Economic Transformation in Eastern Europe under the Background of International Financial Crisis and Its Enlightenment

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Abstract: After getting rid of the economic shocks in the early stage of transition, the economic growth of Eastern European countries in transition has gradually stabilized. Especially after entering the 21st century, most of these countries have achieved sustained and rapid economic growth. The impact and impact of the international financial crisis on eastern European countries is related to the institutional foundation and economic development model formed after the transformation of these countries; Different transition economies are affected differently because of their different ways and comparative advantages in participating in international division of labor. Globalization and Europeanization have created favorable conditions for Eastern European countries to catch up, but the fluctuation of global economy has also brought potential risks to Eastern European countries. Eastern European countries have taken a series of measures to deal with the crisis, but the actual effect is not obvious. International aid is not enough to get Eastern European countries out of the crisis.

1. Introduction

Under the background of economic globalization, the American financial crisis broke out in August 2007 and spread to the whole world, forming an international financial crisis [1]. Since 2008, the three Baltic countries, Hungary, Poland and other eastern European transition countries have been greatly impacted by the international financial crisis. The economic growth rate has obviously declined, and the financial situation has deteriorated sharply, which may even become the inducement for the further deterioration of the international financial crisis [2-3]. Eastern European countries have been transforming from planned economy to market economy for 10 years, and have passed the most difficult period of chaos and recession. Most countries have initially established the framework of market economy, and the transformation has entered a crucial stage. The improvement of institutional foundation and financial system and the transformation of large and medium-sized enterprises will become the main challenges in the future.

The economic transformation in Eastern Europe has been more than 20 years, and most Eastern European countries have established a well-functioning market economic system. Before 2008, the performance of emerging markets in Eastern Europe attracted worldwide attention. The economic performance of the new member countries in Eastern Europe of the European Union was better than that of the old member countries, and the catching-up process of Eastern European countries was obviously accelerated [4]. In February, 2009, the currencies of major countries in Eastern Europe depreciated sharply, so some media asserted that Eastern Europe would set off the second wave of international financial crisis. This paper starts with the impact of the financial crisis on the economic, political and social fields of Eastern European countries, analyzes the internal and external reasons for the occurrence and spread of the crisis in Eastern Europe, and finally evaluates the measures taken by Eastern European countries to deal with the crisis and their effects.

2. Impact of Financial Crisis on Eastern European Countries

Since the financial crisis landed in Eastern Europe at the end of 2008, it has had an all-round impact on the economic, political and social life of the countries in the region. The most direct and serious impact occurred in the economic field. The economic trend fluctuated greatly before and

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after the financial crisis, and the sustained growth before the crisis was in sharp contrast with the rapid decline after the international financial crisis [6]. Eastern European countries are the first to be impacted by the international financial crisis in emerging markets, and Hungary and Latvia have to seek assistance from international financial organizations and the European Union. Indeed, Eastern European countries have been affected directly or indirectly.

2.1 The Local Currencies of Various Countries Depreciated Sharply

Since the end of August, 2008, the currencies of some Eastern European countries have depreciated sharply. According to a report by Bloomberg News on March 20, 2009, the currencies of Eastern European countries have depreciated sharply in the past six months. Among the 26 emerging market currencies, the Polish zloty depreciated the most, 28% against the euro, the Hungarian forint ranked third, the forint depreciated by 20%, the Romanian leu depreciated by 16%, and the Czech Krone depreciated by 11%.

2.2 The Debt Burden Has Increased and the Credit of Foreign Debt Has Declined

According to Eurostat, in the second quarter of 2009, Lithuania (22.1%), Latvian (23.6%), Slovenian (30.7%), Slovak (32.5%), Czech (33.7%), Poland (49%) and Hungary (77.1%) had a larger proportion of general government debt in GDP, with a year-on-year increase of 7.1, 13.1, 7.8, 6.8, 5, 5.8 and 12.1 percentage points respectively. At the same time, the credit ratings of many foreign debts have been lowered, and the prospects are mostly “negative”, or they are listed on the “negative” watch list, while a few countries are “stable” or “positive” [7-8].

