

# Chapter 1

## Institutional Reform and Export Competitiveness of Central and Eastern European Economies

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### ABSTRACT

*Following their political and economic independence in 1989, a group of ten Central and Eastern European countries (CEEs) embarked on major institutional reforms to modernise their economies in order to become an integral part of the global economy. This chapter provides an overview of the main institutional reforms undertaken in the CEEs and their effects on export competitiveness. The chapter focuses on selected meso and macro institutional reforms, namely price liberalisation, competition policy, trade and foreign exchange, privatisation, and corporate governance. The results show that institutional reforms in the CEEs were rapid and generally successful. All CEEs became members of the European Union (EU) and the World Trade Organization (WTO). Institutional reforms contributed significantly to improved efficiency and growth in the export sector. The results also suggest that further reforms are needed to improve competition policy and corporate governance, both of which are still below the standards found in Western industrialised countries.*

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## **INTRODUCTION**

The collapse of the Soviet Union in 1991 and the enlargement of the EU are two historical landmarks that have reshaped the European business, political and geographic landscapes of the twenty-first century. Of major significance is the admission of ten former socialist-based, centrally planned economies of the CEE to the EU. The CEEs comprise Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia. Since gaining independence (see the dates in Table 1), the CEEs have embarked on comprehensive economic restructuring and institutional reforms, in order to modernise their economies and improve the standards of living of their citizens. Some CEEs have approached these reforms in a gradual manner, while others have pursued a ‘big bang’ strategy (Bjørnskov & Potrafke, 2011). The different approaches to economic restructuring and institutional reforms can be explained largely by the physical, demographic and socioeconomic diversity of the CEE economies. The information in Table 1 shows that some of the CEEs are large economies (e.g., Poland, which has 40 million people) while others are very small (e.g., Estonia, which has only 1.4 million people). Similarly, the rate of economic growth varies significantly in the CEEs while their geographic size, in terms of land mass, also varies substantially. In terms of income, the CEEs can be broadly categorised into three distinct groups: low income (Bulgaria and Romania); middle income (Estonia, Hungary, Latvia, Lithuania, Poland) and high income (the Czech Republic, the Slovak Republic and Slovenia). Despite being members of the EU, only three countries (Estonia, the Slovak Republic and Slovenia) have adopted the euro as of July 2013. Finally, the CEEs also vary substantially in terms of their overall international competitiveness rankings. According to the World Economic Forum’s global competitiveness ranking of 144 countries in 2012–13 (see Table 1), Estonia (34<sup>th</sup>) was the most highly ranked CEE country, while Romania was ranked as the least competitive CEE country (78<sup>th</sup>). It is also interesting to note that between 2006 and 2012 only two CEEs (Bulgaria and Poland) improved their world competitiveness rankings. Hence, given the diversity of the CEEs, the challenges they face in modernising their economies following their independence are uniquely different and require different approaches (Bjørnskov & Potrafke, 2011).

Institutional reforms in the CEEs have attracted the attention of scholars from diverse research fields. Early research was generally concerned with socioeconomic conditions, historical institutional legacies, factors leading to the transformation or modification of domestic institutions (e.g., Bornstein, 1997; de Souza & Lundell, 1993; Swaan, 1997). The focus of the early research reflects the reform priorities in the early years of establishment of the CEE block to establish a politically stable membership with strong market-based economies capable of generating jobs and wealth for their citizens. However, in more recent years, the CEEs have

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