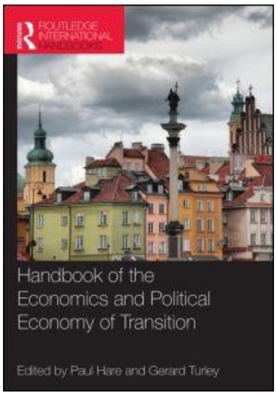

Handbook of the Economics and Political Economy of Transition

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Central and Eastern Europe and The CIS

Publication details
https://test.routledgehandbooks.com/doi/10.4324/9780203067901.ch35
Marek Dabrowski
Published online on: 25 Apr 2013

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CENTRAL AND EASTERN EUROPE AND THE CIS

20 years on

Marek Dabrowski

Introduction

More than two decades have passed since the transition to market economy started in Central and Eastern Europe (CEE). There is a vast literature, including some contributions to this volume, which discusses strategic goals of transition, its historical, political and economic context, optimal transition strategies, major policy components of transition process (such as macroeconomic stabilization, liberalization, privatization and enterprise restructuring, building a market compatible social safety net, etc.), political economy of the reform process, reform results at various time points and in various countries/groups of countries, and many other important issues.

While the present author took an active part in the debate on many of the above issues in the past, the purpose of this contribution is different: trying to find out where the CEE countries and the former USSR are now, what is their role in the global and European economies, what kind of challenges they face in the coming years. Generally, we shall not be revisiting the historical controversy on an optimal transition strategy[1] and/or the superiority/deficiency of certain policies and reform variants compared to others. Neither shall we conduct a counterfactual analysis to find out what might have happened if individual countries or group of countries had adopted different policies or implemented them more rapidly or more slowly. Although intellectually exciting, this kind of analysis has to involve, by definition, a substantial speculative component.

The analysis below will cover the former communist CEE countries and the former USSR, leaving aside other formerly centrally planned economies in Asia (China, Vietnam, Laos, Mongolia and North Korea), Africa (e.g. Ethiopia, Angola or Mozambique), the Middle East (e.g. Iraq and Syria) or Latin America (Cuba).[2] We will provide the aggregate picture rather than an analysis of individual countries and try to use the already existing comparative analyses, databases and ratings.

This contribution falls into six sections. The next one is about the role of CEE/Commonwealth of Independent States (CIS) economies in the global and European economy and their development level. This is followed by two sections which analyse progress in economic transition and in political reforms. Then we discuss the role of external 'anchors', especially the European Union (EU) membership prospects. Finally, we present conclusions and an overview of forthcoming development and reform challenges.

The economic potential of CEE/CIS countries and their development level

The former communist economies of CEE and the CIS[3] do not play a leading role in the world economy or even in Europe. However, both regions together produce some 8 per cent of the world GDP, on a par with Latin America or the Middle East plus Africa (Table 35.1). According to IMF (2011, Table A, p. 167), the largest country of this group – Russia – contributed 3 per cent of world GDP in 2010, less than China (13.6 per cent) and India (5.5 per cent) but slightly more than Brazil (2.9 per cent), another BRIC[4] economy.

For the 10 CEE economies which joined the EU in 2004 and 2007, their share in EU-27 GDP amounted to 5.4 per cent in 2004 and to 7.4 per cent in 2010. The biggest country of this group – Poland – accounted for 2.9 per cent of EU-27 GDP in 2010, followed by the Czech Republic (1.2 per cent) and Romania (1 per cent).[5] In spite of a recorded increase, the share of NMS in EU-27 GDP remains marginal, with a rather peripheral role for the EU10 in the entire Union.

On a positive note, Table 35.1 demonstrates that shares of both the CEE and CIS regions in the global economy slightly increased over the last 15 years,[6] which, taking into consideration the declining share of the EU, the eurozone or the G7 in global output, provides us with indirect evidence of some income convergence. The same conclusion can be drawn from the above statistics on the share of EU NMS in EU-27 GDP.

The evidence of gradual income convergence of the transition economies can also be seen from Table 35.2, which presents gross national income (GNI) per capita calculated according to the World Bank Atlas method.[7] In 2010, the group of low and middle income countries of the World Bank region of Europe and Central Asia (ECA) was still below the world GNI per capita average (US $7,269 against US $9,116, i.e. 79.7 per cent) but this gap substantially diminished compared to previous periods. If one adds seven high-income countries, i.e. Slovenia, Czech Republic, Slovakia, Estonia, Croatia, Hungary and Poland, the entire region will reach the global average or even exceed it.

Nevertheless, the income gap has not disappeared completely. The seven high-income transition economies occupy the bottom end of the entire high-income group, much below its average GNI per capita. The same is true in respect to the EU. The highest-income EU new member state (NMS) (Slovenia) represents only 70.7 per cent of the entire block's average.

Table 35.2 also shows a 30-fold income difference between the richest (Slovenia) and poorest (Tajikistan) transition economy in 2010. However, this is not a new phenomenon. In 1995 this

Table 35.1 Shares in world GDP by regions/country groups (in per cent)

Country group	*1995*	*2000*	*2005*	*2008*	*2010*
G7	50.3	48.9	45.1	41.5	39.3
EU	26.0	25.0	23.0	21.8	20.4
CEE	3.2	3.3	3.5	3.6	3.5
CIS	4.0	3.6	4.1	4.5	4.3
Developing Asia	13.5	15.2	18.4	21.4	24.1
ASEAN-5	3.4	3.1	3.3	3.5	3.6
Latin America and the Caribbean	9.1	8.8	8.4	8.6	8.6
MENA	4.2	4.3	4.7	4.9	5.0
Sub-Saharan Africa	2.0	2.0	2.2	2.3	2.4

Source: IMF World Economic Outlook database, September 2011.

