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DEVELOPMENT STRATEGIES FOR TRANSITIONAL ECONOMIES - THE CASE OF THE TOURISM SECTOR IN CENTRAL AND EASTERN EUROPEAN COUNTRIES

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DEVELOPMENT STRATEGIES FOR TRANSITIONAL ECONOMIES – THE CASE OF THE TOURISM SECTOR IN CENTRAL AND EASTERN EUROPEAN COUNTRIES

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To D. and M., my best friends

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ABSTRACT

The focus of this dissertation is on government strategies toward transformation and achieving better economic results, in Central and Eastern European countries in transition. The study includes an examination of the issues surrounding the ‘top-down’ Shock Therapy transition measures versus the ‘bottom-up’ Gradual Reform set of policies adopted by governments in these countries, and the results recorded in one economic sector - tourism - over a fifteen year period of transformation.

The Shock Therapy strategy highlights the independence and mutually supportive and interactive character of economic relationships, implying that reforms should be introduced simultaneously in a “top-down” manner (practically enforced by the state). The Gradual Reform strategy implies a gradual change in the economic system congruent with society and responding to economic and social needs. According to the gradual theory, change must be “bottom-up” so the people do not reject the reforms or are unable to adjust.

This dissertation contributes to the shock therapy and gradualism transition theories, to the studies of the particularities of tourism in former communist countries and to the studies of transition from a centrally planned to a free-market tourism sector, by addressing three questions about the effectiveness of transition policies adopted in CEE former communist countries. Each question analyzes a number of factors and identifies the result of their implementation. The questions are summarized in the following table:

Research Question	***Factors Analyzed***	***Result of Analysis***
Q1: Is economic performance for a country influenced by the reform strategy adopted and its speed of implementation during the transition period?	Content of transition strategy Speed of application	Economic Performance
Q2: Are the results of these strategies converging across countries over time as countries compete for tourism market share in the region?	Economic Performance	Homogenous Groups of countries
Q3: Which reform strategy was more effective in reforming the economy, in general, and, particularly, the tourism sector during the transition period?	Homogenous Groups of countries	**Best Group according to Best Strategy and Economic Performance**

Integrating these theories and supporting them with 'real' economic performance results, this study shows that the nature of transition government policies is such that countries behave as members of two groups, according to the transition model they adopted. The results recorded by the countries in each group indicate that the application of one strategy, which constitutes the Shock Therapy transition model, at a rapid pace, leads to better performance of an industry (e.g. tourism) over the first fifteen years of transition.

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CHAPTER ONE
INTRODUCTION AND OVERVIEW

1.1 Introduction

The journey to a market economy for the countries of Central and Eastern Europe has by no means been straightforward or easy. It is shown by the enormous hardships faced by literally millions of people, as the philosophy of their lives changed from one day to the next, with the resultant worsening of their living conditions and social and economic provisions. Although tourism was not among the industries with priority for promotion, in 2004 travel and tourism economy in Central and Eastern European countries directly and indirectly accounted for 8.9% of total employment and 10.1% of total GDP[1]. In the 1990s, undergoing major political and economic changes and recognizing the potential of tourism as a contributor to economic growth, Central and Eastern European countries started the transition to free-market economies. This included also the reform of the tourism sector in order to align national tourism destinations to the worldwide required standards. Their various relief, temperate climates and historical sites constituted an important basis for tourism development.

Tourism in Central and Eastern European Countries has been a subject of considerable academic debate and commentary since the political events of 1988-1989. In particular, strategic planning in the region was critical to the future success of tourism as attempts were made to utilize tourism in the process of economic change. Tourism is seen as a useful means of change as it cuts across a variety of economic sectors and is primarily comprised of small and medium

[1] World Travel and Tourism Council, 2004. *Central and Eastern Europe: Travel and Tourism Forging Ahead*, The 2004 Travel and Tourism Economic Research, London, U.K., p. 4

size enterprises. Also, it was perceived as an activity that offered relatively straightforward opportunities to achieve a comparable structure, organization and level of provision to the West. As an underdeveloped and under-exploited sector, it was contended that, if developed according to western criteria, tourism would significantly boost economic output.

However, current research leaves several questions unanswered as to the nature of government policies for a successful transition process in the economies of Central and Eastern Europe, and particularly in the tourism sectors of these countries. Specifically, questions remain as to how policies were formulated and implemented: Which set of policies was more effective in reforming the economy, in general, and, particularly, the tourism industry sector during the transition period? Are the results of these policies converging across countries over time as countries compete for tourism market share in the region? Is economic performance for a country influenced by the set of policies adopted and their speed of implementation during the transition period?

This study examines the influence of the transition strategies adopted by four countries in the region on the results obtained in the tourism industry in an integrated comparative approach drawing on aspects of the “shock therapy” and “gradualism” and constructing economic indicators (ratios) for measuring the impact of the application of these strategies. Previous analyses undertaken on transition methods focus on the levels of formulation and application in time of each strategy. The components of each strategy in all sectors of the economy are considered from a theoretical stand point. Then, a second level of analysis concerns the extent to which the theories were actually adhered to and how they were interpreted and applied. Sachs (1994)[2] concludes that the way shock therapy was formulated contained common elements with the gradual set of transition policies, implying that the difference in performance of the countries in

[2] Sachs, J., 1994. Shock therapy in Poland: perspectives of five years. *The Tanner Lectures on Human Values*, delivered at University of Utah, April 6 and 7, pp. 271-273

the region may be, to a great extent, attributed to the pace of their implementation in time. Integrating these theories and supporting them with 'real' economic performance results, this study shows that the nature of transition government policies is such that countries behave as members of two groups, according to the transition model they adopted. The results recorded by the countries in each group may indicate that the application of one set of policies, which constitute the shock therapy transition model, at a rapid pace, leads to better performance of an industry (e.g. tourism) over the first fifteen years of transition.

1.2 Brief Introduction to the Theoretical Perspectives and Assumptions

Governments behave like organizations in strategy formulation and implementation. Allison (1971)[3] explains this similarity in his analysis of the Cuban Missile Crisis. He discusses how country decision making follows organizational routines and procedures in formulation and implementation of policy and action, even in crisis. Similarly, many like Nadler (1993)[4], Nicholson (1993)[5], Walsham (1993)[6] and Beer et al (1993)[7] use the term shock-therapy in changes in organizational culture as an outcome of a business process re-engineering process (BPR). This may lead to a comparison between decisions on transition policies adopted made by governments and the BPR action plans of firms in an industry, competing for market share. It is expected that country governments competing in the market for foreign tourists form and implement certain competitive strategies to encourage arrivals. On the other hand, a total

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[3] Allison, G. T., 1971. *Essence of Decision: Explaining the Cuban Missile Crisis*, Boston: Little, Brown & Co., p. 56

[4] Nadler, D. A., 1993. *Concepts for the Management of Organizational Change*, In: Maybe, C. & Mayon-White, B. (eds.), *Managing Change* (2nd ed), London: Paul Chapman, pp. 85-98

[5] Nicholson, N. 1993. *Organizational Change*, In: Maybe, C. & Mayon-White, B. (eds.), *Managing Change* (2 ed.), London: Paul Chapman, pp. 207-211

[6] Walsham, G. 1993. *Management Science and Organizational Change: A Framework for Analysis*, In: Maybe, C. & Mayon-White, B. (eds.), *Managing Change* (2 ed.), London: Paul Chapman, pp. 187-196

[7] Beer, M., Eisenstat, R. A., & Spector, B., 1993. *Why Change Programs Don't Produce Change*, In: Maybe, C. & Mayon-White, B. (eds.), *Managing Change* (2nd ed), London: Paul Chapman, pp. 99-107

quality management approach (TQM) at a company level presents conceptual similarities with the gradual approach to transition, which includes more distinct stages of transformation that overlap political developments.

The focus of this dissertation is on government strategies (policies) toward transformation and achieving better economic results, with a focus on the results in the tourism sector. The study includes an examination of the issues surrounding the 'top-down' shock-therapy transition measures in comparison with the 'bottom-up' gradual reform process adopted by various countries in Central and Eastern Europe, and the results recorded in one economic sector -tourism- over a fifteen year period of transformation.

In 1989, the former communist countries (FCC) started the transition from a command, centrally planned economy to a market economy. At the same time, they began to transform their political systems from repressive dictatorships into Western-style democratic regimes. The transition to democracy and the market economy in Central and Eastern Europe (CEE) and in the former Soviet Union (FSU) may be the most important political and economic event in the world history of the last decade of the 20th century.

The thesis analyzes mainly the problem of the optimal transformation strategy for two groups of countries. The intention is to support with real data and statistical analysis the controversy of how quickly and radically the new market rules and their individual components should have been adopted in various countries of Central and Eastern Europe and the economic and political strategies of different transition strategies. The population used includes countries of various sizes (in terms of population and/or land mass), similar levels of development (in terms of per capita income), that belong to the same region (Central and Eastern Europe) and have been through similar political developments (communist regimes) for more than four decades. The objectives in mind when selecting the countries to be analyzed were to assure the application of the maximum number of reform policies that characterize each transition strategy in the countries of the same group, and to minimize the probability of conclusions based on random characteristics of the countries in each group, such as geographic characteristics or size of the country. Poland and the Czech Republic belong the group of countries that applied mostly policies that characterize the “Shock Therapy” transition reform method, as they are defined in the reference literature. Respectively, countries that applied a majority of transition policies that characterize the Gradual Reform method make up the second group and are Bulgaria and Romania. The countries in each group are also different in size and have not been through any major historical (e.g. war) or physical (e.g. earthquake, floods) catastrophe for the past fifty years, including the past 15 years of transition. By including these representative examples of countries of the Central and Eastern European region for each transition reform method, the risk of random characteristics that would have led to similar results are minimized.

A set of macroeconomic tourism indicators were constructed in order to assure a satisfactory representation of the economic characteristics of tourism both in the group of countries that applied a shock therapy set of transition policies (Czech Republic, Poland) and in countries that followed a gradual transition approach (Romania, Bulgaria). A longitudinal study was conducted for the time period between 1989 (the last year of communism before the period of transition started) and 2003.

Fundamental to this dissertation are certain underlying assumptions. First, strategic behavior is purposeful, although given to “bounded” rationality (Williamson, 1975)[8], meaning, first, that governments base their decision-making process on as much information as there is available, and, second, that human beings (foreign tourists) cannot know all the information when making a decision, as is generally assumed under classical economic theory. Second, individual consumers (tourists) make comparisons between countries (destinations) for

[8] Williamson, O. E., 1975. *Markets and Hierarchies*, New York: Free Press, p. 42

standards and benchmarks (Thompson, 1967)[9]. Third, this benchmarking is possible because information that is true is available (Williamson, 1975)[10]. Forth, choice of action by national governments, however constrained by the environment and the internal characteristics, is possible. Fifth, uncertainty is assumed as a condition of the external environment of each country. Sixth, governments behave as if the market for tourism destinations is a "free market" in that no one country can overly affect in-flows of foreign tourists through other than market incentives.

In this context, the relationships between tourism and the transition process are strongly intertwined. On one hand, change in tourism – despite the sector having its own production and consumption characteristics and sector-specific policies – is influenced by the broad impact of the economic, social and political transformation in Central and Eastern Europe. On the other hand, tourism contributes to the transformation, being relatively open to international competition and to shifts in consumer expenditure and being a leading industry in privatization and market liberalization.

More specifically, tourism directly impacts on economies in transition through its net contribution to the national income and to employment. The economic impacts are influenced by the particular models of privatization pursued, the integration of firms in national and regional economies, and the productive, labor market and capital features of national economies. In this respect, the present dissertation focuses on measuring the economic impact on the tourism sector of implementing the two sets of transition policies – shock-therapy and gradual reform – in an attempt to address the question relating to which transition model might have been more appropriate and what was the impact of the application of this model upon economies in the region.

[9] Thompson, J. D., 1967. *Organizations in Action*, New York: McGraw Hill, p. 96
[10] Williamson, O. E., 1975. Ibid 8, p. 53

1.3 Audience for the Dissertation

The results from this dissertation are of interest to several groups. First, the location selected by foreign tourists to travel in the Central and Eastern European region, after 1989, depended mainly upon the country characteristics and the government policy strategies. Understanding that a group of countries competes for a particular tourist market and what the characteristics of the members of this group are, situates a **firm** in a better negotiation posture with a country. Determining where a country is with regard to its group policies assists a firm in anticipating a country's reaction to its investment.

Second, this dissertation offers a way of viewing the competition for incoming tourism in Central and Eastern European region for country policy makers providing factors for consideration by countries in improving the performance of their economic reform. Understanding the trends in international tourism and what each country's present position is with regard to the transition strategies adopted, assists with future strategy determination and implementation. For countries grouped according to the transition strategy adopted and its results, evaluation of where a country is with regard to world and region tourism flows, and where a country is with regard to its group, helps **government policy makers** in their decision toward positioning their tourism product. Better policies lead to more effective performance in attracting foreign tourists and ultimately to better economic results.

Third, for **academics**, this dissertation opens new ground in the integration of transition strategies theory, tourist destination choices literature and country/ organizational theories of performance. Further, this study tests with a longitudinal dataset how countries actually implemented policies toward reorganizing national economies. Finally, the quantitative analysis of the results recorded when putting these theories in practice provides further research with a finer degree of observation of the strategy adoption decisions and their economic, and not only, implications.

1.4 Examining the Issues

This section introduces the methodology, the sample, the data, the data source and the data analysis tools used in this study. Chapter 5 covers all of these subjects in depth.

1.4.1 Methodology and data analysis tools

To test the proposed hypotheses of this study, a variety of statistical techniques and methods are used. First, a representative set of index-ratios is constructed based on macroeconomic indicators for selected countries and for the Central and Eastern European region. Then, the analysis of variance performed uses these ratios to test if the countries chosen belong to homogenous groups, which relate to the transition method that each country employed for the reform of the tourism sector. Further on, the discriminant analysis multivariate technique verifies the validity of this classification of countries into groups by identifying statistical determination with which countries may fall into one group or another. The third type of analysis performed is correlation analysis, used in order to determine particularities in the evolution of tourism through the various relationships existing between the constructed ratios, their type, strength and meaning. Finally, to give further insight into the results expected by the tourism sector in the countries analyzed and grouped according to the transition strategy adopted, a series of forecasting models are constructed. They predict future results of tourism activity and identify probable positive or negative trends. Detailed mathematical models are provided in Chapter 5 and the Annex.

1.4.2 The population and the sample

A population of 20 countries belonging to Central and Eastern Europe (according to the definition given by the World Tourism Organization) is considered. To minimize the probability of conclusions based on random characteristics of countries (e.g. geographic position, size) and to assure a representation of the maximum number of characteristics of ‘shock therapy’ or ‘gradual’ reform policies that characterize each transition strategy, a sample of 4 countries of the CEE region is selected. Tourism indicators from 1989, the first year of transition, up to 2003, the last year for which all data was available, are used. The countries included are the Czech Republic and Poland for ‘shock therapy’ followers and Romania and Bulgaria as representatives of ‘gradualism’. The sample contains countries different in size and that have not been through any major historical or physical catastrophe for the past fifty years, including the first 15 years of transition. Further discussion of the population selection and data collection is addressed in section 5.4.

1.4.3 The data

The data used are longitudinal archival data from a wide variety of sources. For the macroeconomic indicators in CEE region tourism the World Tourism Organization (WTO) and the World Travel and Tourism Council (WTTC) sources including the “Compendium of Tourism Statistics Data” and the “Tourism Satellite Accounts” provide reliable results on foreign tourists arrivals, employment and capital investment in travel and tourism. Data from the National Statistical Offices of the four countries in the study sample and the National Authorities for Tourism are extensively used. Wherever data is missing or unreliable, it is confirmed with data found in a multitude of books and journals (see Bibliography). To augment and to evaluate government policies, private sources of data such as the European Bank for Reconstruction and Development (EBRD) “Transition Reports” are used. Other government and private sources are further described in Chapter 5.

1.5 Definitions

In this dissertation there are several key terms:

1.5.1 Country

A country, for the purpose of this dissertation, generally includes a nation-state government. A country's government includes a sovereignty which has ultimate legal jurisdiction over factor endowments, investments, property and the importing and exporting of goods and services.

1.5.2 Economies in Transition

The definition refers to countries in transition from a planned economy to a free-market economy. Specifically, it refers to the communist states in Central and Eastern Europe and the members of the former Soviet Union. The process began in 1989 with the opening of the Berlin Wall between East and West Germany. The countries in transition, unlike developing countries, have highly educated populations, substantial, though generally run-down, infrastructure and large manufacturing sectors. The economies are dominated by heavily indebted state enterprises, with low productivity and generally uncompetitive products and services. Most are characterized by high inflation and unemployment and balance of payments deficits. Output is generally still under 1989 levels, partly because of the disruption of trade patterns between these countries (Bannock, Baxter, Davis, 1998)[11]

1.5.3 Reform Strategies

The reform strategies are the policy variables used in the change of economic system for a recovery of growth and an improvement in the living standards in former communist countries[12]. They refer to areas such as institutional structure, price liberalization, privatization, monetary policy and the financial system, fiscal policy and international trade.

[11] Bannock, G., Baxter, R. E., Davis E., *The Penguin Dictionary of Economics*, 6th edition, The Penguin Group, 1998, p. 414

[12] This thesis refers only to reform strategies adopted in former communist countries of Central and Eastern Europe

1.5.4 Government policies

The definition of government policies on which this dissertation focuses refers to government interventions, which serve to reform the economic and legal environment of a country. Unlike a country's geographic and geopolitical characteristics, policy variables or strategies toward tourism are subject to immediate manipulation by government policy makers (Lodge, 1988)[13].

1.5.5 Tourism Demand

Effective or actual tourism demand is considered throughout this thesis, taking into account the actual number of participants in tourism or those who are traveling (i.e. *de facto* tourists). From the economists' point of view (demand-side) it represents the amount or the value of tourist services people are willing to buy at each specific price in a set of possible prices during a specific period of time (Cooper et al, 1998)[14]. Demand is considered both from the point of view of the number of tourists in each country and in the region, and from the point of view of their expenditure in the consumption of tourist products.

1.5.6 Tourism Receipts

For the purpose of this dissertation, tourism receipts include spending by international tourists on a collection of products (durables and non-durables) and services (transportation, accommodation, food and beverage, entertainment, government service, etc.) in the country visited.

1.5.7 Employment in Travel and Tourism

Includes those jobs with face-to-face contact with visitors (airlines, hotel, car rental, restaurant, retail, entertainment, etc.) plus faceless jobs associated with industry suppliers (airline caterers, laundry services, food suppliers, wholesalers, accounting firms, etc.), government agencies, manufacturing and construction of

[13] Lodge, G. C., 1988. *Roles and Relationship of Business and Government*, Harvard Business School, p.12
[14] Cooper, C., Fletcher, J., Gilbert, D., Wanhill, S., 1998. *Tourism: Principles and Practice*, 2nd edition, 1998, p. 24

capital goods and exported goods used in travel and tourism, and supplied commodities.

1.5.8 Capital Investments in Travel and Tourism

"Capital investments" is another term used throughout this study. It represents the real capital formation that will produce the stream of goods and services for future consumption in tourism activities. The providers can be the private sector and government services (the public sector) to provide facilities, equipment and infrastructure to visitors.

1.6 Summary of Contributions

This dissertation adds to the knowledge of international economics and business in at least three ways. First, the reform strategies theory is applied to countries, contributing to the concept that countries behave as firms do in formulating and implementing policies and actions for competing for particular tourist markets, even in crisis. Countries compare their reform strategies to countries similar to themselves. This provides a basis for the development of taxonomy of homogenous groups and focuses on the characteristics that determine a particular homogenous group. Second, this dissertation integrates the tourism literature with the transition literature emphasizing that both policy and non-policy locational characteristics of a country determine the level of performance of tourism in a country. Finally, countries react to how their policies perform in attracting tourism activity. A country's focus on reform is limited to comparing itself to countries with similar economic results, i.e. those which are in the same homogenous group according to the reform policies adopted.

1.7 Outline of the Research Project

In the second chapter, the relevant transition reform strategies and tourism in transition literature is analyzed, and a discussion of the dissertation's contribution to the development of the literature is provided. Chapter 3 looks at specific features of transition and the transition strategies relevant to tourism. Chapter 4 presents the particularities of tourism and its strategic evolution during the first fifteen years of transition for each of the four countries in this study. Chapter 5 develops the hypotheses based upon the theoretical contributions and specifies the model to be tested. The sample and the data are selected, and research design and results are presented. Conclusions are provided in Chapter 6.

CHAPTER TWO
LITERATURE REVIEW AND THEORETICAL CONTRIBUTION

2.1 Introduction

In this chapter, some of the literature with respect to shock therapy theory, gradualism and transition results for the tourism industry of this study is reviewed, as it relates to the research questions and developed propositions. These propositions are operationalized into hypotheses in Chapter 5. The contribution to the theories and the combination of all the literature with respect to the research questions are also highlighted in this chapter.

The literature is reviewed in the light of the 3 research question(s):

1. Is economic performance for a country influenced by the reform strategy adopted and its speed of implementation during the transition period?
2. Are the results of these strategies converging across countries over time as countries compete for tourism market share in the region?
3. Which reform strategy was more effective in reforming the economy, in general, and, particularly, the tourism industry sector during the transition period?

Three research streams are investigated to address these questions: the literature on Shock Therapy and Gradualism theories, the literature on the particularities of tourism in former communist countries and the studies of transition in the tourism industry. These research streams are appropriate to the research questions in the following ways. First, the literature on Shock Therapy and Gradualism theories identifies the non-policy characteristics and policies that affected the initial conditions of each of the countries in transition studied. This assists in answering the first research question of whether economic performance is influenced by the policies adopted and their speed of implementation. Categorization of country groups by characteristics of transition and country characteristics for grouping purposes is also drawn from this literature.

Second, the literature on the particularities of tourism in former communist countries provides a theory basis for comparison of countries, their policies and the performance achieved in their transition efforts. This literature proposes that members of a group follow similar strategy formation and implementation. This concept appears to have applicability to countries as they compete in the global tourism industry. This literature assists in answering the second and third research questions of how performance for a country group member converges across countries over time in the competition for tourism market share in CEE and of whether Shock Therapy was a more effective method than Gradualism in the economic reform of the tourism sector of Central and Eastern European countries in transition.

Third, the studies of transition in the tourism industry come to confirm the application in the Central and Eastern European countries, according to one transition method or the other, of the main economic policies of transition in tourism, while integrating tourism industry restructuring in the broader set of policies for the country's transition to a market economy. This literature explores how the choice of policy occurs and the results of implementing the set of policies chosen. It assists in answering the second and the third research questions: if results recorded in the tourism activity converge across countries over time and if one set of policies chosen was more effective than the other.

The following three subchapters review and analyze these research streams. In each subsection, contributions to the literature are noted through the propositions developed. Section 2.5 integrates all the literatures and summarizes the contributions of this dissertation.

2.2 Transition in Central and Eastern Europe

Sixteen years after the launching of the transition process, many books, articles and reports are offering a balance sheet of the transformation that occurred in Central and Eastern Europe. Three major issues are mainly discussed. First, why has there been such a recession in the beginning of the transition process in all countries, and was the recession inevitable? Second, due to the criticisms to the "Washington Consensus"[15] – set of standard policies applied, has a "Post-Washington Consensus" emerged? Third, as the Central and Eastern European countries are engaged in the second decade of the transition process, can it be stated when it is to be over?

2.2.1 Introduction

The topic of the first sixteen years of transition in Central and Eastern Europe has been extensively presented in conferences, newspapers, journals, reports and books. Among institutional contributions, very comprehensive surveys were carried on by the European Bank for Reconstruction and Development (EBRD, 1999)[16] and the United Nations Economic Commission for Europe (UNECE, 2000)[17]. The authors involved in evaluating the transition are academics, advisers to governments, high-level officials of international institutions, sometimes policy-makers, and may belong to more than one of the above categories. For example, J. Kornai[18] defines himself as an adviser and an

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[15] Term used to describe the set of policy proposals used by international financial organizations to address crises in underdeveloped regions

[16] EBRD, 1999. Transition Report, 1999, *Ten Years of Transition*, The European Bank for Reconstruction and Development, London

[17] UNECE, 2000. *Economic Survey of Europe*, vol. 1, United Nations Economic Commission for Europe, New York and Geneva

[18] Janos Kornai, Professor Emeritus, Collegium Budapest, Hungary; he is also the Allie S. Freed Professor of Economics Emeritus at Harvard University and one of the founders of the theory of socialism

academic; S. Gomulka[19] used to be an adviser to the Polish government; G. Kolodko is an academic and has been a policy-maker in Poland in 1994–7 when he was first deputy prime minister and minister of finance.

The purpose of these assessments is not just to measure the evolution registered as compared to the initial plans, but also to provide explanations for the evolution of the transition process, to criticize policies and their application, and to suggest what remains to be done. Ultimately a question is addressed: “is transition over?” (Brown, 1999)[20], and if not yet, “when?”. “The post-socialist transition will last at least several more years” according to Kolodko (2000)[21]. A few years ago Stiglitz stated that "Transition economy is still a well-defined category" (Stiglitz, 1997)[22].

There is little divergence among the authors about the outcomes of the transition (or transformation) process. Usually countries are divided into two groups. One group of countries in transition consists of the Central and Eastern European countries (including the Baltic countries). Within this group, macro-economic stabilization has been achieved, in some countries to a satisfactory degree, in others in a slower rhythm, structural transformation is still incomplete, and growth has resumed. The present thesis concentrates on countries from this group. In the other group, one finds the former Soviet Union (FSU) countries (Russia is to be singled out among the other New Independent States), and the Former Yugoslavia countries (less Slovenia, which belongs to the first group, and plus Albania). In this second group, economic issues of the transition have been secondary in comparison with the impact of heavy legacies from the communist

[19] Stanislaw Gomulka, lead author of the Reform Plan in Poland after 1989; his Plan was copied with variations in every other post-Communist country. He has been one of the most influential economists in the post-Communist transition

[20] Brown, A. 1999. *When is Transition Over?* Kalamazoo: W.E. Upjohn Institute for Employment Research; quoted contributions by Aslund, Gelb, Kornai and Svejnar.

[21] Kolodko, G. W., 2000. *From Shock to Therapy. The Political Economy of Postsocialist Tansformation*, UNU/Wider and Oxford University Press, Helsinki and Oxford, p. 6

[22] Stiglitz, J., 1997. *Transition economy is still a well defined category*. Transition, The World Bank 8 (2), pages 1-3

system (the FSU countries), of the breaking up of strong political links between the countries (both in the FSU and in the former Yugoslavia), of wars, and of the emergence of political regimes largely dominated by corruption. Here stabilization is not yet completed, the prospects for growth remain uncertain, and market institutions do not function. The comprehensive surveys quoted above (especially EBRD, 2003 and UNECE, 2002) provide detailed assessments.

There is a number of issues that dominate the debates on transition over these sixteen years and there are various approaches of these issues in recent literature. The first issue is historical but is still very much discussed. How can one explain the "transformational recession" (Kornai, 1993)[23], or "transitional recession" (Kolodko, 2000)[24] that hit more or less severely all the countries in transition, despite the forecasts of the best experts? A second issue, deriving from the first, deals with the policies applied at the outset of the transition. The magnitude and duration of the slump has led to a questioning of what is usually named the "Washington Consensus", i.e. the package of measures meant to ensure liberalization, stabilization, structural reform, and ultimately growth, in the post-socialist countries. This package has been under attack, especially since the mid-nineties. Is a post-Washington consensus emerging and would it lead to a sustainable growth? Finally, a third issue has come to the fore in 2000: what is the end of the journey and when can we say that this long process of change is over?

2.2.2. Beginning of transition

The collapse of output in the beginning of the transition was not expected to such an extent. The issue emerged very soon, in 1992–3 and three answers emerged

[23] Kornai, J., 1993. *Transformational recession*: a general phenomenon examined through the example of Hungary's development. Economic Appliquée 46 (2), pages 181-227
[24] Kolodko, G. W., 2000, ibid 21

(Lavigne, 1999)[25]. According to the first one, **the collapse was just an illusion**, because the figures for the level reached in the communist times were inflated, and because the post-transition figures did not take the performance of the informal sector enough into account. The second answer was that the collapse in output was the logical outcome of deflationary policies that were required for a successful stabilization. **The quicker and the more radical the stabilization, the swifter would be the movement out of recession**. The third answer was that the transformation (or transition) process itself created imbalances and lags in adjustment that impaired growth. This third answer is sometimes described as a supply-side approach and "regarded as a neo-classical one, though it may be more accurately described as a lower common denominator among all transition economists" (Popov, 2000)[26]. Popov points to the systemic disproportions inherited from the centrally planned system, such as high militarization, over-industrialization, under-openness of the economies, and a distorted structure of trade among socialist countries and among the former Soviet Republics. Some authors especially focus on the impact of the dissolution of the CMEA and of the Soviet Union. Others (Blanchard, 1997)[27] insist on the role of domestic distortions: the disruption of former planned links among state-owned units, which were not immediately replaced by market-type links, entail a process of "disorganization" leading to the collapse of the production in the state sector. In his "transformational recession" approach, Kornai (1993)[28] combines the impact of demand-induced slump and of supply-side and systemic factors.

