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Transition Process in South Eastern Europe Compared to the Central European Transition Countries

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TRANSITION PROCESS IN SOUTH EAST EUROPE COMPARED TO THE CENTRAL EUROPEAN TRANSITION COUNTRIES

Paper prepared for the
45th Congress of the European Regional Science Association
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Abstract

The literature on transition distinguishes between two groups of transition countries: the seven South East European countries (SEEC-7) and the eight Central East European countries (CEEC-8). The former group is generally less developed, receives less FDI, and is more backward in terms of transformation than the CEECs, which also became the EU members and in the literature they are known as New Member States (NMS). However, fifteen years of transition have brought about tremendous changes, driven by broad economic reform programs, including changes in fiscal and monetary policy, widespread privatization, price and trade liberalization, and new regulatory approaches in these countries. But, if the number of people in the SEECs is only twenty per cent lower than in the CEECs, the overall GDP of the former group is one third of the latter's. Analysis of the real sector shows that the macro-stabilization program approved by the International Monetary Fund (has aimed at decreasing inflation and unemployment, and equalizing the balance of payments) has brought good results in the CEE group of countries, but not in the SEE group. In this paper, we analyze the reason why the SEE region has been delaying in the transition process and try to find a general path for successful transformation based on the experience of the CEE-8. In particular, in this paper, the role of the small and medium enterprises as an engine of transition has been researched in some transition countries; and this paper determines whether foreign investors helped in building this sector and to what extent.

JEL Classification: P20; P52

Key words: the transition process, the SEE region, the private sector, small and medium enterprises

1. Introduction

With the collapse of socialism, all ex centrally-planned economies started their path toward building a market economy and their final results depended on their starting positions, as well as their internal and external factors. The long and dissimilar transition processes which they either passed through or are in now divided all transition countries into three groups: Central East European countries (CEEC), the South East European countries (SEEC), and the Commonwealth of Independent States (CIS). The former became EU members in 2004, known in the literature as New Member States (NMS), and it can be said that they have finished their transition process, while the other two groups are lagging more behind the NMS in terms of the speed and success of transition.

The SEE region suffers a low level of the GDP, three times less than today's NMS, extreme unemployment in some of their states, a huge current account deficit, and external debt. Because the transition is a very complex process of complete transformation of the economic and political systems, it includes liberalization, macroeconomic stabilization, privatization, and legal and institutional reforms. Therefore, the SEE region has more or less successfully finished its first and second phase, while the privatization is still in process; in this paper, we put focus on the development of the private sector. The private sector based on private property is crucial for a successful transition, and the development of the private sector can be done through the privatization of socialist state-owned companies or by opening a new company. According to the CEECs' experience, foreign investors might have a crucial influence in the privatization, but their roles in running business can vary between transition countries.

The paper is organized as follows: after the introduction, section 1 provides a general overview of the transition process and introduces the main performance of transition countries, dividing them into two groups, CEEC,c which are today's European members, and the SEE region. Section 3 researches the meaning of the private sector in some transition countries, and the impact of the small and medium enterprises on successful transformation. According to the obtained results section 4 concludes the paper.

2. Transition and the results of the transition process in the CEE and SEE regions

Transition as a process of political and economic transformation of an economic system depends on a country's initial position but generally, the socialist system was politically, economically, and socially unsustainable. After its collapse total reformation was needed. For building an open - on market rules setup economy - it is necessary that the transition process includes four main parallel activities:

- *Liberalization*: opening of the market - free markets determination of prices of all goods and services and reduction of trade barriers;
- *Macroeconomic stabilization*: achievement of a stable economic system - the process through which inflation is brought under control and lowered over time, after the initial burst of high inflation that follows from liberalization in many transition economies;
- *Restructuring and privatization*: the process of privatization of the state-owned companies and creation of a sound real and financial sector;
- *Legal and institutional reforms*: building the institutional infrastructure - these are needed to redefine the role of the state in these economies, establish the rule of law, and introduce appropriate competition policies.

With the first process, liberalization of price and trade, in almost all transition countries inflation burst. Early in the transition, inflation averaged 450 percent a year in the CEE, nearly 900 percent in the Baltic States, and over 1000 percent in the CIS, while for the entire SEE region the data for mentioned period are not available. By 1998, however, annual inflation had been lowered to the single digits in the first two groups and around 30 percent in the third (IMF, 2000). Along with the high inflation rate, the transition countries needed to cope with one more shock, the decline of production and this reduction was different between transition countries. Therefore, the decline in output as well as economic growth in the CEECs during the 1990s was the reflection of the national readiness, policy strengths and weaknesses as well as external influences.

