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DEVELOPMENT STAGES OF COUNTRIES WITH TRANSITION ECONOMY: ENCOUNTERED PROBLEMS, REALISED REFORMS AND OBTAINED ACHIEVEMENTS

Abstract

The countries that gained independence after the collapse of the socialist bloc were directed from the central planning management system towards the free market economy and were called as the countries with transition economy until they completed this process. Though these countries started nearly at the same time and had the same targets, they achieved different results within the last twenty-five years. The reason is having different historical past, geographical location, human and natural resources, social and demographic features. The above-mentioned differences affected the quality of reforms in different degrees and consequently, though the transition process was completed for some countries, it was revealed that the road to be overcome was long. Generally, the transition process was very difficult for every country and the set tasks were achieved after a long period. Therefore, while explaining the mentioned process the same chronological sequence is followed without taking into consideration different features of the countries. The mentioned process was investigated in details in the present article.

Key words: socialist bloc, market economy, transition economy, central planning.

JEL codes: P2, P21

Introduction

The transition economy is explaining the leaving political, sociological and economic values of an economic system adopted by it and a gradual or abrupt transition to another and superior management system. This is the process whose beginning is known, while the end is unknown. Though this process can be short because of the social, political, ethnic, geographical, historical, economic, and even religious features of the country, it can be longer than expected. It is very important to bear in mind that this change is fundamental and the state implements it by its all bodies and strategies. Otherwise, for example, leaving the Keynesian economic philosophy and beginning to apply

the monetarist economic policy by Great Britain in 1979 doesn't mean that it is a country having transition economy. It is only changing direction of the economic strategies realised by political parties selected within the country in accordance with the requirements of the period.

While speaking about transition economy, the historical development process of transition of the countries, which obtained independence after and before the collapse of the socialist bloc in 1990, from the central management system to the free market economy, comes to the mind at first. However, some of similar countries, for example, Azerbaijan, Georgia, Kazakhstan, and others underwent the influence of this process at the beginning of the XX century, while others, for example, Poland, Hungary, Bulgaria, and others in the 1950s and were occupied by communist Russian regime and were forced to accept the application of the socialist management system. However, this transition didn't justify itself and as the result, the above-mentioned countries adopted again an economic system where free market relations called as capitalism were formed.

The present article reflects social, political and certainly economic changes processes of the countries which obtained independence and got the status of transition economy from 1990 up to the present time. The present article deals with the fact why it was called as transition economy and the criteria taken into account in their division on regions. Afterwards, the problems encountered by the above-mentioned countries, the models of economic policy implemented for their settlement and, finally, negative and positive results obtained as the result of this policy were presented to the readers. At the end, a final assessment of the information obtained in result of the investigation was carried out.

Features of the countries with transition economy and their geographical division

The term "transition economy" explains the mass changing process with all components of the society on the way from the central management system to the free market economy (OECD 1999). This process began after collapse of the Soviet socialist bloc and 10 countries in Central and Eastern Europe (CEE), 3 Baltic countries, and 12 countries of the Commonwealth of Independent States (CIS) were called by this name. Though the given explanation encircles only the European and CIS region, but other socialist countries far from this region, for example, China, Vietnam, Cambodia, and Laos can be included in this category, too (IMF 2000). Even it is possible to say that all economic systems leaving a different economic management system and selecting market economy as a target as the countries with transition economy (Falke 2002). For example, such countries as Bosnia and Herzegovina, Serbia, Kosovo, and Mongolia were estimated in the status of transition economy in the report of the World Bank

(2002). The following table includes the classification of the countries with transition economy upon the groups.

Chart 1.1. Classification of transition economies

Central and East European countries	Baltic countries	Commonwealth of Independent States	Southeast European countries
Poland	Latvia	Azerbaijan	Albania
Hungary	Lithuania	Russian Federation	Bosnia a. Herzegovina
Czech Republic	Estonia	Kazakhstan	Croatia
Slovak Republic		Kyrgyzstan	Bulgaria
Slovenia		Uzbekistan	Romania
		Tajikistan	Macedonia
		Turkmenistan	Kosovo
		Georgia	Serbia
		Armenia	Montenegro
		Moldova	
		Ukraine	
		Belarus	

Source: IMF, Regional Economic Issues – 2014.

