INTEGRATION, MACROECONOMIC DYNAMICS AND INSTITUTIONS IN CENTRAL AND EASTERN EUROPEAN COUNTRIES, 1995-2015

Ramona, Ţigănaşu[1]
Gabriela Carmen, Pascariu[2]

Abstract:
Central and Eastern European Countries (CEECs) have undertaken wide-ranging processes of economic restructuring generated by the integration into the European Union, an overall nominal as well as a structural convergence having taken place, differentiated from one country to the other in terms of performance and potential for long-term growth and development. First, the paper provides an analysis of economic dynamics of the CEECs during 1995-2015 using both general macroeconomic indicators, such as GDP/capita, economic growth rate or productivity, and also indicators which reflect specific aspects of the integration of markets(FDI intensity, trade integration of goods). In the second part of the paper, the authors provide an interpretation of the role of the institutions in the dynamics of transformations ocurring in the CEECs and in supporting the process of convergence as result of integration into the EU system. The main conclusion reached by authors is that the institutions and the quality of governance system can sustain and amplify the tendencies towards convergence and compensate the tendencies towards divergence generated by the market, and undergoing economic cyclicals.

Keywords: *European Integration, Central and Eastern European Countries, convergence, institutions*

JEL Classification:*F15, O11, O47*

1. Introduction

Since the 90s, Central and Eastern European (CEE) Countries have undergone a major turn in their development, with a troublesome change-over within an unstable institutional framework promoting structural reforms that largely ended in contradictory effects on the economy. The major challenge for CEECs was to create core institutions, able to efficiently react to mechanisms ensuring dynamic microeconomic and macroeconomic stability (Gros and Steinherr, 2004; White and Batt, 2007; Nahtigal, 2008; Wolchik and Curry, 2010). Transition"pioneers"that undertook radical move toward market economy (shock therapy) included Poland, the Czech Republic, Slovakia, Hungary and Slovenia which subsequently won from adopting this approach. Latvia, Lithuania and Estonia also had a rough start on the path of high inflation. Bulgaria and Romania experienced the most ineffective reforms accompanied by hyperinflation and corruption. These are essentially the main reasons explaining why a number of issues still linger in developing economies after so many years of transition, among which the adoption of coherent rules and reforms sustaining the reform. Moreover, the 2008 crisis occured and affected all countries, to a greater or lower extent, slowing down not only the pace of reform but also the process of growth and convergence of the CEE countries, some of the actions undertaken by them added value to the economy, while others did not (EC, 2009): certain countries opted for a high tax adjustment mainly driven by dramatic cuts in public expenditure (including health and education); other countries opted for increased taxation (radical tax rises occurred in Romania, the Baltic States, Bulgaria and Hungary –2009); some preferred to cut down

[1] PhD Researcher, Center for European Studies, Faculty of Law, "Alexandru Ioan Cuza" University of Iasi, Romania;
[2] PhD Professor, Faculty of Economics and Business Administration, "Alexandru Ioan Cuza" University of Iasi, Romania, corresponding author, gcpas@uaic.ro;

on production costs (significant payroll contractions, especially in the public sector, but also in the private industry) (unpopular measures– the average wage in late 2009 decreased by11% in Latvia, by 9% inLithuania and by6.5% in Estonia; as for Romania, public wages and pensions were cut down by 25% and 15%, respectively); "domestic devaluation" prompted a lowering of wages and public expenditure that turned current account deficits into substantial surpluses: Latvia, Lithuania, EstoniaandBulgaria (Agnello and Sousa, 2013; van Treeck, 2009); market deregulation: the Baltic States mostly liberalized their goods, services and capital markets and removed flexible work restrictions on the labour market and unemployment figures shrank with the EU-funded employment support programmes;VAT increased in Latvia, Lithuania, Hungary and Romania (19%-24%). Also, apart from Estonia and Poland, all CEECs saw a change in the government during the turmoil: political and social instability worsened.

The literature points out that the European economic integration and the framework of EU policies have been inevitably complex and uneven (Feng, 2001; Sirimaneetham and Temple, 2009; Knedlik and von Schweinitz, 2012). Most EU Member States in Central and Eastern Europe paid a lot of attention to economic restructuring (based on common rules and principles – "Europeanization process") as compared to defining locally-adapted efficient policies, with negative long-term impact on the economy and society. Moreover, lack of capital, know-how and traditions deeply rooted in communism made these states advance quite slowly; for this reason and considering the lack of resources, these states cannot be said to have encouraged general wealth (Zahn, 2013). These arguments urge the need for a complex and multidisciplinary approach to the evolution of CEECs in the integration process and for finding out to what extent the involvement in this process is likely to translate into a sustainable growth and convergence process.This paper provides an analysis of economic development dynamics of the Central and Eastern European countries in the integration process, with a specific focus on the institutional challenges, highlighting the obvious risks which can be due to inadequate structure of institutions and limitations of governanance system reforming process.

2. An overview of the CEEC's economic dynamics

It should be noted that there is no universal pattern to follow in terms of economic development but only specific models determined by history, geography, current state in certain countries and conditions favouring the subsequent advancement. The change needs to be oriented towards sustainable development and be used as an upgrade generator. Changes may be slower or faster according to the pole positions in the transition process. Various studies support the idea that the most successful transition economies implemented comprehensive and stable reforms (Dimitrakopoulos, 2001; Tsarouhas, 2005; Greif; 2006). Other studies focus on the fact that the role of initial conditions in explaining growth variations should not serve as an excuse for lack of action (Arthur, 1994; Magnusson and Ottosson, 1997; David, 2005). *Firstly*, their negative impact becomes loose over time and may be overcome by a not so rapid breakthrough in reforms (North, 1990; Redek and Susjan, 2005). *Secondly*, the most important thing comes indirectly: unfavourable initial conditions arise from weaker political will and reform capacity and less reform is less growth (Bridges, 2000). Anyway, Central and Eastern European economies entered the process of transition having as a point of departure relatively similar institutional foundations and, in time, the competitiveness gap resulted from the extent to which each government dealt with suggesting and implementing the appropriate structural reforms in each field of activity. The quality of these reforms was reflected in the dynamics of GDP and, at the end, as an aggregated variable reflecting the level of development of a country, in the tendencies towards convergence of the GDP/capita compared to the more developed coutnries of the Union. The process of European integration favoured a superior economic dynamics to the EU average in the CEE countries (Figure 2), a reduction of the GDP/capita gaps having taken up (Table1, Figure 1), the so-called catching-up process. According to data presented in Table 1, CEECs had different starting positions in the pre-accession process, two big groups of countries being dinstinguished: Romania, Bulgaria, Estonia, Latvia, Lithuania, Slovakia, Poland and Hungary, on one hand, with a lower GDP/capita (20-45%) of the EU15 average and the Czech Republic and Slovenia, on the other hand, with a GDP/capita closer to the value found in the southern periphery of the EU (65%, compared to 68% in Portugal or 73% in Greece, for example).

