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The State and the Transitions in Eastern Europe

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Abstract: This paper is meant to serve as a starting point for a discussion on the transformations taking place in eastern Europe since 1989. Its admittedly liberal bias will be evident in its discussion of the role of the state in these economic transitions. It will conclude with a brief discussion of how the post-1989 transition period differs from other years of great change in twentieth century eastern Europe, and what this transition process tell us about the type of capitalism unfolding in eastern Europe.

Four general positions serve the guiding philosophy of this essay. a) In economic terms, the transformation from state owned command to privately owned market economies should be cautiously judged a relative success. b) Those countries which swallowed their bad tasting medicine early and in large doses have been more successful than those which have attempted to implement a softer, more gradual approach. c) In those countries where the state's direct involvement in the economy has been limited, there is, on the whole, stronger and more potentially enduring economic development. d) Those countries which have avoided collective violence have been much more successful than those who have experienced internal or external conflict.

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The Role of the State

The view presented here is that while efficient, predictable and attentive central and local governments are certainly positive factors, their role in the post-communist transformation process is sometimes overrated. The critical task for the states was to quickly create policies and mechanisms conducive to privatisation, liberalisation of

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prices and the construction of a legal and financial infrastructure appropriate for the establishment of a restructured market economy. This task is seen as economically beneficial in the long run, and is politically advantageous in that there is a window of opportunity during which time the populace will accept the deprivations associated with radical change.

The role of the state in relation to economic growth and development is a complex issue. In the short term there is no direct link between the degree of state involvement and economic growth in the countries of eastern Europe.[1] There were many established conditions in 1989 which had a powerful impact in determining the intrusiveness of the state, the speed and depth of the changes which were implemented,[2] and the level of economic growth in the 1990s. For example, the immediate post-1989 governments of some countries in the region were forced to place priority on controlling high levels of inflation and foreign debt. Some states already had a number of market mechanisms in place (Hungary, for example), others were relatively wealthy (Slovenia or the Czech Republic), while others had to pay close attention to the potential ethnic conflict (Estonia, Latvia, Romania, and of course those in the former Yugoslavia). The existing economic structure was also an important variable. Economies dominated by a few large non-consumer industries selling most of their production to Soviet Bloc countries whose markets were now severely constricted (Slovakia, Romania and Bulgaria) were in a disadvantageous position relative to Hungary which had a sizeable number of smaller, more nimble, consumer oriented companies.

The populace's view of the previous communist regimes also had an impact. The acute material and psychological hardships suffered by Romanians under the dictatorial rule of Nicolai Caeucescu may have caused the short-term austerity associated with a radical approach to establishing a market economy to be politically unacceptable. Conversely, other countries which hold a less negative view of their communist period may also be reluctant to decisively remove the state from the economic affairs of the country. This is a factor in Slovakia's clumsy advance toward a market economy.[3]

However, given the unfortunate experiences of the countries of the former Yugoslavia (except Slovenia), as well as Georgia, Armenia, Azerbaijian and Tajikistan in the former Soviet Union, one would have to note that the above mentioned factors concerning the degree of state involvement in the economy are reduced to relative insignificance when there is an outbreak of nationalistically inspired collective violence. The need to place one's security above the choice of paths to economic development is understandable. This has been the experience of Croatia before 1996, and remains a factor in Yugoslavia, Bosnia-Herczegovina and Albania.

Hence the selection of the most appropriate set of policies is the result of a wide variety of economic, cultural and political factors. Furthermore, the prevailing international relations set limits to the options afforded to the political leaders of countries in transition. This would include the conditions established by international funding agencies like the International Monetary Fund (IMF) or the Bank of European Reconstruction and Development (ERBD), as well as the desire to join NATO or the European Union.

Given the existence of these many diverse variables, one should avoid extolling the virtues of any one model which could then be applied to all the countries of the region. However, the data on macro-economic growth in the 1990s suggests that those nations which moved rapidly to implement price liberalisation, private ownership and restructuring, and the financial, legal, etc. institutions of a market economy have been rewarded.[4] The countries which best serve to illustrate this point are Estonia and Poland, and Hungary after 1994. The Czech Republic also started out on a fast track, but its sharp slowdown in economic growth in 1997 demonstrates the need for the complete and continual implementation of policies which reduce the role of the state and open the economy to a variety of effectively functioning market mechanisms. It is held that there is a causal connection between the policies of states which made a swift and fundamental transformation, and economic success. The countries which acted more decisively and quickly out performed other countries in the region, most notably Bulgaria and Romania, which did not commit to fundamental change in 1996 or 1997.

