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Economic transformation processes of central and eastern European countries

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ECONOMIC TRANSFORMATION PROCESSES OF CENTRAL AND EASTERN EUROPEAN COUNTRIES

1. Introduction

The European Union currently consists of 27 states. Over ten of them come from the former Eastern bloc, and with the forthcoming accession of former Yugoslavia's republics (egg Croatia)[1], this number will increase. The process of the European Union's enlargement not only stimulates the changes in these new countries, but also leads to the transformation of the nature of the entire Europe. In the 1990s the countries analyzed here used to be described as "the transition countries". The term suggests an optimistic perspective, linear progress, and departure from the failed communist past for the future which espouses the Western European model. The countries of Central and Eastern Europe, despite the recent financial crisis, are still undergoing transformation, which is both dynamic and diverse process. Taking into account frequent shocks and economic transformations which take place on the European continent – the future direction of this process is not certain. The transformation leads to the formation of the peripheral economic area adjacent to the highly developed European center. This has economic consequences not only for the countries of the region, but also for the entire European Union. This paper discusses the economic transformation that have taken place in Central and Eastern Europe in the 1990s and in the first decade of the 21st century. Subsequently it presents a comparative analysis of the region's countries in terms of macroeconomic indicators covering the period 2007–2011, as well as contains elements of the forecast covering years 2012–2013. It refers also the crisis in the euro area and to its impact on the CEE region. The analysis allows to formulate the thesis that the region of Central and Eastern European is not homogeneous one. CEE

[1] Probable date of Croatia's EU accession is July 1, 2013.

countries differ in size of their economies and in the level of economic development. Geographical location, a common past as a centrally planned economies, which led to civilizational backwardation vis-a-vis Western Europe, as well as a similar path of economic and political transformation followed in the last two decades, result in those countries having, despite their differences, certain common features. Such a thesis is based on the review of literature, and on analyses of both international statistical data and of the reports authored by the IMF and the NBP.

2. Economic theory and the real processes

Under the system of central planning economic units were never completely detached from the changes in the global markets. They were not able, however, to respond to these changes in an appropriate manner – for example by improving labor productivity or by innovating. After the oil crisis of the mid-1970s, the economies of Central and Eastern Europe began to be subjected to economic and political pressures[2]. The decline in economic activity, which in the Western Europe led to a rise in unemployment, in the Eastern Europe resulted in increased borrowing from Western institutions such as the International Monetary Fund or in the need to accept the gradual decline in living standards. Yet in 1989, many peripheral countries were exporting their products to the Western Europe, mainly drugs, chemicals, coal, textiles and food. At that time the entire region struggled with problems such as overproduction, hidden unemployment and lack of investment in education and low investment in research[3]. Thanks to a kind of symbiosis with the public sector, private SMEs in the countries of Central and Eastern Europe didn't have to be preoccupied with the competition of foreign companies.

Moreover, these domestic companies, were, to some extent, exploiting the weaknesses of the public sector. With such "facilitations" disappearing with the economic changes the situation of the companies in question has become very difficult. Such a state of affairs could not last forever. What followed later, only compounded the difficulties faced by the said companies. Consequently, many of them went bankrupt or were closed. Instead of deploying solutions tailored to the actual economic situation, the politicians in the CEE countries chose to give the ideology an upper hand over the principles of economics. Many of the problems experienced by "accession countries" – and consequently by the entire Europe – resulted from the essentially ideological nature of solutions proposed

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[2] F. Bafoil, *Central and Eastern Europe: Europeanization and social change*, Palgrave Macmillan, 2009, s. 15–16.

[3] Part of these problems remains unsolved to this day.

to the Eastern European countries by the more developed countries. 1990s became marked by privatization and broad support for the liberalization of the economy[4]. This created large investment opportunities for foreign companies. The focus was on privatization and the states of the region espoused the doctrine of so-called "shock therapy". It was to lead to the far-reaching institutional changes in the political economy of the Central and Eastern European countries, and at the same time to opening them to the influence of Western European states. The doctrine, elaborated by Jeffrey Sachs, was supposed to put the region's economies on the capitalist footing, with its restrictive monetary and fiscal policies. The repertoire of the shock doctrine included sudden elimination of subsidies and selling out of state assets[5]. As a result there was almost immediate breakdown of the pattern of trade that previously existed in the region – and the transition countries were left on their own with their limited resources. The shock was to take place prior the appropriate development of the financial markets. In the absence of investment capital, restructuring exerted pronounced influence on the labor market – to be "competitive", it was necessary to reduce unit labor costs. Resultant waves of unemployment in the 1990s overshadowed the experience of the UK 1980s recession – in some areas, unemployment reached 80%. Severing economic linkages and causing massive economic recession in the region's countries, shock therapy led to the economic collapse in the eastern part of Europe[6].

