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Unfinished Europe: Transition from Communism to Democracy in Central and Eastern Europe

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Abstract

The Berlin Wall collapsed a quarter of a century ago. This anniversary led to publication of studies about the success of Central and East European transformation. Some of them maintain that the region became 'normal,' and nearer to their Western neighbors. In reality, the region still belongs to the periphery of Europe with a mostly dual economy and low level of income. Modern sectors and the entire banking industry are subsidiaries of Western multinationals. The political system is often authoritarian. Democratic forms often cover non-democratic contents. Corruption, tax evasion and other symptoms of peripheral political behavior are quite common. Transformation is so far not accomplished and will certainly require two or three generations to achieve.

Keywords

authoritarian governments, corruption, dual economy, peripheral backwardness, unfinished transformation

This year marked the 25th anniversary of the fall of the Berlin Wall, the symbol of the division of Europe, and the collapse of the Soviet Bloc. This anniversary generated a wave of studies and articles examining the results Central and

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Eastern European countries[1] achieved during this 'short' period of transition from communism to democracy.[2] Some of them, such as Andrei Shleifer and Daniel Treisman's recent analysis, portray the transition as hugely successful, declaring that Central and Eastern Europe are, in addition to having close ties to the West, considered to be 'normal' or even 'better than normal.'[3]

Their argument for the titular 'normalcy' is based upon the fast growth of the region's economy, which is reflected by factors such as the ever-growing number of car owners and the remarkably good quality of information technology; the latter is, in some areas, even better than in the West. In general, the quality of life has improved markedly since the fall of Communism. This is not to say, however, that these celebratory accounts completely disregard issues the region is facing – they acknowledge for example that democracy is being undermined by authoritarianism in certain countries and that the most important institutional reforms have been halted or even reversed in some countries.[4]

It would be misguided to deny that Central and Eastern Europe has developed both economically and socially in the last 25 years. However, the picture these authors paint is extremely one-sided and overly rosy. After the failure of communism, they argue, the countries of the East did not have to do anything more than 'return' to Europe to re-emerge as what the authors deem to be 'normal.' According to Shleifer and Treisman, 'normal' means simply being similar to other countries at comparable stages of economic development. The problem of such a definition of 'normal' is that is does not capture the special situation of Central and Eastern European (CEE) states.[5] In classifying them as such, they pay

1 The term 'CEE' includes all the Eastern bloc countries west of the post-Second World War border with the former Soviet Union, the independent states in former Yugoslavia, and the three Baltic states – Estonia, Latvia, Lithuania. By 'Western Europe' we refer to all EU 'old' member states. We are aware of the arbitrariness of this distinction between West and East, but still use it simply because it became a standard definition in the vast literature on transition countries and is used by such international organizations like OECD, the World Bank, and so on. See I.T. Berend, 'What is Central and Eastern Europe?,' *European Journal of Social Theory*, 8, 4 (2005), 401.

2 A. Shleifer and D. Treisman, 'Normal Countries: The Last 25 Years After Communism,' *Foreign Affairs*, 93, 6 (2014), 96; D. Lipton, 'Eastern Europe's 25 Years of Transition,' Project Syndicate, 7 November 2014, available at: http://www.project-syndicate.org/commentary/central-and-eastern-europe-since-1989-by-david-lipton-2014-11 (accessed 25 August 2015); J. Kornai, 'Threatening Dangers,' paper delivered at the Peterson-CEU conference lecture, 2014. Available at: http://www.kornai-janos.hu/Kornai2014%20Threatening%20dangers.pdf (accessed 25 August 2015); J.-W. Müller, 'Eastern Europe Goes South, Disappearing Democracy in the EU's Newest Member States,' *Foreign Affairs*, 93, 2 (2014); I. Banac, 'Twenty-Five Years After the Fall of the Berlin Wall, East European Politics and Societies and Cultures,' 28, 4 (2014); I. Grudzinska-Gros, 'The Backsliding,' *East European Politics and Societies and Cultures*, 28, 4 (2014).

3 Shleifer and Treisman, 'Normal Countries'; Lipton, 'Eastern Europe's 25 Years of Transition.'

4 See for example, M. Dabrowski, 'Central and Eastern Europe: Uncertain Prospects of economic convergence,' Bruegel, December 2014, available at: http://bruegel.org/2014/12/central-and-eastern-europe-uncertain-prospects-of-economic-convergence/ / (accessed 25 August 2015); EBRD, 'Stuck in Transition?' Transition Report 2013 available at: http://www.ebrd.com/downloads/research/transition/tr13.pdf (accessed 25 August 2015).

5 For an illuminating critique of Shleifer and Treisman, see B. Milanovic, 'Four tricks used by Shleifer and Treisman to convince you that the transition was a success,' available at: http://glineq.blogspot.com/2014/11/three-tricks-used-by-shleifer-and.html (accessed 25 August 2015).

no heed to the fact that the countries of the region never were normal in comparison to the West and that the region had long been nothing more than the periphery of Europe, exhibiting both socio-economic and political backwardness. In order to see this historical difference, one needs to look no further than the region's average per capita income, which was between one third and one half of the Western one during the last one and a half centuries. Economic level, however, is only part of the story. The societies had a nearly caste-like division, the middle class was extremely weak and partly foreign, the national elite, in some countries, were either the hardly-transformed old nobility and gentry as in Poland and Hungary, or a bureaucratic-military elite as in the Balkans. Educational level was very backward until the mid-twentieth century: high-school graduates, in the best cases, represented only about 5–8 per cent of their generations while university graduates only about 1–2 per cent. Those countries remained rural and agricultural until the Second World War. The 1989–90 slogans, 'Back to Europe!' expressed an understandable dream, but the region had to change their centuries-long cultural, social and economic characteristics to be 'normal' in the sense of Western Europe that was equalized with 'Europe.'