The experience of the Czech Republic shows that economic results are not straight forward over time, and that contrary to Mr. Klaus' ill-advised statement in 1995 that the Czech Republic had been transformed,[5] the process is long term and must be comprehensive. The populace of eastern Europe and their leadership had unrealistically high expectations in 1989 which could not be realised; transformation is difficult and painful and requires a long term commitment, not just a quick start. The Czech Republic was correct to open its economy, liberalise prices and quickly privatise. However, it also needed to establish transparency in its equities market and a workable structure for corporate governance which would have allowed for restructuring of its sizeable industrial base.[6] The good news is that in the June 1998 elections the Czech people rejected extreme 'solutions' and are providing the leadership with an opportunity to complete the transition process. This, like the recently formed market-oriented governments of Bulgaria and Romania, are positive developments leading to growth based on solid fundamentals.[7]

Romania's late commitment (1997) to a more rapid transition was costly. While its economy grew 7.1 per cent in 1995, in 1997 it shrank by 6.6 per cent. This pattern of harmful delay is even more acute in Bulgaria which avoided declines in 1994 and 1995, but experienced serious drops in 1996 and 1997. However, Slovakia, whose transition has also been marked by delays in fundamental changes and a dominant role for the state, has experienced strong GDP growth since 1994. Slovakia's political leaders have closely orchestrated the privatisation process, set wage and price controls, and resisted a genuine opening of the economy. Selling firms to 'cronies' connected with the leadership has resulted in a weak effort at restructuring and productivity has not been substantially increased. Inflation has been contained only by maintaining very high interest rates and ample short term borrowing.[8] The events of the spring and summer of 1998 in Russia, cause one to be seriously concerned about the problems connected with this formula. It is should be noted that Slovakia's macro-economic performance is dominated by a few large enterprises and that short-term results can be misleading. (The East Slovak Steel Company and Slovnaft, the huge refinery and plastics company, together comprise about one-quarter of Slovakia's exports and GDP.)

Since the post-communist transformation is revolutionary and has yet to stand the test of time, it is extremely hard to put in perspective. It is not difficult to find books or articles written in first half of the decade by thoughtful people who were doubtful about the possibility of a successful transition.[9] The early years of the transition produced some dramatically declining numbers for industrial production and GDPs, with exceedingly sharp drops of about 40 per cent being the norm. For example, one of Europe's fastest growing economies for the last four years, Poland, faced very steep industrial and GDP declines in 1990, 1991 and 1992.[10] A publication resulting from a conference held in 1993 stated that, 'in less than two years the enthusiasm and optimism for the transition ... turned into disappointment and distrust. What went wrong?'[11] The proper response to this rhetorical question is that far too much was expected and that given the revolutionary nature of the transition, surprising little has gone wrong, at least in terms of economic development. On the admittedly rarefied and antiseptic level of macroeconomics, the transformations have experienced a promising start. While there was extreme deprivation in eastern Europe between 1989 and 1993 which caused a great deal of individual pain and suffering, it cannot be overlooked that eastern European economies (excluding Commonwealth of Independent States - CIS countries) have grown roughly between 3.0 per cent and 5.5 per cent in each of the four years since 1994.[12] While these results are not 'tiger-like', there are higher for the Visegrad countries, much better that those posted in the last decade of the old system, and by themselves they are significant increases.

A corollary of this generally positive assessment is that the moderate success experienced in eastern Europe has provided the rationale for the transition process to be kept on track even with the election of left of centre parties which some feared would halt or slow down the transformation. In fact, in Hungary the left was the catalyst for genuine market reforms in 1994. One might add that the transition seems to have more to fear from populist peasant-based parties than from the social democratic left. With the plurality obtained by the Social Democrats in the Czech Republic in June 1998, all the countries of the region have been led by parties on either side of the centre, yet all have shown themselves to be pragmatists, and the transition moves forward, not in a straight line and with understandable uncertainty, yet forward nonetheless.

There also is a need to reduce the fear of social disruptions caused by the austerity associated with the transition. Even Poland with its powerful trade unions has not experienced disruptions any greater than those witnessed in western Europe. Perhaps there will be major disruptions in the future too, but the derailment of the transformation is more apt to be the result of nationalistic antagonisms rather than the frustrations created by the growing gap between rich and poor, however regrettable and potentially dangerous this gap may be.

Nonetheless, this approach to the developments in region runs the risk of being callously glib. The transition has been 'joyless' for much of the population, and only a minority (albeit by 1998 a substantial minority in Poland) have as yet benefited. There is little doubt that many people in eastern Europe are frustrated by their lack of job security, high prices, and inflation which has been extremely difficult for pensioners. Yet they have not taken to the streets in protest in large numbers. Widening income gaps, poor health conditions, and a host of other justified complaints require the close attention of the governments in the region. While there is good reason to question the wisdom of an unassertive state in the area of education, health and other social policies,[13] solutions are not to be found in the previous system's unsuccessful reliance on state control. For example, solving such problems as funding existing and future pensions will require a combination of new public and private initiative. Furthermore, a comparison of Hungary with Poland or the Czech Republic in the early 1990s shows that there is not a clear causal link between countries which moved rapidly to establish a capitalist economy and sharply reduce the role played by the state in the transition process (Poland and the Czech Republic), and the increased severity of the deprivations experienced by the populace.

