Economic policy: Path dependency and path creation, 1989-2015[1]

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ABSTRACT: This chapter addresses fundamental issues of economic policy and systemic change in the post-1989 period. *The research question if, when, and to what degree, the broad institutional and policy changes have managed to boost convergence to western Europe.* In eight theses, highlighted as sub-chapter headings it attempts to present the big picture. The classical agenda: of Stabilization, Liberalization, Institution-building and Privatization/SLIP serves as a read thread in assessing bits and pieces. Issues of long term path dependency versus impacts of policy choices are discussed. Due to space limitations, country experiences are discussed as illustrations only. In terms of timeline 1989 – the Polish round-table talks and the collapse of the Berlin Wall- then 1999, the NATO intervention in Yugoslavia and the Helsinki EU Counclil on Big Bang enlargement- and finally 2008 – the spillover of the global crisis and its management – are taken as watersheds. While 1999-2008 was a period of real convergence, the post-crisis period it came to a halt in most countries. The final, nineth chapter explains how this relates to the rise of illiberalism.

When the Soviet Empire collapsed – in 1989 the external, in 1991 the internal Empire – the general assumption was one of fast and unconditional convergence to western Europe. It was based on both neoclassical economics and the post-1945 experience of fast reconstruction in all Europe. It was both naive and difficult to even imagine what is to come after an earthquake.

It was believed that abolition of the bipolar world and widening European integration will produce yet another economic miracle. SLIP means doing away with distortions inherent in the command economy, cutting military spending, and opening up to international trade and finance – policies that are all welfare enhancing.

Reality turned out to be different. First a deep fall of output – between 20 and 50 pc of GDP, comparable to World War II GDP losses – was registered. Recovery has proven slow. Reaching 1989 levels took a decade in central Europe and the Baltics and 15 years or more elswhere. EU membership has become selective and triggered growth only in 2002 to 2007. Following the global crisis growth though resumed but remained sluggish, at rates about half of the pre-crisis years, i.e 1 to 3 pc in central Europe and 3-4 pc p.a. in the Baltics, with NIS and Balkan states/save Romania and Bulgaria/ in recession. In short, the *Wirtschaftswunder* never happened.

In the following we shall differentiate *three major country groups* of the post-communist world, which differ both historically, institutionally and in terms of economic outcomes: a/Central Europe

[1] Useful comments by I.T. Berend, J.Horvath, K.Kossev and the editor on previous versions are appreciated, with the usual caveats.

and the Baltics; b/the New Independent States or the post-Soviet globe; c/Southeast Europe which includes – economically, though by no means historically – Croatia with its lagging economic and political structures. The grouping is in line with standard history and international studies categorizations and reflects the traditionally different embeddedness of the respective country groups in European integration processes, economic and political alike. Thus the anchor role of EU and the – real or not so real – prospects of eventual mebership are taken as explanatory factor.[2]

1. Social Engineering in Reverse

Putting the experience of post-communist change in pan-European and historical perspecties allows not only for the emergence of new insights. It also allows for developing a new set of co-ordinates, against which theory, polcy practice and outcomes of 'transition' can and should be measured. In line with the new political-cultural narrative on postwar European history/Stone, ed.,2015/ we also call for a re-periodicization, transcending the self-interpretations of contemporaries. *Three distinct periods: 1989-99, then 2000 to 2008 and finally 2009 to 2015 are proposed as units of analysis,* offering relatively distinct and separate entities in terms of policies and reflections on them.

If the *first* phase is that of enthusiasm and wide-ranging changes, the *second* is easing up and Europeanization, helped by the global glut of capital and its eager inflow in this newly discovered region. Finally the *third* phase is that crisis management, which has not been discontinued when the actual slump was over by late 2012. Rather, ad-hoc measures – like quantitative easing or targeted governmental intervention to attain redistributory objectives, survived in all countries. As the second phase already created vulnerabilities, entering the third phase would have been difficult even under more far-sighted policies.

In the following analysis we question the broadly held thesis/Myant and Drahokoupils, 2014/ if an over-arching neo-liberal strategy was imposed upon the naive and also ignorant actors of the region by the international financial institutions and the European Union. Rather than allowing for the popular self-victimization we highlight the *strong presence of statist-paternalistic traditions dating back to the 1930s,* and in some cases even earlier. Social engineering, feared or hoped for via Europeanization, has remained equally limited in shaping the outcomes/Ganev, 2013/.

By contrast, outcomes of human actions tended to deviate regularly and considerably from human constructs, be that in the economy, in welfare provision or the cultural sphere. In line with the famous dictum of Ludwig von Mises/1949/1998/, these have been outcomes of human action but not of human deliberation. True this time, especially in the 1990s, *a reverse social engineering,* away from command and towards a 'free market' has been preached and sometimes attempted in the postcommunist world. Even if it was more smoke than heat, discourses of the period did matter for shaping policy objectives and public expectations[3].

[2] Ukraine and Romania may count as the two polar examples, with the Orange and Maidan Revolutions of 2004 and 2014 proving unable to cut the umbillical cord to Russia. By contrast Romania's EU membership prospect /and reality from 2007/ helped anchor expectations and political action across the board.

[3] In his broad-brush summary Berend/2006/ critically assessess the role of these discourses leading to policy changes, first in the 'Thatcher-Reagan Revolution', undermining the welfare state, and later its replica in the east.

2.Crisis Management Rather than Capitalism by Design

In the current chapter we define *economic policy in a narrow sense.* The term denotes top-down activities by the state aimed at influencing economic outcomes and shaping the rules of the game. In so doing we disregard some classical field covered in this volume by separate chapters, such as growth, international integration, employment and living conditions. Our task is *confined to features specific to post-communist systemic change,* even if specifics have often been over-shadowed by 'pedestrian concerns', as balance of payments problems, or social discontent. While the latter have often influenced actual outcomes on the ground more decisively than ideas and visions of contemporary policy-makers, the current analysis retains its focus on theories, values, academic and policy deliberations, or the ideational behind actions.

