

Neoliberalism and the future of market economy after the world financial crisis in Eastern Europe

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Abstract:

The main hypothesis is whether the recession that followed the financial crisis of 2008 has led to a paradigm shift, by which we mean a substantial shift to the way people think about the economy and the role of the state in Eastern Europe and Albania in particular. This paper uses orderlogit regression to measure 27000 respondents likelihood to accept a greater role for the government intervention in reducing inequality. We find that in line with social mobility theory people are less likely to accept greater government intervention if they believe that they will be able to climb the social ladder in the future. We find that the neoliberalism was under threat prior to the crisis and the latter has not led to a paradigm shift and to an alternative view of the economy.

Key words: neoliberalism, Eastern Europe, economic crisis, people's preferences, inequality

1- Introduction: Neoliberal Reforms in Eastern Europe

Boas (2009) describes that neoliberalism has rapidly become an academic catchphrase. It adds that "from only a handful of mentions in the 1980s, use of the term has exploded during the past two decades, appearing in nearly 1,000 academic articles annually between 2002 and 2005. Neoliberalism is now a predominant concept in scholarly writing on development and

political economy, far outpacing related terms such as monetarism, neoconservatism, the Washington Consensus, and even “market reform”.

The normative valence of neoliberalism in Academic Journals				
	Positive	Negative	Neutral	Mix
	3%	45%	45%	7%
<i>Source: Boas (2010)</i>				

Scholars typically characterize three sets of policies as being neoliberal: those that liberalize the economy, by eliminating price controls, deregulating capital markets, and lowering trade barriers; those that reduce the role of the state in the economy, most notably via privatization of state-owned enterprises; and those that contribute to fiscal austerity and macroeconomic stabilization, including tight control of the money supply, elimination of budget deficits, and curtailment of government subsidies (Wilson 1994: 165).

There isn't a clear path of development for transition economies of Eastern Europe after the collapse of the Berlin Wall despite their implementation of liberal reforms and contraction of state intervention in the economy. It was believed that by implementing across all the countries the policies described by the Washington Consensus the transition economies would overcome in the short run the immediate problems facing their economies and allow for economic development in the long run. In turn neoliberalism came to symbolise the Washington Consensus given its preferences especially for small state, liberalisation of trade, deregulation and privatisation. The long run benefits of these policies are seen across the Eastern European bloc where Poland, for example, managed to double its income levels in just 18 years to \$15.401 by 2007.

Other studies (Kolko 1998, 21) maintain that nations following IMF prescriptions did not prosper: ‘the majority of those nations that have followed the IMF’s advice have experienced profound economic crises: low or even declining

growth, much larger foreign debts and the stagnation that perpetuates systemic poverty.’ Some countries that had declined the IMF’s ‘enhanced structural adjustment’ loans were in contrast better off. The current financial crisis, and the responses to it, seems to have delivered a death blow to neoliberalism. Given that Eastern European countries have been hit hardest it is important to see how neoliberalism is understood and what are people’s preferences for government intervention in these countries and how it could shape the political landscape in the future.

However, neoliberal reforms brought short run costs to these economies in what is known as the post-communist recession, with overall depression in production and deindustrialisation of the economy. The affected countries experienced a dramatic fall in state institutions and in the level of human capital according to UNDP figures. In Russia poverty increased to 50% in mid 1990s from the low levels of 2% in 1989 accompanied with reduced income levels by 38%. (World Bank 2004). Given that neoliberal reforms have become synonymous to privatisation in most East European economies, studies like Stuckler (2009) conclude that that neoliberal reforms and high level of privatisation led to increased mortality rate by 12.8% in males. Also they show that rapid privatisation in these economies led to higher levels of unemployment by around 61% compared to economies that embarked on gradual privatisation.

1.2 Impact of Financial Crisis

According to Orestein (2009) “the stakes in the debate on the effects of mass privatization and neoliberal reforms in general are high. It concerns not only whether the neoliberal economic project works in post-Communist countries, but whether free market policies will continue to be adopted in other parts of the world and whether such reforms are compatible with democracy”.

