Transformation and Structural Change: Central and Eastern Europe's Post-Communist Adjustment in Historical Perspective

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Introduction

The transformation of Central and Eastern Europe after the half-century communist experiment is one of the most important historical events of turn-of-the-century Europe and the emerging new world order. The transformation is a complex phenomenon with far-reaching political, social, cultural and economic aspects. A great number of scholars have analyzed the bumpy road of the former one-party systems and centrally-planned, state-owned economies toward parliamentary democracy and private, market economies. A whole library might be filled with the already existing literature of "transformatology."

I do not attempt to repeat or summarize this vast litterature. My presentation is going to focus on the long-term, determinant undercurrent of the structural changes of the Central and Eastern Europen economies. Although 5-6 years are not long enough to appropriately evaluate these long-term processes, the emerging new trends, the transformation in the making, may give valuable and essential information about the new chapter of the region's history *in statu nascendi.* The main question I am going to analyze is the following: can Central and Eastern Europe successfully adjust to the requirements of the technological-structural transformation of the world economy? The main characteristic of our age that became manifest from the mid-1970s is the change of the old technological regime and its replacement by a new one, or, using the term that several economic historians prefer to use: the dramatic progress of the "Fifth Industrial Revolution." Most of the phenomena of major shocks and turmoils of the end of century world economy might be described by the Schumpeterian "structural crisis," the "creative destruction" of technological transformation. In my interpretation, that was the main reason of the deadly crisis of rigid state-socialism, which could not adjust to the requirements of the age.

The symbolic year of the manifestation of the structural crisis was 1973, the year of the first "oil crisis," and the appearance of the personal computer, a milestone of technological revolution. What was the impact of these changes on Central and Eastern Europe?

Historical Backwardness and Changing Position

The region under examination, as is well-known, has a long history of relative backwardness. My point of departure here is a historical evaluation of Central and Eastern Europe's bold and desperate attempts - in the nineteenth and twentieth centuries - to take off from the backward periphery of the world system and safely land in its core. The countries of the region pursued this goal in various ways. For the half century between the 1860-70s and World War I, they enthusiastically copied the Western pattern, introduced Western institutions, joined the international *laissez-faire* system initiated by Great Britain, and launched an export-led industrialization policy. They definitely achieved certain successes by modernizing their economies. However, they could only slow down but not halt their relative decline and the increase of the gap with the West, which characterized the first half of the nineteenth century. In 1820 and 1870, the countries of the region -according to Angus Maddison's newest calculations*[1] -reached only 58.1 and 48.8 percent of the West European core's per capita GDP level respectively. In 1913, they declined to 42.0 percent of the Western standard.

The semi-success (or semi-failure) generated a desperate revolt against Western values and models. After World War I export-led industrialization was replaced by import-substituting industrialization and *laissez-faire* economics was overturned by protectionism and aggressive state intervention, occurring simultaneously with harsh attacks against the previously adopted parliamentary system and the introduction of various types of authoritarian regimes. The comparative economic level of Central and Eastern Europe, however, stagnated during the first half of the twentieth century. While slowing down itself to a significant degree, West Europe preserved its advantage compared to the eastern half of the continent. The latter's position hardly changed between 1913 and 1938, and totalled 44.1 percent of that of the West by the outbreak of World War II.

The new revolt and the adoption of the Soviet model of a planned economy and forced industrialization, made the East European modernization dictatorships relatively successful for a quarter of a century. In quantitative terms, meaning per capita growth, the historic trend changed and, for the first time in modern times, this led to a somewhat narrowing of the gap with the West. With an average annual growth of 3.9 percent, Central and Eastern Europe achieved the fastest growth rate in a generally rapidly growing world between 1950 and 1973, improving its relative position and seeming to leave behind most of the other peripheral regions.

Central and Eastern Europe's per capita GDP
as percentage of the various regions of the world 1913-1973*

	1913	1938	1973
Western Europe	42.0	44.1	46.6
Overseas West	29.7	34.9	35.7
Southern Europe	88.8	107.9	95.2
Latin America	102.8	105.5	120.9
Asia	209.8	238.3	341.8
Africa	270.8	291.7	450.7
World average	97.8	108.3	132.6

*Angus Maddison's regional figures are based on the average of sample countries. Western Europe is represented by 12 countries; the Overseas West (he calls it Western offshoots) is the aggregate of Australia, Canada, New Zeland, and the USA; Southern Europe is the average of Greece, Ireland, Portugal, Spain, and Turkey; Central and Eastern Europe consist of Bulgaria, Czechoslovakia, Hungary, Poland, Romania, the Soviet Union, and Yugoslavia; Latin America is represented by seven countries; Asia by eleven countries (including China, India, Bangladesh, Japan, Taiwan, and South Korea); Africa is represented by ten countries; the world average is computed by the average of the above 56 countries.

