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The Economic Landscape in CEE Countries

There has been a lot of talk about the CEE countries, mainly the so-called Visegrad Group. There is obvious dissatisfaction, even frustration in these countries, manifested not only in cases of the double food standards.

There is growing tendency for the citizens of these countries to be viewed as second class citizens. The general feeling is that their worries are not heard, their expectations have not been fulfilled and instead of improving the standard of living, they are being patronized by the "West."

The general mainstream presentation of the citizens of these countries is a "immature people" who yet have to learn what is democracy. This patronizing and arrogant approach, typical for the new French president, is deeply wrong.

Firstly, it is important to say that there is a broader tendency of anti-establishment parties rising, like the FPÖ in Austria, or National Front in France, further example can be found in Denmark, Sweden, Finland etc. it is difficult to "accuse" these countries of not being "mature enough." Therefore, there is obviously a deeper problem, lying probably in the socio-economic sphere that is further reflected in the political landscape.

However, this does not mean that there aren´t specific features of the CEE countries. Shortly and briefly, the frustration that is obvious in these countries has two interconnected factors: first one is the disillusion of ever catching-up with the West, which was a serious claim and in some cases a promise of the painful transformation processes in these countries. Second is connected and means that these countries (including the former Eastern Germany) have integrated, or re-integrated into the world economy in the position of dependent economies. This position, as I will argue, does not allow convergence and the fulfilment of transformation promises. This again leads to (justifiable) feeling of being second class citizen in the EU and at the same time to rise of conservative-nationalist policies as a "medicine" to the humiliating economic dependency.

It is important to look at the roots of the current situation. Timing of the transformation process which laid grounds for the current situation and structural features are highly important.

The transformation of the CEE countries started logically at the beginning of the 90´s. While it is not the aim of this article to look backwards to the geopolitical causes and implications, it is important to state that at that time globalization was the stage of capitalist development, accompanied by neoliberal policies in both the academic sphere and the economic policy. Washington Consensus, although to various degrees, was implemented in all the post-communist countries, as it had unshakable dominance at that time. Thatcher´s TINA dominated both economic theory and practice. Simplistic views of "leap into the market economy" worded thus by Jeffrey Sachs (who later changed dramatically his opinion) or the "shock therapy" (which later J. Stiglitz coined at "shock without a therapy) gained firm ground. The EC, later EU did not play such an important role in the economic transformation, more space was given to the World Bank and IMF.

The economic advice incorporated in the Washington Consensus paid little attention to the development of economic structures and the involvement of state was marginalized, or rather was to be marginalized, after the government realized the main policy aims: privatization, liberalization of trade and capital (and of course prices in the domestic market) and deregulation.

What is especially important are the factors of competitiveness that were “hidden” in the Washington Consensus. They were part of the recommended transformation policy. It is crucial to mention them, as they have de facto created the grounds of competitiveness for CEE countries valid until today, and as we will see later, it is very difficult to “switch the road”, once the path has been taken.

Especially for the CEE countries we can say there were these main factors of competitiveness, which created the way they re-integrated into the world (especially European) economy:

Depreciated currency. Deep devaluations were one of the main “instruments” of the Washington Consensus. The idea was built on price competitiveness, which is in the core of the neoliberal concept. It is however a concept used mostly for developing countries, not for countries with the ambition of convergence. Depreciated currency lowered artificially the price and the wage level. As this step occurred mostly at the beginning of the transformation, it has had serious impacts until now. It is one of the reasons why wages cannot converge appropriately. However, there are further impacts of the depreciated currency. As mentioned, it creates the basis for **price competition** – e.g. the country can compete only because it is cheap. This is connected with the wages plus inevitably leads to simple patterns of production and export. Depreciated currency (e.g. Czechoslovakia had three deep devaluations right at the beginning of the transformation) thus influenced not only wages, but the whole direction of the economy, its structure. This led to “re-processed” character of the economy, meaning that typical way was to bring some components in the country, let the people there assemble it (or sew it, or whatever) and export it again, with minimal value added. However, it is important to add that this character is an important feature of CEE economies until today.

In the case of CEE countries another important factor was the proximity to Germany. The unified Germany played the role of the engine and was able to use not only Eastern Germany and its capacities, but also Visegrad countries as “reserve capacities” for its economy.

The Washington Consensus diminished the role of the government in the transformation process (with the exception of introducing its main pillars). However, there was little or no space for industrial policy, for structural policy as such. Simplistic, text book views of economy prevailed and power relations, which are inevitably incorporated in every economic doctrine were completely neglected. The promise of the shock therapy was simple. It was told to the citizens that you “have to survive” for a few tough years and then you will be like Germany. It is necessary to mention that at the beginning of the process there was willingness of the citizens for sacrifice, however we definitely cannot talk about that now.