2.3 Increased Financing Costs

Although the liquidity contraction in foreign markets will be weakened after taking appropriate measures, the existing funds are more scarce, and the allocation of funds will place more emphasis on avoiding risks. According to the International Finance Association, the net inflow of capital from emerging markets will drop sharply. According to the association's estimate, the capital outflow from European emerging markets (including Central Europe, Russia, Ukraine and Turkey) will be US$ 26.7 billion in 2009, while the capital inflow in 2008 will be US$ 241 billion. Even with the assistance of the International Monetary Fund, it is difficult to make up the capital gap faced by Eastern European countries.

2.4 Economic Growth Has Declined

After the outbreak of the international financial crisis, the economic growth trend of Eastern European countries began to show signs of deterioration. From the general trend, the economic growth of most Eastern European economies began to decline in 2007. Among them, the economic growth of Estonia, Hungary and Lithuania all declined significantly [9]. At the same time, however, Latvia, Slovakia and Slovenia still maintain relatively strong economic growth, with an increase of 14.1%, 22.4% and 15.2%, and Poland's economy also has a slight growth, with an increase of 6.5%; Economic growth in almost all economies has declined sharply. Among them, the three Baltic countries suffered the most serious decline, among which Lithuania and Estonia directly entered the economic recession, and their economic growth rates dropped to -4.6% and -3.6%, respectively, with a decline of 146% and 157%; Latvia's economic growth rate also dropped from 8.9% to 3%, with a drop of 66.3%. Hungary's economy declined again on the basis of a sharp decline in the previous year, and its economic growth was close to zero, at 0.5%.

3. Current Situation of Transitional Economy in Eastern Europe

3.1 Degree and Effect of Economic Transformation

(1) Government functions have undergone fundamental changes

At present, the government has got rid of the predicament of “all-powerful government” and walked out of the wrong way of completely pulling away from the economy, and mainly exerted its macro-control role by means of resource allocation and fiscal policy. In 2008, the economic growth rate of all countries decreased to varying degrees (Romania is an exception). Under the circumstances that the determinants of economic development vary from country to country, the economies of Eastern European countries fluctuate at the same time. Obviously, the impact is not mainly from within the economies, but more likely from outside. The biggest possible external shock is the international financial crisis [10]. And by strengthening the autonomous function of local governments and giving full play to the social functions of various institutions in the public domain, the burden on the central government can be reduced.

(2) Economic growth

Eastern European countries experienced what Colne called a “transitional recession” after the transition, and the GDP continued to decline for 2-6 years. Only in 2000 did Eastern European countries achieve general economic growth. Therefore, in the first 10 years after the transition, except Poland, the economic growth records of other Eastern European countries were worse than those of the first 10 years after the transition. After 2000, it should be said that Eastern European countries have embarked on the road of sustained economic growth. From 2000 to 2007, the average economic growth rate of six Eastern European countries greatly exceeded the level of the previous decade. After joining the European Union, the economic development of Eastern European countries accelerated, and its economic growth rate was much higher than the average level of the 15 EU countries. In terms of real GDP, by 2008, Eastern European countries had exceeded the level in 1989 (see Table 1).

Table 1 Changes in Real Gdp in Eastern European Countries

Country	Real GDP growth rate				Real GDP index in 2008	
	Real average annual growth rate%	Annual growth rate%				
	1990-2008	2006	2007	2008	1989 = 100	2000 = 100
Czech Republic	1.9	6.8	6.0	4.4	145	140
Hungary	1.5	4.1	1.1	1.7	134	131
Poland	3.1	6.1	6.6	5.4	178	139
Slovakia	2.6	6.6	10.4	7.0	164	162
Slovenia	2.3	8.5	6.8	4.4	154	138
Bulgaria	0.3	5.9	6.2	6.5	113	145
Romania	1.3	6.1	6.2	8.5	128	164
15 EU countries	2.0	2.7	2.7	-0.1	146	114

