Yearbook of the Institute of East-Central Europe
(Rocznik Instytutu Europy Środkowo-Wschodniej)

Publication details, including instructions for authors:
http://www.iesw.lublin.pl/rocznik/index.php

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Published online: 30 Dec 2016

To cite this article: K. Żukrowska, 'Testing the CEEs' model of transformation in the ENP framework: challenges and opportunities: the Southern Dimension', *Yearbook of the Institute of East-Central Europe*, vol. 14, no. 6, 2016, pp. 27-47.

Yearbook of the Institute of East-Central Europe, 2016, Vol. 14, No. 6, 27-47

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Testing the CEEs' model of transformation in the ENP framework: challenges and opportunities: the Southern Dimension*

Abstract: This paper examines the content of the transformation strategies which were applied in countries of East-Central Europe (CEEs) and highlights these of their experiences that can be emulated to countries included in the Southern dimension of the ENP. Big disparities exist among countries included in the ENP's Southern dimension as well as among the CEEs. Nevertheless, the goal in both groups of countries has been the same, i.e. to build a stable market economy and democracy and improve citizens' prosperity. The methods applied have a number of elements in common like the institutions engaged, models applied, instruments used. The possibilities of the application of the CEEs' model seems to be limited at first sight but there is a number of elements that the strategies applied in both groups of countries have in common. These include the opening of the economy, cooperation with the IMF, World Bank, WTO and the EU, closer regional ties with some harmonization of laws and building a FTA, which is followed by an increasing attractiveness for investors and the stimulation of job creation and exports. On top of that, regional opening should be supported by the process of wider openness, followed by specific solutions applied internally in each of the economies.
Keywords: ENP, Southern dimension of ENP, CEEs Experience in transformation, CEFTA, model of system changes, Action Plan, Progress Report

Introduction

This paper examines the content of the transformation strategies which were applied in countries of East-Central Europe (CEEs) and highlights these of their experiences that can be emulated to countries included in the Southern dimension of the ENP. Big disparities

* This research project has benefited from funding under the Polish National Science Centre (NCN) grant titled 'European Neighbourhood Policy: (multi-level) governance, the reform process and the prospect of enhanced cooperation in the region', OPUS/HS5, no. 2013/09/B/HS5/04534.

exist among countries included in the ENP's Southern dimension as well as among the CEEs. Nevertheless, the goal in both groups of countries has been the same, i.e. to build a stable market economy and democracy as well as to improve citizens' prosperity. The methods applied have a number of elements in common like the institutions engaged, models applied, instruments used. The possibilities of the application of the CEEs' model seem to be limited at first sight but there is a number of common elements which embrace: opening of the economy, cooperation with the IMF, World Bank, WTO and the EU, closer regional ties with some harmonization of laws and building a FTA, which is followed by an increasing attractiveness for investors and the stimulation of job creation and exports. On top of that, regional opening should be supported by the process of wider openness, followed by specific solutions applied internally in each of the economies. The argument is structured as follows: First, the model of transformation followed by the CEEs is examined also in view of its implications. Then, the discussion highlights what elements from the transformation list are not applied in the ENP framework within the Southern Dimension. The Southern dimension includes such states as: Algeria, Morocco, Egypt, Israel, Jordan, Lebanon, Libya, the Authority of Palestine, Syria and Tunisia.

1. Goals which made the list of 'things to do' in the transformation of CEEs

The CEEs' model of transformation drew from a number of theories which are closely linked with development and include the process of liberalizing the economy internally and externally, rendering a shortage economy to regain an equilibrium in a short period of time.[1] Some of the theories were only taken into account as knowing them we can overcome some of the problems which otherwise could occur, e.g. development theories were incorporating such visions as those represented by different economists. To illustrate this, we can use the Balassa-Samuelson theory which says that a catching-up economy goes

1 K. Żukrowska (ed.), *Transformacja systemowa w Polsce* [Systemic transformation in Poland], Warsaw: Warsaw School of Economics Press (SGH), 2010.

through a process of currency exchange rate appreciation. Appreciation limits the cost competitiveness of exports and makes imports cheaper. This information has to be taken into account when states need to increase imports and at the same time they have limited potential to export. The current account deficit in such conditions limits the process of appreciation of the currency in a state in question. The theory illustrates the distributive effect internationally.[2]