Table 1. GDP/capita dynamics, 1995 -2015 (EU15=100%), current prices

	1995	**2000**	**2005**	**2008**	**2011**	**2015**
EU15 most developed countries						
Austria	112	112	112	112	117	118
Belgium	107	107	107	104	109	109
Denmark	108	109	109	113	117	117
Finland	93	102	103	109	107	101
France	99	100	98	96	99	98
Germany	113	105	104	106	112	114
Italy	106	103	96	96	95	89
Luxembourg	188	212	216	234	240	243
Netherlands	110	120	119	125	121	118
Sweden	108	112	109	114	115	114
United Kingdom	96	99	103	99	96	100
EU15 less developed countries						
Greece	73	74	82	84	69	63
Ireland	90	115	130	121	120	163
Portugal	68	72	45	73	59	71
Spain	77	82	89	91	84	83
CEECs						
Bulgaria	28	24	33	39	41	43
Czech Republic	65	61	70	76	76	81
Estonia	30	36	53	62	65	69
Hungary	43	45	55	56	60	63
Latvia	26	31	44	53	52	59
Lithuania	28	32	47	57	60	69
Poland	37	41	45	50	59	63
Slovakia	41	43	53	64	68	71
Slovenia	65	69	77	81	76	76
Romania	26	22	31	45	48	53

Source: authors' presentation based on Eurostat database (2017)

Benefiting from more rapid and more efficient reforms (Poland, Hungary, Slovakia), and/or from a higher quality of the system of institutions (Estonia, Hungary, Latvia, Lithuania), together with a higher performance level of government effectiveness (Hungary, Estonia) Estonia, Latvia, Lithuania, Slovakia, Poland and Hungary got closest to the Czech Republic and Slovenia and implicitly to the EU average (Pascariu and Tiganasu, 2017). Romania and Bulgaria recorded the lowest levels of performance, not only due to delays in the implementation of the acquis communautaire, the delay of the reforms and their later accession to the EU, but also due to a lower quality of the system of institutions correlated with poor government effectiveness. The data in table 1 also confirm a process of beta-convergence, the first group of countries of the CEECs, with a relatively lower GDP/capita level, recording a stronger economic growth than the relatively more developed countries of the same group (Czech Republic and Slovenia), the disparities thus being reduced to measure up to the intensification of the economic integration and the increasing role played by the European policies in the new member states.

The process was more wide-ranging before the 2008 crisis and slowed down afterwards (Figure 1), even reversed in some countries (Latvia, Lithuania, Slovenia), the convergence being slowed down following the economic recession and the degrading of the system of governance in some of the new member states (particularly in Hungary,Slovakia, Slovenia). The 2008 crisis also generated the association of some processes of convergence (reduction of disparities) with processes of divergence (increase of disparities), in the context of an unfavourable evolution of some of the old EU member states, mainly the economies of the south (Greece, Spain, Portugal but also Italy), confronted with negative average growth rates during 2005-2015 as a whole or at least close to zero (Spain). The result was growth in disparities compared to the EU average, but at the same time the convergence with the eastern periphery of the EU. Other developed EU states, members of the EMU, also recorded a reduction of governmental efficiency (Austria, Belgium, Finland, France, the Netherlands, Denmark), translated into lower economic dynamics in the EU17 rather than in CEECs (Figure 2), thus a process of sigma intra-EU convergence occurred during the period analysed as a whole.

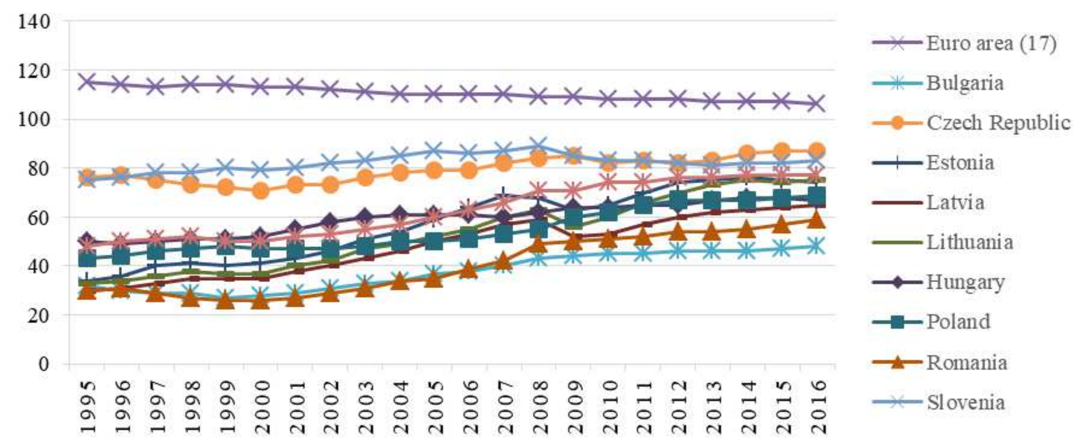

Figure 1. Convergence trends, CEECs vs. Euro area, EU27=100%
(GDP/capita, in PPS)

Source: authors' presentation based on Eurostat data, 2017.

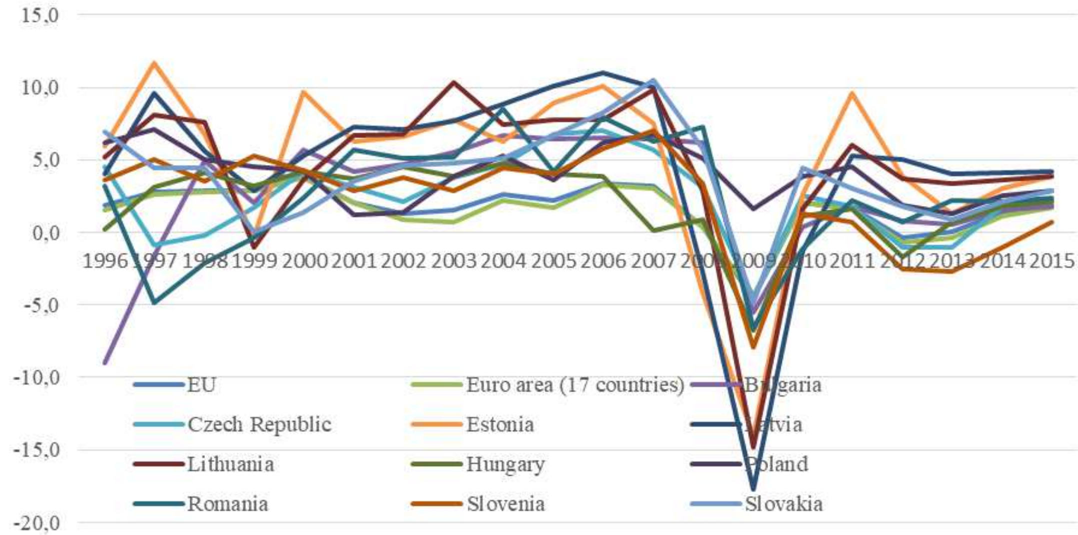

Figure 2. Real GDP growth (% change of previous period)
Source: authors' presentation based on Eurostat database (2017)

The process of nominal convergence of the GDP/capita was first of all the result of a structural convergence, reflected among other aspects in the reduction of productivity disparities. For example, the CEECs have experienced a process of substituting the labour factor (L), with the capital factor (K), above the EU average, resulting in a convergence of production patterns. It may be easily noted that the L-K substitution before 2004, when the EU's enlargement to the East took place, was below the average level and that the integration process featured a number of challenges that the new Member States had to cope with by stressing on the production factors that provided a faster multiplication effect. The replacement of L by K is gradually acknowledged, all considered countries having figures above the average (Figure3).