Much of the transitology literature - as country analyses of EBRD and its *Transition Reports,* OECD country studies, country specific recommendations of the EU Commission - is devoted to classical 'plan-actual' type of comparisons. Government documents, plans signed in stand-by or other agreements with international financial institutions, meeting or missing EU standards in various fields and policy areas prevail. Much of the blame has long been put in transitology on ideological over-zeal, improper planning, lack of professional or social anchoring of the various projects, be those on privatization, stabilization or institution-building or adopting EU norms and standards. *This is simple, but often to the point of being simplistic.* Especially if we abstract away the fundamental trigger of change: the collapse of the Soviet Empire. In much of theorizing, especially of the comparative brand, easy parallels are drawn to Latin America or southern Europe, sometimes to east Asia, without considering the historically unprecedented disintegration of administrative and military structures of a highly militarized Empire with strong pre-capitalistic features. *This makes post-communist change highly unique, both historically and substantively seen.*

The collapse of the Soviet Empire in 1989-91 took most observers and even participants by surprise. This happened not least because major western powers as well as academics had been deeply convinced of both the inherent advantages as well of the infinite *sustainability* of the bipolar world. Thus the unplanned, sudden and therefore by definition a-theoretical collapse, the earthquake took all by surprise. Rather than building on the limited and fragmentary, but still available professional knowledge of Soviet-type economies and market stabilization/Winiecki, 1993/, a large-scale *experimentation* of unprecedented historic scale was launched.

The deeply unscientific term 'transition' soon prevailed, suggesting that starting point and terminus were both familiar and given. Then *it is only the trajectory of change which should be managed*, and that on the ground of available solid economic wisdom. While some sounded skeptical,/Offe, 2004/ if the triple transformation – to market economy, to parliamentary democracy and national revival – was manageable at all, their voice tended to be marginalized. Likewise the above cited old – but deep – insights warning of the misbelief in omniscient top-down policy platforms were neglected. Instead, many international luminaries and self-appointed local experts flocked into the lucrative business of offering policy advice/Greskovits, 2002; Winiecki, 2015, Parts Two and Three/. Blind faith in constructivism prevailed both in the academe and in policy making, *grosso modo.*

First, the end station to be achieved is 'spontaneous order'. No matter how we name it, it has been the antipode of the command economy. *Second*, the trigger of change was a cataclysm of historical magnitude. It was one-time non-replicable event without precedent in history.[4] This rendered it by definition unfit for any conventional mainstream economic analysis focusing on regularities and mass events. Policy analysis informed by the former was even of less avail. Disregard of institutions, of context and willingness to apply market economy options for non-market conditions and even under chaotic conditions was unhelpful/Csaba, 1995/.

Third, changes in scale and scope went way beyond conventional stabilization and liberalization, theorized on the ground of Latin American experiences. It was the entire macroeconomic co-ordination mechanism that collapsed, and so has the recieved trade and specialization pattern. While overlaps with Third World strategies have been manifest, specific postcommunist traits have required the solution of a series of additional tasks. The latter included – most prominently – institution building, often from scratch, followed by tasks specific to European and global integration, at both the corporate and macro-economic levels/Winiecki, 2016/.

Interestingly *there had been an overwhelming professional and even social consensus over the type and nature of change.* Nobody – except marginal groups – doubted: market economy of the European brand and multi-party parliamentary democracy are the only games in town. This is what Russians termed 'becoming a normal country'. However, agreement ended at this abstract level. Both in terms of *means* and in defining the *roads* leading thereto *disagreements* prevailed.

The largely meaningless 'shock therapy or gradualism' debate dominted the public discourse. In countries where the language was radical, especially in Poland, Russia and the Czech Republic, both stabilization and privatization was slow on the ground in 1991-97. By contrast, in some countries where gradualism was the official line, as in Hungary or Serbia or Bulgaria, or there was no ideology, just action, as in the Baltics, policies favored fast privatization and disinflation. While neither speed nor scope is irrelevant in any polcy package, the academic counter-position followed *ideological rather than substantive considerations*. Those who believed in the desirability of most radical changes possible were the shock therapists, advocating to do 'as many good things possible at once as you may'/Aslund – Djankov, eds, 2014/. They tended to be of politically conservative or of right-wing liberal convictions. By constrasts, 'gradualists' came from the social democratic orientation. They stressed the time needed both for institution-building and social acceptance to be built, so that societies could accept and adjust to the new rules of the game. Economically the first camp referred to western mainstream, the second to institutionalism, structuralism and Keynesianism, depending on country and period./Kolodko, 2011;Kornai, 2008; Popov, 2012/. What is truly perplexing is not that tempers, views and suggestions differ. The real surprise is to see that most – if certainly not all - those wo started early- as Estonia and Poland - are still among the leaders, and those who started late- as Moldova or Belarus - are among the laggards/Havrylyshyn et al., 2016/.And similarly, as the insightful comparison of Ukrainian and Polish reform sagas suggest, that contemporary considerations on speed and radicality, policies in

[4] Empires collapse either through foreign conquest, revolution from below, or they are being given up by metropolitan elites out of economic amd military considerations. None of the thre applies to the Soviet Union.

general against institutional and sustainability considerations, have proven to be fallacies./Hartwell, 2016/.

3. IMF and EU – and the Straightjacket

It would be difficult to re-construct the precise role of external and internal factors in shaping outcomes. In some cases the role of external factors have remained subordinate. For instance, in the case of Russia military might coupled with a lastingly strong balance of payments position limited the influence of external actors. The velvet split of Czecho-Slovakia in 1993 was entirely home-made. By contrast the violent disintegration of Yugoslavia in 1991-99 to six different states was a clear case when external forces were decisive.