The opening of the economy has to be preceded by a stage of preparation for it, which covers law adjustments and the institution building phase.[3] There are specific models showing how the economy should open and which geographic direction is the best choice in such a process.[4] This is followed by such requirements as convertibility of the currency, choice of the pegs in the period when the exchange rate regime is fixed, before it is allowed to fluctuate freely. There is also a question of ownership, proportions between the state owned and private owned companies. A smoothly functioning economy needs a good (balanced) tax system. Here, but this is not the only area where temptations are strong, economists have to find answers to the following questions: what is their preferred naïve perspective of high revenues resulting from relatively high taxes, or relatively low level of taxes, which will bring limited revenues? These two options can be additionally supported by two different arguments. High level of taxes can bring limited revenues as business will look for solutions which enable it to pay taxes abroad, where they are low, while others will try to register only part of the transactions, doing business in grey or black market. In the second case, relatively low taxes can bring much higher revenues to the budget which will result in high turnover.

Furthermore, it is also important to have proper proportions among the branches of the economy, i.e. services, industry, agriculture. The named sectors have to be effective and use advanced technologies. This also includes six specific activities: health sector, schools and

2 R. MacDonald, L. Ricci, 'PPP and the Balassa Samuelson Effect: The Role of Distribution Sector', *IMF Working Paper*, no. 01/38, 2001, p. 13.

3 J. Sachs, *The Economic Transformation of Eastern Europe: The Case of Poland*, Boston–Dordrecht–London: Kluwer Academic Publisher, 1992, p. 32.

4 R.J. Hunter, L.V. Ryan, 'A Retrospective on Poland's Foreign Trade: Change in the Regime Accomplished in the Light of Poland's History of Central Planning and its' Membership in COMECON, the Early Years', *Advances Management and Applied Economics*, vol. 5, no. 2, 2015, pp. 1-20.

higher education, research and development, media, administration and management of the economy, banking system, internal and external security. To prepare all the legal and institutional changes in the aforementioned fields takes time, an acceleration here can be reached by copying some of the solutions from the states where they function well with some adjustments and adaptations to specific needs of a state. All those changes also have their financial value, the cost of introducing them, adjusting to the needs, eliminating the old rules, teaching and explaining how the new rules function and why they are superior to the previous ones which are replaced in the process of changes.

Finances of the transformation are important as a state has to cover all the costs of changes and functioning of the state. It cannot lose the financial liquidity in that process. At the same time, it cannot start with high tax rates as they will discourage the investors from coming and investing in the economy. In current times, economy is relatively liberalized which means that it is more or less free but also liberalized economy has to be balanced in different areas which are as follows:

- Current account of the balance of payments, which means that more or less the same amounts of money can be sent abroad as the amounts of money which flow into the market. This balance is needed because of the processes which bring tension in the monetary system, incl. the value of the exchange rate, inflation, exports and imports, salaries, savings, investments, etc.
- Expenditures and revenues of the budget, where a small deficit is not a 'big sin' but a deficit higher than 3% of the GDP increases public debt and, over time, it shows that credits drawn from the capital market by the state create inflationary pressures; this in turn diminishes incomes and the value of investments, savings, etc.

The evaluation of the depth of the changes, which is done in the Progress Reports prepared by the European Commission, allows for the assessment of what was done in time and what was delayed. Such progress reports also give advice on what still has to be done to achieve a completed stage of changes. Such an approach was found in the case of CEEs and is also followed by the EU Commission in the case of the

ENP states.[5] The rates of growth should be also balanced, they should be positive and high enough to reduce the unemployment rate. The development ought to be sustainable.

Institutions, such as state administration on central and local levels; market institutions, like stock exchange or banks and banking system, including national central banks, – all these elements should be adjusted to market conditions with a clear division of competencies and procedures.[6] This should be supported by an effectively functioning jurisdiction system with a government inspectorate and treasury. A state should adequately educate clerks who can run and administer the area which they are responsible for. Good management requires also law execution proving that the state is a state of law and of professionally shaped, transparent accountancy.[7]

Specific requirements come with the stage of development: the lower the stage the lower the requirements, although with the advancement of development those requirements automatically grow. This means that when a state meets all requirements on an initial level of development and it is on the verge of moving to a higher stage there is a need to change the policy and adjust the conditions for this new higher stage. On the initial level which is stimulated by access to factors of production, the state should supply infrastructure, primary education, principal health care services, access to the labour force and administration. In the transition phase, the state has to be prepared to move its economy from the production factor accessible stage to the stage in which attention is paid to effectiveness.

