

THE FALL OF THE BERLIN WALL: TWENTY YEARS OF REFORM IN CENTRAL AND EASTERN EUROPE

COMMENTARY BY

Aleksandr Shkolnikov* & Anna Nadgrodkiewicz**

Abstract

Reflecting upon transition twenty years after the fall of the Berlin Wall yields important lessons about the challenges of establishing democracies and market economies. Neither appears overnight; both require difficult and often unpopular reforms in order to create inclusive and responsive institutions of governance and business. The outcomes of the systemic transition in Central and Eastern Europe are undoubtedly impressive but vary greatly, and even the most successful countries continue to struggle with corruption, delayed reforms of key economic sectors, and disillusionment and lingering nostalgia among their populations. In order for the region's democracies to deliver growth and prosperity, their democratic and market institutions must become more representative and inclusive so that a genuine public-private dialogue can lead to concrete reforms. Local civil societies and business communities are crucial agents of this process, providing grassroots input into policymaking and bringing substance to the region's democratic development.

Keywords: *Central and Eastern Europe, the fall of the Berlin Wall, democracy, market economy, reforms, transition outcomes*

Introduction

Just a few months ago the world celebrated the twentieth anniversary of the fall of the Berlin Wall. There have been many reflections on the significance of the night of November 9, 1989, when the symbol of Europe's division was torn down by the very people it divided – without a

* **Dr. Aleksandr Shkolnikov** is the Director for Policy Reform at the Center for International Private Enterprise (CIPE) in Washington, D.C., where he manages a variety of programs on corporate governance, anti-corruption, democratic development, and business association advocacy. A native of Moscow, Russia, Shkolnikov holds a Ph.D. in economics, a master's degree in international commerce and policy, and a bachelor's degree in marketing – all from George Mason University in Fairfax, Virginia, US.

** **Anna Nadgrodkiewicz** is Program Officer for Global Programs at the Center for International Private Enterprise (CIPE) in Washington, D.C., where she works on projects involving transparency in public procurement, corporate citizenship, and democratic and economic reform. Prior to joining CIPE, she worked as a business consultant in her native Poland on the issues of competitiveness and market entry in Central and Eastern Europe. She holds a master's degree in German and European Studies from Georgetown University in Washington, D.C.

single shot being fired. This memorable event proved to be the turning point of a fundamental transformation. An unprecedented collapse of political and economic systems followed across the post-Communist space, fueled by expectations that democratic market economies would immediately take root.

The wave of democratization that swept through the region ushered in renewed hope for democracies worldwide. In fact, reflecting on the collapse of the authoritarian command economies, Francis Fukuyama, an American political scientist, declared a victory of liberal democracy in his now famous article on the end of history.¹ Although the failure of the command-and-control model was evident, the transition to different political and economic systems was much more difficult than anyone expected at the time. With the collapse of the Wall, the region may have achieved its negative goal of dismantling the old system, but the positive goal of building functional democracies and market economies in its place proved to be much more elusive.

The key questions to ask, twenty years after the Wall fell, revolve around whether this positive goal has indeed been achieved. Have democratic market economies taken root across Central and Eastern Europe (CEE)? Is the job of democratization complete, as the European Union (EU) membership of several former Communist countries suggests, or is there more that remains to be done? And finally, what are the major lessons of the transition?

Uneven Outcomes of Transition

There are certainly fundamental changes that have shaped the region over the past twenty years. In Central Europe, these changes were driven by the hope of EU membership, which provided a strong reform incentive to the aspiring countries and sustained the resolve of their often fragile governments. The EU enlargements in 2004 and 2007 were the fruition of long and painful structural reforms meant to solidify democratic and market institutions. As a result, the new EU members are undoubtedly night-and-day different today from the 1989 starting-point. However, the outcomes of transition are not so uniformly positive throughout the region.

As supported by many studies, including Freedom House *Nations in Transit* reports, the paths of countries in the post-Communism space clearly have been quite diverse. Countries in Eurasia, Central Asia, and the Caucasus are lagging or even regressing in terms of the quality of their democratic and market institutions as compared to their Central European or Baltic counterparts.