Though the date of knocking down of Berlin wall or the day of independence of the countries was taken as the beginning of the transition process, in the reality, taking Washington consensus 1989 as the beginning would be more expedient. The principal reason for calling the package of reforms developed as 10 Articles by John Williamson was its approval and acceptance by the headquarters of this programme located in the capital of the United States of America (USA), Washington, the Bretton Woods¹ bodies and the financial department of the USA (Williamson 2004). This programme mainly provided for improvement of the condition of the countries undergone to economic crisis on the Latin America continent afterwards was considered relevant for the above-mentioned countries and it was decided to realise it (Kołodko 1999).

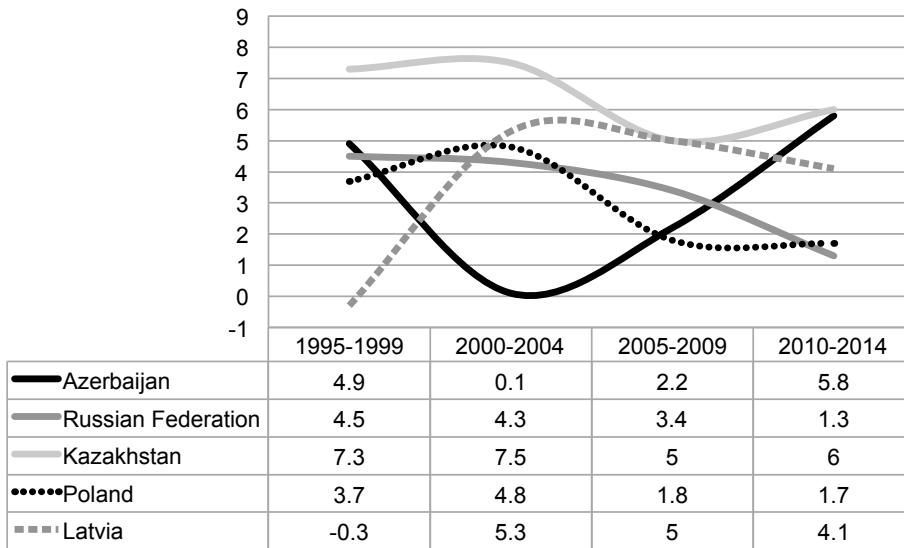
Development stages and encountered problems

Though the countries with transition economy started nearly at the same time and had the same targets, they achieved different results within the last twenty-five years. This difference was both reflected in the economic indicators

¹ The World Bank and the International Monetary Fund called as Bretton Woods was founded at the event held in Bretton Woods, the city of the United States of America, and where 43 countries participated in July 1944. The principal purpose of this body, which took its name of the mentioned city, was recovery of the economy of countries and increase of international economic cooperation during the post-war period.

and in the social measurements called as human development. The growth rate in GDP in five years intervals of the countries selected upon the regions is given in below-presented Chart 3.1.

Chart 2.1. GDP growth (%)



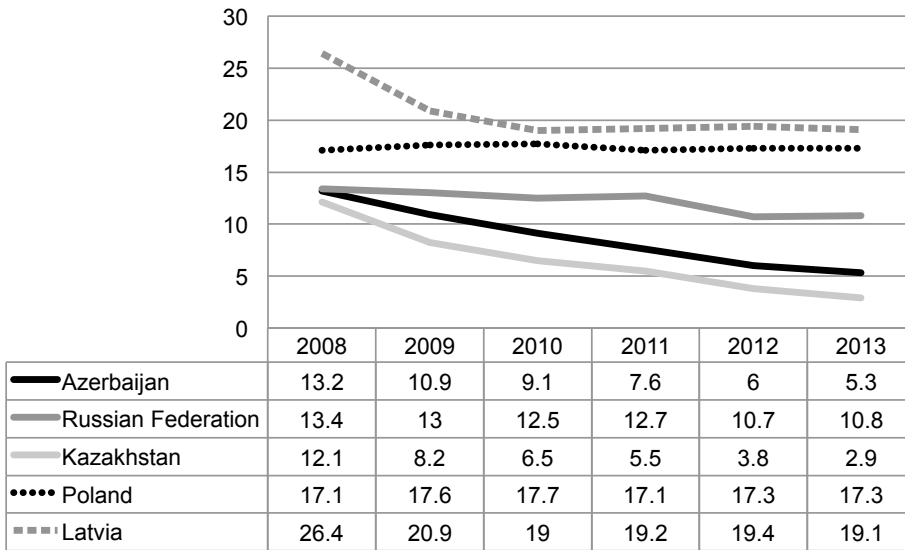
Source: World Bank, <http://data.worldbank.org/indicator>.