From the last third of the nineteenth to the last third of the twentieth century, Central and Eastern Europe could not break through and remained basically at the same relative place; as Maddison's figures demonstrate, it was the fourth-ranking region with the fourth-fastest per capita growth. Although Central and Eastern Europe rose well above the world average, and was much further ahead of the peripheries of the world economy (such as Latin America, Asia and Africa) in 1973 than it was in 1938, it still could only claim a 1 : 2 proportion of the economies of Western Europe, and 1 : 3 to that of Western core countries overseas. The "Second World" still remained the European periphery dispite its neck-breaking drive to catch up with the West.

During the last third of the twentieth century, the endeavor to spectacularly catch up totally collapsed. The countries of the region could not cope with the new structural crisis, could not adjust to its requirements and slowed down from the late 1970s on. During the 1980s the economic crisis deepened. Growth was followed by stagnation and then decline. This was the economic basis of a rapidly emerging political crisis which concluded in the collapse of state socialist regimes in 1989-91.

Since that time, the painful consequences of Soviet-type industrialization, the collapse of the isolationist Comecon market, and the new efforts to change the economic model and revert to pre-World War I *laissez-faire* and export-led industrialization, all led to an additional 25 to nearly 50 percent decline of GDP and industrial output. According to Maddison, Central and Eastern Europe, as an annual average, reached a negative growth of-0.8 percent between 1973 and 1992*[2]

Although they experienced several recessions, stagflation and economic turmoil, the Western core countries successfully coped with the difficult task of adjustment to the structural crisis and regained their vitality. Their annual average growth between 1973 and 1992 reached 1.8 percent, nearly three times more than that of Central and Eastern Europe. As a consequence, the gap, or, more precisely, the abyss, has expanded from roughly 1 : 2 to nearly 1 : 4 between Eastern and Western Europe, and from roughly 1 : 3 to nearly 1 : 5 between Eastern Europe and the overseas West. For the first time in history, Central and Eastern Europe's per capita average GDP fell behind that of Latin America. It's former advantageous position vis-a-vis Africa eroded sharply as well. The average Central and Eastern European per capita GDP dropped to between one-quarter and one-fifth of the Western standards, which had never happened in modern history. Their position is far worse than it was at the beginning of the nineteenth century, when Central and Eastern Europe reached about 60 percent of the Western economic standard.

Even more important is the revitalization of the Western economy, and the success of some of the Asian and other former peripheral countries, through the renewal of the technological base, i.e. the creation of a new communications infrastructure, and the restructuring of industrial output and exports. In other words, growth was generated by a more or less successful adjustment to the requirements manifested in the structural crisis.

It should be noted that some of the former peripheries in Southern Europe and Asia quite successfully caught up with the core during the end-of-the-century structural crisis. Spain, Portugal, Greece, Turkey, and even Ireland, which had a somewhat lower average per capita income level than that of the Central and Eastern European region in the middle of the twentieth century ($2,025 compared to $2,604 in 1950), all gradually caught up with the West in an advantageous political situation. Having already profited from the Cold War division of Europe, Southern Europe achieved a 4.8 percent annual average growth between 1950 and 1973, and rose from 39.5 to 49.1 percent of the western level. In the mid-seventies, the Mediterranean periphery, in terms of average per capita GDP, surpassed its Central and Eastern European counterpart by a modest 5 percent. Between 1973 and 1992, after the collapse of the dictatorial regimes in Spain, Portugal, and Greece, and, due to the logic of the Cold War after their swift incorporation into the European Community, the region reached an annual average 2.2 percent growth rate, higher than the West during these troublesome years of the world-wide recession. From a level rather similar to Central and Eastern Europe between 1950 and 1970, they surpassed Eastern Europe during the last two decades by nearly two times (179.5 percent) in per capita average GDP. Spain and Ireland reached 72.2 and 72.6 percent of the West European level respectively.*[3] Mediterranean Europe and Ireland, former peripheries, are now catching up with the Western core. According to well-based forecasts, Spain may reach the western level in one-and-a-half decades.

The historical road of the former southern and eastern European peripheries, which had a rather similar economic performance during the two centuries between the 1770s and 1970s, diverted dramatically.

Success or Failure of Adjustment

The reasons behind the historical drama in Central and Eastern Europe are broadly discussed, and various, albeit often contradictory, interpretations seek to provide convincing explanations. Paul Marer speaks about a "misdeveloped economy" or "new elements" of structural and institutional misdevelopment during the state socialist decades.*[4] The failure of state socialist modernization during the structural crisis of the seventies and eighties, and, consequently, the collapse and decline of the economies of the countries of the region have been an aftermath of previous "misdevelopment." In János Kornai's interpretation, the steep decline of output and income, although "on the surface ... [is] similar to other cyclical phenomena and structural transformations ... is something rather different ... its cause is the transition from socialism to capitalism."*[5] The transformational depression is inescapable because of "disruption of coordination," a transitory collapse of "enforcement of financial discipline," and of the pain of the "shift from the sellers' to a buyers' market" and in the composition of output and foreign trade.*[6] From this diagnosis follows the suggested therapy: "to end the decline one should not go backward, but forward ... and accomplishing even faster the task still remaining."*[7] The trauma and chaos caused by the economic collapse, according to these interpretations, might be rather remunerative since, as the Nobel-laureate economist Gary Becker argues, "chaos is not all that bad," because order will emerge out of chaos.*[8]

