

INSTITUTIONAL TRANSFORMATION IN COUNTRIES OF CEE: EXPERIENCE FOR UKRAINE

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Abstract:

In the article the experience of post-socialist countries of Central and Eastern Europe on the transformational changes that have been implemented in the political, socio-economic and ideological spheres is considered. The unprecedentedness is determined by the scope and timing of reform. The author reviews the main conceptual models of realization of market transformations.

The features of centrally-planned or command economy and main stages of market reforms with regard to processes that took place in the reformed countries are characterized. It is determined that the first phase concerned the dismantling of the previous social system and its institutions, so that it was not only started the formation of market structures and the introduction of democratic principles, but also significant negative trends in the economy and social sphere. The second stage of reforms in CEE related to the acquisition of the membership in Member States and relevant preparatory and adaptational measures.

Critical importance of institutional reforms to establish an effective functioning of democratic market economy is explained. Based on the analysis of institutional transformations that took place in the reform process in Central and Eastern Europe the main institutional changes in various fields are summarized. With the experience of CEE countries the narrow places of transformation processes in Ukraine are identified and necessary directions for further transformation are reasonably grounded.

Key words: market transformation; institutional changes; command economy; institutional reforms.

JEL classification: P21, P51, O17

INTRODUCTION

At the beginning of the 1990s, the countries of CEE were confronted with the arduous task of transitioning from centrally planned economic systems based on socialist ideology to ones founded almost exclusively on the principles of freemarket capitalism.

The changes that occurred in Central and Eastern Europe since the fall of the totalitarian regimes they Socialism, equivalent in content of whole era. For the first time history of democratization processes of market reformation took place in the world and in such a scale and with such speed. The change of type of socio-economic and political system is impossible without transformation in the functioning of most pillars of society, that is, without institutional transformations. Mentioned events caused intensification of economic research in institutional analysis of market transformations. It is now obvious fact recognized as critical institutional environment for economic development (primarily such components like efficiency of its protection of property rights and contract rights enforcement system, quality and independence of court system as bureaucracy and the deepness of financial markets).

A large number of economic research is devoted to the problems of formation, evolution of efficiency and functionality of institutions, their influence on the processes of growth and development, general, and in terms of market transformations including [1] – [10].

Special contribution to the development of the transitional economy theory and the development of measures implementation of transformational reforms have been made such prominent scholars as L. Balcerowicz[1], Janos Kornai [7], Grzegorz W. Kolodko [18], AAslund [17], J. D. Sachs [15], J. E. Stiglitz [16], D. North[20]. Sachs and Aslund stood at the origins of the development model of reform based on "shock therapy", which was successfully implemented in Poland by L. Balcerowicz. Famous Polish economist G. W. Kolodko has made a careful analysis of

the Polish reforms implementation and summarized the experience in the form of lessons for developing countries [18]. D.North investigated the importance of institutional dynamics for ensuring a successful transformation of command economy into market economy [20].

Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction [9]. The transformation of planned socialist economy foresees the change of the "rules of the game" in all spheres of society.

The experience of Central and Eastern Europe (CEE), which a few years earlier from Ukraine began to modernize its economy and political system and the formation of a market economy and an appropriate institutional structure deserves careful and deep study. Using this experience, taking into account the specific conditions Ukraine will avoid many mistakes, speed up the formation of well-functioning market economy type.

ECONOMIC TRANSFORMATION OF CEE: KEY CONVERSIONS

The market transformation means the process of change from a centrally planned economy towards a market economy, a progression that involves massive change at every level of society. The transition from a centrally planned to a market economy was considered as an effective means of solving social and economic problems in these former socialist countries. A country that wishes to change its economy to a market-oriented one needs to restructure many things such as market liberalization, privatization, institutional development, structural adjustment, economic policy program of stabilization, deregulation and integration with the global economy.