Table 35.2 GNI per capita, Atlas method (current US$)

Country name	*1995*	*2000*	*2005*	*2008*	*2010*	*Income group*[a]
Slovenia	8500	11090	18080	24210	24000	High income
Czech Republic	4470	5800	11330	17140	17890	
Slovakia	4120	5370	10880	16590	16210	
Estonia	3020	4220	9760	14410	14370	
Croatia	3530	5200	9730	13720	13780	
Hungary	4110	4700	10260	13010	12980	
Poland	2970	4590	7270	11870	12410	
Latvia	2050	3220	6810	12020	11620	Upper-middle income
Lithuania	2100	3200	7280	11910	11390	
Russia	2650	1710	4460	9630	9910	
Romania	1470	1690	3920	8290	7840	
Kazakhstan	1280	1260	2930	6140	7440	
Montenegro			3580	6370	6620	
Bulgaria	1360	1640	3640	5700	6250	
Belarus	1370	1380	2760	5590	6130	
Serbia		1400	3430	5520	5810	
Azerbaijan	400	610	1270	3790	5080	
Bosnia and Herzegovina		1510	3000	4530	4790	
Macedonia	1710	1850	2830	4180	4520	
Albania	670	1170	2580	3820	3960	Lower-middle income
Turkmenistan	610	650	1650	2830	3800	
Kosovo				3000	3300	
Armenia	450	660	1470	3340	3090	
Ukraine	920	700	1540	3210	3010	
Georgia	540	750	1360	2460	2690	
Moldova	470	370	890	1500	1810	
Uzbekistan	580	630	530	890	1280	
Kyrgyzstan	350	280	450	770	880	Low income
Tajikistan	200	170	340	620	800	
Memorandum						
World Bank ECA region [b]	1896	1781	3708	6960	7269	
European Union	18146	18946	28286	34762	33980	
High income	23699	25265	33920	38504	38517	
Low income	242	265	339	442	523	
Lower middle income	554	575	914	1397	1660	
Upper middle income	1608	1891	2935	4880	5876	
World	5065	5297	7142	8717	9116	

Source: http://data.worldbank.org/indicator/NY.GNP.PCAP.CD; http://data.worldbank.org/about/country-classifications/country-and-lending-groups.

Note: [a] The income groups are defined according to 2010 GNI per capita, calculated using the World Bank Atlas method: low income, US $1,005 or less; lower middle income, US $1,006–3,975; upper middle income, US $3,976–12,275; and high income, US $12,276 or more. [b] – It includes only low and middle income transition countries (plus Turkey).

difference was even higher (42.5-fold). Furthermore, in the period 1995–2010 several transition economies, e.g. Baltic and Southern Caucasus countries, Albania, Romania and Kazakhstan, recorded a spectacular income convergence. This convergence was facilitated by both internal reforms (market transition) and external factors such as economic integration with the EU (in CEE) and an energy and commodity boom (in the CIS).

All the former communist economies benefited from the global boom of the mid-2000s fuelled by low interest rates in the US and other advanced economies and an abundance of private funding. However, most of them suffered seriously when real estate, financial and commodity bubbles burst in 2007–08.

How much have economic systems changed since the early 1990s?

After analysing development levels and income convergence of the CEE/CIS countries, we next study their progress in transforming their economic systems over the last two decades. Is the transition from plan to market completed and can the analysed economies be considered to be capitalist ones?

The best comparative picture of economic reform progress can be obtained from the transition indicators of the European Bank for Reconstruction and Development (EBRD). Table 35.3 and Figure 35.1 present the evolution of sectoral scores for the period of 1992–2010. Indices for each area of reform have been constructed as unweighted averages of the individual scores of 27 transition countries (all but the Czech Republic and Kosovo which are not listed in the EBRD rankings), using the scale from 1 (no reform) to 4.33 (complete reform).

One can draw some interesting observations from this analysis. First, although the average scores for each reform area have been rising continuously, the 1990s brought much more rapid progress compared to the 2000s when reforms slowed down. In political economy terms this corresponds with the boom period of the beginning and mid-2000s, when high growth rates and an abundance of inexpensive funding discouraged policymakers from undertaking technically difficult and politically unpopular measures.[8] Second, the progress in individual reform areas has been uneven. As seen from Figure 35.1 the fastest progress has been achieved in the areas of price liberalization, trade and foreign exchange liberalization and small-scale privatization, all belonging to the early-stage transition agenda. Large-scale privatization and banking reform have lagged behind but, on average, the cumulative progress can be considered as substantial. Enterprise restructuring, competition policy, development of securities markets and non-bank financial institutions and infrastructure reforms are the less advanced areas which require continuous reform effort in most of the analysed countries.

Table 35.4 presents country scores built up as the unweighted averages of sectoral scores for each country in a given year, with an asterisk indicating years when the score was equal to or higher than 3, considered by us as the advanced stage of transition. One can see that the CEE

Table 35.3 EBRD average transition scores by sector, 1992–2010

Area of reform	*1992*	*1995*	*1998*	*2001*	*2004*	*2007*	*2010*
Large-scale privatization	1.36	2.23	2.68	2.82	3.04	3.14	3.21
Small-scale privatization	2.10	3.12	3.46	3.64	3.79	3.85	3.86
Enterprise restructuring	1.22	1.91	2.10	2.12	2.31	2.43	2.48
Price liberalization	3.05	3.59	3.78	3.95	3.99	4.00	4.04
Trade and forex system	2.23	3.01	3.27	3.58	3.73	3.82	3.91
Competition Policy	1.28	1.73	1.96	2.11	2.16	2.38	2.46
Banking reform and interest rate liberalization	1.27	2.14	2.26	2.42	2.77	2.94	2.98
Securities markets and non-bank financial institutions	1.17	1.72	1.94	2.03	2.26	2.40	2.46
Overall infrastructure reform	1.21	1.46	1.89	2.26	2.38	2.48	2.57

Source: http://www.ebrd.com/downloads/research/economics/macrodata/tis.xls.