Country	Real GDP growth 2009	Budget Deficit as % of GDO	Un-employment
EU 27	-4.2	-3.9	8.9
Post Communist Countries			
Bulgaria	-5	-3.9	9.7
Czech Republic	-4.1	-5.9	7.4
Estonia	-14.1	-1.7	19
Latvia	-18	-9	20
Lithuania	-14.8	-8.9	17.3
Hungary	-6.3	-4	10.4
Slovakia	-4.7	-6.8	15
Slovenia	-7.8	-5.5	7
Poland	1.7	-7.1	9.6
Rumania	-7.1	-8.3	7.4

Also this debate becomes more important when we take into account the negative impact that the world financial crisis had on eastern European economies. The recent events have shown that, in contrast to when small open economies were exporting financial crisis, due to the mismanagement of their economies, there seems to be a paradigm shift. The financial crisis that started in USA and spread to the periphery, had a profound impact on the Balkan economies. According to the Economist Intelligence Unit: The Balkan transition economies (Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Montenegro, Romania and Serbia) were among those emerging markets that suffered the most from the global recession in 2008-09 as the real GDP in the Balkans contracted by 5.2% in 2009. The channels through which the crisis might have impacted these economies are through the fall of foreign investment, fall in demand for their exports or fall in credit to their economies.

The global financial crisis therefore served as a moment of reflection on the role of the state in the economy in transition economies and the neoliberal approach to institutional reforms. This is validated by Will Barlett who finds that all those economies that had made good progress in creating an institutional system that encouraged free entrepreneurship and

competition suffered most from the crisis thus putting into question the future of neoliberalism in Eastern Europe. Concerning this analysis Dani Rodrik (2006) asks not whether the Washington Consensus is dead or alive, but what should replace it?

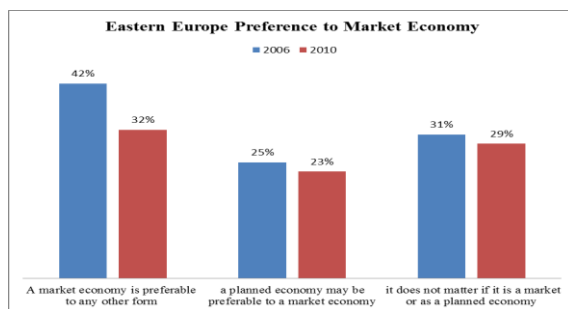
2- Confirming changing preferences for market economy

Hayo (2004) shows that in those economies where there is economic uncertainty and inflation rises by 100% than support for reforms reduces by 1%. This is also supported by evidence that 10% increase in unemployment levels reduces support for reforms by at least 16%. On the other hand support for reforms increases in those economies that have well-functioning financial system. However, almost all Eastern European societies have a negative relationship with the privatisation levels and support for reforms. Olivera (2014) has shown that the economic crisis has substantially influenced the support for redistribution in a number of EU countries where unemployment has increased the citizens' demand for redistribution.

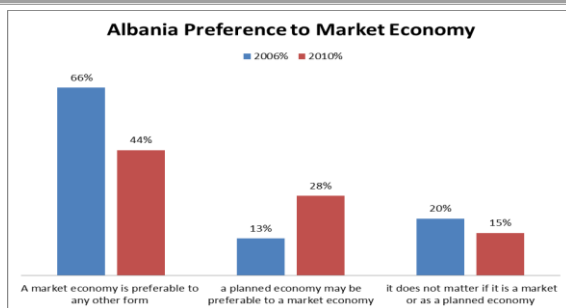
In this model we will try to interpret micro level data to see how likely are people to vote for and support higher government taxes in order to reduce inequality in the country. Given that many studies support the idea that institutional reforms enhance economic growth than it is important to understand how financial crisis might alter people's preferences for reforms. Popular support and people's preferences are just as important as visionary leadership and coherent political economies according to Williamson.

Many studies have made indirect measurement of how people change their support for reforms and government intervention in the economy based on the electoral results of political parties that do support economic reforms and those

that do not. However, these results do not take into account and distinguish the preferences for policies, for the political leader and other factors that might alter people's preferences for more government presence in the economy Warner (2001). It is for this reason that in this paper we argue that personal experiences during the transition period as well as the financial crisis of 2008 has altered the people's preferences for economic reforms and for public policies in particular. Below we show the results from two The Life in Transition survey II, conducted jointly by the European Bank for Reconstruction and Development and the World Bank in late 2006 and 2010, surveyed almost 39,000 households in 34 countries to assess public attitudes, well-being and the impacts of economic and political change. The Survey provides vivid evidence of precisely how lives have been affected by the global economic crisis and its aftermath.



It is clear from these two graphs that the support for free market policies is in decline, not only in Eastern Europe, but also in Albania. Evidence from the EBRD data shows that less than half of the people interviewed support a market economy to any other form of market organization. The fall in support for market economy is striking in the Albanian case given that Life in Transition data shows that 70% of the people in 2006 believed that their life was much better that year than in 1989.