With a view to better understand the nature and complexity of challenges the CEE countries faced on their road from plan to market (or from socialism to capitalism) and to their subsequent integration with the European Union, we will briefly describe the most salient features of the design of a centrally-planned or command economy. Key Properties of the Command:

- Multi-level organizational structure of the national economy consisting of three categories of decision levels: (i) the central (macroeconomic) level, (ii) the intermediate (mezo-economic) level, and (iii) the executive (microeconomic) level. For example, in Poland, which was mostly similar to other fellow socialist countries in this regard, the economic decision making involved four different levels: the central planner, branch ministries and industrial unions (intermediate level) and state-owned enterprises or SOEs (executive level)?

- Hierarchical subordination of the lower-level entities to higher-level decision makers or undefined centralization⁵ that boils down to the lack of clear-cut rules defining the responsibilities and rights of decision makers at different levels of the economic bureaucracy.

- Fulfillment or exceeding of central plan targets as the main performance assessment criterion with respect to intermediate and executive levels.

- Administrative, individually targeted allocation of tasks derived from the central plan by the power center to respective lower levels.

- Leading role of rationing as a chief mechanism for resource allocation.

- Positive correlation of the appraisal yardsticks, aimed at measuring economic performance, with outcomes (output) and no correlation whatsoever with inputs (negligence for costs efficiency).

- Dominant role of short-term plans (one-year or shorter) shaping the scope and content of economic choices being made by economic agents (short-termism).

- Lack of integration between material (or physical) and financial planning and the secondary significance of the latter.

- Dominance of the branch principle (vertical integration) in merging the lower-level organizations into more complex entities (eg. SOEs into industrial unions).

- Low flexibility of the organizational structure in the command economy.

- Strong position of executive bodies relative to representative entities.

- Prevalence of vertical linkages, inherent to the planning process, compared to horizontal connections of a market nature (eg. the supplier-customer relationship) [12].

It should be noted that the process of market transformation was accompanied with changes of political systems. There are two types of such transition – radical and moderate. By radical transition it was carried out in those countries where the old elite has completely lost its legitimacy and regime change took place or through abdication (renunciation of power, as happened in Czechoslovakia, East Germany in 1989 and Georgia in 1993), or by force (Romania 1989, Kyrgyzstan 2005).

The type of transition involves moderate opposition victory in elections, which is negotiating with the old elite on the ways and methods of reform or allow penetration of the old elite to the authorities. The latter path is the longest and most difficult and it was followed by most former Soviet republics, including Ukraine.

One of the problems that these countries had to solve was the choice of model transformation economy. It mainly dealt with two 'implementation options or models: the so-called "shock therapy" and gradual, graded strategy.

The first one got called "shock therapy" by L. Baltserovycha in Poland. Its distinctive feature – the speed of undertaken reform. The another model of post-socialist economies in Europe was "gradual strategy", which was quite successful tested in Hungary. The Professor at Harvard University (the USA) Ya. Kornayi noted that the basis for the Hungarian reform model was based on the principle of gradual or evolutionary (). The main difference between gradualism and "shock therapy" has been phasing in the implementation of market reforms and ensuring minimum social standards.

During the period 1989-2004 two stages of the market reforms in Central and Eastern Europe (CEE) are defined.

The first phase of reform (late 80s - mid 90s) was characterized by the dismantling of mechanisms and institutions prior administrative-command system by: a) elimination of centralized state planning, resource allocation and management of the economy; b) the liberalization of economic activities. It was made by reforming property relations, the formation of markets for goods and services, labor, capital, land, structure of the economic system.

The consequences of such significant systemic change were not only the beginning of market structures, but also significant negative trends in the economy:

- Stagflation (a combination of recession and inflation);
- Destabilization of the financial situation;
- Reducing the living standards of the vast majority of the population;
- A sharp aggravation of social problems.

However, the depth and duration of the economic downturn varied significantly among CEE countries. Thus, in Poland economic recession lasted approximately three years (1990-1992), in Ukraine - about 10 years (1990-1999). If Poland's GDP fell by 20% before it started to grow, the Ukraine GDP fell by 60% and achieved growth only in 2000 - 5.9% (previous year).

The beginning was marked by price liberalization reforms, which led to a long and significant price increases in inflation.