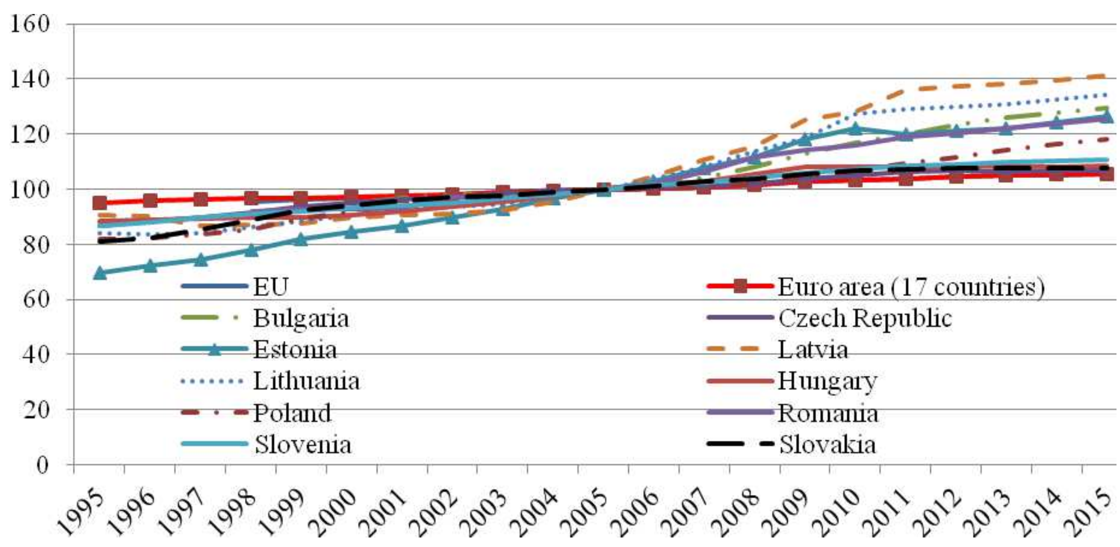

Figure 3. Labour-capital substitution: total economy (2005=100)
Source: based on EC, Economic and Financial Affairs, AMECO database, 2017

In addition, the K by L substitution capacity during 1995-2013 in the Euro Zone gradually decreased from above the average (107 points in 1995) to below the average (93 points in 2013), a further reduction for the years to come being anticipated. This may be due to high competition that boosted technological innovations across the EU's developed states rich in K which ended in the partial replacement of labour by technological equipment.

Structural convergence of production factors occurred mainly due to intensification of trade and investment flows among new and old member states also associated with increase of production and economic competitiveness. In general, the productivity of factors within CEECs started to grow with integration and faced a slight downturn in 2009 when the crisis deepened (Figure4). Although the phenomenon may be explained by transfer of know-how and technology to the East, it also attests additional innovation capabilities in Western countries (Ciobanu and Mocan, 2007).

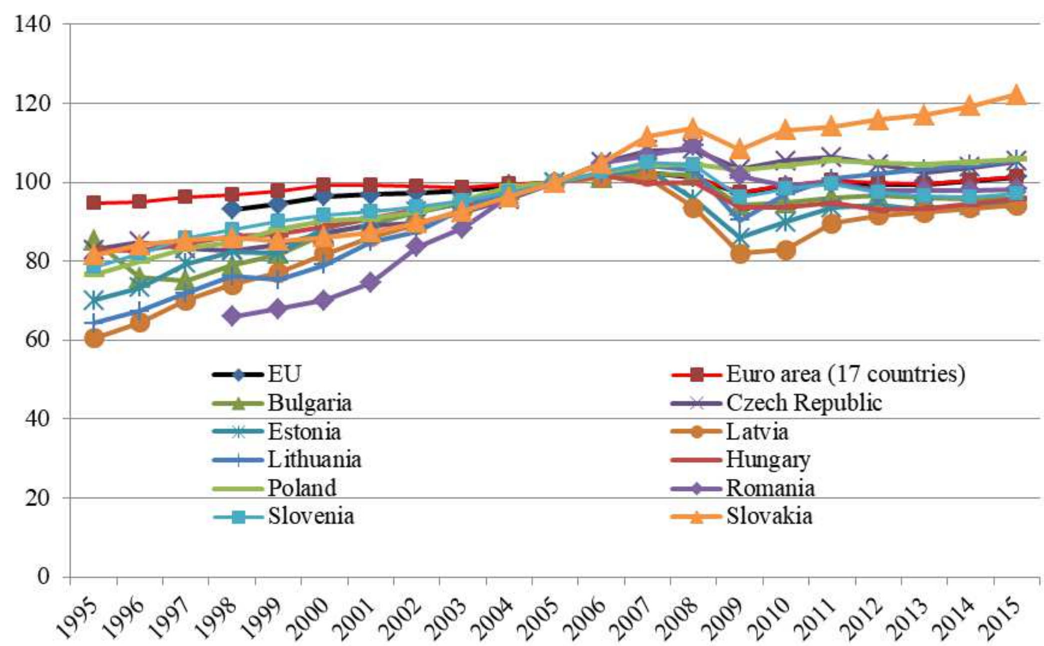

Figure 4. Total factor productivity: total economy (2005=100)
Source: based on EC, Economic and Financial Affairs, AMECO database, 2016

After 2005, Slovakia, Poland and also Romania faced the highest boom in the factor productivity (Figure 4). Although the Euro Zone was the most competitive in terms of factor productivity before 2004, over time it significantly and gradually lost leadership in an overall convergent trend. A possible explanation is that the governments of underdeveloped states understood that success in liberalization required protection of property and freedom in starting private business and therefore succeeded in creating a stronger private industry strengthening competition and streamlining resources for fruitful capital investments. Another factor relates to the opening of international trade (Belloc, 2006). In the short term, the possibility to do business with the West ensured immediate competition and greatly narrowed the local monopoly of giant state companies. In the long term, international trade is the key for economic restructuring and the increase of competitiveness, and implicitly for achieving structural intra-EU convergence. The Internal Market processes may help multiply industry concentrations and spatial aglomerations and reduce disparities by sustained investments, also via the European Cohesion Policy on improving the attractiveness of the less developed countries or regions. But, these concentrations of economic activities do not necessarily and automatically generate the reduction of development gaps, especially at regional level. Convergence is essentially conditional upon elements like factor mobility, spatial spread of technology and innovation, specialization patterns, inter-regional trade flows, quality of public policies, etc. The European integration dynamics rather confirm the concentration of innovating industries (high and medium tech) in developed countries, thus mostly generating intra-industry specialization, while developing countries draw concentration into the primary and labour-intensive sectors and into industries with little added value (low and medium tech), mostly with low dynamics and inter-industry specializations. The differences in the specialization patterns of production and trade generate a widening of disparities, which carries with it important economic, social and political risks for the integration process as a whole. The convergence of the specialization patterns can though result in an increase of the degree of integration of markets as an effect of the intensification of flows of goods and production factors in the internal market. In dynamics, it may be noted in Figure 5 that the degree of openness and trade integration of the CEECs has increased constantly during the analysed period, with a short fragmentation at the peak of the economic crisis. The highest ranked country by trade integration is Slovakia followed by Slovenia, Romania, Poland and Hungary. These states have a relatively high catching-up capacity resulting from the advantages created by the Single Market; their deep integration providing competitiveness and higher ability to reduce disparities.