Of all the countries of eastern Europe, in 1989 Hungary was most advantageously poised to take advantage of the transition. Since 1968 it had been 'tinkering' with its socialist command economy by introducing limited market mechanisms. However the conservative leadership of the Hungarian Democratic Forum, between 1990-1994, decided not to implement radical and deep reforms, hoping to spare its citizens the pain associated with a more radical approach. Poland and the Czech Republic were, along with Estonia, quicker to implement radical reforms. These three countries also grew two to three times faster than Hungary in 1994, 1995 and 1996, and Poland and Estonia continued to outpace Hungary's growth in 1997. It is true that before 1994 Hungary's consumer price index rose less sharply than Poland's, but its increase was still higher than the Czech Republic's.[14] It is also true that Hungary did not experience the steep GDP declines of Poland in the 1990-1994 period, 20 per cent as opposed to almost 50 per cent. Furthermore, real wages did not fall nearly as much as in Poland and Czechoslovakia in the early 1990s. However, real wages in Hungary were weaker in 1993-1994, and in 1995 decreased by 10 to 12 per cent.[15] In 1995 Hungary was forced to institute austerity programmes, which had been implemented earlier in the other countries, and begin reduction of its 1994 budget deficit of $3.9 billion (7 per cent of GDP).[16]

Hungary's failure to implement significant changes in its policies of providing large state subsidises resulted in a gross domestic public debt, which was 4 per cent relative to GDP in 1990, to balloon to about 25 per cent in 1993.[17] In 1995 expenditures on social welfare programmes, especially health and pensions, were almost 30 per cent of GDP, surpassed in Europe only by Sweden, a much wealthier country.[18] Hungary's serious macro-economic imbalances were analysed by several of the country's economic think tanks.[19]

Poland took a different path when it instituted the radical Balcerowizc Plan in January 1990. It freed prices, limited the growth of wages, tightened credit, and many firms were declared bankrupt and not subsidised by the state. In many cases these firms were purchased by its workers and management. Predictably prices skyrocketed, jobs were lost and unemployment shot up to 17 per cent.[20] Yet by 1998, Poland, with its open economy, growing foreign investment, expanding middle class, and impressive growth since 1993 fuelled by strong exports and domestic consumption, had replaced the Czech Republic as the 'poster boy' model of a successful transition.

The Czech Republic initiated its radical transition policies in January 1991. privatisation occurred via the voucher system, as opposed to Poland's privatisation through liquidation. However, while the then Czechoslovak government moved rapidly in many areas, the state played a more active role, including indirect control of privatised firms. State owned banks were also the owners of numerous large investment firms which had secured about 72 per cent of the outstanding vouchers originally purchased by individuals. These vouchers were then converted into shares of specific firms listed on the Prague stock exchange. The state also provided a safety net using wage controls, subsidies for rent, utilities, transportation, etc.[21] It also maintained fixed exchange rates for the koruna, which were relaxed only in October 1995.[22]

The Czech Republic was unique in the region in that it did not initially experience high rates of unemployment.[23] Between 1989 and 1994, 1.9 million jobs were lost, including a 58.4 per cent drop in agricultural employment, a 60.6 per cent loss in wholesale and retail jobs and, most critically, a 36.5 per cent loss in jobs in heavy industry.[24] Yet in 1994 unemployment was only 3.2 per cent at the end of 1994, and a scant 2.9 per cent at the end of 1995. Partial explanations were that the population increases were low and even dropped in 1994, there were substantial job gains in construction and trade, as well as in servicing the huge influx of tourists into Prague. Additional jobs (65,000) were found in financial services which exploded and grew by 275 per cent. The state was also a factor providing 58,000 jobs in public administration, a 51.2 per cent increase over the 1989 level.[25] While the emerging private sector was providing jobs, the low unemployment rate was reflective of an economy whose firms were not significantly restructured, and productivity and competitiveness were being not be well served by the over protective state.[26] The developments in the Czech Republic also demonstrate the need for a perspective that considers the impact of the existing structure of the economy on the policy decisions taken by the leadership. This might be best illustrated by a comparison with Slovakia.

Since 1990 the rate of unemployment in Slovakia has been much higher than in the Czech Republic; in 1993 the comparisons were, 14.4 per cent compared to 3.5 per cent, in 1995, 13.1 to 2.9, and in 1997 they were 12.5 to 4.5 The fact that the Slovak economy was more dependant on the production of heavy, non-consumer goods (steel, armaments, etc.) was an important structural variable contributing to its higher unemployment.[27] Given this economic structure, the leadership of Slovakia was reluctant to travel the same path as the Czech Republic. The party in power, the Movement for a Democratic Slovakia led by Valdimir Mecair, presumably concluded that the suffering connected with the rapid and full commitment to market forces, including a sharp work force reduction in its large firms, would be too severe for the people of Slovakia.

As one commentator noted, 'the government thinks concentration (of ownership) and state intervention are the keys to success.'[28] While Slovakia's export driven economy has grown impressively since 1994, there is no shortage of analysts who believe that Slovakia's top-down, state controlled approach to economic transformation will prove disadvantageous in the long run. There are justifiable concerns that selling firms to the politically faithful at low prices on the margin with payments due over time, does not add sufficient capital to the economy[29] and that a much more open approach is necessary to force significant restructuring.[30]

In contrast to Slovakia's 1994 decision to cancel the second round of voucher privatisation in favour of a somewhat vague plan to reward the populace with bonds redeemable after five years,[31] the Czech Republic intensified its voucher privatisation by placing additional firms on the stock exchange to be purchased by the individuals, and especially investment firms, who held vouchers redeemable for shares in these publicly traded companies. Hence the Czech Republic provided for the rapid privatisation of its economy in a dramatically different manner than Slovakia. Both paths were flawed since the Czech model did not allow for responsible ownership and clear corporate governance which would have spurred restructuring, and the Slovak model is much too closed and short-term oriented to provide an efficient base for sustainable growth.