2. Methods in which transformation was performed in CEEs

With the use of different criteria, we can present different models of transformation. All CEEs went through parallel processes of changes

5 Cf. Commission of the European Communities, 'Implementation of the European Neighbourhood Policy Partnership for Democracy and Shared Prosperity with the Southern Mediterranean Partners Report', *Joint Staff Working Document* SWD (2015) 75 final, Brussels, 25 March 2015.

6 J. Groenewegen, A. Spithoven, A. Van den Berg, *Institutional Economics: An Introduction*, Basingstoke: Palgrave Macmillan, 2010, p. 132.

7 K. Żukrowska (ed.), *Transformation in Poland and in the Southern Mediterranean. Sharing Experiences*, Warsaw: Poltext, 2010, p. 24.

in the economic and political systems.[8] Nevertheless, we can apply a number of criteria which can be used to differentiate the models. Those can be the following criteria: speed, effectiveness, complexity, concentrating on internal matters or including also relations with the region and the world, which are deep and irreversible or shallow and reversible.[9] Using criteria of confidence, we can divide the models into two main categories: models using confidence and trust building methods or a model that can be labelled as the best available choice model (no other option than cooperation).[10]

Looking at speed, we can say that transformation was either gradual or introduced as a shock. The gradual approach assumed that social costs of such a process are lower in comparison with the shock approach. In reality, social costs of gradual changes are higher as the whole process lasts longer and a number of changes are not made as the process is confronted with a political barrier. In most cases, the political scene in post-Communist states is poorly developed which means that it is difficult to replace one political group who starts the changes with two or three subsequent governments, representing different political groupings. The importance of such changes is crucial for the effectiveness of the changes as those who start changes which bring social costs, are sooner or later rejected, another political grouping can continue such a process. The lack of such groups, a limited number of strong parties stops the whole process and can lead towards the reversion of the process. A close cooperation with international organizations can be supportive in the process of changes as they can support them financially, with expertise and by controlling the progress; we can observe the application of this procedure in Ukraine and in Greece today. We can also see heterodox (outside the main stream

8 L. Balcerowicz, *Socjalizm. Kapitalizm. Transformacja. Szkice z przełomu epoki* [Socialism. Capitalism. Transformation. Essays from the turn of the era], Warsaw: Polskie Wydawnictwo Naukowe (PWN), 1997.

9 H. Mueller, 'Why Russia Failed to Follow Poland: Lessons for Economists', *Politik Salon*, 2007, http://www.politik-salon.de/files/hm_receo_2007.pdf [2015-10-20].

10 J. Sachs, 'Shock Therapy in Poland. Perspectives of Five Years', *The Tanner Lectures on Human Values*, University of Utah, 6 April 1994, http://tannerlectures.utah.edu/_documents/a-to-z/s/sachs95.pdf [2015-10-15].

philosophy: going beyond classical economics) or orthodox (within the main stream of philosophy) models.[11]

Each of the models has its advantages as well as some disadvantages (weaknesses). Shock therapy brings up a quick recovery and paradoxically helps to cut the social costs of the process bringing it to the point where it becomes irreversible. Shock therapy needs specific preparations such as the expansion of the political scene, which enables the continuation of the reforms by another party when the first one is losing support. The second is increasing confidence in the whole society to the methods applied, also in the area going beyond the national borders, which means that it also needs to gain support for a closer cooperation with foreign companies, governments, international organizations, etc. Third, it has to be complex, assertive and introduced without hesitations. Otherwise it will turn into a gradual model which is difficult to bring to an end. In other words, it has to be well prepared. Loopholes in the preparation, which mean the incompleteness of the applied model of changes, transform the model to gradualism, which is difficult to bring to a successful end as it lasts much longer than the shock and in reality carries much higher social costs than the shock approach. This statement, paradoxical at first, results from the fact that economy starts to grow departing from the transitional depression in a longer time and the rate of growth is smaller and weaker than in a complex shock therapy.