In order to examine the celebratory accounts critically, we build on the existing critical approaches, which highlight, in various areas and fields, severe shortcomings and flaws of the 'normalcy' arguments presented by Shleifer, Treisman and other authors in their camp.[6]

Even nowadays, the CEE countries are still at Europe's periphery and continue to exhibit the aforementioned peripheral backwardness. By treading far too narrow a path, they have undermined their progress. This post-Communist path was not only limited by path dependency but also characterized by serious policy mistakes – after a sharp economic decline in the early 1990s, the region as a whole needed 20 years to reach the 1989 stage again.

The region's economy is developing, but as a dependent backyard of the West. In order to become truly 'normal,' CEE countries must create domestically based intensive growth rather than importing capital, knowledge, and technology, carried by multinational companies. In political terms, democratic consolidation is still far from complete. Instead, new forms of 'illiberal democracy' which are emerging[7] reveal the vulnerability of 'consolidated democracies' such as Hungary or Slovenia to 'democratic regression.'

Before the 2008 crisis, the larger region as a whole was behind the relative level, compared to the west, they had in the early-mid nineteenth century, and also behind the post Second World War level. The countries of the region fluctuated

6 Müller, 'Eastern Europe Goes South'; I. Banac, 'Twenty-Five Years After the Fall of the Berlin Wall,' *East European Politics and Societies and Cultures*, 28, 4 (2014); Grudzinska-Gros, 'The Backsliding'; D. Mario Nuti, 'Did We Go about Transition in the Right Way?,' in P. Hare and G. Turley (eds), *The Economic and Politics of the Transition* (London and New York, NY 2013), 46–58; L. King, 'Central European Capitalism in Comparative Perspective,' in B. Hancke, M. Rhodes and M. Thatcher (eds), *Beyond Varieties of Capitalism: Conflict, Contradictions, and Complementarities in European Economy* (Oxford 2007), 309.
7 Müller, 'Eastern Europe Goes South,' 15.

Table 1. GDP/capita in Central and Eastern Europe as % of Western Europe[9]

Year	East as % of the West
1820	59
1873	51
1913	46
1950	51
1973	47
1989	40
1995	39
2005	46

at around half of the per capita income level of the West for two centuries, up to the present. As reflected by the figures, the region is still on the periphery of Europe and exhibiting peripheral backwardness, as all the time in modern history.

The post communist road started with serious mistakes. The region had to adjust to the 'Washington Consensus,' a neo-liberal economic program, and open their closed economies that had followed the policy of protectionist, isolationist economic nationalism since the First World War. The term 'Washington Consensus' usually refers to a set of policies advocating economic liberalization, privatization and fiscal austerity, which were initially designed in the 1980s and 1990s by the IMF, the World Bank and the US Treasury to respond to the economic crisis in Latin America.[8] Later, a similar set of policies was applied to former communist countries in CEE. The consequence was a tragic depression and an about 20–25 per cent decline in GDP, and often a 50 per cent decline of agricultural production.[9] The region as a whole needed nearly 20 years to reach the 1989 economic level again, although some of the Central European countries covered this distance in 'only' 10 years and had an impressive modernization after. Nevertheless, after a quarter of a century, only about one-tenth of the population of the region lives in a successfully transformed market-society. During the first few years, the social shock of transformation had an enormous impact, leading to a large percentage of society – in some cases as much as 20–30 per cent – falling into poverty. This situation gradually improved, but the wage level, even counting purchasing power in the better developed countries, is less than half of the West

8 The term was coined by John Williamson in 1989. J. Williamson, 'What Washington Means by Policy Reform,' in J. Williamson (ed.), *Latin American Readjustment: How Much Has Happened* (Washington, DC 1989), 7. Subsequently, the term aquired a broader meaning and usually connotes a market fundamentalism or neoliberal agenda. J. Yifu Lin, 'Lessons from Great Recession,' in N. Birdsall and F. Fukuyama (eds), *New Ideas on Development After the Financial Crisis* (Baltimore, MD 2011), 57.

9 Mario Nuti, 'Did We Go about Transition in the Right Way?'.

European standard. Income differentiation has strongly increased. The Gini coefficient that measures income diversity from 0 to 1 (when 0 means that everybody has the same income, and 1 means that only one person received all the income of the country) elevated from about 0.22–0.24 to about 0.31–0.35, in some countries such the Baltic countries, Romania and Hungary, the increase was quite dramatic. This was in sharp contrast with several West European and Scandinavian countries where the income gap hardly changed and remained at the level of 0.26–0.28.[10] Russia neared the Third World countries with income inequality of about 0.45. A corrupt, kleptocratic oligarchic layer with close ties to respective governments has emerged as well. This social phenomenon started with the privatization throughout Eastern Europe when privileged groups, close to power, robbed the state. Corruption and tax evasion are old malaise in these countries, including the highest echelon of the political establishment, well reflected in the major scandals in which the Croat and Romanian prime ministers were involved. Most of the younger generation does not see their future in their countries. It is little wonder then that nearly half of both Moldova and Albania's labor force is searching for opportunities for work abroad and that about 800,000 Poles, 500,000 Slovaks and 400,000 Hungarians, mostly young and educated people, have emigrated to the West. The number of Hungarians who moved to the West surpassed the numbers of those who escaped from hopelessness after the defeat of the 1956 revolution.