Underinvestment in R & D has been perpetuated by the restrictive credit policy of the World Bank and of the European Bank for Reconstruction and Development (EBRD). These two institutions have made a conscious decision to support only private businesses and privatization activities. With the decimation of local industry, the role of the financial sector expanded. The new capitalist economy needed the financial services sector, which could handle growing demand for capital. The activities of Western institutions had various consequences. First of all, it resulted in making the countries of Central and Eastern Europe dependent on foreign direct investment, and on support of the World Bank, International Monetary Fund and of the specially created European Bank for Reconstruction and Development. The general dependence of the region on the financial institutions led to tremendous growth of debt (both personal one and that of the institutional sector). Banks from a few smaller Western countries, mainly Austria and Sweden, sought to multiply profits by

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[4] Compare: W. M. Orłowski, *W pogoni za straconym czasem. Wzrost gospodarczy w Europie Środkowo-Wschodniej 1950–2030*, Polskie Wydawnictwo Ekonomiczne, Warszawa 2010.

[5] D. Gros, A. Steinherr, *Economic Transition in Central and Eastern Europe: Planting the Seeds*, Cambridge University Press, 2004, s. 37.

[6] Por. M. Bąk, *Europa Środkowa i Wschodnia wobec wyzwania transformacyjnego*, Wydawnictwo Uniwersytetu Gdańskiego, Gdańsk 2006.

increasing market shares in the countries of Central and Eastern Europe through aggressive lending to households. Meeting the expectations of the region's countries, which were interested in borrowing in the wholesale money markets, and at the same time exploiting financial deregulation and weak consumer protection in the CEE countries, banks were extending loans in Euros, Swiss francs and Japanese yens. This enabled them to offer customers lower interest rates than those on loans in national currencies. This lending spree led to a huge increase in household debt – especially in Hungary, Romania, Bulgaria and the Baltic states.

One of the intended consequences of the "shock therapy" was the pressure on the European Union to open its markets to the CEE countries. Adoption by the peripheral countries of the model of export-oriented economy, one based on low wages was dependent on access to the EU markets. In the pre-accession period several trade agreements were signed which aimed at facilitating changes in such a direction. The first one was concluded in 1992 between the EU and the countries of the Visegrad Group (Slovakia, Czech, Polish and Hungary). Nevertheless, in the first half of 1993 the total value of exports (in dollar terms) of all countries of Central and Eastern Europe was 13% lower then in the first half of 1992. These data shows that in a crucial period prior to the accession the EU trade agreements concluded by these countries were not beneficial to them[7].

CEE Member States differ. The implemented different solutions in the economic sphere. Slovenia, the Czech Republic and Poland espoused more conservative, protectionist microeconomic policy, which encompassed in the 1990s postponing the restructuring of state enterprises. This allowed to keep more dynamic domestic sector of small and medium enterprises. Poland also managed to be granted the debt restructuring of 1991,which allowed the State to operate more autonomously and to effectively respond to changing conditions. The situation was different in the case of Hungary, where restrictive monetary policy and the early implementation of the crude bankruptcy law led to the decimation of the domestic small and medium businesses.

Aside from these differences, everywhere the system of positive and negative incentives, necessitated by the widespread privatization, was established. Ultimately, this led to the more valuable assets being taken over by foreign companies. In 1989, the European Union created the PHARE fund, which was set to help in attracting capital to Poland and Hungary, so these countries could commence their "modernization"[8]. Subsequently this program

[7] W. Kosiewski, *Regiony Europy środkowo-wschodniej w procesie integracji. Ze szczególnym uwzględnieniem wschodniego pogranicza Unii Europejskiej*, Wydawnictwo Uniwersytetu Naukowe Mikołaja Kopernika w Toruniu, Toruń, 2008, s. 38–62.

[8] Poland and Hungary: Action for the Restructuring of the Economy

was extended to cover all the accession countries. PHARE was primarily a program offering support for foreign direct investment. In addition, privatization entailed the creation of privatization agencies, which in Eastern Europe, operated as government bodies. Because of the lack of strict rules on the disbursement of the PHARE resources, it was difficult to keep track of these funds.

The information obtained with the help of PHARE allowed such companies as General Electric to quickly identify areas in need of "rationalization". For example, after buying the Hungarian company Tungsram, General Electric, quickly closed the profitable production lines, thus eliminating the source of competition in the domestic market. A similar situation occurred when the Hungarian cement industry has been bought by foreign entrepreneurs. They prevailed upon their Hungarian companies to stop exporting. One of Austria's major steel producers bought the mill in Hungary only to close it and take over the nation's domestic market. These are just few examples of how the Central and Eastern Europe became a "peripheral economy." After only few years of the "shock therapy" a large part of the relevant economic infrastructure – from chain stores, to the power plants and steel mills– of peripheral countries fell into the hands of multinationals. With the accession of ten countries into the European Union in 2004, PHARE has been replaced by the Structural Funds[9]. For the first time resources were allocated for social purposes. However, the EU assistance remained permeated by visible neo-liberal bias and favorable treatment of public-private partnership. The European Union, wherever it invests money, has a tendency to introduce liberalization. The EU infrastructural projects are dominated by the complicated structure of subcontractors. In fact, in such an opaque conditions companies hunt for tenders. At the bottom of the structure there are employees with their "junk" contracts.