The transition process is the process of change of the economic system and transformation from centrally-planned to a free market system based on private property and, by definition, it is a process of introducing the principles and elements of the market into former communist economies. This process represented challenges for all socialist countries and their experiences were different. All transition countries chose between two strategies: the "big bang" approach that means a fast and comprehensive implementation of all major reforms or a

gradualist strategy, which emphasizes the need for a precise sequencing of reforms. Some countries tightly follow the advice of the international institutions like the International Monetary Fund or the World Bank, while some others try to develop their own strategies and find their own way by accepting national weaknesses and strengths as well as environmental influences. Generally, the latter has given better results than the former model.

While all of the transition economies experienced a fall in production at the start of the transition process, some countries in Central and East Europe recovered growth after a few years. The results of other countries were showing little or no recovery of growth through most of the 1990s. In order to confirm this statement we present the data about the GDP in table 1. While the negative growth rate of the GDP was a rule for the SEECs during the 1990s, it had been an exception for the CEECs. Namely, the latter set on the positive trend in the second part of the 1990s, so their average growth rate for the decade was mostly positive; the exceptions were Latvia and Lithuania. In the second analyzed period, 2000-2004, all countries from both groups revealed positive growth rate of the GDP, and the SEECs recorded the faster economic growth than CEEC, but their starting position was very different. So, the faster growth of the SEE region in recent years was not enough to reach the development level of the CEE-8. Furthermore, we should emphasize that there were some differences inside the two analyzed groups, e.g. in the first group, the highest growth rate of the GDP was realized by Romania and Albania, higher than 5%, while the lowest rate was accomplished by FYR Macedonia, less than 1%, other countries from the region reached nearly 5%. In the second group, the most successful countries according to this indicator were Lithuania, Latvia, and Estonia with a growth rate of 7 or more percent, followed by Slovakia and Hungary; while other states generated nearly 3% of the GDP per year (table 1).

Table 1. The growth rate of the GDP and selected economic activities for the SEECs and the CEECs, 1990 - 2004

Country	GDP		Agriculture		Industry		Manufacturing		Services	
	1990-2000	2000-2004	1990-2004	2000-2004	1990-2000	2000-2004	1990-2000	2000-2004	1990-2000	2000-2004
Albania	3.5	5.4	4.3	5.1	-0.5	4.8	N.A.	N.A.	7.0	7.7
Bosnia and Herzegovina	NA	4.9	N.A.	0	N.A.	3.2	N.A.	4.1	-	5.0
Bulgaria	-1.8	4.8	3.0	1.8	-5.0	5.3	N.A.	8.2	-5.2	4.9
Croatia	0.6	4.5	-3.0	0.2	-2.5	5.5	-3.3	3.5	2.2	5.2
FRY Macedonia	-0.8	0.7	0.2	-0.6	-2.9	0.4	-5.4	-1.3	1.0	1.3
Romania	-0.6	5.9	-1.9	8.9	1.2	5.9	N.A.	N.A.	0.9	5.6
Serbia and Montenegro	1.5	4.7	N.A.	5.5	1.2	N.A.	N.A.	N.A.	N.A.	7.2
CEEC-8										
Czech Rep.	1.1	2.8	2.4	1.2	-0.2	4.1	3.8	6.0	1.7	2.0
Estonia	0.2	7.0	-3.4	-2.0	-3.3	10.5	5.9	11.6	3.1	5.9
Hungary	1.6	4.0	-2.4	5.5	3.5	3.3	7.9	4.5	1.2	3.9
Latvia	-1.6	7.0	-5.7	2.7	-8.7	8.6	-7.8	8.1	2.6	7.9
Lithuania	-2.7	7.5	-0.8	2.7	3.3	10.5	5.7	9.6	5.5	6.4
Poland	4.6	2.8	8.0	3.0	5.0	3.3	N.A.	20	42	64
Slovenia	2.7	3.2	-0.5	-1.2	1.6	3.9	1.4	4.7	3.2	3.3
Slovakia	1.9	4.6	2.7	3.6	2.4	5.2	6.6	5.7	5.7	4.4

Source: WB (2006)