As noted, Poland and Hungary took different routes to privatising their economies. Hungary had a head start in that before 1989 it had allowed for small scale non-agricultural privatisation, and it was the beneficiary of foreign direct investment (FDI) which, until 1995, was heavily weighted in its favor.[32] In Poland it was privatisation by liquidation followed by the establishment of 15 National Investment Funds to manage over 500 formerly state owned enterprises, as well as a large post-1995 jump in FDI.[33] Estonia also privatised rapidly through liquidation. These experiences, together with privatisation in Latvia, Lithuania and Macedonia, the recent sell-off of state enterprises in Bulgaria and Romania, and the slower pace in Croatia and especially Slovenia[34] force one to conclude that in a very short time period the economies of the region are largely privately owned. It is important to acknowledge this remarkable development, but it also must be noted that while this is an important first step, it is not the end of the process. In order to grow an economy and provide for improved living conditions, firms, regardless of who owns them, need to be restructured so as to be more efficient. As Frydman and Rapaczynski (1994) have insightfully stated, 'the purpose of privatisation...is not to transfer title, but to initiate a restructuring of enterprises and a rationalisation of the East European economies.'[35]

The seminal ideas of Frydman and Rapaczynski advance the position that the state has a central and positive role to play in the transition process. With unbridled spontaneous development 'the cost of the transition may be so high that the process will be thwarted by political obstacles and the popular resistance that faces the still fragile democratic institutions.'[36] While Frydman and Rapaczynski are critical of a transition left at the mercy of spontaneous developments and post a positive role for the state, they wisely focus their analysis on concepts that extend beyond privatisation, and the need for the transition process to provide accountable and rational corporate governance, as well as restructuring. They are correct in stating that privatisation alone is not a sufficient factor for a successful transition, that one should be concerned about the high cost of the process, that accountable and rational corporate governance is critical, and that the role of the state is important. However, the perspective offered in this paper cautions against exaggerating the role of the state and overlooking a basic fundamental; that privatisation itself is essential and is what distinguishes capitalism from the previous communist systems.

Accepting the warning signals raised by Frydman and Rapaczynski, the case for completely transforming the economy in a way which reduces the role of the state remains. The reasons for not rapidly privatising and making deep structural change range from the populace's and leadership's distrust and fear of the consequences of largely uncontrollable market forces, to the concern that privatisation and austere economic policies could lead to their removable via the ballot box or even disruptive social unrest. All are important factors, but it should be noted that are also risks in not moving swiftly to transform command economies in that the absence of growth can also lead to frustrations which might seek destabilising outlets, ala Bulgaria in 1996. There is nothing inherently wrong with the state guiding the transition process, nor with state ownership coexisting with private ownership, nor with regulations placed upon market forces. However, the key element for success is for the state to create the conditions, politically and institutionally, for free flowing economic activity (within acceptable parameters) and allow for forces which it does not completely control to restructure and grow the economy. If this is done, there can be various degrees of intrusion by the state into the economy.

Poland is an example of a country with a weak and sometimes chaotic government, but a growing economy. It has had eight governments since 1989, yet its economy has grown between at 5 per cent and 7 per cent since 1994. This is not to suggest that political chaos is the best formula for economic success; only that the presence of strong state control is neither virtuous nor necessary. *The Economist* got it right when it stated that Poland's neighbours 'should draw lessons from its experience. Not, though, because Polish reform worked perfectly. It did not. On the contrary, Poland provides an excellent example of how reform works when politicians are weak. (While weak) 'the central government did decide on and create the basic macroeconomic conditions for investment and growth.'[37]

This perspective which focuses on reduced governmental control is not meant to advance the notion that inequities, injustices and outright corruption do not exist, and that all goes well without state intervention. It should be noted, however, that increased inequity is part and parcel of a system based upon private ownership and market relationships. In the former Soviet Union, the choice was made to focus on efficiency as opposed to equality, and the ramifications of that decision are now becoming reality.[38]

Uniqueness of the Transition in Eastern Europe

It is held that the years 1918, 1945 and 1989 were the most pivotal years for eastern Europe in this century. The years following 1918 and 1945 were ones of conflict between various European nations, and the global atmosphere was dominated by division and distrust. After the World War I there were continued conflicts between European nations, and after 1945 international relations were dominated by the Cold War confrontations between the US, western Europe and the Soviet Union, together with its East European 'allies.' Contemporary transformations are unfolding within the context of an expanding Europe Union (EU) and the absence of a Cold War and economic separation between NATO and the Warsaw Pact countries. While serious destabilising nationalistic conflicts in the former Yugoslavia and the Soviet Union cast an ominous shadow over the entire region, the UN embargo against Yugoslavia, the Greek embargo against Macedonia, and Russia's rumblings against Estonia are exceptions to policies of free trade and economic cooperation.