The transformation programme includes measures introduced at a magnitude of levels:

- Macroeconomic level: convertibility of the currency, opening of the economy, macro-stabilization, development of the banking sector and capital market;
- Microeconomic level: privatization of companies, which brings revenues to the state budget;
- Institutional level: creation of institutions which are necessary in market economy;
- State budget: laws determining who shapes the budget and when its different stages should be performed, what are the revenues

11 F.E. Folvary (ed.), *Beyond Neoclassical Economics: Heterodox Approaches to Economic Theory*, London: Edward Elgar Publishing, 1996.

and what are the priorities of expenditures. This also requires a well-set tax system, an effective system of collecting taxes and an institution controlling how the system functions;

- Jurisdiction;
- Laws: creation and launching of laws which are needed in all market economies;
- Media: independent and strong media, able to inform society on what is done in the framework of the programme and who is responsible for what in the project and how he fulfils his obligation.[12]

The shock approach means that the above-mentioned activities are introduced in parallel and the whole process in which one system transforms into another takes a relatively short time. This means that the programme is worked out in details and, when started, is continued consequently and without hesitation. The economic vision is strongly backed up by political will. Political structures are strong enough and determined to introduce the changes.

The gradual approach is applied by those who believe that spreading the activities over time reduces the social costs of the transformation.[13] The contents of the programme in both cases are the same. The main difference is in the timing of introduction of the changes and in spreading the activities over a longer and shorter period. In reality, as burdens spread over a longer period and turn into sources of criticism addressed to those who introduce changes, reaching the defined goals becomes difficult and unrealistic. This is caused by the rejection of politicians who wanted to conduct the changes, spreading them over a longer time. The continuation of changes requires a new set of politicians who are determined to continue the changes. The model of a new leadership in reforms has its limits, as the effectiveness of system changes requires shock therapy or a developed and stable political stage, on which one leader can be successfully replaced by another who will continue changes as planned. This has to be done so despite

12 Groenewegen et al., op.cit.

13 N. von Westernhagen, *Systemic Transformation Trade and Economic Growth. Developments, Theoretical Analysis and Empirical Results*, Berlin–Heidelberg–Potsdam: Springer Verlag, 2002, p. 23.

the former criticism of the project of transformation, contents of the programme or people politically engaged to introduce such changes.

3. Disadvantages

The plan of introducing shock therapy has to be prepared in all details in advance as there is no time for improvisation and hesitation. Any failure in the project moves the model to the gradual approach which prolongs the process of reforms and for political reasons makes the reforms difficult to carry and thus unmanageable. This is accompanied by growing social and financial costs of the process, which is just the opposite of what the politicians wanted and planned when starting the reforms. Such negative and unexpected results, so different from the promises made in advance to voters, bring us to the main disadvantages. The first is the lack of trust to a particular party that was behind the project of changes. Second, it undermines the trust in using specific reform methods. Third, it increases the costs of the whole process, which brings tensions to the system, resulting from increased intervention expenditures financed from the state's budget, blowing up the expenditures. A growing deficit in turn blows up the interest rate, which increases the cost of capital for all capital users: investors, consumers and the state. A country, in its effort to change, often has to cooperate with international organizations (regional integration) as well as some specific (OECD, EU) or global (IMF, World Bank) ones. This can cause some financial consequences resulting in cancelling the consecutive financial instalments negotiated as part of the conditionality of the tough reforms. This can be solved with another agreement but it always brings tougher conditions, namely higher interest rate for the credits obtained.

The complex environment of changes (reforming process), when they are conducted so that they last longer, brings difficulties in a number of areas: social, financial, political, business. This finding seems to be contradictive with the assumptions which decided that politicians were in favour of the gradual approach in system changes. Nevertheless, such a finding is a fact and this means that shock reduces the social, financial, political and business costs of system changes. A short period of changes means that politically it is possible while the spread of changes over time undermines the political support for changes caused by high costs of such a process followed by the rejection of politicians who have introduced the programme and are responsible for their costs.

4. Transformation and the Southern Dimension of the ENP

The region is highly diversified as far as the transformation of both systems, political and economic, are concerned. On the one hand, there is a group of economies which are more successful in catching up by enjoying relatively high rates of growth. On the other hand, there are also economies which have low income per capita and relatively limited perspective to change. Looking at the group of states in the Southern Dimension of the ENP, it could be said that they face a number of challenges, one of them being growing population which has increased by more than three times in the last sixty years.

Countries in this group, similarly to the CEEs, have an expanded public sector, which results from the strategy that was applied directly after the WW2, when both government and expanding public sectors were seen as prerequisite in the process of nation-building. The above-mentioned strategy was strongly supported by the advice coming from the IMF and World Bank. Such a policy, applied between 1945-1970, was accompanied by the expansion of the public sector and resulted in the construction of an economic and political system, which had a number of solutions common with the centrally planned economy. The main feature here was state intervention and redistribution of wealth as two pillars of economy. Over time, attempts were made to replace this model by a more effective one which was guided by market mechanisms of lower costs and better outcomes. Currently, the states in the region are on their way to reforms and changes towards market economies and democracies in political life. Privatization of the state sector, the same as in the CEEs, is one of the driving forces in the changes.