If we research the development process of the GDP by economic activity, the data in table 1 reveal that the agriculture in all transition countries passed through a really hard period, and this sector has probably not yet recovered in some countries like Estonia, Slovenia, and Macedonia where the growth rates were also negative in the second analyzed period. Agriculture in ex-socialist countries was characterized by a considerable share of small-scale farming, and these households often consume a significant proportion of their own production. The reforms and transition to the market in the agriculture sector set out in destroying agriculture production, and its meaning in national production has been sharply decreasing. Amongst the SEEC-7, in Albania, for example agriculture had a high weight in the total economic activities but it decreased during the transition process from 36% to 25%. The same trends were carried out in the other SEECs but agriculture remained with a share more than 10% in their total national productions, while in the CEECs the agriculture participated with only 3 or 4% in total economic activity. According to the presented data, we can conclude that the transition brought the same trends in both groups of countries, but in the CEEC-8, the value and the size of the progress have been weighty.

An important characteristic of the centrally-planned economy is the ideological emphasis on industrial development expressed in policies of "forced growth" (Kornai, 1980, 1992) but in regard to the statistical data during the reforming process that notion is changed. Industry lost its primary position. In fact, the industry's share was nearly 50% in total national activities at the beginning of the 1990s, and it decreased to 30% or less. Therefore, industry sector with an average share of 30% in both groups of countries reached the second position and the service sector took over the primacy. With regard to the statistical data of the World Bank (WB, 2006) the sharpest decline of the industry sector was recorded by Albania from 48 to 19% in the first group, and Latvia (from 46 to 23%) and Estonia (from 50 to 29%) from the second group. We can conclude that, during the transition process, services became the main economic sector in all transition countries, participating with more than 60% in the CEEC-8 and between 45 and 62% in the SEEC-7, what is also the a main characteristic of developed countries. If we only compare the structure of the economy in 2004 (the static approach) the SEEC-7 have conducted equally successful transition processes as the CEEC-8, but with a deeper investigation that statement should be refuted.

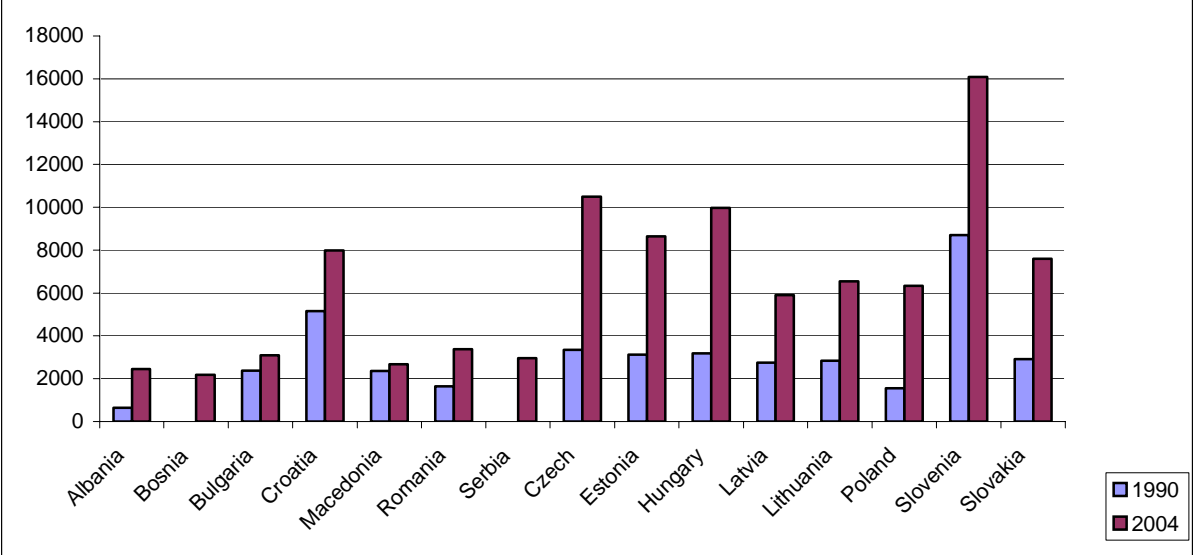
With regard to the statistical data and the development achievement, a general assessment of the transition process, however, allows us to put the SEEC into the category of less successful transition countries but with better results than some Commonwealth of Independent States (CIS), like Azerbaijan, Belarus, or Tajikistan. Furthermore, a major problem for all transition countries was the initial recession that set them back relative to the developed countries. Besides different initial economic and development positions, obvious between and inside the two groups of countries, the transition process has been delayed and complicated or has not given the expected results due to war, particularly in Bosnia and Herzegovina, Croatia, Serbia and Montenegro, and more recently, Macedonia. So, if all the transition countries started with the same initial economic position, they did not have the same environmental conditions; thereby equal results cannot be achieved.

