From Plan to Market, From Regime Change to Sustained Growth

in Central and Eastern Europe

By

Ivan T. Berend

As a critique of the laissez-faire concept in interpreting Central and Eastern European transformation, I would suggest that the process does not end with systemic change. Laissez-faire interpretations maintain that economic growth, prosperity, and catching up are automatic outcomes of marketization. The reality is different. Systemic change, in the sense of economic transformation, would be senseless without creating the potential to respond to the challenge of the technological-structural revolution of the age. Successful restructuring cannot be the mere result of marketization and privatization. It cannot happen without the massive participation of transnational companies. Their investments, however, is not guaranteed and might be a mixed blessing. Appropriate international and national environments are required to generate a spin-off effect and avoid the rise of a dual economy with advanced foreign enclaves in an environment of continued peripheral backwardness. The first decade of transformation clearly reflects two, rather different possible outcomes of transformation and different responses to technological-structural challenges in the diverse areas of Central and Eastern Europe.

State socialism collapsed in Central and Eastern Europe a decade ago. In most cases the change of the regime was quite peaceful since the Soviet Union gave up control of the area, and the communist elite lost its self-confidence and hope to be able to solve the towering economic problems. In the decisive Polish and Hungarian cases significant opposition emerged from without and/or within the ruling party to either attack the regime or to reform it radically. A stormy and spectacular transformation began and characterized the entire period of the 1990s.

From the very beginning, a vast literature of “transformatology” came into sight. Advisers of newly appointed governments, scholars, and experts of various international institutions worked out hundreds and thousands of studies, recommendations and critical analyses alike. A broadly accepted set of criteria for a reform program, the so-called Washington consensus of 1989, originally applied to less developed, crisis-ridden Latin American countries, was offered as a blueprint for the process of Central and East European economic transformation.[1] This prescription was offered for former state socialist countries by the international financial institutions: the International Monetary Fund, World Bank, and the American administration. Its central elements were macro-economic stabilization those countries with significant inflation and indebtedness; the building of new institutions, and legislation necessary for a market economy; price and trade liberalization, and radical privatization of the previously nearly complete state-owned and operated economy.

[1] Williamson, John, “The Washington Consensus Revisited” in: Louis Emmerij (Ed), *Economic and Social Development into the XXI Century,* Washington D.C.: Inter-American Development Bank, 1997.

Most of the "transformatology" literature, covering these above-mentioned topics, is based on the explicit or implicit assumption that the elimination of deformed non-market economies, a restoration of market, and private ownership, paired with a laissez-faire free market system would automatically solve all of the major economic and even social problems of the transforming countries. The transition from plan to market is, thus, the key to the door of prosperity, and catching up with the West. "The economic reforms," stated Jeffrey Sachs in 1991, "will set in motion a sustained process of economic restructuring…Once market forces are unleashed, there should be a strong pull of resources into the previously neglected [service] sectors…Agriculture is another area where we should expect major restructuring…The third major trend that we should expect is a complete restructuring within the industrial sector, from energy-intensive heavy industry to more labor-intensive and skill-intensive industries that can compete on the world market…Western firms…are likely to set up operations…for the sake of export production, in the same way as European firms are investing in Spain…"[2]

This assumption was in the air of the age. The competition of advisers and new governments in radicalism and the attempt to make a *tabula rasa,* to unleash almighty market automatism was partly a consequence of lack of experience in an unbeaten road, but most of all, of the *Zeitgeist* of the 1980s and 1990s, dominated by a Chicago school version of laissez-faire ideology, or, as George Soros named it, *market fundamentalism,* which "disregard social values" and "seeks…to impose the supremacy of market values...".[3] "Reaganomics" was presented as an overall, quick solution to economic ills. Thatcherism successfully undermined the concept of *Sozialpartnerschaft.* These ideals, advocated by the great powers, the international financial institutions, and hundreds of experts, and advisers, penetrated Central and Eastern Europe and the entire world. No doubt, if accepted, they served propaganda and public relation goals well, received headlines and tremendous applause in the West. Provided that this program represented *the only successful road* towards an automatic economic restructuring and prosperity generated by the introduction of market economy, it was logical to urge fast and radical strokes of market reforms. The speed is important if you have to go through the "valley of tears" (Dahrendorf). The faster one concludes transformation, maintained the advocates of this concept, the better it is, because the pain of transformation will disappear and one can reach the other end of the valley of tears earlier. As Michael Mandelbaum of Council on Foreign Relations most characteristically phrased it, "If the people…can endure the hardship that the policies of stabilization, liberalization, and institution building inflict, they will emerge at the other end of the valley of tears, into the sunlight of Western freedom and prosperity".[4]

Thinking in the framework of the laissez-faire paradigm, the dramatic decline in output and GDP during the early 1990s was not as bad as the people of the region thought, because, things first had to be worst to get better later. The dramatic economic crisis is nothing else, as János Kornai interpreted, than a "painful side effect of the healthy process of changing the system". A "transformational recession," caused by a transitory "shift from the sellers' to a

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[2] Sachs, Jeffrey, "The Economic Transformation of Eastern Europe: The Case of Poland". In: Poznanski, Kazimierz Z., *Stabilization and Privatization in Poland,* Boston: Kluwer Academic Publishers, 1993, pp. 208-9.

[3] Soros, George, *The Crisis of Global Capitalism,* New York: Public Affairs, 1998, pp. XVII-XVIII, 196.

[4] Mandelbaum, Michael, "Introduction," in: Sh. Islam and M. Mandelbaum (Eds), *Making the Markets. Economic Transformation in Eastern Europe and the Post-Soviet States,* New York: Council on Foreign Relation Press, 1993, pp.11,15.

buyers' market; contraction of investment; a shift in the composition of foreign trade; disruption of coordination, enforcement of financial discipline". The appropriate cure of the *malaise* is to "accomplish the task [of market reforms] faster".[5] Jeffrey Sachs similarly warned in 1991: "The time in the valley [of tears] depends on the consistency and boldness of the reforms. If there is wavering or inconsistency in economic measures, it is easy to get lost in the valley. Argentina has been lost for forty-five years".[6] He, as well as many others, advocated "comprehensiveness and speed in introducing the reforms" which "can and should be introduced quickly, in three to five years".[7] He also maintained that "macroeconomic stabilization can also be achieved relatively quickly". However, he added, restructuring that follows reform will take "presumably a decade or more".[8]

In sum, if you marketize and privatize fast, not only will systemic change and marketization be concluded in a decade or so, but also the restructuring that automatically follows and generates prosperity. This concept *implicitly* suggests that Eastern European *backwardness is a mere consequence of the planned economy* and state socialism. If this was the case, indeed, it would be enough "to return to normalcy" by introducing Western type of market economy by bold and radical reforms.