Outcomes of reform vary even among the new EU members. Corruption continues to wrack Bulgaria and Romania, who have recently been subjected to strong criticism from Brussels, including a decision to withhold Bulgaria's development funds. High-level scandals continue to erupt elsewhere. In Poland, for instance, there have been notorious cases of undue influence of private interests on legislation. In the Czech Republic, several Defense Ministry officials were accused of corruption in connection with commissioning overpriced public contracts. In Hungary, a scandal shook the country a few years ago when the government admitted to lying about economic indicators and governance in order to win elections.

¹ Francis Fukuyama, "The End of History?" *The National Interest*, No. 16 (Summer 1989): 3-18.

Many similar examples exist, demonstrating that corruption remains widespread even in countries that have made great strides toward solidifying their democratic and market institutions. Corruption is a deadweight loss that scares off investors, increases the cost of conducting business, and hurts economic prospects. Other problems persist as well. Many transition countries have failed to scale back their overblown public sectors, reform public finances, balance their budgets, and reduce excessive credit growth. The current global economic crisis exposed such weaknesses and hit several of the region's economies hard – such as Hungary and Latvia who had to ask for IMF bailouts.

These evident problems that remain in the region contrasted with the success of countries in joining the EU suggest that democratic consolidation is much more than a box-ticking exercise. Yes, the *acquis communautaire* compels countries to introduce and put into place the necessary regulations, but it is only the first step. Much work remains to be done in order to change perceptions, build institutions, and reform practices.

Moreover, nostalgia for the past in Central and Eastern Europe remains strong, indicating that, for large portions of the population, the new system failed to deliver expected material outcomes. A recent survey in Hungary, for example, shows that 70 percent of those who were already adults at the time when the Wall fell are disappointed with the change of the political system.² A similar survey in Bulgaria suggests that 60 percent of the people think they lived better under Communism.³ In Poland, 44 percent of people think positively of the former Communist rule, with the numbers even higher (54 percent) among the elderly.⁴

A recent Pew Global Attitudes Project⁵ survey highlights the evident weakness of many key democratic institutions in CEE by providing interesting insights into the mood of its citizens. For instance, while there is a clear popular desire for democratic values and institutions (in Bulgaria 81 percent say free judiciary is very important, in the Czech Republic 66 percent think free media is very important, and in Hungary 65 percent think freedom of speech is very important), overwhelming majorities of surveyed individuals do not think that such institutions function properly in their countries. In Bulgaria only 8 percent think they have a fair judiciary, in the Czech Republic only 17 percent think they have a well-functioning free media, and in Hungary only 13 percent think freedom of speech prevails. In other words, the region is seeing a significant democracy gap, i.e. the difference between people's notion of democratic values and the actual functioning – or malfunctioning – of the democracy they experience.

² CNBC, "Nostalgia for Communism, 20 Years After," November 9, 2009, <http://www.cnbc.com/id/33784324> (accessed December 7, 2009).

³ Anna Mudeva, "Special Report: In Eastern Europe, People Pine for Socialism," November 8, 2009, Reuters, <http://www.reuters.com/article/idUSTRE5A701320091108> (accessed December 31, 2009)

⁴ M&C News, "Survey: Polish opinion split over communist past," June 19, 2009, http://www.monstersandcritics.com/news/europe/news/article_1484630.php/Survey_Polish_opinion_split_over_comunist_past (accessed December 7, 2009).

⁵ Pew Global Attitudes Project, "The Pulse of Europe 2009: 20 Years After the Fall of the Berlin Wall," November 2, 2009, <http://pewglobal.org/reports/display.php?ReportID=267> (accessed December 10, 2009).