Therefore, the presented data in figure 1 are reasonable. In 1990, the average GDP per capita in the SEECs was 1,600 US \$ and in 2004 it increased to 3,500 US \$, while that increment in the CEE region was more than tripled from 2,500 US \$ to 7,800 US \$¹. The highest development level measured through the GDP per capita was achieved by Slovenia (16,091

¹ Own calculation on the basis of the World Bank data (WB, 2006).

US \$), followed by the Czech Republic (10,491 US \$) and Hungary (9,970 US \$). On the opposite side are the SEEC-7 which hardly crossed 2,000 US \$ per capita in 2004, and the exception in that group is Croatia with 8,000 US \$ per capita, more than Lithuania, Latvia, Poland, and Slovakia from the other group.

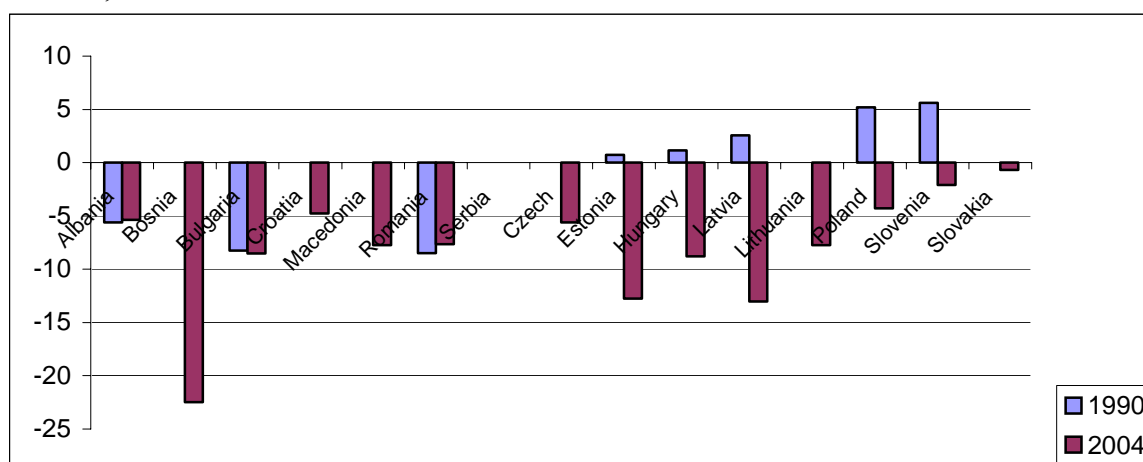
Figure 1. The GDP per capita in the SEEC-7 and the CEEC-8 in 1990 and 2004 in US \$



Source: Own calculation based on the data of the World Bank (WB, 2006)

Not only is the difference in the development level between the two groups a problem, but the contrast is also obvious with respect to foreign relations. Because each group has only one extreme, it is hard to make a general assessment. The SEEC-7 as a group suffered from a huge trade and current account deficit, especially Bosnia and Herzegovina, where the current account deficit made up 22.5% of its GDP in 2004. For Serbia and Montenegro, the data are not available, while for other countries of the SEE region, the share of the current account deficit in the total GDP was between 4.8% (Croatia) and 7.8% (Macedonia) for the year 2004. According to latest trends, with respect to the current account deficit, the SEECs have not run deficits more than the CEE countries. In fact, amongst the CEE-8, there are two different groups: Hungary, Estonia, Latvia, and Lithuania with a huge current account deficit and Poland, the Czech Republic, Slovenia, and the Slovak Republic with a current account deficit equal or less than 5% of their GDP for the year 2004 (figure 2).

Figure 2. The share of a current account deficit in the total GDP in the CEEC-8 and the SEE-7, 1990-2004.