The region's economy is developing, but it is doing so as a dependent backyard of the West. The region became attractive to the West mainly because of its cheap, well-trained labor force. Wages were about one-tenth to one-fifth of the West European wage level, which attracted a huge inflow of foreign capital, thus building up a network of subsidiaries and value-chains and establishing modern export sectors of the economies. It is crucial to note that in the age of financialization of the advanced economies, when finance, insurance and real estate businesses have surpassed manufacturing, the region does not have an independent banking sector: an average of 87 per cent of banking assets is in the hands of giant European multinational banks. The same is true for insurance. Banking business in the region proved to be extremely profitable. Austrian banks, one of the main players in this business area, used 16 per cent of their assets, but gained more than one-third of their profits from East European business activities.[11] True, this situation turned out to be an advantage after the financial crisis in 2008 when several countries, for example Ireland, had to bail out bankrupt banks, leading to dangerous indebtedness of the state. The East European governments did not have to recapitalize the banks because this was done by their Western owners. Immediately after 2008, the Western-owned banks stopped extending credit in Eastern Europe. In March 2009, however, the EU institutions and the IMF invited 40 banks involved in cross-border operations to Vienna and achieved an agreement, the so-called

10 I.G. Tóth, Time Series in GINI Policy Papers 3, 29, available at: www.gini-research.org/system/uploads/566/.../GINI_Policy Paper_3.pdf (accessed 25 August 2015).
11 Österreichische Nationalbank, June Report (Vienna 2006).

Vienna Initiative, to keep lending in the region and prevented a collapse in banking. In 2012, the Second Vienna Initiative stopped selling Eastern banking assets by Western banks. Banking and lending in these highly dependent economies was saved and the financial sector stabilized.[12]

From the mid-1990s, Western bank landings, annually about $5 to $15 billion, covered about 40–50 per cent of corporate funding in Central and Eastern Europe.[13] Around the turn of the century, 26 per cent of capital inflow was loans and 19 per cent portfolio investments. The largest part of inflowing capital, 55 per cent during the transformation period, had comprised foreign direct investments. More than 13,000 foreign companies opened business in Hungary, and 5000 in Poland. Multinational companies occupied the key positions in the region's industry. From the mid-1990s on, $15–30 billion of Western capital is annually being invested in the region. In the cases of the Czech Republic, Estonia and Hungary, the investments equal 10–15 per cent of the respective GDPs, and as an average in the entire region, 2.6 per cent of GDP. Until the 2008 crisis, capital inflow into the region amounted to more than $200 billion. It is not particularly surprising then that in the early twenty-first century, foreign multinational companies dominated the economies of several of these countries. Nearly half of the people employed in industry worked for foreign companies and in Hungary, for example, 82 per cent of investments, 73 per cent of sales and 89 per cent of industrial exports were produced by foreign companies. Furthermore, one-third of Hungarian industrial exports were in the hands of four Western multinational companies. In Poland and the Czech Republic, about 60 per cent of industrial exports were being produced by foreign-owned companies.[14] In the early twenty-first century, capital inflow strongly increased to the Balkans: from 2000 to 2005 by 374 per cent, from $15 billion to $57 billion. The major Western retail chains, the German Metro, the British Tesco and the French Carrefour, represented a huge part of Eastern markets; in the Czech Republic, one of the most advanced economies of the region, sales by Western retailer chains amounted to almost half of the country's retail sales. Philip Morris increased its market share to 75 per cent in the Czech Republic by 2002. Even telecommunications and the well-developed car industry are all in Western hands. The US–German Ameritech-Deutsche Bundespost consortium, the Royal Dutch Telecom and Swisscom, and the Ameritech-France Telecom consortium started buying up the telephone systems of the region.[15] The telecom systems of the Baltic countries were bought by the Swedish Telia and the Finnish Sonera companies.[16]

12 I.T. Berend, *Europe in Crisis: Bolt from the Blue?* (London 2013), 144; www.archive-com-2013.com (accessed 25 August 2015).

13 Transition Report 2000. European Bank of Reconstruction and Development (London 2000), 84–6.

14 *Revue Elargissement* (12 April 2003).

15 *Wall Street Journal* (2 June 1995 and 30 March 1998).

16 I. Jeffries, *The Countries of the Former Soviet Union at the Turn of the Twenty-First Century* (London 2004), 171, 211, 246.

Multinational car manufacturers virtually occupied the Central European countries. The US General Motors opened the gate and made a greenfield investment by building its car factory in Szentgothard, Hungary, somewhat before the collapse of the regime. Japanese Suzuki followed suit and then Volkswagen established its engine factory for its Audi cars in Györ, near to Hungary's border with Austria. Some Central European countries are even called Volkswagen-land because VW factories represent the bulk of their car industries. This development was begun when VW bought one-third of the Czech Skoda factory in 1991 and gradually the entire factory in Prague. Volkswagen's Bratislava factory in Slovakia started producing its Tuareg, Polo and the body of the Porsche Cayenne SUV. Slovakia also attracted the South Korean KIA and the French Peugeot factories. At last, Slovakia became the world number one car producer on per capita basis, delivering 800,000 cars per year by 2006.[17] Volkswagen also established factories in Poland, Ukraine, and Bosnia. In 2000, the ten leading car manufacturers delivered 82 per cent of Central and Eastern European car production led by Volkswagen and Fiat by 22 per cent and 10 per cent shares. The multinational car supply industry such as Visteon, Delphi, and others invested in the region. Faurencia established seven plants in Poland. Volkswagen built a 31 hectare supplier park within 3 miles of Poznań.[18]