This has provided important advantages for the countries of the region. A brief comparison of Poland's international situation in 1918 and 1989 is illustrative. After World War I Poland's relations with its Ukrainian, Lithuanian, and Czech neighbours were tense, and it fought a war against the embryonic Soviet state in 1919 and 1920. In both 1918 and 1989 Poland suffered from the collapse of its important eastern markets, Russia\Soviet Union. Yet after 1989 Poland and other East European countries were able to shift much of their foreign trade to western and central Europe. As early as 1992, Czechoslovakia, for example, had reversed its trading patterns away from a majority with the Soviet Union and eastern Europe to western Europe,[39] and in 1998 only 3.2 per cent of its trade is with Russia. Today, the Czech Republic, Poland and Hungary conduct over two-thirds of their trade with central and western European countries. The situation in the 1920s was very different in that Poland's ability to shift its trade from the East to the West was severely hindered by its poor relations with Germany. While in the 1990s the cross-boarder shopping of Germans in Poland exceeds $3 billion annually and German companies have invested over a billion dollars in Poland, in 1925 Germany protested the poor treatment of ethnic Germans living in Poland by placing an embargo against the importation of Poland's leading export, coal.

The division between eastern and western Europe in the post-World War II era prevented the region from benefiting from international aid, investment from and trade with the West. Eastern Europe was not allowed to accept help from the Marshall Plan and its trade was largely limited to inter-bloc activities. However, in the 1990s there is comparatively little political, military and economic division within Europe. Instead of embargoes, Japan, the United States and western Europe, directly and through the European Bank of Reconstruction and Development, the IMF and the World Bank, are providing timely aid and investments.[40] Instead of separation from the west, ten eastern European countries have applied for admissions to the EU, with Slovenia, Estonia, Poland, Hungary and the Czech Republic having been admitted, and Poland, Hungary and the Czech Republic will soon become part of NATO.

By the end of 1997, eastern Europe (exclusive of the CIS countries) had received over $41 billion in foreign direct investment (FDI) stock.[41] While this accumulation pales in comparison with the amounts invested in China, and is less than what has been invested directly into another emerging market area, Latin American, it is nonetheless an important part of the transition process. In 1995 in Hungary, which at that time had received over 40 per cent of the region's FDI (reduced to about 25 per cent in 1997), foreign companies accounted for about 10 per cent of its GDP and well over half of its exports.[42] In 1996 the FDI stock of eastern Europe and the CIS countries (but exclusive of central Asia) grew 37 per cent and totally $17 billion for the year; impressive but still less than half of Latin America's $40 billion net inflow.[43] Germany is the region's largest investor, but Greece, with far few resources, has invested almost a billion dollars in the Balkans.[44] While there is a debate about positive and negative effects of FDI from developed western and Asian countries (as opposed to portfolio investments about which there is justified widespread concern), many believe that these investments are responsible for upgrading the region's technological base and making its exports more competitive, frequently forcing restructuring, and providing needed management expertise. Regardless of one's view of the desirability of FDIs, they do place these economies squarely within the sphere of the European and global economy, and this is very different than the situation after 1945.

The region's 'return to Europe' is most vividly demonstrated by its incorporation into the eastward expansion of the EU. One must note that, like the conversion to capitalism, this is not automatic panacea for the region. The countries of eastern Europe are poor agricultural exporting nations and this poses problems for them as well as to the EU. The eastern Europe economies are far behind most EU nations in terms of per-capita GDP. Even relatively wealthy Slovenia is less than 60 per cent of the EU average, and another newcomer, Estonia, is only about 25 per cent of the EU average.[45] The EU faces a formidable challenge in integrating these poor nations for whom agriculture is an important export (e. g. about 20 per cent for Hungary).[46] While agriculture comprises less than 10 per cent of the GDP of the original Visegrad countries (and significantly less in the Czech Republic), it is much more important for the Balkan countries. The EU already has sizeable agricultural surpluses and would not welcome more of these goods brought onto its markets. Also, the farms of eastern Europe are small and inefficient, as demonstrated by the fact that 29 per cent of the Polish people live on farms which in turn contribute only 6.1 per cent to its GDP.[47] Furthermore, while estimates on the costs to the EU via its Structural Fund (SF) and Common Agricultural Policy (CAP) vary widely and the rules are likely to be altered for the entering countries, expansion will represent an increase in expenditures, which the 1998 EU meeting in Cardiff (UK) showed, will not be readily accepted.

Yet one should not lose sight of the bigger picture; the eastward expansion of the EU is already underway and it is part of the transition process.[48] There will be temporary setbacks, and the expectations of the eastern Europeans will outpace reality. Thousands of complicated integrative legal and administrative regulations will have to be implemented. The amount of aid to be provided by the SFs and CAP, and the existing EU trade barriers to agricultural products, textiles and steel from the

East will be formidable obstacles. Yet there is the political will to overcome these problems, and the pattern of an economically united, not dismembered, Europe has been established. EU expansion is reflective of the principal difference between the international atmosphere of the 1990s and that which followed the other two years of drastic change in eastern Europe in the twentieth century; 1918 and 1945. While not perfect, the impact of the trans-national relations of the 1990s are politically and economically positive for the countries of eastern Europe. The exception is Yugoslavia and the continuing conflict over Kosovo.

Types of Capitalist Economies Evolving in Eastern Europe

The question of the type of economic system being established in eastern Europe and the former Soviet Union is usually raised in the context as to how these transforming economies will differ from already existing capitalist societies. Given the large number of country specific determining variables, the powerful legacy of 44 (or 74) years of communism, as well as the genuinely revolutionary nature of the process begun in 1989 (or 1991), one should not be surprised if these economies fail to neatly conform to any system now in existence.