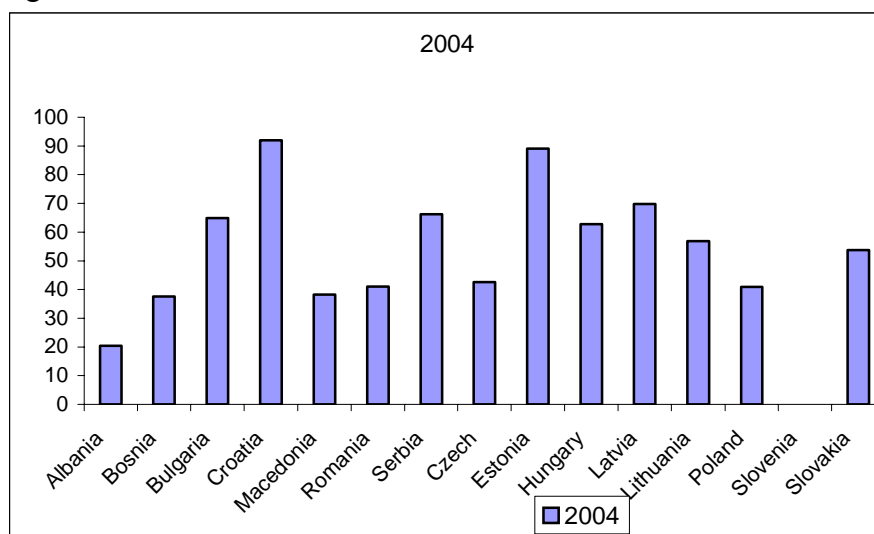
Source: own calculation based on the data of the World Bank (WB, 2006)

Generally, we can conclude that all countries that initially liberalized their external trade aggravated their external position by accumulating a huge current account deficit and external debt. Because the FDI inflows are non-debt-creating, they are a preferred method of financing current account deficits. It is self-explanatory why transition countries try to attract the largest possible amount of the FDI through a friendly macroeconomic framework, and they sometimes maintain “real battle” with other developing countries.

Besides a high trade imbalance and a huge current account deficit, some of the transition countries have a problem with an external debt. The total amount of external debt in the SEE region was 100 billion US \$ in 2004; meanwhile the CEEC-8 debited nearly 270 billion US \$. In terms of per capita, every resident of Central and East Europe is indebted nearly 3,600 US \$ and resident of the SEE region 2,000 US \$. As the data in figure 3 show, the situation with regard to external debt is not equal in all countries. Inside the SEE region, the most indebted country was Croatia, with 7,300 US \$ per capita (value of debt in 2004), and the least indebted country was Albania with only 500 US \$; while other countries from the region averaged debt of between 1,000 and 2,000 US \$. In light of Croatia’s good development results in the SEE region, we cannot only assessment its high debt ratio negatively because the CEECs also financed their development with external funds. As figure 3 shows, the CEECs are also relatively indebted nations; they have owed between 40% (Poland) and 70% (Latvia) of their annual national production. The exception is Estonia with a share of external debt in the GDP of 90%, similar to Croatia. But the main problem, arising from insolvency is how each country used money on loan. The higher proportion of borrowed money used for

opening new activities and firms, particularly productive capacities, the better the development results will be. Although, there are differences in the level of indebtedness, there are also huge differences in the usage of that money. To assess the success in resolving this economic problem, it is necessary to analyze the national possibilities of each country in returning borrowed money. Nevertheless, management of the large external imbalances should yet pose a serious macroeconomic challenge for many countries in both groups.

Figure 3. The share of an external debt in the GDP in the CEEC-8 and the SEEC-7 in 2004.



Source: own calculation on the basis of the data of the World Bank (WB, 2006)

Unemployment is also a problem in SEECs, but not to the same degree in all countries. Bosnia and Herzegovina had the highest unemployment rate of nearly 40%, followed by Serbia and Montenegro with 34%, and Macedonia with 32%. In spite of huge unemployment in the SEE region, Albania, Bulgaria, and Croatia were faced with an unemployment rate below 18%. In Romania, the most populated SEE country, the unemployment rate is relatively low, nearly 8%, while the CEE region has relatively managed its unemployment problem; Slovenia's unemployment rate was about 6%, but in Poland it was much higher, at about 18% in 2002 (Škuflić, Štoković, 2006).