Thousands of multinational corporations built up a broad subsidiary network in Eastern Europe. Among them were the Dutch Philips, the German Siemens, and the Finnish Nokia. The Swiss Asea Brown Boveri opened 13 subsidiaries in Poland.[19] The US IBM corporation established its worldwide center for notebook hard disc production in Székesfehérvár, Hungary. Japanese Sony started subcontracting in Hungary, Poland, and Slovakia and then established production plants. As the chief executive of Sony stated, these operations 'point to a coming of age for Central Europe as a manufacturing base.'[20] Several multinational companies established R&D centers and service centers in the region.

West European, US and Japanese companies played the central role in the economic transformation of Central and Eastern Europe, by establishing the banking industry, creating retail networks and modern, partly high-tech and medium-high-tech industrial sectors. Economic growth, in other words, was for the most part unrelated to the effects of domestic research and development. It is therefore more appropriate to speak about the rise of a dual-economy with advanced export system and a less developed, local sector-oriented domestic market. Because of their structural dependence on Western capital, knowledge and technology, Andreas Nölke and Arjan Vliegenhart argue that CEE economies represent a distinct type of capitalism, a dependent market economy (DME) type of capitalism. According to Nölke and Vliegenhart, DMEs:

17 *Automotive News Europe*, 9, 10 (17 May 2004).
18 Ibid; and *Business Week Online* (5 September 2005).
19 *Wall Street Journal* (5 April 1996).
20 Ibid.

> have comparative advantages in the assembly and production of relatively complex and durable consumer goods. These comparative advantages are based on institutional complementarities between skilled, but cheap, labor; the transfer of technological innovations within transnational enterprises; and the provision of capital via foreign direct investment (FDI).[21]

Having said that, it is important to add that without the European Union's aid and the international direct investments, Central and Eastern Europe would have been still near to their 1989 economic level, nearer to Ukraine, Belarus and Moldova.

However, with labor costs gradually increasing and the competition of lower-cost Asian emerging markets becoming stronger, 'those comparative advantages may disappear. Moving up the value chain and towards more knowledge-intensive sectors (the natural market niche for higher income countries) requires improving competitiveness, and higher spending on research and better education.'[22]

The relative progress of Central Eastern Europe was not only the outcome of foreign economic advance and domination in the region, but also of the huge inflow of aid from the European Union. In recent years the media enthusiastically praised Poland, the only European country that was not hit by the 2008 crisis and which made the best progress in the region. Almost never mentioned, however, is the fact that a great factor of this success is the extraordinary assistance of the European Union. On 5 October 2014, the New York Times reported that Poland, a country with a 2013 GDP of $518 billion, would receive a total of $318 billion of EU aid in the period between 2008 and 2020.[23] This is more than two times the modern-day value of the Marshall Plan. While the annual average of the Marshall Plan for four years accorded to each recipient country was $2.5 billion, Poland will have been receiving $26.5 billion per year by 2020. This amount far surpasses the Marshall aid even for the most privileged recipients, Great Britain and France. These two countries received about 43 per cent of the total aid package for 16 countries, that is, roughly $30 billion in 2014 dollar value for four years and less than $8 billion per year. In the last decade, the 'backward' regions of the EU, Central and Eastern Europe included, received an amount of EU aid 14 times greater than that provided by the historical Marshall Plan. This gracious assistance provided an additional 5–7 per cent to these countries' GDP per year. Poland, the main recipient, which got 25 per cent of the total EU aid for backward regions of the Community, itself gained about one-and-half times more than all of the 16 Marshall Plan recipients put together. But Poland was not alone. While Hungary's prime minister Viktor Orbán has declared at mass rallies that 'we won't be colonies

21 A. Nölke and A. Vliegenhart, 'Enlarging the Varieties of Capitalism: The Emergence of Dependent Market Economies in East-Central Europe,' *World Politics*, 61, 4 (2009), 672. Similarly, Lawrence King described Central and East European countries as examples of 'liberal dependent post-communist capitalism.' See L. King, 'Central European Capitalism in Comparative Perspective,' in Hancke, Rhodes and Thatcher (eds), *Beyond Varieties of Capitalism*, 309.

22 M. Dabrowski, Central and Eastern Europe: Uncertain Prospects of economic convergence (10 December 2014).

23 *New York Times* (5 October 2014).

[of the EU],' he had no qualms about signing a 2014–20 budget agreement with the EU that will provide nearly $40 billion of aid for Hungary, a country with an annual GDP of $125 billion.

Thus, foreign capital inflow and European Union aid play a major role in advancing the economies of the less developed Central and Eastern Europe. The domestic base is still weak and requires further advancement. Small and medium size companies employ 50 per cent of the labor force in the average of the European Union. In the Mediterranean region this figure is between 60 and 80 per cent. In Central and Eastern Europe, even the best cases such as Poland, Hungary and Slovenia, this sector of the economy employs only 20 per cent of the workforce. In most other countries this figure is only the minimal 10 per cent. The lack of strong domestic small and medium size companies is a major weakness of the region.[24] Western economic progress is heavily based on that sector.