Without venturing into the rich and controversial anecdotal evidence on the role of western advisors let us highlight: their role tended to be minimal. In some cases, most explicitly in Slovenia/Mencinger, 1994/, their role was rejected from the very outset. In other cases, as in Russia, their involvement was largely symbolic, despite the considerable media attention drawn by them in a formerly excessively closed imperial center./Brada – Schönfeld, eds, 1996; Gaidar, ed.2003;Olding-Smee- Pastor, 2002/.For a participant observer it is trivial, that even in case of such a small and vulnerable country, as Hungary, it was the internal convictions of individual players which decided. Mighty and visible finance ministers like the three shock therapists, Ferenc Rabár/1990/, Mihály Kupa/1991-93/, or Lajos Bokros/1995-96/, later the unconventional György Matolcsy/2000-2002 and 2010-2013/, all represented strong and different views which mattered, rather than any of the counter-propositions coming from the resident representative of the IMF or the Commission in Brussels.This held even for the most 'neoliberal' among the chages, the Bokros Package of 1995/Antal,1998/.[5]The volume edited by Brada and Schönfeld/1996/provides case studies of how IMF advice was regularly neglected, from Poland to Russia and even Hungary.

In a way, ignorance proved to be mutually reinforcing. Western experts, coming mainly from mainstream economics departments rather than from the – often systematically marginalized – area studies centers, tended to disregard contextuality and de-emphasize the relevance of local conditions. By contrast, local experts have been socialized under the assumption of an ever-lasting Soviet Empire, whose conditions seemed God-given, to be improved but not to be changed in substance. Thus attention focused on detail while most persons were inadequaltely versed in standard macro and financial economics. This allowed for intellectual vacuum and *discontinuity with historical roots and theoretical preliminaries* in each country/Kaase et al eds, 2002/.

Therefore it is hardly surprising that very few of the projects got actually to the point of implementation. The gap between visions and reality has remained even wider than customary in any pluralist society. Convergence towards a new pragmatism in policies has thus been painful and limited./Kolodko, 2000/. Reality has been molded by the transformational recession, a 20 to 50 pc loss of output. As societies expected a new economic miracle, this was cold shower to everyone.

[5] For instance introducing a crawling peg, a differentiated customs levy, or wage ceilings in public sector, that is the most effective heterodox measures were not supported by the contemporary IMF.

It is surprising to note: the steep fall of output and employment has not been forecast by any of the contemporaries. As the trigger of change has been the collapse of all macro-economic and social co-ordination mechanisms, and the ensuing emergence of an institutional vacuum, *restructuring was bound to be brutally painful*. If one considers that a broad international literature on trade reforms/Dornbusch, 1993/, stabilization and the break-up of states all describe each of these processes as inherently contractionary. Thus the outcome – a major recession, or even depression, must be seen as pre-ordained.

By now we possess with extensive literature explaining this peculiar depression./Kornai, 1993; Csaba, 1993; Winiecki, 2002/. The loss of 20 pc of GDP in central Europe and the loss of 50 pc and more in the rest is comparable only to the collateral damages during World War Two. This is shocking on its own, and has shaped the overwhelmingly negative image of systemic change.

Employment losses were comparable and activity rates on the labor market never recovered ever since. *Open registered unemployment sustained at double digit levels in most postsocialist countries for 10 to 15 years,* and reached even 40 pc in extreme cases as in Bosnia-Hezegovina and Kosovo, and not only during the bottom years. This implied a real social tragedy in many cases.[6] All the more so, as joblessness tended to be regionally, sectorally and ethnically *concentrated.*

Let us note: transformational recession has proven to be a transitory phenomenon. Output collapse followed from both favorable and unfavorable changes. For instance, *eliminating useless and negative value added output has been both efficiency enhancing and welfare improving.* Similar effects had trade re-orientation from east to west. Likewise, introducing competitive markets has also improved consumer welfare, even above quantified levels. By contrast inadequate policies, such as the lack of social safety nets in the New Independent States in the first 15 years, or delaying stabilization and liberalization have all contributed to a longer recession than it was inevitable.

4.Economic versus Social Perceptions?

Recovery from the transformational recession has proven to be relatively fast wherever stabilization had been implemented on the ground, not just preached./Roaf et al., 2014/. Also restoration of central power supported by the functioning of markets delivered relatively quick results. In most cases, as in NIS and Southeast Europe, stabilization was delayed and so was liberalization and privatization. Thus *recovery in both regions started in 1998-99 only* against 1992-93 in central Europe and the Baltics.

Since public opinion and the broad political discourse in much of the region expected something of a replica of west European post-war recovery, the 10 to 15 years needed to re-gain previous low living standards was generally seen as sobering. The drift between professional and public perceptions has widened into something ubridgeable/Kornai, 2005/.

As much of the late Socialist crisis was largely covert, and has come into the fore only when the change was launched, the speed of recovery has to be appreciated. On the other hand, inflated

[6] Several studies have related to declines in life expectancy among Russian male population to these processes. Indeed, decreasing life expectancy is exceptional in modern economic history especially in the post-1870 period.

expectations of immediately improving living standards have been massively disenchanted, leading to fast disintegration of both left and right wing movements managing the change, as Solidarity in Poland or the Hungarian Democratic Forum in Hungary. It is legitimate to argue that those tendencies have *deep social roots and much in common with similar trends having emerged in western Europe*.

Populism is used in this chapter as a shorthand for political action and communication *subservient to immediate media attention and electoral policy instrumentalization.* It emerges both on the Left and Right, in old and new EU members and non-EU states alike. Movements like the Italian Five Stars, or the Polish Law and Justice/PiS or the Greek Syryza are cases in point. Impacts of these movements come mostly via 'mainstreaming', i.e penetration of public discourse and also policy platforms of major governing parties. It has little to do with 'aggregating electoral preferences' - a normalcy in any democracy.

The turn away from 'neoliberal' policies was observable already from the mid-90s. Radical liberals as Leszek Balcerowicz in Poland, Yegor Gaidar in Russia, Lajos Bokros in Hungary or Daniel Daianu in Romania were soon losing top administrative positions. Elections tended to be won on platforms promising to remedy the 'injustices' of privatization. This applies both for left and right turns. Thus the slowdown of privatization and liberalization have become manifest by the mid-90s in all countries except Slovakia and the Baltics, but importantly including Russia, Ukraine, Romania, Croatia and Bulgaria.