The countries reflected in the above chart are one or some of the most developed countries among the regional groups where they belong to (see Chart 2.1). Their common feature attracting attention is lack of growth in GDP within the first five years as there was no exact information when they obtained independence at the beginning of 1990. Besides, because of the following reasons obtaining or calculating GDP by the same manner wasn't possible:

- As it is known, the countries took gross material product (GMP) as the main measurement unit of economy instead of gross domestic product during the socialist union and, in its turn, it differs from GDP. Only produced goods were considered in calculation of GMP and the service sector did not take place in this composition.
- There was no free price mechanism regulated by market conditions.
- There were very few companies that made up the supply and demand in the market.
- Mainly, availability of non-registered commercial activities called as shadow economy didn't allow exact calculation of GMP over these years (Brada, King and Kutan 2000).

The poverty threshold of these countries in the 2000s is given in the following graph. No statistical information was obtained in the previous years because of the mentioned reasons.

Chart 2.2. Poverty rate (%)



Source: like in Chart 2.1.

As mentioned above, this difference is due to the different features of the countries. But we can classify them in the following four principal titles:

- Initial condition of the country; it includes industrial development, agricultural development, foreign trade volume, opportunities of procurement of natural sources;
- Political condition of the countries; stability, spread of corruption, and non-transparent management methods;
- Internal and external conflicts;
- Human development, threshold of poverty, brain drain, and other social factors will be crucial (Spoor and Visser 2001).

Though the above-mentioned factors were the main reasons for differentiating the countries having transition economy from each other, they passed through a similar economic evolution process and were under the influence of the same foreign factors in the globalised world. So, after gaining their independence, all the countries entered into a recession period on the eve of leaving the old system and passing to a new one. As we mentioned above, this process was different depending on the initial economic condition of the countries. For example, Central European and Yugoslavian countries had

already been acquainted with the concept of market economy in the mid-1980s. While others were experienced a little in the capitalist system as they had joined to the socialist bloc from the end of World War II. At the same time, as these countries were a part of Europe regionally, their economic crisis was relatively short. However, as the countries composing the Union of Soviet Socialist Republics (USSR) were commercially related with one another and as those relations were broken after their independence, the economic crisis of these countries lasted longer and was deeper.

The establishment and development of the business environment in the country was one of the principal targets of the countries with transition economy after having gained independence. Legal, administrative, and institutional preparations had to be made for realising the above-mentioned target. But taking into account that these countries had had a structure criticising private property and related all legal systems with the state-controlled pricing system for many years, therefore realisation of the mentioned targets in a short term was impossible. Consequently, the high unemployment rate was one of the principal features observed over the country.

As it is seen, the countries with transition economy encountered similar problems and realised certain economic reforms over the past twenty-five years. We can categorise this historical period as follows not depending on the difference of the results obtained from the economic reforms:

- 1990-1993: First reforms and encountered problems,
- 1994-1996: Market reforms,
- 1997-2001: Crisis and economic shakes,
- 2002-2007: Development period,
- 2008-2014: Global financial crisis (IMF 2014).

Each of these periods is presented below separately.