The decline in production and rising inflation led to the need for market reform, along with the conduct of macroeconomic stabilization policies. During this period, rising prices stimulated unwinding of inflationary spiral, which in turn provoked a wage increase and led to the dollarization of the economy. The main measures taken in most CEE countries were tight monetary and credit policy, wage control policy, monetary reform and the use of non-inflationary sources of budget deficit financing. These measures were accompanied by reform of the financial system, including all areas – fiscal, monetary and tax. It was reduced budgetary support enterprises and investments, restricted lending by sharp raising lending rates by a sharp uplift rate loan increased corporate profit taxes (set of value added tax and general income tax instead of payroll tax). Relatively quickly, most countries have reached pre-crisis level of performance, helped by such factors: macroeconomic stabilization – reforms associated with the stabilization of the price level, exchange rate, state budget, etc; microeconomic reforms – the creation of a viable market

environment through privatization of state enterprises, price liberalization, increasing economic openness and reform the institutional structure of the economy.

The second stage of market reforms in post-socialist CEE countries was connected with their preparation for EU accession. In order to join the EU applicant countries had to fulfill the requirements of criteria for selecting new members, the EU developed and adopted by the European Council in Copenhagen (Denmark) in June 1993. The main conditions for EU membership of Eastern European countries were:

- Creation of stable institutions guaranteeing democracy, legal order, human rights and protection of minorities.
- Ensuring a functioning market economy, able to exercise influence on competition and market forces in the EU.
- Taking on the obligations of membership (including the harmonization of domestic legislation with EU laws), including commitment to the objectives of a political, economic and monetary union.

Thus, the necessary changes to EU membership have become benchmarks for CEE socio-economic reform and development. And in 2004 - 2007, following the basic requirements for joining the EU ten CEE countries joined the EU, starting a new stage of development. These are the countries of the former socialist orientation, which joined the EU in 2004 (Poland, Czech Republic, Slovakia, Slovenia, Hungary), the Baltic countries - Estonia, Latvia, Lithuania (former Soviet republics) and so-called "flank" countries - Romania, Bulgaria. By becoming members of the EU during the last two waves of enlargement in 2004 and 2007, 10 post-communist countries have successfully completed one of the longest and most intensive period of preparation for accession in EU history. No exaggeration to say that the European integration strategy in its content, direction and meaning became a kind of national projects of modernization that allowed post-communist countries to overcome civilizational backwardness and brought them to a new level of development.

The following years and even now CEE countries are developing within a single European area and their success depends not so much on institutional reforms, but on the efficiency and effectiveness of this institute. The economies of most of these countries are developing dynamically, taking advantage of internationalization and regional economic integration based on market openness and financial liberalization.

ANALYSIS OF INSTITUTIONAL CHANGES IN CEE

Radical market reforms that swept in the 90s of XX century all post-socialist world, and their outcome in CEE and CIS countries have some common features as well as significant differences. This is partly due to objective reasons relating to joint and excellent baseline systemic change. Common conditions are considered the same type of socio-economic system and political system, the duration of the operation within the world system of state socialism, strong influence of Soviet politics, economy and culture of their fate for nearly half a century, and others.

To the differences belong: differences in the general level of economic development on the eve of systemic transformation; features of industry structure; depth of macroeconomic imbalances; reformational degree of economic and psychological readiness of the population to the changing socio-economic structure; features of social stratification; cultural and historical tradition, the role of religion and others.

However, the factors outlined above, as acknowledged by most researchers were not decisive for systemic change and economic dynamics. The decisive role played by the degree of understanding, quality productions and the pursuit of the realization of state power and system transformation tasks carried out economic policy. They determined the price and different social reform.

Transformation processes triggered significant transformation at the macro – and micro functioning society. At the macro level transformation processes we understand the system changes of the institutional structure of society in economic, political, cultural and legal spheres. This level

is closely linked to the qualitative transformation of interconnected sustainable, social subjects of co-oriented behavior. These are now the political elite, pro-government forces which deliberately rebuild institutional structure of society from above, through its administrative and legal resources.