There is a number of needs and the list of them embraces: creation of jobs for the increasing population, macro-stabilization programmes, tax rates, tax management, competition, access to financing, food production and supply, reducing the dependence of economy on the oil sector.

Table 1. IMF, IBRD and GATT/WTO membership of the Southern Mediterranean states covered by the ENP

Contents	IMF	IBRD	GATT/WTO
Algeria	1963	1963	Observer
Egypt	1945	1945	1970/1995
Israel	1954	1954	1962/1995
Jordan	1952	1952	2000
Lebanon	1947	1947	Observer
Libya	1958*	1958	Observer
Morocco	1948	1958	1987
Syria	1947	1947	Observer
Tunisia	1958	1958	1995
UAE	1972	1972	1994

* Article IV.

Source: Authors own compilation based on portals of the IMF, the World Bank, and the WTO.

The time-spread of the membership is relatively wide, for IMF and IBRD – 25 years (Lebanon and UAE), while for GATT/WTO, even a wider period of 38 years (Israel and Jordan). Differences in the timing of economic institutionalization in the studied group of states also have an impact on the advancement of the reforming process. This can be mainly seen in WTO membership, where three of the states covered by the analysis are observers in that organization (Lebanon, Libya, Syria). All three above-mentioned states participated in the 2011 civil war, while in Syria the conflict has lasted for 4.5 years. More than 250,000 Syrians lost their life, more than 11 million were forced to leave their homes during the war against the forces loyal to President Bashar-al-Assad.

The recent IMF analysis made for the Arab States in Transition (AST) shows that the economic environment in the region is worsening, which is caused by two factors mainly: (1) widening and deepening conflicts, which are interpreted by some experts as civil war, while by others as an open military conflict which engages military force from the outside (like e.g. UN, Russia, France); (2) difficult socio-economic environment, with relatively big differences among the states in the group.[14] The situation in the region is viewed as dangerous and unsta-

14 Jordan and Morocco are a few years after the elections, while Egypt and Tunisia had true parliamentary elections in 2014-2015. In Libya and Yemen, the political instability is relatively high.

ble, which keeps the investors' confidence in the region on very low level. The general economic outcome in the region is reflected in the size of states' expenditures, labour and goods markets, rising prices, which further results in spreading of an informal economy followed by a growing social gap within societies. Tunisia can feel strong blows of the spill-overs coming from the Libyan conflict, while social cohesion and security are pronounced in Lebanon and Jordan. The above-mentioned conditions have a negative impact on the structural reform dynamics. Nearly all of the ASTs (without Libya) enjoy macroeconomic stability. Growth is positive, inflation is under control (mainly one digit, with the exception of Egypt), the state budget deficits are declining, current account deficits are shrinking and currency reserves are stable or indicate a growing tendency.[15] The economic recovery seems to be still modest, which is also evidenced by relatively high unemployment rates.[16]

Table 2. Selected economic indicators of ASTs in 2014/2015[1] (projections of IMF)

Contents	Egypt	Jordan	Libya	Morocco	Tunisia	Yemen
GDP growth, %	3.5	4.0	15.0	4.7	3.0	4.6
CPI inflation, period average, %	13.5	2.6	6.3	2.0	5.0	11.4
General government balance, excl. grants	-10.8	-9.0	-30.2	-5.4	-4.6	-6.0
Current account balance, excl. grants	-5.0	-10.7	-20.8	-6.8	-6.3	-2.1
Fiscal financing needs, excl. grants, US$ bln[2]	43.3	5.1	-	7.5	2.9	3.4
External financing needs excl. grants, US$ bln[3]	29.8	5.8	-	10.3	10.0	1.4
Public debt	94.5	91.1	-	65.7	55.3	50.2
External debt	18.7	30.0	8.8	33.2	61.2	17.0
Reserves in months of imports	2.9	6.1	25.8	4.5	4.3	4.6

[1] Figures may differ from WEO data as they reflect updates by recent missions.
[2] Budget deficit, excluding official grants, plus public external amortization.
[3] Current account deficit, excluding grants, plus public external amortization.

