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Globalization and the Integration-Assisted Transition In Central and Eastern European Economies

Aristidis Bitzenis
and
John Marangos

The transition process has aimed to develop an environment conducive to free, less costly and easier penetration by multinational enterprises (MNEs). The transition process has also involved the integration of localized cultures, domestic entrepreneurship, business and legal institutions, communities, governments, resources and the political environment into the international political economy. In this context, the International Monetary Fund (IMF) and the World Bank also contributed to the integration of transition economies by enforcing shock therapy policies upon transition economies through conditionality. The shock therapy policies ensured that these economies were integrated in the globalized world to facilitate the easy penetration of MNEs.

The aim of this paper is to investigate the policies implemented by the Central and Eastern European (CEE) economies to become part of the "globalized" world; thus, only the word "transition" is a misnomer, as it implies a specific end state associated with the establishment of a capitalist market economy. "Integration" would seem more appropriate, as we argue that a transition to a market economy was carried out not by an autonomous-independent-evolutionary process, but rather by way of inviting and encouraging, and actually at the end, contingent upon the MNEs as a sort of integrator. In actual fact, it was an integration-assisted transition.

Globalization and CEE Integration

Globalization, in its economic sense, is a term used to express the tendency of the world economy to integrate, not only in respect to cross-country trade and investment flows, but also in regard to the harmonization of laws and regulations of economic

Aristidis Bitzenis is an Assistant Professor in the Department of International and European Economic and Political Studies at the University of Macedonia in Thessaloniki (Greece) and Visiting Professor in the Open University of Patras (Greece). John Marangos is an Associate Professor in the Department of Economics at Colorado State University and the Editor of the Forum for Social Economics. *This paper was prepared for presentation at the Annual Meeting of the Association for Evolutionary Economics in Chicago, IL, January 5-7-2007.*

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activity. A mapping of foreign direct investment (FDI) inflows indicates the extent to which host countries are integrating into the world economy and the distribution of benefits of FDI. According to the World Investment Report (WIR) (United Nations Conference on Trade and Development (UNCTAD) 2004), in 2002, in the CEE region, the ratio regarding the stock of FDI inflows over the CEE's GDP was 24.8%; this ratio decreased to 23.7% in 2003, and it was only 0.2% in 1985, and 1.3% in 1990. The ratio of world FDI inflows received by the CEE region was only 0.01% of total world FDI in 1985, and became 3.19% in 1990. The fact that the countries from the CEE region received an increasing FDI inflow as a percentage of the total world FDI, means that the countries become more integrated to the global system since they opened their borders and their economies, and liberalized their systems to facilitate the entrance of foreign multinationals in their countries so as to receive more FDI inflows.

Globalization today is connected with the rise and power of MNEs. During the period 1990 to 2003, world FDI flows accounted for 8% of world domestic investment, that is gross fixed capital formation. International production is carried out by over 900,000 foreign affiliates of at least 61,000 MNEs worldwide. These affiliates account for an estimated one-tenth of world GDP and one-third of world exports (WIR, 2004, 8-9). The bulk of international production is undertaken by a relatively small number of MNEs: the top 100 (less than 0.2% of the total number of MNEs worldwide) accounted for 14% of the sales of foreign affiliates worldwide, 12% of their assets and 13% of their employment in 2002, compared with 27%, 21% and 21%, respectively, in 1990 (WIR, 2004, 9).

Global flows of FDI fell sharply in the period from 2001 to 2002 – the largest decline in the last three decades – following the historical boom during 1999 and 2000 in which FDI flows in the world exceeded US$1 trillion yearly as demonstrated in Table 1 (WIR 2003). This is important and illustrates how much of the 1990s boom was relatively speculative, unproductive and bubble-like. FDI mainly took the form of the takeover of companies (mergers and acquisitions), rather than greenfield investments in productive activities, production networks, and commodity chains. Meanwhile, the CEE economies with an inadequate business environment, absence of market forces and limited quality of business infrastructure attracted FDI in the form of brownfield investments, privatization of State-owned Enterprises (SOEs) and acquisitions/takeovers at a low selling price for local companies. At the end, entry modes of FDI were critical for the integration-assisted transition.

The growth of the services sectors, especially those services dealing with knowledge and information, and the rapid growth of a new generation of technology are the most important factors directly connected and supportive of the latest globalization phase. These features, absent in the previous phases of globalization, make globalization an established, unstoppable and irreversible process (Bitzenis 2005). The current phase of globalization is much more pervasive, deeper and different from previous phases due to new technologies, the facility and rapidity of the distribution of the information, trade liberalization, the reduction of transportation costs of goods, capital and people, and finally, to the "abolishment" of the countries' isolation and loss of their independence (Tanzi 2004, 526).