If the crisis is a repercussion of the "transition from socialism to capitalism," then even chaos is a positive phenomenon. All the painful austerity measures and devastating social-economic effects, in this argumentation, may be paralleled to the bitter pill that must be swallowed to cure the disease. To arrive at the promised land, argue several experts, the best way is to follow the most successful Western model of *laissez-faire* and build the institutions of a self-regulating market economy. These are well-proven and will indeed work. The only questions are time, consistency, and patience. "If the people ... can endure the hardship that the policies of stabilization, liberalization, and institution building inflict," stated Michael Mandelbaum, "they will emerge at the other end ... of the valley of tears, into the sunlight of western freedom and prosperity."*[9]

According to this school of thought the first ray of sunlight illuminated the region in the summer of 1992, when Polish economic decline ceased and economic growth began. Poland soon reached more than 4 percent annual growth, the highest growth rate in Europe. Other countries recently followed: Hungary reached a 2 percent growth of its Gross Domestic Product, and the Czech Republic a 2.6 percent increase in 1994. According to the forcasts for 1995, made by the European Bank of Reconstruction and Development in the fall of 1994, eleven Central and Eastern European countries, virtually all of the countries of the region (except some of the war-destructed former Yugoslav successor states) will have positive growth -with Albania, Slovenia, Estonia, and Poland in the lead with 6 percent growth of real GDP. Poland (97 percent), Slovenia (94 percent), Hungary (86 percent), and the Czech Republic (85 percent) are inching toward the 1989 level of their Gross Domestic Product. Slovakia, Croatia, and Romania also surpassed 80 percent of their pre-1989 level.*[10] Vaclav Klaus proudly stated in February 1995: "The Czech economy and society have already entered what I call the early post-transformational stage, which is a stage where basic transformation tasks have been fiilfilled."*[11] Although most of the successor states of the former Soviet Union, including Russia, are still in decline, and their GDP dropped to less than half of the 1989 level, exuberant reports were published in the summer of 1995 depicting the Russian economy as having bottomed-out; i.e., recovery was about to emerge.

According to this interpretation of transformational depression, the end of decline and a positive growth rate already represent the first signs of a soft landing at the other end of the "valley of tears." Does this mean that, besides the still present economic difficulties and still unfinished macro-economic stabilization and privatization, the post-communist adjustment to the world economy is going essentially well in the region?

Here we're come to the heart of the matter. How can we measure the success or failure of adjustment and transformation? Are the progress of privatization and the increase, rather than decrease, of output and GDP the appropriate parameters of measuring success? Nobody denies the importance and positive role of these factors. The progress that was made in marketization and privatization,*[12] in curbing inflation,*[13] in restructuring foreign trade, and, finally, in halting the steep decline of output and achieving economic growth, definitely were great achievements of the transformation during the last five years.

The essential question, however, is whether all these changes served the appropriate structural changes according to the requirements of the turn-of-the-century international economy. Several analysts argue that even the adopted self-regulating Western market system was not tailored for Central and Eastern Europe, and that "design capitalism" cannot work because of the diverse historical-structural determinants that create a kind of "pathdependency."*[14] Tadeusz Kowalik, for example, speaks about an inappropriate model that was imposed by "shock therapy," which pushed aside the genuine plan of Solidarity to establish a self-managerial system and a Scandinavian type of social democracy.*[15] Alec Nove underlined the potential of a Keynesian model of state-led transformation with a cautious gradualism that would better serve transformation.*[16] I argued for a more organic transformation by introducing a "regulated-market" and a mixed economy with efficient, well-selected state interventions in structural and investment policies, and a well-planned combination of free trade and market protection to achieve better results in structural adjustment.*[17]

The primary question of adjustment, however, is neither the adoption of *a laissez-faire* model and shock treatment nor state interventionism and gradualism. If one accepts the fact that the flux of the world economy, with its tremendous shocks, recessions, inflations, new phenomena such as stagflation, and increasing output without increasing employment, were characteristic signs of a major structural crisis, then the essence of adjustment to the requirements of the "fifth industrial revolution," and the "communications revolution," is a *structural* adjustment. All the market incentives and private initiative measures have to serve this central goal of technological-structural adjustment, of creating competitive new industries and export sectors based on new technology, or revitalizing old, ailing branches, making them competitive and acquiring new markets for their products that had generally lost ground in international trade. (The latter was partly the case with Canada and Japan during the interwar structural crisis, when they gained significant ground in world exports by producing and marketing textile and traditional engineering products in the most competitive way, while these products generally lost ground in the world market.)