Market economy (respectively capitalist economy in the era of globalization) was presented as something natural, easy to implement and most of all – offering all those, who are diligent and hard - working a promising future. Although now, as we speak about it, it may seem highly naïve, many citizens did believe these promises and acted accordingly.

Another crucial aspect of the transformation process was privatization. There are various schemes of privatization, some were more, some less “successful”, however with the combination of other factors (like relatively high external debt of Poland and Hungary, which later led these two countries to privatize just to repay the debts) it led to a high proportion of foreign companies in the CEE economies.

In connection with the price-competitiveness strategy we can see that CEE countries adopted the model of “dependent economy through FDI.” One may of course argue that there are worse models of reintegrating into the world (European) economy, we can refer to the dependency on remittances or on foreign debt.

However, it can be disputed that dependency through FDI is a desirable strategy.

There are various advantages connected with the FDI – led transformation strategy. The host country can gain access to markets, to modern technology, to new management methods and of course capital. However, there are also serious disadvantages that occur more intensively when the FDI strategy is dominant, e.g. when FDI influences the whole country across many sectors.

One is of course the outflow of profits. The outflow of profits, which manifests itself in the current account and therefore contributes to deficits, is dependent of the type of investment. If the investment is of simpler character, e.g. uses the price advantage, the investment matures relatively fast and the outflows will manifest themselves fast and in high volumes. This is the case of the Czech Republic, where the FDI as a whole matured in 2006 and since then the outflows of profits are higher than the reinvested earnings. (In this article I neglect the topic of transfer pricing that is more difficult to estimate, although undisputedly it is present and represents a further outflow from the CEE economies).

The outflow of profits has deep impacts into the economy. Macroeconomically viewed they represent the major difference between GDP a GNI, therefore the GDP indicators are mostly overvalued in CEE countries. Secondly, the outflow represents resources that are missing in the economy and are flowing to the country of the mother company, where they can be used and consumed. These are clear power relations between the centre (central countries disposing of mother companies) and the periphery.

The CEE countries, being the periphery of the "German" core, have a rather limited position in their economic policy. Their companies are mostly in the position of "price takers", e.g. the mother company sets the prices and uses these countries for mostly lower-value added operations. Strictly speaking the transformation strategy, based on the Washington Consensus helped to create these power relations. It is no secret that neoliberal strategy served to renew in an "upgraded" version neo-imperialist concepts. The position of many companies in CEE countries – if they are the official "daughter" of subsidiary, or a legally independent company however totally dependent on commission work from a transnational company – is subordinate. From political level we can view it as morally unworthy. From the economic perspective we can see that these "dependent" companies are included in a position that sets the ceiling for increase in the standard of living, in convergence. You cannot converge to developed countries, which are able to "withhold" the value added through their mother companies if you have dependent economic structure. This is simply not possible. On the other hand, all CEE countries are well aware of the fact, that despite their position being relatively favourable at the beginning of the transformation process, there is a "ceiling" that does not allow them to go further and that the structural weakness represents a serious problem for their further development. The issue of "middle income trap" is therefore on the table for these countries.

The notion of this situation started to grow after the Great Recession that "helped" to eliminate a further myth – that capitalism is superior to the previous regime in CEE countries (we can call it state socialism). Great Recession showed clearly that there are serious problems in the "heart of the empire" and put into doubt the whole issue of transition towards capitalism. (It is interesting to note that in the Czech Republic in the transformation years the word "capitalism" was almost never used. Politicians spoke almost exclusively about "market economy").

The weakening of neoliberal dogmas can be seen not only in the IMF, but also on the level of economic policy. (e.g. Poland with PiS and its welfare programmes are in contrast to neoliberal policies of the previous governments).

While examining the economic policies of CEE countries, we must also take into account the position of the “core countries.” Is it at all at their interest to help CEE countries to converge? I doubt it.

You may say that there are signs that certain aspects of “competitiveness” are not welcomed. We can talk about low corporation taxes, (or event the concept of flat tax) and of low wages as such. However, these “instruments” were at the beginning of the transformation and helped to build the CEE economies. It was at that time the dominant Western model that was indoctrinated to these countries as the “only way” how to become capitalist countries. Western companies of course used (or misused) this model of dependency. Not only were they able to use cheap labour in these countries, but at the same time they could press their workers (as they do until today) – if you don´t accede to conditions of longer working hours and/or less pay etc., we will move our factories to CEE countries.