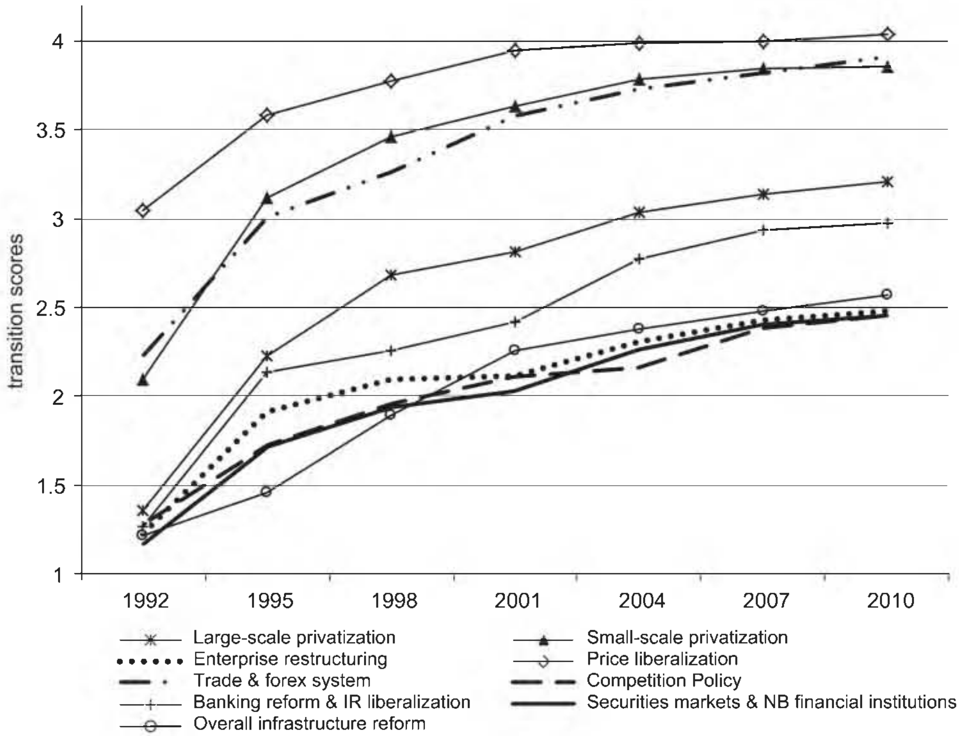

Figure 35.1 EBRD average transition scores by sector, 1992–2010
Source: http://www.ebrd.com/downloads/research/economics/macrodata/tis.xls

countries such as Hungary, Poland, Estonia and Slovakia had achieved the advanced reform level already by 1995.[9] They were followed by Slovenia, Latvia, Lithuania and Croatia whose 1998 average scores exceeded the level of 3. They were joined in the early 2000s by Romania and Bulgaria. Armenia, Georgia, Macedonia, Russia and Ukraine reached this level in the mid- or late 2000s, while Albania and Moldova only did so recently. Armenia and Georgia seem to be the most advanced reformers in the CIS region.

Other CIS and Western Balkan countries remain below the level of 3 even if some of them (Kazakhstan, Kyrgyzstan, Montenegro and Serbia) are pretty close to this level. Three countries can be considered as either non-reformer (Turkmenistan) or very limited reformers (Belarus and Uzbekistan) for the entire analysed period.

While the EBRD scores make it possible to compare the reform progress among transition economies on a systematic basis, they do not provide a benchmark to compare them with the outside world. To fill this gap, Table 35.5 presents the Heritage Foundation (HF) Index of Economic Freedom for transition economies which, with all its shortcomings, seems to be the best to offer global cross-country comparisons of the role of the market mechanism.

None of the former communist economies is ranked by the HF as 'free', i.e. representing a score of 80 or above. However, only six countries in the world fall into this category: Hong Kong (89.7), Singapore (87.2), Australia (82.5), New Zealand (82.3), Switzerland (81.9) and Canada (80.8). Estonia has the highest score among transition countries (75.2), behind Ireland (78.7), Denmark (78.6), USA (77.8), Chile (77.4) and Luxemburg (76.2) but ahead of the Netherlands (74.7), UK (74.5), Finland (74.0), Cyprus (73.3), Japan (72.8), Austria (71.9),

Table 35.4 EBRD average transition scores by country, 1992–2010

Country	*1992*	*1995*	*1998*	*2001*	*2004*	*2007*	*2010*
Albania	1.63	2.33	2.52	2.81	2.89	2.96	3.07*
Armenia	1.48	2.11	2.67	2.85	3.00*	3.11*	3.18*
Azerbaijan	1.19	1.70	2.33	2.44	2.59	2.63	2.63
Belarus	1.26	2.00	1.52	1.67	1.81	1.85	2.11
Bosnia and Herzegovina	1.22	1.11	2.04	2.22	2.52	2.70	2.82
Bulgaria	1.85	2.33	2.81	3.18*	3.37*	3.48*	3.56*
Croatia	1.93	2.70	3.04*	3.22*	3.44*	3.52*	3.55*
Estonia	1.85	3.15*	3.44*	3.70*	3.81*	3.93*	3.93*
Georgia	1.26	1.96	2.78	2.92	2.96	3.11*	3.11*
Hungary	2.63	3.48*	3.78*	3.85*	3.89*	3.96*	3.93*
Kazakhstan	1.30	2.26	2.81	2.85	2.93	3.00*	2.96
Kyrgyzstan	1.48	2.70	2.78	2.78	2.93	2.93	2.93
Latvia	2.00	2.81	3.11*	3.29*	3.56*	3.63*	3.63*
Lithuania	1.59	2.85	3.07*	3.37*	3.52*	3.70*	3.70*
Macedonia	1.81	2.44	2.67	2.85	3.04*	3.15*	3.26*
Moldova	1.44	2.52	2.70	2.81	2.78	2.96	3.00*
Montenegro	1.67	1.44	1.19	1.82	2.41	2.78	2.89
Poland	2.56	3.22*	3.52*	3.66*	3.66*	3.81*	3.89*
Romania	1.59	2.41	2.89	3.07*	3.22*	3.41*	3.48*
Russia	1.89	2.59	2.55	2.70	2.96	3.04*	3.04*
Serbia	1.67	1.44	1.44	1.85	2.44	2.74	2.93
Slovakia	2.52	3.11*	3.22*	3.41*	3.67*	3.74*	3.74*
Slovenia	2.04	2.93	3.22*	3.33*	3.37*	3.37*	3.41*
Tajikistan	1.30	1.70	2.00	2.15	2.30	2.37	2.48
Turkmenistan	1.00	1.26	1.45	1.30	1.30	1.30	1.44
Ukraine	1.19	2.19	2.48	2.63	2.81	3.00*	3.07*
Uzbekistan	1.19	2.22	2.11	2.11	2.08	2.15	2.15