Micro level transformations implies a qualitative change of stable behavior of social actors in the economic, political and cultural spheres. Subjects of micro – are ordinary citizens, who also made some adjustments in these processes, however, according to the resources that are realized through mechanisms of individual choice behavior within the existing scope of their freedom.

Thus, institutional changes that have taken place in CEE, are covering all aspects of public relations. Any social relationships that form the core of the social structure, in fact, is the only holistic, that is indivisible, but they can be seen from all sides. Depending on the subject of science or various research tasks can be allocated the following aspects of social relations: 1) economic, that is related to obtaining resources to play social actors; 2) political, that is definitely organized, ordered and manageable, focused on achieving a specific goal; 3) ideological, that realize a certain idea, or that significant value to society that distinguishes social activities of man from animals. Therefore linked to the current economic, political and ideological spheres of basic institutions – are the main subject of study in the theory of institutional matrices [5].

The theory of institutional matrices partly explains the differences in the success of institutional reforms in CEE countries and Ukraine.

According to the theory of institutional matrices it is distinguished Y-matrix (western institutional matrix) and X-matrix (Eastern institutional matrix). Y-matrix is formed by the following basic institutions:

- in the economic sphere – it is the institutions of a market economy;
- in the political sphere – principles of federal government, federal (Federal-subsidary) political system;
- in the ideological sphere – the dominant idea of individual, personal values, priority I over We, or a secondary ideology, which means the primacy of the individual, his rights and freedoms in relation to the values of community of a higher level, which respectively have the subsidiary, subordinate relation of the individual, character.

Studies suggest that the Y-matrix describes the social system of most Western European countries and the USA.

X-matrix, which is characteristic of Russia, most of Asian, Latin American countries, is characterized by the following basic institutions:

- in the economic sphere – institutions redistributive economy (Term of Polanyi K.). Redistributive economies essence is the mandatory mediation of the values and services movement by the Center and the rights of their production and usage;
- in the political sphere – institutions of unitary (unitary-centralized) political system;
- in the ideological sphere – the idea of collective dominance, transpersonal values, We priority over I, i.e. the komunitarity of ideology [5].

The transformation processes in CEE included the transition from one to another institutional matrix, and their performance was characterized by targeted simultaneous changes in all spheres.

Analysis of institutional reforms in CEE countries makes it possible to summarize the main directions of change (Table 1).

Table 1. The main Institutional Change in in CEE

Political area	Economic area	Social area
<ul style="list-style-type: none"> • Liberalizing legislation . • Massive legislation in support of the expanding markets. • Substantial legislative effort in support of civil society and democracy. • Elimination of party control, reorganizations of the public 	<ul style="list-style-type: none"> • Privatization of the inherited state-owned enterprises; entry of new private firms. • Separating the central bank from the mono-bank and granting it independence. • Privatization of the inherited state banks, entry of new ones. 	<ul style="list-style-type: none"> • Spontaneous growth of private media thanks to revenues from advertising resulting from the growth of a market economy. • Development civil society organizations. • Spontaneous growth of foundations and associations

administration..	<ul style="list-style-type: none"> • Creating the institutions of the capital market. • Dismantling of command mechanism, and largely spontaneous development of markets. 	related to the growth of market economy.
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Formed by the author basing on [1].

In the political sphere CEE countries have demonstrated significant progress in democratization, reforms and implementation of legislative regulation of the electoral law. Experience the rule of law in the CEE countries shows that the process is complex and very long. However, during the transformation a new legal system is created – the number of legislative acts with constitutional value are adopted, based on Western standards the development of new laws on constitutional, economic, civil, criminal and electoral law is made. But the main problem is not so much in making laws that meet generally accepted democratic principles as to ensure compliance with these principles in practice, which does not always lies in the legislative regulation. In most countries in the region there are significant problems with the weight of experience of totalitarian regimes, such as: illegal lobbying of corporate interests at the expense of national corruption, increase government close to organized crime, abuse of office, use their positions for their own welfare. World Bank experts consider corruption a major economic problem today [14] so corrupt acts threaten the integrity of markets, weaken fair competition, and break the balance of allocation resources. Corruption has a negative impact on economic growth and investments, undermines public confidence in the rule of law and as a result creates an anomalous economy in which the fundamental economic laws stop to act. The figure 1 shows the dynamics of corruption perception by investors according to the data Transparency International survey of investors' perceptions of corruption.