In reality, the backwardness of the area and the failed attempt to catch up with the West has a long history. During the second half of the 19th century most of the area adopted the *Zeitgeist* of laissez-faire, free trade and export-led industrialization, and joined the international European economy. That attempt, however, failed, or, at least met with only limited success: Central and Eastern Europe remained agricultural, rural, and traditional, compared to the industrialized and urbanized West.[9] After World War I, in a radical departure from the past, the countries of the region turned to economic nationalism, introduced high protective tariffs, strong state interventionism, some kind of planning, and replaced export-led policy with import-substitution. The result, nevertheless, was the same semi-failure and continued backwardness.[10] The planned economy of state socialism was only a new, bitter, and extremist version of economic nationalism. State interventionism and autarchy served to avoid hopeless competition, and reach the Western level. The effort, again, failed. In other words, Central and Eastern Europe, consequently, is not in a position to simply reject the unpleasant and unsuccessful intermezzo of the last half a century and "return to normalcy". Rebuilding a private-market economy with all of its institutions and legal prerequisites, i.e. systemic change itself, cannot simply produce a mechanism of successful sustained growth, leading to catching up. This mechanism *has never worked* in this area. A brief comparison can illuminate the *longue durée* of economic trends in the region:[11]

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[5] Kornai, János, "Anti-Depression Cure for Ailing Postcommunist Economies". *Transition. The Newsletter About Reforming Economies,* 1993, February, p.2.

[6] Sachs, Jeffrey, "The Economic Transformation of Eastern Europe: the Case of Poland". In: Poznanski, Kazimierz Z. (Ed), *Stabilization and Privatization in Poland. An Economic Evaluation of the Shock Therapy Program.* Dodrecht: Kluwer Academic Publishers, 1993, p. 210.

[7] *Ibid,* pp. 198-9.

[8] *Ibid,* p.198.

[9] Berend, Ivan T. – György Ránki, *Industrialization and the European Periphery1780-1914,* Cambridge: Cambridge University Press, 1982.

[10] Berend, Ivan T., *Decades of Crisis: Central and Eastern Europe Before World War II,* Berkeley: University of California Press, 1998.

[11] Maddison, Angus, *Monitoring the World Economy 1820-1992,* Paris: OECD, 1995, p. 212.

Central and Eastern Europe's per capita GDP as percentage of the West

Regions	1870	1913	1938	1973	1989
Western Europe	44	44	44	45	40
Overseas West	32	30	35	38	32

The aggregate, comparative index of economic development levels, GDP per capita, clearly shows that during the three-quarters of a century, between 1870 and 1983, market and private economy could not generate automatic prosperity and the catching up process. Central and Eastern Europe's relative position vis-à-vis Western Europe and the overseas West remained unchanged. Ironically, state socialism with its planned economy generated a slight transitory catching up between 1950 and 1973, followed by an even steeper decline. Ultimately, the region landed on a lower peripheral level than ever before, or, using Jeffrey Sachs' metaphor, "was lost in the valley of tears" for all of the modern era.

The transitory strength, and, in some places, popularity of state socialism emerged from its promise to cope with historical backwardness, reach prosperity and high living standards. The regime, in the last analysis, collapsed because it could not fulfill its program and did not lead to the Promised Land. The regimes' legitimacy was undermined; a deep disappointment penetrated the masses and even the elite.[12] The peoples of the area longed for a change, and, as the leading slogan of 1989 clearly reflected, wanted to "join Europe". As the demonstrators, welcoming Secretary of State, James Baker, in Tirana airport, expressed on their posters: "Albania wants to be like America!"

The change of the regime, however, is far from equivalent to an automatic beginning of sustained growth and catching up. As an economic historian of the region, I strongly argue against the implicit assumption of a great deal of transformatology literature suggesting that sustained economic growth and catching up with the West is an automatism which starts to work when a country adopts the Western market model.

At this point, I must return to the often-analyzed question of economic decline, or "transformational recession" in the early 1990s. Was it, indeed, a merely unavoidable consequence of changes from the plan to the market, as, among many others, János Kornai interpreted?[13] In my view, the "transformational recession," as Kornai named it, was only *one element* of a long, deep, and complex economic crisis in the area. One should not forget that the crisis had begun much earlier, basically from the mid-late 1970s, when the steam had already run out of the economic drive of forced industrialization in Central and Eastern Europe. Growth slowed significantly – from an annual 3.1 per cent and 3.5 per cent between 1950 and 1973 to 1.3 per cent and 1.2 per cent between 1973 and 1989 in Czechoslovakia and Hungary respectively.[14] Between 1978 and 1983, Polish GDP declined by more than 10 per cent. During the second half of the 1980s, Romania experienced 0.7 per cent, Yugoslavia 0.5 per cent, and Poland 0.2 per cent annual growth, compared to the 3.6 per cent growth rate of the OECD countries. Aside from this,

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[12] Berend, Ivan T., *Central and Eastern Europe 1944-1993: Detour from the Periphery to the Periphery,* Cambridge: Cambridge University Press, 1996.

[13] Kornai, János, "Transformational Recession. A General phenomenon Examined through the Example of Hungary's Development". *Discussion Paper No.1. Collegium Budapest, Institute for Advanced Study,* June 1993.

[14] Maddison, Angus, *Explaining the Economic Performance of Nations,* Aldershot: Edward Elgar, 1995, p. 97.

the terms of trade for the state socialist countries began to deteriorate: during the first decade after the first 1973 oil shock, they suffered a 20 per cent decline, and for some countries even a 26-32 per cent decline of terms of trade. Foreign trade deficits dramatically increased, and almost all of the region's countries dropped into an indebtedness trap. At the time of the collapse of the regime, Poland accumulated nearly $42 billion, Hungary more than $20 billion, Bulgaria nearly $10 billion, the state socialist countries altogether $110 billion in debts. Debt service consumed a substantial portion – 40 per cent to 75 per cent – of the countries' hard currency income.[15] Quite a few countries started to lose control over inflation. That was an overall economic crisis characterizing the last one and half decades of state socialism. Transformation, however, except in Hungary and Poland, was not on the agenda yet. This crisis, needless to say, did not end with the collapse of the regime, but continued; moreover, it became even more serious.

We have witnessed a long economic crisis in Central and Eastern Europe from the mid-1970s on up to now. A quarter-century long crisis is not unknown in economic history. This is a kind of *Great Depression*, Europe experienced during the last third of the 19th century, then in the interwar decades, then again, during the last third of the 20th century. The phenomenon is well explained by economic cycle theories. I prefer, as the most convincing and proven, Joseph Schumpeter's theory on *structural crisis*. Caused by a major "set of technological changes", the replacement of the old technological regime by a new one, leads to the decline of the old leading sectors and export branches based on old technology. This generates a wide-ranging slowing down and decline, and causes an economic crisis even in rich, advanced countries. It happened at the end of the 1970s and early 1980s, when, even in the West, double digit inflation and unemployment, and a significant decline in output exhibited the destruction of the structural crisis. However, rising new technology, "the technical advances in microelectronics", as Everett Rogers stated, "that occurred in the 1970s and 1980s have spurred the Communication Revolution…[connected with the emergence of new] high-technology industry…one in which the basic technology underlying the industry changes very rapidly".[16] A new infrastructure emerged, as Daniel Bell called it, a "post-industrial society", with an increasing number and share of white-collar employment in the ever-growing service sector. The adjustment to the new technology led to the emergence of new industries, new leading export sectors. The structural crisis, as Schumpeter explains, led to a "creative destruction", paving the way for new technology and prosperity. This adjustment created, indeed, solid ground for an impressive new boom in the United States and some other advanced countries.