Technological-structural adjustment is not only an economic task but a very intricate process with far-reaching requirements.

Its complexity might be expressed by its prerequisites and interrelationships with political institutions, societal preparedness, including the general level of education, the flexibility of training and retraining, and the characteristics of entrepreneurial attitude and social behavior. New technology and industry definitely require a new type of labor force, highly skilled and ready to be retrained to meet rapidly changing requirements. Since physical work is broadly replaced by intellectual activities in the emerging "age of information," the role of higher education is exploding.

Adjusting to a structural crisis thus takes quite a long time. Can we evaluate a process that is still only half-a-decade long? Does it offer an appropriate perspective for making a balance-sheet? One cannot, of course, assume an "end result". Nevertheless, the main characteristics of an emerging era, as always in history, are best visible *in statu nascendi.* The past years clearly show certain main trends and idiosyncrasies. Did Central and Eastern Europe start on a good path toward structural adjustment? Can we recognize the progressive elements or, more precisely, the direction towards fiilfilling the main requirements of a complex socio-economic adjustment? From this respect, the short history of the transformation in

Central and Eastern Europe has a rather mixed record.

Structural Changes in the Economy

Positive changes impressively appeared in the economic structure of the former state socialist countries. A dynamic development of the previously neglected service sector should be noted first. According to a broadly accepted view, the backwardness of services and infrastructure have become the major bottleneck of economic growth and a successful adjustment to the end of the century world economy in the region. Marketization and privatization in post-1989 Central and Eastern Europe led to a marked macro-economic restructuring characterized by the decline of industry and agriculture and the development of services that changed the sectoral composition of GDP. Services exhibit now the fastest growth rate and the most spectacular relative prosperity. "Much of the expansion has taken place in retail and foreign trade, and privately-supplied services, such as tourism, construction, catering, finance, and insurance."*[18] While, for example, the output of the material sphere, industry and agriculture, decreased by 30 percent in Hungary during the first years of transformation, the non-material sphere of services achieved a 5-7 percent growth. Trade, transport and non-material services represented, as Eva Ehrlich and Gábor Révész calculated, 44.8 percent of total employment and 46.7 percent of Hungary's Gross Value Added in 1989, but their share jumped to 55.7 percent of employment and 61.5 percent of the Gross Value Added in 1993.*[19] According to United Nations statistics, the share of services as a percentage of Gross Domestic Product similarly increased in Poland and in the Czech Republic, from 36 and 32 percent in 1900 to 53 and 50 percent in 1993 respectively. Paul Marer suggests that these figures were 56 and 53 percent in 1994.*[20] The same trend characterized the less dynamically transforming Balkan countries as well: the share of services in Bulgarian GDP increased from 30 to 47 percent.

Nikola] Ordnung called our attention to the striking facts that banking and insurance tripled their share in total employment in Czechoslovakia during the first four years of transformation. Tourism expanded from 24 to 100 million visitors between 1988 and 1994, and generated a boom in trade, hotel, restaurant and banking industries.*[21]

As one of the most important elements of the expansion and modernization of services and infrastructure, the telecommunications system, which was backward, outdated and paralyzed by COCOM restrictions before 1989 in Central and Eastern Europe, received the biggest Western investments in Hungary and Poland. German-American multinational investors began modernizing the telephone systems of these countries, creating the basis for the belated triumph of the computer age. The fruits of these market initiatives will become apparent in the decade to come.

Structural changes also strongly characterized the previously dominating industrial sectors of the former state socialist countries. Since state socialist modernization failed markedly because of a mistaken model based on an outmoded branch and product structure of output and outdated technology, the restructuring of the mezzo-economic level acquired primary importance.

Restructuring partly occurred in a passive and defensive way as a consequence of marketization and the opening up of national economies. Previously promoted leading branches of state socialist industrialization, such as iron and steel industries, and several branches of heavy engineering, lost their markets and state subsidies. A withdrawing state stopped investing in these branches, which then had to dismiss a great part of their labor force and decrease production. In several cases huge factories and entire branches were closed. As a consequence, the percentage share of the outdated former leading branches of industry sharply decreased. Leading Czech and Hungarian engineering industries lost their previous foreign (Comecon) markets and suffered a great decrease of exports. The export of machinery, transport equipments and other capital goods dropped to less than half of their 1989 volume in 1993 in Hungary. The machinery and equipments represented 55 percent of Czechoslovak exports before 1989, but their share declined to 25-26 percent during the early 1990s. These industries lost a great part of their domestic markets as well, and experienced a significant decline of output. While industrial output decreased by 36 percent in the Czech Republic between 1989 and 1993, metallurgy and metalworking dropped by 45 percent, and mechanical and electro-engineering by 55 percent - all leading to important structural changes of output. In Hungary, total industrial output declined by 30 percent between 1989 and 1993, but metal and engineering industries dropped by 41 to 45 percent. This passive and defensive restructuring caused mainly by marketization and privatization corrected the share of oversized, non-competitive, technologically-outdated branches in industrial production.

