Romania) but also other former communist countries located in Europe such as several states separated from former-communist Yugoslavia and Albania, the label "Central and Eastern Europe" is limited to the new EU member states in this paper.

This paper was written in September 2009 for the presentation in a panel session entitled "Financial Crisis：Challenges and Responses", which was a section of Beijing Forum held at 5-7 November in the Beijing University. Therefore, this paper does not cover the situations of the global and the Central and Eastern European economy after September 2009.

1. Economic Crisis in the US：The Collapse of Finance-led Capitalism

What was the origin of the current global crisis? Possible answers to this question include *finance-led growth regime* (a term used in Regulation Theory, RT. see Boyer 2005. This paper uses "finance-led capitalism" instead of finance-led growth regime), *privatized Keynesianism* (Crouch 2008), *excess-production* (Traditional Marxian) and *shortage of effective demand* (Traditional Keynesian). In the view of this paper's author, RT and Crouch's recent views adequately explain the origin of the current global crisis.

What is *finance-led capitalism*? According to RT, it is the form of capitalism that existed in the USA since the 1990s, in which the financial sector of the economy or asset prices leads the real (material) economy (Yamada 2008). In RT terminology, this was the Anglo-Saxon type of capitalism in the post-fordist period. With respect to this type of capitalism, the starting point of economic growth is the price increase of financial assets (e.g. the share price increase in the 1990s and price increase of sub-prime loan-related securities in the 2000s) or a price increase of real assets (e.g.

the housing price increase in the 2000s). We can compare this finance-led capitalism with the fordist type of capitalism of the "golden age" (1945-1973. Hobsbawm 1994) in which the starting point of economic growth was wage increase indexed productivity. After this golden age, US capitalism had transformed from fordism into finance-led capitalism by the 1990s, passing through a transition period of the Regan and senior Bush administrations in the 1980s when they tried to break down traditional industrial relations by weakening trade unions and replacing Keynesian fiscal policy with monetarism.

Crouch (2008) divides the post-World War II capitalisms of the US and UK into two types. The first one is characterized as a regime of "original Keynesianism," which collapsed in the 1970s. The second is characterized as a regime of "privatized Keynesianism". According to Crouch, both US and UK capitalism shifted from a regime with counter-cyclical state policies to secure income and employment in times of recession (original Keynesianism) to a regime accompanied with the growth of private credit markets for poor and middle-income groups to compensate for stagnating salaries and job insecurity (privatized Keynesianism). Even if Crouch's view is not necessarily the same as that of RT, both are similar in that they consider that the financial sector had produced economic prosperity in the US (and UK) in the 1990s.

What brought about the US finance-led capitalism? At least, four factors should be considered：

①The collapse of the Bretton Woods regime in the beginning of 1970s

The abolishment of the obligation for the US to exchange the US dollars with gold resulted in a relative surplus US dollars and increased excessive-capital internationally, which originated from a continuation of the US current account deficit and financial globalization.

②A change in the industrial structure of the US since 1970s

A shift from manufacturing to service sectors occurred in the US earlier than in other advanced countries such as Japan and West Germany. The latter two countries had maintained a comparative advantage in exporting manufacturing goods by

1980s to the US. During this time, the US administrations tried to maintain a comparative advantage in the financial sector.

③Financial liberalization and globalization

Financial activities have increased through their liberalization since the 1970s. Financial liberalization was perpetuated by at least four measures in the US. First, regulation against capital transactions across borders was removed in 1976. The same measure (the liberalization of cross-border capital transaction) was adopted in other advanced countries during 1970s and 1980s. In addition, the emerging countries promoted financial globalization in the 1990s. Second, the regulation against decision-making of the deposit interest rate by commercial banks was removed in 1986 in the US. Third, the regulation against the location of the financial institution was removed by the middle of 1990s in the US. Fourth, the rule separating the activities of commercial banking from investment banking activities was removed in 1999, and it became possible for the commercial banks in the US to engage in activities of once allowed only in investment banking.

④Financial innovation

Financial innovation includes the securitization and development of futures markets and financial derivatives. The securitization of mortgage-debt began in the 1970s and securitization of bank-loans in general became possible from 1986 in the US. Financial innovation based on the development of financial engineering created the various types of futures markets and financial derivative instruments, such as sub-prime loan-related securities and CDS that prompted capital (US dollars) inflow from foreign countries into the US since the 1990s

How did finance-led capitalism bring about prosperity to the US in 1990s and a financial crisis in the 2000s ?