1990-1993: First reforms and encountered problems

As these years were the first years after the independence, it was the period when the most acute problems were encountered. On the one hand, the countries enjoyed newly gained independence; on the other hand, they were obliged to survive difficult living conditions brought by economic problems. The industrial production was decreased, unemployment reached the threshold stage, shortages of goods in the market and high inflation brought by those shortages were a natural state of every country. The budget deficit showed itself in different intervals, in the best case 7% in Poland and at the highest level 20% in the CIS countries (WB 1996).

However, despite all those difficulties, the government offices believed in overcoming the difficulties as soon as possible. They were induced to this belief

by the leading states of the capitalist system and the World Bank, the International Monetary Fund, the European Bank for Reconstruction and Development, and other financial bodies of such a kind. The principal target was pursuing correct policy and overcoming that economic stagnation. The discussed solution ways were different. The most radical among them was application of the package of reforms called as “shock therapy” and transiting to the market economy system in a short time. Therefore, all features of the socialist management system will be abolished and the package of measures including market relations will be adopted and applied in 1-2 years. Such kind of reforms was worked out for the first time by the commission led by Leszek Balcerowicz and applied at the end of 1989 in Poland. This programme is very risky and the outcome can't be predicted, and it was applied by many financial bodies and under supervision of BVF. The main targets of the programme are the following:

- Tough financial policy. The local currency was devaluated and fixed with the exchange rate of US dollar. The credit possibilities of the international financial bodies were obtained, the bank interests were sharply increased, the tax-oriented income policy was applied, income tax exemptions and subsidies were abolished.
- Liberalisation of the economy. The price regulation policy was abolished, barriers in foreign trade were removed, tariffs began to be applied instead of them, free sale and purchase of foreign currency within the country was provided.
- The market infrastructure was established. The market relations based on the freedom of private property, banking sector, audit and calculation mechanisms were established. The taxation system including value added tax and income tax was re-organised.

The following results were achieved as a result of the above-mentioned reforms:

- The financial market developed. The foreign currency exchange rates were fixed at the intended rate, though the first inflation rate was exceeded, it was under control, monetary policy programme achieved the set objectives.
- The production volume sharply decreased. The unemployment level increased, the functionality of private companies wasn't as expected, new social reforms such as insurance on unemployment, pension, family benefits, and others replaced the social welfare policy and it was abused by the people.
- The stability of economy was provided and market relations were gradually settled. Nevertheless, the achievements obtained by these reforms were not approved by the people and as the result, the government lost the elections at the end of 1991.

This economic policy realised by Poland attracted attention of such countries as Russia, Latvia, Lithuania, Estonia, and Czechoslovakia, too, and

they decided to apply a similar model. However, though some positive results were obtained for a short term here as in Poland, it was very difficult for the society and, consequently, such kind of problems as high budget deficit, high inflation, unemployment and others couldn't be settled.

On the other hand, differing from the above-mentioned practice, such kind of countries as Hungary, Croatia, Slovenia, and others adopted the "gradual" transition policy. For the first, stabilisation and disinflation programme was adopted in these countries, then the privatisation policy was realised and, afterwards, the currency market and the liberalisation of foreign trade were applied. As the result of this kind of economic policy, inflation was decreased as it was considered and decrease in the production volume was at the minimum level. The obtained positive results were an example for such kind of countries as Ukraine, Romania, Belarus closely pursuing these processes and they began to realise the gradual transition policy instead of the shock therapy method (Williamson 2004).

1994-1996: Market reforms

The mid-1990s are the years when the economic reforms gave fruits and the market was gradually regulated in the countries with transition economy. It is possible to say that all the countries with transition economy had been the members of the international financial bodies such as the International Monetary Fund and the World Bank since 1994, and the stabilisation programme was applied under their control. The programme, which aimed principally at settlement and strengthening the free market economy also targeted privatisation, development of the private sector, involvement of foreign investment in the country and decrease of the functionality of the state in the market. Summarising it we can state that the following targets were the principal criteria of the transition years:

- Macroeconomic stabilisation;
- Liberalisation of prices and free conversion of foreign currency;
- Privatisation and development of the private sector;
- Restoration and reconstruction of the social security system;
- Preparation of institutional and legal foundations (WB 2002).