Source: http://www.ebrd.com/downloads/research/economics/macrodata/tic.xls.
Note: * Years when the score was equal to or higher than 3, considered by us as the advanced stage of transition.

Sweden (71.9) and Germany (71.8). Apart from Estonia, only three other countries of the CEE/CIS region – Lithuania (71.3), the Czech Republic and Georgia (both 70.4) – are ranked in the 'mostly free' group (at its bottom), on a par with Taiwan (70.8), Norway (70.3), Spain and Belgium (70.2) and Uruguay (70.0). Fourteen transition countries belong to the 'moderately free' group, the same group where the Republic of Korea, Israel, Iceland, Jordan, Colombia, the United Arab Emirates, Mexico, Malaysia, Saudi Arabia, France, Turkey, Portugal, South Africa, Italy, Greece and Lebanon are ranked. Six transition countries belong to the 'mostly unfree' category and four – Belarus, Uzbekistan, Ukraine and Turkmenistan – to the 'repressed' group.

Summing up, two decades after the collapse of communism, the countries of CEE and the CIS can be considered largely as market economies, with a few exceptions such as Turkmenistan, Belarus and Uzbekistan. Nevertheless, they differ greatly between themselves in terms of the degree of market freedom, maturity of institutions, macroeconomic stability, etc. The Baltic countries and central Europe completed a basic transition agenda by the beginning of the 2000s, before joining the EU, and currently their economic systems do not differ greatly from the 'old' EU members. Other countries, especially in the CIS region, are less advanced and their model

Table 35.5 Heritage Foundation Index of Economic Freedom, transition economies, 2011

Category	*Name*	*Rank*	*Overall score*	*Business freedom*	*Trade freedom*	*Fiscal freedom*	*Government spending*	*Monetary freedom*	*Investment freedom*	*Financial freedom*	*Property rights*	*Freedom from corruption*	*Labour freedom*
Mostly free	Estonia	14	75.2	80.9	87.6	80.7	52.2	78.7	90.0	80.0	80.0	66.0	55.8
	Lithuania	24	71.3	81.7	87.6	86.1	58.0	74.5	80.0	80.0	60.0	49.0	55.6
	Czech Rep.	28	70.4	69.8	87.6	81.0	44.8	80.0	70.0	80.0	65.0	49.0	77.0
	Georgia	29	70.4	87.3	89.2	87.5	60.3	76.7	70.0	60.0	40.0	41.0	92.1
Moderately free	Armenia	36	69.7	82.4	85.5	89.2	85.7	76.0	75.0	70.0	30.0	27.0	75.9
	Slovakia	37	69.5	73.4	87.6	84.2	63.7	81.6	75.0	70.0	50.0	45.0	64.5
	Hungary	51	66.6	76.5	87.6	69.7	27.4	75.9	75.0	70.0	65.0	51.0	67.7
	Macedonia	55	66.0	64.6	83.6	90.0	64.3	84.5	60.0	60.0	35.0	38.0	79.7
	Latvia	56	65.8	72.8	87.6	82.5	55.5	73.5	80.0	50.0	50.0	45.0	61.3
	Bulgaria	60	64.9	75.8	87.6	86.9	58.3	75.5	55.0	60.0	30.0	38.0	82.0
	Romania	63	64.7	72.0	87.6	86.8	57.6	74.4	80.0	50.0	40.0	38.0	60.8
	Slovenia	66	64.6	83.6	87.6	65.1	41.1	80.5	70.0	50.0	60.0	66.0	41.8
	Poland	68	64.1	61.4	87.6	74.0	43.8	78.1	65.0	60.0	60.0	50.0	61.2
	Albania	70	64.0	67.1	79.8	92.1	68.7	79.9	65.0	70.0	35.0	32.0	50.4
	Montenegro	76	62.5	71.3	83.6	89.4	28.6	76.0	55.0	50.0	40.0	39.0	92.3
	Kazakhstan	78	62.1	74.3	80.9	87.3	78.5	69.9	30.0	50.0	35.0	27.0	88.4
	Croatia	82	61.1	65.2	87.6	74.6	50.3	78.5	70.0	60.0	40.0	41.0	44.1
	Kyrgyzstan	83	61.1	75.4	63.2	92.6	74.2	68.6	55.0	50.0	25.0	19.0	88.1
Mostly unfree	Azerbaijan	92	59.7	72.9	77.1	83.9	71.0	72.6	55.0	40.0	20.0	23.0	81.1
	Serbia	101	58.0	59.0	75.2	83.6	41.9	66.0	60.0	50.0	40.0	35.0	68.9
	Bosnia and Herzegovina	104	57.5	60.4	86.0	83.9	24.1	80.6	70.0	60.0	20.0	30.0	60.2
	Moldova	120	55.7	69.5	80.2	85.6	48.1	77.0	35.0	50.0	40.0	33.0	39.0
	Tajikistan	128	53.5	60.7	82.5	88.6	77.3	64.5	20.0	40.0	25.0	20.0	56.4
	Russia	143	50.5	50.7	68.2	82.7	65.1	63.1	25.0	40.0	25.0	22.0	62.9
Repressed	Belarus	155	47.9	70.6	80.3	83.6	26.2	62.2	20.0	10.0	20.0	24.0	82.3
	Uzbekistan	163	45.8	66.8	66.2	90.5	71.0	61.7	0.0	10.0	15.0	17.0	60.2
	Ukraine	164	45.8	47.1	85.2	77.3	32.9	63.2	20.0	30.0	30.0	22.0	50.0
	Turkmenistan	169	43.6	30.0	79.2	93.6	95.5	69.6	0.0	10.0	10.0	18.0	30.0