The Challenge of Building Democracies that Deliver

As much as Central and Eastern Europe has achieved, the lingering feelings of nostalgia and disillusionment are worrisome. As Hungarian economist Janos Kornai put it, [when the Berlin Wall was still standing], people “felt it a hopeless daydream that within the foreseeable future their countries would become democratic market economies. Today, however, though this has become a reality, many are disappointed and bitter.”⁶ These attitudes are shaped by the fact that it is not enough to desire democracy in the abstract, as people did in the 1980s; it is much more important to build the institutions of democratic governance and make democracy deliver for all segments of the population.

This task is not easy, although it seemed that way for many. When the Wall fell, it seemed that without the bonds of Communism, those countries would quickly achieve the same degree of democratic rule and economic prosperity for which they had long envied their Western neighbors. This understandable euphoria, however, presumed that the institutions and attitudes underlying democracies and market economies would just spring up in the absence of authoritarian restraint. That certainly has not been the case. As Zbigniew Brzezinski noted, “It is especially difficult to restructure a statist centralized economy into a functioning market system. The latter involves not only an intricate set of economic relationships but also the emergence of an entrepreneurial culture.”⁷

Whether an entrepreneurial culture has truly replaced the culture of dependence on the state remains to be seen. Certainly the results of the polls cited above indicate that older generations in particular long for the social welfare aspect of Communism, while the current global financial meltdown has undermined confidence in free markets among younger citizens. According to the World Bank, CEE is forecast to experience the deepest economic contraction among all emerging and developing regions, with GDP in Central and Eastern Europe and the Commonwealth of Independent States expected to shrink by 5 percent and 6.7 percent, respectively, in 2009.⁸ Although it was largely due to international factors outside their control that triggered it, this crisis showed that in order to stay competitive, post-Communist countries must reinvigorate much needed reforms. And in order to continue reforms, they must build and sustain public support for them through improved social dialogue and more inclusive political processes.

Democratic institutions cannot be just minimalist frameworks that engage the citizenry only during periodic elections but between them provide little opportunity for policy input. This has been the Achilles’ heel of the young CEE democracies, as polls show that parliaments and political parties are among the institutions with the lowest levels of social confidence. In a recent Eurobarometer survey, public trust in parliaments was only 20 percent in the Czech Republic, 18 percent in Poland, 15 percent in Hungary, and a mere 6 percent in Latvia – the lowest in the EU. The trust in political parties was

⁶ Janos Kornai, “The Great Transformation of Central Eastern Europe: Success and Disappointment,” Presidential Address, delivered at the 14th World Congress of the International Economic Association in Marrakech, Morocco, on August 29, 2005.

⁷ Zbigniew Brzezinski, “A Common House, a Common Home,” *New York Times*, November 15, 1989, <http://www.nytimes.com/1989/11/15/opinion/a-common-house-a-common-home.html?scp=3&sq=communist+transition&st=nyt> (accessed December 10, 2009).

⁸ Pradeep Mitra, Marcelo Selowsky, and Juan Zalduendo, *Turmoil at Twenty: Recession, Recovery, and Reform in Central and Eastern Europe and in the Former Soviet Union* (Washington, DC: The World Bank, 2010), 1.

even lower, with Estonia's 16 percent (highest among the new EU states), 15 percent in the Czech Republic, 12 percent in Poland and Romania, 10 percent in Hungary, and 5 percent in Latvia.⁹

Similarly, a market economy cannot exist in its full form if it is tainted by corruption and cronyism. Despite progress, governments in the region still too often pick economic winners and losers and fail to create business environments that would effectively foster entrepreneurship. This interdependency between economic and political reforms points to the fact that democracies and market economies are intrinsically linked, because democracies need well-functioning markets to deliver and market economies, in turn, need democracies to provide the right economic policies. That is why political and economic reforms should not be considered in isolation from each other. The transition process showed that if these reforms are to deliver expected results, they must be pursued in tandem.

Lessons Learned from Transition

There are several lessons that stand out from successful political and economic transitions of the past twenty years. These are particularly relevant for countries that have not sufficiently moved forward in shaking off the institutions of the old system, and still boast largely uncompetitive political environments, weak economies, and poor policy development and implementation.