The macroeconomics of transformation has long been seen by most analysts in the combination of three interrelated policies, which in an ideal case scenario act in self-reinforcing synergy. The first is *stabilization.* It means dis-inflation, often from triple digit levels to de facto price stability of 3 to 5 pc p.a. This is usually associated also with attaining a sustainable public finance position. The second is *liberalization,* that is replacing quantitative restrictions and licensing with monetary constraints and free pricing. The third is *institution-building*. In practical terms it means creation of an independent central bank and judiciary, a competition agency, independent regulatory agencies and many more. Finally the fourth item is *privatization*. The latter is a complex matter, both technically and politically. While global experience is mixed, it should be noted that in most cases a mere 4-5 pc of national wealth was covered by the process. By contrast in post-communist context it was 50 to 80 pc of national wealth that changed hands. *Thus the political component was overwhelming, from the very outset to date, leading to a restructuring of national power relations/*Aslund, 2012/. The fundamental dividing line has been if, and to what degree, foreigners could obtain dominant positions in strategic branches as energy, banking and trade. As shown in the book cited above, foreigners tended to provide a counter-weight to local politics. By contrast, where the closed shop nature of the game sustained, as in the NIS, but also on the Balkans, 'political capitalism' of the Latin American brand emerged, with power and property mutually and intimately intertwined. This translates into illiberal, often oligarchic capitalism, reminescent of the Asian types.

Interestingly we could observe a trade-off between the strength of central power and the two major aspects of change. Weak government position turned Poland in a slow stabilizer/not until 1993 could annual inflation came under 40 pc/. In Russia inflation came down to 21 pc only by 1997.

Both governments at the time preached shock therapy, but could not practice it. On the other hand, *as soon as the government stabilized, privatization started to slow down in both countries*. In fact, the share of private property – one of the major indicators for the progress of reforms – has hardly increased in these/and most other/ countries since 1996.

The London-based *European Bank for Reconstruction and Development,* created in 1991 to analyze , assist and evaluate systemic change after Communism, *applies six indicators to measure progress.* These are: large and small privatization, governance and firm restructuring, price liberalization, trade and forex system, finally competition policy. They are standardized for all countries of activity of the Bank, thus post-communist countries but since the extension of the mandate in 2014 to the Mediterranean, also Turkey and Morocco. In the paragraph above we referred to the most important one for the first stage of transformation, large-scale privatization. To illustrate our point: while Estonia reached the top score of 4.3 by 1996 and Hungary by 1997, Montenegro is still stuck with 3.3, Kazakhstan with 3.0 and Tajikistan with 2.0/EBRD, 2016/. In a way these numbers do orient investors and laymen alike in a complex web of interrelationships, without having to be too long. It also indicates, that in line with our grouping, central Europeans take the lead, NIS follow, and southeast Europe lags behind.

The softest and thus *most controversial element of the SLIP agenda was institution building.* In this respect stagnation has generally been seen as inadmissible. Not least because of the 'beauty contest' induced by the prospect of EU membership, or in reverse, the threat of being left out. If one considers that the second most western and advanced among the Yugoslav successor sates, Croatia was admitted to the EU only as late as 2013, a decade after the Big Bang enlargement of 2002 in Copenhagen, the threat must be seen as very real indeed.

The twists and turns of these complex processes could be a subject of separate monographic analysis/Berend, 2009/ In a way acceeding to a given political and organizational structure has been equalled in political discourse, ambition and also action to 'becoming a normal country' or a ' return to Europe', the natural environment, from where the region had been forcibly torn out by the Communist conquest. Owing to this peculiar atmosphere *the bargaining chips of the Union in 1993-2002 have proven to be much more powerful, than the actual size of economic carrots would have justified.*

The *per se* fully legitimate question, if and to what degree, actual EU arrangements are optimal under any theoretical angle, or if and when, these are tailored to developmental needs of the would-be members, had been entirely suppressed. Copying EU arrangements, also enforced via 'acquis screening', has largely shaped institutional change in the entire 1990-2004 period.

On balance, the SLIP agenda could serve as a good rod of measure both for EU and local societies. Fast reformers of central Europe recovered in 1993-4, while slow reformers, as the NIS and the Balkans a decade later. The most conspicuous control case is that of the Baltics. Torn out of the single Soviet economic space after half a century of forcible integration, these small open economies suffered steep recession, or 50 pc of pre-crisis GDP. But recovery was fast and started already on par with central Europe, i.e in 1993, but its space exceeded their peers. While Russian recovery started in 1999 only, by that time the Baltics have already regained by and large their pre-crisis levels of output and continued to grow vigorously over a decade. By now, per capita GDP of Estonia is 17 300 USD, of Latvia13 700 and of Lithuania 14 200 against Russian 9 thousand.[7] This is truly a very rare case of overtaking the imperial core, accomplished in a mere 25 years.

Summing up the past two sections we may ask if radical reforms overlapped with the so-called Washington Consensus, or the IMF view on structural reforms./Marangos, 2007/. As the above cited artile elaborates in fine detail, in part yes, in part no. It was compatbile insofar liberalization and stabilization had to be front-loaded in order to succeed. It was not, especialy because of its de-emphasis of institutional and quality factors, which backfired in phony privatizations, especially in the NIS, where lacking competitive environment and of state controls led to massive asset stripping and lastingly low efficiency. Contemporary Russians coined the term *prikhvatizatsiya,* i.e grabbing, as redistibution dominated efficiency gains.

5. *Does EU Membership Matter? When and How?*

As we have shown in previous sections, 'distance from Brussels' did matter, *both in geographical and institutional planes.* Those closer to the west had a better chance to get integrated – politically and economically alike. In line with new economic geography, distance was formative also for institutional reform. One may argue that reforms were pre-conditions to EU membership, as explicitely stated in the membership criteria of Copenhagen of June,1993. But one may also raise reverse causality: in countries with no or distant EU membership perspective, both sticks and carrots for radical and comprehensive change were missing. Thus the non-reform scenario may, at least in part, be ascribed to the less than ambitious EU strategy on the east and particularly on the stop on further enlargements, save Croatia,[8] since 2002. This is much of a chicken and egg dilemma in explaining weak growth and lack of convergence of the non-EU part of the region.