Since 2004, the Structural Funds and the Cohesion Fund are the main instruments of EU regional policy. They are designed to alleviate the disparities in development between the EU regions, thus effectively promoting stable and sustainable development of economies of individual Member States and of the entire Community. For most new Member States, regional policy instruments constitute a major cash injection needed to carry out the necessary reforms and adaptations required to enable the smooth functioning within the framework of both the EU administrative structures and of the Single European Market and – and consequently in the economic and monetary union. However, programming and management of local and regional development also constitutes a great challenge, especially for economically diverse countries of Central and Eastern

[9] M. Klimowicz, *Fundusze strukturalne oraz Fundusz Spójności w państwach Europy Środkowej i Wschodniej*, CeDeWu, Warszawa 2010, s. 8–15.

Europe. In order to achieve the objectives of EU regional policy in the Member States appropriate institutions are established and even the separate system of implementation of EU structural funds is introduced. This indicates the great importance attached by the countries of Central and Eastern Europe to role of the EU funds in the economic, social, and administrative developments[10].

Among the wider effects of the transformation are numerous benefits for corporations as well as establishment of rich elite in the countries of Central and Eastern Europe. The said elite, however, is often corrupt and even has links with organized crime. German and Austrian companies have proved particularly adept at identifying and capturing investments financed from the EU funds – in this way they seek to reduce costs, increase production capacities, and cope with labor shortages. As a result, in Austria and Germany the model of "dynamic comparison" became widespread. By resorting to this “model" the companies’ boards of directors are able to identify areas of low wages and low unionization in the transition countries.

With the introduction of the shock therapy electorate often massively sided with the left-wing parties. It was hoped that such parties would ameliorate the most negative social and economic impact of the capitalist transformation. To facilitate their own countries entry into the EU, these parties, however, were strong supporters of privatization and of the main tenets of neoliberal economics. The accompanying ideological chaos contributed to the establishment in the entire region of right-wing populist movements aiming to exploit public discontent. The political forces such as anti-Semitic "Christian socialism" and the patriotic "national liberalism", that developed in the Austro-Hungarian monarchy, were reborn. It may be exemplified by certain parties in Poland and in the Czech Republic. In a situation where the policy remains largely in the shadow of the economy and is increasingly embroiled in the geopolitical interests of the United States – with the latter being the guard of the "global national security" – the legitimization of the post-transformation elite began to depend on these countries catching up with the Western Europe. After the financial crisis such an ambitious strategy faces the most daunting challenge, an its outcome could have disastrous political consequences. Leftist parties observed shrinking legitimacy, and the liberal left is not capable of formulating its own critique of globalization and of the problems associated with the new political system. Therefore, the disappointment often goes hand in hand with extreme rightist postulate of a return to traditional culture[11].

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[10] Ibidem.

[11] Por. D. Stark, L. Bruszt, *Postsocialist Pathways: Transforming Politics and Property in East Central Europe*, Cambridge University Press, 1998, s. 30–42.

The Policy imposed by the IMF, the EU and by other international organizations, leads to petrifying the situation in which indebted states are heavily dependent on these institutions. It will result in a progressive weakening of social bonds and in growing regional disparities across the European Union. State's ability to maintain basic level of services and of social protection will become threatened. The phenomenon of population aging further exacerbates the situation, even in the region's more stable countries[12].

These problems can be remedied in several ways. These entail: a more intensive cooperation between the countries of Central and Eastern Europe; their autonomous elaboration of own development framework, while maintaining access to key external financing sources; looser fiscal policy and, if necessary – devaluation, as well as improving the effectiveness of the public sector instead of its gradual elimination or privatization.

It is difficult to say whether and when the shape of the CEE will change[13]. With the transforming shape of the EU, resulting from its continued eastward enlargement, the economic crisis could shape the European economy, which, though institutionally united, could become divided in economic and social terms. If this happens, the ultra-capitalist "formation" will be established, flawed in both social and political terms.[14]

3. General comparison of Central and Eastern European countries

Socio-economic development of Central and Eastern European countries was most frequently analyzed in the context of the systemic transformation processes. This implied a macroeconomic approach at the national level, which was further facilitated by easy availability and comparability of statistical data. However, the growth of deconcentration and decentralization of political systems in individual countries combined with the administrative reforms that led to the growing importance of local governments (including the creation of their new levels) stimulated the current of regional studies[15]. Such studies were usually hindered by poor comparability of statistical data, particularly at sub-

[12] G. Gorzelak, *Rozwój polskich regionów a polityka spójności Unii Europejskiej.* [w.] G. Gorzelak (red.), *Polska regionalna i lokalna w świetle badań EUROREG-u*, Wydawnictwo Naukowe Scholar, Warszawa 2007.