Source: National authorities and IMF staff calculations, quoted after: International Monetary Fund, *Arab Countries in Transition: Economic Outlook and Key Challenges*, Washington D.C.: International Monetary Fund, October 2014.

The macro-stabilization status of the ASTs is relatively good in general. States covered by the study should make further attempts to im-

15 International Monetary Fund, 'Arab Countries in Transition: Economic Outlook and Key Challenges', *Non-paper*, 9 October 2014, Washington D.C.: International Monetary Fund, p. 3.
16 Ibid., p. 4.

prove the fiscal position and try to reduce budget and current account deficits where they are large and hamper the economic development, dragging up inflation. Policies applied there should be focused on subsidies and safety nets reforms; tax reforms which should include broadening tax bases and improving tax collection and public management of the budgetary spending. The traditional advice here is to raise taxes but such a decision hurts consumers, so it would be better to decrease the taxes, simplify them and improve tax collection. In most of the listed economies the inflation needs to be controlled by strict monetary policies, which can eliminate the risk of up-trend in prices. This mainly concerns the most basic food, beverages, agriculture products, the majority of which are imported as the region is not self-sufficient there.

All the economies in this group should put emphasis on tax policies, where they should look closer into the fairness of the system. They need to improve the business climate, opening the economies more for foreign business and reducing the number of days needed to start a business. Finally, they should make efforts to improve education systems, training and labour market policies. All those characteristics are currently important and their role for the creation of people's wealth will increase over time as the states listed there will climb the ladder of growth, showing that their markets are also able to create jobs, stabilize the economies and facilitate trade and FDI.

Looking at the economic freedom indexes for the group of states in question, we can see that Jordan is the most open economy in the group, ranked on the 7th position in world economy where 157 states are studied and compared using a similar method. Israel is on the 39th position, Morocco – 109th, Egypt –118th, Tunisia – 116th, Yemen – 124th, Libya – 155th. The position of the listed states has been changing, in a number of cases it has deteriorated since 2011.[17] Looking at the rest of the states covered with the Southern dimension of the ENP, we can see that Israel is on the 39th position, Lebanon on 76th and Syria started in 1970 with 3.95 points and recently has 4.85 points, while in 2011 it obtained 5.88 and afterwards the evaluations gradually fell.[18]

17 J. Gwartney, R. Lawson, J. Hall, with H. Pitlik, D.M. Redin, M. Rode, *Economic Freedom of the World: 2015 Annual Report*, Vancouver: Fraser Institute, 2015.

18 Ibid.

Looking closer at the data collected by the Fraser Institute which are used to build the Freedom index, we can divide the ENP – Southern states into three main categories: relatively open economies in which both tariff and nontariff barriers are relatively low and the quality of government is evaluated as high (Jordan, Israel), medium open economies (Morocco, Egypt), and relatively protected ones (Tunisia, Libya). In most cases, non-tariff barriers to trade are high and used to protect national markets, in some cases also tariffs are high. In addition to trade barriers, the ENP states in question protect their markets against inflow of capital. With the exception of Jordan and Israel where a small increase in the inflow of capital was recorded between 2008-2013, in remaining economies, a deterioration of inflow of capital was recorded. Moreover, the markets do not attract much FDI in comparison to their absorption potential.[19] As far as the FDI trend in the region is concerned, these relatively small inflows are interpreted as one of the obstacles to development in the region. One of the explanations for that is the increased insecurity, followed by different types of barriers to foreign investments.[20]

The policies conducted in the region should scale up the support offered by other states and international organizations, which are applied in the states of the region. This has to be proceeded by the capacity building process which embraces government institutions, local institutions as well as NGOs.

Looking at the external sector, in most cases we can see relatively high current account measured as the share of the GDP. This indicates relatively low competitiveness of the economies of the Arab countries in transition (ACT), i.e. Egypt, Jordan, Morocco, Tunisia, and Yemen. Their marginal participation in the creation of final goods within the framework of international cooperation stimulated by work in global value added chains should be also noted.

19 UNCTAD, *World Investment Report 2014. Investing in the SDGs: Action Plan*, Geneva–New York: United Nations, 2014, pp. 205-206.

20 World Trade Organization, 'Egypt and the WTO', *Member Information*, www.wto.org/english/thewto_e/countries_e/egypt_e.htm [2015-10-12].