3. The role of the private sector in the transition process

The socialist economic system based on government management of production and consumption developed an economic structure that could not survive on the market principles. In socialist conditions with regulated prices, many businesses earn losses; a lot of them were

inefficient and many of them hired more people than they needed; thereby their productivity was very low. Along the initial liberalization of prices and trade, imports in transition countries burst because everything was cheaper from abroad, and businesses started their reconstruction process during which many of them became insolvent and went bankrupt. The faster a country liberalized its trade, the faster its current account deficit exploded. In some countries, there were only a few businesses that could cope with the competition from abroad. Therefore, reconstruction of firms and structural reforms were crucial for a successful transition process; where structural reforms were put in place early and firmly, new production networks developed quickly and encouraged a swift recovery. At the beginning of the transition process, many ex-socialist countries had inadequate economic structure with a large proportion of heavy and military industries for which, when the Berlin Wall fell, the market disappeared.

Therefore, after the initial phase of strong progress in liberalization, privatization, and the establishment of macroeconomic stability, all transition countries, to a great extent, completed; the second phase that covers the building of a sound private sector, institutions, policies and practices, all countries did not put successfully through. We should stress that the building of the private sector depends on the quality of the privatization process to some extent, but it depends even more on the quality of infrastructure and institutions in these countries. Because a market economy is built on the private property and private sector, the privatization of state companies can reverse or amplify expected results. For example, Hungary followed a gradualist approach to privatization, and it appears to have proved more conducive to genuine restructuring of enterprises, and, on the opposite, the experiences of the Czech Republic and Russia have shown some of the pitfalls of the rapid privatization approach (IMF, 2000). But, as Stiglitz (1999) has argued, the following steps are necessary for successful transition: (1) the mass emergence of successful small- and medium-scale family enterprises; (2) the privatization of large enterprises in a transparent competitive process with many bidders and clear information; and (3) the emergence of a new economic system that functions under perfectly competitive conditions.

Not only is the private sector important, but the size and the quality of small and medium enterprises is also relevant. The development of small and medium sectors is essential to create the political and social environmental conditions necessary to allow desirable changes to occur elsewhere in the system (McIntyre, 2001) Therefore, if the privatization has either

been delayed or done in a way that does not sever their already-existing working relationships, no significant and sustained SME growth can be expected. On the other side, entrepreneurship is crucial for a successful transition process and for building a market economy. With regard to the definition of the entrepreneurs, a person who starts business and is ready to take risks, in many cases introduces the new products and services; we once again stress the significance and quality of the SME sector as a crucial factor for the transition process. Sustained and healthy growth of this sector is obviously necessary, since it is difficult to imagine raising overall living standards and social peace without such a development. Not only is the development of the SME sector important, but the share of productive small enterprises is also relevant because, in many transition countries with the liberalization and strong foreign competition, the industry base was completely destroyed. In order to evaluate the size of the SME in transition countries, we use the total number of small and medium enterprises and their percentage in total employment, which we will present in table 2.

Table 2: Micro, small and medium size enterprise in transition countries, 2000-2004

Country	Number of firms	Employment % of total	SMEs per 1000 people
Albania	35,694	56.7	11.5
Bosnia and Herzegovina	75,000	62.6	19.2
Bulgaria	224,211	64.7	28.7
Croatia	96,146	40	22.4
Macedonia	27,938	N.A	14.0
Romania	347,064	N.A	16.0
Serbia and Montenegro	68,220	70.4	8.4
CEEC-8			
Czech R.	2,350,584	62.2	230.5
Estonia	32,801	55	25.2
Hungary	855,058	55.8	84.7
Latvia	32,571	36.6	14.1
Lithuania	55,825	70.6	16.4
Poland	1,654,822	68	43.3
Slovak R.	93,392	64.1	17.3
Slovenia	70,553	66	35.3

Source: WB, 2006 and own calculation based on the World Bank data

Attending with the data in table 2, amongst the CEE-8, Lithuania (70.6%) realized the highest share of employment in small and medium enterprises, followed by Poland (68%), Slovenia (66%), and the Slovak Republic (64.1%). Latvia (36.6%) and Estonia (55%) noticed the lowest level of the SME in total employment. In the SEE region, Croatia hired the least part of total workers in small and medium enterprise (40%) while Serbia and Montenegro performed the highest share. Although some of this data are unexpected, like a high portion of

employment in small-medium enterprises in Serbia and a low share in Latvia or Croatia, it could be connected with the other before-presented data. For example, Croatia based its development process on external debt, and accumulated a relatively high amount of it, but simultaneously this country did not envelop its production base and especially did not build up its small and medium enterprise entity. The next, graver Croatian fallacy is that it has not developed a productive small and medium enterprise base, because, in that share of 40%, many enterprises are located in the service sector. In fact, at the beginning of the transition process, when many people lost their jobs, some of them opened their own businesses and, because they did not have initial capital, they started to deal with activity for which it is not necessary to invest greatly. Therefore, without its own strong production base, capable of coping with foreign competition, Croatia must import a lot of goods, and, however, that increases its high trade deficit. An opposite example is Slovenia, a country in which people in first year of transition replaced job losses with the opening of new companies, so today's SME employment is nearly 70%, the current account deficit and the external debt is not very high, but its development results are very impressive.