The 2008 to 2016 period carries in this respect a mixed bag. *The dividing line between the 'ins' and the 'outs' has become manifest.* Systemic and policy change in Russia, Turkey, Kazakhstan and even Georgia are rarely discussed, if at all, in the same breath as those in the EU, even the agenda is different. Underlying fundamental dissimilarities in polity vouch warranty for different standards of assessment, be those in human rights or state aid to private banks.

With the benefit of hindsight it is clear: *perspectives of full EU membership mattered primarily as a kind of soft power*/Nye, 2004/, rather than its set of concrete arrangements, as prescriptions on animal welfare or on security of water boilers. Actually, the *acquis communautaire* to be taken over covers 95 pc the latter. But technicalities were minor points. The major feature was if and when the EU acted as a focal point, rallying all forces across the political spectrum to support policies needed to sustain structural refoms against backsliding, particularly, but not exclusively, in the run-up, 1989 to 2004.

It is intriguing to observe *a perverse effect of EU accession*. During the years of conditionalities prospective members tended to outperform incumbents in terms of macropolicies and reform zeal

[7] *Data/worldbank/org,* retrieved on 1 September, 2016.
[8] Croatia was sidelined for inadequate co-operation with the Hague Tribunal on War Crimes.

alike. With arrival in the safe haven the ambition to implement far-sighted reform without immediate political gain was bound to have ebbed – and so it did/Csaba,2004/. The latter was most blatantly the case in Romania, Croatia and Bulgaria/judging by the recurrent official reprimands coming from Brussels e.g on the role of the judiciary, corruption and crime-business relationship/.

Therefore one part of the answer to the question in the subtitle is *affirmative*. The EU, with its increasingly supra-national powers of enforcing its rules, from EU Court of Justice to stipulations of the Fiscal and Banking Union, has developed into a major policy actor, no longer to be side-stepped.

Meanwhile compliance to EU standards have clearly weakened in the 1999 -2008 period in east and west alike. *Third generation reforms,* such as of pensions, healthcare, regional administration, fiscal management – *all tended to be delayed or even put on ice*/except Slovakia, the Baltics and Romania, but including Poland, the Czech Republic, Russia and Hungary/. This has been facilitated- though by no means triggered - by the global savings' glut, negative real rates of interest and robust inflows of both portfolio and direct investments.

Terms of EU accession implied early EMU entry, which in turn triggered a broad inflow of FDI. This was betting on the so-called *convergence game,* which means that those acting fast can benefit from three combined effects. These are: lower interest rates/at repayment/, appreciating exchange rate/in the run-up to EMU/ and ensuing rises in asset prices, owing to forseeable price convergence. These processes did play out in all previous accessions. No surprise therefore that *public and private inflows were lavish and mutually re-inforcing*.The overall feeling was – like in contemporary US – that the party will know no end.

In most countries status quo bias, re-inforced by the *availability of abundant and cheap external funding,* have turned acting on reforms politically suicidical. In major players, especially in Hungary, the Czech Republic and Poland, but also in Russia, Bulgaria and Ukraine the no change scenario prevailed. Elites could afford it, masses have not revolted, intellectuals offered complacent accounts, equalling to an acquittal for non-action.

Let us note: *1999 to 2008 was indeed a period of real convergence to core Europe/*Iradian, 2009/ – a rare moment in history indeed, especially when funded from foreign savings to a large extent. This outcome may be explained by the *fortunate interaction among several favorable – exceptional – circumstances.* The latter include the following five factors.

a/actual policy and institutional reforms implemented in 1989-2000;

b/favorable atmosphere and expectations created by EU accession and the prospect of further enlargements;

c/parallel inflows of large and increasing amounts of private and public money, especially FDI;

d/impacts of stabilization of the politico-economic system;

e/embeddedness in the western security and economic alliance. The latter particularly improved the quality of the region as investment spot;

f/ borrowing formal institutions and relying on the impact of European epistemic communities. Informal channels of transmitting tacit knowledge have often proven to be more powerful/Hare, 2010, than controlled copying enforced by European institutions, themselves struggling with considerable implementation deficits in the post-2004 period.

6. Did the Global Crisis Disprove the Strategy?

The spill-over of what initially seemed to be an exclusively American banking crisis has come for post-communist countries as bolt out of the blue. These governments – like many of their west-European counterparts – *exercised no contingency planning* thus no alternative armoury for action was available to them. The crisis triggered recession, unemployment and soon it also produced calls to re-think the entire strategy of outward orientation cum market orientation./Myant – Drahokoupil, eds, 2011/. This claim was re-inforced by the fact, that in the frontrunner countries of the first group an internationally unprecedented forign dominance of banking/50 to 80 pc of assets/ prevailed. Thus the insider – outsider problem, as well as the *cui bono* question gained new prominence.

First, some countries implementing quite radical reforms, like Poland, have not suffered recession at all. Second, some other free-marketeers, like the Baltics, did suffer, but their contraction has proven quite short lived, a bit more than a year. Growth has been going on in 2010-16, at rates above the European average. Thus, unlike the rest, *Baltic countries, Romania and Slovakia continued to converge to the core EU income levels in 2008-16.* Third, in some countries, which did collapse, recession was largely home-made. The latter implies the decade long procrastination with second generation reforms, as well as a series of military conflicts and internal strife, as in Russia and Ukraine. In all, new EU members tended to outperform many incumbents both in terms of stabilization and in terms of structural and institutional adjustment.