(3) Adjustment of financial structure

In the transition countries of Eastern Europe, the banking system is mostly controlled by foreign capital (see Figure 1). In the process of transformation in Eastern European countries, the order of transformation of state-owned banks is to clean up the balance sheets of state-owned banks and dispose of their bad assets, then privatize state-owned banks and sell them to foreign strategic investors. From the statistical data, in the 21st century, the banking sector of most eastern European countries has been controlled by foreign capital. 90% of these foreign banks come from other EU member States. The proportion of foreign capital in the banking sector of Eastern European countries is estimated by its loan share, which is between 55% and 97% except Slovenia and Romania. It can be said that the banking system of these countries has been dominated mainly by foreign banks.

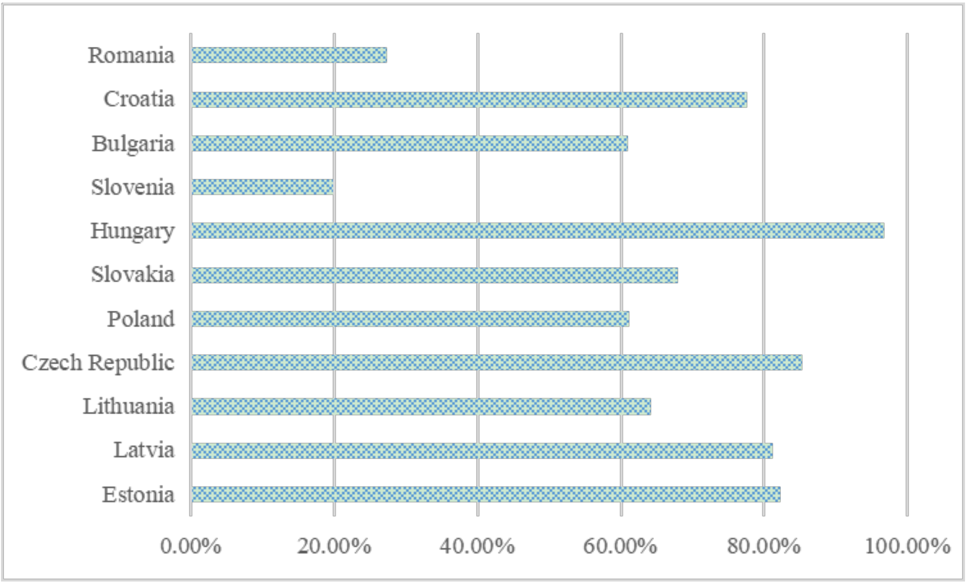

Fig.1 The Proportion of Foreign Banks in the Total Loans of the Banking Sector

This kind of financial asset structure creates conditions for foreign banks to control the financial system of Eastern European countries. Foreign bank ownership accounts for a high proportion in the financial system of Eastern European countries, which on the one hand increases the impact of foreign capital on the economies of Eastern European countries, and on the other hand makes the economies of Eastern European countries face higher conductive financial risks.

(4) Convergence of fiscal and taxation system with EU

By introducing the concept of “public finance” commonly used in the West, the budget scope is limited to administrative management, national defense, education, medical care and other departments, and no longer includes corporate finance, and various price subsidies have been basically abolished. Reduce taxes, mainly collecting value-added tax, profit tax, income tax, consumption tax, etc., and implementing the central and local tax-sharing system.

(5) Labor productivity

After the transition, the labor productivity in Eastern European countries has been improved, especially in the countries that joined the European Union, the use of labor is more efficient, showing a connotative growth. Assuming that the level of labor productivity in 1990 was 100, by 1999, the labor productivity in Czech Republic was 159. 5, Hungary was 172. 4 and Poland was 195. 7. Even during the transitional recession, the labor productivity of Central European countries did not decline, but increased (see Table 2).