Table 1. FDI Inflows in the World (in billions US$)

Year	Inflows
1990-1995 (Annual Average)	$225
1996	$386
1997	$478
1998	$694
1999	$1,088
2000	$1,491
2001	$735
2002	$726
2003	$632
2004	$648

Source: WIR Reports (1995-2005)

As a result, there is an essential link between the liberalization of FDI and competition policy. Hence, integration with the globalized world is achieved through liberalization of FDI and trade flows. MNEs are the main vehicles of the FDI and trade flows. However, the behavior of MNEs results in regionalization and concentration of FDI as a result of the establishment of regional agreements. Meanwhile, privatization in the Central and East European (CEE) economies resulted in reforms in regulation, liberalization and privatization in an attempt to integrate transition economies to the globalized system. The final goal of transition was not only the establishment of a market economy but the integration of these economies, not only on a regional basis but rather in the global system. These transition countries' goal was to become members of the European Union (EU) and then members of the Economic and Monetary Union (EMU). Membership in the EU is based on the satisfaction of the Copenhagen criteria and the implementation of the 31 chapters of the *acquis* determining the economic structure of the member country. The criteria require that a state has the requisite institutions to preserve democratic governance and human rights (political criterion), a functioning market economy (economic criterion), and that the state accepts the obligations and intent of the EU. Membership presupposes the candidate's ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union (administrative criterion - *acquis*). This involves among others, the free movement of goods, services, capital and labor. Free movement of goods is one of the cornerstones of the internal-single market. The principle of the free movement of goods requires a common regulatory framework to ensure products can move freely from one part of the Union to another just as they would within the boundaries of an

individual country. Further, the EMU involves integrated economic policies, common monetary policy, common currency, and one central bank completing in this way globalization and integration for transition economies.

Inward FDI Policies as a Means of Facilitating Transition in CEE

The transition economies presented a new opportunity to MNEs. However, the transition economies lacked private capitalists with the necessary financial capital to purchase enterprises "legally," making foreign ownership the only alternative. It was not by coincidence that foreign capital came to the rescue of transition economies. This was an act of purposeful action by the mature market economies, ensuring that foreign ownership was the only permissible "legal" medium of privatization. The aim of the shock therapy approach was a rapid transition to capitalism, disregarding any consideration of the political, social and cultural elements of the society, which were seen as constraints. A process like this implicitly had the goal to initiate the destruction of any institutional barrier inhibiting the penetration, influence and power of foreign capital.

The IMF and the World Bank were responsible for creating the depression in transition economies through the collapse of domestic markets and the Council for Mutual Economic Assistance (COMECON) – the establishment of the hard budget constraints and the provision of foreign aid conditional of satisfying specific targets based on shock therapy. In such an environment, the only interested buyers will come from abroad at a price "for next to nothing" (Gowan 1995, 45). There was "a brutal struggle to steal everything they could get their hands on" (Holmstrom and Smith 2000, 7). Equally important was the pressure exerted on governments of transition economies to sell state owned assets and public utilities to MNEs (the only possible buyers) to reduce fiscal deficits, inflation and discipline the labor market by inducing high unemployment. Effectively, multinationals practiced "cherry-picking" in the name of global integration and national disintegration (Radice 1993, 10). Packages of incentives and legal regulations were often negotiated on a case-by-case basis, making the process appear arbitrary and even corrupt (Smyth 1998, 366). As Bucknall (1997, 8) put it, "it must be great fun remaking nations, a chance few ever get, and it must be even better when it is personally profitable." Nevertheless, "this does not so much suggest a new era on the globe as something rather old fashioned which, in the days of communism, used to be called imperialism" (Gowan 1995, 60).

The depression initiated in the integrated-transition economies was different and uneven. All transition economies experienced a reduction in GDP. The cumulative output decline in Romania, Poland, Slovakia and Slovenia was the lowest, while the largest was in Georgia, Moldova, and Tajikistan. All transition economies experienced inflation, most of them hyperinflation. By 2000, none of the countries of the former Soviet Union had achieved their 1990 real GDP level and by 2006, most of them still had not achieved that same level. The Gini coefficient of income per capita for most of the transition economies increased from the period 1987-90 to 1996-98, with the exception of Croatia, which registered a small decrease (EBRD

1999) . While all regions around the world registered a decrease in poverty rates from 1990 to 1998 measured as the percentage of the population living on less than US $1 a day, the region of Eastern Europe and Central Asia (which includes all of the transition economies) registered a substantial increase (World Bank 2002, 5, 9).

The international organizations and mature market economies were certainly not sending massive amounts of aid eastward to facilitate the transition. There was no second Marshall Plan. However, this did not preclude massive political intervention from outside to ensure the transition economies adopted the "right" course of economic action (Arnot 1998, 224). The development policies pursued and funded by the IMF and World Bank were inimical both to the interests of the poor and to the natural environment in transition economies (Barratt-Brown 1995, 326). Meanwhile, both the international organizations and mature market economies did not wish to see the transition economies descend into complete chaos. Hence, the strategy was to provide limited and conditional support for market reforms, to allow for the international exploitation of parts of the transition economies and to permit a very narrow sector of the domestic population to enrich themselves and integrate into the world financial system. This, of course, would not lead to the rebirth of the transition economies, nor would it improve the lives of ordinary people. However, it would keep the elite of transition economies quiet internationally and prevent disturbances spilling over into the wider world system. And, if the MNEs could gain access to cheap resources, then so much the better for them (Arnot 1998, 234).