Except for a short period after the Asian currency crisis, in the US, share prices had constantly risen until the collapse of the dot-com bubble in 2000. Thanks to the increase in share prices, the US firms expanded their investment and US households expanded consumption. The ratio of household consumption to GDP had

continually increased and amounted to 70 percent by the beginning of the 2000s. As described above, US capitalism was finance-led capitalism in the sense that the rise of share price increased investment and consumption and induced GDP growth (Yamada 2008). It could be said that at least by the late 1990s an improvement of the real economy, including the "IT revolution"—an increase of investment and production in the IT sector and an increase in productivity in many sectors due to the use of IT instruments—contributed to the constant share price increase.

However, it was apparent that the increase of share price since the late 1990s was mostly attributed to a large increase in foreigner's investment into the US stock market, particularly to the IT firms' shares. But several years of enthusiasm in the stock market resulted in the burst of the dot-com bubble in 2000.

Then FRB lowered interest rates step by step to one percent by 2004. In this period, housing prices steadily increased due to a rising demand for housing by the middle and lower classes. The lower income groups could gain easier access to sub-prime loans at lower interest rates. The rise in housing prices stimulated consumption of other goods such as automobiles. This is what economists call an "asset effect" and what Crouch terms "privatized Kenynesianism"(Crouch 2008). The FRB feared a housing bubble was developing and turned its stance toward a more restrictive monetary policy (i.e. a rise in interest rate). However, the FRB did not cool down the over-heating housing boom.

On the one hand, the long-term interest rate did not rise because a large amount of excess-US dollars from Asia due to a current account surplus flowed into the US state bond market. On the other hand, the excess-US dollars from Europe were more invested into the US sub-prime loan- related securities (Tokunaga 2009). Subsequently, the US housing price began to fall after 2006, which meant the end of housing bubble. Then the price of sub-prime loan-related securities also began to fall. It brought about great losses for financial institutions, which owned the above securities, and led to bankruptcies in the financial sector. The bankruptcy of Leman Brothers, one of largest investment banks of the US, on 15 September 2008 was epoch-making after which it became common knowledge that a serious financial

crisis had hit. The US financial crisis deepened and exacerbated a serious recession in the US broder economy. The seriousness of the US recession is represented by the bankruptcy of GM and its subsequent nationalization. The US crisis spread rapidly around the world.

The US financial crisis signaled the end of finance-led capitalism. Crouch refers to the end of "privatized Keynesianism" and asks, "What Will Follow the Demise of Privatized Keynesianism"(Crouch 2008). The phrases from the newly elected US President Obama such as "from Wall Street to Main Street" and "Green New Deal" also seem to reveal the end of finance-led capitalism and a shift to a new type of capitalism in which not the financial sector but perhaps new ecological-related industries will lead the economy.

2. The Spread of the US Economic Crisis to the Advanced European Countries, Japan and China

Some European countries, including the UK, Ireland and Spain, experienced their own bubble and subsequent burst in the housing sectors and had already fell into recession prior to the "Leman shock". Furthermore, there were some tendencies towards an "Americanization" of financial systems in the advanced European countries since the 1990s, run parallel to deepening EU integration. In addition to the UK, the financial system in Germany and France had also shifted, more or less, from a deposit-base to market base system. The large banks and financial conglomerates of these countries had engaged in transactions of various securities, including the US sub-prime loan related securities. They also engaged in their own securitaization of mortgage-related loans (Hosino 2009). It was apparent that the financial crisis in the advanced European countries was brought about from the US. However, these countries also had issues that contributed to their financial crisis. It is important to remember that their banks had provided a large amount of credit to the CEE prior to their financial crises.

Due to counter party risk, the inter bank market in the advanced European

countries dried up and advanced European economies fell into a serious recession in the real economies. The parent banks of the old EU members decreased financial provisions to their affiliates located in the CEE countries that caused financial difficulties in that region(see below).

Financial liberalization and a shift from deposit-based to market-based finance has been under way since the 1980s in Japan as well. However, the manufacturing sector still leads the economy. Although the credit squeeze occurred in Japan since September of 2008, the main cause of Japan's serious recession originated from the shrinkage of the export market.