[13] M. Bąk, *Transformacja w Europie Środkowej i Wschodniej jako proces wpływający na dynamikę integracji europejskiej*, W: (red) A. Stępniak, J. Stefaniak, J. Taraszkiewicz (red), *Wybrane problemy integracji europejskiej*, Fundacja Rozwoju Uniwersytetu Gdańskiego, Gdańsk 2008.

[14] D. Stark, L. Bruszt, *Postsocialist Pathways: Transforming Politics*...op. cit. s, 45.

[15] W. Sokół, M. Żmigrodzki (red.), *Systemy polityczne państw Europy Środkowej i Wschodniej*, Wydawnictwo: Uniwersytet Marii Curie – Skłodowskiej, Lublin 2005, s. 22–31.

regional level (NUTS2). However, gradually, the efforts of EUROSTAT related i.a. to the preparation of cyclical reports on socio-economic cohesion of the European Union, as well as research undertaken within the framework of the ESPON (European Spatial Planning Observatory Network) in order to facilitate the implementation of the European Spatial Development Perspective (presently called. Territorial Agenda) has led to an improvement in this area. Undoubtedly, the processes of regional convergence in the countries of Central and Eastern Europe strongly depend on the national context, understood as similarities and differences between region's countries. Table 1 presents basic data on the countries of Central and Eastern Europe, including: the area in square kilometers, population and the per capita GDP.

Table 1. General information on the Central and Eastern European countries (as of December 31 2011)

	Area in square kilometers	Population		GDP in millions EUR	GDP per capita in EUR	
		Thousand persons	Persons per na 1 sq. km		At the nominal Exchange rate	At PPP
Bulgaria	110 879	7 564	68	36 034	4 700	10 600
Czech Republic	78 867	10 507	133	145 049	13 800	19 500
Estonia	45 227	1 340	30	14 501	10 800	15 900
Lithuania	65 300	3 329	51	27 410	8 300	14 200
Latvia	64 559	2 248	35	17 970	8 000	12 600
Poland	312 685	38 167	122	353 667	9 300	15 200
Romania	238 391	21 462	90	121 942	5 700	11 000
Slovakia	49 035	5 425	111	65 906	12 100	18 100
Slovenia	20 273	2 047	101	35 974	17 600	21 200
Hungary	93 028	10 014	108	98 446	9 800	15 700

Source: author's own elaboration based on the Eurostat's data

In 2011 the most developed country in the region was Slovenia, which produced, products and services valued at EUR 21.2 thousand per capita, followed by Slovakia (with EUR 18 100). Another group encompassed countries such as: the Czech Republic, Hungary, Estonia and Poland, with the GDP per capita ranging from EUR 15.2 thousand to EUR 15.9 thousand. Latvia and Lithuania produced, on the per capita basis, goods and services worth EUR 12,6 -14,2 thousand, respectively. Among the poorest countries were Bulgaria and Romania, with the GDP per capita amounting to mere EUR 10.6 thousand and

EUR 11.0 thousand respectively – which was over two times less than in the richest Slovenia[16]. Differences in the level of economic development were associated with the difference of economic structures in individual countries as well as with distinct differences in labor productivity.

The GDP growth rate was also very diverse. In the period 2010–2011 the largest increase occurred in Poland, Slovakia, Estonia and Lithuania[17]. The Baltic states, overcoming the far-reaching crisis of the period 2008–2010, recorded in 2011 the average growth of 6.5% (with Estonia growing at over 9%). At the opposite extreme were Slovenia, Hungary and the Czech Republic, where the GDP growth did not exceed 2% (it stood at mere 0.9% in case of Slovenia). The variation in growth rate resulted primarily from disparities between respective domestic demand dynamics.

Table 2. Gross Domestic Product (in %, over the previous year)

	2009	2010	2011
Poland	1.7	3.8	4.2
Czech Republic	-4.1	2.3	1.2
Slovakia	-4.7	4.0	3.2
Slovenia	-8.2	1.0	-0.1
Hungary	-6.3	1.2	1.5
Estonia	-14.1	3.1	8.3
Lithuania	-14.8	-0.3	7.3
Latvia	-18.0	1.3	6.1
Bulgaria	-5.0	0.2	1.6
Romania	-7.1	-1.3	4.4

Source: Eurostat

Also, the labor market's situation in individual countries differed quite significantly. Actually, one of the reasons of the weakness of private consumption in the CEE region was the lack of significant improvement in the labor markets. According to the Eurostat data, after a period of visible growth in the unemployment rate, which took place in late 2008 and 2009, the said indicator remained at the high, almost unchanged, level for the next nearly three years. Its decline observed in 2011 took place in the Czech Republic, Slovenia and Slovakia (by 0.1-0.5 percentage points), and slightly bigger decline (1.2 p.p.)

[16] Based on the IMF data.

[17] In the case of the last two states in the period 2007–2009 there was an annual decline in GDP by 10%.

observed in Hungary. Since the beginning of 2011, the harmonized unemployment rate in the region decreased significantly only in the Baltic states (by about 3 percentage points.), though it remained there almost three times higher than at the beginning of 2008.In Poland and Bulgaria, in the same period of 2011, the unemployment rate increased (by 0.3 and 0.8 percentage points, respectively.). The lowest unemployment rate in the region was observed in the Czech Republic (6.7%), while the highest – despite a significant decline – was noted in case of Lithuania (15%)[18].