However, the IMF adopted some new social policies (protecting the poor, quasi lender of last resort, etc.) which recognized – to some limited degree – their mistakes. The World Bank now targets social capital and human development. This is what Rodrik (2002, 1) christened the "Augmented Washington Consensus" as the new set of policies adopted by Washington, which demanded "heavy-duty institutional reform," targeted problems associated with good governance and acknowledged the need for some social policies.

FDI Inflows in CEE Economies

The integration of the CEE countries into the globalized system as a result of their openness and liberalized policies is profound as witnessed by the increased volume of FDI inflows in the CEE. Table 2 shows the volume in six time periods, ranging from US$49 million of accumulated FDI stock until 1985 in the whole region, to US$263 billion in 2003 (WIR 2004, 379). The ratio of FDI inflows/GDP for the CEE was 0.2% in 1985 and grew to 23.7% in 2003 (WIR 2004, 409). Although there are increased FDI inflows received by the CEE region, the FDI performance of the whole CEE region in global figures is still weak considering that in 1985 a mere 0.01% of the world FDI inflows were received by the CEE region. By 2003 that figure had only grown to 3.19% (WIR 2004, 376-379).

Table 2. FDI in the CEE region in terms of World FDI Inflows

	1985	1990	1995	2000	2002	2003
Accumulated FDI stock in US$	$49 million	$2,828 million	$40 billion	$138 billion	$228 billion	$263 billion
Ratio of FDI Inflows to GDP	0.2%	1.3%	5.4%	19.2%	24.8%	23.7%
World FDI Inflows Received by CEE Region	0.01%	0.15%	1.32%	2.27%	3.10%	3.19%

Source: World Investment Report, UNCTAD 2004.

The CEE economies presented an opportunity to MNEs to provide new markets and extend their productive base. The transition process involved stabilization, liberalization of the domestic and external economy, structural and institutional reform, privatization and restructuring of the SOEs, creating a sound business environment for new private companies to be established, with the ultimate aim of developing national comparative advantage and integrating these economies through international trade and investment into the global system. But, the integration in the early years of transition (the first decade: 1989-1998) took the form of imports, not exports, due to the limited competitiveness of the countries' production base and output collapse. Also, capital inflows increased as a result of FDI inflows partially by the purchase of state owned enterprises by foreign investors, and the remaining as joint ventures and greenfield FDI. So, while transnational penetration of production via FDI as a percentage of private domestic investment has increased markedly in the CEE region, at the same time, domestic investment decreased by more than half between 1990 and 2002, and there has been a similar drop for real GDP in CEE as a percentage to world real GDP (O'Hara 2006, 81). FDI is crowding out national investment even in the better performing nations of CEE.

As most transition economies, especially the South East European economies, struggle to achieve the institutional prerequisite accession for the EU and the Commonwealth of Independent States (CIS) to stimulate growth, the differentiated outcomes of the transition process increased. Thus, a degree of variability is noticeable in the integrated transition economies as we can categorize the whole CEE region into three different-speed economies: 1) the advanced CEE economies, which are already members of the EU (together with the Balkan country of Slovenia); 2) the "towards" South-East European economies that are potential members of the EU (Bulgaria and Romania are members of the EU since 01/01/2007); and 3) the lagging countries of the CIS with GDP levels less than they had at the start of transition.

Conclusion

Globalization, which the transition economies struggled to become part of, in its economic form envisages an interdependent world economic system dominated by global enterprises not identified with any individual country. Meanwhile, if the mature market economies really wished to improve the chances of economic-democratic consolidation in transition economies they should have forgiven old debts, offered generous new aid and dismantled their own trading restrictions (Blackburn 1991, xv). Meanwhile, IMF and World Bank financial and technical assistance programs to transition economies stipulated that recipients could neither place restrictions on FDI nor encourage development banking. For example, the terms of a World Bank loan agreement constrained the ability of the Polish Development Bank to issue direct, subsidized industrial loans. Moreover, these international organizations have barred transition economies from pursuing gradualist reforms or state intervention (Grabel 2000, 13). Instead, the conditional nature of IMF and World Bank funding assured investors that transition governments would not bend to popular pressures to abandon the shock therapy policies. The dependence of the IMF and World Bank on the international capital market for funds has effectively transformed the institutions into facilitators of the international globalized financial market.

Integration means that a country becomes part of the globalized world. Integration is the goal of globalization, and integration is defiantly achieved by inviting multinationals and entering the EU. Integration is further enhanced by membership of the EMU and the adoption of the single currency. Both the EU and the EMU are the best examples of integration and globalization, as membership involves the abolishment of barriers to entry, liberalization policies, and the adoption of the 35 chapters of the acquis (6th EU enlargement policy). All of them determine the legal, political and economic convergence among member countries, and create the fundamentals for the members for stability and a sound business environment to attract FDI and trade flows.

In conclusion, the terms "integration and transition" are more appropriate than just "transition" of what essentially took place in the CEE and generally in transition economies. In fact, it is an integration-assisted transition. These terms, integration, assistance and transition, are not substitutes but complements in demonstrating the transition process in the CEE economies.

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