Likewise, the slow-down of China's economic growth since autumn 2008 resulted from a decline in exports, although thanks to a huge amount of fiscal spending for creating domestic demand, the country is likely to grow faster than 8 percent in 2009. In General, the Asia's emerging countries, including China, recorded better economic performance in the first half of 2009 which contributed to the moderate economic recovery of the developed countries in the third quarter (June-September) of 2009.

3. The Economic Crisis in the CEE

As previously described, one of the features of the current global crisis is that it hit Central and Eastern European post-communist countries more strongly than the other emerging countries in Asia and Central- South America. For some years prior to the financial crisis of the US and European core countries, almost all new EU member states had enjoyed a higher growth rate than the old EU members' average growth rate and underpinned the economic growth of the EU as a whole. The economic growth of the new EU member states had resulted from an increase of exports to the old EU member states. Yet, this growth had in part originated from the housing boom, which was promoted by foreign currency denominated loans mostly from affiliates of the old EU member states' banks.

However, the latter can not be applied to Slovenia. While domestic banks

dominated and household indebtedness was relatively small in Slovenia, in the rest of new EU member states, the affiliates of the old EU members' banks were in a dominant position and expanded foreign currency denominated loans to the household. The affiliates could finance loans from their parent banks, which had been sought at "new frontier" due to strong competition in the financial sector in the old EU member's market.

A few years before 2008, some international organizations and experts had expressed a concern of "housing bubble and burst" in the CEE region (e.g. Enoch and Ökter-Robe 2007 ; Barisitz 2008). This fear had turned into reality in Latvia prior to the bankruptcy of Leman Brothers in September 2008. After the country enjoyed a high average annual growth rate of 7.6 percent from 2001 to 2005, housing prices had fallen 24 percent from mid-2007 to mid-2008.

The financial crisis in the US and the old EU member states quickly led to a currency crisis in several CEE countries where currencies were less pegged with the euro. Due to the rapid credit squeeze in the old EU member states, foreign investors, including the old EU members' financial institutions, sold shares and governmental bonds of the CEE countries and decreased their lending to them. As a result, currency crises occurred in the new EU member states such as Hungary, Poland and the Czech Republic. In addition to a weakened currency, their stock markets also fell sharply. Slovenia, a member of the EMU (euro zone), and the countries whose currencies had been pegged strongly with the euro (the Baltic states and Bulgaria) did not face to a currency crisis, but their stock markets also fell sharply.

As described above, the affiliates of the banks of EU members such as Austria, Italy, Belgium, Germany and Sweden had played a dominant role in the banking sector in almost all CEE countries, except Slovenia. The affiliates had provided households with foreign currency denominated loans. Because capital from their parent banks to affiliates decreased due to credit shrinkage in the old EU members markets, the CEE countries faced financial difficulties. The Slovenian domestic banks also could not escape the consequences of international financial turmoil.

The financial difficulties led to an economic crisis in the CEE. In Latvia in where

housing boom led to high economic growth and then a sharp decline in housing prices, household consumption rapidly declined along with the overall GDP. This drop in GDP was the largest among the new EU member states in the first quarter of 2009(−18.6 percent compared to the first quarter of 2008. see Table 1). In three Central European countries, namely Poland, the Czech Republic and Hungary where their currencies were severely weakened against the major currencies, the rise of household indebtedness calculated in the domestic currency became one of the factors discouraging household consumption, as housing loans were denominated by foreign currencies such as the Swiss franc and euro in these countries.

Although the impact of the financial crises in the US and the old EU members on Slovenia was small since domestic banks dominated the financial system relative to the other CEE countries, the shrinkage of its export market hit the real economy of the country after autumn 2008. In this respect, all CEE countries faced a similar serious situation. However, the scale of damage from a shrinking export market differed across these countries. That difference stemmed from the export dependency ratio to GDP, the economic situation of main trading partner, and the potential domestic demand of the respective countries in the region.