The increased financial markets tensions associated with the exacerbation of the debt crisis in the peripheral countries of the euro area strongly influenced exchange rates in the region of the CEE. Since mid-2011, the rapid weakening of the forint and of the Polish zloty – not only against the U.S. dollar but also against the euro – was observed. Throughout the year 2011, the rate of the Czech koruna against the euro was relatively stable, indicating that the Czech Republic could become a "safe haven" of the Central and Eastern Europe. Towards the end of 2011, along with the emergence of information about a possible bankruptcy of not only Greece but also of Italy, and due to weakening growth prospects in the Czech Republic, the koruna started to depreciate rapidly. In the period May 2011 – January 2012 its value lost 7.2% vis a vis EUR. Much deeper depreciation was observed in the case of Zloty (13% against the euro), or of the Forint (almost 19% against the EUR). The period of strong depreciation of both currencies took place at the turn of 2011–2012, and resulted from the turmoil in the Hungarian economy. The Act which restricted the independence of the central bank, failed negotiations on the EU's and the IMF's assistance and the downgrading of the Hungarian debt to a "junk" category by all three major rating agencies have led to an increase in investors' aversion to the region, which had negative effects not only for the exchange rate of the forint, but also for other currencies, especially Zloty. The exchange rate of the Romanian leu was relatively more stable, and depreciated between May 2011 and January 2012 against the euro by 7%[19].

In 2011, the current account deficit of the the CEE region continued to shrink. This was due primarily to improved foreign trade balance. Much faster growth of exports than imports, observed in this period (except for Poland and Baltic states), have caused significant decline in the goods' trade deficit. There was also slight increase in the surplus in services trade and in current transfers. The decrease of external imbalances in the region would have been even greater

[18] *Analiza sytuacji gospodarczej w krajach Europy Środkowej i Wschodniej*, Narodowy Bank Polski, Instytut Ekonomiczny Biuro Gospodarki Światowej i Europejskiej Integracji Gospodarczej, Warszawa, styczeń 2011, s. 8–9.

[19] International Monetary Fund, *Regional Economic Outlook: Europe Navigating Stormy Waters*, October 2011.

had it not been for increased transfer of profits from foreign investments, which led to an increase of the deficit in the income account. The slowdown in the foreign trade turnover, expected to take place in the years 2012–13, should affect exports and imports to a similar extent, which in turn should not exert significant impact on the regions foreign trade balance. The current account balance, shouldn't significantly change either in the next two years. On one hand lower inflows from the EU funds are expected, while on the other the transfer of income abroad (particularly from foreign direct investments) should also decline, due to projected lower corporate profits.

According to the fiscal notification (of October 2011) and to European Commission's forecasts (November 2011) in most countries the result of the public finance sector in 2011 was to reflect the projections contained in the updates of the Convergence / Stability programmes, or was projected to be slightly better than that. This is confirmed by current estimates of budgetary deficits, prepared at the end of the financial year. Such a situation reflects better, than expected, economic situation, but in few countries (Hungary, Czech Republic, Latvia) stems also from additional measures aimed at limiting expenditures. Only in Slovenia the fiscal imbalance in 2012–2013, will be slightly deeper than originally assumed (by about 0.2 percentage points of the GDP). In 2012, the strongest reduction of the deficit of public finances is expected to take place in Romania (by 2.8 percentage points), Poland (by 2.7 percentage points) and Lithuania (by 2.3 percentage points.) which will contribute to reducing its level in these countries below the reference value to meet the deadline set in the excessive deficit procedure.

Table 3. Balance of the public finance sektor, ESA'95 methodology (in % of GDP)

	2007	2008	2009	2010	2011	2012F	2013F
Poland	-1.9	-3.7	-7.3	-7.8	-5.6	-4.0	-3.1
Czech Republic	-0.7	-2.2	-5.8	-4.8	-4.1	-3.8	-4.0
Slovakia	-1.8	-2.1	-8.0	-7.7	-5.8	-4.9	-5.0
Slovenia	0.0	-1.9	-6.1	-5.8	-5.7	-5.3	-5.7
Hungary	-5.1	-3.7	-4.6	-4.2	3.6	-2.8	-3.7
Estonia	2.4	-2.9	-2.0	0.2	0.8	-1.8	-0.8
Lithuania	-1.0	-3.3	-9.5	-7.0	-5.0	-3.0	-3.4
Latvia	-0.4	-4.2	-9.7	-8.3	-4.2	-3.3	-3.2
Bulgaria	1.2	1.7	-4.3	-3.1	-2.5	-1.7	-1.3
Romania	-2.9	-5.7	-9.0	-6.9	-4.9	-3.7	-2.9

F – Autumn forests of the European Commission, November 2011
Source: Eurostat (Autumn fiscal notification from October 2011), European Commission

Within the timeline of The European Commission forecast's only in case of Hungary, the public debt will (and significantly so) exceed the reference value of 60% of the GDP. In Estonia the level of the debt of government and self-government sector will decline (from 6.7% of the GDP in 2010 to 6.1% in 2013). In few countries (Slovenia, Lithuania) the growth of public debt will be supported by the banking system. In early 2012, Hungary's rating was lowered to junk status, due to worsening economic situation and to a controversial government policy, which undermined investor confidence and made it difficult to reach agreement on a new support program of the International Monetary Fund and of the European Union.