Crisis management, too, tended to be different by the country. Some countries – most notably Poland and Russia – relied on fiscal expansion to revive output growth. Others – most prominently the Baltics, but also Slovakia and Romania – adopted an orthodox line[9]. Comparative analyses have however highlighted*: it is not the shallow and mostly misleading austerity debate which proved decisive for the outcomes in the real sector.* It is rather the quality of institutions and coherence across various policy areas, including structural reforms, which - in interplay - defines end-results/Orlova- Egiev, 2015; Győrffy, 2015;Staehr, 2015/.

Managing the crisis *did bring back the IMF in several countries.* This was a surprise as conventional wisdom held it unneccessary for EU members to resort to harsh IMF rescue packages. Reality turned out to be different: Latvia/2008/, Romania/2009/, Hungary/2008/ – as several old EU members, like Ireland/2010/, Greece/2009/ and Portugal/2011/– had to resort to IMF funding.[10] What is truly interesting in this issue is that the IMF has refrained from the intrusive policy

[9] Note: the dividing line on macro/austerity- *policies - does not follow the conventional dividing line* – drawn along *institutions* - reform champs/laggards in the region either.

[10] Sometimes, as in Greece, it was the troika of IMF, EU Commission and ECB, in other cases, as in Hungary, just the IMF on its own.

advocacy which used to characterize its practices in the 80s and 90s. The focus was more on narrow and short term balance of payments issues, with the details left to the locals/Grabel, 2012/.

One further aspect underscored by the Great Recession has been the *pre-eminent role of foreign banking in the financial intermediation of the NMS except Slovenia*, as contrasted to the basically domestic bank ownership in the NIS. It goes without saying that foreign ownership means decision-making outsourced to the headquarters located abroad.

This state of affairs has at least two ramifications. From the allocational perspective strategic foreign ownership enhances the probability of better quality decisions, not constrained by production traditions, employment concerns or plain political expediency. From the policy-makers' perspective, however, the same translates into *limited sovereignty in the choice of methods in crisis management and investment priorities.*

At the end of the day it remains an empirical issue which is the balance between dangers and opportunities inherent in any of the polar options. Case studies of the 2008-2011 period have shown that *foreign banking in general has exerted a largely stabilizing influence* in warding off the spillovers from global volatility to the economies of the NMS/Vogel – Winkler, 2012, de Haas, 2014/.

How can we explain that despite these pluses macro-economic performance has not been impressive? Why has *'new Europe' not become a new growth pole in the old continent?* We list the region-specifics only, though global factors played an equally important role.

1. As discussed in the preceding sub-chapter, major *structural reforms in most post-communist countries ended by about the turn of the millennium*. Recapitalizing banks or balancing the budgets may be welcome, but these are a far cry from coherent development strategies. Cyclical policies could not replace institution building, professionalism and strategy as proposed by modern economic theory.

2. The EU, with its policies focusing on issues of immediate political concerns primarily via re-distribution, through both the Common Agricultural Policy and Cohesion Funds, *has never been a growth enhancing institution. This had been a problem for incumbents as much as for the new members.* The lagging behind the USA had been discernible ever since the 1970s.

3. Issues of *allocational inefficiency,* internal to the post-communist countries also need to be highlighted. Capital markets remained in ther infancy while banking is getting increasingly state-controlled. The latter rarely bodes well for funding innovative, risk-taking projects. The process of global *de-leveraging,*[11] though extraneous to the region, is a dominant one also in the post–crisis years and limited credit expansion in 2012-16. In the NMS and in post-Yugoslav states, especially in Slovenia and Croatia, national ownership translated in too cosy relationships between banking,

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[11] Owing to the new Basel Three regulations,effective from 2020, coupled with a more pessimistic assessment of future growth prospects, banks have two choices. Either to put more capital in existing banks in order to sustain their market share, or – more probably – withdraw from crediting in order to improve capital/outstanding ratios.

industry and the state which led to financial collapses and inability to restructure. In a way, seclusion again turned out to be a bad option.

4. Growing *interventionism,* coupled with issuing ever more complex *regulations,* do not provide a favorable environment for enterpreneurial activity, especially for start-ups. While the Baltic States, Slovakia, Bulgaria and Romania have all rolled back their traditionally high state redistribution to around 35 pc of GDP/in line with their standard in terms of levels of development/, others still rely on *large or even growing share of public expenditures in GDP.* The 'champions' of statism in 2014 were Hungary-50.1 pc – and Slovenia – 49.8 pc – still below Finland – 58.7 pc – but well over Latvia – 36.9 pc –, Ireland – 39.pc - or Poland-41.8 pc.[12]

7. Growing Divergences Among Policies, Institutions and Outcomes

In much of the literature there is an unmistakable trend to enter into sweeping generalizations on the success or failure of post-communist change, mostly based on a single country experience. Against this background it is reassuring to find detailed factual and meticulously documented evidence highlighting our major claim. Namely that the thirty countries *had all different starting points, entered in distinct trajectories, and thus arrived obviously to different termini.* In so doing while there were some commonalities with democratic and pro-market transitions elswhere and in other time, still *differences have proven to be prevelant/*Turley-Hare, eds, 2013; Kollmorgen et al eds, 2015/.

At a certain level of conventional economic analysis the differences from other than post-communist transformations are easy to explain ot the grounds of major and surviving differences in economic structures at the macro level/Keren – Ofer, 2007/. Meanwhile *sustaining intra-transformational differences are much less easy to interpret,* especially in the ahistoric analytical frame of modern economics.

Perhaps the majority of observers will allow for invoking *path dependence* in one way or another. This is not a trivial claim. All the less so since the progress of transformation has long been measured on how far and how fast the distance to the Communist past has been growing in both political and economic terms/Wagener, ed., 1993/.

Notwithstanding the obviously important role of ad-hoc measures and improvizations, and also the social learning proess in terms of formulating and implementing policies, references to the long term historical trends are difficult to escape. Those produced and indeed, *reproduced historic economic, social, structural and strategic dissimilarities* across the Baltics and central Europe as one, the NIS as a second, and the Balkans as a third group of nations./Szűcs, 1983/.