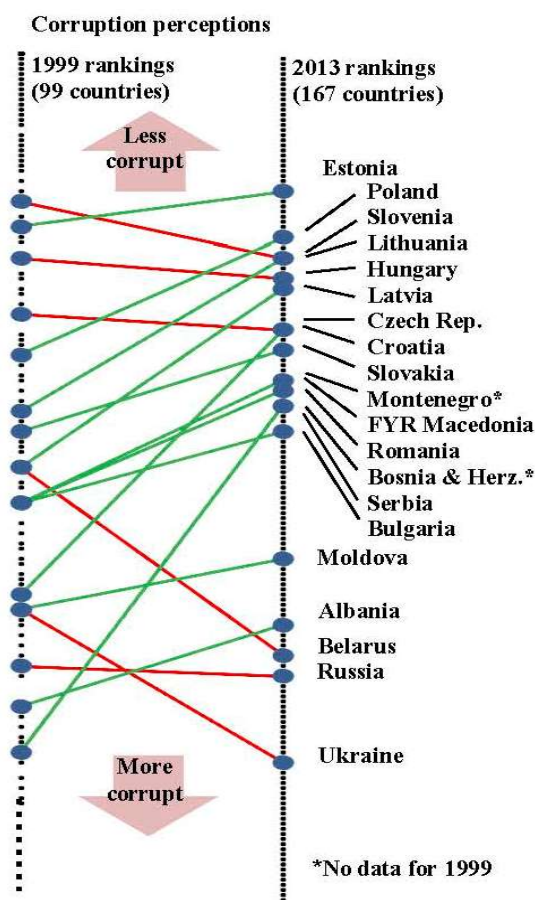


Figure no. 1. Corruption perceptions

Source: [4]

In general, there has been a strong improvement: the large majority of transition countries have raised their rankings relative to the rest of the world over the past 15 years, some very markedly, with only a handful falling back.

In the economic sphere there were significant changes in the functioning of basic market institutions – property relations and competition (diversity of ownership of the prevalence of private property as a result of the privatization of most state enterprises), institutionalization of the financial sector (development of institutions of different segments of the financial market). Significant role in these processes is owned by foreign capital.

Also note that an important motivation for reform CEE countries was the purpose of joining the EU, accompanied with Europeanization processes. Europeanization – is the formation, distribution and institutionalization of formal and informal rules, procedures, paradigms policies styles, modes of action, common beliefs and norms which are first identified and approved in the EU decision-making, and later incorporated into the logic of domestic discourse, special features, political structures and areas of public policy of the Member States [11]. Thus Europeanization as a means of institutional change and modernization: transition to democracy and market economy.

Despite several shortcomings of democratization, there is no doubt that at the beginning of XXI century CEE countries are major institutions, rules and procedures of a democratic state with a socially oriented market economy.

Comparing the achievements of post-soviet Ukraine and European countries, the problem areas can be identified:

- *goal-setting and shifts in values system*. CEE countries because of being less time under the direct influence of USSR while making reform clearly defined objectives, criteria and directions of ongoing reforms, it was observed the unity of views of the new political elite and the public on the fundamental values (Y-matrix) formed the basis of comprehensive reform. In Ukraine multi and constant oscillation is proclaimed between western and eastern vector of development, with the difference of views aggravated questions of residents and representatives of the political elites of the West and East of the country;

- *development of a political system based on democratic pluralistic basis*. Revolutionary changes that occurred in the late 80's - early 90's in CEE became legal on the basis of conducted in these countries multiparty democratic elections on competitive basis. It is due to the democratic elections held immediately after the fall of the pro-communist regimes, many opposition to the Communist regime forces managed to take the appropriate place in the political system. In Ukraine, the reforms held a quicker change of names and the distribution of political forces - the Communist Party and the people and therefore the content remained the same. Only after almost 15 years during the "orange revolution" occurred qualitative change, but because of lack of consent democratic forces lost benefits gained;