It will be quite some time before Central and Eastern Europe can be considered as economically 'normal' and close to their Western neighbors. Hence, we can speak only about the first chapter of transformation, the systemic change within the framework of the European Union. A second main and definitely much longer chapter of this process is the foundation of the domestically based intensive growth rather than importing capital, knowledge and technology, carried by multinational companies. This development that will create an economically 'normal' Central and Eastern Europe that is really near to their Western neighbors may take several further decades, and it is likely to succeed in only some countries of the region.[25]

In the 25 years since the fall of the Berlin Wall, many Central and Eastern European countries have managed to significantly strengthen their nascent democracies. [26] According to Freedom House's *Nations in Transit* 2014 report[27], eight of these countries are 'consolidated democracies.' Only three of the 11 EU member states from the region (Bulgaria, Romania, and Croatia) are not a part of this group and, together with two other ex-Yugoslav republics, Serbia and Montenegro, form a second group of 'semi-consolidated democracies.' For many observers, this trend of consolidation has signaled the ultimate victory of democracy and rule of law over the legacy of totalitarianism.

However, a closer look at the same report also reveals a more disturbing trend: it shows that the ratings of countries that joined the EU in 2004 and 2007 have

24 D. Dyker, *Catching Up and Falling Behind: Post-Communist Transformation in Historical Perspective* (London 2004), 308–9.

25 I. Berend, 'Central and Eastern Europe in the Word Economy: Past and Prospects,' *Development and Finance*, 1 (2011), 2; N. Crafts, 'The World Economy in the 1990s: A Long-Run Perspective,' in P.W. Rhode and G. Toniolo (eds), *The Global Economy in the 1990s: A Long Term Perspective* (Cambridge 2006), 40.

26 This section builds on B. Bugaric, 'A Crisis of Constitutional Democracy in Post-Communist Europe: 'Lands In-between' Democracy and Authoritarianism,' *International Journal of Constitutional Law (I-CON)*, 13, 1 (2015), 219–45.

27 Freedom House, Nations In Transit 2014 Report; Eurasia's Rupture with Democracy available at: https://freedomhouse.org/sites/default/files/NIT2014%20booklet_WEBSITE.pdf (accessed 25 August 2015).

declined, rather than improved, since accession. Furthermore, without significant changes in Hungary, which at the moment seem quite unlikely, Hungary will be the first country to be expelled from the category of consolidated democracies. In their overview of the state of democracy in the region, Jacques Rupnik and Jan Zielonka point to the fact that when CEE joined the European Union in 2004—7, they were proclaimed to be consolidated democracies with 'seemingly workable constitutions, administrations, and markets,' whereas nowadays they 'are seen as particularly vulnerable and susceptible to a dictatorial turn.'[28] Moreover, Jan Werner Müller argues that in CEE 'something new is emerging: a form of illiberal democracy in which political parties try to capture the state for either ideological purposes or, more prosaically, economic gains.'[29] He points to an alarming similarity of these new forms of 'democracy' with Putin's 'managed' democracy:

> Like Moscow, the governments of these countries are careful to maintain their democratic facades by holding regular elections. But their leaders have tried to systematically dismantle institutional checks and balances, making real turnovers in power increasingly difficult.

At the moment, the Hungarian version of 'illiberal democracy' represents the most problematic example of this trend. The Fidesz government achieved a fundamental revision of the rules of the constitutional and political order in Hungary. In only four years (from 2010 to 2014) it managed to transform Hungary from one of the success stories of the transition from socialism to democracy into a semi-authoritarian regime based on an illiberal constitutional order by systematically dismantling checks and balances and thereby undermining the rule of law. Such a 'constitutional revolution' produced a nominally democratic constitution, but, as Miklós Bánkuti, Gábor Halmai and Kim Lane Scheppele argue, Hungary 'can no longer be described substantively as a republican state governed by the rule of law.'[30] The major 'deficiency' of the new constitutional structure is that it vests so much power in the centralized executive that no real checks and balances exist to restrain this power.[31]

The European Union is thus facing a unique historical situation: a political club of democratic regimes established primarily to promote peace and prosperity in post-Second World War Europe is confronted with the first EU member state ever sliding into an authoritarian illiberal political regime. While the Commission has launched several separate infringement procedures against Hungary, it has failed, together with other EU institutions, to utilize the most powerful weapon, the use of

28 J. Rupnik and J. Zielonka, 'Introduction: The State of Democracy 20 Years on: Domestic and External Factors,' *East European Politics and Societies and Cultures*, 27, 1 (2013), 21.

29 Müller, 'Eastern Europe Goes South,' 15.

30 M. Bánkuti, G. Halmai and K. Lane Scheppele, 'From Separation of Powers to a Government Without Checks: Hungary's Old and New Constitution,' in G.A. Töth (ed.), *Constitution for a Disunited Nation: On Hungary's 2011 Fundamental Law* (Budapest 2012), 268.

31 Ibid.

Article 7 TEU.[32] When the European parliament attempted to take action against Hungary, it became apparent that EU officials and MEPs are internally divided over the priority and severity of the situation. Namely, the largest party in the European Parliament, the European People's Party, the center right bloc in the EP, opposed the proposal.[33] But the strongest critique of the new Hungarian constitutional order so far came from the Tavares report adopted in the European Parliament in July 2013. The Tavares Report harshly criticizes the state of fundamental rights in Hungary and it recommends the setting up of an independent mechanism to follow the development of fundamental rights in Hungary.

