

Introductory remarks

30 years of transition: united in diversity

Letná Plain in Prague is one of quite a few mesmerizing places in the Czech Republic's capital. From the top of a hill, it overlooks the city's historical center, its romantic bridges spanning across the Vltava river and the majestic Prague castle. But it is quite a symbolic site, too. It used to be the site of the world's biggest Stalin monument and used to host mass parades celebrating the communist regime. Then, however, at the end of November 1989, at least three-quarters of a million people gathered there to demonstrate against that same communist regime and to call for political and economic freedom. The communist party's rule collapsed under the mass protests soon thereafter. With a touch of historical irony, in the following years Letná Plain hosted the pope and major rock stars before, at the end of June 2019, it witnessed the biggest mass demonstration since the fall of communism. Reportedly, at least one-quarter of a million people came together in a city that has become one of the richest regions in the European Union – a prime example of highly successful economic transition – to express their dissatisfaction with political developments in their country. Hence, Letná Plain is a place that symbolizes, in a nutshell, the long way countries in Central, Eastern and Southeastern Europe (CESEE) have come over the last thirty years both politically and economically, while also representing some of the challenges they are facing today.

30 years ago, in line with the developments in what was then Czechoslovakia, people throughout the entire former Eastern bloc rose up against their governing authoritarian regimes and thereby helped bring down the Iron Curtain and terminate the long-lasting division of the European continent. Thus began a long and difficult – for many unexpectedly long and difficult – journey of transition from totalitarian states with centrally planned, controlled and mostly state-owned economies to modern liberal democracies and market economies. This unprecedented metamorphosis was paralleled by a process of European reunification, which peaked in three Eastern enlargement rounds of the European Union. As a result, 11 former Eastern bloc countries are united today with their once bitter ideological opponents under one European flag. While being emancipated and self-confident partners with their own views and interests, they share equal democratic, legal, institutional and economic values and principles, partially also under the umbrella of a common currency. Moreover, also for countries which are not yet members of the European Union, the EU constitutes a crucial anchor stabilizing them as they proceed on their transformation path.

Buttressed by European integration and (prospective) EU membership, the economic transition the CESEE countries had to undergo spurred an unparalleled process of social, political and economic overhaul and convergence in the region. After an initial economic shock marked by, inter alia, deep recessions, massive price increases and unemployment, the countries' intrinsic strengths came to the fore as state-owned industries were privatized and reforms were implemented. The capital and foreign investment thus attracted improved productivity and competitiveness which, in turn, boosted economic growth. As a result, up until the onset of the global financial crisis, the CESEE economies established a record of significant growth and economic progress.

But it has to be stressed that not just the CESEE countries have benefited from the fall of the Iron Curtain and the ensuing integration of the region into European structures, trade linkages and value chains. Western European countries have profited a great deal, too. Particularly Austria has managed to make use of its strategic location in the heart of the “new” Europe and its strong historical and cultural ties with the CESEE region. As a result, Austrian businesses identified the economic potential of the CESEE region at an early stage. Not only did they expand – often as first movers – their activities into the new markets but in many instances, especially in the banking sector, they developed into key players in these markets, and the CESEE region, in turn, became a significant contributor to Austrian firms' profits.

The boon of the ever-closer trade and financial linkages with Western Europe turned into a bane for the CESEE region during the economic and financial crisis that broke out a bit more than a decade ago. The economic shock quickly spilled over and harshly hit most of the CESEE countries despite their heterogeneity. Countries where the strong, in several instances excessive, pre-crisis expansion had been driven by unsustainable levels of consumption and borrowing were affected in particular. As growth slackened in the aftermath of the crisis, economic convergence temporarily slowed down as well. While it has to be highly acknowledged that, overall, the CESEE countries have caught up impressively to Western European income levels over the last thirty years, partially substantial income gaps still persist. Following unsustainable growth rates just prior to the crisis, average real GDP growth in CESEE has since more than halved, even though the growth momentum has picked up somewhat recently. In addition to lower total factor productivity and investment, adverse demographic developments in CESEE are likely to strongly limit potential growth in the future. Hence, CESEE's growth differential vis-à-vis the euro area has become smaller – despite remaining positive – in recent years. Against this background, it is one of the key challenges for the CESEE countries to kick-start convergence by spurring their potential growth. Related efforts should focus particularly on investment in infrastructure, human and physical capital endowment and innovation aimed at productivity improvements but also on improving the institutional, legal and business environment.

This special issue of the OeNB's Focus on European Economic Integration (FEEI) pays tribute to the impressive historic events and developments in CESEE of the last 30 years. It collects contributions by distinguished experts from outside and inside the OeNB who have kept a close eye on the region throughout transition. The present issue thus represents the OeNB's strategic CESEE research focus as well as its close cooperation with experts from, and on, the region that the OeNB has developed since the early 1990s. The topics covered in this publication are diverse. Peter Backé and Doris Ritzberger-Grünwald, together with guest authors Iikka Korhonen and Laura Solanko, review transformation strategies and experiences as well as public perceptions of transition outcomes across countries. They also highlight the EU's important anchoring role in the transition process. They briefly present the CESEE-related analysis and research work of the OeNB and the Bank of Finland and their research cooperation in this field. Michael Landesmann was invited to provide an overview of 30 years of East-West integration in Europe, reflecting on lessons learned and challenges ahead. He covers, inter alia, issues related to the economics of transition after 1989, institutional and economic catching-up as well as trade and production integration. He also discusses reform reversals and the political regression we see in some CESEE countries today. Specifically, he voices concerns about the development of "illiberal democracies" and the rise of populist forces in the EU as a whole and in CESEE in particular. From a comparative perspective, Philipp Ther's guest contribution focuses on the economic reforms in CESEE and in Germany, the challenges of German unification and the "price" of German unity. Like Landesmann, Ther concludes that one of the consequences of the neoliberal reforms has been the rise of right-wing populist parties in Germany and in some CESEE countries. This issue also presents two pieces of current OeNB research, the first of which has resulted from a research cooperation with the Bank of Albania. In their study, Elona Dushku, Antje Hildebrandt and Erjona Suljoti find that banks' exposure to the housing market has a positive and significant impact on bank stability. Of course, in this context one has to be aware of the problem caused by excessive bank lending denominated in foreign currency. Finally, Thomas Scheiber investigates the use of euro cash in CESEE and the role of expectations about euro adoption. Based on OeNB Euro Survey data, he finds that euro cash holdings are widespread in some CESEE countries and that they are positively affected by people's expectations of euro adoption.

Looking ahead, it is key to sustain our commitment to the region against the background of current economic and political developments in CESEE and to stick to the values and principles laid out in the EU treaties. In particular, we should always keep the European Union's official motto in mind and remain united in diversity. If we do so, I am positive that the success story of the past decades will continue for many years to come. And I hope that mesmerizing places in CESEE like Letná Plain will see people gathering to listen to rock stars or the pope rather than to express their discontent and to call for a change.

A handwritten signature in black ink, appearing to read 'Ewald Nowotny', written in a cursive style.

Ewald Nowotny, Governor