Parallel to this spontaneous restructuring were promising, although limited Western investments that established some new industries and infant export branches in the western rim of transforming Central and Eastern Europe. Multinational companies played the pioneering role in establishing the Hungarian automobile industry and modernizing the traditional Czech and Polish automobile industries, as well as restructuring the PoHsh chemical industry, Hungarian pharmaceutical firms and Hungarian bulb production. The most promising elements of restructuring were created by the emergence of Polish, Czech, and Hungarian *sub-contracting* industries, the so-called screw-driver industries in the mid-1990s that were producing parts for Western, mostly German and american companies.

The process of restructuring had important results not only on the macro and mezzo-economic levels, but also on the micro-economic, i.e. enterprise and product, level. The shift of exports from Comecon to Western markets encouraged and even mandated the improvement of several export items, and liberalized import competition has had a similar impact in the domestic arena as well. Industrial consumer goods, for example, unlike engineering products, could preserve their volume of export while markets were shifted from the previous undemanding eastern Comecon region to the demanding and highly competitive West. Hungarian foreign trade made a sudden about face: eastern trade dropped back from 45 to 25 percent of its previous level while western trade grew from 54 to 75 percent of total trade during the first half of the 1990s. While total exports diminished by 20 percent, exports of industrial consumer goods declined only by 2 percent in the early 1990s in Hungary. Without major micro-structural changes, improvement in quality, cost of production, assortments, etc., exports of these products would be unable to preserve their previous levels.

Regarding long-term structural economic changes, however, the positive signs are strongly mixed with negative trends. Although a spontaneous passive and defensive restructuring (i.e. the sharp decline of outdated oversized sectors of the state socialist economy) has an important positive effect on adjustment, the same process reflects a rather negative trend in terms of end-of-the-century modernization requirements. Foreign trade statistics, for example, reflect a negative structural change of exports from processed and sophisticated products to unprocessed goods and materials with high energy content. This phenomenon is not only exhibited by the less advanced Balkan countries, but characterizes as well the most advanced Czech Republic, Hungary and Poland. While the volume of exports of engineering products and capital goods declined by 56 percent, the export of fiiel and electric energy increased by 26 percent in Hungary, the export of raw materials and semi-finished products was able to retain its previous volume in 1993. The collapse of exports of engineering products in the Czech Republic was accompanied by a relative increase of the exports of raw materials, fuels, manufactured goods classified chiefly by material, and food:

their share in exports jumped from 31 to 61 percent. "On the whole," concluded Nikolaj Ordnung, "the structure of the Czech exports moved closer to that of the developing countries."*[22] As a consequence of spontaneous, passive restructuring, decline was much more dramatic in sophisticated processing branches than in material and energy intensive branches of Hungarian industry. "The visible losers are," stated Ehrlich and Révész, " ... metals and machinery. Relative winners, i.e. those who lost the least are food, wood and electricity industries ... The winners in this branch-level breakdown belong to less prestigious, or material producing profiles."*[23] The same authors reported the virtual disappearance of "a large part of historically developed Hungarian work culture." Micro-economic structural changes reflect the very negative trend of the disappearance of a nearly century-long industrial culture of sophisticated branches of Hungarian engineering industry: employment in radio, TV, and communications equipment and apparatus dramatically plummeted by 72 percent; the production of medical, precision, and optical instruments lost 67 percent of its work force.*[24] Promising high-tech branches of Hungarian industry could not adjust, ultimately collapsing in bankruptsy. Ifit is true for the Czech Republic and Hungary, the most advanced countries of the region, it was even more so in the case of other, less developed former state socialist economies.

The future of structural adjustment depends on the possibility of investment in modern sectors. The transformation strategy unanimously adopted during the early 1990s in Central and Eastern Europe was built on an assumed major capital inflow into the region. That assumption was behind the idea of introducing a laissez faire policy, opening the borders for foreign imports, giving tax exemptions for foreign investors, etc. The first post-state socialist governments had entertained ardent hopes regarding capital inflow that could cover roughly one-third of the required privatization investments. It was a major miscalculation.