Slovenia, another example of the 'success stories' of the transition, is experiencing its biggest constitutional and political crisis since its independence in 1991. The Slovenian transition model, which has been hailed as the most 'balanced and inclusive' form of transition,[34] is currently facing a simultaneous economic and political crisis.[35] As it turned out, both gradualism and consequent 'soft' transition had a strong negative side effect. The chosen path of soft transition or gradualism 'was strongly connected with the high reproduction of elites, which means that the majority of the old – partially already "modernized and reformed" – communist elites managed to retain their positions in the new social circumstances.'[36] This in turn led to 'long-term malignant effects, including the establishment of monopolies and rent-seeking behavior.'[37] This aspect, which had previously been shrouded, became apparent to the public after the eruption of the economic crisis in Slovenia in 2010.

The capture of the state by various political and informal groups has progressed to such a dramatic extent that it is undermining the independence and credibility of almost all rule-of-law institutions in the country, with the exception of the Constitutional Court. Formal democratic rules and institutions often operate in the shadow of informal networks and practices. A myriad of interest groups, political parties and individuals use these networks and practices to extract resources from the state. One of the most troubling aspects revealed by the economic crisis is the ease with which the politically installed managers of public enterprises, banks, insurance companies, public universities, and the national broadcaster distribute money and other non-pecuniary gains (jobs, privileges) to their political friends, relatives, etc. Quite often, this extraction of public resources was carried out to the letter of the law, but in sharp contrast to its spirit. In other words, public

32 Often described as the 'nuclear option,' Article 7 of TEU empowers the Council, if it finds the existence of a serious and persistent breach of EU values by a member state, to suspend certain rights of the member state.

33 The ruling Fidesz party is a member of this bloc.

34 D. Bohle, B. Greskovits, 'Capitalist Diversity in Eastern Europe,' *Economic Sociology*, 8, 2 (2007), 4.

35 I. Guardiancich, 'The Uncertain Future of Slovenian Exceptionalism,' *East European Politics and Societies and Cultures,* 26, 2 (2012), 380–99.

36 F. Adam, P. Kristan and M. Tomšič, 'Varieties of Capitalism in Eastern Europe (with special emphasis on Estonia and Slovenia),' *Communist and Post-Communist Studies*, 42 (2009), 78.

37 Ibid., 71.

procurement, state aid, loans and employment practices usually adhere to formal rules, but the factual meaning of these rules is informally re-interpreted in the shadow of informal practices.

The reality behind Slovenia's supposed 'smooth transition'[38] reveals many 'structural weaknesses of Slovenian model of socio-economic regulation that led to development of its version of 'crony-capitalism' characterized by entanglement of the political and business elite.'[39] The thorough politicization and informal subversion of these institutions leaves constitutional democracy in Slovenia incomplete and vulnerable at a time of democratic recession and financial crisis in the Eurozone. At the very moment the rule of law is most needed as a legal 'immune system' to protect constitutional democracy, it is either unavailable or under strain.

As Abby Innes argues, the problem of state capture is pervasive in the entire region.[40] Even the Czech Republic is not completely exempt from this trend. She points to the recent data on public procurement compiled by three doctoral students from Charles University (Zindex). Namely, the Zindex reveals a systemic nature of state capture by various party-political groups in the Czech Republic. As the Economist reports, the Zindex of public procurement shows:

> that 67% of the €13.7billion ($19 billion) spent between 2006 and 2010 is not tracked in the government's official procurement database. About 14% of all tenders during that period (worth some €2 billion) only had one bidder, and none meet the criteria of the OECD and the Regional Development Ministry.[41]

According to Jiri Pehe, former chief of Vaclav Havel's cabinet, the country suffers from rampant corruption, weak and inefficient state bureaucracy, and political instability.[42]

As these examples of democratic regression into various forms of 'illiberal democracy' and state capture in Central and Eastern Europe show, democratic consolidation is still far from complete. The most disturbing detail is the vulnerability of 'consolidated democracies' such as Hungary or Slovenia to 'democratic regression,' which reminds us that democracies are inherently unable to be 'definitely established.'[43] While significant progress in the development of 'electoral

38 A. Bebler, 'Slovenia's Smooth Transition,' *Journal of Democracy*, 13, 1, 127–40 (2002).
39 M. Tomšič and L. Prijon, 'Ideological Profile and Crisis Discourse of Slovenian Elites,' Paper prepared for the 8th Pan-European Conference on International Relations, September 2013, Warsaw, Poland, available at: http://www.eisa-net.org/be-bruga/eisa/files/events/warsaw2013/Tomsic%20Prijon_Ideological%20Profile%20and%20Crisis%20Discourse%20of%20Slovenian%20-Elites.pdf (accessed 25 August 2015).
40 A. Innes, 'The Political Economy of State Capture in Central Europe,' *Journal of Common Market Studies*, 52, 1 (2014), 88.
41 'Czech politics, State Capture,' *The Economist* (2 November 2011).
42 J. Pehe, 'The Czech Republic and the EU: Democracy without Democrats,' *Huffington Post* 6 October 2014 available at: http://www.huffingtonpost.com/jiri-pehe/czech-republic-democracy_b_5479764.html (accessed 25 August 2015).
43 Rupnik and Zielonka, 'The State of Democracy 20 Years on,' 21.

democracy' in the region has been achieved, 'liberal democracy' still remains fragile and weak. Here liberal democracy is understood as a political system marked not only by free and fair elections, but also by the rule of law, the separation of powers and the protection of basic freedoms. Moreover, the legal institutions of liberal democracy in CEE countries significantly differ from those of their Western European counterparts. Behind a facade of harmonized legal rules transposed from various EU legal sources, several cracks have begun to appear, exposing the fragility of constitutional democracy in these countries. Several recent studies emphasize this aspect and argue that formal democratic institutions operate 'in the shadow of informal networks' which undermine formal law and institutions.