3. Survey Results and Ordered Logit Regression

It is important to note that most criticism to neoliberalism is addressed to its approach on the role of the state in advancing social issues and economic inequality. In this model we will try to identify people's preferences for government intervention in the economy and how neoliberal reforms are perceived in Albania as compared to other countries in Eastern Europe. It is important to note that neoliberal reforms want to advance deregulation, privatization, and overall reduction of state's role in the economy. Therefore any change in people's preferences on the role of the state in achieving social justice in the country is likely to put into question the role of neoliberal ideology in these countries with important consequences for the political landscape in these countries.

In this model we will use ordered logit regression given that it interprets ordered answers from the 2006 2010 Life in Transition report. The ordered probit and logit models have a dependent variable that are ordered categories. Examples include rating systems (poor, fair, good excellent), opinion surveys from strongly disagree to strongly agree, grades, and bond ratings.

We expect that the probability that respondents chose the first option, (1) , the state should not intervene to reduce poverty in the economy if they think the future of their children will be more prosperous in the future than their own and (7) the state should do more to reduce inequality. On the other hand,

results show that with increasing age and deteriorating health conditions , citizens reduce support for the assertion that the state should not interfere in the economy and increase it when the claim is that the state must intervene to reduce inequality in the country. It is important to notice that trust in political parties is also of importance in supporting or not state intervention to reduce inequality.

Overall we expect citizens to have experienced communism in different ways and also the experience during transition could not have been uniform across individuals in these countries. Therefore, factors affecting the support for state intervention in the economy should not be the same. For example, in Albania, if the citizens had had a positive experience during transition, they are likely to require less state intervention in the economy. It is important to note also that trust other citizens, which is measured as social infrastructure , which helps in difficult times, is also a negative effect on intervention state. But what is striking is the fact the role that political parties play in these countries. If citizens believe that political parties are reliable, then they will do what they say if they come to power, the citizens are still willing to delegate this power to them to reduce poverty in the country.

Other factors such as age of the respondents, employment in the last 12 months, the perception about the future of the children seem to have no relevance to determine state intervention in the economy. But it is worth noting that all Balkan countries are willing to allow inequality to be addressed by the state if political parties are reliable for them.

Ordered Logistic Regression	State
intervention to reduce inequality	
Children who are born now will have a better life than my generation	-0.022 (2.48)*
Social Mobility	-0.131 (14.73)**
Social Capital/ Trust in others	-0.096

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	(9.39)**
Health assessment	0.041
	(2.60)**
Age	0.001
	(0.55)
Education	-0.105
	(8.10)**
Employment in the past 12 months	-0.161
	(5.25)**
Trust in Political Parties	1.022
	(46.78)**
<i>N</i>	27,892
	LR chi2(8)=3154.29
	Prob > chi2
	Pseudo R2=0.0761

Government preferences for spending public money is another issue that needs to be taken into account. In a time of economic turmoil governments will find it difficult to satisfy such demands given the declines in production and tax revenues on the one hand, and increasing fiscal debt on the other hand. This in turn, will create more tensions and will further demoralize individuals since they count on more redistribution for economic relief.

What should be the government’s priority in public spending

	2006	2010
Education	18%	36%
Health	37%	33%
Shelter	8%	5%
Pensions	13%	9%
Social care for the poor	2%	6%
Environment	6%	2%
Infrastructure (public roads)	14%	6%
I don’t know	2%	2%

For the 2006-2010 period the Albanian government had set as a main priority the building of road infrastructure. This was indeed a very accurate decision when one considers the fact the Albania had the least developed road infrastructure in Europe. The Ministry of Transport would also receive most of the funds from the public taxes. However, it is important to note that

even if we perceive that the public requires more state intervention in production or to reduce income inequality than we are not sure how it should achieve these priorities. In The Albanian case, as we can see from the data the public saw as priority for public spending education and health care while infrastructure was third in 2006 and fourth in 2010.

4. Conclusion

Despite a fall in support for market economy across all the transition economies of Eastern Europe and Albania we draw the attention that citizens still see their long term interest as a means of judging government policies and greater role for the government in pursuing social policies. As we have seen even if the government wants to increase public expenditure and justify higher taxes it is difficult and not always possible to have same expenditure and priorities as the public in general. While the world economic crisis might have brought into the public debate the role of the markets and the government in the future it is however impossible to conclude that there has been a paradigm shift to neoliberalism and its future.

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