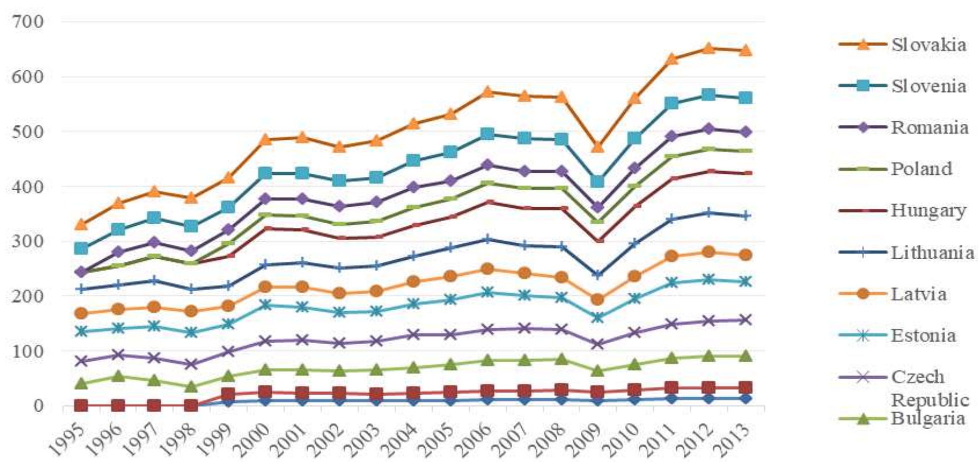

Figure 5. Market integration - trade of goods as % of GDP

Source: authors' presentation based on Eurostat data, 2017

The CEE countries have also concentrated their priorities on growth policies attracting forein capital, most of them facing low level of accumulation and implicitly reduced capacity of local capital to participate in the process of economic growth. The internal market has also played a significant role

The 2012 Ernst & Young study indicated that regions including the Czech Republic, Hungary, Poland, Slovakia, Estonia, Latvia, Lithuania and Slovenia are considered to rank second in terms of FDI attractiveness after Western Europe and that this is the most preferred position for industrial investments (30%). The CEEC performance in attracting FDI also derives from the interest manifested by multinational companies to expand sales markets, delocalize production due to lower costs, especially labour costs (L), extend the privatization process and infrastructure development. All these resulted in market integration at the FDI level (Figure 6).

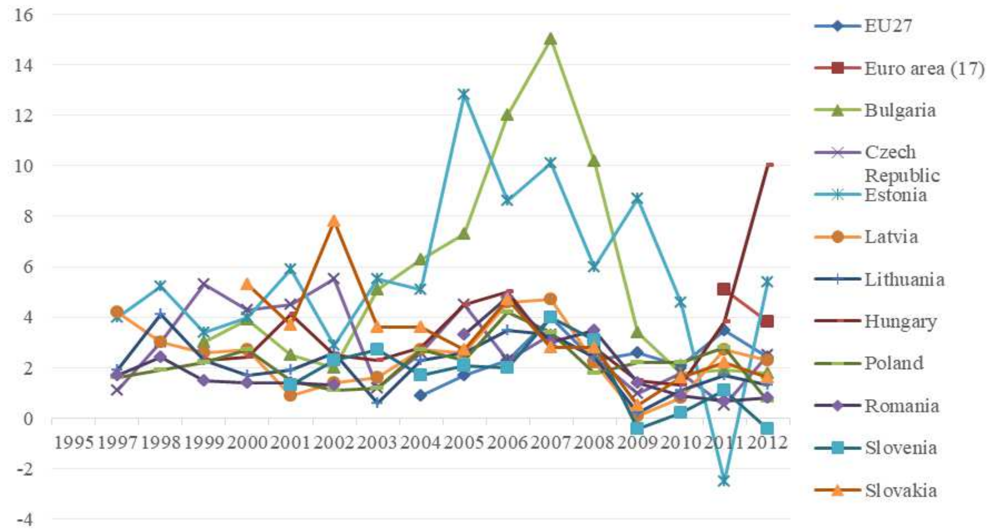

Figure 6. Market integration - FDI intensity as % of GDP

Source: authors' presentation based on Eurostat data, 2017

When refering to the two phases of EU enlargement to CEECs, it was found that country which attracted most FDI from the cluster of 2004 admissions was Estonia, which subsequently lost ground in favour of other states with a similar potential for development. In 2011, Estonia recorded negative figures and this highlighted its vulnerability to external shocks and to exchange rate fluctuations. As it is well-known, Estonia's adhesion to the Euro Zone on January 1st of 2011 determined, at least in the short-term - the period when the Euro and the national currency were simultaneously used - a high inflation rate which triggered higher interest rates, as well as an increase in imports and a fall in exports, which ultimately ended in capitals migrating towards the exterior. Among the 2007 integrated states, the one winning against FDI was Bulgaria. The sector which benefitted the most from FDI was the real estate followed by coal, oil and natural gas, transport, alternative energy, food and tobacco industries, with investments, tourism and communications found at the bottom of the list. Essentially, the decrease in FDI due to the crisis is directly linked to the GDP dynamics.The statistical data show however a relatively modest contribution of the FDI to economic integration of TECE and, as a result, a reduced potential for sustaining the process of structural convergence. Moreover, the impact of "the longest, deepest and broadest recession in the EU's history", as the European Commission called it in its 2009 fall economic forecast (European Commission, 2009), precipitated a decline of cross-border transactions within and beyond the EU borders, both in the field of goods and services and in investment flows, the decline which is in close correlation with the dynamics of GDP.

3. Institutional challenges

The studies on transition to market economy highlight that the decline of socialism triggered an institutional vacuum in Central and Eastern Europe (Polanyi, 1994; Havrylyshyn, 2001; Kornai, 2007). In this area, the transition process essentially stood for the search of a new body of institutions. Leaders faced two issues: 1) how to choose new institutions and 2) to what extent the new rules of the game should replace the old ones (Pejovich, 1994). The laws, the institutions and the property structure underwent gradual reform, rather slowly, to allow the implementation of private property. To be effective, such transformation should rely on market relationships fostering a stable and responsible competitive environment. As a matter of fact, how can the industry be upgraded, privatized and restructured without market signals to guide the process? Furthermore, if developing countries are poor because their current institutions anticipate a weak basis for growth incentives, what kind of institutions should they set up? And can we get there? The essential answer to these questions resides, according to the views shared by most contemporary ecoomists, in encouraging private incentives and initiatives towards growth of modern economy by capital accumulation and capital and labour conversion in market production (Ratajzcak, 2005; Pranab, 2005). Rodrik (1999) distinguishes two approaches to the "acquisition"of institutions. *Under the first approach*, it is possible to "borrow the institutional plan"from developed countries. Following the same line, the privatization of undertakings should be accompanied by a set of administrative reforms including legal enactments (often at the same level as developed countries), the creation of an impartial judiciary system, etc. *The second approach* puts emphasis on the idea that local conditions will, in many cases, require a unique plan that fits into the institutional context. The significance of this approach may be understood and appreciated through a real warning launched by North (1994): "and economies that adopt the formal rules of another economy will have very different performance characteristics from the first economy because of different informal norms and enforcement. The implication is that transferring the formal political and economic rules of Western market economies to third-world and Eastern European economies is not a sufficient condition for good economic performance". Although institutions are crucial in supporting growth, the latter, in order to get to considerable levels, must not wait until a large-scale institutional transformation is triggered. The different performance of transition economies is therefore explained by efficiency in reacting to the demands of market and the newly-created institutions (Knack and Keefer, 1995). Even though most views relate to the fact that only the institution of private property may induce market democratization, the experience of CEECs is special. At the end of 1989, these countries enjoyed special institutional/economic features: state ownership was overwhelming; the economic structure was biased and stressed on developing the industry to the detriment of services and of traditional sectors; the financial system was underdeveloped; the trade with developed countries was almost zero (Rostowski, 1998; Popov, 2007).

The transition process urged structural changes in CEECs that were mostly reflected at the level of formal institutions (adjustments in relation to the free market functionality, contractual relationships, the compliance with the dominance of law and of ownership rights). Obviously, some changes also manifested in informal institutions (organizational culture, area-specific traditions) and even if their impact is not reflected to a lower extend in the economic development, the evolution of informal institutions is to a greater proportion influenced by the dynamics of formal ones (Khalil, 2012). Despite the fact that the start was from different positions, in the context of European economic system adaptation to market demands, a Europe in which law and legislation prevail, as the experience of CEECs shows that the elaboration and implementation of most reforms can be dictated by political interests, should be a priority. It was not sufficiently well understood that formal institutions are indispensable to building market relationships, pricing and performing exchange based on mutual benefits. It is often too easily disregarded that mindsets, deemed to hinder economic success, are maintained and furthered with the state's intervention in economy. Institutions are therefore important for economic growth because they influence investmentin the physical and human capital, in technology and in the organization of production. Even if cultural and geographical factors may also be crucial for development, the differences between the economic institutions trigger most welfare disparities among countries. These determine a number of actions linked to the future distribution of resources (fortune, physical capital, human capital, etc) and not only the global potential of economic growth.