The discrepancy between the form and substance of liberal democracy in this part of the world should come as no surprise. The work of Ivan Berend shows that Central and Eastern Europe is home to a continuing pattern of 'forms without substance.'[44] The region has witnessed a series of unsuccessful attempts to emulate Western European democratic institutions which often resulted in legal forms devoid of real substance. Those who expected that a decade of 'EU accession' would lead to an irreversible break with the totalitarian past were simply naïve. They forgot that institutions of liberal democracy cannot be created overnight. Developing liberal democracy requires not only a longer time frame, but also continuous support from citizens. This last aspect has proven to be particularly troublesome, and has to a large extent been responsible for the 'partial' democratic consolidation in the region.

Modernization of state institutions in CEE countries was not a key policy priority during the initial stage of the transition. Given the anti-statist bias prevalent among the reformers of that time, this is not surprising. It is only during the accession negotiations with the EU that administrative reforms became an important item on the policy agenda of the CEE governments. Furthermore, state modernization in the region was not only delayed but also badly designed. Many reforms in the region are examples of what Matt Andrews, Lant Pritchett, and Michael Woolcock describe as 'isomorphic mimicry' – that is, reforms copying the forms of Western institutions but without their substance.[45] Such emphasis on the forms of Western institutions was a direct corollary of the dominant transition paradigm of the time, the Washington Consensus, and its insistence that a single set of most appropriate institutions – rule of law being one of them – is required for successful development. As a result, the reformers in the region too often neglected the importance of the 'homegrown development' and the need to adapt Western models to local conditions and needs. As William Easterly forcefully argues in *The White Man's Burden*, 'the great bulk of development success in the Rest comes from self-reliant, exploratory efforts, and the borrowing of ideas, institutions and

44 I.T. Berend, *Decades of Crisis: Central and Eastern Europe Before World War II* (Berkeley, CA 1998), 10, 300–1.

45 M. Andrews, L. Pritchett, and M. Woolcock, 'Escaping Capability Traps through Problem-Driven Iterative Adaptation (PDIA),' Working Paper 299, Center for Global Development (Washington, DC 2012), 12.

technology from the West when it suits the Rest to do so.'[46] Many state institutions created during the last 25 years need further reforms. It is time for real democratic deliberation and experimentation, which could usher in much needed institutional reforms in the region. In order to improve the institutional framework, we must not start from some idealized 'best model,' but from the existing context in which these institutions function. New institutions in CEE may in the end resemble their Western models. But what is more important is that they actually work well for CEE, even if they look different to their Western counterparts. This is probably one of the most important insights to be derived from a critical overview of the post-communist transition.

The transformation of most of the region was characterized by exaggerated nationalism. Civil wars erupted in regions from Yugoslavia to Moldova and the Ukraine. In 1989, the region comprised eight countries; today, there are 28, many of them with explosive border problems. Most unfortunately, even episodes of right-wing nationalism such as those of the Mečiars in Slovakia and the Kaczynskis in Poland are not solely a thing of the past. As Irena Grudzinska-Gross argues, Poland, Hungary and other countries in the region witness the revival of 'of the very old conservative style of politics, including the resurrection of the extreme right-wing movements and, in Poland, of religious fundamentalism.'[47]

Xenophobic nationalism in Central and Eastern Europe has, like a dangerous virus, spread throughout the region. Hungary, again, is leading the trend. After Victor Orbán's speech in July last year in Tusnadfurdo, it became more than clear that he wants to create an illiberal state, a different kind of constitutional order from liberal democracy. In his speech, he denounced a decadent and money-based West and out outlined a future Hungarian state, based on 'a work based society... of a non-liberal nature.'[48] Orbán's government is implementing many questionable policies inspired by the right-wing extremist Jobbik party. For example, the Roma minority was 'forced' to perform volunteer work and allow their living spaces to be inspected for orderliness in order to receive social assistance payments.[49] Furthermore, as a concession to Roma-haters, the rights of paramilitary organizations have been strengthened.[50] A virulent form of hate speech directed at the Roma and Jewish minorities has become an almost daily routine in Budapest these days. There are even reports of physical violence against the Roma and outbursts of antisemitic statements requiring all Jews living in Hungary to be

46 W. Easterly (2006) *The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good* (London 2006), 363.
47 Grudzinska-Gros, 'The Backsliding,' 664.
48 K. Edy, 'EU urged to monitor Hungary as Orbán hits at "liberal democracy",' *Financial Times* (30 July 2014).
49 K. Verseck, 'Hungarian Leader Adopts Policies of Far-Right,' Der Spiegel (30 January 2013), available at: http://www.spiegel.de/international/europe/ruling-hungarian-fidesz-party-adopts-policies-of-far-right-jobbik-party-a-880590.html (accessed 25 August 2015).
50 Ibid.