The structural crisis in the backward areas, however, has a somewhat different outcome. It is definitely destructive, but lacks the creative impact. The peripheral countries of the world economy suffer more because of the severe decline of their terms of trade. Prices and markets for their export items, less processed and much less sophisticated than those of the core countries, drastically decline. They do not have sufficient sources for research and development, know-how and financial sources to follow closely the new technological-industrial revolution, build up new leading export sectors. In other words, they suffer all the negative consequences of the structural crisis but are unable to catch the stormy wind of technological changes in their sails. The "peripheral structural crisis", as I call this phenomenon, is *destruction without creation.* Central and Eastern Europe experienced this situation three times from the 1870s to the 1970s-1990s and

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[15] Berend, Ivan T., *Central and Eastern Europe 1944-1993: Detour from the Periphery to the Periphery,* pp. 230-1.

[16] Rogers, Everett M., *Communication Technology. The New Media in Society,* New York: Free Press, 1986, pp. 14-5.

had only a "backward" exit. The countries of the region preserved their obsolete economic branches and export sectors, and sold the otherwise unsaleable old products in a safe and highly protected regional market. That was guaranteed before World War I in the framework of a multi-national empire, (Habsburg or Russian). In the 20th century, in an alliance system led by a nearby great power (Hitler's Germany, then Stalin's Soviet Union).

After the collapse of state socialism, this type of "backward" exit from the structural crisis was blocked. Without technological adjustment, the only shield against competition on the world market, although counterproductive in the long run, was Comecon isolation and regional self-sufficiency. After 1989, however, the countries of the region lost the protective shield of the safe and undemanding Comecon market, were forced to enter the world market and compete with the advanced countries, which have already adjusted to the new technological age. Moreover, they had to compete not only on the world market, but also on their own, opened domestic market. As a consequence, the peripheral structural crisis, prolonged since 1973, not only continued but also became much deeper during the 1990s.

Serious policy mistakes also contributed to the economic drama of the early 1990s. Richard Portes noted "serious macro-economic policy errors…[such as] initial excessive devaluation of the currency". Instead, he recommended, "do not devaluate excessively; peg initially: then go to a crawling peg". Another major policy mistake was that "the opening to trade with the West – with convertibility, low tariffs, and few quantitative restrictions – was too abrupt…".[17] Domenico Nuti rejected the interpretation of economic decline as a "necessary concomitant of transition". In his view, it was an "unnecessary consequence of policy failure". Most of all "the failure in government management of the state sector".[18]

Although the march towards Europe and the reform from plan to market, in the long run, are very positive changes in the region, and this is the only promising road after the failure of state socialism. The economic policy during the first part of the transition period was, however, in many respects, mistaken. The difficult transformation process required a pragmatic and ideologically non-biased approach to reality. The countries of transformation should not have had to attempt to jump directly from a centrally planned to a laissez-faire economy, from an entirely state-owned to a one hundred percent privatized economy. State regulations and government policy were needed in the difficult transformation process when self-regulating mechanisms were not yet developed and market imperfections and non-market friendly behavior among the players was the rule. A regulated market, instead of a self-regulating market, a mixed economy with a restructured and efficient state-owned sector for at least a period of time, and a "fine mixture between market and state"[19] would have been a more natural transition from plan to market. This approach, however, was immediately rejected and most of the transforming countries rushed to join the Reaganites and blame "big government", and state intervention. It caused unnecessary pains, led to the collapse of a great many old companies, which lost the bulk of their value and had to be sold for a fraction of their previous value. All these contributed to mass unemployment, a sharp decline in living standards, especially for certain rather vulnerable

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[17] Portes, Richard, "From Central Planning to Market Economy". In: Islam, S – Mandelbaum, M. (Eds), *Making Markets. Economic Transformation in Eastern Europe and the Post-Soviet States,* 1993.

[18] Nuti, Domenico, "How to Contain Economic inertia in the Transitional Economies?" *Transition. The Newsletter About Reforming Economies.* The World Bank. Vol.3, No.11. December 1992-January 1993.

[19] Kolodko, Grzegorz, *Transition to a Market economy and sustained Growth: Implications for the Post Washington Consensus,* p. 45.

layers of the society. People in poverty, those with incomes less than 35 per cent to 45 per cent of the average wage, increased from 14 per cent to 54 per cent in Bulgaria, from 4 per cent to 25 per cent in the Czech Republic, from 25 per cent to 44 per cent in Poland and from 34 per cent to 52 per cent in Romania during the early 1990s.[20] "Living standards of 57 per cent of the population of Russia", reported the journal of the World Bank in October 1999, "are below the minimum subsistence level…the average life expectancy does not exceed 61.7 years".[21] Social polarization, an emerging mortality and health crisis, sharply declining life expectancy sharply declined – all of them phenomena typical for 19th century "wild capitalism," or, very late 20th century "bandit capitalism", as two leading economists, N.Stern and J.Stiglitz named it.[22]

Can all these be considered unavoidable negative side effects of a positive transformation, or, the economic and social decline became much steeper and deeper because the "transformational recession" was deepened by severe policy mistakes? Peter Murell's theoretical explanation hit the head of the nail: "Economic and political decisions", he maintains, "are circumscribed by limits in social knowledge…inherited from the past…If one attempts to eradicate all…characteristics [of existing organizations] immediately, then one invites economic collapse…Large changes in the legal and policy framework produce highly dysfunctional outcomes…".[23] Not only speed and scope, but the inappropriate adoption of the laissez-faire market model also caused "highly dysfunctional outcomes". Grzegorz Kolodko, arguing against laissez-faire policy,[24] quotes three genuine authorities, George Soros, the World Bank, and IMF's Stanley Fisher: "The untrammeled intensification of laissez-faire capitalism and the spread of market values into all areas of life", warns Soros, "can cause intolerable inequities and instability".[25] "Establishing a social consensus will be crucial for the long-term success of transition", argues the World Bank in its report on "From Plan to Market", since "societies that are very unequal in terms of income, or assets tend to be politically and socially less stable and to have lower rates of investment and growth".[26] Stanley Fisher argues in the same way: "adjustment programs that are equitable and growth that is equitable are more likely to be sustainable".[27]

Regulation, state intervention, and a mixed economy are among the requirements for Central and Eastern European transformation. After a decade, it is clear that all of the transformational economies are mixed economies, and this fact, provided that they adopted good policy, did not block the road for successful transformation at all. In Hungary, one of the success stories of transformation, "under the privatization law, 92 firms will remain in permanent state

[20] *Central and Eastern Europe in Transition: Public Policy and Social Conditions: Crisis in Mortality, Health and Nutrition,* UNICEF, Economies in Transition Studies, Regional Monitoring Report No.2, August 1994, p. 2.