The need to implement often painful and politically unpopular but necessary reforms

Much of the debate on transition has focused on “shock therapy vs. gradualism.” Proponents of shock therapy argued that swift economic reforms on all fronts were needed, while proponents of a gradual approach suggested more restrained measures with minimized impact on the population. Analyses on transitions have largely exposed the fallacy of this debate, showing that both approaches can be relevant, and that the choice of either one depends on the unique set of country conditions. In other words, what is good for Poland may not necessarily be good for Hungary, and vice versa.

However, what did become clear is that regardless of the reform approach – shock therapy or gradualism – the politics of economic reform matter. It is not enough to develop economic solutions to economic problems – countries must also solve the political barriers to implementing such solutions. One such barrier, with the introduction of competitive elections, is politicians' fear of losing popularity and re-elections.

Perhaps the best example of a reformer who has been able to overcome these barriers is Leszek Balcerowicz, known for pushing through his plan of rapid economic reforms in Poland in the early 1990s. The plan introduced a number of measures, such as the liberalization of exchange rates and prices, which were implemented all at the same time with a significant impact on the country's socio-economic conditions. Although the reforms were unpopular at the time, over the long term they made Poland one of the best performing economies in CEE. Balcerowicz, who endured much public scolding and saw his popularity decline significantly, noted that he was ready to sacrifice personal

⁹ Eurobarometer 71 (September 2009), http://ec.europa.eu/public_opinion/archives/eb/eb71/eb71_std_part1.pdf (accessed December 10, 2009).

popularity for the good of the country.¹⁰ This is, in fact, one of the key lessons many leaders in transition economies around the world should take to heart.

The need to prepare a reform plan focused on institution-building in the local context

There are no substitutes for being prepared. This lesson particularly stood out in the early years of transition. Our earlier distinction between the “negative” goal of dismantling the old system and the “positive” goal of building democratic market economies in its place shows that the focus in post-Communist transitions has been on the negative rather than the positive. Thus, when the system collapsed, many reformers tried simultaneously to develop a plan for transition and to implement it in an environment where economic and political conditions changed dramatically on an almost daily basis.

Former Czech President Vaclav Havel once said that politics is not the art of the possible, but the art of imagining the impossible – and then making it happen. But there was no plan for transition. Neither local reformers nor the international community had a blueprint for what to do. As a result, CEE countries all too often uncritically accepted the advice of Western experts who had little understanding of the conditions on the ground. Their recommendations frequently followed the Washington Consensus mantra, “stabilize, privatize, and liberalize,” with little consideration given to the political economy of reforms and the need to simultaneously build strong market and democratic institutions.

This pattern partly relates to the mistaken views of market economies and democracies. One of the myths of development has been that if the government gets out of the way, a market economy would emerge almost instantaneously – that if the government gets out of micromanaging the economy, a market economy simply takes its place.¹¹ It was a wrong assumption in post-Communist countries and elsewhere, since markets require good governance institutions and effective governments that can fulfill their fundamental role of policymakers and referees – setting clear, fair, and transparent rules of the game and enforcing them consistently. In fact, transparency, accountability, and fairness of governance still remain a major problem in many transition countries, epitomized by a weak judiciary and a general view of politics as corrupt.

The need to build domestic capacity to reform and engage civil society and the private sector

Apart from economic transition, the most fundamental post-1989 challenge was creating viable democratic systems. That challenge required defining what democracy actually means. At a most basic level, democracies must have free and fair periodic elections that facilitate freedom of political expression and peaceful transfers of power. But this minimalist definition does not capture the core of democratic aspirations that propelled the fall of Communism in Eastern Europe. People there yearned

¹⁰ Steven Greenhouse, “Upheaval in the East: Poland; Warsaw's Economic Chief Opposes Weakening of Plan,” *New York Times*, January 6, 1990, <http://www.nytimes.com/1990/01/06/world/upheaval-in-the-east-poland-warsaw-s-economic-chief-opposes-weakening-of-plan.html?scp=8&sq=balcerowicz+said+&st=nyt> (accessed December 10, 2009).