As it is known, Eastern Europe developed a specific type of capitalism. In the 1990s, institutional frameworks were unstable and easily shifting and this triggered dramatic behavioural changes in individuals: opportunism, bribery, favouritism, etc. As one could expect, all these resulted in quite different development paths from those of Western Europe, which was translated into economic divergence. Hence, it is not by chance that in 2017, according to *The Global Competitiveness Report 2016–2017,* the World Economic Forum ranked Romania and Bulgaria in the stage 2 of development (efficiency-driven), Hungary, Latvia, Lithuania, Poland and Slovakia in the transition from stage 2 to 3, and only Estonia and Slovenia in stage 3 (innovation-driven) (WEF, 2017). For 7 out of the 10 CEE countries (Bulgaria, Romania, Czech Republic, Latvia, Hungary, Poland and Slovak Republic), the institutions are listed among the three most important aspects affecting deficits of competitiveness, except for market size. In 2015, Hungary (3.3), Slovakia, Bulgaria (3.5) and Romania (3.6) had the lowest institutional index. The best placed among the CEECs was Estonia (5.1), followed by Slovenia (4.1), compared to a maximum of 6.1 for Finland among the EU member states (on a scale of1:7). In the cases of Estonia and Slovenia, the relatively high quality of institutions correlated with a high level of government effectiveness, which explains in fact the ranking of the two countries in stage 3 of development. The crisis affected the CEECs also from this perspective, the quality of institutions decreasing or maintaining itself very close to the levels reached in 2008.

Significant disparities are recorded in the CEECs also in terms of *governance indicators*, weighting the degree of the voice of government and accountability, political stability and absence of violence, government efficiency, regulatory quality, the rule of law and control of corruption, according to the methodology of the World Bank (Kaufmann, Kraay and Mastruzzi, 2010). Over 200 countries and territories were analysed starting with 1996 and the indicators were measured on a scale from– 2.5 (weak governance) to + 2.5 (strong governance). Since governance is a key factor for development, the review of indicators highlights areas which CEECs must try to improve. As to the extent to which the nationals of a country can participate in government elections and choose the freedom of expression, the freedom of association and a free media (voice and accountability), the indicator for the CEE region did not exceed 1.2 points, which means that governments are deficient and lack involvement in supporting the institutions that drive the economy. After the 2004 enlargement, Estonia, Poland, Czech Republic, Lithuania and Slovenia, recorded relatively similar governance levels and a clear differentiation became apparent between earlier accessions and 2007 accessions (Figure 7).

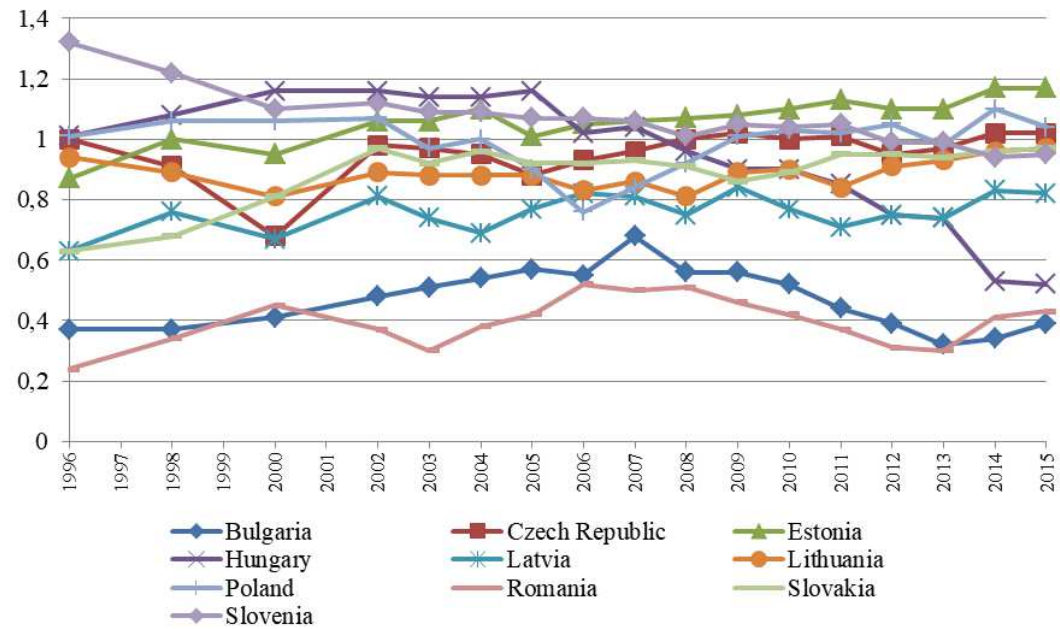

Figure 7. Voice and accountability

Source: after World Bank data, 2017

It should be noted that the governance system in both Romania and Bulgaria (with 0.30-0.60 values) is extremely frail and faulty, which entails severe deficits in the economy, fed by the instability caused by the turmoil and political disputes in the two states. In their case, it was not understood that any nation should defend and strengthen its institutions in order to achieve prosperity (Beyer and Fening, 2012; Srivastava, 2004). Hence, a natural question arises: do institutions guarantee the development itself by merely being there or a constant synergy and practical complementary actions are needed for their protection and respect? This question may get various answers, but the identification of institutions and their differentiation from one country to another is the first step towards understanding the manner in which economy grows, stagnates or declines. The simple process of Europeanization through the transfer of institutions from the EU to the new member states is not a guarantee of their effective contribution to a process of growth and development in the long term. For example, a key role in the efficient action of the institutions has been played by the extent to which the *rule of law* is respected. According to the World Bank database, the rule of law indicator reflects the extent to which agents trust and respect the rules of society and the quality of contractual performance, ownership rights, police and courts of law (Figure 8).

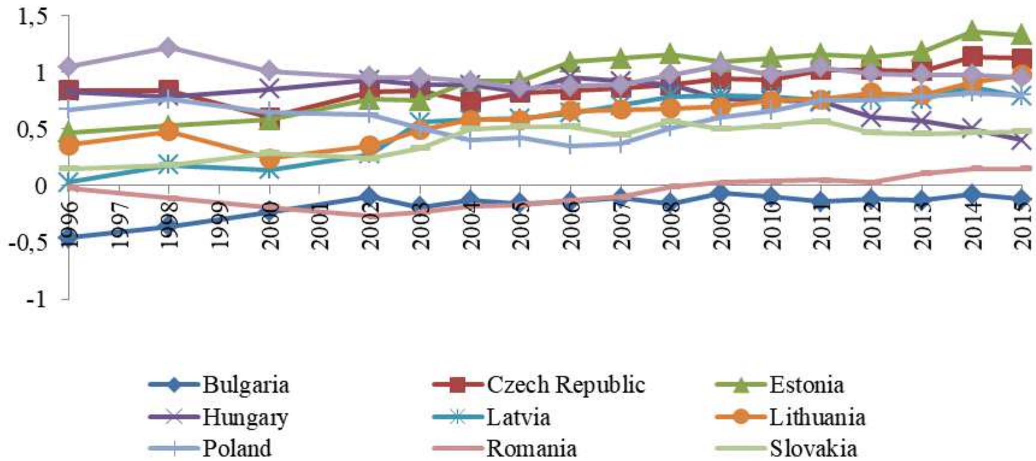

Figure 8. Rule of law
Source: after World Bank data, 2017

Between 1996 and 2015, Romania and Bulgaria recorded a slight improvement in the rule of law, but the indicator values remained negative or around zero, the countries being ranked at the bottom of the CEECs list. The highest performing countries were, as was the case for the rankings related to voice and accountability indicator, Estonia, Czech Republic, Slovenia, Lithuania and Poland, with a strong progress of Estonia and Slovenia, countries which, as we have seen above, recorded also the best performances in terms of evolution of competitiveness. The same correlation can be observed in the control of corruption and political stability and absence of violence indicators (Figure 9 and Figure 10).