The political and economic transformations in eastern Europe and the former Soviet Union are unique and defy exact comparisons. In an attempt to underscore the exceptionally wide lens needed to pursue the subject, a few selective, and by no means comprehensive, issues will be raised. One important element of the transition process is the relative lack of progress in restructuring the region's agriculture.[49] The heavily industrialised countries of eastern Europe did not begin by restructuring their agricultural, as did China. Also, eastern Europe differed from many Asian transformations in that they were more open politically and stressed the need to establish a genuinely democratic political structures, as well as rapid privatisation. The Asian model did not include a stress on open, democratic decision-making, and focused on both private and state ownership. Comparisons to the experiences in Asia add breadth and depth to the debate between the high degree of state involvement, more gradual, agricultural-led approach preferred in China or Vietnam, as opposed to the relative absence of the state, more radical, industrial-led variant underway in eastern Europe and the former Soviet Union.

Some analysts have presented a case for a state-led transition as in China, which has certainly enjoyed economic success since 1978.[50] Yet one of the lessons of the 1997-1998 Asian Crisis is that capitalist economies which are closed to inputs from the populace, and where the role of the state has distorted many market principles, are not the models for long term economic success. On the other hand, this article is not a call for states to remove themselves from the problems associated with the transitions. For example, it is pragmatically understandable why some countries need to implement some short-term protectionist trade measures to help their farms and industries, or in the case of Russia, to raise tax revenues. Yet there is also a need to keep these barriers both low and temporary to avoid the closed nature of the state dominated economies.

The problem for the region is not what form of capitalism will emerge, but is there sufficient political resolve to make a firm and enduring commitment to a privately owned market economy which provides for substantial industrial and agricultural restructuring? The other key ingredients to achieving a successful transition are the avoidance of the violent nationalistic conflicts, and the continued presence of a co-operative international atmosphere. Given what has transpired in the last nine years, there are grounds for optimism.

Conclusion

There are few certainties but that each country in transition will assign a somewhat different weight to the role of state, banks, large industries, foreign companies, agriculture, etc. The role of the state will vary widely as the diverse experiences of Poland and Slovakia demonstrate. However, it seems reasonable to assume that the role played by the states in the region will be greater than in the US where there is relatively limited state involvement. Yet asking if the model for the region will resemble to those economies where the state bureaucracy and of the large companies are closely intertwined, is in essence unfair and somewhat misguided. There are several accepted models for economic growth in a capitalist system. Given the uniqueness of the transformations from communist systems, and the region's specific cultural and historical traditions, eastern Europe is going to establish their own brand of capitalism and attempts to categorise it are not productive.

NOTES & REFERENCES

[1] For example, Poland and Estonia, countries where the state is the farthest removed from the economy, have experienced strong GDP growth since 1994, yet Slovakia, where the state has been very intrusive, has also grown relatively rapidly.

[2] Ben Slay, 'Rapid Versus Gradual Economic transition', *RFE/RL Research Report*, vol. 3, no.31, 12 August 1993,31-42. See also Herman W. Hoen, *The Transformation of Economic Systems in Central Europe* (Cheltenham, UK: Edward Elgar, 1998), 7-21.

[3] See Jiri Musil, ed., *The End of Czechoslovakia* (Budapest: Central European University Press, 1995), especially chapters by Prihoda, P., 128-138, Miroslav Kusy, 139-154, and Sharon Wolchik, 225-244.

[4] This trend is clear from a variety of sources. See, for example, European Bank for Reconstruction and Development, *Transition Report 1995: Investment and Enterprise Development* (1995). National growth charts for 1994-1996 are presented in Kevin Done and Anthony Robinson, 'EBRD Praises 'Fast-track' Countries,' *Financial Times,* 2 November 1995. Also, from *Plan to Market: World Bank Development Report,* 1996, (Washington, D.C., 1996). More recent publications of the EBRD and the UN Secretariat of the Economic Commission of Europe, as well as analyses of the Economic Intelligence Unit and bank reports presented in the *Wall Street Journal's Central European Economic Review* show that by 1997 'fast-trackers' like Poland, Estonia and Hungary have grown faster than 'gradualists' such as Romania and Bulgaria. Although there are exceptions, Slovakia, for example, the results to date seem to favour those countries which instituted a 'shock treatment' approach to transition.

[5] 'The Czech Republic', *Financial Times Survey,* 22 November 1995, 24. Note that Mr. Klaus did say 'that the transformation is more or less over', he did go on to note that he needed the power to implement 'the remaining systemic changes we have to make'.

[6] Jan Svejnar, ed., *The Czech Republic and Economic Transition in Eastern Europe,* (Budapest: Central European University Press, 1995), 14. For the negative consequences of a lack of restructuring, see 'Sink or Swim', Business Central Europe, vol. 6, number 48, February 1998, 11-13; and John Coffee, 'Investment privatisation Funds: The Czech Experience', in *Corporate Governance in Central Europe and Russia,* (Washington, D.C.: Transition *Economics Division of the World Bank, Dec.* 1994), 25-53.