The share of exports to the old EU member states (EU-15) had amounted to around 70 percent of total exports of the new EU members (EU-10) by 2004. The largest trade partner for the Visegrad countries (Poland, the Czech Republic, Slovakia and Hungary) was Germany in 2008 ; Italy was the largest importer for Romania ; Austria was an important trade partner for Hungary, Slovakia and Slovenia ; Greece and France were important trade partners for the South Eastern European countries (Bulgaria and Romania). The Baltic states still maintained trade relations with Russia, and Russia is the largest trade partner for Lithuania. However, Germany is also the second largest importer for the country and Germany is second largest importer for Latvia, where Estonia is first. Finally Finland, Sweden and Germany are the three largest trade partners for Estonia. For almost all countries in the CEE, Germany is a significant trade partner. Therefore, it could be said that the steep recession in Germany deteriorated the CEE economies since the third quarter

of 2008. Then the moderate economic recovery of Germany in the third quarter of 2009 (July to September) contributed to the economic improvement of some CEE countries such as the Czech Republic and Slovakia(see Table 1).

The indicator of export dependency measured by the ratio of exports to GDP is very high in Slovakia (86 percent in 2007, OECD 2009), Hungary (78 percent in

Table 1

Growth rates of GDP in CEE,EA16 and EU27

(Volume. Based on seasonally adjusted data)

	Percentage change compared with the previous quarter				Percentage change compared with the same quarter of the previous year			
	2008	2009			2008	2009		
CEE (EU member states)	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Bulgaria	-	-	-	-	3.5	−3.5	−4.9	−5.8
Czech Republic	−0.8	−4.5	0.3	0.8	0.4	−4.3	−4.7	−4.1
Estonia	−4.5	−6.0	−3.4	−2.8	−9.2	−15.0	−16.1	−15.3
Latvia	−4.7	−11.0	−0.8	-	−10.7	−18.6	−17.4	-
Lithuania	−1.2	−11.3	−7.7	6.0	−1.5	−13.1	−19.7	−14.3
Hungary	−1.9	−2.6	−2.0	−1.8	−2.2	−5.6	−7.2	−8.0
Poland	−0.1	0.1	0.7	-	2.8	1.3	1.1	-
Romania	−2.8	−4.6	−1.1	−0.7	2.9	−6.2	−8.7	−7.1
Slovenia	−4.1	−6.4	0.7	-	−0.9	−8.9	−9.0	-
Slovakia	1.2	−8.6	1.1	1.6	1.6	−5.7	−5.5	−4.9
EA16	−1.6	−2.5	−0.2	0.4	−1.8	−4.9	−4.8	−4.8
EU27	−1.9	−2.4	−0.3	0.2	−1.7	−4.8	−4.9	−4.3

(source) Eurostat(2009), *news release euro indicators* 173/2009, 3 December.
http://ec.europa.eu/eurostat (Access date：10 December 2009)

2006, OECD 2007) and the Czech Republic (76 percent in 2006, OECD 2008a). In Poland, it is smaller (41 percent in 2007, OECD 2008b) than the above three countries due to its larger size of domestic demand, primarily due to its large number of population (38 million in 2007). In addition to a relatively lower export dependency, the improvement of the agriculture sector after accession to the EU is the another reason why the impact of the global economic recession on Poland has been modest compared to the other three Visegrad countries. While the GDP of the first quarter (Q1) in 2009 compared to Q1 in 2008 was lower by 5.7 percent in Slovakia, 5.6 percent lower in Hungary, and 4.3 percent lower in the Czech Republic, the Polish GDP of Q1 in 2009 was higher by 1.3 percent compared with Q1 of 2008 (see Table 1).

The Export dependency of Baltic states is lower than that found of the Czech Republic, Slovakia and Hungary and also higher than that of Poland. Export dependency is highest in Estonia (70 percent) among Baltic states. It could be said that both decline of the exports and domestic consumption have resulted in the sharp economic decline in the Baltic states. The GDP in Q1 of 2009 compared to that in Q1 of 2008 was lower by 18.6 percent in Latvia, by 15 percent in Estonia, and by 13 percent in Lithuania. As described above, the damage from the financial crisis in the advanced European countries was smaller in Slovenia. Bulgaria did not face a currency crisis due to its implementation of a currency board system. However, their real economies have been damaged from severe recession of the old EU members. The Romanian real economy was also hit hard (see Table 1).

4. Emerged Varieties of Capitalism and Challenges for Economic Recovery and Sustainable Growth in the CEE

As previously outlined, all CEE economies were hit by the global economic crisis. So, how can the CEE countries get past the economic crises and implement sustainable development in the future? Even if recovery in the CEE economies will be impossible without a strong recovery in the European core economies, these

countries also have their own challenges to improve their economies. Some challenges are common to all the countries, but others differ among the CEE countries. Those differences are related to the varieties of emerged capitalism in the CEE.