Central and Eastern Europe, after the collapse of the Soviet Union and the conclusion of the Cold War, lost its crucial political importance for the West. The first generous gestures, the $62.5 billion assistance pledged by the G-24 countries to six countries of the region, was only partially disbursed. During four years between 1990 and 1993, only $10.6 billion was disbursed to five countries, with aid totalling $19.1 billion (adding in the Polish debt reduction of more than $8 billion).*[25]

Most of the hopes and promises stressed the importance of private direct investments. During the first four years of transformation the countries of Central and Eastern Europe received barely more than $ 10 billion in direct foreign investments, 80 percent of it channelled to Hungary and the Czech Republic. In 1993, the six countries received only $3.5 billion in direct investments. These amounts are disappointing. However, 1994 and 1995, especially in the case of Hungary represent a better result. Hungary is the biggest beneficiary of the investments of the first half of the decade. Foreign capital inflow totalled 3.8 percent of the GDP in 1993 instead of the assumed and forecasted 30-33 percent, but Budapest itself received one-third of total foreign investments to Central and Eastern Europe, and the Trans-Danubian city of Székesfehérvár, a township of 100,000 inhabitants, gained more investments than the Balkan countries altogether. In the Czech case -instead of the Hungarian 3.8 percent- the percentage of foreign investment compared to GDP was only 0.8 percent; it was 0.6 in Slovakia, 0.2 in Poland, and 0.08 in Romania.

Central and Eastern Europe was not correspondent with most other areas of the world regarding the role of foreign assistance. Southern Europe, the former Mediterranean periphery, received incomparably far more from the European Community. Compared to the extremely modest $36 and $30 per capita capital inflow to Central and Eastern Europe in 1992 and in 1993, Portugal received $173, Ireland $262, and the Edinburgh summit in December 1992 agreed to transfer $ 195 billion to the new member countries during the second half of the 1990s. It should be mentioned that the new *Bundeslander,* the former East Germany, gained roughly $ 100 billion as an average annual capital inflow from the former Bundesrepublik between 1991 and 1994. On a per capita basis, in contrast to the Central and Eastern European $30, it reached $5,900.*[26]

If we broaden the comparative picture, we have to realize that Asia and Latin America are much more attractive for investors than Central and Eastern Europe. Tiny Singapore itself acquired 50 percent more capital between 1990 and 1993 than did the six countries of the region put together. Brazil and Mexico enjoyed a capital inflow of $100 billion each during these years. The most telling example is the Mexican financial-economic crisis in 1994, which generated an immediate American action and an opening of $40 billion in assistance. Mexico received nearly twice as much in a week than did the six Central and Eastern European countries during the entire first half of the 1990s.

The countries of the region are thus left to their own devices. Their resources, however, are rather shallow. Accumulation and investments from domestic sources decreased in the nineties. One should not forget that this was a natural consequence of the collapse of the Soviet modernization model, which was based on a forced accumulation pattern. No doubt, the central virtue of the Soviet model, the main attraction for backward, agricultural countries, was the high rate of accumulation and investment generated by central planning, the destruction of market prices, and the stagnation or slow increase of consumption levels.

Central and Eastern Europe thus has to face an unsolvable task: to adjust to the transforming world economy by modern structural changes, by creating a new infrastructure, new technology and new export branches, competitive on the world market - without a sufficient amount of domestic and external financial sources. The history of the area, maintains the economic historian Scott Eddie, "suggests a highly pessimistic outlook both in short-term and long-term ... [Theses countries] have to depend on their own resources for growth for a long time to come. There seems little chance of escape from the vicious circle."*[27]

Does this mean that economic growth and relative prosperity will be impossible to reach? Certainly not. Economic growth has begun and will continue. Gross Domestic Product will increase. A relative prosperity is around the corner, especially if the world economy properly recuperates from the recent recession. WhatJkind of prosperity and growth will thus be possible?

I can offer the lessons of Central and Eastern European responses to the challenge of previous structural crises of the 1870s-80s and 1930s. At that time, when the second and third industrial revolutions in the mid-late-nineteenth century, followed by the fourth industrial revolution during the interwar years, challenged the fragile, partly modernized economies of the region, and made the traditional leading sectors obsolete and exports to the competitive world markets virtually impossible, the countries of the region were unable to invest and modernize their economies in an appropriate way. Hardly any new export sectors emerged, and barely no structural modernization prepared the way for a successful adjustment. Prosperity, however, still followed, and the crisis-ridden countries not only reached the pre-crisis level of output and income, but impressively surpassed them. In other words, *they became revitalized without structural adjustment.* The region's response was not an escape towards a higher stage of economic maturity, but rather a "reverse escape" to preserve the obsolete structures by isolation from the world market and competition via regional arrangements. The agricultural areas of the Austro-Hungarian Empire increased economic growth based on traditional sectors of output and exports, because the Habsburg Monarchy turned to protectionism and imperial self-sufficiency. The still agricultural countries of South-Eastern Europe would repeat this pattern during the 1930s by way of a regional agreement system, orchestrated by Nazi Germany and based on a series of bilateral agreements, which offered a safe market for the non-competitive agricultural products of the East. Central and Eastern Europe could thus cope with the short-term negative side-effects of the structural crises such as high unemployment, declining output and exports and a huge deficit in foreign trade, without adjusting to new technological and structural requirements. Although "reverse escape" was advantageous in the short-term, it was rather destructive in the long-run. Since the countries could not adjust, they preserved their peripheral, dependent and backward status. They remained more and more defenseless during the repeated structural crises to come, and they remained on the periphery of Europe without narrowing the gap between themselves and the advanced world.