[7] For recent assessments of this positive trend, see the *1998 U.N.'s Economic Commission Report for Europe* which expects 4.5 per cent GDP growth for the region, compared with 2.8 per cent in 1997, which was kept low by the sharp declines in Romania, Bulgaria and Albania. See also, Brushan Bahree, 'Eastern Europe's Economy Likely to Accelerate, But Russia's Looks Dimmer, U.N. Survey Says'. (*Wall Street Journal,* 22 April 1998, A19). The EBRD's May 1998 forecast is less positive (but more realistic given the problems now facing emerging market economies), as it expects growth in 1998 to be 3.9 per cent for eastern Europe, but only 1.7 per cent for CIS countries. See Stefan Wagstyl and Charles Clover, 'East Europe Pressed on Financial Controls', *Financial Times,* 9-10 May 1998, 2.

[8] 'Slovakia', *Financial Times Survey,* 20 December 1995; 'Can Cronyism Work?', *Business Central Europe,* vol. 6, no. 50, April 1998, 11-13; and 'Decline and Fall?', *Business Central Europe,* vol 5, no. 47, Dec.1997/Jan.1998, 43-50. For a more comprehensive view, see Andrian Smith, *Reconstructing the Regional Economy: Industrial Transformation and Regional Development in Slovakia,* (Cheltenham, UK: Edward Elgar, 1998).

[9] One of the most challenging books in this regard focuses on Russia and China, yet nonetheless relevant in its strong disagreement with the positions taken in this paper concerning eastern Europe. See Peter Nolan, *China's Rise, Russia's Fall: Politics, Economics and Planning in the Transition from Stalinism,* (New York: St. Martin's Press, 1995). For another insightful opposing view, see Peter Murrell, 'Evolutionary and Radical Approaches to Economic Reform', *Economics of Planning,* 25, 79-95.

[10] Henryk Kierzkowski, Edmund Phelps and Gylfi Zoega, *Mechanisms of Economic Collapse and Growth Eastern Europe,* (Warsaw: Polish Policy Research Group, July 1994), Discussion Paper No. 10, 4-6.

[11] Yilmaz Akyuz, 'Reform and Crisis in the Transition Economies,' in *Privatisation in the Transition Process: Recent Experiences in Eastern Europe,* (United Nations Publication, 1994), 3.

[12] Sources would include reports in *Central European Economic Review*, the Economist's Intelligence Unit as reported in *Economies in Transition* and *Business Central Europe*, EBRD reports, as well as data presented in *Economic Survey of Europe in 1994-95*, (Geneva: United Nations' Secretariat of the Commission for Europe, 1995), and subsequent publications of this UN Secretariat.

[13] Mitchell Orenstein, 'The Failure of Neo-Liberal Social Policy in Central Europe', *Transitions*, vol. 2, 28 June 1996, 16-20.

[14] *Economic Survey of Europe in 1994-1995*, 97.

[15] *ibid*, 103. For 1995, see Ernest Beck, 'Focus on Hungary: Taking Stock', *Central European Economic Review*, March 1996, 15, and 'Hungarian Survey', *Business Central Europe*, vol. 3, Dec. 1995/Jan. 1996, 35-46.

[16] Zsofia Szilagyi, 'A Year of Economic Controversy', *Transitions*, vol. 1, 17 November 1995, 62-66.

[17] *Economic Trends in Eastern Europe*, Kopint-Datorg Economic Research, Budapest, vol. 3, no. 3, 1994, 172.

[18] Virginia Marsh, 'Search for New Cuts as Hungary Court Rules on Austerity Package', *Financial Times*, 4 July, 1995, 2 ; Virginia Marsh, 'Hungarian Coalition Left Exposed', *Financial Times*, 21 September 1995, 3; and Anthony Robinson and Virginia Marsh, 'Hungary Revived by Tough Medicine', *Financial Times*, 31 October, 1995, 3; 'Hungary', *Financial Times Survey*, 21 November 1995; and 'Hungary Survey', *Business Central Europe*, vol. 3, December 1995/January 1996, 35-46.

[19] See, for example, *Economic Outlook for Hungary*, 1995, (Budapest, GKI Economic Research Co., July 1995).

[20] Henryk Kierzkowski, et al., *ibid*, (1994); and Dagmar Mroziewicz, 'Polish Economic Reform Marked by High Unemployment', *Transitions*, vol. 2, 28 June 1996, 26-27.

[21] Orenstein, *ibid*

[22] Vincent Boland, 'Koruna Ready to Enter Uncharted Seas,' *Financial Times*, 20 June 1995, 2; Vincent Boland, 'Czechs Take Plunge on Koruna Convertibility,' *Financial Times*, 28 September 1995, 3. And Joe Cook, 'Czech Balancing Act', *Central European Economic Review*, March 1996, 18.

[23] Daniel Munich, and Vit Sorm, 'The Czech Republic as a Low-Unemployment Oasis', *Transitions*, vol. 2, 28 June 1996, 21-25.

[24] *Cesky statisticky urad*, 1995. See also, Svejnar, chapter 7.

[25] *Cesky statisticky urad*, 1995.

[26] David Rocks, 'Harsh Medicine', *Central European Economic Review*, vol.6, no.,2, March 1998, 15.