[21] *Transition. The News Letter About Reforming Economies*, The World Bank, Vol.10, No.5, October 1999, p. 35.

[22] Stern, Nicholas – Joseph Stiglitz, *A Framework for a Development Strategy for Market Economy: Objectives, Scope, Institutions and Instruments,* European Bank for Reconstruction and Development. Working Paper 20, London: European Bank for Reconstruction and Development, April 1997.

[23] Murell, Peter, "Evolutionary and Radical Approaches to Economic Reform". In: K.Z. Poznanski (Ed), *Stabilization and Privatization in Poland,* p. 222.

[24] Kolodko, Grzegorz, *Ten Years of Postsocialist Transition. Lessons for Policy Reform.* Working Paper 2095. Washington: The World Bank, 1999. (The next three quotations are from pp. 14, 17.)

[25] Soros, George, "The capitalist Threat". *The Atlantic Monthly,* February 1997.

[26] *From Plan to Market. World Development Report 1996.* Washington D.C.: The World Bank, 1996.

[27] Fisher, Stanley, "Opening Remarks." Conference on *Economic Policy and Equity,* Washington D.C.: The International Monetary Fund. June 1998, p. 1.

ownership".[28] In one of the most successfully transforming countries, Slovenia, "the state still owns more than 50 per cent of total assets in the economy".[29] The state needed and still needs to guide the extremely complex process of transformation. In 1997, the World Bank called the attention to the important role of governments in various fields where market automatism will not work.[30] Governments have a role in macroeconomic policy, investment in basic social services, education, training, and infrastructure, creating and keeping a strong social safety net in order to prevent disastrous social side effects for the most vulnerable parts of the society.

The unavoidable "transformational recession", together with the avoidable policy mistakes, adoption of laissez-faire concept and policy – although more visible on the surface – were additional factors in the prolonged peripheral structural crisis, the basic cause of long-term decline. The interpretation of the East European economic crisis as basically a long depression of non-adjustment to a changing world economy, a peripheral structural crisis (deepened by transitory factors), might be strengthened by comparing it with the strikingly similar performance of other peripheral but non-state socialist countries in the world.

Latin America offers a telling parallel: from the mid-late 1970s on, as in Central and Eastern Europe, the same economic troubles emerged. Growth significantly slowed from an annual 2.5 per cent to a 0.8 per cent. The terms of trade had a similar 20 per cent to 30 per cent deterioration than in Eastern Europe, and the trade deficit became unbearable. Mexico had an annual trade deficit of about $20 billion throughout the 1980s. Indebtedness, however, was only a temporary solution and became a long term trap and disaster: Brazil, Mexico, and Argentina accumulated billions in debt which surpassed their exports by three to five times and the debt service consumed 50 per cent to 62 per cent of their export income. The striking similarity between Latin American economic performance and the East European one clearly exhibits the *region-specific*, and thus the *peripheral character of the crisis*.[31]

Believers in an almighty market automatism, however, argue that consistently reforming Central Europe is already elevated to the stage of sustained growth, while the hesitantly reforming Balkan and post-Soviet countries are still "lost" in the valley of tears. The European Union, evaluating economic transformation in Hungary and Slovenia, announced on July 15, 1997: "Hungary can be regarded as a functioning market economy. Liberalization and privatization have progressed considerably…Hungary should be able to cope well with competitive pressure and market forces within the Union in the medium term… Hungarian enterprises are already competitive in EU markets…". The same was said about Slovenia, Poland, and the Czech Republic.

Regarding Romania's preparedness, although "considerable progress in the creation of a market economy" was recognized, "prices have been almost fully liberalized", the European

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[28] *Transition Report Update April1999,* European Bank for Reconstruction and Development, London, 1999, p. 38.

[29] *Ibid,* p. 44.

[30] *The State in a Changing World. World Development Report 1997,* Washington D.C: Oxford university Press for the World Bank.

[31] Berend, Ivan T., "End of Century Global Transition to a Market Economy: Laissez-faire on the Peripheries?" in: Berend, Ivan T. (Ed), *Transition to a Market Economy at the End of the 20th Century*, München: Südosteuropa-Gesellschaft, 1994, p. 14.

Union criticized, among others, the "still fragile legal system and the lack of coherence of policy making on economic issues". Furthermore, "much of Romania's industry is obsolete and agriculture needs to be modernized. The low levels…of skills among the workforce also suggest that the economy needs a number of years of sustained structural reforms", thus "Romania would face serious difficulties to cope with competitive pressure and market forces within the Union".[32] Similar statements could be made about several other Balkan and post-Soviet countries.

In the group of at least six Central European countries – Poland, the Czech Republic, Hungary, Slovenia, Slovakia, and Croatia – market economies are functioning, economic decline and rapid inflation are over, the annual economic growth is impressive. The "well functioning market economies" basically recovered the early decline and mostly reached the 1989 level of per capita GDP.

GDP % change from previous year; last column = 1999 as a % of 1989[33]

Country	1990	1991	1992	1993	1994	1995	1996	1997	1998*	1999**	%
Croatia	-9.3	-28.7	-11.7	-8.0	5.9	6.8	6.0	6.5	2.5	1.0	79
Czech R.	–1.2	-14.2	-3.3	0.6	3.2	6.4	3.9	1.0	-2.7	0.0	95
Hungary	-3.5	-11.9	-3.1	-0.6	2.9	1.5	1.3	4.4	5.0	4.2	99
Poland	-8.0	-7.6	2.6	3.8	5.2	7.0	6.1	6.9	4.8	3.0	121
Slovakia	-2.5	-14.5	-6.5	-3.7	4.9	6.9	6.6	6.5	4.4	1.0	101
Slovenia	-4.7	-9.3	-5.5	2.8	5.3	4.1	3.3	3.8	4.0	3.8	107

*estimated, ** projected.

It is important to clarify that reaching the 1989 economic level in 1999 does not prove that these countries have arrived "to the other end of the valley of tears" and already enjoy the "sunlight of Western freedom and prosperity" (Mandelbaum). They hit the bottom then recovered the deep decline. Additionally, industry recovered only in two countries, Poland and Hungary. Real industrial output reached the 1989 level in these countries in 1997-98, while Slovenia, Slovakia, and the Czech Republic recovered only by 75-80 per cent until 1999.[34] But we might not forget that the gap between them and the West, in that single decade increased from the nearly 1:2 level in 1989 to a 1:3 and 1:4 difference in 1999. The gap between East and West, as a consequence, is broader than ever in modern history.

In some countries, decline reemerged or continued, and they remained increasingly behind, nearing non-European standards. Bulgaria and Romania, after the severe decline of the early 1990s and a partial recovery of the mid-1990s, experienced a new crisis when output and GDP

[32] "Agenda 2000. Summary and Conclusion of the Opinions of the Commission Concerning the Applications for Membership to the European Union Presented by the Candidate Countries. Strasbourg-Brussels, 15 July 1997." In: Thanos Veremis and Dimitrios Triantaphyllou (Eds), *The Southeast European Yearbook 1997-98,* Athens: Hellenic Foundation, 1998, pp. 333, 339, 344, 349.