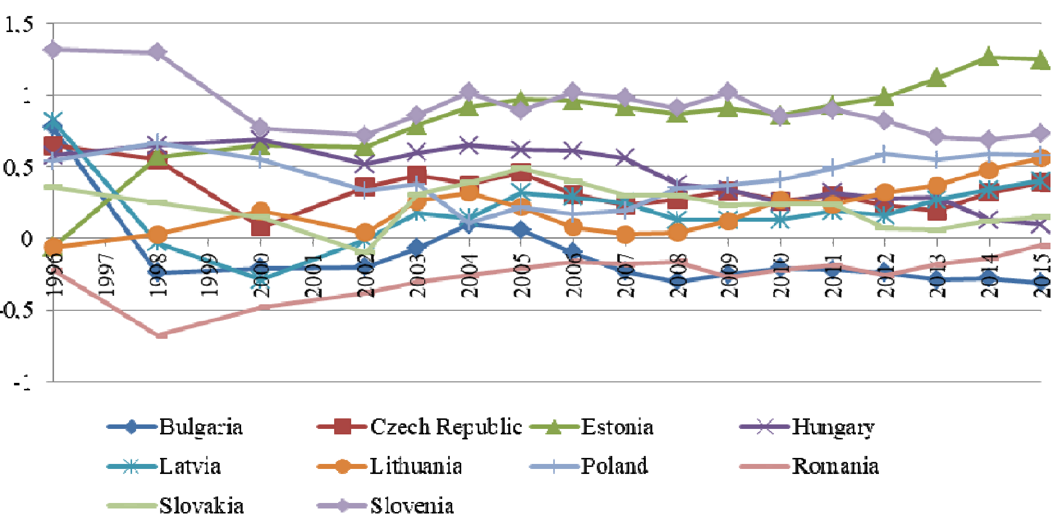

Figure 9. Control of corruption
Source: based on World Bank data, 2017

Until 2007, Romania had been among the first countries in the corruption top in Europe and, despite adhesion, the situation did not change dramatically: from -0.17 in 2007 to -0.16 in 2008, -0.27 in 2012, with a slight improvement in 2015. In the analyzed period, it was only Bulgaria that generally followed the same pattern, except for the 2004-2005 period, when a slight improvement in terms of corruption wasd recorded, reaching a -0.24 value in 2012 (Figure 9). It is not accidental that Estonia (1.29), followed by Slovenia (0.77), holds the top position, followed, although at a considerable distance, by Lithuania (0.62), Poland (0.56) and Czech Republic (0.43); all these countries holding higher positions in the CEECs hierarchy of competitiveness (with the exception of Slovenia, which holds its position due to the relatively low level of innovation and development of its financial markets and reduced size of its market, and not due to poor quality of its institutions (World Economic Forum, 2017). Furthermore, with some exceptions, the hierarchies of political stability have been maintained (Figure 10), showing a high level of interdependence among the institutional determinants of good governance.

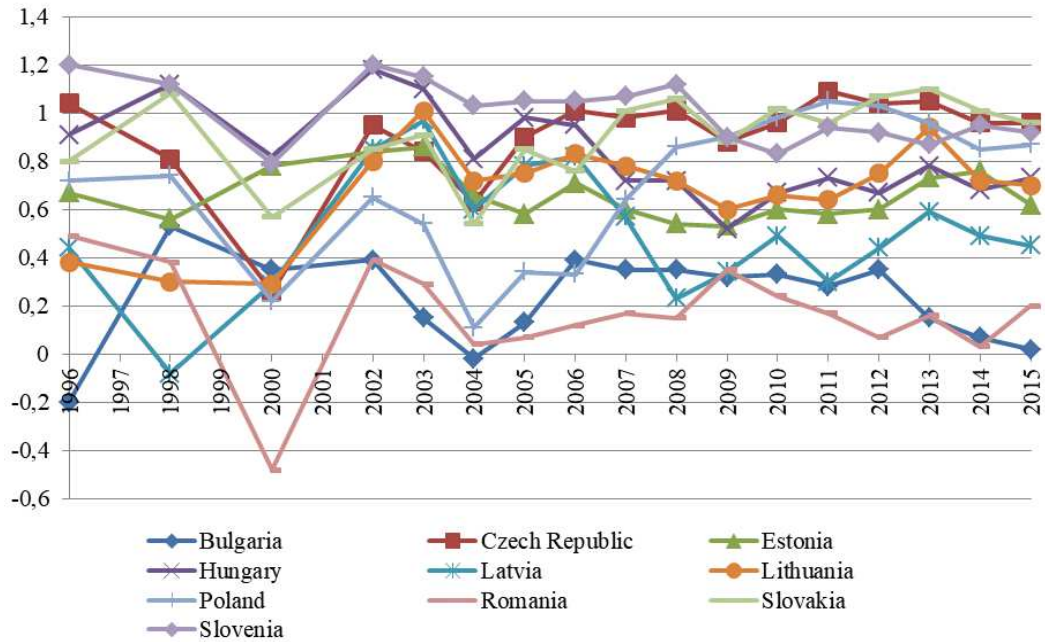

Figure 10. Political stability and absence of violence
Source: based on World Bank data, 2017

Political stability eliminates the possibility for the government to be destabilized or overthrown by using unconstitutional means, including the use of politically motivated violence or terrorism. This is the reason why political stability and governmental effectiveness are strongly connected.