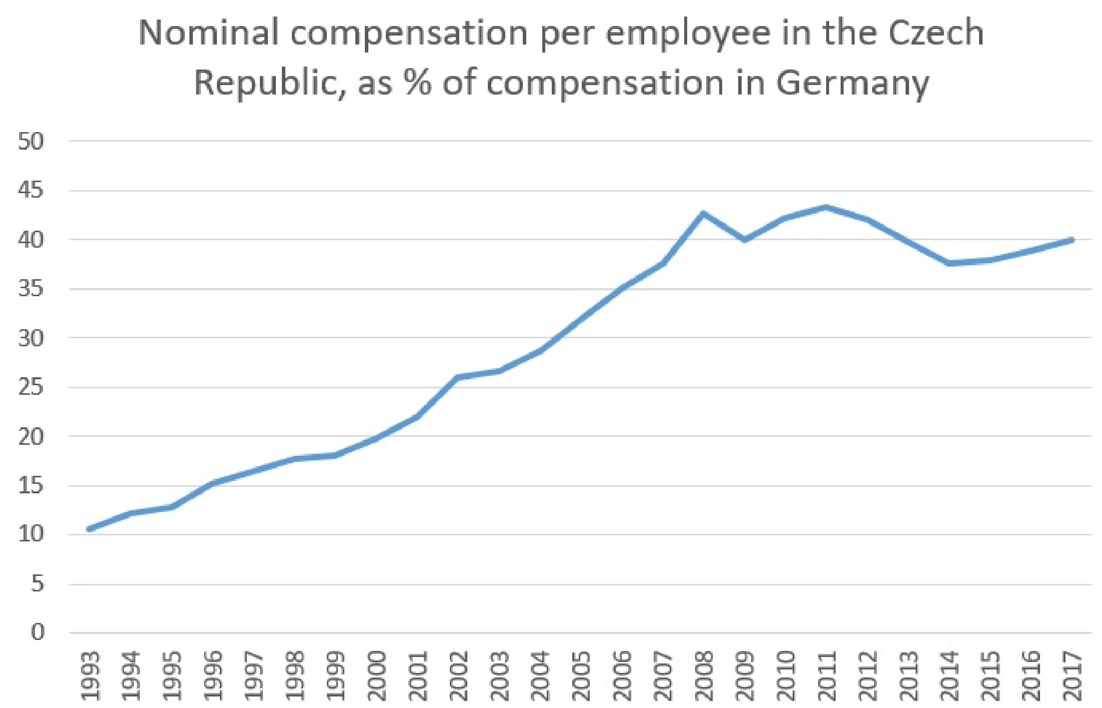
The European integration got trapped in its love for neoliberal policies. The CEE countries are not happy as the neoliberal (Washington Consensus) transformation made them dependent economies with limits as to convergence. (See the picture of halted convergence of nominal wages in the Czech Republic in comparison to Germany).

The Western countries, mainly France, as voiced by the new president, are angry about the “unfair” competition and lower remuneration of the CEE countries employees. It is highly ironical if Macron calls these policies (which he himself wants to “try” on French workers via the liberalization of the Labour Code in order to renew the power parity with Germany) “the betrayal of European principles.”

When the countries of EU, and the more under the “Schäuble doctrine” of austerity adopted neoliberal policies as the only possible way how to solve asymmetric shocks, are the CEE countries at fault that they adapted policies of “race to the bottom” nature? It is not the citizens of the Czech Republic, nor Hungary that profit from such situation. But transnational corporation certainly do.

It shall be noted that the current tendency of institutionalizing one “right” policy into binding documents such as Fiscal compact represents another straitjacket for CEE countries and practically disabled them from evolving different competitive approaches – besides the permanent pressure on wages and limited role of state that is a firm part of the German-driven treaties and policy “recommendations.”

Very often, the argument is used that CEE countries receive funding from the structural funds. This argument needs a close examination. If we look at the example of the Czech Republic and the latest data, we will see that in thirteen years of membership the Czech Republic got from the structural funds 1 151 billion crowns, which is about the sum of revenue of government budget for one year. During the same time, we sent to Brussels about 500 billion crowns, which means that the Czech Republic is the “net receiver.” However, when we look at the outflow of profits, we see a different picture. Only in the last three years, foreign investors (which are mostly European, and mostly German) siphoned out of the Czech economy about 737 billion crowns. Only in the last three years. I believe these number help to clear the true picture a bit.



The CEE countries are no “deviations” from the otherwise unproblematic, smooth development. On the other hand, there are the perfect products of neoliberal policies.

EU has adopted an economic stance preferring lenders, capital and transnational corporations. Workers somehow “got lost.” In the austerity policy there is simply no room for their demands.

EU neglected its social pillar and also through CEE countries reaps what sowed.

Joseph Stiglitz wrote truly that in the race to the bottom there are only losers.

Maybe the appropriate answer to remarks of immaturity of CEE countries and the “betrayal of European values” is: it´s capitalism, stupid.