[33] For 1990-1: *Wiener Institute für Internationale Wirtschaftsgeschichte Research Report*, No.207, Wien, July 1995; For 1992-99: *European Bank for Reconstruction and Development Transition Report Update,* London, April 1999, p. 6.

[34] *Economic Survey of Europe 1998,* No.2, New York: United Nations, 1998, p. 146-8.

declined again. In Russia and Ukraine as well as several other successor states of the Soviet Union, decline has continued without stop throughout the entire decade. As a consequence, in 1999, Romania and Bulgaria reached only 74 per cent and 66 per cent of their 1989 GDP level respectively. Russia (53 per cent) and Ukraine (35 per cent), and the entire Commonwealth of Independent States (former Soviet Union) (53 per cent) arrived only at half of their 1990 level in 1999.[35] In 1989, the ratio between the GDP of Russia and Poland was about 7:1, by 1998; it was roughly 3:1.[36]

The utterly different performances of Russia and the Balkans, compared to Central Europe, are often explained by the lack of determination to pursue radical reforms. This certainly has relevance. However, the major difference between the economic performance of Central Europe, the Balkans and Russia has important causes in addition to hesitant reforms. Besides pursuing systemic change, the countries in transformation also have to *adjust to the structural crisis,* by restructuring the economy according to the requirements of modern technology, and, on this basis, reach *a sustained and higher than average growth.* Restructuring and adjustment, i.e. technological and structural transformation of the economy are central elements of the transformation, and, in some sense, the end and essence of it. However, only a few countries have begun doing so, while very little or nothing has been done in two-thirds of the region's economies.

The potential for adjustment to modern technology and new economic structures are not automatic outcomes of marketization and privatization. Even consistent reforms are unable to guarantee success; they represent only the very first steps in a long process of required adjustments. "Only a part of the multi-layer transition process, namely liberalization linked with stabilization, can be executed…in a radical manner", stated Grzegorzg Kolodko, one of the main architects of Polish transformation. "As for structural adjustment…and behavioral change, they will take a long time under any conditions".[37] It needs, argued Peter Murell, a different social knowledge and behavior, since "socioeconomic mechanisms are information-processing devices…a society's stock of personal knowledge is acquired through a long historical process shaped by the institutions and organizations of that particular society".[38] Transformation is not only "a process leading from plan to market", as Marie Lavigne argues, "it could also be…a process leading from under-development to development".[39] Transformation, without development, is quite senseless. If the countries remain in a backward state on the periphery of Europe, with huge masses in poverty, systemic change results only in inefficient capitalism instead of inefficient socialism. Both had a long history in the area, moreover, they generated each other. Transformation, thus, must lead to sustained growth and catching up with Europe. "When is transition over?" asks Marie Lavigne. When the transforming countries approach the economic level of the least developed members of the European Union. According to Stanley Fisher (and his co-authors) and Tsuneo Morita, if they achieve a growth rate in the range of 4.5 to 6.0 per cent annually against an assumed 3 per cent growth in the low-income countries of the EU, it may take, in the best possible scenario, about 30 years. The Czech Republic may reach

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[35] *Ibid.*

[36] Kolodko, Grzegorz, *Transition to a Market Economy and Sustained Growth: Implications for the Post-Washington Consensus,* 1999, p. 74.

[37] *Ibid*, p. 28.

[38] Murell, Peter, "Evolutionary and Radical Approaches to economic Reform." In: Poznanski, Kazimierz Z. (Ed), *Stabilization and Privatization in Poland,* pp. 219, 221.

[39] Lavigne, Marie, *The Economics of Transition. From socialist Economy to Market Economy,* New York: St.Martin's Press, 1999, p. 276.

that level in 10-15 years, Hungary, Poland, and Slovenia in 20-25 years, Romania and Lithuania in 35 years, and Albania in 65-75 years.[40]

The way towards sustained growth and catching up leads through structural adjustment. Reforms and systemic change, no doubt, have already triggered such a development. The most widespread structural change, a consequence of privatization, was for example, the foundation of millions of new family enterprises, improving the previously backward service sectors throughout the region. During the first half of the 1990s, the share of services in percentage of the GDP in Hungary, Poland and the Czech Republic increased from 55 per cent, 36 per cent, and 32 per cent in 1990, to 63 per cent, 56 per cent, and 53 per cent respectively by 1994.[41] This trend became characteristic even in the more backward regions. In Bulgaria, the share of services in GDP increased from 30 per cent to 47 per cent.

Hand in hand with this process, radical change occurred in the size-structure of enterprises as well. The previously existing well-known "upturned pyramid", the top heavy structure of enterprises, with absolute domination by huge companies and the relative lack of small-scale units was replaced in a few years by a normal pyramid structure.[42]

The key elements of adjustment, however, the adoption of revolutionary new communication technology, high-technology industries, and the building up of a competitive, highly productive export sector, in most cases, have not been achieved. This process has just started in Hungary, Poland, Slovenia, the Czech Republic, and Slovakia. The Balkan countries and Russia, with her partners in the Commonwealth of Independent Countries, about two-thirds of the former Soviet Bloc, are not even close to launching a successful technological-structural transformation and have descended into a continuous and deepening crisis.

While systemic change is the result of strong political will and consistent political-social-legal actions, technological-structural adjustment is mostly beyond that sphere. Although good economic policy can make a difference, successful adjustment to the transforming world economy, and an appropriate response to the challenge of structural crisis is impossible without massive *Western investments and the participation of transnational companies*, the main carriers of modern technology and innovation.

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[40] Fisher, Stanley, Ratna Sahay, Carlos Végh, "How Far is Eastern Europe from Brussels?" *International Monetary Fund, Working Paper* No.53, April 1998; Morita, Tsuneo, "The Hidden Growth Potential of EU Candidates," in: *Transition. The News Letter About Reforming Economies,* World Bank, Vol.10, No.5, October 1999, p. 9.

[41] Marer, Paul, "Comparative Privatization and Restructuring in Hungary, Poland, and the Czech Republic, 1998-1995." In: Berend, Ivan T. (Ed), *Long-Term Structural Changes in Transforming Central and Eastern Europe,* p. 140.

[42] Ehrlich, Eva, *Shift in the Size Structure of manufacturing Establishments and Enterprises: An International Comparison,* Budapest: Institute fro World Economics. Working Papers, 1993, p.18.

Central and Eastern Europe, similarly to other peripheral regions, has never been able to pioneer technological revolutions. Insufficient resources for research and development, lack of knowledge and know-how, mediocrity and other cultural factors have always been obstacles to innovation and have never allowed a pioneering role in technology for a peripheral country in modern history. Many scientists and inventors, from the turn of the century on, left these areas to realize their dreams and became successful in one of the rich countries.