Kolodko (2000)[29] gives a very comprehensive answer. The lack of experience of the experts led to implementing standard restrictive fiscal and monetary policies, which in turn triggered an overshooting — in the case of Poland, even an overkilling — of stabilization targets, and hence too much contraction in demand.

[25] Lavigne, M., 1999. *The Economics of Transition, From Socialist Economy to Market Economy* (2nd ed ed.),, Macmillan and St. Martin's Press, London and New York.
[26] Popov, V., 2000. *Shock therapy versus gradualism: the end of the debate (explaining the magnitude of transformational recession)*. Comparative Economic Studies 42_1, pp. 1–57
[27] Blanchard, O., 1997. *The Economics of Post-Communist Transition*, Clarendon Press, Oxford
[28] Kornai, J., 1993. ibid 23, pp. 27-31
[29] Kolodko, G. W., 2000. ibid 21, pp. 86-88

Of course "the healthiest response would have been even stronger export-led growth and additional inflows of foreign direct investment" (Kolodko, 2000)[30], but as we know such inflows occurred only later when the growth path was resumed, and export-led policies reminded of state interventionism which was precisely to be fought off in the early stages of transition. Kolodko is also very critical of policy mistakes, combining poor diagnoses and wrong economics, as far as structural transformation was concerned, largely due to the fact that the communist legacies were not understood and not taken in consideration. Because of such neglect, policies applied were simply borrowed from other experiences (post-war reconstruction in Europe, structural adjustment in developing countries). Kolodko particularly insists on the bad sequencing of policy measures: privatization should have occurred only after de-monopolization and "corporatization" of the state sector, and also after an overhaul of the state sector, some regulation of the capital markets should have been introduced prior to the early liberalization of the capital flows, and sound fiscal reform should have been applied before macroeconomic measures aiming at curbing the budget deficit (Kolodko, 2000)[31]. More significantly, the transitional contraction occurred in a situation when the market was still lacking while the planned system had been overturned, especially in Russia and other post-Soviet republics.

2.2.3 Policies applied

Many of the explanations provided for the post-transition economic results thus point to the lack of proper market institutions at the outset. The second much debated issue in transitional economics hence refers to this missing element in the **"Washington consensus", the term used for the first time by John Williamson to describe the set of policy proposals used by the international**

[30] Kolodko, G. W., 2000. ibid 21, p. 91, p. 94
[31] Kolodko, G. W., 2000. ibid 21, p. 99

financial organizations, and especially the IMF, to address structural crises in underdeveloped regions (Kolodko, 2000)[32].

The consensus included reforms that should be undertaken from 1989 (these reforms were also summarized by the World Bank in its year 2000 Poverty Report):

- Fiscal policy discipline
- Redirection of public spending toward education, health and infrastructure investment
- Tax reform - Flattening the tax curve: Lowering the tax rates on proportionaly high tax brackets (typically above median income), and raising the tax rates on the porptionally low tax brackets (typically below median income); lowering the marginal tax rate.
- Interest rates that are market determined and positive (but moderate) in real terms
- Competitive exchange rates
- Trade liberalization - replacement of quantitative restrictions with low and uniform tariffs
- Openness to foreign direct investment
- Privatization of state enterprises
- Deregulation - abolition of regulations that impede entry or restrict competition, except or those justified on safety, environmental and consumer protection grounds, and prudential oversight of financial institutions
- Legal security for property rights

The challenging of the Washington consensus first came from an "insider" as far as IFIs are concerned: Joseph Stiglitz, the chief economist at the World Bank, who subsequently, in November 1999, left the World Bank and voiced still fiercer

[32] Kolodko, G. W., 2000. ibid 21, pp. 119-120

critics against the IMF (Stiglitz, 2000)[33]. Kolodko opposed the "Consensus" in his practice as a policy-maker in 1994–7, and later in more theoretical terms. "The negligence of institutional arrangements has been a grave miscalculation of the orthodox approach." (Kolodko, 1998)[34].

The Washington consensus indeed highlights the importance of stabilization as a result of liberalization measures. Institutions are supposed to emerge spontaneously once central planning is abolished. So as to rebuke the objections from the "unorthodox" camp, the "mainstream" school however attempted to show that it had never neglected institutions-building: "The need for legal reform, the creation of a central bank and effective fiscal system, and other aspects of modern government, were widely recognized from the start of the transition process[…] The outcomes have, nonetheless, differed a great deal, with corruption and governance problems apparently endemic in some countries, and far less prevalent in others" (Fisher and Sahay, 2000)[35]. The assessment of the reform is currently conducted by the EBRD, which annually publishes an index of "transition indicators" in its annual Transition Report and is growing concerned with institutions-building: "The evidence now shows clearly that the central lesson in transition is that markets will not function well without supporting institutions, a state that carries through its basic responsibilities and a healthy civil society" (EBRD, 1999)[36].

Kolodko (2000)[37] argues that a "new consensus" has indeed emerged in Poland in the mid-1990s, before being widely acknowledged in "high-level international circles", through the "multitrack" policy then implemented (when he was in charge of economic policy in 1994–7). One might certainly add that other failures of the

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[33] Stiglitz, J., 2000. *What I Learned at the World Economic Crisis*. The Insider. The New Republic, 17 and 24 April
[34] Kolodko, G. W., 1998. *Economic neo-liberalism became almost irrelevant… Transition*. The World Bank 9_3, pp. 1–6
[35] Fisher, S., Sahai, R., 2000. *The Transition Economies after Ten Years*. IMF Working Paper, WP/00/30, p.20
[36] EBRD, 1999. *Transition Report 1999, Ten Years of Transition*. The European Bank for Reconstruction and Development, London, p. 5
[37] Kolodko, G. W., 2000. ibid 21, p.127

Washington Consensus, namely the tackling of the East Asian crisis in 1997, and of the Russian crisis in 1998 (cruelly attacked by Stiglitz, 2000) perhaps played a greater role than the outcomes in the transition countries, especially after the growth had resumed in Central Europe.

But then, what is the new role of the state? Once the need for institutions-building is recognized, the role of the state has to be emphasized. But what exactly should the state do? Here the right lessons have yet to be learnt. Should the state just establish the right institutions and then let them operate while enforcing the rule of law (introducing commercial, banking, tax, and pension codes)? Or should the state conduct a more active policy? If so, which one? Should it engage in industrial policy? The issue has been much debated in the beginning of the transition, in particular because the very quick liberalization of foreign trade led to an overall lowering of tariffs that left the countries unprotected against the initial shocks from opening up. As far as industrial restructuring is concerned, while past over-industrialization has been widely criticized, few solutions have been offered to transition countries apart from closing the unprofitable factories. An important example for restructuring industries (especially iron and steel industries) is provided by the set of policies applied in post-war Europe through a very active involvement of the state.

Kolodko (2000) is advocating an industrial policy so as to shift back "the economy to the path of growth"[38] in particular in the countries where growth has been late or has failed to resume (e.g. Romania, Bulgaria, etc.). He also quotes the Polish experience 1994–7 as a "redefined role of the state"[39] which was not easily accepted initially. He again insists on the role of the state in steering the growth process, through a new type of partnership between government and private sector[40], implying not just “de-regulation” but, using Stiglitz's wording, "re-regulation". Ultimately, "the only ‘really good’ government is a capable

[38] Kolodko, G. W., 2000. ibid 21, p. 114
[39] Kolodko, G. W., 2000. ibid 21, p. 152
[40] Kolodko, G. W., 2000. ibid 21, p. 257

government, which can ensure robust economic growth and a fair distribution of the result"[41]. But Kolodko admits that such a goal has not been attained in post-socialist economies, because governments were eager to cut state expenditures, on the basis of "the half-baked advice according to which the sooner government becomes small, the sooner the market economy can begin to rise and expand"[42].

As far as the "Washington Consensus" is concerned, Joseph Stiglitz has had to leave the World Bank and is the target of strong critics (Dabrowski et al., 2000)[43], largely based on the fact that he entered the field of transition countries without knowing much about the relevant countries. Also, his "Comprehensive Development Framework" outlined in his proposal (Stiglitz, 1999)[44] remains fuzzy and seems more inspired by the post-Soviet experience than by the Central European context. The controversy around the policies suggested in the "Washington Consensus" has been put aside in the past five years by the fact that growth has resumed in Central and Eastern Europe (except in Romania, where the first signs of growth appeared as late as 2002. Thus the major tenets of the initial "Washington Consensus" set of policies re-emerge unchallenged:

"Shock therapy" was the right policy[45]

Wherever it has been consistently applied outcomes were positive. Broadly speaking, the CEE countries where shock therapy was applied (e.g. Poland and the Czech Republic) exemplify the success of shock therapy, and the FSU countries, especially Russia, the consequences of inconsistent policies. "It has paid to start early and to move fast" (Wyplosz, 1999, p. 28)[46]. "The success of

[41] Kolodko, G. W., 2000. ibid 21, p. 267
[42] Kolodko, G. W., 2000. ibid 21,p. 268
[43] Dabrowski, M., Gomulka, S., Rostowski, J., 2000. *Whence Reform? A Critique of the Stiglitz Perspective*. A supplementary paper prepared for the United Nations Economic Commission for Europe Annual Seminar, Geneva, 2 May 2000.
[44] Stiglitz, J., 1999. *Whither Reform? Ten Years of the Transition*. Annual Bank Conference on Development Economics, April 28 to 30, World Bank, Washington D.C.
[45] "Shock Therapy" as a reform strategy and the way it is presented in related literature is extensively discussed in subchapter 2.3 of the present thesis
[46] Wyplosz, C., 1999. *Ten Years of Transformation: Macroeconomic Lessons*, Annual Bank Conference on Development Economics, April 28 to 30. World Bank, Washington, DC.

transition depends above all on the rapid creation of conditions — institutional, legal, microeconomic and macroeconomic — which are conducive to the development and growth of a new private sector, domestic and/or foreign." (Gomulka, 2000)[47]. Thus initial "shock therapy" looks justified not only because the countries where it was applied did better than others (in this light the Czech crisis of 1997 is an exception due to wrong structural transformation policies). Not only has 'Shock Therapy' proved efficient, but looking back at the 90s, most economists defuse the debate on Big Bang as opposed to 'Gradualism'. "Rapid policy action was possible in some areas of reform — price and trade liberalization, and inflation stabilization, and perhaps small-scale privatization — but in others it was clear that reform would take a long time." (Fisher and Sahay, 2000)[48]. Actually 'Gradualism' has almost dropped out of the vocabulary of transition. Even its supporters (Stiglitz, 1999)[49] agree that quick action proved right in some areas of transition: "I have no great quarrel with "shock therapy" as a measure to quickly reset expectations say in an anti-inflation program." (Stiglitz, 2000)[50].

Quick and extensive liberalization helped recovery in growth

The relation between liberalization and growth has been strongly emphasized in the Word Bank World Development Report (1996)[51] which may be considered as the reference book on the first five years of transition. At that time, the report was on a forecast level, as few countries were beginning to recover. At the turn of the century, it is difficult to challenge the fact that liberalization was necessary and useful. The opponents are left with the argument that in some (many) cases

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[47] Gomulka, S., 2000. *Macroeconomic Policies and Achievements in Transition Economies, 1989–1999*. An invited paper prepared for the United Nations Economic Commission for Europe Annual Seminar, Geneva, 2 May, p. 22
[48] Fisher, S., Sahai, R., 2000. p. 11
[49] Stiglitz, J., 1999. ibid 44, p. 21
[50] Stiglitz, J., 2000. *What I Learned at the World Economic Crisis*. The Insider. The New Republic, 17 and 24 April, p. 21
[51] World Bank, 1996. *From Plan to Market*. World Development Report 1996. World Bank and Oxford University Press, Washington, DC and Oxford

liberalization occurred too soon, and was carried with too little protection. This may be true, but it is too late to go back.

Curbing inflation has facilitated recovery

The link between disinflation and growth has been forcefully stressed. "Real GDP rebounds following inflation stabilization" (Fisher et al., 1997, p. 89)[52]. "Stabilize first, grow next" (Wyplosz, 1999)[53]. But then the question arises: is there a threshold of inflation beyond which growth would be affected? According to Gomulka (2000)[54], "the inflation rate need not, and initially should not, be very low, but it must not be high (not more than 40 percent), and it should be converging to the EU level". In fact the CEE countries that have applied to the EU indeed seek inflation rates closest to the EU convergence level (presently 3%), and 1999 data show that in most of these countries, one-digit rates have been achieved along with recovery.

Thus the ‘Washington Consensus’ is alive and well, with some insignificant changes. And the discussion itself seems largely irrelevant, as one issue is now dominating the scene: the end of transition is increasingly associated with the accession of transition countries to the European Union (EU).

2.2.4 EU Accession as the End of the Transition Process

When is transition over? This was a question asked from several economists during a cycle of lectures organized at the Western Michigan University (Brown, 1999)[55]. A variety of answers were given. Andras Aslund, starting from the Russian case, argued that transition will be over there when rent-seeking behavior will come to an end, which was already almost the case in this country

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[52] Fisher, S., Sahay, R. and Végh, C.A., 1997. *From transition to market: evidence and growth prospects*. In: Zecchini, S., Editor , 1997. *OECD, Lessons from the Economic Transition: Central and Eastern Europe in the 1990's*, Kluwer Academic Publishers, Dordrecht, pp. 79–101
[53] Wyplosz, C., 1999. ibid 46, p. 28
[54] Gomulka, S. 2000, ibid 47, p. 22
[55] Brown, A., 1999. ibid 20

(Aslund A. in Brown, 1999)[56]. Examining the Hungarian case, Kornai stated that while transformation was not yet over, transition certainly was: "the system is now a capitalist one"[57]. What was missing for transformation to be complete was a set of institutions, among which he singled out a modern welfare system. In a similar way and dealing with Central European countries, Svejnar considered that these countries now had functioning market economies[58] while still having much to do to improve market efficiency and to ensure growth. Alan Gelb, who edited the World Bank Development Report 1996 on transition from plan to market, gives the same answer: "transition is over when the problems and the policy issues confronted by today's 'transition countries' resemble those faced by other countries at similar levels of development"[59].

The question seems thus quite ambiguous. Starting from the same data, one may or may not conclude to the end of transition, and include different countries in the list of countries having successfully achieved it. The set of indicators devised by the EBRD to assess the progress in transition and published each year in its Transition Report does not allow one to state that transition is over in a given country, as none of the transition countries reach the highest mark (+4) for all the indicators, and probably will never do; it just allows one to say that some countries or groups of countries are closer to the end than others.

Kolodko (2000)[60] remarks that "the transition is a generation-long process of change". He states that there is a great fuzziness of concepts: are we talking of systemic transition, transformation, market reform? According to him the most important issue is the relation between transition and development, the latter relying on market forces and guided by a wise government policy. He quite aptly compares the emerging markets (which are considered as market economies but have many features in common with transition economies) and asks "how long

[56] Brown, A., 1999. ibid 20, p. 66
[57] Brown, A., 1999. ibid 20, p. 100
[58] Brown, A., 1999. ibid 20, p. 90
[59] Brown, A., 1999. ibid 20, p. 39
[60] Kolodko, G. W., 2000. ibid 21, pp. 353, 346

does it take to 'emerge'"?[61]. Formally, he says, "from a formal viewpoint membership in the OECD and in the EU should be considered a seal of approval that the transition process has been completed" (ibid.), but he immediately adds that in practice new EU (or OECD) members will still have much to do to complete their transformation (such as Portugal and Spain experienced for example after 1986).

The new members and the applicants to the EU have had to and continue to incorporate the so-called acquis communautaire into their laws and regulations. This procedure conforms neither to the "Washington Consensus" pattern (as here market institutions and rules are enforced by an authority upon the applicants, and are not left to emerge by themselves), nor to any "post-Washington consensus" scheme (national governments are not free to build market institutions according to the specifics of each country). For the time being though, the countries that are not yet engaged in this process, or are not considered as possible applicants (in the Balkan area or in the Commonwealth of Independent States) are indeed largely lagging behind both in the transformation process, and on the path to sustainable growth. And for those among them which associated or will sooner or later associate with the EU, the "EU effect" will no doubt accelerate systemic change.

"There is no end in challenges" as far as sustained growth, integration into the global economy, and the construction of a civil society are concerned (Kolodko, 2000) [62]. One cannot but agree, with the reservation that these challenges affect most of the developing and even the developed world; it is not just a question of transition.

[61] Kolodko, G. W., 2000. ibid 21, p. 346
[62] Kolodko, G. W., 2000. ibid 21, p. 355

2.3 The Reform Strategies: “Shock Therapy” and “Gradual Reform”

The most relevant strategy of economic transition from a centrally planned economy to a market economy is controversial and has dominated the political and intellectual debates of the past fourteen years. The choice of relevant transition strategy is more difficult than designing the final economic model, i.e., a private market economy with a stable currency. Perhaps a useful lesson for the former Communist countries in elaborating adequate transition policy is the experience (mainly negative) of those countries which tried to reform the socialist economy during the last 30 years of the communist regime.

The initial policy dilemma seemed to be the **radical** strategy of fast and comprehensive changes (very often called *shock therapy* or *big bang)* on the one hand and the **evolutionary way** of *gradual* (step by step) changes on the other. During the last sixteen years, this controversy was widely discussed and various arguments came from the following:

- the theoretical foundation of economic science (Ees and Garretsen, 1994)[63],
- political economy and political dynamics of the transition process (Aslund, 1994; Dabrowski, 1992b; Balcerowicz, 1994)[64],
- inertial nature of human behavior (Murrell, 1992)[65],
- the gradual nature of institutional changes (ECE, 1993)[66],
- consistency of the new economic system and necessity to break down the inertia of the old system (Balcerowicz, 1993; Dabrowski, 1992b)[67],

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[63] Ees, Hans van and Garretsen, H., 1994. *The theoretical foundations of reforms in Eastern Europe: Big Bang versus Gradualism and the limitations of Neo-Classical Theory*, Economic System, Vol. 18, Issue 1

[64] Aslund, A., 1994. *Lessons of the first four years of systemic change in Eastern Europe*, Journal of Comparative Economics, Vol. 19, No. 1

Dabrowski, M., 1992. *From planned economy to market economy: rate and stages of transformation process*, paper for the second EACES Conference on Problems of Transforming Economies, Groningen, the Netherlands, September 24-26.

[65] Murell, P., 1992. *Evolution in Economics and in the Economic Reform of the centrally planned economies*, in Clague, C. and Rausser, G. C. (eds.) The Emergence of Market Economies in Eastern Europe, Oxford, Basil Blackwell

[66] ECE, 1993. *Economic Survey of Europe in 1992-1993*, UN Economic Commission for Europe, Geneva – New York

- nature of the macroeconomic stabilization and the role of expectation (Sachs, 1994; Balcerowicz, 1989; Balcerowicz and Gelb, 1994)[68],
- negative experience of the reforms of the socialist economy in the past (Sachs and Lipton, 1990; Dabrowski, 1992b)[69],
- economic and social costs of transformation (output decline and unemployment) (Nuti and Portes, 1993; Laski, Bhaduri and Levcik, 1993; Roland, 1994)[70],
- fiscal consequences of adopted transition strategy (Kolodko, 1992; Aghion and Blanchard, 1993)[71], and
- the environment for private sector development (Johnson and Loveman, 1995)[72].

The transition process was characterized by uncertainty and the absence of any historical paradigms. Hence, the *Economist*'s metaphor about the transition process was that there was no known "recipe for unmaking an omelet"[73]. Few economists attempted to approximate the initial conditions of centrally

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[67] Balcerowicz, L., 1993. *Common fallacies in the debate on the economic transition in Central and Eastern Europe*, Working Paper No. 11, EBRD, October

[68] Sachs, J. D., 1994. *Russia's struggle with stabilization: conceptual issues and evidence*, in Bruno, M. and Pleskovic, (eds.) Proceedings of the World Bank Conference on Development Economics 1994, Washington D. C.

Balcerowicz, L., 1989. *Either fast or not at all*, Baczyski, J. and Tarnowski, P. talk to Leszek Balcerowicz, Polityka, No. 48

Balcerowicz, L., Gelb, A., 1994. *Macro-policies in transition to a market economy: a three-year perspective*, paper presented at the World Bank's Annual Conference on Development Economics, Washington D. C., April 28 & 29

[69] Sachs, J. D., Lipton, D., 1990. *Poland's economic reform*, Foreign Affairs, Vol. 69, No. 3

[70] Nuti, D. M., Portes, R., 1993. *Central Europe: the way forward*, in R. Portes (ed.) Economic Transformation in Central Europe: A Progress Report, London: Centre for Economic Policy Research

Laski, K., Bhaduri, A., Levick, F., 1993. *From planned economy to a market system: what failed and what is necessary to do now*, in The Polish Economy 1990-1993: Assessment of Experience and Proposals for the Economic Policy, INE PAN & Semper, *Studia I Materialy*, No. 43

Roland, G., 1994. *On the speed and sequencing of privatization and restructuring*, Economic Journal, 104, pp. 1158-68, September

[71] Kolodko, G., 1992. *From output collapse to sustainable growth in transition economies: the fiscal implications*, Fiscal Affairs Department, IMF, December

Aghion, P., Blanchard, O. J., 1993. *On the speed of transition in Central Europe*, Working Paper No. 6, European Bank for Reconstruction and Development (EBRD), July

[72] Johnson, S., Loveman, G., 1995. *Starting Over in Eastern Europe: Entrepreneurship and Economic Renewal*, Boston: Harvard Business School Press.

[73] The Economist, 1990, Article "*No Half-way House*", page 18

administered economies with the stabilization programs initiated in the mature market economies. For example, Jeffery Sachs (1993)[74] argued "the prototypical case in Europe that I will refer to is that of Spain, which in many ways provides a kind of guidepost to the path that the economies of Eastern Europe should follow." Sebastian Edwards (1992)[75] argued "the large number of stabilization attempts in Latin America during the last four decades provides a wealth of lessons – both positive and negative – on different aspects of anti-inflationary programs". Or, "an analogy is presented by what Central and Eastern Europe encountered just after the World War I" (Aslund, 1992)[76].

The initial conditions of the centrally administered economies, though, were different than the experience of mature market economies (Marangos, 2003)[77]. The stabilization programs initiated in mature economies assume a well-functioning market, with developed institutions and the dominance of private property and inflexible prices and wages, in the short run, and forward-looking economic actors motivated by individual material incentives. The initial conditions of centrally administered economies – such as the dominance of state property, central control of the whole economy, and the encouragement of non-material incentive – did not approximate the conditions of any mature market economy. As such, the experience of mature market economies was irrelevant for the transition process.

In the following sections, I will present a detailed analysis of the arguments extensively discussed in economic literature (1) in favor of shock therapy and (2) in favor of gradual reform.

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[74] Sachs, J., 1993. *Poland's Jump to the Market Economy*, Cambridge: The MIT Press, p. 3
[75] Edwards, S., 1992. *Stabilization and liberalization for economies in transition: Latin American lessons for Eastern Europe*, The Emergence of Market Economies in Eastern Europe, edited by C. Clague and G. Rausser, Cambridge: Blackwell, p. 131
[76] Aslund, A., 1992. *Post-communist economic revolutions: how Big a Bang?*, Washington D. C.: The Center for Strategic and International Studies, p. 26
[77] Marangos, J., 2003, *Was shock therapy really a shock?*, Journal of Economic Issues, Vol. XXXVII, No. 4, December, p. 944

2.3.1. The Arguments in Favor of Shock Therapy (Top-Down Reform)

The shock therapy model highlights the independence and mutually supportive and interactive character of economic relationships, implying that reforms should be introduced simultaneously. Fragmented changes would have been ineffective. As one Polish economist argued, "you don't try to cross a chasm in two jumps" (Sachs, 1990)[78]. The program has been described as "a leap to a market economy" (Sachs and Lipton, 1990)[79] and "a jump to a market economy" (Sachs, 1993)[80].

According to the shock therapy model, restructuring could not have taken place without an effective pricing system, and an effective pricing system could not have existed without a convertible currency. In turn, a convertible currency was impossible without opening the economy to international competition, and international competition could not have been effective without restructuring. The idea that there was a choice between doing one radical measure or another was misleading. There was no trade off, but on the contrary, complementarity (Aslund, 1997, Ericson, 1991)[81]. The transition economies, experiencing such severe economic imbalances, could not have afforded to implement their reform policies slowly. "They need a strong dose of medicine quickly" (Thomas and Wang, 1997)[82]. Both the economic and political situation required a rapid and comprehensive reform (Lipton and Sachs, 1990)[83]. "If a house is on fire, you do

[78] Sachs, J., 1990. *What is to be done?*, The Economist, January 13, p. 19
[79] Sachs, J. and Lipton, D., 1990. *Poland's economic reform*, Foreign Affairs 69, No. 3, p. 48
[80] Sachs, J., 1993. Ibid 74.
[81] Aslund, A., 1997. Epilogue, *Russia's Economic Transformation in the 1990's*, edited by A. Aslund, London: Printer, p. 187
Ericson, A. E., 1991. *The classical Soviet-type economy: nature of the system and implications for reform*, Journal of Economic Perspectives 5, No. 4, p. 24
[82] Thomas, V., Wang, Y., 1997. *East Asian lessons from economic reforms*, Economies in Transition: Comparing Asia and Europe, edited by W. T. Woo, S. Parker and J. D. Sachs, Cambridge: MIT Press, p. 223
[83] Lipton, D., Sachs, J., 1990. *Creating a market economy in Eastern Europe: the case of Poland*, Brookings Papers on Economic Activity, No. 1, p. 99

not tell the fire brigade to pour water slowly" (Aslund, 1994)[84]. "Shock therapy, on the other hand, means a person who, while putting in his first leg, cannot wait to put in his second one" (Woo, 1994)[85]. "Bitter medicine is easier to take in one dose than in a prolonged series of doses" (Balcerowicz, 1994)[86]. Hence, it was preferable to employ one shock instead of a series over a prolonged period (Dabrowski, 1997, Aslund, 1997, 1994)[87].

However, the implementation of microeconomic liberalization without macroeconomic stabilization would have been a shock without therapy (Woo, 1994)[88]. Thus macroeconomic and microeconomic reforms had to be concurrent (Sachs, 1990)[89]. The negative consequences associated with the transition program, such as reduced living standards and the rise in unemployment, could have been minimized as long as the reform program was comprehensive and consistent. The transition countries should have borne the necessary recession and endured the radical reform because in the long run economic growth prospects were guaranteed (Sachs and Lipton, 1990)[90]. Otherwise the period of output reduction would have been extended unnecessarily (Sachs and Woo, 1994)[91]. The speed of transition would have been negatively correlated with the continuance of output decline and positively correlated with the intensity of output recovery (Parker, Tritt and Woo, 1997)[92].

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[84] Aslund, A., 1994. *Lessons of the first years of systematic change in Eastern Europe*, Journal of Comparative Economics 19, No. 1, August, p. 37
[85] Woo, W. T., 1994. *The art of reforming centrally planned economies: comparing China, Poland and Russia*, Journal of Comparative Economics 18, No. 3, June, p. 281
[86] Balcerowicz, L., 1994. *Understanding post-communist transitions*, Journal of Democracy 5, No. 4, October, p. 87
[87] Dabrowski, M., 1997. *The first year of Russian transformation*, in 'Russia's Economic Transformation in the 1990's', edited by A. Aslund, London: Printer, p. 47
Aslund, A., 1997. *A critique of Soviet reform plans*, Russia's Economic Transformation in the 1990's, edited by A. Aslund, London: Printer, p. 16
Aslund, A., 1994. Ibid 12, p. 36
[88] Woo, W. T., 1994. Ibid 85, p. 278
[89] Sachs, J., 1990. Ibid 78, p. 21
[90] Sachs, J. and Lipton, D., 1990. Ibid 79, p. 63
[91] Sachs, J. and Woo, W. T., 1994. *Experience in the transition to a market economy*, Journal of Comparative Economics, June, p. 274
[92] Parker, S., Tritt, G., Woo, W. T., 1997. *Some lessons leaned from the comparison of transitions in Asia and Eastern Europe*, in Economies in Transition: Comparing Asia and Europe, edited by W. T. Woo, S. Parker, J. Sachs, Cambridge: MIT Press, p. 14

Official data tended to overstate the decline in output and failed to recognize the benefits associated with increased quality of products and the eradication of queues (Balcerowicz, Blaszczyk, Dabrowski, 1997)[93]. The negative outcomes were not the result of the reform process as such; rather, they were due to inconsistencies inherited from centrally administered socialism. “This mistaken attribution results in an overstatement of the ‘costs’ of the reforms, and therefore, an undue pessimism about the reform policies themselves” (Lipton and Sachs, 1992)[94]. There was no foundation for criticism of the shock therapy process, which was “politically motivated, rather than analytically sound” (Lipton and Sachs, 1992)[95]. In fact, more radical reforms would have resulted in a smaller fall in output (Aslund, Boone, Johnson, 1996)[96].