[27] 'Slovakia', *Financial Times Survey*, 16 December 1994; 'Slovakia' *Financial Times Survey*, 20 December 1995; Peter Martin, 'Slovakia: Calculating the Cost of Independence', *RFE/RL Research*

Report, vol. 1, no. 12, 20 March 1992, 33-38; and Sharon Fisher, 'The Slovak Economy: Signs of Recovery', *RFE/RL Research Report,* vol.3, no. 33, 26 August 1994, 58-64.

[28] Vincent Boland, 'Slovakia's Investors in a Gloomy Mood', *Financial Times,* 28 August 1995, 17. See also his, 'Meciar Slows Slovak March Towards Market', *Financial Times,* 14 July 1995, 3.
[29] Peter Green, 'A Slovak Approach to privatisation', *International Herald Tribune,* 30 May 1996, 13 and 17; 'Monopoly Capitalism', *Business Central Europe,* vol. 6, no.32, 27-29, which also notes some positive aspects of the Slovak approach; and Sharon Fisher, 'Privatisation Stumbles Forward', *Transitions,* vol.4, no.8, 26 May 1995, 44-49.

[30] See endnote No. 8.

[31] Vincent Boland, 'Slovakia Clips Investors' Wings', *Financial Times,* 15 March 1995, 20; 'Slovak Privatisation U-turn Shocks Funds', *Financial Times,* 9 June 1995, 2; 'New Sell-Off Fever Grips Slovaks', *Financial Times,* 10 January 1996, 3.

[32] 'Thinking Global: Foreign Investment Survey', *Business Central Europe,* vol. 4, April 1996, 39-55.

[33] 'Investing in Central and Eastern Europe', *Financial Times Survey,* 8 May 1998

[34] 'Slovenia', *Financial Times Survey,* 18 May 1998; and Matthew Kaminski, 'Slovenia's Challenge', *Central European Economic Review,* vol.6, no., 5, June 1998, 12-13

[35] Roman Frydman and Andrzej Rapaczynski, *Privatisation in Eastern Europe: Is the State Withering Away?* (London: Central European University Press, 1994), 17.

[36] *ibid,* 46. It should be noted that Frydman and Rapaczynski do not favour strong governmental control. They view the state as important and necessary, but not so dominant that it would be a suffocating factor in the transition process.

[37] 'Poland's Economic Reforms', *The Economist,* 23 January, 1993, 23; and 'Poland', *Financial Times Survey,* 28 March 1995.

[38] See Ed Hewett, *Reforming the Soviet Economy: Equality Versus Efficiency,* (Washington, D. C.: The Brookings Institution, 1988).

[39] Patrice Dabrowski, 'East European Trade,' Parts I, II and III, *RFE/RL Research Report,* vol. 2, no. 40, 4 October 1991, 28-37; vol. 2, no. 41, 11 October 1991, 28-36; and vol. 2, no. 42, 18 October 1991, 30-37. In 1928 only 27 per cent of Czechoslovakia's foreign trade was with former CMEA nations, but in 1985 inter-CMEA trade accounted for 55.3 per cent of its total foreign trade. By the first quarter of 1992, CMEA trade was reduced to 21.8 per cent. Conversely, Czechoslovakia's trade with EU and EFTA nations was 60 per cent in 1928, but only 23.6 per cent in 1985, and back up to 61.1 per cent in the first quarter of 1992. *Privatisation Newsletter of Czechoslovakia,* no. 7, June 1992, 8. For annual changes in foreign trade by world region between 1992 and 1994, see *Economic Survey of Europe 1994-1995,* 124.

[40] James Bjork, 'The Uses of Conditionally: Poland and the IMF,' *East European Quarterly,* vol. XXIX, no. 1, March 1995, 89-124.

[41] This does not include the money invested in treasury bills or the various equity markets.

[42] 'Thinking Global: Foreign Investment Survey', *Business Central Europe,* vol. 4, April 1996, 43.

[43] 'Friendly Invaders', *Business Central Europe,* vol.6, no. 51, May 1998, 43.

[44] 'Greece and South-East Europe', *Financial Times Survey,* 1 June 1998.

[45] Matthew Kaminski, 'Slovenia's Challenge', *Central European Economic Review*, vol.6, no., 5, June 1998, 12-13, 13.

[46] Virginia Marsh, 'Hungary Knocks Hard on EU Door,' *Financial Times,* 19 July 1995, 2.

[47] Christopher Bobinski, 'Poles Await the Starting Gun to Begin Race for EU Entry,' *Financial Times,* 10 July 1995, 3.

[48] Herman W. Hoen, *ibid,* chapter 2, 22-46.

[49] Pradumna B. Rana and J. Malcolm Dowling, 'East Europeans Could Learn from Asian Patience', *International Herald Tribune,* 22 October 1993, 6; and Thomas Sigel, 'The Dismally Slow Pace of Agricultural Reform', *Transitions,* vol. 1, no. 8, 26 May 1995, 15-18; Thomas Sigel, 'The Dismally Slow Pace of Agricultural Reform,' *Transitions,* vol. 1, no. 8, 26 May 1995, 15-18.

[50] See Nolan, *China's Rise, Russia's Fall,* which is certainly thoughtful, but completed in late 1994 and praises many aspects of China's more closed model which have been the source of much of Asia's troubles in 1997 and 1998.