Although peripheral countries have made, in the best cases, minor contributions to technological innovation, in appropriate historical circumstances, they were able to adopt Western technology, accommodate themselves to technology leaders, and follow their footsteps. Since the 1870s, this was mostly connected with direct foreign investments resulting in the establishment of new firms and the introduction of modern Western technology and know-how.

During the last third of the 20th century, the extreme harshness of the structural crisis in Eastern Europe mostly emerged as a consequence of total inability to adjust to the new world economy under state socialism. During the half century after World War II, the Central and Eastern European countries, could less than ever before accommodate them to the Western technological and structural transformation. This extreme situation resulted partly from the import-substitution policy of the Soviet Bloc, the lack of entrepreneurial and market incentives, and its self-isolation from the "capitalist world market". However, a major, if not *the* major, factor of the Soviet Bloc's incapacity was the economic warfare at the Cold War inspiring a strict Western embargo on modern technology transfer to the East.

The National Security Council of the United States concluded in December 1947: "US national security requires the immediate termination…of shipments from the United States to the USSR and its satellites…which would contribute to Soviet military potential". The intent of the policy was "to inflict the greatest economic injury to the USSR and its satellites".[43] NATO, and, a few months after its foundation, the new Coordinating Committee for Multilateral Export Controls (COCOM), established in November 1949, institutionalized this policy. Even the export of products of "secondary strategic significance" such as steel rails and trucks, the export of between two- to three thousand commodity categories was banned. The Bucy Report of February 1976, enforced in August 1977, recommended the ban of any kind of assistance in infrastructural development, building entire factories, and selling advanced technology in general. "The widespread use of computers, even in commercial applications, enhances the 'cultural preparedness' [of the communist countries] to exploit advanced technology".[44] From 1979 on, the export of all new technological achievements was strictly forbidden: computer network technology, large computer system technology, software technology, telecommunication technology, microwave component technology, advanced optics and sensor technology. The list "contains a virtual roll call of contemporary techniques, including videodisk recording, polymeric materials, and many dozens of others".[45] The traditionally accommodating economies of Central and Eastern Europe, consequently, could not buy and introduce modern communication technology and were totally unable to follow the technological revolution of the 1970s-1980s.

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[43] Long, William J., *U.S.Export Control policy,* New York: Columbia University Press, 1989, p. 15.
[44] Mastanduno, Michael, *Economic Containment. COCOM and the Politics of East-West Trade,* Ithaca: Cornell University Press, 1992, p. 194.
[45] *Ibid,* pp. 213-5.

The window of opportunity slowly opened after1989. The question was whether the technology leaders were ready and interested to transfer the new technology and knowledge. Direct foreign investment become the key factor in technological modernization, and restructuring, in the area. The inflow of capital immediately began in 1989-90, but until 1995, nearly half of the $23.2 billion direct foreign investment to Central and Eastern Europe was channeled only to Hungary ($11.4 billion). Hungary, in that period, received more than the successor states of the Soviet Union together ($6.4 billion). During the second half of the decade, however, capital inflow significantly increased in a few other countries as well:

Foreign Direct Investment in Central and Eastern Europe[46]

Country	Total inflow, 1989-99 in bn $	Inflow per capita in $
Hungary	18,3	1.830
Poland	24.8	653
Czech Republic	13.5	1.350
Central Europe & Baltics & Balkans	72.1	566
Former Soviet Union	23,7	84

Nevertheless, foreign direct investment played an important role only in the three frontrunners of transformation, the small Baltic countries and Slovenia. Hungary, Poland and the Czech Republic received nearly three-quarters of all investments in Central and Eastern Europe, including the Baltic countries, and more than half of the total investment in the East, including Russia and the other successor states. Western investors, counting on a per capita basis, also preferred some of the small countries such as Estonia ($947), Latvia ($634), and Slovenia ($596), especially during the second half of the decade. During the last years of the decade, annual foreign investment reached 3-4 per cent of the GDP of the favored countries, while in Russia it remained only a fraction of 1 per cent.[47] The comparative attractiveness of a country for foreign investors, measured by the stock of direct foreign investment relative to GDP, shows the unquestionable lead of Hungary and Estonia with a 39 per cent and 35 per cent share respectively. They are among the leading foreign investment recipients, while the Czech Republic and Latvia surpassed the world average of 15 per cent. Slovenia and Lithuania are on the world average, while the Balkans' stock of foreign investments reached 5-6 per cent of their GDP.[48]

Not all of these investments have contributed to restructuring. Some of them served only to enlarge the investors' markets. Major American film distributors bought up movie theaters in order to screen Hollywood movies. Retail chains were acquired: the Austrian-German Meinl took over a great part of the former state-owned Hungarian supermarket network. The Danone Group, one of the world's largest producers of dairy products, established a series of subsidiaries in Poland, the Czech Republic, Hungary, and Bulgaria during the first half of the 1990s. "In strategic terms", stated the Chairman of the company in his annual report in 1994, "we persuade a

[46] *Transition Report Update April 1999,* London: European Bank for Reconstruction and Development, p. 12; *Transition. Newsletter About Reforming Economies,* Vol.10, No.5, October 1999.
[47] *Ibid.*
[48] "Foreign Direct Investment: New Trends in Transition Countries." *Transition. Newsletter About Reforming Economies.* The World Bank, Vol10, No.5, October 1999, p. 8.

very active acquisition policy…targeting markets outside Western Europe”.[49] Quite a few multinational companies also gained access to local and regional markets. Major tobacco companies, Colgate-Palmolive, PepsiCo, Nestle, and Ikea, and many others invested only in order to enlarge their markets. Quite a few of them gained monopoly position in the region. In spite of the short-term advantage of substantial investments, and the significant improvement of supply, market acquisition weakened the domestic market for domestic producers in the long run, and is therefore counterproductive from a local point of view.

Key investments were made, however, in the most backward infrastructural sphere, especially telecommunication that serves as the basis for any kind of technological progress to date. In a few rapidly changing countries, some of the world’s telecom leaders began investing and modernizing. Hungary went the farthest by selling 67 per cent of MATAV, the formerly state-owned telecom monopoly of the country to Ameritech International and Deutsche Telecom. Only 6.5 per cent of the ownership remained in the hands of the state. Estonia sold 49 per cent of Estonia Telecom Ltd to BalTel, Litvania 60 per cent of Lietuvos Telecom to Amber Teleholding. Poland sold the first 25 per cent of TPSA at the end of 1998. Three international telecommunication companies, AT&T, Alcatel, and Siemens gained ground in Poland. In many other countries of the region, state ownership of telecommunication remained dominant (74 per cent in Slovenia, 51 per cent in the Czech Republic), or remained untouched as in Slovakia, Romania, Bulgaria and the successor states of the Soviet Union,[50] and foreign investment did not generate modernization.