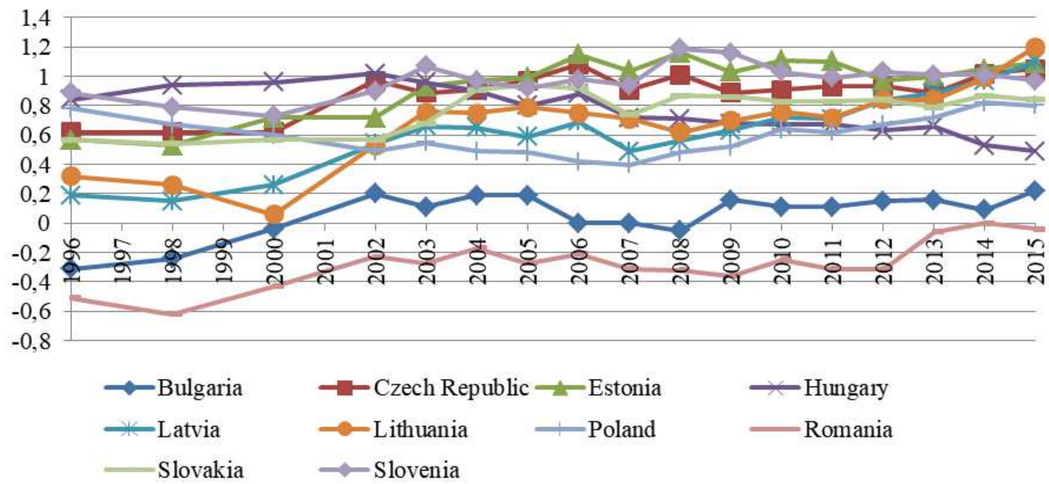

Figure 11. Government effectiveness
Source: based on World Bank data, 2017

Governance effectiveness is the lowest in the case of Romania and Bulgaria (Figure 11), with reduced progress recorded over the entire period, and this is the reason why serious question marks are put over their capacity to adopt and implement some efficient policies for macroeconomic stability and sustainable development and implicitly for the prospect of institutional modernisation. In 2015, in terms of governance effectiveness, the top positions in the CEECs were held by Lithuania (1.19), which recorded the most remarkable progresses over the entire period, followed by Estonia (1.07), Czech Republic (1.06), Latvia (1.00), Slovenia (0.97) and Poland (0.80), with much higher levels than in some of the old member states, such as: Greece (0.21) or Italy (0.52). The high level of governance effectiveness is reflected in a relatively better positioning in the competitiveness index rank (35 Lithuania, respectiv 30 Estonia, 36 Poland) and/or in the superior institutional index (5.1 Estonia; 4.2 Lithuania and Czech Republic; 4.1 Slovenia; 3.9 Poland and Latvia), or in a better quality of the regulations (Figure 12) that strengthen the efficiency of the markets and stimulate the investments' trust as engines of economic growth. Quality is ensured, among others, by the government's ability to draft and implement solid policies and regulations aimed to allow and promote development in the private sector. Obviously, in the case of the states where the rule of law does not function optimally, the citizens'trust in politicians, poor quality of regulations, corruption control, and other negative aspects are interconnected, all problems esentially deriving from flawed governance.

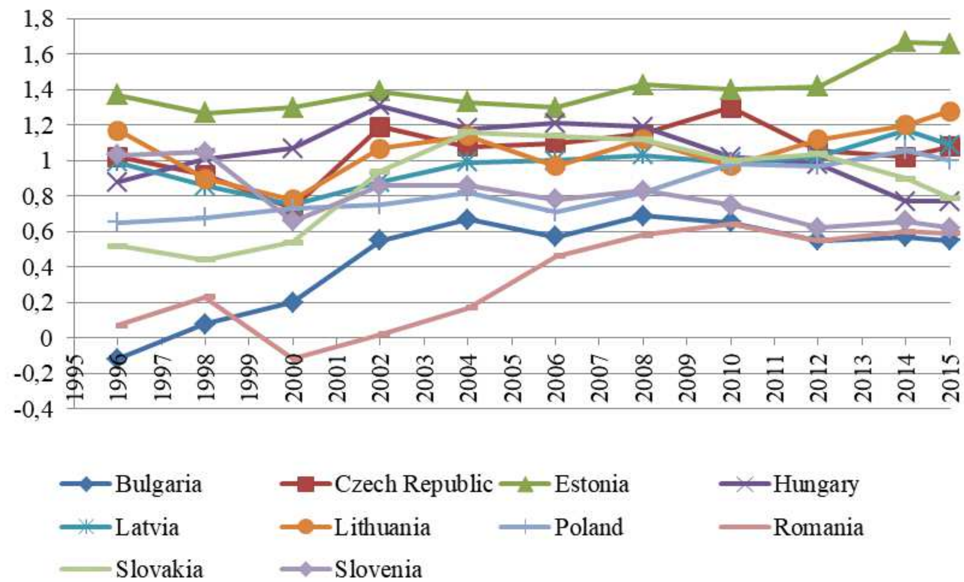

Figure 12. Regulatory quality

Source: based onWorld Bank data, 2017

The two states which were integrated in 2007 (Romania and Bulgaria) do not match the evolution of the other CEECs, Estonia clearly having a different status (interval +1.37 to +1.40). If the political system in a country is perceived as unstable and subject to accidental law change, private incentives will be weakened (Persson and Tabellini, 2003; Grindle, 2004). Moreover, a clear, coherent and stable legislation generating the so-called "state of development" has a major contribution (Rodrik et al., 2002; Skelcher and Torfing, 2010). Also, the government has an important role since it must have the capacity to establish and defend the institutions of economic competition, eliminate corruption and promote public-private partnerships (Kaufmann, 2005; Elmke and Levitsky, 2004). Consequently, the governance quality in a state, as well as the attention paid by its decision-makers to society needs, in general, represent some options which should be permanently taken into account by any nation striving towards economic competitiveness.

4. Conclusions

Generally, the European integration process had positive effects on macroeconomic dynamics in CEECs.When a sustainable balance between economic, social, institutional and governance objectives is desired in this area, then the EU should strengthen and develop European integration and cohesion measures. The institutions and the governance system quality play a key role. It was believed that the establishment of institutions similar to those in the West would be a relatively simple process and that it would consequently take a short period of time to solve the problems related to technological delay and economic inefficiency. But the last years have proved that these are far from being simple tasks and that development and essential structural change in CEECs have divergent results. It is the institutions which are mainly held responsible for explaining what has actually happened and, then, what has to be done in order to accelerate the recovery process of these states.

The weaknesses in the rule of law and in respecting the property right are the major obstacles for economic progress in the case of emergent European societies. These economies need functional markets, which represent both a result and a condition for development. Institutional changes, which may be implemented in a country with the purpose of improving the level of development need long time in order to become efficient. The pace of change in formal institutions turned to be more rapid than in informal ones, which are characterized by a profound cultural inertia. It refers to what institutionalists call "the path dependence". Moreover, the dependence mentality, seen as an obstacle in the way of economic success, is maintained and perpetuated by the state's intervention in the economy and is often overlooked. Although, in the short and medium term, no miraculous solution seems to be available for the gaps recovery of European economies, we consider that a general institutional consolidation could be the key for providing stability in the European Union by creating the necessary conditions for catching-up processes of the CEECs.

References

1. Agnello, L., Sousa M. R. (2013), Political, Institutional, and Economic Factors Underlying Deficit Volatility, *Review of International Economics*, Vol. 21, Issue 4, pp. 719–732.

2. Arthur, B. (1994), *Increasing Returns and Path Dependence in the Economy*, Ann Arber: University of Michigan Press.

3. Belloc, M. (2006), Institutions and International Trade: A Reconsideration of Comparative Advantage, *Journal of Economic Surveys*, Vol. 20, Issue 1, pp. 3–26.

4. Beyer, H., Fening, F. (2012), The Impact of Formal Institutions on Global Strategy in Developed vs. Emerging Economies, *International Journal of Business and Social Science,* Centre for Promoting Ideas, USA,Vol. 3, No. 15, pp. 30-36.

5. Bridges, A. (2000), Path Dependence, Sequence, History, Theory, *Studies in American Political Development,* Vol. 14, No. 1, pp. 109-112.

6. Ciobanu, Gh., Mocan, A. C. (2007), Technology Transfer in the New Member States of the European Union. In Ciobanu, Gh., Rovinaru, M., Mocan, A.C. (Eds.), *Competitiveness and European Integration*, Alma Mater Publishing House, Cluj-Napoca, pp. 223-231.

7. David, P. A. (2005), Path Dependence in Economic Processes: Implications for Policy Analysis in Dynamical Systems Contexts, In Dopfer, K. (Ed.), *The Evolutionary Foundations of Economics,* Cambridge: Cambridge University Press, pp. 151-194.

8. Dimitrakopoulos, D. G. (2001), Incrementalism and Path Dependence: European Integration and Institutional Change in National Parliaments, *Journal of Common Market Studies*, Vol. 39, No. 3, pp. 405-422.