Table 3. Arab Countries in Transition: Financing Needs[1] (bn of USD)

Contents	2011	2012	Estimation	Projections	
			2013	2014	2015
Current account deficit (excluding official transfers)	26.1	33.3	28.4	34.0	33.0
External amortization	14.3	14.3	15.5	21.5	34.4
External gross financing needs[2]	40.3	47.7	43.9	55.5	67.4
Budget deficits (excl. grants)	37.1	47.0	56.2	61.6	57.6
Public external amortization	5.4	5.3	5.5	6.2	9.4
Fiscal financing needs[3]	42.5	52.3	61.7	67.8	66.9

[1] Comprises: Egypt, Jordan, Morocco, Tunisia.
[2] Current account deficit, excluding grants, plus amortization.
[3] Budget deficit, excluding official grants, plus public external amortization.

Source: National authorities and IMF staff calculations, quoted after: International Monetary Fund, *Arab Countries in Transition: Economic Outlook and Key Challenges*, Washington D.C.: International Monetary Fund, 9 October 2014, p. 7.

Since 2011 (the beginning of the Arab Spring), the ACTs have agreed with the IMF credit allocations worth 4.4 bn USD. This allocation covers programmes for Jordan, Tunisia, Yemen and finances Morocco (since 2014) within a new Precautionary and Liquidity credit line offering 5 bn USD. The IMF announces readiness to start their talks concerning expertise and financial support of Egypt if they are asked for such an engagement.

Transformation requires a good programme which can be implemented by the states' administration but, at the same time, it requires also approval and support from citizens. There is no chance for success in effective systemic changes (transformation) without such a support. This support should be seen not only in the general approval of the system changes but also in particular support for opening the economy, i.e. openness for trade, inflow of capital, intensification of competition, which enables more effective economy, structural changes and creation of new jobs.

5. Emulating the CEEs' experience: prospects and caveats

The situation in CEEs in comparison to the ACTs seems to be different in a number of aspects but some elements are similar. The economies in CEEs were more destabilized than the economies of ACTs, they were engaged in production but this production was not necessarily improving the supply of the market. In other words, the production was to supply factories and their demand, not the consumer demand. This resulted in relatively high prices and selective supply. In the ACTs, we can also find some gaps in supply which specially can be seen in food and agriculture products markets. The remaining segments of the market are not so badly supplied but this can also be improved. This is conditioned by the opening of the markets for trade and inflow of capital. This move increases supply and competition, it also results in falling prices, helps to control production costs, stimulates competitiveness. This was done in all CEEs and the result was in all cases spectacular, although it does not mean that politicians as well as economists were in some cases not scared of such a move. They used an argument that first one needs to be prepared for the opening which means that production should grow on home market. This vision, which in practice does not work, is based on an assumption that an economy has to produce goods which will replace imports. Such a strategy was worked out in the 1950's in Latin America and Asia. With years of efforts to put such an approach into practice, it was finally replaced by a pro-export strategy. This also has proved to be effective in a limited way. Finally, economists have decided that the best solution for a producer is to be part of an international value added chain, which helps to get access to FDI, technology, know-how and distribution chains. This can be done by adjusting laws and institutions, by following the guidelines given by the IMF as far as convertibility of the currency is concerned. Such a strategy was proved by CEEs, China or India. In each of the markets, the development strategy applied was partially different but it had some common elements which all were linked with the opening of the market and international cooperation.

The data collected for the purpose of the conducted study show that the currency reserves in all the ENP's Sothern Dimension countries are growing. This can be seen as one of the safeguards. States are scared that growing current account deficit, resulting from increasing imports can bring them to the point in which they have to announce bankruptcy. With growing reserves this does not happen. Moreover, the IMF, World Bank and other international organizations can provide money for a safety fund which can guarantee the stability of the exchange rate of a country. Poland gathered such a fund and never used it, returning collected money to the donor institutions and states.

The second thing which seems to be important and can be done following the guidelines that were earlier used in Poland is writing off a bulk of the external debts. Poland reduced its external debt negotiating the deal with the Paris Club (state guaranteed credits) and the London Club (private banks credits without state guarantees). Poland reduced its external obligations by half and obtained a postponement in paying back the rest of the debts till the moment it was possible. The agreement with the two clubs was conditioned. Poland declared that it would not ask again for such reduction, carefully controlling the state of finances. Moreover, the agreement was also conditioned by an agreement with the IMF which was aimed at macro-stabilization of the economy: reducing inflation, conducting safe monetary and exchange rate policy and opening of the economy. The Polish experience in this respect was unique as other states did not make a decision to reduce their external debts. Hungary e.g. had relatively higher debts than Poland in relative terms, not in absolute figures. This means that in per capita terms, the Hungarian external debt was higher than the Polish one, it was also higher as a share of the GDP and of the foreign trade turnover. This information can be used as an argument against such a decision concerning the reduction of external debts (debt release strategy). This could be seen as a correct approach if one does not see the rates of growth of the GDP in the whole period since 1989. Released from the external debt burdens, the Polish economy was growing faster, covering the development gap quicker than the Hungarian economy.