Direct investments revolutionarized Hungarian telecommunication. In 1990, only 9.6 main telephone lines existed per 100 people, in 1995 this improved to 18.5, and the number increased to 33.2 by 1997. Meanwhile, between 1990 and 1998, the number of mobile cellular telephone subscribers increased from 0.03 to 8.4 per 100 inhabitants and is rapidly approaching the Western level. In 1990, the Hungarian telecommunication system was 45th among 56 analyzed countries. In 1995, ranked 34th, near to the medium standard, and by the end of the decade, it rose to the top third. While the Czech Republic, started at a higher point (15.8 main phone line per 100 people in 1990), Slovenia, and Estonia reached more or less the same level as Hungary, and most of the others are behind. Moreover, the ranking of Russia (43 to 52), Bulgaria (28 to 48), Romania (41 to 54), and Ukraine (50 to 53) declined to the bottom of the 56-country sample. Starting from virtually zero, the number of internet hosts (varying between 25 and 50) and internet users (varying between 100 and 200) per 10,000 inhabitants, reached the medium Western level in Slovenia, the Czech republic, Estonia, and Hungary, surpassing France, Italy, and Japan already by the mid-1990s. On the other hand, Bulgaria, Russia, Romania, and Ukraine have hardly moved from 1 to 2 Internet hosts and 5 to 15 Internet users per 10,000 people.[51]

Foreign investors slowly began creating modern industrial branches and competitive export sectors in Hungary, Poland, the Czech Republic, Slovenia, and Estonia. Until the mid-1990s, however, only one-quarter to one-third of foreign direct investment went into industry in Poland, the Czech Republic, and Slovakia. Hungary has a unique position with a nearly 80 per cent

[49] Koparanova, Malinka, “Danone-Serdika J.S.Co.” *Eastern European Economics,* Vol.36, No.4, July-August 1988, p. 28.
[50] Ehrlich, Eva, *The Communications Infrastructure of the Central and Eastern European Countries,* Budapest: Institute for World Economics, February 1999.
[51] *Ibid.*

proportion of industrial investments.[52] As in the spectacular Spanish and Irish economic miracle between the mid-1970s to the 1990s, when traditional local industries developed only slightly but transnationalization generated an unparalleled growth in modern sectors, here too, the transnational companies are the main actors. A few major companies sought to exploit the low wage level of the qualified labor force, quite a rare combination in less developed countries. The wage level in the Czech Republic and Hungary is less than one-tenth of the German level. As Anna Krajewska maintains on Poland, "a mean wage of US $250 is one of the important motives in making direct investments…especially in labor-intensive industries". The labor cost in Portugal, with the lowest labor cost level in the European Union, is three-and-half times higher than the Polish one.[53] Using the region as a low cost basis for exports, and gaining an important market share within the region, leading transnational companies have moved to some of these countries. Besides, Central European countries have a geopolitical advantage as well: their closeness to the West and well-developed transportation systems. These countries also have a historical-cultural closeness to the West, an environment suitable for Western economic activity. Late 19th-20th century experience, traditional economic connections, especially with Germany, also helped the renewal of cooperation. Central Europe belonged to the German *Grossraumwirthschaft* during the 1930s-40s, and Germany became the number one trade partner and investor in most of these countries in the 1990s.

The Volkswagen Werke, Audi, Bayer, Siemens, and Henkel stepped in rather early. European and American companies also played a role. Thomson, the worldwide number two television tube producer established its firms in Warsaw and is selling the products via its European sales network. Philips transferred part of its battery production from Belgium to Poland, and exports more than half of the products in the European Union. Asea Brown Boveri founded 70 affiliates employing 23,000 employees in the region after 1990. Half of the machine tools the company uses in power plants for the South-East-Asian market are produced in Central Europe. Fiat integrated its long-existing Polish subsidiary into its global network and concentrates the production of Fiat Uno exclusively in Poland. Three-quarters of the output are sold to the parent company. The German Continental tire manufacturer in its Czech firm produce more tires than in its other branches, while basic tire parts (modules) are produced in the Czech Republic and Hungary, then shipped to the market for assembly.[54] Slovenia also attracted direct foreign investments into its industrial sector: by the mid-1990s, half of the foreign investment stock was invested in manufacturing, with the biggest share in the auto (14 per cent), paper (10 per cent), and electrical machinery (9 per cent) branches. Leading multinational companies, Renault, Bayer, Henkel, Siemens, Semperit, and others sought to exploit the low wage level of otherwise well-developed Slovenia. Two outstanding projects were Renault's investment of a 54 per cent share in the Revoz car factory for 54 million dollar, Danfoss International's investment in the largest Slovenian enterprise, Gorenje GA and jointly established the Biterm Company to produce thermostat in 1994. Characteristically enough, however, the Danish multinational Danfoss did not make the most modern type of thermostat available. Research and development also remained in Denmark. "Danfoss does not allow Biterm a lot of initiative in the field of

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[52] Szanyi, Miklós, "Experiences with Foreign Direct Investment in Eastern Europe." *Eastern European Economics,* Vol.36.No.3. May-June 1988, p. 35.
[53] Krajewska, Anna, "Transformation of the Polish Economy." *Eastern European Economics,* Vol.34, No.1, January-February 1996, p. 15.
[54] Enzmann, Anne-Ev, "Investment Promotion in the Czech Republic, Hungary and Poland." In: Bastian, Jens (Ed), *The Political economy of Transition in Central and Eastern Europe,* Aldershot: Ashgate, 1998, pp. 47-8, 58.

technology and R&D".[55] This attitude of multinational companies is rather common. In February 1991, the German Linde firm bought 52 per cent of the Czech Technopolyn, and, in 1995, it became the sole owner of the Czech gas, metallurgical and chemical plant. "Since the foreign partner's entry, the subsidiary has ceased to do its own research and development. These activities are carried by the Technical Application Center and a modern laboratory in Höllriegelskreuth near Munich on a centralized basis…".[56]

Transnational companies made substantial investments in their East European firms. By the mid-1990s, foreign companies owned 12 per cent of the Czech manufacturing firms, but their share of industrial investment was 25 per cent; in Poland and Slovakia, also with 12 per cent ownership in both countries, their participation reached 30 per cent and 36 per cent respectively. In Hungary, foreign share in industrial investments was nearly 80 per cent.[57]

One of the best results in restructuring occurred in Hungary, where a few major greenfield investments created new and modern factories and industrial branches. General Motors, Ford, Suzuki, and Audi established a previously non-existent car industry in Hungary with $1.3 billion investments (until 1996), partly producing partly assembling cars, engines, and parts. Philips, Guardian Glass, IBM, and Fuchs Metalwerke also made altogether $420 million greenfield investments for producing electronics parts, glass, and metal products. In 1995, 34 per cent of foreign direct investments went into greenfield projects. In 1998, as a single example in the region, 94 per cent of investments financed greenfield projects.[58] The single most successful investment case was the privatization of the Hungarian light-source producer, Tungsram, which had 2-3 per cent share of the roughly $12 billion world market, and a 5-6 per cent share within Western Europe. The American transnational company, General Electric, acquired 50 per cent of the shares of Tungsram for $150 million in 1990, then virtually the entire company (99.8 per cent) in 1994. General Electric integrated Tungsram into its global operation, invested about $600 million by early 1995, rationalized the company by closing down certain production lines and branch subsidiaries, and specialized production, mostly toward high-margin products, including new energy-saving compact fluorescent lamps. In 1994, they started the production of a revolutionary new product, Genura, the world's first compact reflector lamp using induction technology. From 1995 on, 90 per cent of GE's European output was concentrated in Hungary, while several newly acquired West European facilities were closed down.