9. Elmke, G., Levitsky S. (2004), Informal Institutions and Comparative Politics: A Research Agenda, *Perspectives on Politics*, Vol.2, No. 4, pp. 725–40.

10. Ernst & Young (2012), *Shifting perspectives. Ernst & Young's attractiveness survey 2012. Middle East*, Special edition for the Growing Beyond Summit 2012 - 16 and 17 October, Qatar, http://www.ey.com/Publication/vwLUAssets/Shifting_perspectives_ Middle_East_2012/$FILE/Shifting_perspectives_Middle_East_2012.pdf.

11. European Commission (2009), The EU's Response to Support the Real Economy during the Economic Crisis: An Overview of Member States' Recovery Measures, *Occasional Papers No 51*, Directorate-General for Economic and Financial Affairs, Brussels.

12. European Commission, Directorate-General for Regional and Urban Policy (2017). Cohesion Policy Data portal. https://cohesiondata.ec.europa.eu/d/99js-gm52?category=dataset&view_name=ESIF-2014-2020-Finance-Implementation-Details

13. Feng, Y. (2001), Political Freedom, Political Instability, and Policy Uncertainty: A Study of Political Institutions and Private Investment in Developing Countries,*International Studies Quarterly*, Vol. 45, Issue 2, pp. 271–294.

14. Greif, A. (2006), *Institutions and the Path to the Modern Economy: Lessons from Medieval Trade*, Cambridge: Cambridge University Press.

15. Grindle, M.S. (2004), Good Enough Governance: Poverty Reduction and Reform in Developing Countries, *Governance: An International Journal of Policy,Administration, and Institutions*, Vol. 17, No. 4, Blackwell Publishing, Boston, pp. 525–548.

16. Gros, D., Steinherr, A. (2004), *Economic Transition in Central and Eastern Europe: Planting the Seeds*, Cambridge: Cambridge University Press.

20. Havrylyshyn, O. (2001), *Recovery and Growth in Transition: A Decade of Evidence*, IMF Staff Paper, Vol.48, pp. 53-87.

21. Kaufmann, D. (2005), *Myths and Realities of Governance and Corruption*, World Bank, Washington, D.C.

22. Kaufmann, D., Kraay, A. and Mastruzzi, M., The Worldwide Governance Indicators: Methodology and Analytical Issues (September 2010), *World Bank Policy Research Working Paper* No. 5430, Available at SSRN: https://ssrn.com/abstract=1682130.

23. Knack, S., Keefer, Ph. (1995), Institutions and Economic Performance: Cross-Country Tests Using Alternative Institutional Measures, *Economics andPolitics*, Vol. 7, No 3, pp. 207–270.

24. Khalil, L. E. (2012) Why Europe? A Critique of Institutionalist and Culturalist Economics, *Journal of Economic Surveys*, Vol. 26, Issue 2, pp. 351–372.

25. Knedlik, T., von Schweinitz, G. (2012), Macroeconomic Imbalances as Indicators for Debt Crises in Europe, *Journal of Common Market Studies*, Vol. 50, Issue 5, pp. 726–745.

26. Kornai, J. (2007), The Great Transformation of Central Eastern Europe: Success and Disappointment, *Economics of Transition*, Vol. 14, No 2, pp. 207-244.

27. Magnusson, L., Ottosson, J. (1997), *Evolutionary Economics and Path Dependence*, Cheltenham: Edward Elgar.

28. Nahtigal, M. (2008), *From Transition to the European Integration: Institutional Transformation of the Countries inCentral and Eastern Europe*, VDM Verlag.

29. North, D. (1990), *Institutions, Institutional Change, and Economic Performance*, Cambridge: Cambridge University Press.

30. North, D. (1994), Economic performance through Time, *The American Economic Review*, Vol. 84, No 3, pp. 359-368.

31. Pascariu, G. C., Tiganasu, R. (2017), Integration, Growth and Core-Periphery Pattern in EU's Economy: Theoretical Framework and Empirical Evidences, in Pascariu, G.C. and Pedrosa Da Silva Duarte, M.A. (eds.) *Core-Periphery Patterns Across the European Union*, Emerald, pp.23 – 85.

32. Pejovich, S. (1994), A Property Rights Analysis of Alternative Methods of Organizing Production,*Communist Economies & Economic Transformation*, Vol. 6, No. 2.

33. Persson, T., Tabellini G. (2003), *The Economic Effects of Constitutions*, MIT Press, Cambridge.

34. Pranab, B. (2005), Institutions matter, but which ones?, *Economics of Transition*, Vol. 13, No. 3, pp. 499–532.

35. Polanyi, K. (1994), The Great Transformation. The Political and Economic Origins of our Time, *Beacon Paperback*, No. 45, Boston.

36. Popov, V. (2007), Shock Therapy versus Gradualism Reconsidered: Lessons from Transition Economies after 15 Years of Reform, *Comparative Economic Studies*, 49, 1–31.

37. Ratajzcak, M. (2005), Institutions in Transition: from Centrally-Planned to the Market Economies, *Transformations in Business & Economics*, Vol. 4, No 2 (8), pp. 73-86.

38. Redek, T., Susjan, A. (2005), The Impact of Institutions on Economic Growth: The Case of Transition Economies. *Journal of Economic Issues*, Vol. XXXIX, No. 4, pp. 995-1027.

39. Rodrik, D. (1999), *Institutions for High-Quality Growth: What They Are and How to Acquire Them*, Massachusetts: Harvard University Press.

40. Rodrik, D., Subramanian A., Trebbi F. (2002), Institutions Rule: The Primacy of Institutions Over Geography and Integration in Economic Development, InternationalMonetary Fund, *Working PaperNo. WP/02/189*, IMF, Washington.

41. Rostowski, J. (1998), *Macroeconomic Instability in Post-Communist Countries*, Oxford: Clarendon Press.

42. Sirimaneetham, V., Temple, R.J. (2009), Macroeconomic Stability and the Distribution of Growth Rates, *World Bank Economic Review*, Vol. 23, Issue 3, pp. 443–479.

43. Skelcher, C., Torfing, J. (2010), Improving Democratic Governance through Institutional Design: Civic Participation and Democratic Ownership in Europe, *Regulation & Governance*, Vol. 4, Issue 1, pp. 71–91.

44. Srivastava, M. (2004), Moving Beyond 'Institutions Matter': Some Reflections on How the 'Rules of the Game' Evolve and Change, *LSE Discussion Paper No. 4*, London School of Economics, London.

45. Tsarouhas, D. (2005), European Integration and Path Dependence: Explaining the Evolution of EU Social Policy, *European Political Economy Review*, Vol. 3, No. 2, pp. 87-111.

46. Van Treeck, T., (2009), A Synthetic, Stock-Flow Consistent Macroeconomic Model of 'Financialisation', *Cambridge Journal of Economics*, Vol. 33, pp. 467–493.

47. White, S., Batt, J. (2007), *Developments in Central and East European Politics*, Durham: Duke University Press Books, Fourth edition.

48. Wolchik, L.S., Curry, L.J. (Eds.) (2010), *Central and East European Politics: From Communism to Democracy*, Maryland: Rowman & Littlefield Publishers, Second edition.

49. World Economic Forum (2017). The Global Competitiveness Report 2016–2017. Retrieved from http://www3.weforum.org/docs/GCR2016-2017/05FullReport/TheGlobalCompetitivenessReport2016-2017_FINAL.pdf

50. Zahn, R. (2013), European Enlargement and the Economic Crisis: Impact and Lasting Effects, *Working Paper 2013.01*, European Trade Union Institute, ETUI aisbl, Brussels, pp. 1-24.