Maintaining distorted prices and entry barriers, as the gradualists recommended, would only have encouraged activities such as speculation, diversion of state supplies and corruption. Gradualism would have resulted in an environment of ill-defined property rights, badly operated markets, distorted investment, an uneven distribution of wealth, reduced social welfare, a closed economy, high inflation, shortages, recession, social dissatisfaction and possibly unrest (Aslund, 1995; Boycko, 1991; Dabrowski, 1997; Ericson, 1991)[97]. Regulation, which was what a gradual process involved, would only have resulted in corruption by politicians and bureaucrats (Aslund, 1995)[98]. Once regulation is in its place, it keeps

[93] Balcerowicz, L., Blaszczyk, B., Dabrowski, M., 1997. *The Polish way to the market economy 1989-1995*, Economies in Transition: Comparing Asia and Europe edited by W. T. Woo, S. Parker, J.Sachs, Cambridge: MIT Press, p. 139
[94] Lipton, D., Sachs, J., 1992. *Prospects for Russia's economic reforms*, Brookings Papers on Economic Activity, No. 2, p. 214
[95] Ibid 22
[96] Aslund, A., Boone, P., Johnson, S., 1996. *How to stabilize: lessons from post-communist countries*, Brookings Papers on Economic Activity, No. 1, p. 236
[97] Aslund, A., 1995. *How Russia became a market economy*, The Brookings Institution, Washington D. C., p. 267
Boycko, M., 1991. *Price decontrol: the microeconomic case for the Big Bang approach*, Oxford Review of Economic Policy 7, No. 4, p. 41-2
Dabrowski, M., 1997. Ibid 87, p. 54
Ericson, A. E., 1991. Ibid 81, p. 25
[98] Aslund, A., 1995. Ibid 97, p. 78

expanding to repair the perceived damage cause by the original regulatory framework. Thus, self-interested groups should not have been allowed the necessary time to coordinate and change the course of the reform (Frydman, Rapaczynski, Turkewitz, 1997; Aslund, 1995)[99]. The shock therapy process was believed to be the only efficient course, as it provided benefits quickly, with minimum private and social costs. Gradualism has not been confirmed as superior to the shock therapy approach (Aslund, Boone, Johnson, 1996; Samonis and Hunyadi, 1993)[100]. Importantly, the longer the transition process, the more time available for self-interest pressure groups to regroup and use their monopoly and political power to oppose the reforms.

In summary, a gradual process would have substantially undermined the credibility of the reforms. "Move too slowly and the consensus that supports the reform can collapse. It is uncertainty, not speed, that endangers the reform program and casts doubt on the government's credibility to carry it out" (Macesich, 1991)[101]. Only comprehensive programs implemented rapidly and vigorously had any chance of succeeding. Boris G. Fedorov (1992)[102], who initially supported a gradual approach, changed his mind and argued that a gradual reform was politically unacceptable. He became one of the most important supporters of applying shock therapy.

Most importantly, a gradual process would have resulted in wastage of the precious reserve of political capital developed after the collapse of centrally administered socialism. At the time, people were willing to accept radical solutions to the difficult economic problems they faced. A gradual process would

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[99] Frydman, R., Rapaczynski, A., Turkewitz, J., 1997. *Transition to a private property regime in the Czech republic and Hungary*, Economies in Transition: Comparing Asia and Europe, edited by W. T. Woo, S. Parker, J. Sachs, Cambridge: MIT Press, p. 89
Aslund, A., 1995. Ibid 97, p. 99
[100] Aslund, A., Boone, P., Johnson, S., 1996. Ibid 96, p. 252
Samonis, V., Hunyadi, C., 1993. Big *Bang and Acceleration: Models for the Post-communist Economic Transformation*. New York: Nova Science Publishers, p. 20
[101] Macesich, G., 1991. *Reform and Market Democracy*, New York: Praeger Pub., p. x
[102] Fedorov, B. G., 1992. *Monetary, financial and foreign exchange policy*, in The Post-Soviet Economy: Soviet and Western Perspectives, edited by A. Aslund, New York: St. Martin's Press, p. 108

have resulted in political competition between parties based on self-interest and, thus, disillusionment of the public. Leszek Balcerowicz, Barbara Blaszczyk and Marek Dabrowski (1997)[103] argued that, **according to social psychology, people are more willing to adjust their behavior in an environment that is going through a radical change than during a gradual change. People conceive that the initial crisis is less significant as long as there is a positive outlook for early benefits in the future** (Aslund, 1992)[104]. In contrast, the longer it takes to implement the necessary reform, the more the public's psychology changes, influenced by the possible social costs (Graham, 1997)[105]. Thus, if people had been properly informed and psychologically prepared, they would have accepted the hardships with relative ease (Aslund, 1992)[106] and people were willing to accept suffering if they were convinced of the positive benefits associated with the radical solution (Alund, 1992)[107].

It appears that while the theoretical foundation of the shock therapy model required the necessary policies to be implemented in one shot, the formulation of the model as interpreted for the conditions of the transition economies to a large extent incorporated gradual policies, and the actual experience of transition economies reveals that those economies which implemented shock therapy, opted, in numerous sectors and policies, for a gradual implementation of the model. A more detailed presentation of the actual implementation of the model is offered in Chapter 3, Section 3.3. The results of this application in Poland and the Czech Republic are largely discussed in Chapter 4, Sections 4.2 and 4.3.

[103] Balcerowicz, L., Blaszczyk, B., Dabrowski, M., 1997. Ibid 93, p. 135
[104] Aslund, A., 1992. Ibid 76, p. 32
[105] Graham, C., 1997. *Strategies for addressing the social costs of market reforms: lessons for transition economies in East Asia and Eastern Europe*, Economies in Transition: Comparing Asia and Europe, edited by W. T. Woo, S. Parker, J. Sachs, Cambridge: MIT Press, p. 338
[106] Aslund, A., 1992. Ibid 76, p. 176
[107] Aslund, A., 1992. Ibid 76, p. 30

2.3.2 The Arguments in Favor of Gradual Reform (Bottom-up Reform)

Since the fall of communism, Eastern European countries have been restructuring their economies in order to create a Western-type, competitive market. All the nations have concluded that a command economy is not viable and are converting to a market economy. Yet, there are different methods in which this can be done. The most prominent theories are shock therapy, discussed in the previous section, and gradualism. David Lipton and Jeffrey Sachs are the leading advocates of shock therapy. On the other side, Peter Murrell[108] is the advocate of the Gradual Reform strategy. In the article, "What is Shock Therapy? What Did it do in Poland and Russia?"[109], Peter Murrell, refutes Lipton and Sachs' theories and believes in an altered version of gradualism, which he calls an “evolutionary or organic view of society”.

Peter Murrell considers the difference between shock therapy and evolutionary "reflects fundamental disagreements about the way human societies function, differences in judgments on matters of politics, psychology, and society, as well as economics." (Murrell, p.116) Although this statement is quite vague, Murrell specifies differences between the two approaches. One of the differences is the behavior of the economic agents. The author explains that shock therapists believe that economic agents will be functional in a new economic society because reformers are only concerned with present issues and incentives, not with the historical means in which these agents were formed. The evolutionists believe that these agents are formed by both historical and current issues. That these agents "accumulate knowledge in a learning-by-doing process". (Murrell, p.119).

[108] Peter Murrell is professor of economics and chair of the Academic Council of the Center for Institutional Reform and the Informal Sector (IRIS), University of Maryland, U.S.A.
[109] Murrell, P., 1993, *What is Shock Therapy? What did it do in Poland and Russia?*, Post Soviet Affairs, April-June, No. 9, Vol. 2, pp. 111-140

Another difference is the belief by shock therapists that the technocrats who create the reforms should be outsiders who have an objective point of view. Murrell believes that the outside technocrats are just familiar with the theories of economics and this is not enough. He believes reforms must be made "intertwined with the social system". (Murrell, p.120).

Shock therapists believe in top-down reforms. This entails the elite of the nation to command the reforms and society must adhere to them. Evolutionists (gradualists) feel that "formal policies will be most effective if they are a product of the deeper informal structures of society. Law can be a powerful tool, but only if it is created by society rather than imposed upon it." (Murrell, p.120).

Peter Murrell reveals that the evolutionist believes in a gradual change congruent with society and is "efficient only if it responds to real economic needs" (Murrell, p.122). He believes change must be bottom-up so the people do not reject the reforms or are unable to adjust.

The gradualist approach is preferred much more by Murrell because of its ease in application purposes. Unlike shock therapy which assumes to have all the right answers, the Evolutionary viewpoint takes a "learning-by-doing" approach. This method, according to Murrell, values the society factor (Murrell 120). It values the concept that before society can use new rules it must be able to understand them; that is be able to apply them. In summation then, the evolutionary (gradual) standard, interprets market transformation progress to be judged by the number of new small businesses in the private sector. This means a bottom-up transformation that starts in the small private sector and eventually leads to the giant state sector. Under the Gradual process, society has a great voice in the progress of economic transformation.

Gerard Roland[110] argues (1994)[111] that political constraints necessitate a gradual approach to restructuring and that gradualism has implications for speed and sequencing privatization. In opposing speedy reforms or "big bang" theories, he states that although such schemes are widely publicized, they are often difficult to implement. In Poland for example the scheme has been blocked politically for more than three years, the reason being that the ruling party lacked credibility with respect to commitment to privatization. In the presence of political constraints, a policy of fast and non-differentiated privatization carries the danger of partial renationalizations and general delays in restructuring. Raising capital is the real problem in the transition economies for privatized firms as well as intermediaries such as mutual funds and banks. This is the case under giveaway policies where firms can not find a substantial investor first when privatization takes place. The government then has to intervene by subsidizing a large number of firms; in essence partial renationalization, in order to prevent high levels of liquidation.

According to Roland, under gradual restructuring the policy will work in three ways. Firstly, there will be a screening process to separate the good firms from the bad ones; secondly, an emergence of a sound financial system and thirdly, a credible policy of gradual restructuring and hardening of budget constraints in the state sector. With gradual privatization, only those firms get privatized that find a private acquirer who takes the responsibility of financing future outlays of the firm. Firms will then be in two categories: private firms and S.O.E's. Once firms are privatized, the government will not intervene in any way. S.O.E.'s will still be directly financed through the budget and will not have access to private investment channels. Once the good firms are privatized, the government can concentrate its monitoring activities on the bad firms and reinforce control over them. From this standpoint, finance for good and bad firms will remain separate.

[110] Gerard Roland is Professor of Economics and Political Science at University of California, Berkeley, Department of Economics.
[111] In the article *'On the speed and sequencing of privatization and restructuring'*, Economic Journal, Vol. 104, No. 426, September

Good firms will become independent through privatization and face hard budget constraints, while bad firms would operate under more stringent government controls. If all firms are financed through the banking system, bad firms are likely to spoil the financial system.

Roland proposes that because of political constraints involved with speedy reform measures, policies are often not implemented. Industries are often said to collapse because of bureaucratic bungling. He states that the government should select certain industries for privatization and develop a scheme for this eventual purpose.

Under the present analysis, there are also other points to be considered in order to better estimate the results of implementing the gradual approach:

1. While politicians are deciding which industries should be privatized first, many inefficient and outdated concerns will still be operating. This means that the state will have to finance these concerns to keep them afloat. Immediately the real incentive for restructuring within these concerns is removed and they can continue operating as usual.
2. East European countries are competing vehemently to make their products more competitive within the western arena. To do this, many companies need hard currency from foreign investors in order to restructure their firms. Those countries which offer the most expedient and profitable portfolios will certainly get the share of investors.
3. Internal disagreements will ensue as politicians decide which companies should be privatized. Many industries are large entities stemming from the communist era and which employ many people. Privatization of these firms will mean the loss of many jobs, which immediately makes the regional politician very unpopular. Political unity, I think is the key if any reform plan is going to be introduced successfully. The more the politicians intervene with the privatization of industries and firms, the more problems seem to evolve.

Hare and Revesz (1992)[112] present a list of justifications in support of gradualism by highlighting the disadvantages of shock therapy as a method of transition to a market economy:

- the standard of living would decline drastically. Rapid structural change cannot occur without an accompanying increase in unemployment, and a general decline in living standards. People in transition countries would not be willing to tolerate substantial falls in living standards during the transition period. For the same reason, it would be difficult to convince them that a decline was a requirement of transformation.
- Big Bang disturbs the expectations of domestic and foreign investors. The best course of action for lowering the burden of big debt is to (a) increase foreign trade and (b) continue to attract foreign investors. It is argued that these conditions are best served by a gradual transition, because it is much more predictable and therefore "friendlier" to investors.
- Credibility. In tune with the above argument, it is very important for countries in transition to retain their credibility with foreign nations and thus maintain the debt payments. The Big Bang would be too chaotic, which would be detrimental to the economy.
- Big Bang is not necessary. Some of the countries in transition had allowed private businesses to be established starting in the 1980s. By 1990 small private businesses were already producing 5-10% of industrial output. People gained incentive and knowledge and therefore does not need to follow any drastic policies, because much of the market economy had already been established.

[112] Hare, P., Revesz, T., 1992, *Hungary's transition to the market: the case against a Big Bang*, Economic Policy, Cambridge University Press, ed. 14, April

According to Marek Dabrowski (1996)[113], the speed and sequencing of the transition debate continues. Slow and gradual macroeconomic stabilization does not make sense for countries which entered the transition process with a big monetary overhang and substantial fiscal and monetary flow imbalances. The rationality of slow price and trade liberalization applies only in countries which had more open and deregulated economies before the post-communist transition started and inherited less price and structural distortions (Hungary and the former Yugoslavia). The real choices are about

- **the speed of privatization,**
- **more sophisticated institutional changes, and**
- **the restructuring of state-owned enterprises.**

The transition process in every country has been more difficult that ever anticipated. However, one should not overlook the positive effects. Most important, of course, is the fact that progress, of different extents, is being made. Nobody should have expected a smooth transition, and those countries that are having a particularly difficult time should not only look towards current economic policies for blame, but also towards the past communist system and the initial starting conditions of individual countries.

2.4 Tourism in Transition

Tourism in Central and Eastern European Countries has been a subject of considerable academic debate and commentary since the political events of 1988-1989. In particular, strategic planning in the region was critical to the future success of tourism as attempts were made to utilize tourism in the process of economic change. Tourism is seen as a useful means of change as it cuts across a variety of economic sectors and is primarily comprised of small and medium size enterprises. Also, it was perceived as an activity that offered relatively

[113] Dabrowski, M., 1996. *Different strategies of transition to a marketing economy*, Policy Research Working Paper 1579, The World Bank Policy Research Department Transition Economics Division, March, p. 28

straightforward opportunities to achieve a comparable structure, organization and level of provision to the West. As an underdeveloped and under-exploited sector, it was contended that, if developed according to western criteria, tourism would significantly boost economic output (Hall, 1998)[114].

Since 1998-99, academic debate has often focused on Central and Eastern European countries, whose future free market depends on planning, including planning in tourism. It was concluded that the industry could contribute to the needed changed by unifying various economic sectors with its smaller businesses (Hall, 1991; Kerpel, 1990)[115]. However, the academic literature has yet to see material on the practical difficulties and issues of utilizing tourism as a medium of change, simply because the lessons are still being learned.

Between 1945 and the late 1980s, the countries of Central and Eastern Europe could be said to form a political and economic region differentiated from the "western countries". Largely for political reasons, both the demand and supply of tourism acquired a special identity (Boniface and Cooper, 1994; Buckley and Witt, 1990)[116].

Following the political events of the late 1980s, the countries of Central Europe are moving from a centralized to a market economy, and from a totalitarian – one party system – towards a pluralist democracy. The change is complex, particularly in those countries where the regimes had developed a super centralized economy. Allcock and Przeclawski (1990) suggest that a variety of

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[114] Hall, D., 1998. *Central and Eastern Europe: Tourism Development and Transformation*. In A. M. Williams and G. Shaw, Tourism and Economic Development: European Experiences. (3rd. ed.), Wiley, Chichester, pp. 345-374

[115] Hall, D., 1991. *Tourism and Economic Development in Eastern Europe and the Soviet Union*, Belhaven, London, pp. 3-28

Kerpel, E., 1990, *Tourism in Eastern Europe and the Soviet Union, Special Report no. 2042*, EIU, London

[116] Boniface, B. and Cooper, C., 1994. *The Geography of Travel and Tourism*. Butterworth Heinemann, Oxford

Buckley, P. J. and Witt, S., 1990. *Tourism in Centrally Planned Economies of Europe*. Annals of Tourism Research 17:7-18 approaches are evident as the transition is made. These range from acceptance of the "old" centrally planned model of tourism development, which is still evident in countries such as Romania, to the import of the Western techniques and approaches.[117]

In all Central and Eastern European countries tourism is seen as playing an important role in the process of planned economic change (Hall, 1991)[118]:

- privatization of state monopolies exposes them to competition and efficiency measures;
- private sector entrepreneurs are encouraged as tourism is often used as a demonstration project
- tourism provides international exposure and so demands the imposition of universally reorganized standards such as hotel classification.[119]

Authors group the constraints to the restructuring of Tourism into manageable categories, which include:

- economic restructuring / fiscal constraints
- tourism administration
- regulation of travel
- environmental image
- human resources
- tourism infrastructure

Overall, the progress towards a market economy is hindered by the fact that privatization is as much a political process as it is an economic one (Rapp, 1991)[120].

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[117] Allcock, B., Przeclawski, K., 1990. Introduction Annals of Tourism Research 17, pp.1-6
[118] Hall, D., 1991. ibid 115, pp. 23-28
[119] Buckley, P. J. and Witt, S., 1990. ibid 116, pp. 13-18
European Commission 1992, Tourism Research and Study Programme DGXXIII
Hall, D., 1991, ibid 115, pp. 49-78
Hall, D., 1992. *The Challenge of International Tourism in Eastern Europe Tourism Management 13*, pp. 41-44
Williams, A. M., Shaw, G., 1988. *Tourism and Economic Development. Western European Experiences*, Belhaven, London
Witt, S. F., 1994. *Global Tourism: The Next Decade*, Butterworth-Heineman, Oxford, pp. 217-225
[120] Rapp, I., 1991. *Changes in the East,* ITA Magazine 68, pp. 14-18

Most authors agree that effective planning and management are a prerequisite for the successful utilization of tourism as an agent of change in the region. However, as Franck (1990) notes, it is important to distinguish between the short term impact of the 1988-89 political changes and the need for a long term strategic view of the tourism industry. At the same time, it is essential to establish the general principles of tourism planning and to use the lessons which have been learned elsewhere relating to successful plan implementation (McIntyre, Hetherington and Inskeep, 1993)[121]. While the discussion on the most appropriate forms of tourism development has begun early in most Central and Eastern European Countries, much of the expertise for the process has been imported in the region from the West, through the mechanism of international aid, from different agencies and from the European Community. However, it was important to ensure that the general principles of tourism planning and development are imported into Central Europe with locally-sensitive implementation.

In part, this is a recognition of both the role of tourism as an agent of economic development and the fact that tourism can change attitudes and act as a medium for cultural change.

Tourism is seen as transcending the traditional economic sectors and is viewed as an industry which can actively regenerate the small business / entrepreneurial sector due to its flexibility and responsiveness to dynamic changes. However, the transformation of a centralized economy, characterized by inflexible practices and a low priority for tourism, involves changes in both principles and mentality, as much as it needs outside expertise. Hall (1991) and Turnock (1989) [122] list tourism's benefits as including:

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[121] McIntyre, G., Hetherington, A., Inskeep, E., 1993. *Sustainable Tourism Development: Guide for Local Planners*, WTO, Madrid

[122] Hall, D., 1991. ibid 115, pp. 27, 28

- hard currency earner
- agent of social change
- symbol of new freedoms
- upgrading of local infrastructure
- complement to other business sectors such as conference and business tourism

However, Hall's (1991) most persuasive point is that tourism is seen as an integral part of economic restructuring by exposing the system to both national and international forces and, in doing so, introducing potential investors, encouraging privatization and reducing the level of bureaucracy and centralization. Yet, while the debate as to which were the appropriate forms of development continues, the academic literature offers little analysis of the practical issues and experience involved in utilizing tourism as a means of economic and political change.

2.5 Contributions to the Literature

In this section, the contribution to the shock therapy theory, gradualism and transition results for the tourism industry of this study are noted.

Contribution to the Shock Therapy Theory

The contribution to this stream of literature includes the identification of the main characteristics of Shock Therapy theory and its application to the economic transition research for countries in Central and Eastern Europe. As such, the question of whether convergence of government policies and speed of their application occurs in the same strategic group is tested. The research is sparse in observing government policies over time in a cross sectional analysis over a group of countries, but previous studies that measure macroeconomic and microeconomic liberalization indicate that convergence may be occurring in the

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Turnock, D., 1989. Eastern Europe: *An Economic and Political Geography*, Routledge, London, pp. 255-285 same group of countries (Dunning, 1993)[123]. Recent research shows that government policies over time affect the environment for private sector development (Johnson and Loveman, 1995)[124]. Thus, categorizing countries by groups provides a better understanding of policy adoption and implementation over time and helps policy makers with revising decisions and behavior.

Analyzing and measuring countries' performances in the tourism industry after adopting and implementing the Shock Therapy reform set of measures is another major contribution to this area of research. Adding the dimensions of internal characteristics, type of policies and historical considerations to the previously addressed speed of implementation (Balcerowicz, 1989)[125], not only provides further research with a finer degree of observation of the strategy adoption decisions, but also provides factors for consideration by countries in improving performance of their economic reform.

Contribution to the Gradualism Theory

The main contribution of the dissertation to this stream of literature is the identification of the application of the theory to countries in Central and Eastern Europe, and particularly in the tourism industry. This integrates these countries' policies formulation and implementation process into a broader theoretical background of the Gradualism theory. This theory provides a basis for comparison between countries by their characteristics, policies and performance in implementing transition policies. Performance for a country group member comes from convergence in strategic policies with the group over the transition period.

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[123] Dunning, J. H., 1993. *Multinational Enterprises and the Global Economy*, Wokingham, England: Addisson – Wesley Publishing Company

[124] Johnson, S., Loveman, G., 1995. *Starting Over in Eastern Europe: Entrepreneurship and Economic Renewal*, Boston: Harvard Business School Press

[125] Balcerowicz, L., 1989. *Either fast or not at all*, Baczyski, J. and Tarnowski, P. talk to Leszek Balcerowicz, Polityka, No. 48

Another contribution to Gradualism theory is the empirical testing of group member behavior. Previous research assumes that organizations with common traits in an industry follow similar strategies (Oster, 1990)[126]. Strategic groups of countries are defined from previous research as organizations with similar strategies (Fiegenbaum, 1987)[127]. Common traits among these organizations are assumed. This study also analyzes the assumption of whether similar nations with common traits or characteristics actually follow similar transition strategies over time.

Contribution to the Studies of Transition in the Tourism Industry

This study integrates the main economic policies of transition in tourism applied in the Central and Eastern European countries in the broader set of policies for transition to a market economy. These are complex changes involved in the uneven transformation from a strongly collectivist and partially closed (internationally) model of tourism to one shaped by market principles and relationships and integration into a global system of tourism.

The main dimensions of change are centered on: (1) the role of the state, (2) privatization policies and practices and (3) consumption and economic results of companies active in tourism. These are strongly related both among themselves and with the transformation processes of other parts of society. There is also a causal relationship between the first two factors – how they were designed and implemented, and the last one (results). The research presents in-depth case studies analyses in this respect, for each of the countries in the study.

[126] Oster, S. M. 1990. *Modern Competitive Analysis*. New York: The Free Press

[127] Fiegenbaum, A., 1987. *Dynamic Aspects of Strategic Groups and Competitive Strategy: Concepts and Empirical Examination of Industry and Competitive Strategy*

CHAPTER THREE
TRANSITION STRATEGIES
IN CENTRAL AND EASTERN EUROPEAN COUNTRIES

3.1 Introduction

In 1989, the former communist countries started the transition from a command, centrally planned economy to a market economy. At the same time, they began to transform their political systems from repressive dictatorships into Western-style democratic regimes. The transition to democracy and the market economy in Central and Eastern Europe and in the former Soviet Union may be the most important political and economic event in the world history of the last decade of the 20th century.

This chapter deals mainly with the problem of the optimal transformation strategy for the groups of countries analyzed in the present thesis. The intention is to present the controversy of how quickly and radically the new market rules and their individual components should have been adopted in Poland, the Czech Republic, Romania and Bulgaria and the economic and political strategies of different transition theories.

The purpose of this chapter is not to elaborate or support a comprehensive and stable theory of post-communist economic transition, which is a too difficult task for one thesis, but to discuss specific results of different strategies in light of the advantages and disadvantages that each of them presents in different contexts of transition. In Chapter 5 I will proceed to the analysis of the performance of each strategy for two groups of countries.

3.2 The Specific Features of Post-Communist Transition

3.2.1 Economic Specifics

The agenda of post-communist transition differs very much from the policy reforms adopted in the last ten to fifteen years by many middle-income, developing countries, such as Chile, Mexico, Argentina, Peru, Bolivia, Egypt, and India and after World War II by some of the developed countries, such as Germany and Japan. The comprehensive and complex reconstruction program undertaken in post-war Germany involved only the reintroduction of a stable currency and market regulation after some ten years of a fascist command economy and war. The economy was never nationalized, and all basic legal market institutions survived the war. The Japanese economy, though less developed than the German one, was also mostly privately owned and severely damaged by the war. Its market mechanism was partly suspended by war and by command-type regulations (Sachs, 1995)[128].

Most of the developing countries seeking to change their economic systems had to contend with high inflation or hyperinflation and with economies that were overregulated and closed to external competition. Some of them had accumulated a lot of structural distortions. However, these distortions were not as dramatic as those inherited by the Central and Eastern European countries. Some developing countries also had to privatize their economies, but all of them, including Chile, undertook their reforms in a private economy. Chile's transition was probably the most comprehensive and radical outside the former communist block. But even the Chilean transformation of the 1970s and 1980s seems less difficult and dramatic than that of Eastern Europe and the FSU (Edwards and Edwards, 1991)[129].

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[128] Sachs, J. D., 1995. *Reforms in Eastern Europe and the Former Soviet Union in Light of the East Asian Experiences*, Studies and Analyses, No 39, Center for Social and Economic Research, Warsaw

[129] Edwards, S., Edwards, A. C., 1991. *Monetarism and Liberalization: The Chile Experiment*, Chicago: The University of Chicago Press

Stanley Fisher and Alan Gelb (Marer and Zecchini, 1991)[130] wrote:

"In fact most of the individual requirements for socialist economy reform have been faced before, in China, and in Latin American and African countries where the combination of a weak private sector, political monopoly, heavy policy induced distortions and macroeconomic imbalance is not uncommon. Nonetheless the challenge is unique, in its system-wide scope, in its political and historical context, and in the speed of desired reform. "

A similar view was expressed by Leszek Balcerowicz (1994, p. 80)[131] three years later:

"[Under communist rule [...] capitalism was destroyed and not merely suspended (as in Germany before 1948) or distorted (as in Latin America and India before their respective rounds of economic liberalization).

The new democratic governments in the Central and Eastern European countries inherited a range of serious economic problems which determined the agenda of the transition. The four chief problems are as follows:

1. Total or almost total nationalization of the economy left a very limited role for private savings and implied either explicit prohibition of or serious restrictions on private economic activity. To make matters worse, the official systems of education and propaganda in all the FCC tried to convince people of the superiority of state control (sometimes referred to as "social" or "all-national") over private ownership. This indoctrination lasted more than 40 years in CEE.
2. Huge structural distortions stemmed from the monopolization, economic autarky, administrative price regulation, and centralized investment decisions. The former communist economies were strongly oriented to domestic and regional markets (the latter through the Council for Mutual Economic Assistance - CMEA) and were separated from other markets by

[130] Marer, P., Zecchini, S., 1991. *The Transition to a Market Economy*, Paris, OECD, p. 184

[131] Balcerowicz, L., 1994. *Understanding Postcommunist Transitions*, Journal of Democracy, Vol. 5, No. 4, p. 80

currency inconvertibility, price controls, trade restrictions, and the state monopoly in foreign trade.