Political democratization and economic transformation from communism to capitalism were common challenges for all former communist countries in the CEE. For former Czech- Slovakia and Yugoslavia, the establishment of nation states was also important. Also, in the Baltic States, the priority of transformation has been placed on maintaining independence from Russia. Further, it should be noted that CEE countries had to face the issue of integrating into the former Western economy, especially into the EU. Accordingly, some researchers characterize the transformation in the CEE as the "quadruple transition"(e.g. Orenstein et al.2008).

Every CEE country has attempted to carry out common economic agendas such as the liberalization of foreign trade and capital transactions, privatization of state-owned firms, shifting trade partners away from the former the COMECON to the EU-15 (old members) and the accession into the EU. The CEE countries have succeeded in implementing those economic agendas. However, varieties of capitalism have emerged among the CEE countries. Bohle and Greskovits (2007a；2007b) classified them into a pure neo-liberal type of capitalism, embedded neo-liberal type of capitalism and neo-corporatist type of capitalism. And this diversity has resulted mainly from historical legacies and governmental priorities among the challenges described above. Furthermore, the difference of configuration into the EU economy has also created the above diversity. The varieties of capitalism and the challenges of the CEE are examined below, mainly on the basis of the works of Bohle, Greskovits and Berend.

①The Baltic states, Bulgaria and Romania

Bohle and Greskovits(2007a；2007b) classify the Baltic states (Lithuania, Latvia and Estonia) as a pure neo-liberal type of capitalism. The Baltic states intentionally adopted neo-liberal policies recommended by the IMF and World Bank in order to

establish a type of capitalism far removed from communism and their policy priorities were placed on a discontinuity with the age of Soviet Union to maintain independency of their new states as described above. They also placed a high priority to a restrictive fiscal policy in order to maintain the strength of their own new currencies as a symbol of independency. As a result, social expenditure has remained at the lowest level among the CEE countries (see Figure 1). The governments of the Baltic countries, especially those of Latvia and Estonia, adopted identity politics, namely policies, which excluded Russian speakers as a minority in order to prevent social unrest resulted from the majorities' (Latvian and Estonian speakers) dissatisfaction with a low living standard.

Although Baltic republics in the age of Soviet Union had supplied relatively complex (techniques-intensive) manufacturing goods to the Russian Republic and other former republics of Soviet Union, the new Baltic states lagged behind the Visegrad countries in FDI inflow and in the upgrading of the manufacturing sector (Bohle and Greskovits 2009). In Baltic states, the leading export goods from manufacturing sector are still composed of products in the light-basic sector such as wood, simple wood products, textiles and clothes as well as heavy-basic products such as oil-chemical and steel, although the share of products of the light-complex sector such as telecommunication to total export has increased in Estonia. Greskovits characterizes the export structure of Baltic states as that of "semi-periphery" countries (Greskovits 2008).

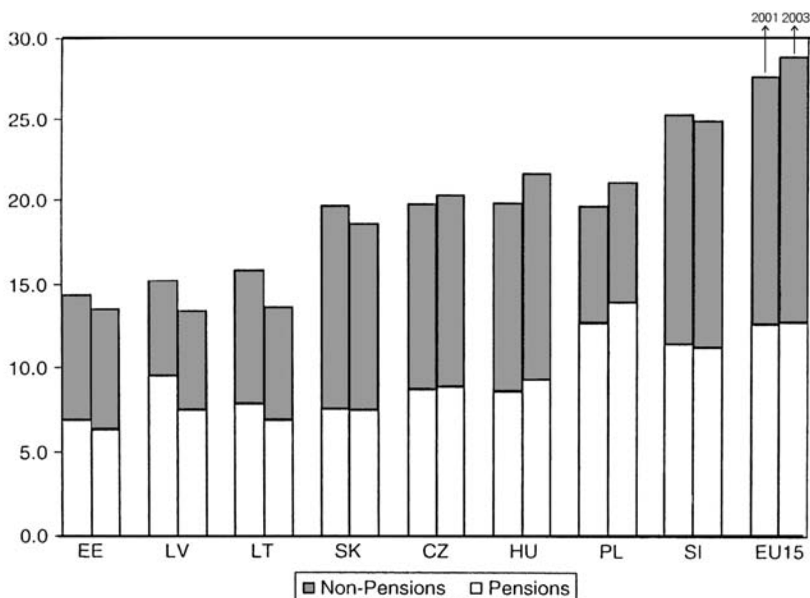
Bohle and Greskovits(2007a : 2007b) do not define Bulgaria and Romania as a pure neo-liberal type of capitalism. Yet, both countries are similar to Baltic states in the respect that the levels of social expenditure are low compared to Visegrrad countries and Slovenia. Furthermore, both countries have also lagged behind the Visegrad countries and Slovenia in up-grading the manufacturing sector(Bohle and Greskovits 2009). Recently, the FDI inflow from European core countries into the Bulgarian and Romanian manufacturing sector has tended to increase because labor costs of the Visegrad countries have risen. However, exports of heavy-basic products such as steel and non-ferrous metallurgy still accounted for 42 percent of total