Source: http://www.heritage.org/Index/ranking, http://www.heritage.org/Index/explore.

of capitalism, with weak property rights, repressive government and a high level of corruption, is closer to that of many developing countries. Most of the analysed countries face the challenge of unfinished and incomplete reforms, as we discuss further below.

Political systems

Economic transition in the region was triggered by political changes, i.e. the collapse of communist regimes. Thus, simultaneously with building a market economy the former communist countries were expected to develop political freedom, pluralism and democracy. To assess progress in this field we use the Freedom House (FH) rating Freedom in the World (FIW) (Table 35.6). Each country in this rating is evaluated by two criteria: political rights (PR), and civil liberties (CL), both measured on a one-to-seven scale, with one representing the highest degree of freedom and seven - the lowest.

Based on FIW scores one can distinguish three groups of transition countries:

- countries that democratized their political systems in the early 1990s and sustained their 'free' status over the entire analysed period (this group includes countries that joined the EU in 2004 and 2007);
- countries that recorded limited progress in democratization in the 1990s but substantially improved their performance in the next decade (western Balkans);
- countries that, after the short period of political freedom and democracy in the early 1990s, moved back towards authoritarian or semi-authoritarian regimes (most of the CIS).

For the CIS region, even the wave of so-called colour revolutions (the 'Rose' revolution in Georgia in 2003, 'Orange' revolution in Ukraine in 2004 and 'Tulip' revolution in Kyrgyzstan in 2005) did not change the picture. Their outcomes proved unsustainable, with new authoritarian tendencies emerging after the revolutionary enthusiasm faded away.

Table 35.7 presents the results of another FH analysis Nation in Transit (NIT), which gives us a more detailed picture of countries' political systems by their major components. It is quite clear that even the best performers in these ratings (EU NMS) face problems in such areas as Judicial Framework and Independence (JFI) and Corruption (CO).

Finally we analyse the interrelation between political and economic reforms. Figure 35.2 plots the HF Index of Economic Freedom scores against the FH NIT scores (from the 2011 edition of both rankings). One can observe a certain degree of correlation in both spheres but not particularly strong (and obviously weaker than could be observed at the end of the 1990s and the beginning of the 2000s – see Dabrowski and Gortat, 2002). CIS countries (except Ukraine) are located above the trend line, indicating more economic freedoms than political ones. In the specific case of the Caucasus and some Central Asian countries this asymmetry is even stronger. In contrast, the EU NMS (plus Ukraine and Serbia) occupy the space below the trend line, i.e. they are relatively freer politically than economically. Other western Balkan countries are located close to the trend line.

The question of causality is more complicated. Democratization seems to facilitate market reforms as was empirically shown in the early transition period (when countries which experienced radical changes of political regimes and elites started their economic reforms earlier and conducted them in a more comprehensive and consistent way) and later episodes of both reform acceleration (election victories of democratic forces in Romania in 1996, Bulgaria in 1997 and Slovakia in 1998, collapse of Milosevic's regime in Yugoslavia in 2000, 'Rose' revolution in Georgia in 2003) and reform stagnation or reversal under authoritarian regimes

Table 35.6 FH Freedom in the World scores, transition countries, 1992–2010

Country	*1992*			*1995*			*2000*			*2005*			*2010*		
	PR	*CL*	*Status*	*PR*	*CL*	*Status*	*PR*	*CL*	*Status*	*PR*	*CL*	*Status*	*PR*	*CL*	*Status*
Albania	4	3	PF	3	4	PF	4	5	PF	3	3	PF	3	3	PF
Armenia	4	3	PF	4	4	PF	4	4	PF	5	4	PF	6	4	PF
Azerbaijan	5	5	PF	6	6	NF	6	5	PF	6	5	NF	6	5	NF
Belarus	4	3	PF	5	5	PF	6	6	NF	7	6	NF	7	6	NF
Bosnia and Herzegovina	6	6	NF	6	6	NF	5	4	PF	4	3	PF	4	3	PF
Bulgaria	2	3	F	2	2	F	2	3	F	1	2	F	2	2	F
Croatia	4	4	PF	4	4	PF	2	3	F	2	2	F	1	2	F
Czech Republic[a]	2	2	F	1	2	F	1	2	F	1	1	F	1	1	F
Estonia	3	3	PF	2	2	F	1	2	F	1	1	F	1	1	F
Georgia	4	5	PF	4	5	PF	4	4	PF	3	3	PF	4	3	PF
Hungary	2	2	F	1	2	F	1	2	F	1	1	F	1	1	F
Kazakhstan	5	5	PF	6	5	NF	6	5	NF	6	5	NF	6	5	NF
Kosovo	..	..	..	..	..	..	..	..	..	..	..	..	5	4	PF
Kyrgyzstan	4	2	PF	4	4	PF	6	5	NF	5	4	PF	5	5	PF
Latvia	3	3	PF	2	2	F	1	2	F	1	1	F	2	2	F
Lithuania	2	3	F	1	2	F	1	2	F	1	1	F	1	1	F
Macedonia	3	4	PF	4	3	PF	4	3	PF	3	3	PF	3	3	PF
Moldova	5	5	PF	4	4	PF	2	4	PF	3	4	PF	3	3	PF
Montenegro[b]	6	5	PF	6	6	NF	4	4	PF	3	2	F	3	2	F
Poland	2	2	F	1	2	F	1	2	F	1	1	F	1	1	F
Romania	4	4	PF	4	3	PF	2	2	F	2	2	F	2	2	F
Russia	3	4	PF	3	4	PF	5	5	PF	6	5	NF	6	5	NF
Serbia[b]	6	5	PF	6	6	NF	4	4	PF	3	2	F	2	2	F
Slovakia[a]	2	2	F	2	3	F	1	2	F	1	1	F	1	1	F
Slovenia	2	2	F	1	2	F	1	2	F	1	1	F	1	1	F
Tajikistan	6	6	NF	7	7	NF	6	6	NF	6	5	NF	6	5	NF
Turkmenistan	7	6	NF	7	7	NF	7	7	NF	7	7	NF	7	7	NF
Ukraine	3	3	PF	3	4	PF	4	4	PF	3	2	F	3	3	PF
Uzbekistan	6	6	NF	7	7	NF	7	6	NF	7	7	NF	7	7	NF