3. The state undertook a high level of social spending relative to the level of economic development (Sachs, 1995)[132]. This part of the communist heritage is a relatively young one, because the first decades of the communist regime were characterized by austere policies in social spending. This situation started to change some time after the death of Stalin and the round of social and political unrest (Poland in 1956 and 1970, Czechoslovakia in 1968, Romania in 1965 and Bulgaria in 1958). Less repressive (in comparison with the Stalinist period) mutations of communist regimes looked for some form of social support and legitimization. In some cases, social spending was an attempt to neutralize the expected social unrest coming from political tightening.
4. Domestic and external macroeconomic disequilibrium prevailed and was especially strong during the final years of the communist regimes, when they lost their capacity to control economic and social life. Partly it resulted from factors described in points 2 and 3. Only the former Czechoslovakia, avoided dramatic macroeconomic crises, but even here the degree of macroeconomic stability was far from Western standards. Domestic disequilibrium manifested itself in the form of a rising budget deficit and monetary expansion, difficulties in controlling wages, and other serious problems leading to high inflation either in repressed or in open form. The external imbalances usually led to growing foreign debt.

These four characteristics show the differences of Central and East European and transition in comparison with communist countries in East or South East Asia, such as China, Vietnam, or Laos. They inherited less structural distortions mainly because they were far less industrialized than the CEE (Sachs and Woo, 1994)[133]. Asian communist countries offered their people far less social support

[132] Sachs, J. D., 1995. Ibid 128
[133] Sachs, J. D., Woo, W. T., 1994. *Structural factors in the economic reforms in China, Eastern Europe and the former Soviet Union*, Economic Policy, Vol. 18, April

than did the FSU and CEE (Sachs, 1995)[134], and they succeeded in keeping more macroeconomic equilibrium (especially China) in comparison with most of CEE. According to Dabrowski (1996)[135], the post-communist transformation is a complex undertaking concerning almost all aspects of the economic system and many aspects of the political system. The most important aspects of the political system are presented in the next section.

3.2.2 Political issues

Along with changes in the economic system, the political transition from an authoritarian and highly repressive system to a democratic one has taken place. Here also the 20th century history of the discussed region has not been helpful to achieve this goal. If we look back at the inter-war period only Czechoslovakia had Western European type democracy all that time. Other Eastern European countries (including Baltic states) enjoyed only a limited period of rather unstable democracy with frequent attempts of authoritarian coup d' etats. Some of them were successful leading to semi-dictatorial regimes (example of Poland). Russia and other nations of former Russian (later Soviet) empire did not have any democratic tradition in their history. Additionally, many of them did not have any experience with their own independent state. Their influence that followed after the WW II upon the Central and Eastern European countries had a major impact upon the political, social and economic evolution of these countries for almost half a century.

In these circumstances, a young parliamentary democracy often is connected with political instability (e.g., Bulgaria, Romania and Poland) that complicates an economic transition. On the other hand, the socially painful and politically difficult agenda of economic transition contributes to political turbulence.

[134] Sachs, J. D., 1995. Ibid 128
[135] Dabrowski, M., 1996. *Different strategies of transition to a market economy: how do they work in practice?*, Policy Research Working Paper 1579, the World Bank, p. 5

There are many historical cases when a transition from "suspended" or "distorted" capitalism (using Balcerowicz's terminology)[136] to its more liberal and macroeconomically more stable version was accompanied by the political changes from an authoritarian regime to a democratic one. It happened not only in Germany, Austria, and Japan after World War II but also in many developing countries during the last 20 years (especially in Latin America). In many cases, e.g., in Germany and Austria, however, democracy was restored rather than created for the first time. In some other countries, economic reforms were implemented by authoritarian regimes (as in Chile, South Korea, Taiwan, and Singapore). In China and Vietnam, extensive economic reforms have been implemented without any substantial changes in the political system. Balcerowicz (1994) classifies these two cases as a peculiarly Asian kind of post-communist transition, as opposed to the Central and Eastern European one which was developed in the context of a destroyed, and not just damaged, capitalism. For this reason and because of different economic specifics, these countries are not included in this analysis.

3.3 Transition Strategies – Policies and Results

More than 30 countries in Europe and Asia are currently involved in the transition from communism. With the exception of Cuba and North Korea, there are no classic communist economies left. Not all the transition countries, however, have already completed the journey - or even most of it - from a socialist economic system to a market economy. Indeed, until 1996 some of the post-Soviet states, such as Ukraine, Belarus, and some of the Central Asia countries, had not yet made a definite decision to move toward a market economy. They were either looking for a third way or trying to preserve what remains of the communist system in politics and in the economy (e.g., partial price controls, export controls, and a central role for state ownership).

[136] Balcerowicz, L., 1994. *Understanding post communist transitions*, Journal of Democracy, Vol. 5, No. 4, October

Based on the empirical experience available for both researchers and policy makers, I will present in this section a classification of the transition strategies adopted in the Central and Eastern European countries subject of the present thesis (Poland, the Czech Republic, Romania and Bulgaria), while also evaluating their impact both from the economic and political points of view during the period 1989-2003.

3.3.1 Identification of Transformation Strategies

The classification of transition strategies that follows is done in view of three basic classifying parameters that I consider to be the most relevant in the implementation of different policies in countries of the Central and Eastern Europe and the Former Soviet Union, during the transition period:

1. The speed of actions in the main fields of transition: macroeconomic stabilization, liberalization and institutional changes, privatization and restructuring
2. The comprehensiveness and internal consistency of implemented policies, creating the so-called 'critical mass of reform' and avoiding both macroeconomic mismanagement and its serious consequences on the micro level.
3. The cumulative progress in transition achieved up to 2003.

With respect to all three factors, the countries of Central and Eastern Europe and the former Soviet Union may be classified into **six** broad categories. They are defined mainly along the third criterion, i.e., the cumulative progress in the transition process, although the two other criteria also play an important role. The proposed categories are:

1. One country (the former GDR in mid-1990) embarked on an extremely **radical,** once and-for-all transformation of the economic system, made possible through the rapid "importation" of a stable currency and of most economic institutions from West Germany.
2. A group of countries (**Poland**, the **Czech Republic**, Slovakia[137], Albania, Estonia, and Latvia) embarked on a **radical** path of transformation (in terms of the speed and consistency) referred to as **"shock therapy"** and containing the initial macroeconomic stabilization and an extensive domestic and external liberalization of the economy. These programs were followed by the launching of privatization. (Some delays in privatization came from the need to draft appropriate legislation and set up monitoring institutions). By the end of 1994, these countries accomplished the critical mass of reforms and completed the first stage of the transition process.
3. By the end of 1994, Hungary and Slovenia achieved a level of progress in the transition process similar to the second group of countries. They moved, however, **much slower** but in a rather **well coordinated** way. They had a better starting point, especially in terms of the earlier liberalization of the economy and institutional reforms. In the case of Slovenia, the notion about a slow path of transition concerns the large privatization. The macroeconomic adjustment after separation from the Yugoslav federation in 1991 was really radical. Slovenia did not need to take any dramatic measures about the domestic and external liberalization because the former Yugoslavia had a far more deregulated and open economy than other former communist countries. Hungary moved gradually on all three transition dimensions. Its liberalization program lasted at least three years (Gacs, 1994)[138], and macroeconomic policy never adopted any dramatic measures. Hungary also has not adopted any

[137] After the dissolution of the Czecho-Slovak federation, this country slowed down the transition process in comparison with the Czech Republic, especially in the sphere of privatization
[138] Gacs, J., 1994. *Trade policy in the Czech and Slovak Republics, Hungary and Poland in 1989-1993: a comparison*, Studies and Analyses, No. 11, Center for Social and Economic Research, Warsaw,

spectacular mass privatization policy like the Czech, Russian, or German ones.

4. Countries in the **middle of the** process implemented a number of significant changes through a comprehensive package to transform their economies, but these were **gradual** and had not been fully implemented until the end of 1994. This diverse group is made up of three types:

    a) Lithuania, Kyrgyzstan, and Moldova failed to do radical stabilization and liberalization at the beginning of transition. Now, they are doing more to stabilize and liberalize their economies successfully, and they have a chance to catch up with the second and third groups in the near future. Lithuania and Kyrgyzstan are doing quite well in the privatization sphere.

    b) **Romania** and Russia engaged in important reforms but have not had well coordinated transition policies (especially in the macroeconomic sphere) and have suffered macroeconomic mismanagement.

    c) In 1991, **Bulgaria** started a very radical liberalization and stabilization program similar to Polish and Czecho-Slovak ones, and it makes up this category. But later, it slowed down the transition process and did not achieve the critical mass of changes. Moreover, the inability to start large-scale privatization has led to the return of a policy of soft budget constraints in relation to state owned enterprises and to the significant erosion of macroeconomic policy in 1993-94.

5. A few countries undertook no significant systemic changes and made little progress towards liberalization and privatization of the economy until the end of 1994. This lead sooner (Ukraine) or later (Belarus, some Central Asian states) to economic destabilization and high inflation or hyperinflation.
6. Countries at war (Bosnia and Herzegovina, Serbia and Montenegro, Georgia, Armenia, Azerbaijan, Tajikistan, and Croatia) where economic

reforms were never launched or were halted and where war-related expenditures and the destruction and disorganization of the economy have led to hyperinflation make up this group. Like the fourth category, this one is made up of countries with important differences among themselves in the level of economic development, intended economic strategies, and the size of real war damages. For example, Armenia, Croatia, and Serbia started reforms but stopped them. The inability to implement a comprehensive transformation package could be seen, however, as the common denominator of this group.

Dabrowski (1996)[139] believes that in practice, there is more than one variant both of the radical *(shock)* scenario and of gradualism. Some cases escape neat classification. For example, in the beginning of 1994, the new Yugoslavia[140] and Croatia had taken ambitious anti-inflationary measures. At the end of 1994, large transition packages were discussed in Ukraine, Georgia, Armenia, and Belarus.

The scope of research of this study includes four countries: Poland, the Czech Republic, Romania and Bulgaria which are comprised, in the classification presented above, into two groups characterized by the implementation of two strategies: (1) Poland and the Czech Republic – shock therapy, (2) Romania and Bulgaria – gradual reform.

3.3.2 The Shock Therapy Model

The shock therapy model derived its name from Poland's stabilization and liberalization program initiated on January 1, 1990, which became known as "shock therapy" or "big bang". The countries that followed the shock therapy approach were the Czech Republic (starting January 1991 – while it was still part of Czechoslovakia), Russia (February 1992), Albania (July 1992), Estonia

[139] Dabrowski, M., 1996. ibid 135, p. 9
[140] The new Yugoslavia is Serbia and Macedonia

(September 1992) and Latvia (June 1993). In summary, the shock therapy model was a neoclassical model of transition which supported the immediate implementation of the necessary reforms to establish a free market economy.

The shock therapy model of transition was attractive to transition governments, international financial institutions and mature market economies due to its simplicity and narrow transition policies recommended. "Get prices right" and the remaining elements of a market capitalism system would, more or less, fall into place was an antithesis to an institutionalist approach to transition.

The leaders of the Revolution of 1989 in Poland and Czechoslovakia had an outward-looking agenda from the start. They saw the revolutions in their countries as the opportunity to rejoin the mainstream of Western Europe. The goal of the 1989 events was "Return to Europe." This was the main reason why radical, comprehensive economic reform measures could be acceptable in these countries. The politicians and the general public understood intuitively that a "shock therapy" approach was not simply another utopian scheme of economic reform, but rather was a quick route to a relatively clear target. In 1989, that clear target was Western Europe. There was already a general, if unexpressed, consensus in the society that whatever would reintegrate these countries fastest with Western Europe should be adopted. They understood that the collapse of communism gave an opportunity for decisive steps of reintegration with Western Europe and that these steps should be taken as rapidly as possible.

Poland's shock therapy had as a main idea to create institutions of the kind already in existence, and with proven merit, in Western Europe. Leszek Balcerowicz, the first Prime Minister of Poland after 1989 said it best, when he declared in 1989, "We are too poor to experiment. If the rich countries want to experiment, let them. For us, it is better to take proven models."

The Contents of Shock Therapy

The people in Central and Eastern Europe had a realistic picture of the failures of Communist economics and recognized the need for fundamental change of the economic system. Nonetheless, large parts of the population misjudged the detailed character of the economic crisis confronting their countries.

A change of economic system would make possible a gradual recovery of growth and a gradual convergence of living standards over the following decades. But no economic reform could cover the economic gap that had grown over decades, and that had already been significant between Eastern and Western Europe before World War II.

To understand the situation of the post-Communist economies it is useful to observe that there were **three deep economic crises** (Sachs, 1994)[141].

(I) The **first**, and most widely recognized and discussed, was the ***systemic crisis***: the need to change from a Communist system to a market system. Despite that, there are a lot of debates and misunderstandings around these issues. In Poland today, there are still those who advocate a market system with extensive state ownership (sometimes called "market socialism" or a "mixed economy"). Advocates of market socialism believe that state enterprises can finally be made efficient and profitable. A lot of contrary evidence is provided by examples from the rest of the world, including Western Europe, Latin America, Africa, China, India, and the rest of Asia.

(II) The **second** crisis, distinct from the systemic crisis, was the ***financial crisis*** of the post-Communist states. In almost all of Eastern Europe and the former Soviet Union, governments had financial problems. Many governments, including

[141] Sachs, J., 1994. *Shock therapy in Poland: perspectives of five years*. The Tanner Lectures on Human Values, delivered at University of Utah, April 6 and 7, pp. 271-273

Poland and Bulgaria, suffered from a heavy burden of foreign debt taken on by the old regime. Almost all governments in Central and Eastern European Countries suffered from huge budget deficits, as tax collections declined and social demands increased. The result was a battle against inflation and default on debts. There were some exceptions, most notably the Czech Republic, which benefited from the fact that the old regime was too conservative and repressive to engage in foreign borrowing.

(III) The **third** crisis, and the longest-term, was the crisis of ***structural adjustment***. Even if there were no problem of the economic system, and even if the government were financially solvent, there would still be a deep crisis of living standards as a result of the structural characteristics of the Communist economies. Central planning under communism was inefficient in particular ways. The central planners, under Soviet dictates, were oriented to building up heavy industry, and especially military industry, at the expense of consumer industry and services. Thus, the Central and Eastern European Countries' economies had vast capacity in steel, chemicals, coal, and other heavy industries, but were very poor in services (banks, real estate, restaurants, even shops) in 1989. The structural crisis could not be resolved immediately by legislative or political changes. Even after a market economy was in place, Central and Eastern European countries would still suffer from having too much heavy industry. Workers in defunct heavy industrial enterprises would lose their jobs; regions would see sharp drops in living standards and employment; and living standards would remain low for years as a result of the lopsided economic structure. This is the main sense in which "shock therapy" was a misleading metaphor. "There was no way to shock the patient to economic prosperity. There was only the chance to give the patient a fresh opportunity to start rebuilding, acknowledging that restructuring and new economic development would take years, even decades, to bring to full fruition" (Sachs, 1994)[142].

[142] Sachs, J., 1994. Ibid 141, p. 273

The idea of radical economic reform was to address all three crises, recognizing that each poses a problem with a different time horizon for solution. The financial crisis was the most acute, but also the one susceptible to the fastest successful resolution. At the time of the Communist collapse, Poland, for example, suffered intense inflation, soon to burst out into full hyperinflation by October 1989. (Economists define hyperinflation as inflation of more than 50 percent per month. Inflation reached 54 percent per month in October 1989). Moreover, the combination of large budget deficits, extensive printing of paper currency with lowering value, and Communist era price controls meant that hyperinflation was combined with intense shortages in the shops and the burgeoning of black markets. Fears of hunger in the main cities of Poland were widespread and realistic.

The solution to hyperinflation and shortages was given by the twentieth-century economic history and from the experiences in Latin America in battling high inflation. A decisive break with high inflation and shortages required a series of actions:

- cutting the budget deficit;
- stabilizing the foreign exchange value of the currency;
- raising market interest rates and tightening central bank credits to the government and to the banks;
- removing artificial price controls that prevent the equilibrium of supply and demand at market-determined prices.

This combination of measures was introduced in Poland and in the Czech Republic, as part of a single package.

The systemic crisis could also be addressed rapidly, but not on the same time horizon as the financial crisis. While the financial crisis could be brought under control within months, the systemic crisis required years to address, even under the most favorable political conditions with the government and the public united behind the reform actions. The conversion from central planning to market economies required two sets of actions. The first, and administratively the easiest, was the elimination of central planning. Bureaucratic interventions in the economy were ended, and markets were allowed to function freely. This involved, among other things:

- the elimination of price controls,
- licenses for international and internal trade,
- freedom of entry of new private firms into virtually all sectors of the economy,
- the end of bureaucratic interventions inside particular enterprises.

The second set of measures involved the building up of new institutions of modern capitalism, including:

- modern commercial law,
- an independent judicial system to enforce the new commercial law,
- a private, corporate ownership structure to replace the state ownership of enterprises.

While the dismantling of central planning could be done literally in days or months, the building up of new institutions required years. Even the fastest mass privatization of state enterprises, as undertaken in the Czech Republic, was a project of several years.

If <u>financial stabilization</u> could be accomplished in the <u>first year</u> of radical reforms, and <u>systemic transformation</u> in the <u>first five years</u>, the <u>structural change</u> in the economy is a task of <u>one to two decades</u>. Policy could ease the transition by implementing crucial measures of social protection for the vulnerable groups in the society. Policy could not, however, cause a sudden one-time jump in living standards when the underlying economic structure remains inefficient for years to come. The real growth in living standards requires the birth and development of many new businesses, as well as important new investments that must be made over the course of years.

An analysis of the shock therapy model can be based on an analysis of three distinct levels. The first is a theoretical level: the neoclassical theory, which is the basis of the shock therapy theory. Using Sachs' statement, "Poland's goal was to establish the economic, legal and institutional basis for a private sector market economy in just one year" (1990)[143]. This level of analysis is concerned with what would happen if the transition were undertaken using this theory. It is expected that the neoclassical theory would recommend immediate:

1. price liberalization,
2. privatization,
3. development of the necessary institutions,
4. establishment of an independent central bank,
5. privatization of state banks,
6. achievement of a balanced budget,
7. introduction of free trade and a fully convertible flexible currency.

The second level of analysis concerns the extent to which the theory was actually adhered to or how it was interpreted. A close observation of the way the shock therapy model was formulated reveals that the model incorporated a large number of policies of transition that were implemented, in a well coordinated way, over a longer period of time. The neoclassical theory as it was formulated for the conditions of the transition economies in the form of shock therapy had some hidden form of inherent gradualism.

The third level of analysis is concerned with reality itself, the actual implementation of the model. The transition experience also reveals that the transition economies which implemented shock therapy opted for an implementation of the model that extends over time.

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[143] Sachs, J., 1990. *What is to be done?*, The Economist, January 13, p. 19

The Actual Implementation of Shock Therapy in Transition Economies

The recommended transformation policies formulated by shock therapy supporters refer to the following areas:

a. institutional structure
b. price liberalization
c. privatization
d. monetary policy and the financial system
e. fiscal policy
f. international trade

The presentation and analysis of these policies is considered in parallel with the actual implementation of the model in transition economies.

a. Institutional Structure

The first aim of the shock therapy model was to establish the appropriate institutions in organizing the new market mechanism for allocating resources in order to eliminate the central allocation system of resources. The transition economies did not have any capitalist institutions. In direct contrast they were command economies (Dabrowski, 1997)[144]. Participation in the market process was based on the means used to achieve a certain result, which had to be within defined rules. Thus the transition economies required the development of an independent judiciary and an executive subject to the rule of law. This was in sharp contrast to the traditions of autocratic rule under centrally administered socialism. The move toward a market economy required the destruction of the legal and political processes of the past (Boone and Fedorov 1997; Ericson, 1991)[145]. Transition economies had to develop appropriate laws and institutions

[144] Dabrowski, M., 1997. *The first year of Russian transformation*. In 'Russia's Economic Transformation in the 1990's', edited by A. Aslund, London: Printer, p. 44
[145] Boone, P, Fedorov, B., 1997. *The ups and downs of Russian economic reforms*. In 'Economies in Transition: Comparing Asia and Europe', edited by W. T. Woo, S. Parker and J. D. Sachs, 161-188, Cambridge: MIT Press, p. 184

that included defined property rights and well enforced rules of contract, which were essential if they were to be able to obtain the benefits associated with the market process (Aslund, 1995; Boone and Fedorov, 1997; Thomas and Wang, 1997)[146]. "Without law, there can be no property rights and without these there can be no real economic stabilization and development" (Aslund, 1997)[147]. In addition, the institutional structure would also have guaranteed that there would be no return to the previous system. Consequently, the reforms could not have prospered until authorities and individuals developed respect for the law and legal processes (Boone and Fedorov, 1997)[148].

The institutional structure was one of the most challenging aspects of the transition modeling process (Sachs, 1991)[149]. The development of institutions appropriate to the market process was extremely complex and time-consuming, and, once operative, was very difficult to change (Furubotn, 2000)[150]. This raised doubts regarding the feasibility of the shock therapy approach. Actually these doubts were unwarranted. Property rights and the institutional structure, like any other good, were the result of consumer sovereignty. "Contrary to the common economist's assumption that a system of property rights is a precondition for a market economy, the development of market institutions is often a prerequisite for a viable property regime" (Rapaczynski, 1996)[151]. Thus the development of

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Ericson, R. E., 1991. *The classical Soviet-type economy: nature of the system and implications for reform*, Journal of Economic Perspectives 5, No. 4, p. 26

146 Aslund, A., 1995. *How Russia Became A Market Economy*, Washington DC: The Brookings Institution, p. 264

Boone, P, Fedorov, B., 1997, Ibid 145, p. 181

Thomas, V., Wang, Y., 1997. *East Asian lessons from economic reforms*, Economies in Transition: Comparing Asia and Europe, edited by W. T. Woo, S. Parker and J. D. Sachs, 217-242, Cambridge: MIT Press, p. 222

147 Aslund, A., 1997. *A critique of Soviet reform plans*. The Post-Soviet Economy: Soviet and Western Perspectives, New York: St. Martin's Press reprinted in *Russia's Economic Transformation in the 1990's*, London: Printer, p. 14

148 Boone, P, Fedorov, B., 1997, Ibid 145, p. 184

149 Sachs, J., 1991. *Crossing the valley of tears in East European reform*, Challenge, 34, No. 5 (September / October), p. 30

150 Furubotn, E. G., 2000. *Legal reforms in Russia: visible steps, obvious gaps and invisible hand*, Journal of Institutional and Theoretical Economics 156, No. 1, p. 121

151 Rapaczynski, A., 1996, *The roles of the state and the market in establishing property rights*, Journal of Economic Perspectives 10, No. 2, p. 102

the market relations did not need to be postponed until an appropriate institutional structure was in place, since the emergence of markets did not require a sophisticated institutional structure. A simple economy did not need an advanced judicially enforced system of property rights. “Little economic or legislative sophistication is required” (Aslund, 1992)[152]. Some simple rules would have been adequate and as the markets evolved, the legal system and enforcement mechanisms would have simultaneously evolved too. “Thus, institutional structure was a necessary but not a sufficient condition for the needed reforms” (Klaus, 1995)[153].

Efficient solutions could not have been intentionally designed. Governments and individuals did not have the knowledge, because past experiences were inadequate or irrelevant. No one was able to predetermine the market outcome; thus, there could not have been any prescription to develop market institutions. The development of the institutional structure was path independent, which implied that the development of the necessary institutions were not based on countries’ cultural elements. Institutional change comes as a result of free market relations, which would have delivered the best outcome in response to the need for structural change based on the universal principles of self-interested behavior. Fundamental changes in relative prices are the most important source of institutional change by altering norms, which subsequently creates incentives to construct more efficient institutions (North, 1990; Nee and Matthews, 1996; Lo, 1995)[154].

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[152] Aslund, A., 1992. *Post-Communist Economic Revolutions: How Big a Bang?*, Washington, D. C.: The Center for Strategic and International Studies, p. 11

[153] Klaus, V., 1995. *Privatization experience: the Czech case*, Policy 11, No. 1, p. 46

[154] North, D. C., 1990. *Institutions, Institutional Change and Economic Performance*, Cambridge: Cambridge University Press, pp. 7, 84, 138

Nee, V., Matthews, R., 1996. *Market transition and societal transformation in reforming state socialism*, Annual Review of Sociology 22, p. 411

Lo, D., 1995. *Economic theory and transformation of the Soviet-type system: the challenge of the late industrialization perspective*, The Transformation of the Communist Economies: Against the Mainstream, London: Macmillan, pp. 81, 85

Individuals participate in the market process based on a set of rules. The culture of respect for property rights in mature market economies is not the result of habits, convictions, religious beliefs, or the rule of law (Moore, 1994)[155]. Rather, it is the result of a self-enforcing process initiated by spontaneous market behavior (Rapaczynski, 1996)[156]. These self-enforcing mechanisms would not have preceded the emergence of market relations. In the same way, they would not have been the result of government action. While government initiation may have developed the necessary institutions, market-produced institutions frequently appeared and were operative before that. The development of the institutional structure was a very elaborate procedure, which the government did not have the knowledge to implement. These institutions were "nearly never created by conscious design" (Frydman, Rapaczynski and Turkewitz, 1997)[157].

Balcerowicz (1995)[158] recognized that while economic reforms complement one another there is a distinction between liberalization and institutional reform and the former could be implemented more rapidly than the latter. At the same time, slowing down liberalization and stabilization, in order to enable them to keep pace with the fundamental institutional reform, was a dangerous option. Nevertheless, stabilization and liberalization had to be largely completed before the institutional framework of the economy could be radically changed.

Thus, shock therapy supporters required the immediate destruction of the institutions of central administration, which implied the establishment of market institutions by the government, minimizing the time to create these institutions. But, even more than speed, governments' intervention was totally undesirable.

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[155] Moore, M., 1994. *How difficult is to construct market relations? A commentary on plateau*. The Journal of Development Studies, No. 3, April, p. 819

[156] Rapaczynski, A., 1996. Ibid 151, p. 89

[157] Frydman, R., Rapaczynski, A., Turkewitz, J., 1997. *Transition to a private property regime in the Czech Republic and Hungary*. Economies in Transition: Comparing Asia and Europe, edited by W. T. Woo, S. Parker and J. D. Sachs, 41-102, Cambridge: MIT Press, p. 42

[158] Balcerowicz, L., 1995. *Socialism, Capitalism Transformation*. Budapest: Central European University Press, p. 346

b. Price Liberalization

Price liberalization and stabilization were preconditions for a successful reform process (Blanchard and Layard, 1993)[159]. Price liberalization was also required for the establishment of a hard budget constraint (Aslund, 1993)[160]. Reform of the price mechanism was necessary to allow prices to reach their equilibrium values. Impersonal market forces determined prices, not the government, which was influenced by political considerations (Ericson, 1991)[161]. In this way, the increased prices reduced real money balance to the appropriate level for monetary equilibrium. Given the lack of scarcity-based price system, it was infeasible to develop an effective stabilization program. The price system had been so distorted under the centrally administered socialism, that it was impossible to determine which enterprises should have closed or continued operation. Furthermore, the valuation of enterprises could not have taken place without knowing the prices of inputs: this necessitated market competition. Higher prices were in the interests of society because they eliminated shortages and queuing, induced greater availability and quality of goods, and facilitated lower prices than the black market because they eliminated the risk premium associated with illegal activities and eliminated corruption. It was better to face a single increase in prices rather than high and persistent inflation, since there was nothing beneficial associated with high inflation and its accompanying corruption (Aslund, 1995)[162]. In fact, prices were often lower than on the black market, even though the official inflation rate had increased. However, in reality, no country fully adjusted prices in one step. Poland initiated large adjustments at the beginning; Czechoslovakia adjusted prices more gradually.