Table 2 Changes of Labor Productivity from 1991 to 2006 (%)

Zone	1991-1995	1996-2000	2001-2006
Central Europe	2.3	4.1	3.6
Southeast Europe	-3.6	5.4	4.6

(6) The social security system was initially established

Countries take developed market economy countries as examples, and establish social security systems shared by the state, collectives and individuals to provide residents with minimum living security. In the aspect of endowment insurance, most countries adopt multi-pillar system instead of pay-as-you-go monopoly system [11]; In terms of medical insurance, most of them have established medical insurance funds, which are jointly paid by employers and employees. In terms of unemployment insurance, unemployment benefits ranging from six months to two years are provided to the unemployed, and re-employment training is provided free of charge.

3.2 Problems and Costs in Transition

(1) The lag of legal system construction

In the early stage of transformation, the legal system under the planning system was destroyed, but the new legal system adapted to the market economy was not established correspondingly, and the market operation was in a semi-anarchy state. Some officials and entrepreneurs took advantage of the "legal vacuum" and their positions, took advantage of the privatization of state-owned enterprises, wantonly embezzled state assets, automatically changed from "state-owned entrepreneurs" to "private entrepreneurs", and even colluded with social black forces, forming a special publishing group that was not subject to legal supervision. At present, Eastern European countries have generally realized the seriousness of this problem and began to intensify the legal system construction.

(2) Rising unemployment

Due to the impact on export, stock market, domestic market, investment and consumption demand, industrial production and other fields, the unemployment rate in Eastern European countries keeps rising. In October 2009, the unemployment rates in Slovenia, Czech Republic, Bulgaria, Poland, Croatia, Hungary and Slovakia reached 6. 2%, 7. 1%, 7. 9%, 8.4%, 9.7%, 9.9% and 12.2% respectively, which increased by about 2 percentage points over the same period of last year, while the unemployment rates in the Baltic States increased by more than 5 percentage points over the same period of last year

(3) The structural deficit of foreign trade is difficult to reverse

Eastern European countries have low labor productivity, low technical content of products and lack of international competitiveness. Their exports still focus on raw materials, textiles, metallurgy, chemical industry, machinery manufacturing and other rough products with low added value, and their export structure and quantity have not changed significantly. However, the import demand for western consumer goods has increased greatly, resulting in import growth faster than export growth in most countries, and the trade deficit has continued to increase. For example, in 1999, the foreign trade deficit of Bulgaria was equivalent to 10% of GDP, while that of Poland was as high as 14.462 billion US dollars, which became the most prominent problem hindering the rapid economic development.

In June and July of 2008, while the overall export trade showed a downward trend, Bulgaria's export trade increased greatly compared with the same period of last year; Moreover, in January and February of 2009, the change of Bulgaria's exports compared with the same period of last year was obviously different from that of other Eastern European countries, showing a slight increase, and the reasons need further analysis.

(4) The surge in credit has boosted domestic demand on a macro level, resulting in a current account deficit

Eastern European countries balance the current account deficit through FDI and foreign debt. After entering the 21st century, in Eastern European countries, the proportion of foreign debt in GDP continued to rise. In the third quarter of 2006, Romania's foreign debt accounted for the lowest proportion of GDP, and its scale also reached 28% of GDP. High debt makes the economy vulnerable to the risks of foreign exchange, interest rate and exchange rate, especially under the fixed exchange rate mechanism, which is implemented by the Baltic countries in Eastern Europe. In addition, Eastern European countries continue to run deficit policies, although the scope is small, but they cannot form wealth accumulation when the economy is growing at a high speed, which weakens the ability of national economies to cope with risks.

(5) Excessive economic external dependence

The foreign trade of Eastern European countries occupies an important position in the economy, and 1/3 to 1/2 of their gross national product is maintained by exports. In recent years, the economic downturn in Western Europe has caused the export of Eastern Europe to be frustrated, the foreign trade deficit has increased substantially, and the economic growth has been greatly affected; In addition, all countries in Eastern Europe have heavy foreign debts, especially Hungary, Bulgaria and Poland. Due to poor debt repayment ability and high annual debt service, the already poor balance of payments situation has worsened. The national financial burden is even heavier.