Will history repeat itself again? Although the possibility of a repetition of the old pattern can not be excluded, history definitely offers alternatives. In reality, not only fast and successful adjustments and failed attempts have characterized the countries efforts to respond to the world economy's challenge. A number of relatively backward countries that could not adjust rapidly to the most advanced technology and economic structures have still found an exit from being trapped in the frozen old structures. During the structural crisis of the interwar decades Japan and Canada, (and several successful Asian countries in the 1970s-1990s) followed a strategy of undertaking an output of products that were not the latest word of the most advanced new technology and, had thus lost their importance in the most advanced countries. Producing these technologically "expired" products, the less developed countries could exploit their comparative advantages, their lower wage levels and the geopolitical benefit of being near to one of the leading economic powers of the world, and establish close cooperation with it.

In this way huge capacities of the iron industry "migrated" from Germany to Japan, then to South Korea. A similar trend characterized the less sophisticated branches of the textile industry that were relocated to Japan, and then from Japan to the neighboring "small tigers." The world market was filled with cheap textile products from Hong Kong and Taiwan. During the 1980-90s, China took over and gained ground in the market of the core countries. The pattern is as follows: the "heart" of hi-tech industries, the newest products, a few steps before the present, are always produced by the most advanced core countries, the United States, Germany, Japan and some others. Hong Kong, Taiwan, and South Korea that emerged with a cheap output of traditional, mostly textile consumer goods, now turned toward mass consumer goods production (the "second raw") of hi-tech branches such as TV sets, personal computers, and other more sophisticated products, and "gave up" producing earlier, more "primitive" traditional ones. China, again one raw behind, follows in their footsteps.

The secret of the success of these countries that started from behind is their comparative advantage in the cost of production, much lower wages, and rapidly increasing labor productivity. The peripheries that were able to catch up with the core increased their labor productivity by leaps and bounds. Japan between the two wars - according to my calculations based on the figures of Angus Maddison*[28] - more than doubled its labor productivity. Ireland, Spain, and China, during the quarter of a century after 1973, also doubled the gross income produced in one work hour. South Korea and Taiwan, in the same period, were able to increase their productivity level by three times. It pays to note that the productivity level in Japan reached less than one-third that of Switzerland in 1913; today, they have roughly the same level. The productivity of Spain, in 1950, was 20 percent of that of the United States'; today it reaches 70 percent.

The strategy of follow up is based on close cooperation with one of the most advanced countries, and on the efforts of rapid changes of product mix if needed. Most of the successful Asian countries that started from way behind used strong state support, and combined domestic market protection with stateassisted export expansion.

Central and Eastern Europe did not follow this path and could not increase labor productivity while trying to cope with structural adjustment. During the decades since 1973, Czech labor productivity, with slight ups and downs, stagnated. Poland and Hungary reached a minimal increase of 7 and 13 percent respectively. The productivity scissors, compared to the advanced core, consequently increased, since the countries of Western Europe, as an average, increased productivity by 50 percent, and in some cases by more than 60 percent. Hungary's relative productivity level is thus declining: in 1973 it reached one-third, now only one-quarter of the West European standard. Compared to Spain, the Hungarian level dropped from two-thirds to one-third. (The Argentine, Brazil, and Mexican productivity level exhibited similar tendencies; moreover, labor productivity of Venezuela and Peru, as well as Russia, are 15 to 30 percent lower than in 1973.)

Advancing from the "second raw" by increased labor productivity and competitiveness in less sophisticated branches, thus, has not yet characterized Central and Eastern Europe. The potential alternative, however, might not be excluded, especially because of the striking increase of labor productivity in Hungary and Poland in 1994-95.

Which pattern will be repeated by history? If a historian may risk any kind of forecast for the future - a slippery field for the researcher of the past - the "reverse escape" pattern will be repeated in the cases of all those Central and Eastern European countries that won't be admitted into the European Union in the decade to come.

Those countries which might be the majority of the region's nations, that will remain outside, will show a development in the traditional peripheral pattern without any hope of joining the advanced core of Europe. In their case Andrew Tylecote's forcast might be the reality: "Europe is tending to polarize into a dynamic core and a less dynamic periphery, the core being characterized by a tendency to rapid product innovation and low inflation, and the periphery by the opposite ... The ex-command economies are taking their place, inevitably, as a new periphery."*[29]

The peripheries, although they can and will increase their income, may lag behind since the gap between the advancing core and the un- or semi-successM peripheries is consistently and considerably growing: in 1913, intercountry income spread was 10 : 1, in 1950, 26 : 1, and in 1989, nearly 40 : I.*[30] Other calculations reflect an even more dramatic opening of the gap.*[31]