Source http://www.freedomhouse.org/images/File/fiw/historical/FIWAllScoresCountries1973–2011.xls.
Notes: a In 1992 – scores for Czechoslovakia.
b Scores for Yugoslavia until 2003 and for Confederation of Serbia and Montenegro in 2004–06.
PR, political rights; CL, civil liberties; NF, non-free; PF, partly free; F, free.

(Belarus since the mid-1990s, Russia since 2004). Generally, there is little evidence that market-friendly authoritarianism can be a promising option in the analysed group of countries.

However, the opposite causality can also hold true. There is a large body of literature (e.g. Lipset, 1959; Barro, 1996; Przeworski and Limongi, 1997) that claims that chances for democracy and its survival increase with a higher level of economic development and higher economic growth and both depend on better performance of economic systems based on market forces. Summing up, in spite of individual country deviations from the trend line in Figure 35.2, democratization and market reforms seem to reinforce each other in the long run.

Table 35.7 FH 'Nations in Transit' Scores, 2010

Country	*EP*	*CS*	*IM*	*NGOV*	*LGOV*	*JFI*	*CO*	*DS*
Albania	4.00	3.00	4.00	4.75	3.25	4.25	5.00	4.04
Armenia	5.75	3.75	6.00	5.75	5.75	5.50	5.50	5.43
Azerbaijan	7.00	5.75	6.75	6.50	6.50	6.25	6.50	6.46
Belarus	7.00	6.00	6.75	6.75	6.75	6.75	6.00	6.57
Bosnia and Herzegovina	3.25	3.50	4.75	5.25	4.75	4.25	4.50	4.32
Bulgaria	1.75	2.50	3.75	3.50	3.00	3.00	4.00	3.07
Croatia	3.25	2.50	4.00	3.50	3.75	4.25	4.25	3.64
Czech Rep.	1.25	1.75	2.50	2.75	1.75	2.00	3.25	2.18
Estonia	1.75	1.75	1.50	2.25	2.50	1.50	2.25	1.93
Georgia	5.00	3.75	4.25	5.75	5.50	5.00	4.75	4.86
Hungary	1.75	2.00	3.25	3.00	2.50	2.25	3.50	2.61
Kazakhstan	6.75	5.75	6.75	6.75	6.25	6.25	6.50	6.43
Kosovo	4.50	3.75	5.75	5.75	5.00	5.75	5.75	5.18
Kyrgyzstan	6.00	4.75	6.50	6.50	6.50	6.25	6.25	6.11
Latvia	1.75	1.75	1.75	2.25	2.25	1.75	3.50	2.14
Lithuania	1.75	1.75	1.75	2.75	2.50	1.75	3.50	2.25
Macedonia	3.25	3.25	4.50	4.00	3.75	4.00	4.00	3.82
Moldova	4.00	3.25	5.50	5.75	5.75	4.50	6.00	4.96
Montenegro	3.25	2.75	4.25	4.25	3.25	4.00	5.00	3.82
Poland	1.50	1.50	2.25	2.75	1.75	2.50	3.25	2.21
Romania	2.75	2.50	4.00	3.75	3.00	4.00	4.00	3.43
Russia	6.75	5.50	6.25	6.50	6.00	5.75	6.50	6.18
Serbia	3.25	2.25	4.00	3.75	3.50	4.50	4.25	3.64
Slovakia	1.50	1.75	3.00	2.75	2.50	2.75	3.50	2.54
Slovenia	1.50	2.00	2.25	2.00	1.50	1.75	2.50	1.93
Tajikistan	6.50	6.00	5.75	6.25	6.00	6.25	6.25	6.14
Turkmenistan	7.00	7.00	7.00	7.00	6.75	7.00	6.75	6.93
Ukraine	3.50	2.75	3.75	5.50	5.50	5.50	5.75	4.61
Uzbekistan	7.00	7.00	7.00	7.00	6.75	7.00	6.75	6.93

Source: http://www.freedomhouse.org/images/File/nit/2011/NIT-2011-Tables.pdf.
Notes: The ratings are based on a scale of 1 to 7, with 1 representing the highest level of democratic progress and 7 the lowest. The Democracy Score (DS) is an average of ratings for Electoral Process (EP); Civil Society (CS); Independent Media (IM); National Democratic Governance (NGOV), Local Democratic Governance (LGOV); Judicial Framework and Independence (JFI); and Corruption (CO).