The 'history strikes back' argument can no longer be easily rejected with references to coincidental factors and policy blunders, which all played some role in shaping outcomes. It is remarkable that people coming from outside the historian profession, but presenting their analyses at one level of abstraction higher than policy analysis, tend to highlight the long term continuities and the ensuing specificities. In short, *it matters, if policies are embedded or rejected* by the social and institutional environment. The dividing line is rather obvious in the case of Russia and its one-time internal

[12] Source: *Eurostat Newsrelease,* 7 July, 2015, last retrieved on:26 January, 2016.

Empire/save the Baltics/ from the rest of Europe. In this interpretation *policy choices have been largely endogenous.*

Put simply: only those policies could survive which had been in line with both formal and informal institutions, social norms and behavioral traditions/Gaidar, 2012; Hedlund, 2011; Rosefielde, 2009/. Also in the less trivial case of the various Yugoslav successor states the pre-eminent role of both the heritage of self-management and of economic nationalism has been demonstrable, even at the elementary level of informed policy analysis/Estrin – Uvalic, 2014/.

On the other hand it would also be a fallacy to overlook cases of *path creation,* which has been so impressive in the Baltic States/from 1992 on/, Romania/only in the 2000s/ and Slovakia/since 1998/, all coming from disadvantaged quarters. By contrast, the less impressive cases, Slovenia, Croatia and Hungary used to count among the best pupils in the Communist class.

Path creation thus matters both in successful and less successful cases. We have no space to detail the individual cases./Turley – Hare, eds,2013/. Perhaps the most startling among the non-path-dependent success stories has been that of the three Baltic States. They had long been the periphery of the Russian Empire, without any raw material base, deeply divided societies – along ethnic and ideological lines – and saddled with weak institutions. Likewise, Slovakia used to be a backward part of both historical Hungary and Czecho-Slovakia in 1918-1993.

Romania, one of the most lagging countries both of the inter-war and Communist periods, has shown steady nominal and real convergence in 2000-2015 period. This is reflected in one of the lowest debt/GDP ratio being 38.4 pc in 2015 against 92.9 pc in the Euro-zone and 88.9 pc in EU-28. Meanwhile, in terms of relative per capita GDP,as reported in Eurostat *Newsrelease* measured on PPP, Romania reached 18 600 US dollars against 23 600 in Hungary and 30 240 on EU average. The Romanian level in 2015 was thus over 88 per cent of the Hungarian, *a historically unprecedented attainment.* Let us add: Romania did not enjoy the historic and geographical advantages akin to the Baltics. Instead, the burden of the Stalinist past weighted particularly heavy, rendering the first decade of transformation anything but a success story/Daianu, 2001/2013/. Against this background the steady catch-up cum financial stability of the subsequent 15 years can not be seen as pre-ordained or path-dependent, it is all the more remarkable.

But we have some further, less trivial cases, showing how ’the first shall be the last’. Slovenia, once considered as a showcase for successfully combining social well-being with economic stability, has yet to recover from the collapse of its banking in 2012. The Czech Republic is also a long way from what was termed as a ’miracle’ in the 1990-97 priod despite the recent revival of growth under stable public finances. Output recovered pre-crisis levels only by mid-2015. Croatia, a leading reformer of the Socialist period, has suffered a serious slump coupled with unemployment reaching close to 18 pc, against below 11 pc of EU average in 2015. GDP levels in 2015 stood at 57.2 bn US dollars, still a long way from the 2008 top of 70.45, exacerbated by a notorious balance of payments imbalance. In the case of Hungary, traditional balance of payments disequilibria though disappeared in 2009-2015, showing regular surpluses instead. But per capita GDP levels have reached only in 2014 the 2008 levels- 23 609 against the peacetime peak of 23 334 US dollars – but absolute levels still lagging. In 2014 Hungary’s GDP accounted for just 137 bn USD against the historic hight of 156.6 bn in 2008, reflecting in large part the devaluation of the currency in 2011-15.

How can we interpret the divergence? As seen above, history matters and so does geography, favoring the Baltics and disfavoring the Balkans, Ukraine and even more the Caucasus. This notwithstanding *the vital role of policies, and even more broader public choices can also not be underestimated.* Stabilization of inflation in Russia could happen only from 1997, following the electoral victory of Boris Yeltsin in December, 1996. By contrast, Serbia/in 1994/, the Czech Republic/in 1990/ and Croatia/in 1991/ could stabilize in only a few months. Poland has been sticking to its pro-market line broadly all across the 1990-2015 period, despite occasional twists and turns. Parallel to this Slovakia in 1998 and Romania in 2000 did master a mostly unexpected turn for the better.

But georgaphy is far from being the 'final cause': if one compares Belarus and Romania*, one would not venture the claim that spatial distance alone* – and excluding the despotic rule of Lukashenka and his sustaining the ossified over-industrialized structure – *could explain the startling dissimilarities*. While Romanian identity has always been constructed as central European/over the past two centuries/, it is questionable if a separate Belorussian identity, can be discerned. As a consequence policy orientations may reflect deeper cultural and historic factors than usually thought.

This observation doesn't imply our subscribing to the view of active participants that 'policy is everything'/Aslund- Djankov, eds, 2014; Roaf et al., 2014/. *Policies may imply inaction or not launching the necessary correctives.* The latter has been the case in the declining countries. However one may well ask if there may be deeper explanations for the latter woes than ignorance, ill-will or bureaucratic inaptness? *The statist-populist turn seems to be ubiqutous thus in need of deeper going explanation*. The more we consider this as a Transatlantic trend, the more so. It is interesting to observe that – similarly to the 1930s – statism is back in respectability. In part this mirrors lessons from 2007-2009, but in part *it reflects a drift between elites and the masses,* academic discourse and infotainment. Listing the most obvious cases – Brexit and the ascent of the radical left in Greece, the victory of Law and Justice over the liberal-conservatives in Poland in 2015, or what János Kornai/2015/ termed Hungary's U-turn in 2010-16 are all cases in point.