¹¹ John D. Sullivan, “The Business of Democracies that Deliver: Reflections on CIPE’s 25th Anniversary,” *Economic Reform Feature Service*, Center for International Private Enterprise, May 15, 2009, <http://www.cipe.org/publications/fs/pdf/051509.pdf> (accessed December 10, 2009).

for a more meaningful democracy, comprising a system of participation, feedback, and accountability in the policymaking process. In this regard, civil society and the private sector have been crucial components of democratic transition.

A system of governance based on active civil society is a negation of the Communist utopia of a society coerced into an undivided and unquestioned ideological unity. In contrast, the very nature of civil society is diversity, pluralism of views and opinions, and checks and balances that provide ways to overcome differences through a compromise that respects individual rights. Not by coincidence are these attributes also the essence of liberal democracy – a vibrant civil society underlies its capacity to function. One example of how civil society has been contributing to successful transitions is the emergence of think tanks.

Although local think tanks did not play a significant role during the initial wave of reforms, they made their impact during the later part of transition once the democratic structures and procedures were better established. From 1991 to 2000, an average 24.5 think tanks were created per year in the region (though the rate decreased to 7.43 from 2001 to 2007), reflecting think tanks' increasing importance. Independent think tanks such as Bulgaria's Center for Liberal Strategies, Hungary's Center for Security and Defense, Agroconsult, or Poland's Gdansk Institute for Market Economics became a voice for reformers and provided valuable advice and support for the new democratic governments who were often unprepared for day-to-day policymaking. Moreover, these organizations often became hybrids that not only produced quality policy research that compensated for the shortcomings of the entrenched state bureaucracy, but also mobilized the public behind reforms and filled gaps in fledgling civil societies.¹²

Getting to that point was a long and a difficult process. In fact, this profound transformation of civil society and how it approaches reform throughout the region has been one of the key underestimated successes. In the early years of reforms, civil society groups would be excellent in pointing out structural problems and mistakes. Yet, in many instances, much of the contribution to the policy process would end at this stage, as delving into the problems in extensive detail remained beyond their capacity. Over time, however, civil society groups have learned and significantly improved the advocacy processes, becoming politically savvy in addressing key economic issues, developing and determining reform priorities, and accomplishing positive policymaking results.

These civil society groups included not only think tanks, but also business support organizations. In fact, the private sector is an often overlooked stakeholder and actor in the transition process, largely as a result of another persisting development myth that business is a monolith.¹³ In reality, businesses that emerged after 1989 were extremely diverse, ranging from small and medium-sized enterprises and the informal sector to crony firms and state-owned companies. The latter often gave business a bad name, especially in the early days of transition filled with corrupt privatization and other abuses. Such firms fear the loss of their privileged position, but that does not mean that the entire business community is anti-reform. The majority of businesses do want reform; they want a better business environment with rules that apply fairly to everybody in the marketplace.

¹² James G. McGann, "European Think Tanks: Regional and Trans-Atlantic Trends," *The Think Tanks and Civil Societies Program*, University of Pennsylvania (September 2009): 27-30.

¹³ Sullivan 2009: 4.

Just as the business community, representative private sector organizations – associations and chambers of commerce – were not uniform. Some of these organizations in the region were clearly redistributive in nature, seeking to provide select benefits to their members, such as tariffs or legal protections against foreign investors, and in fact represented a barrier to reform. Yet, there were others who had as their goal broader reform efforts that had benefits far beyond their immediate membership – such as simplification of business registration procedures or improvements in contract enforcement. Just as think tanks, many of the pro-reform business organizations were quite weak in the early stages of the transition process, and required a significant investment in internal governance reforms, membership development, and advocacy to become effective participants in public policy reform representing the views of the broader business community.¹⁴