Tungsram's restructuring led to a double-digit annual increase in productivity. The number of employees was reduced from 20,000 to 9,000, and the company spent $30 million annually for retraining and redeployment. Moreover, "this is the only example where a global multinational…decided to concentrate its worldwide R&D capability in a transforming economy in Central Europe", stated Paul Marer and Vincent Mabert, the analysts of the GE-Tungsram

[55] Svetlicic, Marjan – Matija Rojec, "Biterm d.o.o." in: *Eastern European Economics,* Vol.36, No.5. September-October 1988, p. 84.
[56] Bohatá, Marie, "Linde Technopolyn a.s." in: *Eastern European Economics,* Vol.36, No.4, July-August 1998, p. 95.
[57] Szanyi, Miklós, "Experience with Foreign Direct Investment in Eastern Europe." In: *Eastern European Economics,* Vol.36, No.3, May-June 1998, p. 36.
[58] *Transition. Newsletter About Reforming Economies,* The World Bank, Vol.10, No.5, October 1999, p. 7.

case.[59] Out of the eight major research program sponsors by GE worldwide, four are at GE's Nela Park headquarters in Cleveland, the other four in Budapest. About half of GE's professional R&D personnel work in Hungary. Tungsram became the world's largest producer of light-sources, which sells, using GE's commercial network, 40 per cent of its product in Western Europe, 30 per cent in the Middle East and Asia, another 15-20 per cent in the United States, and only 10 per cent in Hungary and Eastern Europe. The earnings from its export are nearly $300 million in 1994, making Tungsram Hungary's largest industrial exporter.[60]

As in the Hungarian case, transnational car producers made one of the greatest investments in the region. The Volkswagen Werke with the largest Czech investment, Fiat, Renault, and General Motors are the leaders, but Daewoo and Suzuki are also present. Toyota and Isuzu are preparing to invest in Poland. In five years, Volkswagen may replace the Russian AvtoVAZ (Lada) company as market leader. According to the London based Economist Intelligence Unit's report, by 2005, car production in Central and Eastern Europe may increase by 30 per cent and reach 2,88 million cars. Three-quarters of output, according to the report, may come from Russia, Poland, and the Czech Republic and 60 per cent of the cars might be sold in Russia and Poland.[61]

As a result of creating internationally competitive industrial sectors, the transnational companies representing 10 per cent of Hungary's GDP produced 50 per cent of the country's exports in 1993. This share increased to 65 per cent in 1994, and to 70 per cent in 1996.[62] Hungary's export increased by 238 per cent between 1989 and 1999, and by the second half of the 1990s, more than 45 per cent of the country's exports consisted of machinery and transport equipment. Hungary was the only country in the region, which significantly increased its machinery exports (from 26 per cent in 1990) during the 1990s. Although the Hungarian performance is quite unique, other Central European countries, as a clear indication of the progress of restructuring, are exhibiting similar trends: Poland increased its exports by 243 per cent, the Czech Republic by 223 per cent, Slovakia by 330 per cent. Slovenian export more than doubled up to 1997. In all of these cases, machinery and transportation equipments represented between 20 to 35 per cent of total exports.

The export development took place during a rather difficult regional restructuring of foreign trade. About 40 per cent to 75 per cent of the foreign trade of the Central and Eastern European countries was Soviet Bloc trade before 1989. The collapse of Comecon and the Soviet Union drastically decreased the Eastern markets. The countries of the region turned toward Europe, and, as early as 1995, the European Union became the main partner of the Central European countries: Poland, Hungary, the Czech Republic, and Slovakia sold 63 per cent, 51 per cent, 46 per cent, and 38 per cent of their export products in the European Union. Small wonder, 50 per cent to 60 per cent of their European exports still consists of primary products, i.e. food,

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[59] Marer, Paul – Vincent Mabert, "GE Acquires and Restructures Tungsram: the First Six Years (1990-1995)" in: *Performance of Privatized Enterprises: Corporate Governance, Restructuring and Profitability,* Paris: OECD, 1996.

[60] *Ibid.*

[61] *The Automotive Industry of Central and Eastern Europe: Perspective to 2005,* London: Economist Intelligence Unit, January 2000.

[62] Enzman, Anne-Ev, "Investment Promotion in the Czech Republic, Hungary and Poland," p. 52.

beverages, unprocessed raw materials, fuels, and basic manufactures, mostly intermediate goods.[63]

Important investments, thus, had a significant spin-off effect in Central Europe. They generated the growth of domestic business, which is itself an important contributor to economic growth, especially in Poland. Small domestic business, however, is rarely able to become technology leader. Various deals between local governments and transnationals contained clauses of compulsory reinvestment of part of the profit, mandatory use of domestic products and sub-contractors. Big transnational business, thus, often initiated small local business activities. Sometimes, as in the case of Volkswagen's Czech investment, various suppliers of VW also moved to the Czech Republic. Transnational companies play a significant positive role in Central European restructuring and sustained growth.

Russia, the successor states of the Soviet Union, and most of the Balkan countries exhibited minimal progress in restructuring. Foreign direct investment was minimal in this area, and mostly went into the extracting branches of oil, gas, and raw materials. Consequently, export is not the main vehicle of economic development as in Central Europe. Moreover, a sort of dual economy emerged: only the extracting branches belong to dynamic export sector – with or without foreign investments, and generate one-quarter of the GDP in Russia, while the processing industry produces non-competitive products for the domestic market. In this part of Eastern Europe, restructuring, in terms of producing competitive modern products based on new technology, hardly made any important steps. Transnationals are present but do not trigger any significant spin-off effect, and, in some cases, remain a foreign enclave, extracting and exporting critical raw materials, without developing modern processing industries and export branches, similar to the early 20th century situation in Romania, Serbia, and some other countries. This area, consequently, was unable to adjust to the late 20th century technological revolution and declined into a continuous peripheral structural crisis.

In those Central European countries, where impressive foreign direct investment assisted technological-structural adjustment, transformation is paving the way to sustained growth and catching up with the West. These countries became members of NATO and are candidates for European Union membership. These decisive institutional changes might accomplish progress towards an equal partnership with the West, or perhaps, the road from the periphery to the core of Europe. Two-thirds of this large region, however, have taken only the very first steps towards, and cannot even meet the basic requirements of transformation into the new age of the Communication Revolution and the 21st century. They remain seemingly outside the integrating continent, behind a new "Poverty Curtain" as a pruned, deeply disappointed and explosive periphery of Europe.

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[63] Hoen, Herman W., *The Transformation of Economic Systems in Central Europe,* Cheltenham: Edward Elgar, 1998, pp. 136-9.