Poland, the Czech Republic, the Slovak Republic and Hungary have created a free trade zone which helped them to harmonize laws and institutions making the market more attractive for FDI flows. The agreement was called CEFTA (Central European Free Trade Agreement) and has played a double role as investors looked at it as the final target of their investments when the production was supposed to be sold on the markets of the four cooperating economies, or as an indirect link with the EU market where the manufactured goods could be sold without tariffs.[21] A similar solution is advised for the Southern Mediterranean ENP states.

21 S. Parzymies (ed.), *Europejskie struktury współpracy: informator* [European cooperation structures: an overview], Warsaw: Polish Institute of International Affairs (PISM), 1995.

The needs of foreign capital of the ACTs are shown in Table 3, some of the needs result from the domestic policies and decisions, some reflect the costs of reforms, others reflect the ineffectiveness of the policies conducted earlier and their costs inherited from the past. The conducted analysis and comparisons indicate that the writing-off part of the external debts brings a big release to the economy, nevertheless such a decision has to be followed by specific decisions which bring a number of changes: convertibility, opening of the economy, improvement of the institutions including the central bank and monetary policy, privatization, macro-stabilization measures. Some of the decisions which had to be undertaken in CEEs were much more drastic than those that have to be taken in most of the ACTs. Macro-stabilization does not require such big efforts as it was the case in CEEs, state institutions are also in better shape. There is a need of development of democratic institutions such as media which play an important role in controlling and informing society on different aspects of economic, political, social and cultural issues. There is also a need to develop some of the market institutions and mechanisms which are in most cases there but do not function well and effectively. CEEs experience is in a way better to follow than the same processes earlier which were introduced in such economies as Portugal or Spain, but in their case, it was more the political scene that was changing rather than the market. In the CEEs, both systems political and economic were changing at the same time.

Conclusions

There are big differences between the starting point for reforms in the CEEs and the current stage of events in the ACTs, nevertheless, studying the list of requirements and recommendations which are formulated by the IMF and the EU Commission, one can see a number of elements in common, which show that some components of the programme that was applied in the CEEs can be also used in the ACTs. This concerns the macro-stabilization measures, convertibility, harmonization of laws and institutions (helping to eliminate some non-tariff barriers), improving the quality of the state institutions, privatization, opening of the economy for competition.

Also, it would be worth considering the possibility of applying the policy that was used in Poland and which helped the Polish economy to reduce the burden of external debt servicing and payment. In Poland, this solution has really brought about a big release to the economy and the rate of growth accelerated and was the highest in the region, giving the best performance of the GDP growth in the whole period of transformation. This was a big achievement on its own but additionally, it also helped to cover the development gap which separated Poland from the average per capita income in the old member states of the EU. Recently, the gap has been shrinking and the time needed to cover the whole distance is also shorter in comparison with the prognoses which were made in the past.

It seems to be advisable to make use of the positive and negative experience of the CEEs in the sense of what should be omitted and what should be followed in the transforming programmes of the ACTs. One of the positive experiences is building regional blocs. Poland, Hungary and the Czech Republic with the Slovak Republic have created CEFTA. This has additionally increased the attractiveness of the region for FDI, enlarging the market beyond the national borders.

Summing up, it must be noted that a successful programme of changes has to be well constructed, which embraces all elements of the transformation strategy and sequencing of implementing them. There is also a strong need to have efficient political power to perform all the planned changes of what has to be done with support of the citizens, of the voters, of the people who live in the country. That is possible to obtain when, first, credits given to the political power eligible to conduct the changes are not lost but fully utilized in what can and has to be measured by improvement of standards of living of the people involved in this process as reform-takers or reform-users. This can be achieved e.g. by a specific approach to food supply and agriculture products supply on the markets, which, improving in the sense of quantity, quality, choices and prices, can be supportive in conducting further, more advanced changes.

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