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[159] Blanchard, O., Layard, R., 1993. Overview. *Post-Communist Reform: Pain and Progress*, Cambridge: MIT Press, p. 1

[160] Aslund, A., 1993. Comment on Gradual versus Rapid liberalization in socialist economies, *Proceedings of the World bank Annual Conference on Development Economies*, World Bank. Washington D. C., p. 99

[161] Ericsson, R. E., 1991. Ibid 145, p. 26

[162] Aslund, A., 1995. Ibid 146, pp. 175, 222

An efficiently functioning labor market was a principal prerequisite for a successful transition (Frydman, Rapaczynski, Turkewitz, 1997)[163]. The indexation of wages and the large percentage of the labor force employed in state enterprises were obstacles to the achievement of stabilization (Sachs, 1997)[164]. Thus, wages should have also been market determined, giving rise to unemployment, which was part of the remedy. However, at the beginning of the reform program, to avoid a wage-spiral due to hyperinflation, Sachs and Lipton (1990)[165] recommended a tax-based wage policy to encourage wage rises below the increases of inflation. All countries relied on wage controls (Balcerowicz, 1995)[166]. For example, the Polish government initiated penalties on wage increases, known under the name of *popiwek* (Balcerowicz, Blaszcyzyk, Dabrowski, 1997)[167], under which wages were to increase by 30% of the monthly inflation rate in January 1990 and 20% thereafter. Enterprises conceding wage increases above the norm were heavily taxed. Despite this, the shock therapy supporters recommended a step-by-step process of establishing market-determined wages and a free labor market without government regulation.

c. Privatization

The industrial structure under the command system was inefficient since state enterprises were inefficient and inclined toward financial crisis (Sachs and Lipton, 1990)[168]. This was because of internal rent seeking and the imposition of on-economic goals by governments upon state enterprises (Woo, 1997; Boycko, Shleifer and Vishny, 1993; Aslund, 1994)[169]. Thus privatization aimed to reduce

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[163] Frydman, R., Rapaczynski, A., Turkewitz, J., 1997. Ibid 147, p. 63

[164] Sachs, J., 1997. *An overview of stabilization issues facing economies in transition*. Economies in Transition: Comparing Asia and Europe, edited by W. T. Woo, S. Parker and J. D. Sachs, 243-256, Cambridge: MIT Press, p. 248

[165] Sachs, J., Lipton, D., 1990. *Poland's economic reform*, Foreign Affairs 69, No. 3, p. 56

[166] Balcerowicz, L., 1995. Ibid 158, p. 226

[167] Balcerowicz, L., Blaszczyk, B., Dabrowski, M., 1997. *The Polish way to the market economy 1989-1995*. Economies in Transition: Comparing Asia and Europe, edited by W. T. Woo, S. Parker and J. D. Sachs, 131-160, Cambridge: MIT Press, p. 138

[168] Sachs, J., Lipton, D., 1990. Ibid 165, p. 62

[169] Woo, W. T., 1997. *Improving the performance of enterprises in transition*, Economies in Transition: Comparing Asia and Europe, edited by W. T. Woo, S. Parker and J. D. Sachs, 299-324, Cambridge: MIT Press, p. 306

political interference in the economy. The undesirable functioning of state enterprises was due not only to soft budget constraints but also to the principal-agent problem which was that managers of state enterprises acted according to their self-interest and could not be motivated by the central authority to act according to plan and report truthfully on their actions. Privatization was a precondition for the transition to a free market system. Overall, there was a need for a radical change in the property structure by reducing, restructuring, modernizing and privatizing state enterprises. Consequently, "until privatization has been accomplished, the economic crisis was likely to persist" (Aslund, 1992)[170].

This called for privatization techniques that could have been implemented quickly (Balcerowicz, 1995)[171]. The privatization process had to be initiated simultaneously for all enterprises, using a mechanism that comprised a multitude of privatization methods to include all sectors. "The great conundrum is how to privatize such an array, in a manner that is equitable, swift, politically viable and likely to create an effective structure of corporate control" (Sachs, 1990)[172]. Thus privatization had to take place through a combination of different methods: sales, free distribution, or other means, but preferably through free distribution (Sachs, 1991)[173].

The shock therapy supporters argued that the government should not allow unreasonable claims to slow down the process, which should have been rapid and transparent. To achieve a fast privatization process, the authorities were to avoid the lengthy, laborious and costly task of case-by-case privatization, as this could become easily politicized. This danger is especially prevalent in important

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Boycko, M. A., Sleifer, A., Vishny, R., 1993. *Privatizing Russia*, Brookings Papers on Economic Activity, No. 1, p. 143
Aslund, A., 1994. *Lessons of the first years of systematic change in Eastern Europe*. Journal of Comparative Economics 19, No. 1, August, p. 37
[170] Aslund, A., 1992. Ibid 152, p. 87
[171] Balcerowicz, L., 1995. Ibid 158, p. 197
[172] Sachs, J., 1990. Ibid 143, p. 22
[173] Sachs, J., 1991. *Sachs on Poland*, The Economist, January 19, p. 67

“strategic” sectors of the economy such as infrastructure and mining, which were very much in need of privatization.

Privatization and financial restructuring manifested the greatest intellectual and political complexities of the entire transition program. This was due to privatization being driven by many conflict objectives. First, there were issues of fairness, compensation, restitution, enterprise efficiency, budgetary revenues and employment concerns. Second, it was based on previously unknown methods such as vouchers, management acquisitions and worker buyouts, which were characterized by administrative complexity as there were thousands of small, medium and large enterprises that operated within a legal vacuum and incomplete markets and could have been affected by corruption (Sachs, 1996; Porket, 1998)[174].

The aim of the shock therapy process was to develop an economy based on market relations without the presence of discretionary power. In such an environment it did not matter whom the individual private owners were, because ultimately the only firms that could have survived were those employing efficient management practices. Therefore, whether the privatization process gave ownership to the workers or management, or to members of the society, they would only be able to retain their ownership rights if they used their property productively by satisfying market demand at minimum cost. If they used their ownership for non-market purposes it would increase the cost of production. In the long run, in a competitive environment, this would result in a substantial fall in consumer goods produced by the enterprise, endangering the viability of the enterprise.

[174] Sachs, J., 1996. *The transition in the mid decade*. American Economic Review Papers and Proceedings 86, No. 2, p. 129
Porket, J. L., 1998. *Modern Economic Systems in Their Transformation*. St.Martin’s Press Inc., 1998, p. 205

In a competitive market, which was the ultimate goal of the shock therapy supporters, only efficient owners and efficient behavior would have been able to survive, independently of how the initial distribution of ownership took place. Grigory Yavlinski and Serguey Braguinsky (1994)[175] stated: “the laissez-faire argument maintained that it does not matter who the initial owners are. It is sufficient to create free trade in new asset claims, and the most efficient owners will eventually take over”. Andrew G. Walder (1996)[176] and Xiaokai Yang (1993) agreed with this notion. The establishment of competitive market conditions ensures that managers serve interests of enterprises and not their self-interest, which may damage the viability of the firm. In addition, the development of small and medium-sized enterprises increased competition and helped force enterprises to behave in an appropriate manner. The development of a free market process would have lead, with time, to an efficient ownership structure, making the method of privatization unimportant as long as the privatization process was rapid. Thus, while privatization could be implemented rapidly, an efficient ownership structure could only be created in the course of its application.

d. Monetary Policy and Financial System

Financial stabilization was extremely urgent because it “is a prerequisite for social stability and for many other reforms” (Sachs, 1996)[177]. As a consequence, monetary policy was central in achieving stabilization and liberalization (Dabrowski, 1997)[178]. The role of the central bank had to be redefined. It had to become an effective monetary authority: it could not have been the provider of a soft budget constraint. Most important, there had to be one Central Bank to administer the effective instruments of monetary policy. It was essential to realize

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[175] Yavlinsky, G., Braguinsky, S., 1994. *The inefficiency of laissez-faire in Russia: hysteresis effects and the need for policy-led transformation*, Journal of Comparative Economics 19, No. 1, p.105

[176] Walder, A. G., 1996. *Markets and inequality in transitional economies: toward testable theories*, American Journal of Sociology 101, No. 4, p. 1060

Yang, X., 1993. *Theories of Property Rights and China’s Reforms*, Department of Economics, Monash University, Melbourne, Australia, pp. 1, 2, 8

[177] Sachs, J., 1996. Ibid 174, p. 131.

[178] Dabrowski, M., 1997. Ibid 144, p. 53

that the control of the money supply and credit required one independent central bank. The central bank had to establish credit-targets to hold overall money growth to levels consistent with the rapid elimination of inflation (Sachs, 1993)[179]. This was because inflation is a monetary phenomenon (Aslund, 1993; Rotowski, 1993)[180]. The quantity theory of money states that the monthly rate of inflation is equal to the rate of growth of the monetary supply minus the rate of growth in output (Sachs, 1994)[181]. Therefore, monetary policy should have followed a specific rule, i.e. increasing the money supply in a similar rhythm with the increase in real output. In this way, the danger of inflation should have been reduced. This was possible only by establishing an independent central bank with the aforementioned rule stated in its constitution. Independent central banks have emerged in all of the countries included in this study: Bulgaria, the Czech republic, Poland and Romania (Grabel, 2000)[182]

In reality, while the Czech Republic and Poland established 'independent central banks', the central bank in Poland was supposed to support the governments' policies as well as attaining price stability. The central bank in the Czech Republic, the most 'independent central bank' in all countries in the region implemented monetary policy in close cooperation with the government (Anderson, Bergolf and Mizsei, 1996)[183]. The process from a dependent central bank, due to the inheritance of the past, to an independent central bank required a number of stages. During transition the independent central bank had to provide support to the liberalization and stabilization policies initiated by the reformist governments. As the economy is liberalized and stabilized, the interventionist policies of the central bank lose strength and influence until the

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[179] Sachs, J., 1993. *Poland's Jump to the Market Economy*, Cambridge: The MIT Press, p. 49

[180] Aslund, A., 1993.Ibid 23, p. 99
Rotowski, J., 1993. Comment on 'Gradual versus Rapid Liberalization in Socialist Economies' by McKinnon, *Proceedings of the World Bank Annual Conference on Development Economies*, Washington D. C., p. 105

[181] Sachs, J., 1994. Ibid 141, p. 5

[182] Grabel, I, 2000. The political economy of 'Policy Credibility': the new classical macroeconomics and the remaking of the emerging economies, *Cambridge Journal of Economics* 24, No. 1, p. 6

[183] Anderson, R. W., Bergolf, E., Mizsei, K., 1996. *Banking Sector Development in Central and Eastern Europe*, London: Centre of Economic Policy Research

economy is fully liberalized and stabilized and the interventionist policies are not required anymore. Only when the economy were fully liberalized and stabilized could the central bank be truly independent.

The privatization of the banking system was essential to facilitate the reallocation of resources. Meanwhile, the development of efficient owners as a result of privatization of state banks, in the same way as the privatization of state enterprises, could generate results only after a period of application of these policies.

e. Fiscal Policy

The reduction of budget deficits was required in order to eliminate hyperinflation. As the budget deficit was the main source or money creation and, as a result, inflation, the reduction of the budget deficit was at the top of the agenda for any economic plan (Fedorov, 1992)[184]. Contracting military expenditures, extinguishing subsidies, eliminating enterprise investment financed by government expenditure and reducing state administration expenses, were measures to reduce the budget deficit. In addition, the aim was to reduce the power of the bureaucracy to impede the reform, with no reductions in social expenditures being necessary (Aslund, 1995)[185]. A balanced budget and fiscal responsibility were essential guarantees to new firms and foreign investors that the transition government was acting in the right direction.

The budget deficit was directly linked to the inflation rate; the higher the budget as a percentage of GDP, the higher the inflation rate. Consequently, "in this sense, the most important step towards monetary stabilization is, in most cases, not really monetary policy, but fiscal policy" (Sachs, 1997)[186]. This was why the

[184] Fedorov, B., G., 1992. *Monetary, financial and foreign exchange policy*, The Post-Soviet Economy: Soviet and Western Perspectives, New York: St. Martin's Press, p. 105
[185] Aslund, A., 1995. Ibid 146, p. 181
[186] Sachs, J., 1997. Ibid 164, p. 249

IMF and other international organizations recommended that the transition economies substantially reduce their budget deficits. In the same time, the reduction of the budget deficit would result in a substantial increase in the resources available to diminish the negative consequences of the transition program, such as unemployment and reductions in the standard of living.

f. International Trade

The shock therapy supporters recommended the complete liberalization of the international trade sector by currency devaluation to the black market level and the removal of trade barriers. Radical trade liberalization was an essential component of the successful trade performance of transition economies (de Menil, 1997)[187]. It also seemed likely that free trade was the way to initiate competition. Trade liberalization would create a positive effect from the outside by stimulating privatization, even though privatization was taking place slowly due to political pressures and sector interests. Transition economies would be able to import a rational price system and benefit from the transfer of technology, which would stimulate increases in productivity growth. This would also permit the reduction of environmental pollution, since foreign investors were able to modernize plants and equipment (Esty, 1997)[188]. Integration in international markets would bring a substantial increase in exports.

The liberalization of international trade and the establishment of a convertible currency were among the most important prerequisites for a successful transition to capitalism (Aslund, 1995)[189]. The exchange rate had to be liberalized at the same time as domestic prices. The arguments that devaluation would not stimulate exports, but only increase the price of imports, that trade liberalization resulted in unemployment, and that protectionism had to remain, had no

[187] de Menil, G., 1997. Trade policies in transition economies: a comparison of European and Asian experiences. *Economies in Transition: Comparing Asia and Europe*, Cambridge: MIT Press, p. 275
[188] Esty, D. C., 1997. Environmental protection during the transition to a market economy. *in Transition: Comparing Asia and Europe*, Cambridge: MIT Press, p.378
[189] Aslund, A., 1995. Ibid 146, p. 174

empirical basis. “These arguments were false for Latin America and they are false for Eastern Europe” (Sachs, 1991)[190]. Limitations on international trade, such as tariffs, trade licenses and quotas, had to be eliminated.

A free floating exchange rate would reduce inflation and stimulate competition. The achievement of a stable foreign exchange market was only possible by maintaining a restrictive monetary policy. Both fixed and floating exchange rates are consistent with the shock therapy approach, since neither involves government intervention. Nevertheless, a fixed exchange rate eliminates the instability caused by a fluctuating exchange rate. Sachs (1996; 1997)[191], Aslund (1995)[192], Fischer, Sahay and Vegh (1996)[193] and Sutela (1992)[194] were in favor of a pegged exchange rate at the start of the stabilization programs and then a more flexible rate after one or two years. The international experience revealed that the most successful stabilization programs were based on a pegged exchange rate, such as in Bolivia in 1985, in Israel in 1985 and Mexico in 1987 (Sachs, 1997)[195]. In the transition economies, the countries who adopted a pegged exchange rate early – such as the Czech Republic and Poland – performed much better than the countries who adopted a floating exchange rate. The Czech Republic and Poland achieved inflation below 100% per year by 1994.

Another component, foreign direct investment, would be encouraged as long as the traditional conditions existed (Aslund, 1992)[196]:

- political stability,
- free markets,

[190] Sachs, J., 1991. Ibid 173, p. 67
[191] Sachs, J., 1996. Ibid 174, p. 149
Sachs, J., 1997. Ibid 164, p. 249
[192] Aslund, A., 1995. Ibid 146, p. 183
[193] Fischer, S., Sahay, R., Vegh, C. A., 1996. Stabilization and growth in transition economies: the early experience, *Journal of Economic Perspectives* 10, No.2, p. 62
[194] Sutela, P., 1992. The role of the external sector during the transition. *Post-Soviet Economy: Soviet and Western Perspectives*, New York: St. Martin’s Press
[195] Sachs, J., 1997. Ibid 164, p. 149
[196] Aslund, A., 1992. Ibid 152, p. 58

- an appropriate legal environment and
- a stable and convertible currency.

These conditions could only be achieved by using the market mechanism. The development of an institutional structure based on a self enforcing mechanism would be able to attract foreign investment. Protectionism was inconsistent with the shock therapy model. Moreover, protectionism by mature economies "could undermine the economic logic of reform and eat away the political and social consensus of the reform program" (Sachs, 1993)[197]. However, a low tariff (10-15%) to protect domestic industries for a short time and to raise state revenues was maintained during the initial stages of transition.

Thus, according to the shock therapy supporters, the necessary policies for establishing a free trade regime involved, in the initial period of transition, that the exchange rate to be pegged and certain tariffs to be maintained.

Therefore, the formulation and implementation of the shock therapy model was radical but not dogmatic. It was radical because many important reforms were implemented almost at top speed. It was not dogmatic because market-type mechanisms were not introduced during the first stages in areas where the necessary institutional conditions did not exist (e.g. wages were not deregulated right away, interest rates were raised sharply from a negative real level but not fully liberalized, foreign trade barriers were largely abolished, but customs duties were maintained, although at a reduced level).

Most elements of the transition program were introduced step-by-step, but in a radical, coordinated way. The necessary institutional structures were developed in time, as well as an efficient ownership structure. Independent central banks were formed, measures were taken for achieving balanced budgets and a convertible exchange rate was implemented. The actual experience of transition economies reveals that those economies which implemented shock therapy

[197] Sachs, J., 1993. Ibid 179, p. 102

have, in time, achieved better economic results. The implementation of the model for the tourism industry in Poland and the Czech Republic, as well as its results, are analyzed in Chapter 4.

3.3.3 The Gradual Reform Model

In the context of the processes of economic and social reform, the gradual reform model, which includes Romanian and Bulgarian economies that followed a similar path of transformation, passed through three distinct stages that overlap the political developments. Using economic and political data from widely available public sources, I will evaluate the performance and the sustainability of these countries' transitions to a market economy.

They started their transition from a difficult inherited position. They were under communist rule for over forty-five years and the economic crisis had been growing steadily from the beginning of the '80s[198]. With investment dramatically diminished, their technological infrastructure was much behind that of their other Balkan neighbors. A largely obsolete industrial base and output unsuited to the countries' needs were additional burdens for the transition to the market economy. The legacy of the communist regime and the lack of experience of partial reforms, such as those undertaken in Poland or the Czech Republic during the 1980s, left Romania and Bulgaria with long and unstable paths towards a market economy.

[198] In Romania the crisis had been triggered by the former president -Ceausescu's- decision to embark upon a program designed to help Romania pay off nearly $10 billion in foreign debt, in 1982.

The Economic Performance and the Structural Changes in the Economy: the Three Political Stages

The first stage of transformation ran from 1990 to 1993 and its main objective was the creation of a democratic state and an institutional framework for a *market social economy*, abandoning central planning and liberalizing prices, trade and production. As a consequence the economic activity declined sharply during the period 1990 – 1992. The patterns of resource allocation matched neither real costs of production nor the preferences of consumers and the GDP sharply declined during this period. In 1991 most prices were freed and small trading firms were privatized, while the former nomenclature appropriated larger firms.

Collective farming remained almost untouched. The first measures of economic and social reform were concentrated almost exclusively on short-term objectives aimed at opening the domestic market for massive imports and ensuring productive output irrespective of the level of economic efficiency. The government's dedication to radical change was low for fear of social discontent. The real national income per capita, had dropped in comparison with the maximum levels reached at the end of the 1980s. The same can be said of real wages, the fall in which closely followed the GDP drop. Therefore, several unpopular measures were postponed during the first three years and the final results were a worsening of the inherited structural macro-economic and sectional imbalances and the delay of the external financing from international institutions.

Starting in 1993, under pressure from international organizations, these countries implemented a strict macroeconomic stabilization, amplifying simultaneously the gradual processes of structural adjustment in order to give the national economy a competitive composition. This second stage was characterized by decisive actions in all fields of activity, using economic and financial key factors in order to halt economic decline, to release productive activity, and, in particular, to reduce the social costs of transition. Inflation rate was curbed in the first stage of transition and the GDP returned to growth in 1993 and 1994, thanks to an extraordinary export performance. In this context, special importance has been devoted to assuring the functions of the institutional system and to completing the legislative framework necessary to carry on market economy activities, permitting the principal procedures to adopt suitable types of economic behavior based on initiative and competition. Perceptible progress had been registered initially by the implementation of the programs of mass privatization, development of managerial attitudes, the strengthening of the financial discipline of the autonomous regions, the regulation of bankruptcy procedures, and the promotion of competition within the economy.

Corrective actions, such as price liberalization for most products, the elimination of certain subsidies for output and consumption, the introduction of new taxes and fiscal regulations, gradually influenced positively the behavior of the economic entities, leading to a reduction of the inflationary expectations and to an increase of the perceived welfare. The economic recovery of the second stage had a negative effect upon the psychological attitude of a population still unfamiliar with the market mechanisms. Many citizens believed that the market economy would automatically and almost immediately bring affluence, improved living conditions and better qualities of all kinds of goods imported from the Western countries.

Common to other CEE countries, the renewed stability was driven and sustained by the partial recovery of the external markets for the companies having comparative cost advantages and by the resumption of infrastructure investments. The business climate improved and the output of industry increased slightly. Economic recovery was much more accentuated by the good performance of the agriculture sector. In this respect, several measures were implemented that permitted an upward evolution of the market demand for consumer goods and sustained the purchasing capacity if the internal market. The state continued to be involved in agriculture by means of the specific mechanisms it used to assist small producers, namely: interest allowances and subsidies for production credits and investments, production allowances and compensations, fiscal advantages, guaranteed purchasing prices for agricultural products of national importance, and the provision of specialized technical assistance.

In the framework of the process of transition during the 1994 - 1995, a renewed place was reserved for the privatization of the commercial companies in the portfolio of the State Property Funds through the distribution of new vouchers instead of the direct negotiations with employees (management and employee buy-out – MEBO method). The easiest companies to privatize were those having few structural problems and therefore potentially profitable for investors. They were, respectively, those involved in agriculture, the food industry, textiles and clothing, wood processing, trade, **tourism**, transport, construction and building materials. Consequently in the private sector, in addition to very small units created through individual initiative, some enterprises having a significant productive potential also began operations, a few of which were listed on the newly opened Stock Exchanges.

However, the postponed privatization of the large loss-making enterprises and the explicit support given by the banking sector, still under the control of the State, contributed to the deterioration of the fiscal deficit in these countries. The lack of financial discipline in the large SOEs contributed to the acceleration of inflation. In the final analysis, the risks of the gradualist strategy materialized in December 1995, when, dissatisfied with the slow pare of reform, the IMF and World Bank halted their financial support.

Going beyond the immediate positive implications of the economic recovery, the results obtained after this period overshadowed the true picture of the socio-economic transformation and the risk factors that interfered with the evolutionary trend of the economy. That is, on one hand, its high levels of subsidies to the autonomous regions and the extra-budgetary funds to agriculture, and on the other hand its high level of dependence upon exports of the energy-intensive branches of industry. In the context of the accentuated international competition as a result of geo-political modifications and the stagnation of demand faced by the developed economies (in particular the European Union), the growth of output could no be based exclusively on external orders. Therefore when the export performance, based as it was to a large extent on unrestructured heavy industry highly dependent upon imports of energy and raw materials, fell behind the original expectation, the government decided to allocate the scarce foreign exchange to these priority sectors on the basis of a non-market ‘official’ exchange rate. As a result, temporary recovery structural problems re-emerged as a serious obstacle to growth and the economic situation deteriorated. The excess demand for hard currencies led to the development of a parallel market and the significant deterioration of current account deficits resulted in a sharp depreciation of the official exchange.

<u>The third stage</u> of transition was launched in 1996, with a bold program to address the problems that had caused previous programs to fail. The governments tackled the economic problems in two stages, with an emergency plan to ensure social and political stability, followed by a radical structural reform program over its remaining years aiming eventually at EU accession.

In the enterprise sector, the program focused on restructuring, involving liquidation or privatization of many state-owned farms and industrial enterprises. Reform of the financial sector centered on strengthening the legal framework governing banks and other financial intermediaries and the privatization of banks. At this third stage, Romania and Bulgaria have decided to break with the past hesitant approach to reform. In applying for membership, the two countries accepted the objectives of the Treaty on European Union and the challenge now is to implement all measures set out in the White Paper, particularly the Single Market directives in the fields of taxation, public procurement, banking and intellectual property, or other important areas of the European Union's activity such as the environment, energy, agriculture, telecommunications, transport and social policy.

Economic Policy Reforms

Progress towards economic policy reform is assessed from indicators drawn from the European Bank for Reconstruction and Development (EBRD) annual Transition Report[199], as well as other official sources. The indicators focus in critical economic aspects of liberalization and institution building in the transition process, and are divided into 'rounds', roughly corresponding to stages of development through which emerging economies pass.

The building of a new economic system involved two steps:

1. increasing economic freedom and
2. a comprehensive transformation of the economic institutions.

The sequence and speed of these steps are key issues in assessing the progress in different areas of reforms and their sustainability during the restructuring. For both countries the strategy over the years can be summarized as 'a quick and widespread liberalization and a slow institutional restructuring'; this means that liberalization took place in a basically unchanged institutional structure, a source of errors and a misallocation or resources, precluding the elimination of the massive shortages as well as the needed adjustment of the price structure to the market conditions. Besides, the gradualist approach advocated by particular political parties benefited the 'normal' politics conducted

[199] Sufficient progress must entail an adequate threshold of reform as well as a favorable trend over time. Nine indicators are formulated in the EBRD's Transition Report (November 2003) and compared with comparable indicators from EBRD's previous two annual reports, measured on a one-to-five scale. A "five" represents standards and performance norms typical of advanced industrial economies. Depending on the particular indicator, a "3" or a "4" may correspond to the goal set by the country in its accession process.

by political parties and the game of particular interests, but left an incomplete and inconsistent reform. The drawback of this strategy, with the high level of conflicts within the fragmented political systems and the frequency of changes of governments influenced negatively the expectations of the economic agents and therefore their willingness to engage in longer-term investments, which led to stagnations of economic growth and increase of unemployment.

First Round of Reforms

- liberalization of prices
- external trade and currency arrangements
- privatization of small-scale unions.

In many respects, this first round of reforms were designed to introduce a free market in as many sectors of the economy as possible. Since they required relatively little institution building, they have been the easiest. In other CEE countries, the economic liberalization by freeing up prices, eliminating subsidies, removing import restrictions and encouraging the establishment of private commercial ventures were generally adopted rapidly and quite thoroughly. The governments which ruled Romania and Bulgaria avoided serious economic reform, fearing anticipated social costs. Confusion characterized the first round of reforms, with acute economic disorganization, exacerbated by a breakdown of law and order and dramatic worker absenteeism. Half of the prices in the consumer good basket were liberalized by Romanian and Bulgarian governments. The successive liberalization programs were not fully implemented by the governments. The pattern of resource allocation matched neither the real costs of production nor the preferences of consumers, thus resulting in a temporary dislocation of production. Therefore, the down side of the price liberalization was a sharp reduction of domestic consumer demand, which soon had a slowing down effect on industrial and agricultural production.

These effects had a negative impact on retail consumer prices and quickly led to increases in unemployment. Although a reform agenda was developed and a large body of legislation enacted, little was done to actually implement reforms because of the fear of social unrest and social conflicts. Only the pressure of the International Monetary Fund and its imposed conditions for extending the structural adjustment loans convinced the governments to eliminate most of the consumer subsidies, while deciding to keep under direct control the prices of raw and basic materials, including all agricultural products, oil and energy products.

In the attempt to re-establish the correct signals to the producers and reduce the burden on the state budget, explicitly required by a new stabilization program, the governments decided to complete price liberalization by limiting the number of controlled prices to less than twenty times (essentially prices of public utilities and energy). For agricultural products the controls on prices were lifted following the decision to reorganize the state monopolies.

The liberalization of the foreign trade regime was completed leaving quantitative import restrictions only for a few products related to public health or security. The monopoly of foreign trade was abolished and enterprises were entitled to retain and trade in foreign currencies. However, a feature of trade policy has been the proliferation of discretionary and temporary reductions in tariff rates, in particular in the form of tariff quotas, which covered around half of the countries imports. Also additional trade restrictions (including export prohibitions and export quotas) were introduced in an attempt to curb a rising trade deficit.

The initial effect of economic liberalization was an immediate escalation in retail prices, but also a rapid elimination of goods shortages that benefited the consumers after years of falling living standards. The primary objective, as advocated by transition economists, was to enable the emergence of effective price signals for the further development of a market economy. But in the cases of Romania and Bulgaria, the price liberalization undoubtedly worked to the advantage of the monopolistic large-scale enterprises which continued to dominate the state sector, since the de-monopolization was delayed in favor of the selective approach adopted by the governments.

Problems with the monopoly position of some producers and buyers inherited from the previous system were acknowledged and, in other transition economies they were combated by a specific anti-monopoly legislation which was enacted in the late years and therefore had only marginal effects. While conceding that privatization was virtually impossible to complete in the short run, the government enacted orders and laws that changed the status and way of operation of the state enterprises: above all, through specific laws they were immediately transformed into joint stock companies, with the state as the 100% shareholder and with state-appointed supervisory board of directors, until suitable divestiture provisions could be arranged. As a second step, a certain proportion of the shares would be sold and/ or distributed to the citizens and other designated 'financial intermediaries'.