Without aiming at being exhaustive we may formulate some *preliminary answers.* First, the tremors of the global financial crisis have shaken the previously blind faith in unfettered markets. Second, secular trends, as aging, the IT revolution, globalization and mass migration have changed labor markets and also the provision of welfare services. Funding the welfare state has become a challange also for Scandinavia.

Third, calls for more – rather than for better quality – regulation have become a dominant feature of public discourse. Fourth, anti-austerity sentiments have spread as the revival of growth remained timid, short-lived and very unevenly distributed. Inequalities grew both east and west. Thus, fifth, calls for more governmental redistribution replaced earlier emphasis on privatization and deregulation. *Democratic governments, aiming at re-election must have shown a fair degree of responsiveness to the popular sentiment,* even if many of the calls are intellectually shallow.

8.Reform Fatigue and Illiberal Tendencies

The quarter of a century since 1990 is still a largely open-ended chapter in history. Still, we do see the re-emergence of the three historical regions following Jenő Szűcs cited earlier. For the post-communist world it consists of the largely westernized central Europe and the Baltics, followed by Russia and its 'near abroad' as a closed system, finally southeast Europe struggling with its identity, its legacies and still incomplete and uncertain integration in western alliances.

The principal question is the following. Is sufficiently robust growth to be generated outside the NIS to avoid the replica of the authoritarian trends of the interwar period? And if yes, through what measures and under what conditions? *Why have so many countries have missed the unique historic opportunity for accelerated real convergence to the core*, that opened up by a combination of Europeanization and cheap external funding in the 1990-2015 period? Good outcomes are though concievable, however, by no means pre-ordained, as neo-classical growth theories or neo-functionalist integration theories would suggest.

For the time being much of the region seems to have been caught in a middle income trap. This was exacerbated by a largely populist reaction to the spillover of the global financial crisis. If the first decade was clearly dominated by structural and institutional changes, this was followed by 15 years with a disregard for this and an all-encompassing, exclusive focus on managing the business cycle. If and when the former played a role – as with industrial policies – a return to statism has been formative/Szanyi, 2016/.

While capital accumulation is not extremely low – in line or sometimes above the 20-22 pc characterizing OECD countries – its allocation has remained notoriously inefficient. Schooling years are though long and enrollment rates impressive - 90 plus per cent in secondary and 35 plus pc in tertiary education – but quality of schooling is not very high and its match to labor market needs is inadequate. The use of IT in households, bureaucracy, business and banking is unimpressive. Expenditure on R+D and higher education is way below the leading economies, at about 1 pc of GDP/OECD, 2015/. Also R+D spending in terms of share of- much lower – per capita GDP, around 1 pc against 4 pc in the USA and 5 pc and more in Sweden and South Korea.

Policies in most countries tend to be still pre-occupied with crisis management. Thus issues of longer term impact, as structural reforms, promoting education and innovation fall in the backgound. As immediate growth potential tends to have been used up, *any radical catchup scenario looks unlikely.* One of the open questions is if the revival of populism has been inevitable in any Great Transformation *á lá* Karl Polányi/1944/1957/?

Polányi argues that the blind faith in markets and ensuing policies lead inevitably – logically and historically – to totalitarian regimes. Given that postcommunist transformation has been about creating markets and private property, the backward move of the shuttle was only to be expected. As Polányi/1957, pp 223-258B/ explains, *preserving freedom in a complex society requires contiuous reforms*. In other words: taming the free market and its impact on vulnerable but by now vocal social groups. If this holds, the quality of policies and institutions of the post-2002 period must be seen as *inadequate to manage this broader task.*

What broader lesson is to be drawn from this *tour d'horizon?* In the post-1990 period *path creation* – moving out of the inherited gridlock - *has proven possible*, at least in several countries. Mostly in ones which were not pre-destined for it. This all went contrary to prevalent pessimism at the time. But success required in all cases a *rare combination: economic professionalism embedded in a fair degree of social consensus/*Frye, 2010/.It would take perhaps a monograph to expand: if and when nationalism – as in the Baltics or Slovakia – could play a favorable role, and why did the same backfire in Croatia and Russia.

Noting lack of outright regress in marketization since 2000 needs to be complemented by two remarks. First: EBRD indicators are technocratic in nature and do not capture such fundamental elements as big fiscal expenditure/thus overtaxation/, or qualitative features that relate to the documented return of statism in political and economic spheres/Meka, 2016/. Second: these indicators were constructed to measure progress in the elementary sense only, e.g. if an independent regulatory agency for energy is around or not. No surprise that in the past decade nearly all postcommunist countries except Belarus and central Asia look to be good performers over the new EBRD clients, like Egypt or Morocco. However for long run growth performance it is the broader concerns which really count. *Equalling good EBRD indicators with an overall picture of 'normality' would be a very perfunctory reading of events.* They do not reflect the diminishing competitiveness of the region reflected in global competitiveness reports, as of WEF, IMD or OECD, and disregard the rather axiomatic relationship between the economic and political subsections of any macro-system.

9. Balance Sheet

The window of opportunity for accelerated catching up and convergence to core countries is unlikely to come again, especially not in the uniquely favorable combination of external and internal factors. In hindsight *much of the period under scrutiny must be seen as an exceptional period favoring the region.* Between 1995 and 2015 Europeanization and cheap external funding have mutually been re-inforcing. While the Baltics, Poland, Slovakia and Romania used the opportunity, others have not. And *the likelihood for a recap is usually low in history.*

Some analysts go as far as claiming this as a state of normalcy for Post-Communism./Shleifer – Treisman, 2014/. This is a very different reading from ours. The contested view builds on an unconventional interpretation of 'normalcy'. If annexation of foreign territories- as of the Crimea by Russia in 2014-, life-long presidencies as in Kazakhstan, Uzbekistan and Belarus, resource curse and stagnation as in Ukraine and central Asia were the rule, further path creation of the frontrunners were to be exclueded, this view could perhaps hold a modicum of truth. But as long as we stick to the academic mainstream summarized above, this position counts as ideologically biased at least and no way squaring with the facts at worst.

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