Macroeconomic stabilisation was obtained in many of the Central and Eastern European countries and structural reforms necessary for provision of its durability began to be carried out. It was impossible to obtain these achievements in Bulgaria and many of CIS countries. Such kind of problems as ethnic conflicts within the country, foreign conflicts with neighbouring countries and political instability made hindrances in obtaining economic stability by these countries and, in the result, obtaining such kind of

fundamental macroeconomic targets as inflation, unemployment, budget shortages and others was observed.

1997-2001: Crisis and economic shakes

The end of the 1990s is the years of economic crisis in wide geography from Mexico to Asian countries including the countries with transition economy. There is no doubt that this crisis exerting negative influence on the economy of any of developing countries would also affect negatively the countries with transition economy having weak financial system and incomplete institutional building activities.

Especially the Russian Federation experienced this crisis more profoundly among the mentioned countries. However, these years were the years when Russia gained economic and political stability. The targets on increase were achieved and inflation was under control. But fiscal policy and delay of structural reforms was disregarded, just therefore the economic crisis occurred in Asia shook the Russian Federation more deeply and made economic complications in the country.

Certainly, this crisis of Russia having the biggest economy of the region shook other countries deeply, too. Despite the collapse of the communist system, the neighbouring countries depending on one other and especially on Russia felt this crisis in their own countries to some extent. One of its biggest reasons was relation with the Russian market in the foreign trade and living on the basis of remitter income obtained from Russia. As the result, such kind of recessionary results as devaluation of local currencies, increase in unemployment rate, decrease of the national income showed themselves.

However, despite all these difficulties, improvement of economy occurred rapidly and the countries of the region continued their economic reforms in 1999-2001. Thus, the growth rate in GDP was 4% in 1999 and 7% in 2000 in the CIS region. As the main cause of the crisis, the Russian Federation was the driving force of the recovery process (IMF 2000).

2002-2007: Development period

The mid-2000s were the most successful years of the countries with transition economy. However, the main locomotive power of this economic development was external borrowing, revenues obtained from natural resources, and the development of the construction industry. One of the most important factors here was membership in the European Union obtained by 10 countries on these dates and as the result, positive atmosphere appeared in the economy of the above-mentioned countries and the emerging tendency

increased the hope of people on future and their consumption capacity². Other benefits obtained by the new member states are given below:

- Liberalisation of the market and making free the trade opportunities. The banking financial market developed rapidly in the countries newly adopted for the membership after the integration to the European Union, the trading opportunities were facilitated in the member states of the Union and free movement of the labour force within the continent was faster. According to the average figures, 2-3 million labour forces migrated from the countries with transition economy to the developed European countries.
- Adoption of the European standards by local self-managements and other governmental or non-governmental institutions caused strengthening of democratic values and legal norms in the country.
- Issuance of subsidies by the European Union for development of the institutional building activities, agriculture and other important areas of the countries with transition economy created a serious revival in the economy of these countries (WB 2014).

In general, people estimated this emerged stabilisation as an opportunity and increased their demand on goods and services in all countries with transition economy having fought with the economic crisis for many years. The principal driving force of this increase in demand was the development of the financial-banking sector and realisation of the facilitated mechanisms in obtaining consumption credits. The main source of financial resources was long-term cheap loans obtained from the international banks and financial institutions and it caused an emergence of serious competition for possessing a larger share in the market. Enjoying this competition, people implemented spending on their monthly incomes and bore risks on the consumption behaviours. Being blind to this tendency in order to keep up with the competition the local banking and financial sector couldn't even predict that they could encounter with a very severe financial crisis in the near future, i.e. in 2008.