This scheme, together with specific Laws for 'setting up' small and medium-sized private firms', was intended to address the major problems of country legacy, but it is worth illustrating the pitfalls awaiting serious programs of economic reform. The state involvement in the economy during the previous regime has had qualitative, as well as quantitative dimensions; therefore we have to consider its nature which leads to the 'nomenklatura capitalism' or 'spontaneous privatization', where members of the former communist ruling elite take advantage if their old connections and new opportunities to gain control over state enterprises as their de facto personal property. This occurred on a massive scale as managers and local officials managed to gain control of the enterprises. Another problem inherited from the past, which illustrates the psychological legacy of the command system is the preference on the part of workers and former officials alike for worker ownership and worker self-management of the privatized enterprises. The ideological basis of this preference is clear since the beginning, as evidenced by Bulgarian and Romanian endorsement of this form of privatization in their effort to retain a socialist element in the market reforms. The main drawback was a bias against long-term development and the likely isolation from domestic and international market forces.

Second Round of Reforms

- property restitution
- large-scale privatization
- enterprise

The governments had an essential role to play in modifying their own functions in the economy and in creating a more favorable framework for structural and systematic changes meant to encourage the progress of economic reform. Despite several attempts to grant more freedom of initiative to lower management levels, decision-making power still remained largely with controlling ministries and their subordinated agencies. In addition, decentralization without discipline and responsibilities continued to reproduce inefficiencies and losses.

The return of collectivized farm land to its cultivators was one of the first initiatives after 1989, but it resulted in a short term decrease in agricultural production. Many of the recipients of land were elderly or city dwellers, and the slow progress of granting land title was an obstacle to leasing or selling land to active farmers.

For the industrial sector, by using moderation and gradualism, progress towards these reforms has been slower than the one of the first round reforms. According to the EBRD 1997 Transition Report, only the Czech Republic, Hungary and Estonia had progressed sufficiently in this regard (with an indicator of 4), since Romania and Bulgaria score “2” for the large scale privatization (beyond the threshold) and “3” for small scale privatization. So, at that time, the structure of these economies was still largely socialized and the privatization program was still affected by political infighting. Thus, even though the radical reform programs were pushed through legislature, and approved by the IMF and the EBRD, real progress towards the market and privatization was not satisfactory. Many large SOEs and state farms did not face any real risk of bankruptcy and they continued to obtain cheap credit easily from the state-owned commercial banks, which in turn refinanced them at the National Banks.

A number of legal and political obstacles undermined the integrity of the privatization program. The government owned virtually all industrial SOEs and controlled the state farms, which still accounted for an important part of agricultural lands. While it is true that the development of a private sector had started to modify the structure of the economy, basic industries had seen little change, expectations being that they would remain under state control for the foreseeable future.

The process of enterprise restructuring and privatization was especially slow. By the end of the second round of reforms (1996) a very small part of the SOEs had been transferred to private owners and none of the large state-owned companies had seen meaningful restructuring. The chaotic and in some cases primitive state of the industrial and infrastructure networks in Romania and Bulgaria offered few attractions for foreign investors, and the available pool of domestic savings, besides the structural and psychological preconditions for private investment, were still rudimentary.

The agriculture sector reflects most of these general problems, as well as special demographic and socio-economic problems unique to the sector. Former SOEs inherited common problems from the command system, which seriously stood in the way of the creation of an efficient privately owned agriculture system. Given the decisive role of the state sector, this necessarily implied the privatization of state farms and producer co-operatives under the pressure of strong movements to legislate for the restitution of collectivized and nationalized land to their former peasant owners. In the meantime, efforts were made to retain the most efficient large-scale farming enterprises and to give alternative parcels of land to private farmers. In Romania, the resulting legislation implemented in 1991[200] was one of the most radical land reforms in the region. More than four million private farms were created, because the law favored the division and the quick restitution of land. The new private firms were relatively small in size, even by the West European standards, and a limit of one hundred hectares had been established for private land holdings. Property rights were ill defined and the majority of farmers were assigned only temporary ownership titles. The resulting uncertainty about property rights meant that individuals were able neither to sell land nor use it as collateral for credit operations. Alternatively, encouragement was given to private farmers to farm or to join already existing co-operatives and maintain some form of large-scale joint farming enterprises on a share-holding basis. The scarcity of small implements and other farming inputs was a good reason for adopting this strategy, at least as a temporary expedient, until a fully fledged market in farm inputs and outputs was established.

The development of a private sector agriculture system was seriously affected by the problems of inadequate and inefficient infrastructures, by insufficient mechanization and the lack of a fully functioning credit and banking system meant to meet the specific needs of small farmers. Also the presence of monopolistic industries that supplied input for agriculture did not provide technology appropriate for the relatively small-scale private farmer. Exports had been directed to Russian and other eastern markets to help pay for imports of needed fuels and raw materials, which were severely cut back by the collapse of Soviet trade in 1991. In short, the initial reliance on a totally free market in agriculture had effectively been abandoned, as the governments were faced with the realities of international agricultural trade. Prices were liberalized again in 1997, together with the reorganization of State controlling enterprises for

[200] Land Law No. 18/1991

agricultural input and output. Given their natural endowments and past trade patterns in Europe, there are reasons to believe that Romania and Bulgaria will again become a major exporter of agricultural products, from horticultural to meat and dairy items, food and feed grains as well. Given the likely persistence of import restrictions on their products by the EU, it is highly possible that they will appear as competitors of traditional exporters like Australia and New Zeeland on the world markets.

Third Round of Reforms

- banking reform and private non-bank financial institutions
- competition policy
- investment-related legal reforms

These reforms are the most challenging, and progress is least evident in this domain. It may be that no CEE country, regardless of the set of reform measures it adopted, has yet adequately restructured in this third round set of reforms. While the Czech Republic and Poland have gone the farthest, Romania and Bulgaria are far behind the leaders, not having implemented any form of radical reform.

A two-tier banking system was first introduced in Romania and Bulgaria: the National Banks assumed the traditional central banking functions, while their commercial operations were transferred to the newly created Commercial Banks. In Romania, the general banking law No. 33/1991 was introduced in April 1991. It provided for the transformation of the existing four banks into joint-stock companies. Consequently, the banking system consists of five state owned banks and a relative small number or private banks. The state owned banks include the Commercial Bank, the Romanian Bank for Foreign Trade responsible for lending to the trade sector, the Romanian Development Bank (formerly the Investment Bank) responsible for long term lending to the State owned enterprises, the Banca Agricola (formerly the Agricultural Food and Industry Bank) responsible for lending to the agricultural sector and the Savings Bank mobilizing the savings of households.

Romania adopted the universal banking system (banks that offer the entire range of banking services) granting equal treatment to foreign bank branches. The high demand for capitalization from the banks facilitated the uncontrolled growth in their numbers – 41 banks were authorized to operate as at December 2003, one quarter being foreign banks – which in turn prevented numerous bankruptcies.

The Bulgarian National Bank (BNB), as the chief financial instrument of economic policy making during the communist era, assumed virtually all of the financial functions in the country under the centrally planned economy. Only the granting of foreign trade and consumer credits were separate functions, performed respectively by the Bulgarian Foreign Trade Bank and the State Savings Bank, both of which were subordinate to the BNB. The BNB worked with the Ministry of Finance to finance capital investments in the economy. The BNB also monitored the economic organizations that received investment funds to ensure their use for accomplishing plan targets. As enterprises became more self-financing in the 1970s, a greater share of their investment capital was composed of bank credits granted by the BNB. Between 1965 and 1975, the BNB share of investment funds jumped from 7 percent to 54 percent; the trend then moderated as enterprises began to rely more on retained earnings to finance investments.

A 1987 reform nominally split Bulgarian banking into a two-tiered system. The function of the BNB was restricted to money supply, although it also retained significant supervisory power. The reform also created several specialized banks including the Agricultural and Cooperative Bank, the Biochemical Bank, the Construction Bank, the Electronics Bank, the Transportation Bank, and the Transport, Agricultural, and Building Equipment Bank, each responsible for an industrial sector.

The Bulgarian National Bank Law was passed in mid-1991, and the Banking and Credit Law was adopted in March 1992. These two major acts of the Bulgarian parliament set up the legislative framework of the new financial and credit system in the country. Presently the banking system in Bulgaria is a two-tier one, and is composed of a central banking institution - the Bulgarian National Bank - and commercial banks built up on a share-holding basis. In fact, the commercial banks are universal and may engage in both trade and investment operations. The new structure of the financial system is complemented by newly established non-banking institutions - financial and brokerage houses and foreign exchange offices.

Post-Zhivkov banking reform began hesitantly but grew more comprehensive in 1991. In a controversial policy decision, the government first increased interest rates from 4.5 to 8 percent in 1990, then let them float freely beginning in 1991. Although the first private commercial bank was established in May 1990, a new National Bank Bill was not passed until June 1991. That law provided for a two-tier bank system independent of direct government control but accountable to the National Assembly. The first tier of the new system was to be the Central Bank, the second a separate system of commercial banks and lending institutions serving private citizens and enterprises. Three-month bank credits would be available to cabinet ministries. The BNB was to issue monthly balance statements and report semiannually to the National Assembly.

In addition to these specific features, some unresolved problems remain within the banking system of both countries. These include:

- delays in the system of payment operation,
- loose application of the supervisory standards,
- reduction in attraction of resources and loans granted,
- long absence of banking privatization.

The need for modern clearing and payment procedures will reduce the delay in bank payments, which impose a kind of inflation tax upon creditors. Perotti and

Carare (1997)[201] conclude their investigation of the quality of credit allocation in Romanian and Bulgarian banks by arguing that these banks have continued to play a passive role, funding large and unprofitable SOEs. Although there were some improvements in the allocation of credit among profitable SOEs, there was still a tendency for credit to be directed at larger firms and most recently to those with the most trade arrears. They found that for the worst performing SOEs, the evidence suggested that the quality of credit alocatin was deteriorating. The evidence was not consistent with the hypothesis that as a result of a market oriented reform of the banking system, the allocation of bank credit would improve. There was still neither a stock market nor a bond market. Their existence would increase eligible portfolio investment. Developing the capital market and increasing the number of actors which could mediate between foreign investors and the authorities on this market (like investment banks, etc.) are two of the main issues which needed to be addressed in order to attract foreign investors.

Thirteen years after the introduction of the banking legislation, important changes transformed the banking sector with the opening of new private banks and the diversification of its services. Despite plans to increase bank privatization, the sector continues to present considerable segmentation and concentration. It remains dominated by state-owned banks, some of which have a high portion of bad loans in their portfolio and are therefore exposed to difficulties in the course of the current restructuring process in the enterprise sector.

Overall, reforms in competition policy lag the most while investment-related legal reforms show the most progress. Foreign investors adopted a cautious approach, and because of the defiance of leading political forces to accept foreign investment. Only occasionally (1994, 1999 in Romania, 1994, 1998 in Bulgaria) did the flows of the FDI pick up, but they have remained insufficient to make a

[201] Perrotti, E. and Carare, O., 1997. *The Evolution of Bank Credit Quality in Transition. Theory and evidence from Romania and Bulgaria*, CERT discussion paper no. 97/02, CERT

strong impact on the economy. Foreign investors were authorized to own land and repatriate profits only as late as the third stage of transition, and under an unstable legal framework.

Until 1990, most real estate in Romania and Bulgaria was owned by the state. Industrial and commercial property office and retail were state owned. Agricultural land was either state owned (or operated as state farms), nominally privately owned but under state control (co-operatives) or owned by individuals. The majority of the urban housing was state owned, having been either nationalized or built after 1950. The new constitutions adopted in 1991 guarantees the right to ownership of private property. Commercial and industrial real estate has been assigned to various commercial companies into which state enterprises were organized under privatization laws. These commercial companies have started to be privatized since 1996-1998. As private owners take control of the companies, the land is moving to private control.

Most residential housing unit built with state funds (generally after 1950) have been sold to their occupants. Prices and interest rates reflected the rent already paid and the condition of the units. The issue of how to privatize nationalized residential properties was resolved only in this third stage by new laws. The new laws also stipulated that a national legal entity with partial or total foreign capital could acquire ownership of land.

As far as the protection of property rights, Romania and Bulgaria are signatory to international conventions concerning intellectual property rights and have enacted legislation protecting patents, trademarks and copyrights.

Therefore, following a gradual path in restructuring their economies, Romania and Bulgaria have not kept up with the reform measures, and results, implemented by the Czech Republic and Poland. The third round of reforms in these countries started as late as 1996 and are still being implemented, aiming eventually at EU accession in 2007.

As a result of the transformation measures adopted, the private sector in Romania and Bulgaria is composed of mainly small and medium sized enterprises, primarily in agriculture and services. There were frequent changes in legislation, and sometimes the laws were issued in unpredictable and uncorrelated ways. Known laws were modified by amendments and ordinances which contradicted others already issued. There were in addition frequent changes in governmental institutional structures.

The political factors were important for Bulgaria and Romania, as they influenced the expectations of the economic agents and therefore their willingness to engage in long-term investments. The negative results of the Romanian and Bulgarian economic programs have been the consequence of this instability and also because most of the changes were not introduced during the first four years when there was continuity in the economic leadership. The new priorities of the governments in power are:

- to accelerate economic reform,
- to structure and privatize,
- to introduce fiscal and monetary austerity,
- to reduce the state's role in the economy.

in order to create countries open and attractive to economic investment.

The results are essential to improve the economic efficiency as a pre-condition for lasting stability and sustained growth. Furthermore the governments should be prepared to face external, structural and political constraints and avoid the temptation to resume populist measures to accommodate the costs of the liquidation of large loss-making companies. Negative development has started to be minimized, and even turned into positive evolution (e.g. the positive evolution of GDP after 2000) and it will help avoid pushing Romania and/or Bulgaria into an undesirable fourth phase dominated by a gradualist approach.

CHAPTER FOUR
TRANSITION IN TOURISM

4.1 Economic Transition and Tourism

In this chapter, the main economic policies of transition in the Central and Eastern European countries considered in the present research are reviewed for the case of the tourism industry in each of these countries. The chapter presents some of the complex changes involved in the uneven transformation from a strongly collectivist and partially closed (internationally) model of tourism to one shaped by market principles and relationships and integration into a global system of tourism. The main dimensions of change are centered on:
(1) the role of the state,
(2) privatization policies and practices and
(3) consumption and economic results of companies active in tourism.

These are strongly related both among themselves and with the transformation processes of other parts of society. There is also a causal relationship between the first two factors – how they were designed and implemented, and the last one (results), which are statistically analyzed and extensively presented in Chapter 5. An in-depth analysis of the transformation strategies in tourism, for each of the countries in the study, is presented in sections 4.2 through 4.5.

4.1.1 Tourism under State Socialism

In 1989 state socialism that had been built in the Central and Eastern European countries for 45 years was dismantled in a few months. The collapse of central planning was one of the most defining series of moments in the second half of the twentieth century. The ineffectiveness of central planning was the underlying cause of failure of state-socialism across the region. In contrast, decentralized decision-making and the linking of decisions, information and motivations provided market economies with great flexibility in the face of globalization and shifting demand in the twentieth century.

During the socialist era, the emphasis was placed on developing the primary and secondary industry sectors, while service industry – including tourism - was considered to be of minor importance. There was an ideological legacy with roots in the Marxist theory of production, according to which only the production of material goods could be considered a real and/or efficient form of production. In the service sector, only those activities directly supporting the production of goods were considered to be productive (Hall, 1984)[202].

Tourism was classified as being 'unproductive', that is as an 'inefficient' activity, and had a low priority in the national development strategy. Instead, during the 1950s and 1960s, tourism was mostly considered to be a social activity. Its main role was conceptualized as being 'to regenerate the labor force' and 'to satisfy the demand for recreation' (Hall, 1991)[203]. The nature of the recreation, of course, was supposed to be based on the 'socialist way of life'. Holidays, for example were to be spent with other members of the worker collective and a parallel tourist industry was established to serve the needs (Veyret, 1963)[204]. Trade union and recreation centers were constructed. Prices in company-owned tourism facilities were highly subsidized, either directly by the state or indirectly by the parent firms. There was also a parallel commercial tourism sector, the main function of which was to provide low cost holidays for domestic tourists and from visitors from other communist countries. Both the prices and quality of the

[202] Hall, D., 1984. *Foreign tourism under socialism: the Albanian "Stalinist" Model*, Annals of Tourism Research, Vol. 11, Issue 4, pp 539-555

[203] Hall, D., 1991. *Evolutionary Pattern of Tourism Development in Eastern Europe and the Soviet Union*. In D. Hall (ed.), Tourism and Economic Development in Eastern Europe and the Soviet Union, Belhaven, London

[204] Veyret, P., 1963. *Tourism in Czechoslovakia*. Revue Geography de l' Est, Vol.3, Issue 2, pp. 131-136

tourism services were planned with these goals in mind. The outcome was high volumes of nights spent and modest quality levels.

The rigid model of state-socialism was similar in content and results in most countries of Central and Eastern Europe. In terms of economic policy, tourism was recognized as an industry in its own right during the 1960s, when National Committees for Tourism were established in these countries. The main functions of such a Committee were to advise on the regulation of the tourism industry and to represent the country on international tourist bodies. The first signs of decentralization, though limited, appeared later, when District Tourist Enterprises were established by District Councils and charged with the responsibility for the development of regional tourist infrastructure, sports facilities and information centers. Regional tourism development plans were prepared by the tourism units of the District Councils. Despite their limited financial and personnel resources, they contributed significantly to the creation of a more sophisticated tourism industry in many regions of these countries.

In the early 1980s, the state-socialist economic system started to encounter systemic difficulties when heavy industries failed to innovate, therefore be competitive, in Western markets. Exports were diminished and there was an acute shortage of convertible currency. Reconstruction of the industrial base required massive imports of technology. At this stage, tourism began to be viewed as a potential resource for diminishing the foreign currency gap and there was a shift in its ideological perception and policies. Incoming tourism generating foreign currency was reclassified as ‘productive’ rather than ‘unproductive’. This was significant, because in the centrally planned economy, the allocation of resources – financial and human – was determined by the priorities established by the Communist Party, usually in its general assembly. As a result, there was investment in new hotels, particularly in the capital cities. In some Central and Eastern European countries limited foreign capital participation in hotel construction was even permitted, through joint ventures (especially in Poland and Hungary, much less in Czechoslovakia, Romania and Bulgaria) (Hall, 1991)[205].

The priorities for tourism development set out during the 1970s and 1980s were:

a. the development of mass sport and tourist activities, with the aim of regenerating the labor force
b. promotion of friendships between nations
c. generation of foreign exchange, in tourism sectors specific to each country (the tourism sector emphasized in most Central and Eastern European Countries was spa tourism)
d. improved utilization of hotel, restaurant and spa facilities
e. development of more sophisticated tourism services.

A number of tourism policy instruments were designed to achieve these goals:

a. price regulation linked to the goals of social policy
b. promotion and information activities
c. regulation and administrative measures
d. infrastructure development
e. vocational training
f. tourism research and planning.

Some of these instruments were contradictory. For example, the regime in Czechoslovakia invested substantially in marketing abroad in order to attract more foreign tourists, and the expenditure on marketing abroad (Kč 14.95 million) in 1989 was much higher than it would be in the early transition years (only Kč 8.56 million in 1992). Yet, the insistence that Western tourists should spend a compulsory minimum daily amount of foreign exchange was highly unpopular, creating the image of a greedy and unwelcoming destination. This affected tourism foreign exchange receipts, which were less than one-seventh the level that would be realized by 1992 under transition conditions.

[205] Hall, D., 1991. Ibid 203, p. 64

Social policy considerations also contradicted the goal of maximizing foreign exchange. In 1976-80 for example, the Tourism Fund spent Kč 810 million on tourism infrastructure development, marketing, information and related activities (Medved, 1984)[206], which far exceeded the corresponding state expenditure in the 1990s. Yet the resultant poor quality services in cheap hotels, constructed primarily for domestic tourism and for foreign tourists from other socialist-countries, did not match the expectations of Western tourists.

The volume and structure of tourist flows to and from the countries in this region were mostly determined by political considerations (Hall, 1991)[207]. Visitor from Western countries accounted, on average, for only about 5 % of total flows. Tourist exchanges with neighboring socialist countries accounted, on average for about 90% of all flows. A system of special permissions in each country was in force (e.g. in Poland after 1982, with a difference of 1 to 2 years in the other three countries of this study) severely reducing tourism exchanges.

Administrative barriers were also utilized to limit tourist exchanges with Western countries. For example, every potential traveler had to apply to the respective State Bank for a foreign exchange allowance. There were no transparent or equitable criteria for allocating such allowances, and few applicants were successful. Even after securing such an allowance, a formidable series of other travel barriers followed. A potential traveler to the West had to obtain recommendations on his/her reliability from the local committee of the Communist party and/or the army and or the police or other bodies. There were also visa barriers to overcome as there were no free-travel agreements with Western countries. This sophisticated system of travel barriers was against the 1975 Helsinki Agreement which was supposed to guarantee free travel in Europe and which all the four countries has adhered to.

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[206] Medved, J., 1984. *Tourism Finance*, selected chapters. Bratislava: Rectorát, VŠE
[207] Hall, D., 1991. Ibid 203, p.89

In terms of its contribution to the international tourism account, state-socialism tourism policy can be judged to have been successful. In the late1980s, tourism foreign exchange earnings increased rapidly. Tourism inflows were far larger than outflows (though, mainly because outflows had to overcome so many barriers) and the system of administrative controls ensured there was a positive balance in exchanges with western countries. The volume of foreign exchange allocated to travel to western countries was determined centrally and planned in advance, usually being set at a level equal to about one quarter of the expected income from foreign tourism. However, the total volume of convertible currency income was relatively low. Tourist exchanges with other state socialist countries generated considerable foreign exchange, but not in widely convertible currencies.[208]

A critical assessment of state-socialism tourism policy is not entirely negative. There was virtually universal access to holidays in domestic tourism establishments, although at low service levels. This was one of the first features to be threatened during the transition to a market economy.

4.1.2 Tourism and Economic Policies during Transition

Reforms in tourism are incorporated in the broader context of economic, social and political transformations taking place in the Central and Eastern European countries, while the sector has its own production and consumption characteristics and specific policies. Tourism contributes to the overall transformation, being open to international competition and to shifts in consumer expenditure, and being one of the first sectors going through privatization and market liberalization.

[208] Details about the level of these indicators per country are presented in the following sections of this chapter. It is to be noted that they follow similar patterns of evolution in all of the four countries analyzed.

Tourism development directly impacts on economies in transition through its net contribution to the national income and to employment. The economic impacts are influenced by company structures and the particular models of privatization pursued, the integration of firms in the national and regional economies (Grabher and Stark, 1998)[209] and the productive labor market and capital features of national economies.

The contribution of tourism to the net balance of payments surplus has been recognized in the economic strategies of European governments, particularly in the late industrializing Southern European economies in the early post-war decades (Williams, 1997)[210]. Since the late 1970s, the economic potential of tourism has also been recognized in more mature economies facing de-industrialization crises. Tourism earnings can help balance the national income and finance imports, whether of consumer, intermediate or capital goods.

The same considerations apply to transition economies, where tourism was one of the few sectors capable of generating a surplus on international trend. Although there are considerable problems in quantifying the foreign exchange earnings of tourism, the statistical data available suggest that the sector generated foreign exchange surpluses which helped balance the net international deficit and finance critical imports of intermediate and capital goods. The growing appreciation of the role of international tourism repositioned it as a priority in state policies during transition.

Employment is the other key aspect of the economic impact of tourism. The more visible jobs are those in hotels and catering. There is also a range of jobs related to tourism in public administration, manufacturing, the producer service, retailing

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[209] Grabher, G. and Stark, D., 1998. *Organizing Diversity: evolutionary theory, network analysis and post-socialism* in J. Pickles and A. Smith (eds.) Theorising Transition: the Political Economy of Post-Communist Transformations, London: Routledge, pp. 54-75.

[210] Williams, A. M., 1998. *Tourism and uneven development in the Mediterranean* in R. King, L. Proudfoot and B. Smith (eds.), The Mediterranean: Environment and Society, London: Edward Arnold, pp. 208-226.

and transport (Shaw and Williams, 1987)[211]. However, the contribution of tourism to employment in the transition economies is given additional weight by the high unemployment rates recorded especially in the sharp-shock economic reforms (Williams and Baláž, 1998)[212].

The overall contribution of tourism to these economies is dependent on a number of features, including the following:

- The overall balance between the outflow and the inflow of tourists and tourist expenditures. During transition, the removal of the 'iron curtain' created opportunities for new patterns of international tourist flows. These were particularly encountered in Romania, and until the late 1980s, in Czechoslovakia, which previously had been more 'closed' to international tourism (Hall, 1995)[213]. The most significant changes concerned the attraction of tourists from Western countries, while there were also changes in the international tourist flows among former Eastern block markets: organized holiday tourism declined amongst them, there were significant flows for shopping, business and trading purposes. Many of these flows were generated by the price and supply differences resulting form the uneven speed and form of the transition process in neighboring economies. Therefore, some forms of tourism contributed to the ecnomic adjustments in the region and diminishing the social and economic transition gaps between countries.
- Foreign Direct Investment (FDI) in tourism is relatively small scale in most of Central and Eastern European region, but it is already strong in sectors such as air transport and travel agencies. FDI is an important indicator for the evolution of tourism development. In this context, an important issue is ownership, because it determines how firms are integrated into

[211] Shaw, G. and Williams, A. M., 1987. *Firm formation and operating characteristics in the Cornish tourism industry*, Tourism Management, 8, pp. 344-348.
[212] Williams, A. M. and Baláž, V., 1998. *Transformation and division in Central Europe* in R. Hudson and A. M. Williams (eds.), Divided Europe: Society and Territory, London: Sage.
[213] Hall, D., 1995. *Tourism change in Central and Eastern Europe* in A. Montanari and A. M. Williams (eds.), European Tourism: Regions, Spaces and Restructuring, Chichester: Wiley, pp. 241-243.

international markets (Beattie, 1991)[214]. Foreign ownership is not encountered very often in privatized or new tourism units. Linkages between firms are more often used during the transition period (Grabher and Stark, 1998). In respect to tourism, the key point is that many tourism establishments were integrated within large company structures which were more or less privatized (or at least commercialized), thus influencing the contribution of tourism to national and regional economies. The issue of how tourism companies were privatized is explored in the next section.

- The contribution of tourism to the national economy is dependent on the regional structure of the industry providing different types of tourism services. The performance of the national tourism sector is the result of how regional tourism assets and services were integrated into both a national reform strategy and an international order, relationships which continued to be mediated by national states. The changing territorial organization of tourism has contributed to the overall process of regional development during transformation.

Besides contributing to economic transformation, **tourism is influenced by a series of interrelated economical, political and social changes**. Three main dimensions of transition have significance for tourism:

1. **the economic transition strategies** (‘shock-therapy’ and ‘gradual reform’) applied in the countries included in the present research (Czech Republic, Poland, Romania, Bulgaria)
2. positioning the national economies into the international transactional environment
3. the strategies for privatization adopted.

These have shaped the macro-economic environment for tourism, have exposed the sector to globalization and have redistributed property rights.

[214] Beattie, R. M., 1991. *Hospitality internationalization and empirical investigation*, International Journal of Contemporary Hospitality Management, 3, pp. 14-20.

1. The **'shock-therapy'** economic reforms were based on a particular version of liberal capitalism, with four main constituents: market liberalization, privatization, currency convertibility and trade liberalization. These were combined with macro economic stabilization measures, involving limiting the money supply and budgetary controls. They were applied in Poland and the Czech Republic. The result, in the first phase of the transformation (1990-1993), was a decrease in production and living standards with consequences for domestic tourism and for the ability of entrepreneurs to restructure existing tourism establishments or to invest in new ones. Economic recovery was recorded in the second phase (1994-1997) when new markets were created and domestic tourism started to increase (although highly uneven in the society). The **'gradual reform'** is based on a sequence of economic measure taken step by step, namely in three rounds, taking in view the social and political immediate consequences they might have upon the population. The slow rate of privatization and the absence of a coordinated strategy for reform in tourism led to stagnation and in many cased decrease of the living standards and economic performances.