4. Enlightenment of Economic Transformation in Eastern Europe

4.1 In the Process of Transformation, We Must Implement the Overall Steady Advancement Strategy

Economic transformation is a complex systematic project, which promotes the overall change of society in all aspects. It includes not only property right transformation and price adjustment, but also changes in the whole economic structure, operating mechanism, management system and a series of other policies and social contents. Eastern European countries mostly adopt sharp shock therapy, which revolves around the reform of ownership and price, and fail to effectively form an all-round economic transformation strategy, resulting in a heavy price. In the implementation of the transformation strategy, we should not rush for success, but pay attention to steady progress, fully consider the social psychological and material endurance and traditional inertia, and avoid excessive social shocks.

4.2 Redefining the Role of Government

After the economic transformation, the state's all-round intervention in the economy has ceased to exist, but it has not completely withdrawn. The amount of state intervention in economy has decreased, but the demand for intervention quality has increased. In times of crisis, the state's intervention in economy has increased. When the economy comes out of the crisis, intervention policies need to be adjusted, and the permanence of temporary measures will have an adverse impact on the economy. The government also has great room for improvement in providing public services, reducing administrative barriers and investing in infrastructure. For example, as a leader in economic transformation, the Polish government faces challenges such as improving the quality of public services, increasing investment in infrastructure, and withdrawing from non-competitive areas.

4.3 Improve the Social Security System on the Basis of Providing the Minimum Guarantee

While improving the social security system, we should also achieve the goal of reducing government financial expenditure. Poland and Hungary have done a good job in unemployment insurance and multi-pillar endowment insurance, and listed the reform of medical system as the focus of the next stage. The limit of medical insurance expenditure will be stipulated in the government's annual budget, and the establishment of public and private medical service institutions will be encouraged to achieve the purpose of saving costs and providing the most basic protection for residents; Generally speaking, the better countries in the north will continue to keep up with the social security system in Western Europe. Due to financial constraints, the southern countries can only take providing the most basic security as their primary goal. Moreover, due to the lag of the reform in previous years, the future reform will be more difficult than that in the northern countries.

4.4 Strengthen the Rule of Law

Eastern European countries have made great progress in the construction of the rule of law, among which the progress of Central European countries is faster than that of Southeast European countries. However, compared with developed countries in Western Europe, even the new member countries in Eastern Europe of the European Union still have a big gap. With the exception of Hungary, the trust in the legal system of the European Union is lower than the average level of the European Union. Therefore, Eastern European countries need to support the courts in terms of human resources and funds to solve the problem of excessive legal backlog. Bulgaria and Romania, which have joined the EU, cannot satisfy the EU in fighting corruption and organized crime. Corruption and organized crime in other Southeast European countries are still quite serious. However, in general, from 2003 to 2008, except Bulgaria, the new EU member countries in Eastern Europe improved their transparency international corruption index.

5. Conclusion

It should be said that the most difficult days of the impact of the international financial crisis on Eastern Europe's economy have passed. Whether Eastern European countries can get rid of the crisis as soon as possible depends on whether the government's response measures are appropriate on the one hand, and on the other hand, the international economic environment, especially the recovery of the Eurozone economy. Eastern European countries can't give up the existing growth strategy, but they can't rule out fine-tuning the existing growth strategy. How to avoid disadvantages and prevent risks under the background of globalization and Europeanization is the main challenge faced by decision makers in Eastern European countries. The impact of the international financial crisis on Eastern European economies provides a unique opportunity to comprehensively examine the economic transformation in Eastern Europe. At present, the politics of Eastern European countries are gradually stabilizing, the economy is on the right track, and the process of diplomatic integration with Europe is more clear. Therefore, it can be predicted that the economic development prospects of Eastern European countries will be optimistic at the beginning of the 21st century.

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