Table 4. Public Debt, ESA'95 methodology (in % of GDP)

	2007	2008	2009	2010	2011	2012F	2013F
Poland	45.0	47.1	50.9	54.9	56.7	57.1	57.5
Czech Republic	27.9	28.7	34.4	37.6	39.9	41.9	44.0
Slovakia	29.6	27.8	35.5	41.0	44.5	47.5	51.1
Slovenia	23.1	21.9	35.3	38.8	45.5	50.1	54.6
Hungary	67.0	72.9	79.7	81.3	75.9	76.5	76.7
Estonia	3.7	4.5	7.2	6.7	5.8	6.0	6.1
Lithuania	16.8	15.5	29.4	38.0	37.7	38.5	39.4
Latvia	9.0	19.8	36.7	44.7	44.8	45.1	47.1
Bulgaria	17.2	13.7	14.6	16.3	17.5	18.3	18.5
Romania	12.8	13.4	23.6	31.0	34.0	35.8	35.9

F – Autumn forests of the European Commission, November 2011
Source: Eurostat (Autumn fiscal notification from October 2011), European Commission

Tourism attractiveness of the region (including business tourism) has been quite varied. Apart from Bulgaria (Black Sea Coast), the most popular tourist destination were Estonia (proximity of Helsinki), Czech Republic (high-class monuments of material culture in Prague) and Slovenia (Adriatic coast). In all these countries there was over 1 visitor spending at least on night at the hotel, for each inhabitant. Other countries were less attractive to tourists, though in Hungary and Slovakia tourism could, in certain regions, play a role in the development processes. As the above-mentioned comparison reveals, the countries of Central and Eastern Europe do not form a homogeneous economic macro-region. Differences between countries are in many respects very large, and are influenced, among other factors, by their different levels of socio-economic development at the beginning of the transition process.

The debt crisis and resultant economic slowdown in the euro area countries are forecasted to be a major factor shaping the economic situation in the CEE

region in the years 2012–2013. The escalation of the crisis, which took place in the second half of 2011, resulted in a significant revision of growth forecasts for the CEE countries. In November of 2011 the European Commission in November, downgraded its forecast for 2012 in case of all countries of the region. The biggest changes were observed in case of forecasts for Slovenia, the Czech Republic, Hungary and – most of all – Slovakia, since those countries have the strongest links with the euro area's economy.

4. The crisis in the euro area and the region of Central and Eastern Europe

The transmission of the crisis in the euro area countries to the countries of the CEE takes place primarily through weakening demand on the part of major trading partners and through the resulting fall in exports. The crisis in the euro area will directly affect the weakening of the already very slowly revival of the domestic demand in the CEE region, including further lending cuts by local branches of European banks and the curtailment of the inflow of capital from Western Europe. Additional factors that inhibit growth of domestic demand will include continued fiscal consolidation and the lingering stagnation in the labor market. In addition, the increase in risk aversion caused by the crisis euro area's debt crisis at the turn of 2011 and 2012 and the political and economic crisis in Hungary, led to a significant depreciation of currencies (CZK, HUF, PLN, RON) and to an increase in bond yields in the region. This will not only increase costs of foreign debt service (especially in the public sector), but also will bring about the reduction in disposable income of a large part of households and enterprises burdened with foreign currency loans (especially in Romania and Hungary). As a result, the GDP growth rate in the region could fall to 1.5% in 2012 (as against an increase of 3% observed in 2011). In the year 2012 the countries of the region will post diverse rates of economic growth, but the differences will be narrower than those observed in 2011. The fastest growth is expected to take place again in the Baltic States and in Poland (2.5%), while in the Czech Republic, and Slovenia, it should not exceed 0.5%, with Hungary projected to observe GDP fall[20].

The region of Central and Eastern Europe is not homogeneous, with its constituent countries differing in size of their economies (Polish GDP is 20 times larger than that of Estonia), the level of economic development (GDP per capita in Slovenia is twice higher than in Bulgaria when expressed at purchasing power parity and as much as four times higher when expressed in nominal euro terms). These countries also differ in terms of exchange rate regimes and of the

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[20]*Analiza sytuacji gospodarczej w krajach Europy Środkowej i Wschodniej...*op. cit., s. 33–36.

degree of integration with the euro area. However, geographical location, a common past as a centrally planned economies, which led to civilizational backwardation vis-a-vis Western Europe, as well as a similar path of economic and political transformations that these countries have followed in the last two decades, cause them despite the existing differences, to share certain common features[21].