2. A distinctive model of international tourism had developed within Central and Eastern Europe during the period of state-socialist central planning, with most trips being made to other neighboring socialist countries or to the Black Sea resorts. After the removal of passport and visa barriers this system was no longer viable. Particularly for holiday tourism, a new system emerged, focused on Western Europe, for both inbound and outbound flows.

3. Privatization has brought major changes in the conditions for production and provision of tourism services. In most cases, tourism has been among the first sectors to be exposed to privatization measures. It demonstrates many of the advantages and disadvantages associated with changes in property rights, the availability of new sources of capital and entrepreneurship, and economic performance. More types of privatization programs have been applied in each of the countries of the present study, resulting in different forms of property ownership, prices paid, capital structure and firm performance. The privatization programmes have been shaped by social and political interests and have been economy-wide rather than being tailored to the specific conditions and requirements of tourism.

4.1.3 Privatization in Tourism and the Development of the Private Sector

Privatization signifies the expansion of privately owned property and it can be divided into two main forms (Dallago, 1995)[215]: *Distributive Privatization*, involving the redistribution of property rights relative to existing assets, and *Creative Privatization*, based on the creation of new privately owned assets.

Distributive Privatization is one of the key components of the transformation in Central and Eastern Europe (Nielsen *et al*, 1995)[216]. It plays a number of roles in both the ‘shock-therapy’ and the ‘gradual reform’ models of economic transformation, and especially in improving enterprise efficiency and facilitating the creation of markets. Individual property rights are directly related to the

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[215] Dallago, B. 1995. *Privatization in Europe: A Comparison* in R. Davvidi (ed.), Property Rights and Privatization in the Transition to a Market Economy, Maastricht: European Institute of Public Administration, pp 231-265

[216] Nielsen, K., Jessop, B. and Hausner, J., 1995. *Institutional change in post-socialism* in J. Haussner, B. Jessop and K. Nielsen (eds), Strategic Choice and Path Dependency in Post Socialism: Institutional Dynamics in the Transformation Process, Aldershot: Edward Elgar, pp. 3-44

linking of enterprise performance, and the return to individual owners, managers and workers.

Privatization was mainly presented as an economic issue in the early stages of transformation. The transformation from central planning to a market economy required a strong private sector but in a region where the average salary was only between $40 (Bulgaria) and $110 (Czechoslovakia) per month, this presented an enormous challenge. The creation of a private sector through 'normal' market process of capital accumulation, *Creative Privatization*, would have taken several decades. Instead, the privatization of state-owned enterprises offered a shortcut for creating a private sector within three to five years. This strategy, though, had major shortcomings, one of which was that it generated little new capital, as privatization was mainly implemented as a form of property re-distribution, due to a general lack of capital in Central and Eastern Europe.

The redistribution of property rights after 1989 has followed distinctive phases. There were different strategies of controlling and distributing property rights in the countries analyzed which were determined less by technical issues than by political and social interests (Cox, 1994)[217] which perceived that privatization provided an opportunity to accumulate wealth. A major drawback was that more attention has been given to property rights than to creating an effective regulatory framework for privatization through institutions and regulations.

Tourism has often been at the leading edge of privatization and the sector has not been largely analyzed in research (but see Johnson, 1997 on the Hungarian tourism industry and Hall, 1995 for a general overview). The key issues discussed in literature are:

- the privatization of the main state-owned tourism enterprises,
- the volume of property privatized,

[217] Cox, T., 1994. *Privatization and social interests in Eastern Europe*, Journal of European and Public Policy, 1(3), p. 406

- the privatization timetable and
- the methods and processes of establishing a new class of owners.

As mentioned before, the transformation in Central and eastern European countries was done mainly through distributive privatization. According to Estrin (1994)[218] there are ten possible approaches to distributive privatization:

1. sale by public offerings of shares
2. sale by private treaty (closed or limited tender)
3. sale by public auction
4. leasing assets or firms
5. management and/or worker buyouts
6. free (almost free) distribution of shares / vouchers to the population at large
7. free or subsidized distribution of shares to the workforce / management
8. free distribution of shares to social institutions
9. restitution of property to former owners
10. privatization via liquidation or bankruptcy.

This list omits one important form of privatization, the transfer of state property to municipalities, which accounted for a significant part of the total volume of property privatized in most Central and Eastern European countries (and in all four countries included in the present study).

Most of these different privatization mechanisms have been used in the Central and Easter European countries, and their mix reflects:

- *the differences in political organization*
- *the inherited economic structures*

While there have been important national differences in the privatization programs, there have also been broad similarities in their sequencing and in their

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[218] Estrin, S., 1994. *Economic transition and privatization: the issues* in S. Estrin (ed.), Privatization in Central and Eastern Europe, Harlow: Longman, pp. 3-30

speed. In every country there were two basic stages of privatization: small-scale and large-scale. The Small Privatization, which included the companies in the service sector, began almost immediately after the fall of the communist regimes in 1989 or, in Poland, even earlier. Auction was the most popular form of privatization. Retail units, restaurants and small service and manufacturing firms were sold to domestic investors, backed in some instances by foreign capital. Sale prices were close to book or market values, and investors were paid by cash or through loan allowances. This stage lasted a limited time period of two to three years in Poland and the Czech Republic, while it took longer in Romania and Bulgaria.

Large-scale privatization began later and was usually based on tenders and direct sales of medium and large State-owned enterprises (SOEs). Both domestic and foreign investors participated. Domestic investors usually relied on bank loans and the large discounts from the market value that were available to management led employee collectives, while the foreign investors had the resources to pay the full market price. In the period 1991-1996 this overlapped with the mass privatization programs implemented in Poland, the Czech Republic and Romania. These programs converted SOEs into joint-stock companies and distributed their shares free of charge amongst the population. Finally, there are indications that a third phase of privatization has taken place, implemented not by the state but by powerful industrial and finance interest groups. These lobbies gathered (bought out) individual shareholders from the mass privatization programs and used the effect of majority stakes in investment funds to secure control of much larger capital in the underlying companies (Williams and Balaz, 1999)[219]. One of the positive outcomes of Large Privatization was the creation of capital markets. Although these were not liquid and, in many cases, corrupted,

[219] Williams, A. M., Balaz, V., 1999. *Privatization in Central Europe: different methods, legacies and outcomes*, Environment and Planning C: Government and Policy

they significantly helped to advance the process of investment allocation and reallocation (Balaz, 1996)[220].

4.1.4 The Economic Performance of Tourism Businesses

After 1989, international tourism was seen as an important source of international currency in the transition economies (Balaz, 1996)[221]. Paradoxically, the state did little to foster tourism in most of these countries and there was an assumption that the private sector would be able to utilize their natural and cultural heritage to attract foreign tourists. Despite the delayed measures taken in tourism in Romania and Bulgaria, changes can be notices in all countries[222] in the per capita international tourism income (growth or decrease), the volume of international tourism receipts reflected in their share of receipts for the whole CEE region, and by the employees engaged in travel and tourism activities (see Table 4.1)

In interpreting the data presented in Table 4.1, it is important to take into account the numerous methodological problems encountered in any comparison of the tourism economy before and after 1989. During the state-socialism period, the statistics were based on the Material Product System (MPS), which was rooted in the Marxist concept of 'productive and unproductive' industries. Except for food production in restaurants and international tourist receipts, all tourism services were considered to be 'non-material and unproductive' and were not taken into account in computing the Gross National Product (GNP). In addition, many tourism services were provided by the recreation units of industrial and other companies, and therefore, were not recorded in tourism statistics. A system of

[220] Balaz, V., 1996. *The Wild East? Capital markets in the V4 countries*, European Urban and Regional Studies 3(3), pp. 251-266
[221] Balaz, V., 1996. *International tourism in the economies of central European countries*, Exeter: Tourism Research Group, University of Exeter, Discussion Paper No. 9.
[222] The data analyzed refers solely to the countries included in the present research: the Czech Republic, Poland, Romania and Bulgaria, although similar trends can be noticed for other countries in the region as well.

National Accounts was introduced in 1992 and since then tourism data have been broadly comparable to those used in market economies.

Table 4.1 International tourism receipts in the Czech Republic, Poland, Romania, Bulgaria, '89-'02

Year	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Czech Republic														
Receipts (US$ million)[1, 2]	128	419	714	1126	1158	1966	2875	4075	3647	3792	3035	3229	3468	3110
Share of receipts of the CEE region (%)	4.37	8.64	9.55	13.81	11.71	12.59	14.38	16.53	14.45	13.03	11.61	12.43	13.59	14.55
Employees in Travel and Tourism activities ('000)	140	122	94	112	126	131	122	168	164	159	145	152	138	127
Poland														
Receipts (US$ million)	118	358	2800	4100	4500	6150	6700	8444	8679	7960	6104	6100	4815	4500
Share of receipts of the CEE region (%)	2.38	7.38	37.46	50.28	45.51	39.39	33.52	34.26	34.38	27.35	23.36	23.48	18.87	21.05
Employees in Travel and Tourism activities ('000)	226	313	383	417	452	626	435	452	470	435	400	380	310	280
Romania														
Receipts (US$ million)	12	106	145	262	197	414	574	629	560	260	254	389	558	647
Share of receipts of the CEE region (%)	0.24	2.19	1.94	3.21	1.99	2.65	2.87	2.55	2.22	0.89	0.97	1.50	2.19	3.03
Employees in Travel and Tourism activities ('000)	66	76	85	123	104	114	142	132	142	114	123	117	113	102
Bulgaria														
Receipts (US$ million)	23	320	44	215	307	362	473	425	391	966	932	1074	1201	1334
Share of receipts of the CEE region (%)	0.46	6.60	0.59	2.64	3.11	2.32	2.37	1.72	1.55	3.32	3.57	4.13	4.71	6.24
Employees in Travel and Tourism activities ('000)	20	27	33	43	40	77	67	77	80	120	120	127	132	125

Sources: National Banks, National Statistical Offices and data compiled by the researcher

Notes: 1 = data for the 1989-1991 were recalculated by the National Statistical Offices from state-socialist national income; 2 = since 1994, the recommended IMF methodology has been used to compute receipts.

A brief comparison of the receipts from tourism before and after 1989 provides a superficial assessment of the impact of transformation and privatization: tourism businesses appear to have had more positive trajectories after 1989. The number of foreign visitors, for example, has grown rapidly in the Czech Republic, international tourist receipts increased at almost 100% per year and tourism became the most rapidly growing sector in the transformation of the economy.

Tourism businesses in the transition economies had to overcome several major shocks in a relatively short period of time: a switch from a planned to a market economy, privatization, the loss of traditional markets, changes in the structure of demand. Most of these changes occurred in the period 1991-1993. Because of these shocks a very differently structured tourism sector emerged after a few years of transformation. By 1998, very few of the original business units operated within the same organizational structure as before 1989. These transformations affected the old hotel and restaurant businesses negatively. The new owners had to face the same difficulty as other small businesses in the transition economies: lack of capital, high interest rates, incomplete and unclear regulation, bureaucratic obstacles and corruption. Many privatized businesses accumulated debts and were bankrupted in relatively short periods of time. There were rapid ownership changes in such companies which had positive or negative results. On the other hand, many new tourism companies and successful personal businesses emerged in this period. The relative importance of different forms of ownership changed after 1989. The public sector share of total turnover decreased, while that of domestic private sector increased.

The economic performance of tourism firms in each country depended largely on the nature of privatization in the country, as discussed in the following sections of this chapter. The particular conditions of privatization had a major influence on the capital and debt structures of privatized tourism firms. The relatively unfavorable position of tourism I respect of capital, debt and profits, compared to other industries is mainly due to the large number of small firms in this sector.

4.2 Tourism in the Czech Republic

Brief Country History and Data:

Following the First World War, the closely related Czechs and Slovaks of the former Austro-Hungarian Empire merged to form Czechoslovakia. During the interwar years, the new country's leaders were frequently preoccupied with meeting the demands of other ethnic minorities within the republic, most notably the Sudeten Germans and the Ruthenians (Ukrainians). After World War II, a truncated Czechoslovakia fell within the Soviet sphere of influence. In 1968, an invasion by Warsaw Pact troops ended the efforts of the country's leaders to liberalize Communist party rule and create "socialism with a human face." Anti-Soviet demonstrations the following year ushered in a period of harsh repression. With the collapse of Soviet authority in 1989, Czechoslovakia regained its freedom through a peaceful "Velvet Revolution." On 1 January 1993, the country underwent a "velvet divorce" into its two national components, the Czech Republic and Slovakia. The Czech Republic joined NATO in 1999 and the European Union in 2004[223].

Map of the Czech Republic

Population (in 2000): 10.3 million
GDP/capita (in 2000): $ 4.859

The aim of this subchapter is to analyze the process of transformation of tourism in the independent Czech Republic which emerged from Czechoslovakia after its 1993 “velvet divorce” from the Slovak Republic. It provides an insight into how a deeply socially and territorially segmented tourism industry adapted to changes after 1989, the policies that were adopted and the results obtained.

4.2.1 Tourism in the Czech Socialist Republic

Pre-1989 Czechoslovakia was a federation of the Czech and Slovak Socialist Republics, within which tourism development was regulated at the national level (Table 4.2) As regards the Czech Socialist Republic, most commercial tourism establishments were controlled by the Ministry for Trade and Tourism, including

[223] *The World Factbook*, CIA Publications, 2005 (http://www.cia.gov/cia/publications/factbook/geos/ez.html)

the Čedok Travel Agency and the main hotel chains (six Interhotel chains). District councils controlled the Restaurace, district network of restaurants, pubs and hotels. The Jednota, national consumer cooperatives / associations, were another important player in the tourism sector. They had, and still have, shops in every municipality, as well as networks of restaurants and hotels in tourism areas.

Table 4.2 The tourism system in the Czech Socialist Republic

Funding body	**Tourist enterprises in Czech Socialist Republic**
Ministry of Trade and Tourism	*Čedok*, Travel Agency *Čedok Interhotel* (Praha, Karlovy Vary, Liberec, Brno, Ostrava, Krkonoše, Bratislava, Rušomberok, Tatry) hotels
Ministry of Health *	*Balnea*, Czechoslovak State Spas and Springs (Prague), spa, travel agency
Other ministries and central bodies*	Tourism units of the state-owned enterprises and organizations
District councils	*Restaurace*, hotels and restaurants District Tourist Enterprises, hotels, cable cars, information
National Sports Associations	*Sport-tourist*, travel agency
National Agriculture Cooperatives' Associations*	*Recreation office*, hotels
National Consumer Cooperatives Associations	*Rekrea*, travel agency (Prague) *Fednota*, shops and restaurants
Funding body	**Federal bodies** (for both Czech and Slovak Socialist Republics)
Socialist Youth Association	*CKM*, travel agency
Trade-Union Committee*	*Central Office for Recreation*, trade union owned hotels
SVAZARM ('Army Friends')	*Autotourist*, travel agency

Source: Kopso, E., 1985. *Economics of Tourism*

Note: * = non-commercial bodies providing services for their members or within the health, insurance framework.

There was a parallel network of non-commercial tourism establishments, of which there were three main types:

1. spas and similar establishments controlled by the national Ministries of Health;
2. trade union owned hotel chains;
3. tourism units established by almost every enterprise and state organization.

The non-commercial sector was designed to provide services for 'insiders' – trade union members, employees, or, in the case of the spas, individuals nominated by the health service. It is important to stress the scale of the non-commercial tourism sector. The number of beds in this sector matched those in the commercial one, and the quality of establishments varied from five-star hotels in Karlovy Vary spa or the High Tatras to wooden mountain chalets (Table 4.3)

Table 4.3 Capacities and performance in the Czech Socialist Republic tourism industry in 1989

	Number of establishments	**Beds**	**Visitors**	**Occupancy rates (%)**
Commercial sector	2,863	158,288	7,434,371	50.5
Spas	n.a.	34,781	459,593	88.7
Trade union hotels	75	10,621	519,818	84.7
Tourism units of non-tourism bodies	10,625	264,539	2,833,750	21.9

Source: Federal Statistical Office, *Statistical Yearbook of the CSSR for 1985-1992*, Prague

Note: Figures for the commercial sector, spas and trade-union hotels are for 1989; figures for non-tourist bodies are for 1985.

Although the non-commercial sector was fundamentally designed for domestic tourism, the trade unions had exchange schemes with their partners in state-socialist countries. Most of the major Czechoslovak enterprises also had their own tourism units on the shores of Lake Balaton in Hungary, or the Blak Sea coast in Bulgaria and Romania.

The tourism industry in the Czech Socialist Republic was typical of Central Europe, in that it handled large volumes of visitors and generated low income. In 1990, for example, the 46.6 million visitors generated only US$ 365.9 million of income in the accommodation sector, an average of only US$ 7.9 per visitor. The prices of accommodation and other services were centrally planned and there was neither the need nor scope for competition. The quality of service was generally poor and the large tourism potential of the country was underutilized in terms of tourism receipts.

After 1989, the new governments considered that tourism offered major development opportunities but that **privatization was a basic precondition for increasing sector's efficiency**. Before 1989 many hotels and restaurants had operating deficits, and the new regime was neither willing nor able to continue subsidizing them. Private ownership was expected to improve profitability in the tourism sector and generate international currency receipts which were a national economic priority. In addition, income from privatization would strengthen the state budget. There were also strategic reasons for tourism privatization: to promote a private sector and to create a new entrepreneur class. The tourism industry was ideal for this purpose, because of potentially strong demand conditions in that sector, and the relatively low prices of the units to be privatized.

4.2.2. Privatization and Tourism: Timetable and Methods

The Small Privatization program was based on Act 427/1990 ('the Small Privatization Act'). This project mainly applied during 1990-93 to operational units of state enterprises active in retailing, travel and catering services. The process was managed by regional privatization commissions and included sales and auctions. In total, 22,212 units, with a total opening bid value equivalent to US$ 725 million were sold for an aggregate price equivalent to US$ 1,077 billion, equivalent to 3.4% of GDP in current market prices in 1993. Foreign investors were officially excluded from bidding, but given the shortage of domestic capital, they are believed to have backed many domestic bidders. This is also supported by the fact that the average wage at that period in the Czech Republic was US$ 100 and that the price of even a medium sized hotel with 50 beds was US$ 500-700,000.

The Large Privatization program was based on the 'Large Privatization Act' 91/1991. SOEs, or parts of these, were transformed into joint-stock companies (JSCs), transferred to the National Property Fund (NPF) and, finally, privatized. By 1991, total assets equivalent to UD$ 54-58 billion (i.e. 125-133 % of the 1995 GDP in current market prices) had been selected for denationalization. 78% of these assets had been entered into the privatization process by the end of 1994. This involved the following steps:

1. compilation, by the relevant ministry[224], of a potential list of enterprises to be privatized, which required state approval;
2. submission of privatization projects by interested parties;
3. reviews of the projects by the relevant ministries and the Ministry or Privatization
4. approval of the projects by the Government or National Property Fund (NPF).

A number of different methods were used in the Large Privatization: public auction, public tender, capital market sales, direct sales, transfer free of charge (mainly to municipalities and restitution) and contributions to the property of joint-stock companies (including coupon privatization). A limited number of companies were sold directly to foreign investors. However, foreign investors were able to buy all, or significant portions, of the privatized property from their new owners. Some SOEs, or large shareholdings in such companies, have not been privatized and represent strategic state holdings by the NPF. Table 4.4 summarizes the extent of the Large Privatization program as of December 1995.

[224] In some cases called Ministry of Tourism or National Authority for Tourism

Not all SOEs were sold to new, individual owners. The transfers of state property to municipalities and restitution were expected eventually to account for US$ 16.5 billion of capital assets. There was also the process of mass privatization. In the First and Second Wave of Coupon Privatization, the shares of 1688 companies with a nominal value equivalent to US$ 11 billion were distributed. All citizens aged over 18 were authorized to buy a book of coupons, entitling them to 1,000 coupon points for a total cost equivalent to US$ 35. The coupons could not be exchanged for shares in the privatization of particular companies (Dlouhy and Mladek, 1994)[225].

Table 4.4 The Large Privatization in the Czech Republic from 1991 to 31 December 1995 by privatization methods

Method	Total units planned for privatization	Property value in US$ mil.	Units privatized by 31.12.1995	Property value in US$ mil.[c]
1. Property sales and restitution				
Auctions	911	0.3	762	0.3
Public bids	1,030	1,102.9	528	684.4
Direct sales	4,600	2,251.1	3,459	2,006.3
Free-of-charge transfers	3,427	1,557.3	2,939	1,076.0
Restitution[a]	467	19.8	409	16.0
Restitution with sales[b]	256	149.0	239	135.2
Total	10,751	5,351.3	8,336	4,171.6
2. Transfers from state-owned enterprises (SOE) to joint-stock companies (JSC) and between joint-stock companies				
From SOE to JSC	1,415	20,161.6	1,398	20,121.1
From JSC to JSC	309	8,080.5	306	8,185.7
Total	1,724	28,242.4	1,704	28,194.4
1. + 2. Total	12,475	33,593.8	10,040	32,366.1

Source: ČNFP, The Czech National Property Fund, in: Ekonom 19/1996, pp. 31-35

Notes: a = restitution free of charge; b = restitution free of charge plus payments for additional privatized property; c = the exchange rate on 31.12.1995 was 1US$ = 26.602 Kč

In 1995, the so called ‘Third Wave’ took place: large financial and industrial lobbies campaigned aggressively to persuade minor shareholders to sell their shares to the new majority group. These lobbies initially obtained minority stakes

225 Dlouhy, V. and Mladek, J., 1994. *Privatization and corporate control in the Czech Republic*, Economic Policy, Supplement, December 1994, pp. 155-170.

in the main investment privatization funds and via leveraging, effectively came to control a considerable part of the Czech economy (Williams and Balaz, 1999)[226].

By 1995, the private sector nominally accounted for about 70% of GDP and the Large Privatization program was essentially completed. In general, private companies outperformed SOEs, but the results varied according to the form of privatization (Williams and Balaz, 1999) and by sector. In addition, the results for the state sector are lower also because many basic industries, with financial problems, were not privatized.

Tourism was viewed as one of the priority sectors for privatization. A standardized privatization approach to the sector was not possible, given the variety of ownership forms involved. For example, *Fednota* - the consumer cooperative chains of restaurants and hotels – was recognized as a private sector body, exempted from privatization, and remained in cooperative ownership. The trade-unions also rejected attempts to privatize their hotels, which included some of the largest and best organized hotel chains. Non-profit associations (Socialist Youth and Agriculture Cooperatives) have been transformed but still retain most of their original property. However, the remainder of the tourist sector was included in privatization plans, but different sub-sectors were privatized at different times and by different methods:

- Enterprises controlled by the national Ministry of Trade and Tourism were transformed into state enterprises and, later, into state-owned, joint-stock companies. The removal of the central planning was seen as the first step in their privatization. The Čedok Interhotel enterprise was divided into six independent (Czech) Interhotel enterprises, which were further subdivided to the level of individual hotels. During 1991-1994 the hotels were included in the coupon privatization. The property of

[226] Williams, A.M., Balaz, V., 1999, *Privatization in Central Europe: Different legacies, methods and outcomes*, Environment and Planning C: Government and Policy

the Čedok Travel Agency, one of the largest travel agencies in Eastern Europe, was divided between the Czech and Slovak Republic. The Czech component was given the rights to the original trade mark, while the new Slovak organization emerged as Satur, plc. Both enterprises were sold via public offer.

- The *Restaurace* chain and the District Tourist Enterprises was mostly allocated to the Small Privatization program during 1991-1992, but many units were transferred to municipalities.
- Privatization of spas was closely linked to the privatization of health care, which was too challenging a project for the early years of the transition period. Most spas were privatized via the coupon method in 1992, but some units were sod through direct sales or scheduled for restitution. Selected health establishments specializing in health care for children and the treatment of particular diseases were retained in state ownership for social reasons.
- The transformation of the tourism units of the non-tourism enterprises had to wait for the privatization of the parent companies. Coupon privatization was used in the case of large industrial firms. The approaches of the new owners to the tourism units they had acquired along with their industrial units were diverse. Some divested and sold the tourist facilities, while others incorporated these into the new business structures. Unfortunately, there are no reliable statistics available on these units. However, most of them seem to have been transformed into commercial firms. The tourism units of the non-profit organizations in the public sector were also transformed into commercial units, but they still maintained the function of providing cheap holidays for the ‘insiders’, even if their markets were increasingly operating by free market rules.

Most tourism establishments were privatized within the Small Privatization and the Large Privatization programs. Each program had advantages and shortcomings. In the Small Privatization program the main method was public auction, with the outcome being determined almost only by bid prices. The Small Privatization program was a rapid means for effecting the transition from central planning to a market economy in the tourism industry.

In general, the results of the Small Privatization program were positive. The thousands of new owners significantly helped tourism development in the Czech Republic. They were flexible in responding to the increased demand from incoming tourism after 1989. However, there were also shortcomings in the process. Many bidders had little or no experience on the market economy. They took large privatization loans, guaranteed with the privatized property, and sometimes ended up paying inflated prices for these assets. Some of them entered in bankruptcy and the properties were acquired by the banks. The banks tried to resell them at the original valuation prices because rigid accountancy rules did not allow discounting to their real market values. As a result, many bank-owned tourism establishments remained closed for several years which lead to their deterioration.

Within the Large Privatization program 11 large hotels were included in the First Wave of coupon privatization, which offered stakes ranging from 40 - 90% of their estimated capital value. In 1994, the remaining stakes in six of these hotels were offered in the second wave of coupon privatization. The bank and the major privatization funds became major shareholders, but the state still retains major stakes in some instances. Spas were also included in the Large Privatization program, starting from 1992. There were 34 spas in the Czech Republic that after a rapid privatization process up to 1997, passed into the ownership of various plc and limited companies. Since 1993, free care in the spas started being provided for a very limited number of patients, while the state paid only the health care fees of most patients, with the individuals having to bear the costs of accommodation, food, etc. In contrast to the previous system, the patients were able to choose among different spas and facilities, which resulted in intense competition. This has also helped to improve the quality of services provided.

Privatization was the main precondition for establishing a market economy in a country where almost all the GDP had been generated in the public sector. In this process, the Czech Republic opted for the rapid road to transition. One of the challenges was that, in a country where the average monthly salary was just $ 110, the nationals lacked the capital to buy their own property, at market or book values. As massive sales to foreign groups were politically sensitive, a free of charge distribution to the population and to investors (through sales at substantial discounts) was implemented.

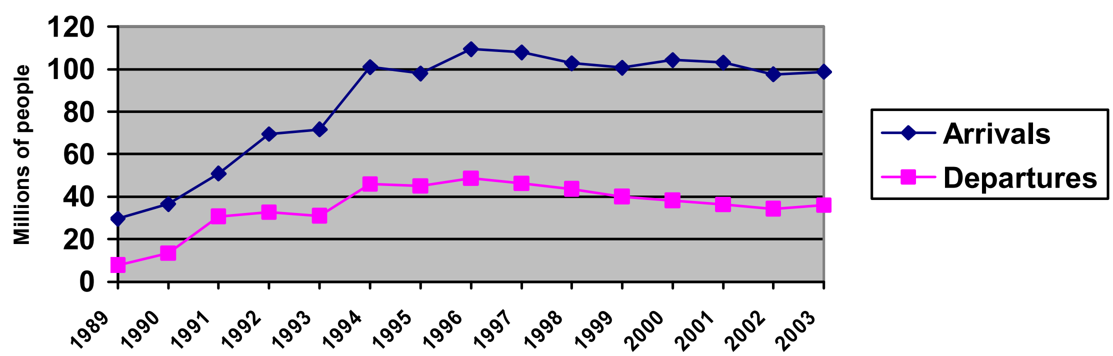
By 1997, privatization was in its final stages. About 80% of GDP was generated by the private sector and private enterprises seemed to have been a great contributor to the country's economic recovery. Tourism was one of the most privatized industries. Most establishments, particularly in the restaurant sector, were sold in public auctions within the Small Privatization Program. This privatization was transparent and fair. It also enabled a form of 'natural selection' of property owners under market conditions. Large hotels and spas were privatized via coupon privatization or via direct sales. The new domestic owners were not burdened with privatization debts and were able to use their capital for the reconstruction of the establishments.

4.2.3 Evolution of the Tourism industry in the Czech Republic after 1989

The tourism industry in the Czech Republic has grown very rapidly in the past fourteen years. Its development is demonstrated by the multitude of foreign tourists arriving in the Czech Republic and the number of their Czech counterparts traveling abroad.