2008-2014: Global financial crisis

The global financial crisis that began in the summer of 2007 exerted influence all over the world beginning from the developed countries and including the countries with transition economy. The severity of the crisis was accepted by everybody with the bankruptcy of Lehman Brothers in 2008 and the capital flows circulating between the countries were suddenly cut. In its

² Among these countries, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Slovenia and Slovakia obtained membership of the European Union on 1 May 2004 and Bulgaria and Romania on 1 January 2007. From other countries, Croatia entered the Union on 1 July 2013.

turn, it caused a sharp drop of purchase both in the local market and in foreign trade, decrease of demand, drop in production, increase in unemployment, decrease of social expenditures to minimum by governments and companies, and other chain problems.

Almost all of the above-mentioned problems were specific for the countries with transition economy located in the Eurozone and this crisis was deepened along with other problems brought by the Eurozone. The drop in the volume of GDP sharply emerged in the Central and Eastern European countries, Baltic countries, and other countries. As it is mentioned above, one of its principal reasons was related with the large-scale capital flows from the developed countries and the financial support of European countries received by these countries.

The countries began to apply monetary stimulation and tough financial policy in front of this recession. Of course, the sudden appearance of the crisis and its rapid influence on everybody made hindrances in successful realisation of the regulating reforms. First of all, the foreign currency reserves were not at the expected level in every country, the crediting competition and the enthusiasm to get more customers of the banks caused an increase of the volume of credits without guaranty and, as the result, no additional source could be obtained to finance them when artificially inflated balloons exploded. But those countries, which implemented more cautious external borrowing policy, had long-term monetary and financial policies, less budget deficits and public debt and, of course, the inflation level was lower, could overcome this crisis in a short term and were able to get the development rate with positive interest. Generally, the stabilisation began in 2010 and continued to increase in 2014 in the countries with transition economy. Though the results were not satisfactory in the principal macroeconomic indicators such as unemployment, positive results were obtained in the factors as the growth rate of GDP, revival of production and foreign trade, and so on.

Results

According to experts, the countries, which gained independence after the collapse of the socialist bloc, would obtain high development rates in the social economic direction together with the transition to free market economy and would reach the level of welfare states as soon as possible. The reason of the emergence of such kind of idea was the belief in more rational realisation of management of resources by using the high technological opportunities presented by the West and the tools of free market economy by the countries that were free from the central planning and solved their own destiny. But, unfortunately, the intended achievements were not obtained and the economic

performances of the countries lagged behind the developed countries. Its reason was lack of the fundamental preparations such as legal, institutional and other preparations having great importance. Just therefore, the economic development rate of these countries wasn't satisfactory within the first ten years after having gained independence. However, positive progress was observed and some major achievements were obtained in the economy of the mentioned countries in the next decade or since 2000. Though this tendency was peculiar to all countries with transition economy, there were differences upon their geographical locations. The Central European countries passed ahead the Baltic and Balkan countries for their economic performance and, in their turn, they passed ahead the CIS countries. Some of these countries, especially the countries with full membership of the European Union, have already completed their transition period and gained the status of free market. This process is being continued in the countries representing other regions.

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Streszczenie

Kraje, które uzyskały niepodległość po rozpadzie bloku socjalistycznego, przechodzące z centralnego systemu planowania gospodarki do gospodarki wolnorynkowej, aż do momentu ukończenia tego procesu, nazywa się krajami z gospodarką przejściową. Kraje te, mimo że rozpoczęły reformy w tym samym czasie i miały podobne cele, w ostatnich 25 latach uzyskały zupełnie inne wyniki. Powodem tego jest fakt, że były to kraje, które mają bardzo różną przeszłość historyczną, położenie geograficzne, zasoby ludzkie i naturalne oraz społeczno-demograficzne. Wyżej wymienione różnice w odmienny sposób wpłynęły na jakość procesu transformacji. Podczas gdy niektórym krajom udało się skutecznie zakończyć proces transformacji, inne nadal znajdują się w procesie przebudowy. Ogólnie rzecz biorąc, proces transformacji jest procesem bardzo trudnym dla każdego kraju i postawione cele zostają osiągnięte dopiero po długich latach zmagania. W artykule szczegółowo omówiono proces powyższych przemian.

Słowa kluczowe: blok socjalistyczny, gospodarka rynkowa, gospodarka przejściowa, centralne planowanie.

Kody JEL: P2, P21

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