We have seen business associations play a much more pro-reform role than chambers, especially in the early stages, which is largely determined by the institutional structure of the organizations and the resulting set of incentives. The reason the role of chambers of commerce has been less pronounced in terms of grassroots advocacy is that chambers in CEE largely followed a continental model of organization, based on public law and mandatory membership (as opposed to the Anglo-Saxon model based on private law statute and voluntary membership). Although there are some benefits to the mandatory membership model, it lacks the independence and dynamism of the Anglo-Saxon approach which guarantees that the chambers are purely private sector organizations working for the benefit of their members. Voluntary membership in chambers provides the necessary set of incentives for them to continuously survey the needs of their members and deliver both in terms of concrete services as well as effective advocacy in creating a better business climate.¹⁵

Conclusion: Going Forward

The transition in Central and Eastern Europe showed that democracy is a living process, not a rigid checklist of activities and policies. It is a process with no easily defined final destination that allows reformers to declare the job done. On the contrary, countries can move closer to and further away from democratic market economies at any point in time as demonstrated by the uneven progress of reform in countries across the region and challenges persisting even among the most successful reformers.

Despite setbacks and a degree of nostalgia, we believe that democracies and market economies indeed have taken root in most countries of the region. Few would argue that no fundamental changes have taken place in the economies of even the slowest reformers, and even those nostalgic for the “good old days” surely do not miss the inefficient, scarcity-ridden command economy. Similarly, it seems inconceivable today that given the opportunity to join the EU any of the transition countries would choose to return to a repressive dictatorship. But backsliding is by no means out of the question, and reforms are still needed to solidify democratic and economic gains.

¹⁴ John D. Sullivan, Kim Eric Bettcher, and Aleksandr Shkolnikov, “Business Associations, Business Climate, and Economic Growth: Evidence from the Transition Economies,” CIPE Economic Reform Issue Paper, No. 0807 (September 2008), <http://www.cipe.org/publications/papers/pdf/IP%2008-07%20ISNIE.pdf> (accessed December 10, 2009).

¹⁵ Markus Pilgrim and Ralf Meier, “National Chambers of Commerce: A Primer on the Organization and Role of Chamber Systems,” Center for International Private Enterprise (May 2005): 51, http://www.cipe.org/programs/ba/pdf/Chamber_Primer.pdf (accessed December 10, 2009).

In the political sphere, governments in the region must strive to become more participatory and more responsive to the needs and concerns of their people. In countries where reforms lag behind, a greater engagement of social stakeholders in decision-making between elections is crucial to ensure popular support for reforms. Countries that have progressed further with reforms and became EU members must avoid post-accession complacency and make sure their efforts to combat corruption and improve democratic governance are not de-prioritized.

In the economic arena, CEE countries must not succumb to the malaise of the global economic crisis and instead should use it as an opportunity to speed up difficult, often painful and long overdue reforms in areas such as healthcare, education, or unsustainable entitlement programs. They must also improve business environments to be able to deliver prosperity to their people.

Finally, transition countries must rid themselves of the myth that having private sector – after full state ownership of the economy under Communism – automatically means having a functioning market economy.¹⁶ A market economy requires a complex institutional framework that goes beyond the presence of private enterprises. That framework can only be built through the democratic political process that establishes the rules of the economic game and puts into place key market institutions such as property rights and the rule of law.

The European Bank for Reconstruction and Development's (EBRD) surveys of perceptions of business obstacles, conducted in 1999, 2002, 2005, and 2008/09, indicate that even though there certainly have been improvements, there was also a decline in perceptions of several indicators during the last three years. Today as many as 70 to 85 percent of respondents across the CEE region consider access to finance, corruption, tax administration and tax rates as serious business obstacles. As the EBRD concludes, "Transition should therefore be about redefining the state as opposed to simply minimizing it, and about improving the quality of state and private institutions and ensuring that they work well together."¹⁷ This probably is the greatest lesson of transition.

¹⁶ Sullivan 2009: 4.

¹⁷ "Transition in crisis?" EBRD Transition Report 2009, 96-98.