The said similarities are related, above all, to ties with key countries of the euro area[22] . Firstly, the euro zone, and in particular Germany, is the main trading partner of the CEE region. In addition, the model of growth followed in recent years by the CEE countries, one based on the inflow of foreign capital – both in the form of foreign investment (direct and portfolio) and foreign loans. In the majority of cases this capital came from European investors and lenders. A significant part of it was directed to the financial sector, particularly to the banking sector, causing the big banks from the euro area countries to become the major players in the banking market of the Central and Eastern Europe. The growing ties with the euro area allowed in the past to record rapid economic growth and consequently to reduce the distance towards Western European countries. In the face of economic and financial crisis, observed in 2011 in the euro area countries, the strong dependence on the latter economies poses, however, a serious threat to region's development. In both the European Union and in the CEE region, there is an ongoing debate about the "pros and cons" of joining the euro zone[23].

Rapidly growing foreign trade turnover, constituted in recent years one of the major forces driving economic growth in the countries of Central and Eastern Europe. In the case of the region's states external demand was extremely important. CEE countries are small open economies in which exports account from 40% of GDP (Poland, Latvia) to 80% of GDP (Czech Republic, Slovakia, Hungary)[24].

Geographical location, as well as growing, in the last two decades capital ties, caused the euro area to be the “natural" most important trading partner for most countries of the CEE region. With the exception of the Baltic countries, which have closer with the Scandinavian states (mainly Sweden) and Russia, than with the countries of the euro area, in case of the remaining countries of the region in 2010 exports to the euro area accounted from 45% to nearly 60% of their total exports. These figures do not fully reflect, however, the role of the

[21] Ibidem.

[22] The analysis not include to euro zone new countries EU: Slovenia, Slovakia, Estonia, Cyprus and Malta.

[23] Por. szerzej S. I. Bukowski, *Strefa euro. Pespektywy rozszerzenia o Polskę i inne kraje Europy Środkowo-Wschodniej*, Polskie Wydawnictwo Ekonomiczne, Warszawa 2007, s. 8.

[24] *Analiza sytuacji gospodarczej w krajach Europy Środkowej i Wschodniej*...op. cit., s. 34.

euro area in foreign trade of CEE countries. In the course of the two decades of transformation, CEE economies entered into the international trade and production networks. Leading role in this network is played most often by the Western European corporations. The intra-company trade not only stimulated the trade between the CEE countries and the euro area, but also influenced the development of trade within the region. Taking into account the degree of openness of individual CEE economies, the problem of dependence on demand from the euro area economies appears to be the largest in Slovenia, Slovakia, the Czech Republic and Hungary, where in previous years, exports to the euro area countries constituted 30–40% of GDP. On the other hand, in Poland and Romania, despite the fact that over half of their exports was directed to the euro area, a smaller share of foreign trade in the economic activity means that these countries seem to be relatively more resistant to the direct effects of the fall in demand from the euro area[25].

The particularly important role for the CEE regions is played by the euro area's largest economy, i.e. Germany. Exports to Germany account for about half of the exports of this group of countries to the euro area. In addition, German companies are the main facilitators of intra-company trade in the region[26]. Surprisingly rapid growth in Germany in 2010 and in the first half of 2011, despite continued slowdown in the other euro area countries, constituted one of the main drivers of the process of rebuilding of the CEE economies after the crisis of 2009. The increase in demand on the part of Germany was due to the economic recovery in the euro area's external environment which stimulated German exports, and indirectly also exports from CEE countries. In 2011, the German economy clearly slowed down, and the forecasts indicate a further slowdown in that country, and therefore in the whole euro area. This signifies that the growth impulse observed in the previous quarters was coming to an end[27].

At the same time, much of the CEE countries' exports – approximately 10% of the total exports, and in the case of Bulgaria, Romania and Slovenia, close to 20%) was directed to the highly indebted countries in the south of the euro area (the periphery)[28],. These imports were mainly going to the Italian market, since the country belonged to the major trading partners of the CEE countries. In case of Bulgaria and Romania, the trade with crisis-ridden Greece was also of high importance.

[25] Ibidem, s. 34–35.

[26] Por. I. Bil, K. Cisz, B. Brocka-Palacz, M. Gomułka, F. Kamiński, Marzenna A. Weresa, *Gospodarka Niemiec a kraje Europy Środkowej i Wschodniej*, Wydawnictwo Szkoły Głównej Handlowej, Warszawa 2006.

[27] International Monetary Fund, *World Economic Outlook Update Global Recovery Stalls, Downside Risks Intensify*, January 2012.

[28] Greece, Spain, Portugal and Italy.

One of the common characteristics of the CEE's economies is their growth model, relying on foreign capital inflows, especially from developed countries. As in the case of commercial links, also in the case of foreign capital inflows the euro area countries played a dominant role. This was true both for direct and portfolio investments and for foreign loans.