registered and then evaluated for the potential danger to Hungary.[51] Several prominent intellectuals, close to Fidesz, endorse the works of antisemitic writers from the interwar period.[52] Jacques Rupnik sees a worrisome resemblance between Orbán's rhetoric and the pre-communist authoritarian regime of Miklós Horthy. Key features of these pre-communist traditions include strong antisemitism, anti-Bolshevism and an obsession with the Trianon trauma which cost Hungary more than two thirds of its land and a third of its people. Imre Kertézs, a Nobel laureate, thinks that there are many parallels between the situation in the 1930s and the present situation. Kim Lane Scheppele offers another poignant observation of the current Hungarian political situation: the Fidesz government does not jail its opponents, it does not ban free travel, but it does punish political dissent, fire members of the political opposition from state sector jobs and intimidate the families of critical journalists. Even if it is not yet a full-blown authoritarian regime, the negative effects of the new constitutional order are real and show strong signs of a slide into authoritarianism.[53]

As a consequence, CEE countries are once again displaying certain features of 'lands in between' which call attention to their constantly precarious and indeterminate location on the political map of Europe. *Zwischen-Europa*, as some interwar German writers called it, lies in the territory between the West and the Russian East and is said to have been the 'unfinished part of Europe' for most of the twentieth century.[54] Hence, we fully agree with Ivo Banac, who argues that:

> there are no guarantees that the region has succeeded in effecting a permanent transformation of its societies in a more democratic and economically progressive direction. Slippages are possible and, as in 1989, much depends on the developments in Russia and the West. Unfortunately, in both cases, the overall situation is significantly worse than it was twenty-five years ago. That is the real balance a quarter century later.[55]

Moreover, if normality implies the rule of law, prosperity, stability, and security, 25 years after the fall of the Berlin wall much of East Central Europe is not yet 'normal.'[56] There is nothing surprising in this situation. The region's past history still penetrates the present. Past-dependence is a major historical force. In reality, Central and Eastern Europe could not just return to, or re-unite with Europe, because during its entire history it was not an equal part of it. The region's history started half a millennium later than that of the Western half of the continent. Nation building was not a finished process even at the end of the twentieth century

51 N. Berend and C. Clark, 'Not Just A Phase,' *London Review of Books*, 36, 22 (20 November 2014).
52 Ibid.
53 K.L. Scheppele, 'Goulash Post-Communism,' *NewsNet, News of the Association for Slavic, East European, and Eurasian Studies*, 52, 3 (June 2012), 3–4.
54 Berend, 'What is Central Europe?,' 402–3.
55 Banac, 'Twenty-Five Years After the Fall of the Berlin Wall,' 655.
56 Ibid.

as demonstrated by the desintegration of several multi-ethnic countries and the formation of several new states. Xenophobic nationalism is still a major phenomenon here. The societies, unlike in the West, were uneducated peasant societies until 'yesteryear.' Middle class and entrepreneurial traditions are very weak. These latter layers were mostly Germans and Jews who eventually disappeared at the end of the war. Cultural and behavioral patterns are creating major road-blocks to successful and rapid transfromation. The elite was always closely connected to the state and enjoyed major privileges. The tradition of paternalistic state and deeply corrupt social-behavioral patterns are still there.

Nevertheless, the legacy of the past only partially explains the current malaise. As we have tried to show in this article, it was almost an uncritical adoption of foreign institutional models and best practices which crucially contributed to failed institutional reforms and policies in the region. CEE, like any other developing countries, cannot just imitate international best practices but need 'second- best' solutions and institutions that take into account context-specific market and government failures that cannot be removed in short order. As such, they promise a more effective institutional framework conducive for economic development than 'best-practice' institutions, which are 'almost by definition, not contextual and do not take account of these complications.'[57] Instead of blindly copying 'first-best institutions' from the rich industrial economies, developing economies should be encouraged to experiment with various forms of institutional configurations most likely to advance and promote their development. Most fundamentally, there is no development without developmental strategies indigenously created by developing countries themselves. For the last four decades, the development agenda was generated primarily in the developed world for implementation primarily in the developing world. Yet many of the most pressing problems are political economy obstacles that require local knowledge of who benefits and loses from reform, and ultimately a political solution. The World Bank and other international donors are not well-positioned to address these types of local political contests, in some cases, because of limited mandates, in other cases because of the lack of local knowledge and other financial and institutional limitations. Accordingly, ready-made models of legal texts, political institutions or economic policies must yield to a more dialogical approach based on context-specific discussions between the donors and the recipients of developmental aid. Although the developed world and international institutions will remain important sources for development advice and financial aid, actual configuration of appropriate development models will have to be done at home, in the periphery.

But, at the same time, it is important to emphasize that a quarter-century, a single generation, is not a long period of time in terms of radical social-cultural transformation, state building, promoting democracy, and economic development. For example, it took the United States of America more than 40 years to eliminate

57 D. Rodrik, 'Second-Best Institutions,' *American Economic Review: Papers & Proceedings*, 98, 2 (2008).

partronage at the federal level. State building is hard work, and it takes a long time to accomplish. Hence, even though if CEE countries are not yet 'normal,' the development they undertook from 1989 was 'normal,' if viewed from a long term historical perspective.

In the early 1990s at one of the conferences, most of the participants expressed their firm belief in the region's fast catching up with the West. One of the colleagues, however, used a biblical metaphor to issue a warning: Moses led his people for 40 years in the desert because for the new life in the Promised Land generational changes are needed. Indeed, to catch up depends not only on free market and enterprise, free flow of capital and investment, but also on major social-behavioral-moral transformation as well. Central and Eastern Europe is still crossing the desert.

Biographical Notes

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