- *conditions of «path depends»*. CEES less time were under the dominance of the Soviet regime, were still living representatives of a generation that remembered life before the Soviet regime (especially such as the Baltic States). In Ukraine dependence on previous development trajectory manifests itself more as a large population was decimated during collectivization, famine of 1932-33, postwar famine (1947-1948.). And public opinion regarding the movements for independence 20s and period World War II was distorted by Soviet historiography;

- *decentralization*. In most CEE countries were conducted administrative reforms implemented fiscal decentralization, enabling more efficient to provide public services to citizens and communities, effectively using limited resources. Ukraine is only on the path of reforms, decentralization, the first step of the financial decentralization process is introduced by amalgamation of communities on the basis of voluntary association, but still very much taken in this direction;

- *real privatization*. In those CEE countries, where there is made cash privatization, was formed effective class of owners in Ukraine voucher privatization in the absence of any knowledge of financial literacy of the general population and access to the resources of the former party nomenclature led to the formation of clan-oligarchic system property;

- *external influence and financial market development*. At the beginning of transformation CEE countries receive tangible financial support of Western countries, by reducing the percentage of debt to GDP of Poland from 83% in 1990 to 56% in 1993, the debt did not exhaust economy; there was a significant inflow of foreign capital, especially in the financial sector, making it possible to create financial market and its institutions quickly. In Ukraine financial assistance, which went through the budget, was used ineffectively – “was eaten” and because of the high officials corruption money was withdrawn into private accounts;

- *relations between the Government, individuals and society*. The effective functioning of the rule of law and civil society has paramount importance for the establishment, consolidation and self-identity in a democratic European community. Over the last twenty-five years in most of the "young democracy" (CEE) were adopted certain strategic policy documents that govern the relationship between the state and civil society. Civil society in CEE plays a significant role in the formation of stable models of social democracy. In Ukraine, only in recent years have been seen the establishment of working relations in the framework of cooperation on a "government - citizen - civil society", and this interaction takes time and perseverance, prudent and mutual interest.

CONCLUSION

Transformations of the former so-called Soviet camp had unprecedented character as intersystem reform took place. Intersystem reform involves the following changes and transformation, leading to the formation of the economic system and socio-economic system on a new basis because it is primarily concerned with the replacement of the basic components of the existing system (property relations, coordination and motivational mechanisms etc.). Radical change of economic system is an integral component of a higher order – the transformation in the social macro in which economic and non-economic, primarily political factors also are intertwined and interdependent.

Most experts-transitologists have concluded that it is the lack of institutional changes prevented many countries at a faster transition. And so it is logical to assume that the institutional parameters of socio-economic development of countries in transition factors directly characterize the efficiency of their transformation. It is the creation of a new social (economic, political, administrative) and market institutions that determine the capabilities of these countries in transition to a more advanced model of economic development and strengthening national economic capacity.

Considerable positive experience gained post-socialist countries of Europe gives grounds to assert the need to ensure the functioning and effectiveness of political institutions, economic and social spheres to achieve the objectives of Ukraine. Such aspects are reflected in the criteria of the European Neighborhood Policy to establish "privileged neighborhood", rule of law, good governance (good governance), respect for human rights and minority rights, respect for the principles of market economy and sustainable development, the fight against terrorism, non-proliferation of weapons of mass destruction.

Today Ukraine once again faces the need for rapid large-scale reforms, in order to ensure macroeconomic stabilization, to resume economic growth and to improve the welfare of the population. The main development vector is defined – European integration. These goals can be achieved through consideration the experience of European countries that have already passed this way and became members of the European Union. The adaptation of the best practices of European countries in the privatization, decentralization, combating corruption and reforming the justice system to the realities of Ukraine is a relevant perspective for further research.

This subject is interesting not only for Ukrainian scientists. Reforms in Ukraine are carried out under the auspices and in cooperation with international financial institutions and are built on the basis of recommendations from foreign experts. Therefore, the effectiveness of the reform may become an example of how it should or should not do in the future.

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