The role of external anchors

The question of why some countries accomplished greater progress in both economic and political transition while others were less successful has been explored by many studies that investigated the initial political and economic conditions, reform strategies, interactions between the political and economic spheres, geographic location and many other factors. In this section we address just one factor, namely the role of external anchors.

The literature on the political economy of reforms explains why external anchoring is important for both reform design and reform implementation and, even more important, for sustaining reforms, in particular avoiding policy reversals (see, for example, Rodrik, 1996 and Fukuyama, 2004 for an overview). This may relate, among others, to insufficient domestic

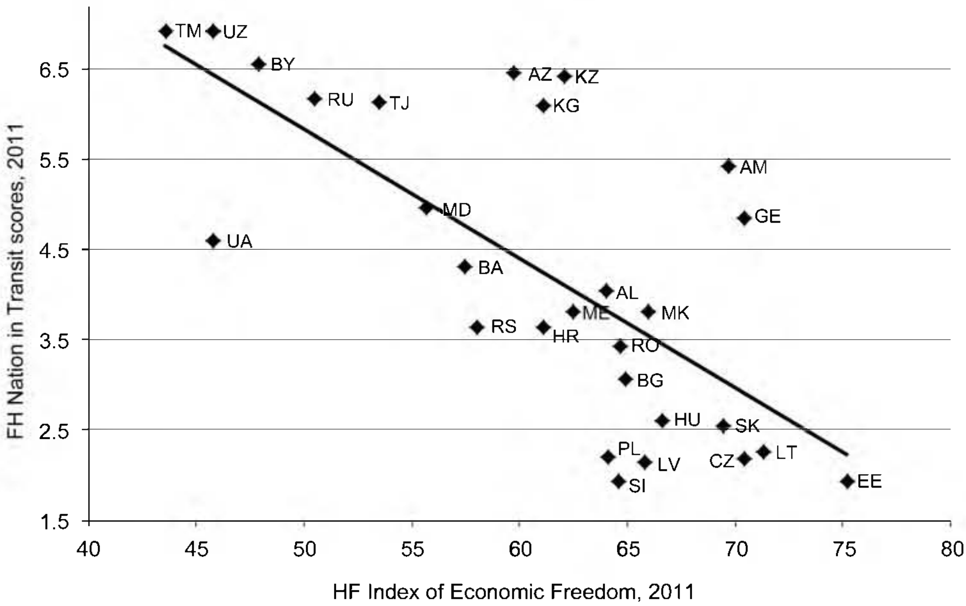

Figure 35.2 Interrelation between economic and political freedoms in transition countries
Source: http://www.heritage.org/Index/explore; http://www.freedomhouse.org/images/File/nit/2011/NIT-2011-Tables.pdf; http://www.freedomhouse.hu//images/fdh_galleries/NIT2007/rating%20and%20democracy%20score%20summary3.pdf

political consensus, high reform costs (in both socio-economic and political terms), uncertainty about reform results and a lack of the technical skills needed to implement them. The external incentives can have both a positive and a negative character (i.e. they can take the form of 'carrots' or 'sticks'). Among the former one can mention, for example, financial aid, technical assistance, market access, perspectives of foreign investment inflows, international security guarantees and membership of prestigious country clubs such as the EU. The 'sticks' may involve the danger of a country experiencing economic and political isolation, downgrading its economic and geo-political status and losing the external support enjoyed so far. In some extreme instances, lack of reforms can even challenge a country's territorial integrity and existence.[10]

Among the various external anchors, the most important role has been played by either actual or perspective membership in international organizations and regional integration blocks and the 'rules of the game'/conditionality related to this membership. Since the collapse of communism, the CEE and CIS countries became members of global financial institutions and organizations such as the IMF, the World Bank, the WTO and the OECD,[11] regional development banks (EBRD and Asian Development Bank), regional integration blocks (EU, the CIS and narrower integration initiatives within the CIS such as EvrAzES or custom union), geo-political and security alliances (NATO, CIS Collective Security Treaty Organization) and political organizations (Council of Europe, Organization for Security and Cooperation in Europe). However, only a few organizations/blocks that have offered meaningful long-term incentives and benefits have had a substantial impact on the transition process.

This relates, in the first instance, to the EU in all cases where it has opened its door to a country's prospective membership. Table 35.4 gives us a hint on how the perspective of EU membership helped to advance market reforms, first in Central European and Baltic countries, then in Bulgaria and Romania, and finally in the western Balkan state, on the one hand, and how the lack of such a perspective discouraged reforms in the CIS, on the other. This is even more visible in the case of political systems (Tables 35.6 and 35.7) with 'free' EU NMS, 'partly free' prospective EU candidates in western Balkans and mostly 'non-free' CIS.

Again one can raise the question of causality. Good economic and political reform scores can result from the presence of an EU membership perspective but the opposite may also be true: countries more advanced in these reforms have a greater chance and interest to meet the Copenhagen criteria and successfully join the EU accession process. None the less, the total absence of an EU accession perspective (even in a quite distant future) eliminates that important incentive for economic reforms and keeping them on track and makes political systems more vulnerable to authoritarian drifts. It is enough to compare the developments in the CIS versus South Eastern Europe. In the mid-1990s both regions represented, on average, a similar level of economic development and, as seen from Tables 35.4 and 35.6, exhibited comparable progress in their economic and political reforms. However, after offering the Western Balkan countries the EU membership perspective in the early 2000s, they moved quickly ahead in both areas while the CIS countries stagnated and some of them even regressed in the political sphere.

Neither the European Neighbourhood Policy nor the Eastern Partnership, the EU co-operation initiatives addressed to six Eastern European and Caucasus partners (Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine) have brought meaningful results yet. A similar co-operation framework launched between the EU and Russia has had a similarly disappointing outcome. These initiatives included the EU's offer of partial access to the Single European Market, but without a membership perspective.

Regarding other institutions there is some evidence of the positive impact of NATO membership, especially in the areas of political and institutional reforms, and a much weaker impact in respect to WTO membership (Schweickert *et al.*, 2007).