exports in Bulgaria in 2003, while exports of light-basic products such as garments and textiles accounted for 46 percent in Romania in the same year. Such an export structure is also similar that of other "semi-periphery" countries (Greskovits 2008).

On the other hand, by 2005 the share of majority foreign-owned banks in total banking assets had amounted to more than 50 percent in the above countries (for instance, 58〜59 percent in Latvia and Romania and 92 percent in Lithuania. Sugiura 2008). Although the economies of these countries grew at a quick pace in the 2000s, it was growth in which the housing boom and an increase of household consumption by foreign currency denominated loans played a major role(Bohle and Greskovits 2009). This was the growth regime that Crouch named "privatized Keynesiianism"(Crouch 2008). In the above "semi-periphery" countries, it was not

Figure 1.

Ratio of expenditure for social protection to GDP (2001 and 2003)



(Source) World Bank (2007), p.14.

government but individuals that took on debt for growth. This "privatized Keynesianism" (or "housing Keynesianism". see Bohle and Greskovits 2009) increased the current account deficit, especially in the Baltic states. After the sharp credit crunch occurred in the European core countries, Latvia had to request and received standby loans from IMF in order to make up a shortage of foreign currency reserves. As a result, Latvia has been forced to adopt a restrictive fiscal policy, which has further deteriorated the overall situation and living conditions..

In the long run, the most important challenge facing the above countries must be the upgrading of the real economic structure because the internal root of the current crisis rested in "semi-periphery" types of industrial structures in those countries.

②Visegrad countries

According to Bohle and Greskovits (2007a ; 2007b), the Visegrad countries (Poland, Hungary, the Czech Republic and Slovakia) are classified as an embedded neo-liberal type of capitalism. Although economic policies have been influenced by neo-liberal ideas in these countries, they have maintained a higher share of social spending to GDP (around 20 percent in 2003) than Baltic states (around 15 percent in 2003. see Figure 1). They also combined policies towards a promotion of FDI inflow with measures geared to protection of the TNCs that entered into their countries. Bohle offers some examples in which TNCs entered into Poland and Hungary enjoyed import protection and tax holidays (Bohle 2009). It could be said that a neo-liberal type of capitalism was "embedded" in society, to some extent, by the dual measures of social inclusion and of economic protectionism for the TNCs.

The author of this paper agrees with Bohle and Greskovits with some reservations. First, neo-liberalism has been socially less embedded in Poland than other Visegrad countries, which can be seen by the higher poverty rate in Poland than that of the other Visegrad countries. Second, Slovakia has turned towards a more neo-liberal policy line since the end of 1990s (Fisher et al. 2007). One example is the introduction of a flat income tax regime. It had already been adopted in the Baltic states. Needless to say, this regime weakens the role for the tax system

to redistribute wealth from the rich to the poor. Accordingly, one should take the Czech Republic and Hungary to be typical examples of “embedded” neo-liberal type of capitalism.