Due to the structural changes that have taken place in the period of economic transformation, foreign direct investment (FDI) played very significant role. During the last twenty years, foreign investment inflows to the region amounted to over 50% of their combined GDP (as of end of 2009). Over 70% of the inflow of FDI were investments from euro area countries[29]. In this case the lower intensity of links was observed between the euro area and the Baltic States (approximately 35% of the inflow of FDI came from the euro area, while majority was of Scandinavian origin). In the other countries of the region the inflow of investment from the euro area countries ranged from 65% to almost 90% of inbound flows[30].

FDI flows are directed to a large extent to the non-tradable sectors (construction, services), which are oriented on domestic demand. On the one hand these investments constituted, in the period before the outbreak of the global financial crisis, yet another factor supporting the growth of domestic demand in the CEE countries, while on the other they led to the overheating of the economy, appreciation of national currencies and to a significant increase in labor costs. Consequently this led to more profound, than in other regions, reaction of the CEE region countries to the global financial crisis.

The outbreak of the financial crisis in 2009 caused significant decrease in the inflow of foreign capital. This applied not only to direct investment inflows (down from nearly 5% of GDP in mid-2008 to less than 1% of GDP in early 2010), but above all to very sudden cessation of the influx of other foreign investments – which mainly encompassed trade credits and loans to the banking sector. In the period 2004–2008, the inflow of foreign loans was the dominant position in the financial account, especially in the Baltic countries, Bulgaria and Romania, and from 2010 the outflow of foreign capital from CEE countries was visible. Similarly as in the case of FD,I inflow of foreign loans was instrumental in propping up most of all the domestic demand[31].

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[29] *Analiza sytuacji gospodarczej w krajach Europy Środkowej i Wschodniej*, Narodowy Bank Polski, Instytut Ekonomiczny Biuro Gospodarki Światowej i Europejskiej Integracji Gospodarczej, Warszawa, grudzień 2010.

[30] International Monetary Fund, Regional Economic Outlook: Europe Navigating Stormy Waters, October 2011.

[31] M. Allen, *The Impact of the Global Economic Crisis on Central and Eastern Europe*, Fourth Central European CEMS Conference , Warsaw, February 25, 2011.

The high degree of risk aversion and liquidity problems of financial institutions struggling with the euro area's debt crisis will be hindering rapid growth of foreign investments. This signifies that the CEE economies lost yet another engine stimulating their domestic demand.

At the same time, since the financial crisis we have seen an increased inflow of portfolio investments, especially channeled to the treasury's debt instruments[32]. A large share of portfolio investment in the structure of foreign capital inflows poses a risk to the stability of the CEE economies, especially in the periods of higher risk aversion. In case of further deepening of the debt crisis in the euro zone there is a possibility of a sudden outflow of investment from the region, which may lead to destabilization of financial markets on a scale similar, or even larger, to the one observed in the second half of 2008 and in early 2009.

5. Conclusions

The turn of the century brought significant changes in the regional structure of Central and Eastern Europe (CEE). Rationale, objectives, principles and factors of development in this part of the continent underwent a fundamental reorientation. The transformation caused what previously were strengths in some countries to became a hard to overcome barriers, causing underdevelopment and lack of prospects. On the other hand, decentralization of management and freeing of initiative on the part of the populations created an important stimulus which reinforces the development dynamics. Great expectations, but also fear accompanied the process of accession to the European Community, which – accepting as its members economically backward, post-communist countries – undertook to support their development in accordance with the principle of economic, social and territorial cohesion. This task proved difficult, and controversial from the standpoint of both the "old" and "new" European Union. The analysis of statistical data indicates that the region of Central and Eastern Europe is not homogeneous. CEE countries differ not only in the size of their economies, but also in the level of economic development. This was seen especially during the economic crisis the first decade of the XXI century.

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[32] International Monetary Fund, *Global Financial Stability Report GFSR Market Update*, January 2012.

Ekonomiczne procesy transformacyjne
w krajach Europy Środkowej i Wschodniej

Artykuł dotyczy zjawiska procesu transformacji i przemian ekonomicznych jakie dokonały się w krajach Europy Środkowej i Wschodniej w latach 90. ubiegłego wieku i w pierwszej dekadzie XXI wieku. W dalszej części opracowania zaprezentowano analizę porównawczą krajów tego regionu w zakresie wskaźników makroekonomicznych w latach 2007–2011 wraz z elementami prognozy na lata 2012–2013. Odniesiono się także do kryzysu w strefie euro i jego wpływie na region EŚiW. Przeprowadzona analiza pozwala sformułować tezę, że kraje Europy Środkowej i Wschodniej nie są homogeniczne; różnią się wielkością gospodarek, poziomem rozwoju gospodarczego. Położenie geograficzne, wspólna przeszłość jako gospodarek centralnie planowanych, która wpłynęła na cywilizacyjne opóźnienie wobec Europy Zachodniej, a także podobna droga transformacji gospodarczo-ustrojowej, jaką przebyły w ostatnim dwudziestoleciu spowodowały jednak, że pomimo zróżnicowania istnieją pewne cechy wspólne dla tej grupy gospodarek.