Interventions and surveillance by the Bretton Woods institutions (the IMF and the World Bank) seem to be important for short-term policy adjustments (like macroeconomic stabilization programmes) when some degree of domestic policy commitment ('reform ownership') is in place. However, they are unlikely to serve as the long-term external anchor, especially in the area of institutional reforms which require political changes.[12]

Looking ahead: reform agenda for the future

Two decades after the collapse of communism, all the CEE and most of the CIS countries completed the basic transition agenda in the economic sphere. This means they can be considered as market economies, but representing various development levels and various degrees of maturity and perfection of market institutions.

In spite of this completion of the basic transition agenda almost everywhere, further reforms are badly needed. The recent global financial and economic crisis revealed many shortcomings of existing policies and institutions which require correction. However, the reform agendas differ by individual countries and country groups/subgroups.

The formerly centrally planned economies never constituted a homogenous group. At the start of transition in the late 1980s/early 1990s they already differed in terms of development level, resource endowment, degree of openness, macroeconomic stability, external debt, structural distortions, role of market forces and non-public ownership, civil liberties, etc. However, the common institutional legacy and transformation challenges were strong enough to justify broadly similar policy agendas at the start.

Such an approach is not justified anymore. Ten CEE countries are part of the EU (and three of them have already joined the eurozone) and this restricts their freedom of choice in many important spheres of economic management in favour of the EU's common policies. Thus, apart from their national policy agendas they must participate in the process of intra-EU policy debate and institutional changes. Six countries of the western Balkan states are also at various stages of the EU accession process, and their priority is to adopt the EU *acquis communautaire*.

Due to their high level of trade and investment integration within the EU, the economic future of the CEE countries is strongly dependent on Europe's growth perspective and the EU's ability to make its institutions and policies more growth-friendly. At the national level, similarly to the 'old' EU members, most of them need to cut back their excessive welfare programmes and entitlements, increase labour market participation and its flexibility, reform their education and healthcare systems, stimulate innovation, continue deregulation of product and service markets, and public administration reforms. Some countries such as Hungary need substantial fiscal adjustments in order to avoid a sovereign debt crisis and to be able to meet the Maastricht criteria soon.

The reform agenda in the CIS region is much more complex and challenging. While countries of the former Soviet Union must also reform their pension, healthcare and education systems, their major development obstacle is related to the poor business and investment climate, which, in turn, is underpinned by the low quality of state institutions (especially public administration and the judiciary), widespread corruption and organized crime. These problems cannot be solved through technical economic measures, since they require a broader agenda of political reforms and overcoming authoritarian tendencies to be addressed. The second major challenge is related to the dominance of energy and raw materials in production and the export structure, which makes these countries vulnerable to shocks generated by commodity price volatility. However, this kind of 'monoculture' cannot be overcome without improving the business and investment climate, which would create more room for structural diversification.

It is also important to appreciate that the CIS region is becoming increasingly heterogeneous, not only in terms of the level of economic and social development but also with institutions and policies that are tending to diverge. Furthermore, geographic location may have an increasing impact on future development trajectories, directions of trade and investment flows, as well as on these countries' institutional design. The so-called western CIS countries (i.e. Belarus, Moldova, Russia and Ukraine), owing to their geographical proximity to major European markets, have the chance to build stronger economic and institutional ties with the EU, even in the absence of an EU membership perspective.

In contrast, the five central Asian countries suffer from being landlocked and from dysfunctional transportation networks inherited from the Soviet period. Their location makes them geographically closer to Russia, China, Iran or India than to the EU. In turn, the three Caucasus countries, although located closer to the EU and Turkey, suffer from their 'frozen' territorial conflicts, which limits their development options.

Notes

1 In particular, the question of optimal reform speed, i.e. the controversy over fast versus piecemeal reforms (or the so-called shock therapy *vs.* gradualism in more journalist-type debates) was hotly discussed in the 1990s.
2 Some of them, like North Korea and Cuba, have not yet started market transition.
3 In the IMF *World Economic Outlook* (WEO) country grouping, which we use here, the CEE region does not include the Czech Republic, Estonia, Slovakia and Slovenia (because of either their current income per capita level or membership in the eurozone, or both) but does include Turkey. The CIS

region in WEO also includes Mongolia, which is neither a CIS member, nor is covered by our analysis. It also includes Georgia which left the CIS in 2009 but is treated by both WEO and us as part of the CIS region for analytical convenience.

4 BRIC stands for the four largest emerging-market economies, i.e., Brazil, Russia, India and China.

5 See http://appsso.eurostat.ec.europa.eu/nui/setupDownloads.do.

6 The year 1995 has been chosen as the starting point of our comparison to exclude the period of dramatic GDP adjustment at the very beginning of transition. In 1995 most of CEE and some CIS countries had already ended this period while in Russia, Ukraine and Moldova output decline, although at slower pace, continued until 1999.

7 For the detailed methodology of the WB Atlas method – see http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/EXTDECSTAMAN/0,contentMDK:20877893~pagePK:64168427~piPK:64168435~theSitePK:2077967~isCURL:Y~isCURL:Y,00.html.

8 However, there may be a methodological bias coming from the limited scale of the EBRD ratings. As a result, in some areas countries reached the upper ceiling pretty soon without measurement room to reflect further reform progress at the later stage. The same doubt applies to the country ratings presented in Table 35.4.

9 The same applies to the Czech Republic, which is not included in the EBRD rating.

10 Some regional conflicts in the early 1990s (in the former Yugoslavia and Caucasus region) triggered economic reforms in the countries involved to strengthen their capacity to deal with security challenges.

11 It relates to higher-income countries.

12 See Dabrowski and Radziwill (2007) for comparison of the role of EU membership perspective and IMF/World Bank conditionality as the external reform anchors.

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