Those countries that will be accepted by the European Union, and the Western rim of Central and Eastern Europe might have this historical opportunity to break out from the vicious circle of peripheral status, will get access to Western markets and assistance and may repeat the Mediterranean "miracle". Five or six countries at the eastern border of Austria and Germany, mostly relatively small with five to ten million inhabitants, but, together with Poland, altogether not larger than sixty to seventy million people, may get this opportunity because of a vital Western security interest. A relatively declining humiliated and chaotic East and South-East Europe, with its explosive ethnic and minority conflicts as well as an emerging nationalist extremism, might represent a dangerous challenge for the West, especially for neighboring Germany, and demand a response to safeguard the eastern borders of the European Union by creating a *cordon sanitaire* between its eastern borders and the crisis-ridden East and South-East Europe. Additionally, these countries with their relatively well trained, well - educated, and relatively cheap labor force (with a labor cost of one-tenth that of Germany's) have started to emerge as a next-door subcontractor of western, most of all German industry. If security and economic interests demanded it and were recognized, the western rim of Central and Eastern Europe, which made the best advance toward adjusting to the West, and has a tradition of being the backyard of German-speaking Central Europe, might be consolidated and restructured in Western cooperation and by Western assistance, and accepted as part of an enlarged Europe.

The first signs of this development have appeared on the horizon.

Notes

1 Angus Maddison, *Monitoring the World Economy 1820-1992,* Paris: OECD, 1995.

I Angus Maddison, "Explaining the Economic Performance of Nations, 1820-1989" in: W. Baumol, R. Nelson, E. Wolf (Eds), *Convergence of Productivity. Cross-National Studies and Historical Evidence,* Oxford: Oxford university Press, 1994.

3 Angus Maddison, *Monitoring* ..., 1995.

4 Paul Marer, "Comparative Privatization and Restructuring Exoeriences and Prospects: Russia, China, and the Countries of Central Europe" in: I. T. Berend (Ed), *Long-term Structural Changes* ... (forthcoming)

5 János Kornai, *Magyar Hírlap,* December 24, 1992.

6 János Kornai, " Anti-Depression Cure ..." p. 2.

7 János Komái, *Magyar Hírlap,* 1992.

8 Paul Marer id. mii.

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

10 *The Annual Report of the European Bank of Reconstruction and Development,London:* EBRD, 1995.

II Nikolaj Ordnung, "Structural Changes in a Transforming Economy: The Case of the Czech Republic" in: I. T. Berend (Ed), *Long-term Structural Changes* ... (One cannot escape from historical *déja vu:* Czechoslovakia was the first country in the Soviet Bloc that declared the end of the transformation from capitalism to socialism in the mid-sixties and even changed its constitution accordingly.)

12 The share of private sector in producing the GDP reached 60 to 70 percent in the Czech Republic, Estonia, Albania, Hungary,

Poland, and Slovakia; around 50 percent in Russia, Lithuania, Slovenia, Croatia, and Bulgaria.

13 The Inflation rate is already a one-digit figure in Albania and Croatia, around 10 percent in the Czech Republic, Estonia, Slovenia, and Slovakia.

14 David Stark, "Can Designer Capitalism Work in Central and Eastern Europe?" in: *Transition. The Newsletter About Reforming Economies, The* World Bank, Vol. 3. No. 5. May 1992.

15 Tadeusz Kowalik, "Five Years After the Big Bang in Poland: Achievements and Costs," in: I. T. Berend (Ed), *Long-term Structural Changes...* (forthcoming)

16 Alec Nove, "Economics of Transformation: Some Gaps and Illusions" ,in: B. Crawford d), *Markets, States, and Democracy,* Boulder: Westview press, 1995.

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18 Paul Marer op. cit.

19 Eva Ehrlich and Gábor Révész, "Structural Changes in Hungary, 1989-1994," in: I. T. Berend (Ed), *Long-term Structural Changes* ....(forthcoming)

20 Paul Marer op. cit.

21 Nikolaj Ordnung op. cit.

22 Nikolaj Ordnung op. cit.

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24 Eva Ehrlich and Gábor Révész op. cit.

25 Krzysztof J. Ners and Ingrid T. Buxell, *Assistance to Transition Survey,* Warsaw: Pecaet, 1995.

26 Krzysztof J. Ners and Ingrid T. Buxell, *Assistance* ..., 1995.

27 Scott Eddie, "The Transition to Market Economies. Lessons from Hungary and the Case for Pessimism," in: David Good (Ed), *Economic Transformations in East and Central Europe,* London: Routledge, 1994, pp. 127-8.

28 Angus Maddispn, *Monitoring* ... pp. 248-49.

29 Andrew Tylecote, "Core-Periphery Inequalities in European Integration, East and West," in: W.Blaas and J. Foster (Eds), *Mixed Economies in Europe. An Evolutionary Perspective on their Emergence, Transition and Regulation,* Aldershot, Hants, Brookfield: Edward Elgar, 1992.

30 Angus Maddison, "Explaining the Economic Performance ..." 1994.

31 See Zsuzsa Férge op. cit.