The level of the SME sector in a national economy is also important due to its influence on the labor market. However, the SME sector can simultaneously absorb resources and workers from the large enterprise sector which underwent a heavy transformation during the first transition years and, at the same time, it can help to create a labor market situation in which the process of reorientation and fundamental reorganization of the large enterprise sector can be carried through without threatening social peace (McIntyre, 2001). Therefore, it is easy to understand why Croatia has to struggle with a relatively high unemployment rate, according to the before-presented data, but it is hard to explain why the unemployment rate is so high in Serbia and Montenegro, and Bosnia and Herzegovina, where the SME employ nearly 70% of total employed. Additionally, it is necessary to stress one more important fact for interpreting the presented data. The data in table 2 show only the share of small and medium companies in total employment but they do not tell us anything about the employment level and overall economic activities. We conclude that, according to the before-reviewed data, Serbia and Bosnia have a very low level of employment and economic activities; thereby even with a high share of the SME sector it is not enough for starting the serious development process, and this is the reason why those countries realized the worst economic results during the transition process.

Thereby, the presented data should be considered with special care, and for a precise conclusion it is necessary to conduct more additional research. For this reason, to make the data more comparable, we calculate the number of small and medium enterprises per capita (table 2). With respect to the number of SME per 1,000 inhabitants, the previous hypothesis about Serbia and Montenegro has been proven. This country during 2000-2004 ran only 8.5 small and medium companies per 1,000 inhabitants while Croatia noted almost four times more enterprise activities, and the unemployment rate in the latter is lower than in the former. Although, Bosnia and Herzegovina revealed nearly 20 companies per 1,000 residents, its economic activity is still too low to employ a huge number of unemployed people, which brought that country an unemployment rate of about 40%. Bulgaria obtained the best results from the SEE region with nearly 29 small and medium companies per 1,000 inhabitants. The range of that indicator is much higher in the CEE region than in the SEE region; the Czech Republic with 230.5 companies is on one side, and Latvia with only 14.1 on the other. Due to the very wide range of that indicator inside CEE-8, we can firmly draw a tie between the SME sector, development results and transition success. The Czech Republic, Hungary, Bulgaria, and Croatia, countries with a better performance in the SME sector, are positioned a relatively high on the list of successful states in their own group.

At the current level of analysis, we can ask a very obvious question: why did some countries have better success while others obtained less desirable results in building the private sector, as well as small and medium enterprises due to very large range of differences? Namely, the size of the SME sector depends on a “set of fundamental political, social, and legal ground rules that establishes the basis for production, exchange, and distribution” (Davis, North, 1971). Fundamental rules such as private property rights are a major influence on the nature and extent of any entrepreneurial activity, whilst day-to-day economic and political decisions, as well as unwritten rules, determine the actual scope for the behavior of entrepreneurs and their actions. As the small and medium enterprises depend on a range of factors, it is impossible to find out the reasons for the before-mentioned differences; and we leave that for further research. Also, but not less important, the role of the foreign direct investors can be crucial in developing the SME sector. According to the statistical data, Poland, Hungary and Czech Republic from the CEE region received the higher amount of the FDI, while Romania and Croatia attracted the most FDI from SEE region (www.unctad.org). During the first year of the transition, the FDI inflows were closely associated with the privatization process, but in recent years, many FDI inflows were realized through Greenfield investments (Botrić and

Škuflić, 2006). Because the consistent data on privatization-related FDI are not available for all countries, Demekas, and others (2005) used the value of cross-border mergers and acquisition as the approximating variable for privatization-related FDI inflows. According to the mentioned source, Estonia, Latvia and Lithuania received an unusually high portion in account to non- privatization related FDI, but they are not countries with best performance in developing SME sector, assessed through number of SME per 1,000 inhabitants. Hungary, Poland and the Czech Republic (countries which FDI stock in 2003 was the highest) also noticed the significant share of non privatization-related FDI, but less than the before mentioned states, and their results in developing SME sector are very impressive as well as the best between all analyzed transition countries. Romania and Croatia from the SEE region received the almost triple the amount of non-privatization related FDI than privatization-related FDI; this is also true for Albania, and Bosnia and Herzegovina, but their total FDI stock in 2003 was negligible, and their SME performances are also very different. At this level of research, we can conclude that foreign investors help in developing small and medium enterprises in some transition countries, but not in all cases. If the country received a large amount of non-privatization related FDI, it does not automatically mean that it will burst enterprise activities. So, the enterprise activity as well as transition and economic development are complex categories depend on many factors. We emphasize that, due to the unavailability of the more detailed data, our results are only indicative, and should be taken with additional care.