In the Hungary, an increase of social expenditure was one of the causes of the current crisis, although it was an indirect cause. The socialist-led government increased the wages of public servants and provided additional pensions for the elderly in the period from 2002 to 2006 in order to distribute the fruits of growth, which continued from mid-1990s. Yet, it turned out to be over spending as the ratio of the budget deficit reached to almost 10 percent of GDP at the peak in 2006 (Farkas 2009). Therefore, the Hungarian government shifted to a restrictive fiscal policy for several months after the general election in 2006 according to EU recommendations. However, by the mid-2000s housing and consumption boom, especially demand for automobiles had over-heated, which deteriorated the current account. Hungary had faced the problem of twin deficit prior to the Leman Shock in September 2008. After the currency crisis hit and the financial market turmoil occurred in October 2008, the Hungarian government requested standby loans to IMF for financing, above all, for the government debt service. Hungary received loans amounting to a combined 20 billion euros from the IMF, World Bank and EU. However, its cost was great because the Hungarian government has been forced to take restrictive measures such as an increase of the VAT and wage cuts of public servants during the recession. It could be said that the current Hungarian economic crisis was an outcome of both “original Keynesianism” and “privatized Keynesia-nism”.

As for integration into global economy and industrial restructuring, the Visegrad countries have gone far ahead of the Baltic countries and South-Eastern countries (Romania and Bulgaria). The Visegrad countries already had prior experiences of economic reform in the communist era. Accordingly, these countries (and Slovenia as well) have established infrastructures for a well-functioning market economy earlier than other post-communist countries. This was an important reason why the Visegrad countries have attracted the most FDI inflow and have carried out the FDI-

led industrial restructuring. In fact, Poland, Hungary and the Czech Republic attracted the amount of FDI equivalent to 56 percent of total FDI inflow into the former Soviet bloc from 1989 to 2004 (Berend 2009).

Although Poland received the most amount of FDI from abroad, the Czech and Hungary were top-runners in terms of cumulative FDI inflows per capita in the period 1989 to 2004. The cumulative FDI per capita of Poland in the period (1,471 US dollars) amounted to only about one-third to that of the Czech republic (4,045 US dollars.) The corresponding amount of Hungary was 3,719 dollars and that of Slovakia was 2,094 dollars (Berend 2009). This cumulative FDI has contributed to industrial upgrading in the Visegrad countries. The leading export products are those of the heavy-complex sector, typically automobiles in the Czech Republic and Slovakia and those of the light-complex sector such electrical and electronics in Hungary. In Poland, the ratio of heavy-basic sector's products to total exports is still high (32 percent in 2003), although the export share of heavy-complex products (mainly, automobiles) to total export has increased (31 percent in 2003). On the whole, the Viesegrad export structure can be similar to that of the "semi-core" countries (Greskovits 2008). Capital inflow into the banking sector had steadily increased, and by 2005 the share of the majority foreign owned banks to total banking assets amounted to over 74 percent in the Visegrad countries (74 percent in Poland, 83 percent in Hungary, 84 percent in the Czech Republic and 97 percent in Slovakia. Sugiura 2008). Majority foreign banks have been market seeking and thereby fueled the housing boom and promoted household consumption by providing loans. On the other hand, SMEs lending has not taken off in the Visegrad countries, except in Hungary, where the OTP transformed from the previous state-owned national saving bank has inherited the domestic network from the communist era (Barisitz 2008).

There are several problems related to industrial upgrading in the Visegrad countries. First, the spin-off effect from FDI has been limited and economic growth has not been linked to domestic R&D and a technology effect (Dyker 2004). Berend points out that the role of domestic firms as suppliers to the TNC located have been

small in the Visegrad countries. Only 40 percent of total supplies is produced by domestic suppliers in Poland. This share is 45 percent in Hungary (Berend 2009). Second, expenditure on R&D has declined from 2.5 percent of GDP to 1.6 percent of GDP in the Central and European countries (in this case, the CEE is not limited to the EU new members). Third, SMEs have not developed in the Visegrad countries that can be partly attributed to insufficient support by the financial system as previously described. While, in the EU as a whole, SMEs employing up to 100 workers, employ about 50 percent of total employment, in the best cases of Visegrad countries such as Poland, Hungary and Slovenia, only 20 percent of the employed work in SMEs (Berend 2009). High tech has often been produced by SMEs, which have also provided employment in the US, European core countries and Japan. Development of SMEs is necessary for Visegrad countries to move towards a more balanced growth pattern, balancing export and domestic demand. As Berend argues, Visegrad countries have completed the first chapter of transformation in which adjustment to the market economy and integration into European production networks were the most important goal. However, the economies of the Visegrad countries are too dependent on foreign capital as King point out (King 2008), while the domestic base of growth is too weak. Accordingly, the second chapter of transformation in the Visegrad countries must include the enhancement of the domestic base both in manufacturing and the financial sectors, which will bring about sustainable development in the region (Berend 2009).