4. Conclusion

Economic transition can be defined as a process of an economic and political transformation but also as a process of dramatic institutional changes. The institutions and operating mechanisms of the centrally-planned economy were so different from those of the market economy, that the transformation from the former into the latter economic system requires deep behavioral change (Kornai, 1992). The dangers of market liberalization in the absence of strong institutions are now being recognized according to the often unsuccessful stories from some transition countries. A strong infrastructure and institutions are necessary and desirable factors for foreign investors. As foreign investors bring new technology, know-how, and essential capital for investment as well as open new markets, it is easy to understand why it is an advisable macroeconomic policy for development. Therefore, after the initial reform of liberalization and macroeconomic stabilization, which almost all transition countries resolved

by themselves with occasional foreign assistance and in third phase privatization and the building of the private sector, the role of the FDI might be very significant, but not necessary.

Along with a collapse in output, many countries also experienced outbreaks of hyperinflation for at least short periods of time. Countries that quickly tamed inflation and sustained gains experienced a speedier and stronger recovery in output (IMF, 2000). The differences in the depth of reforms are increasingly the result of policy choices rather than the initial conditions because, as the obtained results reveal, differences are maintained inside the groups. As we analyzed in this paper, transition has brought about significant structural changes, with some sectors contracting (agriculture industry in all countries) and others expanding (services in both regions) in terms of shares of total activities. Besides a relatively equalized economic structure, there is very a different development level amongst the two analyzed groups, the CEE-8 and the SEE-7, but also inside them. According to our research, we only confirm that the CEE-8 are more successful than SEE-7, this region lags behind in terms of development and employment level as well as the FDI inflows, but not significantly in employment in the SME sector.

Thereby, the development of an efficient private sector and entrepreneurship is of critical importance to support the economic transition process; we try to find the tie between the level of the SME sector and the transition process. After the collapse of socialism, when many companies became insolvent and unsustainable, entrepreneurship evolved into a basic requirement for a properly- and functionally-running market economy. Most of the former state-owned large industries have faced difficulties in becoming competitive on the global markets.

While statistics on start-ups and small business development are scarce and often not directly comparable to small business data in developed countries, the available data reveal some trends. According to the before-reviewed data, for example, Poland with 38.5 million inhabitants has about 1.7 million small businesses, whereas the Czech Republic with a population of about 10 million records about 2.3 million enterprises. Overall, the share of the economy represented by new and small businesses appears to be lower than in developed countries (in Italy it is nearly 80%) but not much lower, which is an indication that important structural changes remain to be accomplished. In the mentioned structural reforms, the foreign investors could have an important role, but we cannot find a strong tie between the small and

medium business sector, the FDI inflows, and transition success; thereby structural reforms should be the task of the government. Additionally, on the experiences of the Czech Republic and Hungary, there can be drawn a positive relationship between the SME sector and the development results, what is not true for Slovenia and Estonia, countries with good development success. According to empirical experience in developing small and medium enterprises, it is a multidimensional task that must bring a wide range of public, private, and non-governmental actors to work together. But in the short transition history, governments for some time did not used to promote new and small business as a priority. But, due to some successful stories many governments in transition countries are now considering how to reconstitute and improve their support for entrepreneurship. Foreign investors can help, but the government cannot expect that they resolve the problem. In our opinion, the government which covers a range of ministries, together with regional and local administrations and financial institutions, should develop a horizontal approach and horizontal incentives for boosting the SME sector. Besides a central government, the role of local government levels is crucial in promoting entrepreneurship through local partnerships, development agencies, business incubators, and other policy tools. Successful transition countries such as Poland, Hungary, and the Czech Republic have applied these strategies. Only if a country creates the appropriate environment for entrepreneurship will it be able to launch a sustainable process of growth and job creation and run a successful development story.

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