③Slovenia

Bohle and Greskovits (2007a, ; 2007b) classify only Slovenia among the CEE countries into a neo-corporatist type of capitalism. Buchen (2007) characterizes the Slovenian economic system as an antipode of those of the Baltic states. Indeed, based on the heritage of self-management socialism, this country has created labor-management relations similar to the German type of negotiation system at the industry level and co-determinant system at the firm level for the period of transformation from communism to capitalism. Among new EU member states, the scale

of Slovenian social expenditure is highest (around 25 percent to GDP in 2003, World Bank 2007) and closest to the average of the old EU member states (near 30 percent in 2003. see Figure 1).

Already before collapse of communism in 1989, the Slovenian economy was opened to the Western European countries, which were important trade partners for the country. Although FDI inflows from European-core countries have been relatively slow in Slovenia compared to the Czech Republic, Hungary and Slovakia, the amount of cumulative FDI inflows per capita in the period from 1989 to 2004 in Slovenia (1,507 US dollars) is greater than that of Poland (As described above, 1,471 US dollars). The indicator of export dependency (ratio of export amount to GDP) of Slovenia (60 percent in 2004) is lower than those of the Czech Republic, Slovakia and Hungary, but higher than that of Poland. The Slovenian leading export products are those in heavy-complex and heavy-light sectors such as automobiles and pharmaceutical products ; therefore, the export structure of Slovenia is also classified into that of "semi-core" countries (Greskovits 2008).

Although Slovenia maintained an open economic policy, the country relied heavily on domestic forces, including labor, in transforming economy and kept its important sectors in national hands (Bohle 2009). The ratio of the amount of majority foreign banks'assets to total amount of assets of banking sector is much lower in Slovenia (23 percent in 2005. see Sugiura 2008) than found in any other CEE countries. And this was the reason that the impact of the financial crisis in the European core countries on the Slovenian financial sector was smaller than that of other CEE countries. However, the Slovenian economy has deteriorated mainly due to the shrinkage of its export market, namely the old EU members' market during the severe recession. Slovenia, as most wealthy countries in the CEE, could fortunately adopt Keynesian expansion policy similar to other advanced countries.

The Economic development and transformation in Slovenia were less dependent on foreign capital. The long-run task for Slovenia will be to catch up with European-core economies since its GDP per capita was still about 70 percent of old EU-15 member average when it became an EU member in 2004.

Conclusion

At least, three conclusions can be drawn from above description.

First, the origin of the global crisis from autumn 2008 was a special type of capitalism, namely finance-led capitalism, which was founded in the US that brought about prosperity in the country in the 1990s. However, the base of prosperity was fragile in the sense that much of the US economic growth was the result of inflows of excessive-liquidity and a rise of financial return less connected with the development of the US real economy, even if it was true that the "IT Revolution" (or "New Economy") strengthened the US real economy as well. This is why US President Obama emphasizes such phrases as "Green New Deal" and "from Wall Street to Main Street".

Second, the European core countries were also responsible with respect to the current global crisis, even if its origin was primarily in the US. Paralleled with a deepening integration and enlargement of EU, the large European banks and financial conglomerates have committed to securitaization and also over-lending in the EU area including the new member states. As a result, the European-core countries fell into severe recession after the US and European financial crisis occurred.

Third, the financial turmoil and economic crisis in the CEE can be mostly attributed to crises of the European-core countries. However, internal reasons also played a role in the economic crisis of the CEE countries. Although these countries have succeeded in transforming from communism to capitalism, their pattern of transformation and development has been dependent on foreign capital, especially capital of the European core countries, except Slovenia. This is not to say that all countries in the CEE made serious mistakes during the transformation period. It was necessary to integrate their economies into the larger EU economy and broader global economy. However, in almost all countries in the CEE, the efforts at enhancing domestic economic structures and raising productive domestic demand such as investment for SMEs have been weak. This is one reason why the CEE

economic recovery is slower than China and India, which have created their own domestic brands, maintaining an open market policy to foreign capital. The CEE countries are now entering the second chapter of transformation in which economic development will be linked more closely with enhancing domestic firms.

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