Incoming and outgoing tourism. Almost 100 million visitors arrived in the Czech Republic in 2003, a 300% increase from 1989. The decline that occurred in 1995 was caused by introduction of a minimum obligatory amount of foreign currency that had to be exchanged by foreign tourists the equivalent of CZK 7,000[227]. A lower number of incoming tourists in 1997 has been attributed mainly to large floods which affected the Czech Republic in the third quarter of that year the period when the greatest drop in foreign arrivals occurred. However, experts say that another decline, which occurred in 1998, was not caused by a specific factor and may be due to wider implications and the overall situation within the Czech tourism industry (lacking infrastructure, poor quality of services, limited offer of regional tourism products, some negative phenomena of the Czech tourist industry, etc.).

Figure 4.1 Arrivals of foreign visitors and departures of Czech nationals for 1989-2003



Source: Czech Statistical Office

The number of foreign tourists (overnight visitors) increased in all regions of the country during 1989 - 2003, except for Prague. Prague's share of foreign tourists has declined steadily since 1996, in contrast with the increasing number of travelers who have visited other regions. A particularly high increase was

[227] Source: Ministry of Regional Development of the Czech Republic (http://www.mmr.cz/en/tourism/koncepce), June 2004

registered in East Bohemia during 1995 - 2003; in the same period the number of foreign tourists traveling to South Moravia somewhat declined (see Table 4.5).

The number of Czech tourists who visited foreign countries soared during the first years after the political changes of 1989. Another remarkable increase was registered in 1994. Since then, more than 40 million Czech tourists have traveled abroad every year.

Table 4.5: The number of foreign tourists* visiting Czech regions (millions of persons, %)

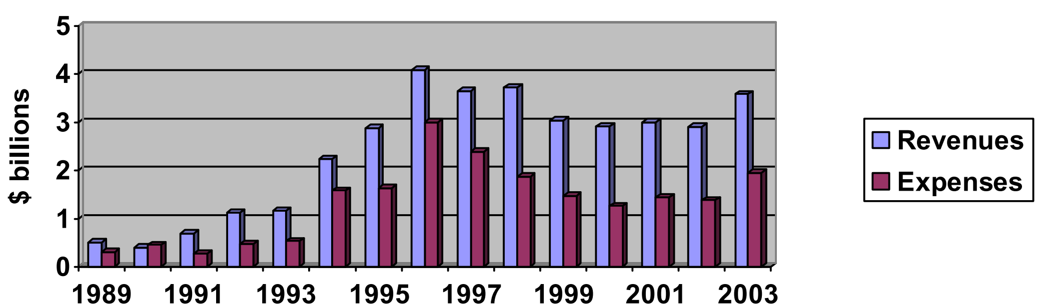
Region	1995		1999		2001		2003	
	Persons	%	Persons	%	Persons	%	Persons	%
Prague	1 538	46	2 168	47	2 252	45	2 075	37
Central Bohemia	163	5	220	5	275	6	338	6
South Bohemia	174	5	222	5	271	5	353	6
West Bohemia	355	10	446	10	508	10	539	10
North Bohemia	242	7	348	8	416	8	489	9
East Bohemia	305	9	493	11	533	11	719	13
South Moravia	381	11	405	9	436	9	559	10
North Moravia	223	5	256	5	284	6	491	9
Czech Republic	**3 381**	**100**	**4 558**	**100**	**4 975**	**100**	**5 563**	**100**

**) The figures include only foreign tourists who sought accommodation in hotels registered by the Czech Statistical Office. The actual number of incoming tourists may be higher.*

Source: Czech Statistical Office

Foreign currency revenues and expenditures. Growth of the Czech tourism industry is also reflected in foreign currency revenues and expenditures:

Figure 4.2 Foreign currency revenues and expenditures from incoming and outgoing tourism for 1989-2003



Source: Czech Statistical Office, Czech National Bank

In 2003, foreign currency revenues from tourism were more than seven times higher than in 1989. With the exception of 1997-1998, annual revenues grew more rapidly than the number of visitors, an obvious sign of a gradual improvement in the structure of incoming visitors, which changed from shopping trips to sightseeing and other types of tourism. In addition, the length of stay has increased as a result of this change. Between 1990 and 2003, the average period of a foreign tourist's stay in the Czech Republic increased by almost 25 percent from 3.4 days to 4.1 days.

In 1994 and 1996, tourism-related foreign currency expenditures grew considerably. The two increases were determined by changes in the calculation of the relevant indicators, in accordance with the methodology of the International Monetary Fund. The balance of tourism-related revenues and expenditures has always been positive, except in 1990.

Accommodation. During 1989 - 2003, the number of accommodation establishments increased almost four times and their capacity (number of beds) nearly doubled. Beds in hotels, motels, boatels and pensions amount to about one third of the accommodation capacity of the Czech Republic. Accommodation in private homes contributes about 7% to the total number of beds (this figure amounted to slightly above 4 % in 1989). Accommodation in most other establishments has a seasonal character. The Czech tourism industry relies on the accommodation base presented in Table 4.6.

During the transformation process, many holiday accommodation establishments for employees and workers' hotels have been transformed into commercial accommodation establishments. Some of them, however, are technically outdated and unable to provide accommodation services of adequate quality. This fact is illustrated by a low use of such establishments.

Table 4.6: Capacity of accommodation establishments in the Czech Republic

Type of establishment	**Number of establishments**		**Number of beds, place[1)]**		**Index**
	1989	2003	1989	2003	2003/1989
Total	**2 863**	**13 268**	**342 246**	**652 862**	**190.8**
hotels, motels, boatels	860	1 778	75 742	170 637	225.3
pensions/boarding houses	.	1 891	-	59 857	x
tourist dormitories	774	780	32 681	34 269	104.9
chalets, lodges/cabins	239	407	18 617	29 018	155.9
camps	411	462	161 098	161 457	100.2
inns	571	-	15 463	-	x
bungalows	8	-	296	-	x
other[2)]	-	2 367	23 532	150 744	x
individual accommodation	-	5 583	14 817	46 880	316.4

Notes:
1) Including places in open areas (in 2003 there were 148 947 such places).
2) "Other" includes for example spa hotels, holiday accommodation establishments for employees, training centers, and other accommodation establishments that reserve a certain part of their capacity for tourists (for example student dormitories, workers´ hotels, etc.).

Source: Czech Statistical Office

Domestic tourism. Following the change of regime in 1989, the tourism industry has undergone substantial changes. The government has stopped subsidizing measures supporting domestic tourism. Formerly offered by state-owned enterprises, employee recreational programs have been more or less abandoned. Holiday accommodation establishments for employees previously owned by trade unions have been transformed into the corporation OREA, a commercial entity that provides recreational and tourist services. Stays in spa resorts have also declined. Money spent by Czech citizens on tourism amount to only about 3-5% of their total expenditures, depending on the family income (Western Europeans spend approximately 13% of their money on travel).

Contribution of Tourism to the Development of the Czech Economy

b) Contribution to the balance of payments of the Czech Republic

Contribution to the balance of payments of the Czech Republic for the period 1993-1998:

Table 4.7: Balance of payments of the Czech Republic (USD million)

Parameter	1993	1994	1995	1996	1997	1998
Current account	-53,5	-744,8	-1 362,3	-4 291,6	-3 211	-1 046,1
of which - trade balance	-479,8	-1 339,2	-3 677,9	-5 877,3	-4 540,4	-2 580,7
- services balance	1 010,8	488,3	1 842,0	1 923,0	1 763,3	1 882,3
of which - tourism industry revenues	1 558,5	2 229,7	2 875,2	4 075,2	3 647,4	3 718,9
- tourism industry expenses	527,1	1 584,6	1 632,8	2 953,4	2 380,1	1 868,7
- tourism industry balance	1 031,4	645,1	1 242,4	1 121,8	1 267,3	1 850,2
Balance of payments/service balance (%)	102,0	132,1	67,4	58,3	71,9	98,3

Source: Czech National Bank

The foreign currency balance of the Czech tourism industry has stayed in the positive range permanently since 1991. Until 1994, it was effectively offsetting the trade deficit. The high proportion of services in the balance of payments of the Czech Republic is another factor demonstrating the economic importance of the tourism industry. According to WTO data from 1996, tourism industry revenues amounted to 53% of the balance of services in Central and Eastern European countries, whereas in the European Union this figure reached only 31.3% on average. In the Czech Republic, tourism industry revenues totaled 58.3% of the country's balance of payments in 1996 and 98.3% in 1999.

c) *Contribution to public budgets*

In addition to contributing a significant amount of foreign currency revenues to the balance of payments, the Czech tourism industry represents a substantial source of income for the national budget. The value added tax is the most important item in this regard. In 2003, CZK 117.6 billion (USD 3.1 billion) in VAT and CZK 55 billion (USD 1.44 billion) in corporate income tax was collected. Estimates show that the share of the tourism industry, including catering and accommodation establishments whose services are subject to 22% VAT, totaled about 4%, i.e. approximately CZK 7 billion (USD 183.6 million). Additional tax revenues come from tourists' purchases of goods and services.

Municipal revenues, excluding government subsidies, totaled CZK 109.5 billion (USD 2.9 bill) in 2003. Of this amount, CZK 15.9 billion (USD 417 million) was income tax collected from individuals, CZK 38.6 billion (USD 1.2 billion) income tax collected from employees, and CZK 3.9 billion (USD 102.2 million) property taxes. Based on the importance of tourism for the economy, tax revenues from tourism businesses can be estimated to total at least 3%, that is CZK 3-3.5 billion (USD 82.2 million). In addition, municipalities collected an estimated CZK 130-150 million (USD 3.7 million) in fees (fees for hotel beds, overnight stay, use of public areas, etc.).

d) Contribution to exports and the gross domestic product

Development of foreign currency revenues from incoming and outgoing tourism and the relation to the volume of exports and the gross domestic product of the Czech Republic for the period 1993-1998:

Table 4.8 Contribution of tourism industry foreign currency revenues to exports and GDP in the Czech Republic

Year	**Tourism industry foreign currency revenues**	**Volume of exports**	**GDP**	**Tourism industry foreign currency revenues contribution to:**	
	CZK million	***CZK million***	***CZK billion***	***exports***	***GDP***
1993	45 437	414 833	1 002,3	11,0	5,0
1994	64 170	458 437	1 148,6	14,0	5,6
1995	76 301	569 549	1 348,7	13,4	5,7
1996	110 620	588 792	1 532,6	18,8	7,3
1997	115 700	722 501	1 649,5	16,0	7,0
1998	120 000	850 530	1 776,7	14,1	6,8

Source: Czech National Bank, Czech Statistical Office

These figures show that the tourism industry is a very important 'export' sector. Its significance is enhanced by the fact that a substantial proportion of these 'exports' are services and that tourism-related payments are made in cash, involving no risk of late payment. In 1998, foreign currency revenues from the tourism industry contributed more than 14% to total exports of the Czech Republic (tourism products are essentially the third largest commodity).

In 1989, the tourism industry contributed 1.3% to the Czech gross domestic product. In 1997 taking into account contributions to the country's balance of payments and budgets at all levels, and tourist autonomous demand for goods and services, the tourism industry earned a minimum of CZK 150 billion (USD 4 billion). It is estimated that the tourism industry has been generating 9-11% of the GDP. In 1999, the tourism industry's earnings were expected to be about the same. A more accurate estimate is impossible because of the lack of detailed information about the contribution to public budgets and the average amount of money spent by foreign tourists in the Czech Republic.

e) Employment

Since 1990, employment in the Czech Republic has declined by almost 8%, which means that about 400,000 jobs have been lost. Structural economic changes have resulted in a different sectorial structure of employment. The importance of the tertiary sector has increased considerably. While the tertiary sector provided 42.8% of all jobs in 1990, this figure grew to 54% in 2003 thanks to the creation of about 344,000 new jobs. Growth within the services sector has made it possible to absorb a large number of employees laid off by the primary and secondary sectors. Although it is problematical to estimate the number of jobs created by the tourism industry, it can be assumed based on international experience (an OECD study based on ILO documentation shows that direct employment in the tourism industry equals about a half of induced employment) that tourism provides, directly or indirectly, jobs for 480-500,000 people in the Czech Republic. Hence, the tourism industry contributes 9-10% to total employment.

4.2.4 Present Position of the Czech Tourism Industry

The Czech Republic has remained attractive to tourists as it was able to pass adequate laws and create a favorable business climate. In addition to effective promotion, the key prerequisites for further growth of the Czech tourism industry are implementation of a good tourist information system, compiling of statistics as a marketing information source, development of travel infrastructure, professional education, and support for creation of new local travel products. In this regard, the Government clearly formulated a positive policy that views the tourism industry as a generally recognized and effective economic sector, which provides a significant number of jobs and acts as an important factor of regional development. In this respect, the Government took into account the strengths and weaknesses of the Czech tourism industry. In addition, a close attention has been paid to opportunities and threats in this area.

It will be important to use effectively the membership of the Czech Republic to the EU and its professional institutions and associations in international travel organizations, such as WTO, WTTC, OECD, CEI, European Travel Commission, UFTAA, ASTA, IHA, CEN, Eurogites, and others.

Strengths

- Advantageous geographical position of the Czech Republic (center of Europe, morphology, altitude, climatic conditions).
- Wealth of cultural, historical and technical monuments; numerous cultural and folkloric events; traditional spas/ health treatment; attractive nature (protected regions and national parks); sports establishments and facilities; Prague a tourist phenomenon of world importance.
- A dense and well-marked network of hiking trails throughout the country.
- Sufficient accommodation capacity (not always offering the necessary quality).
- Flexible workforce.

Weaknesses

- Poor quality of basic and supplementary tourist services.
- Absence of marketing studies for development of potential tourist regions.

- Poor promotion of the country and its regions abroad, poor promotion of regions at the national level.
- Insufficient tourism industry infrastructure (poor information system, transport, communications, etc.).
- High demand for skilled personnel.

Opportunities

- Strengthening of the position of the Czech tourism industry in the world, on the European travel market in particular, both in general and through products designed for specific groups of tourists.
- Expansion of cooperation of border regions and other areas and local communities and their counterparts outside the Czech Republic.
- Development of modern travel products (rural and environmental tourism, congress tourism, incentive tourism, cultural tourism, cyclotourism, etc.), including attractive accompanying programs tailored to the needs and specifics of individual regions.
- Using the Rural Regeneration Program for development of tourism in regions.
- Preparation of the tourism industry for subsidies from EU structural funds.

Threats

- Underestimating of the importance of a firm legislative framework for business activity and quality of services.
- Lack of capital necessary for stabilization and development of tourism industry businesses.
- Underestimating of the importance of cooperation between the central government, local self-governments, regional development agencies, regional tourism associations, and professional tourism industry associations.
- Underestimating of the tourism industry's importance for development of small and medium-sized businesses and job creation in regions.

- Underestimating of the human factor and professional training of tourism industry specialists, including consulting and educational services for newcomers to the sector (adult education).

An assessment of strengths and weaknesses as well as opportunities and threats exposes the following **priorities of future** development of the Czech tourism industry:

- better visibility of the Czech Republic on the international tourism market and development of new products for tourists from source countries;
- development of the domestic tourism industry and improvement of its competitiveness;
- improvement of the quality of tourism services;
- improvement of the range and quality of basic and supplementary tourism services;
- development of regional tourism products;
- creation of a favorable business climate;
- training of human resources;
- better consumer protection and safety.

For further growth of the Czech tourism industry it is necessary to define existing problems and propose adequate solutions.

4.2.5 National Strategy for the Development of the Czech Tourism Industry

Problems have been identified and solutions have been proposed and implemented as part of the National Strategy for the future development of the Czech Tourism Industry. They are presented below.

National Strategy for the Public Tourism Sector

Problem 1. Insufficient government-sponsored international publicity and information about the Czech Republic

Current promotional activities, through which the Czech government tried to attract foreign tourists to the Czech Republic, were insufficient, mainly due to the following factors:

- absence of systematic marketing;
- lacking territorial coverage (insufficient promotion in such lucrative areas as North America, Asia, and Northern Europe);
- insufficient number of information centers in foreign countries;
- lack of systematic promotional materials about the Czech Republic and its regions;
- narrow range of special products for specific groups of foreign tourists;
- limited funds.

Measures: Starting in 1999, the Czech Tourist Authority shifted its primary focus on expansion and improvement of government-sponsored international publicity and information about the Czech Republic. Funding for these activities has been increased.

Problem 2. Absence of a tourism development strategy in most regions

Although almost 80% of Czech territory is suitable for recreational use, there was no consistent concept of regional tourism development. The Czech Republic has a number of cultural, technical and historical monuments including UNESCO-protected heritage sites and a host of attractive nature sites (protected regions, national parks with rare fauna and flora, ponds, lakes, karsts, etc.). Dispersed throughout the country, specific cultural and folkloric features have a great potential to attract visitors. The Czech Republic has a dense and well-marked network of interconnected hiking trails that are kept in good condition by the Czech Tourist Club. The groundwork for a system of biking trails is being developed. Rooted firmly in a long historical tradition, Czech spas are well known throughout the world (Karlovy Vary). In addition to that, the Czech Republic has a unique chance to become a prominent player on the travel market by focusing on such new areas as congress and incentive tourism, sports and cycling tourism, and cultural and rural tourism. However, even though ideal conditions for such activities exist, the opportunities remain largely unused for various reasons, including the fact that almost 70% of foreign visitors concentrate on the city of Prague. Unfortunately, these conditions persist despite the fact that tourism has a very positive impact on regional development.

Table 4.9 Capacity of tourist accommodation establishments according to zones as of July 31, 1998

	Number of establishments	Number of rooms	Number of beds	Structure of beds, %
Total	13 268	185 121	503 915	100.0
urban and cultural heritage tourism	2 573	61 845	150 259	29.8
spa / health treatment tourism	675	19 468	43 172	8.6
tourism near rivers and lakes	1 938	20 303	67 140	13.3
mountain tourism	3 882	39 574	122 345	24.3
unspecified	4 200	43 931	120 999	24.0

Source: Czech Statistical Office

Development of a comprehensive strategy required an assessment of strengths and weaknesses of individual tourist regions as well as an analysis of opportunities and risks. Marketing studies on which the assessment was based defined individual tourist regions. Such an approach is important for development and implementation of various tourism products and/or for finding products that are optimal for a given territory. This strategy was based on the **Phare 1999** cross-border cooperation program, which foresees the establishment of regional funds that were managed by Regional Management Committees and used to support development of individual Euroregions as far as technical infrastructure, tourism, and countryside regeneration. In addition, the funds support "people to people" projects.

Since 1999, the Czech Republic has received funding for development of travel services from the SAPARD fund. This assistance was used to co-finance the Rural Development Program, which comprises development of rural tourism, hiking and biking trails traditional crafts, local specialties, activities of rural clubs and associations, and reconstruction and repair of historical monuments in villages and rural areas. Starting in 1999, there are a number of other opportunities under the Northwest Bohemia and North Moravia Regional Development Support Program and under a pilot development program in the Hans and Jesensky micro-regions funded from the national budget with the aim to improve tourism-related infrastructure (information system, transport infrastructure, hiking and biking trails, etc.).

The regional tourism strategy also embraces a new approach to the planning of regional development, in accordance with the applicable methodology of the European Union. Regional development planning is closely tied with the Regional Development Plan, sectorial operations plans, and regional operations plans. The regional tourism development strategy has been an important basis for creation of regional operations plans.

Measures: Based on the deadlines set forth in the Regional Development Strategy of the Czech Republic, the methodology of regional tourism development in the Czech Republic were created as a basis for development of individual regions. Based on the timetable of preparation of the Regional Development Plan (RDP) of the Czech Republic, the sectorial operations plan (SOP) for tourism has been transformed into regional operations plans (ROP).

Problem 3. Unclear jurisdiction concerning tourism

Development of regional tourism products had to be firmly anchored in the Czech regional policy. In addition, the roles of the Ministry for Regional Development, the Czech Tourist Authority, and regional authorities had to change. A new approach was brought by an upcoming public administration reform, which defined in detail the jurisdiction and role of newly created higher territorial self-governing units.

The Ministry for Regional Development supervised implementation of the regional policy, including definition of tourism industry objectives and needs in the context of the Regional Development Plan. Consequently, these objectives and needs were transformed through regional operations plans into actual tourism products in individual regions.

Hence, the Ministry for Regional Development had to be responsible for the tourism development strategy. The strategy contained the following:

- legislative framework,
- definition of priorities and development program.

Definition of priorities included description of tourism development products (e.g. cultural tourism, spas, rural tourism, etc.). To support implementation of individual programs, the Ministry for Regional Development granted subsidies and provided methodological assistance to regional authorities.

As regards the determining of priorities, the Ministry for Regional Development relied on analyses and concept materials prepared by regional bodies. Additional information was provided through marketing studies conducted by the Czech Tourist Authority with the aim to define tourist products in individual regions, including nature sites and new products such as the Heritage Trail, environmental tourism, agro tourism, cyclo tourims, etc.

On the regional level, the key role in implementation of priorities and development projects was played by:

- the Czech Tourist Authority (methodological assistance with implementation of various products, promotion, etc.);
- regional development agencies;
- professional tourism industry associations.

Regional authorities directly cooperated with the Ministry for Regional Development on such matters as allocation of government subsidies, methodological assistance for agencies and associations, etc. At the same time, regional authorities monitored implementation of the national tourism policy in their respective territories, overseeing flow of budget funds as well as implementation of capital expenditures and other projects that were financed from the Fund for Support of Development of Tourism, etc.

This system of project implementation made it possible to secure, sufficiently in advance, thorough preparation for cooperation within EU, using support provided by pre-structural and structural funds.

Measures: Within the context of the upcoming reform of public administration, the jurisdiction of the public administration and regional authorities including the planned higher self-governing administrative units concerning tourism were clarified.

Problem 4. Absence of a standard tourist information system

A total of 265 tourist information centers are registered in the Czech Republic. However, they do not form a homogeneous network and are very dissimilar in terms of organization, status and technical resources. Information centers are run by municipalities, district councils, scientific libraries, museums, private travel agencies and civic associations. About 90 information centers are members of the Association of Tourist Information Centers (ATIC). The present situation can be characterized as follows:

- existence of several separately operated tourist information systems incompatible with each other;
- absence of a national register offering tourism products and linked with international information networks;
- absence of a standard for services provided by the tourist information centers;

- minimal interconnection of tourist information systems with regional information systems and other tourism-related information systems;
- varying density and quality of direction signs in cities and villages.

Measure: Starting in 1999, coordinated development of a standard tourist information system was secured.

Problem 5. Inconclusive statistics

Tourism statistics in EU countries are compiled in accordance with Directive 95/57/EC, adopted on November 32, 1995 as a basic document defining collection of tourism-related statistical information. The Directive had not been fully implemented in the Czech Republic. Statistics did not provide sufficient information for strategic planning of tourism development; the same applied to regional planning and marketing.

Conclusive statistics were necessary for ensuring conformity with the EU legal system in the context of the Czech Republic's membership to the European Union (2004) and for measuring the size and development of the tourism industry as such. The satellite account system clearly determines the effect of the tourism industry on other branches of the national economy. In addition, it transparently shows the key benefits of tourism for employment, GDP, national and local budgets, and autonomous tourists' demand, which generates transfer of capital between regions.

Measures: A tourism industry satellite account (EC Council Directive 95/57/EC on collection of tourism-related statistical information) has been opened and tourism-related activities were reclassified.

Problem 6. Lacking cooperation between institutions that have indirect effect on tourism

Being in the jurisdiction of the Ministry for Regional Development, development of tourism is closely linked with regional development and European integration. However, the Czech tourism industry was affected by numerous factors that are outside Regional Development Ministry's control. These issues involved transport, environmental protection, heritage protection, business support, the Trades Act, education, rescue and mountain rescue services, safety, consular and visa administration, health and welfare, etc. Cooperation with other ministries had taken place mostly on an ad-hoc basis, lacking a systematic approach.

Cooperation with professional tourism industry associations and various social institutions was secured by the Regional Development Ministry's Tourism Advisory Staff, which consists of representatives of professional associations, parliamentary deputies, and officials from local self-governments.

Measures: An inter-ministerial tourism commission an advisory body of the Ministry for Regional Development was established in September 1999.

National Strategy for the Private Tourism Sector

Problem 1. Excessive value added tax on tourism-related services

Up to 1999, the rate of the value added tax (VAT) on tourism-related services was very high, considerably hindering investments into the tourism industry. In addition, there was a difference between the tax rate that applies to the input and output of the hotels and restaurants industry. The high VAT rate was considered to be a potential destabilizing factor in the tourism industry.

On February 8, 1999, the Government approved a proposal made by Ministry for Regional Development to reduce the VAT on hotel and restaurant services from 22% to 5%. In mid-June, the Government approved a paragraphed version of a draft amending the Value Added Tax Act. Due to the fact that the amendment failed to pass through the Parliament, however, the problem remains unresolved.

Measure: The Value Added Tax Act (588/1992) was amended, including a reduction of the rate of value added tax on hotel and restaurant services.

Problem 2. Deficient tax collection system

According to the current laws, corporate and individual income tax is paid to local authorities according to the business address or domicile. However, many corporations and entrepreneurs conduct business in other areas, which means that tax revenues are not paid in localities that bear the burden of their business activity. This structure discourages regions from investing into tourism-related infrastructure.

The taxation system should be sensitively modified, to ensure direct link between entrepreneurs and the communities where their businesses are located. This principle is important for development of technical infrastructure and business support in regions. Hence, the planned reform of public administration has to ensure development of tourism-related infrastructure and define the relationship between the public and private sectors.

Due to the fact that the proposed changes would involve substantial changes in the current taxation system, it may be useful to consider increasing taxes and fees levied by local authorities. This process would allow restructuring taxes, increasing revenues of local budgets.

The Government took the first step in this direction on May 10, 1999 by approving a draft of the Municipal Taxes Act; the draft eliminates local fees, introducing municipal taxes instead.

Measures: The planned tax reform will include a proposal involving direct allocation of taxes to areas where they are generated (restructuring of taxes and increase of tax revenues of local budgets).

Problem 3. Illegal business practices in the tourism industry

Illegal practices in the Czech Republic are pursued by both Czech and foreign nationals. Consisting of transfers using foreign buses, activities of foreign representatives, rental of private apartments, and guide services provided by foreign nationals, illegal practices involve considerable tax evasion. Although current laws provide solid grounds for prosecution of illegal business practices, they are used in an insufficient and ineffective manner.

Measure: Starting in 1999, travel-related business activity was subjected to stricter control.

Problem 4. Quality of guide services

During 1991 - 1995, guide services were regulated by the Trades Act, under which they were included in the category of licensed trades. In the beginning of 1996, guide services were excluded from the control exercised under the Trades Act, a change that has provided an opportunity for unskilled and unreliable guides.

The current quality of guide services shows that deregulation in this area (now classified as a free trade) was not a fortunate move. Reintroduction of guide services among licensed trades and of compulsory examinations (as specified in the Trades Act amendment submitted to the Parliament) will improve professionalism of travel guides, imposing stricter conditions especially on foreign guides who work in the Czech Republic.

Measure: Guide services need to be classified as a licensed trade in the Trades Act.

Problem 5. Food services

Excessive requirements for professional qualifications of food industry workers are an impediment to the development of rural and agro tourism, which mostly has the form of accommodation in private houses (rental of rooms on farms, in family homes, holiday establishments, chalets, cabins etc.). Consequently, considerable capacities are left unused (the accommodation capacity of such facilities usually ranges between eight and ten beds). In most such cases, food services involved the serving of breakfast. The amended legislation stated that accommodation in private houses and facilities with up to ten beds included the serving of breakfast - an unregulated trade with no requirements for professional qualifications - in order to legalize a service viewed as an integral part of accommodation services.

Outside the Czech Republic, accommodation on farms and the serving of breakfast was normally not subject to the trades legislation. For example, in Germany establishments with up to eight beds and in Austria with up to ten rooms are exempt.

Measures: Amendment to Government Regulation 28/1998 Coll., which defines manual trades, included a statement that the serving of breakfast was not considered to be a food service in the case of accommodation in private homes, on farms, etc. with up to ten beds.

Problem 6. Insufficient and uneven quality of professional education

Professional education and skills of graduates from secondary schools, colleges and universities did not fully meet the needs of the tourism industry. This situation was mainly due to an increase in the number of secondary schools after 1989. Despite the fact that most of them have focused on commerce, including tourism, there were large differences in the quality of education provided by individual schools. To remedy the situation, the Ministry of Education, Youth and Sport drafted the "Standard of Secondary Education for the Tourism industry" and the "Standard for Professional Education Provided by Hotel and Restaurant

Schools". Put into practice in the 1998/1999 school year, the standards outline minimum requirements for tourism-related education.

In a like manner, inadequate attention was paid to adult education. Being in the jurisdiction of multiple institutions, the system was poorly coordinated and overly complicated as far as training and counseling for prospective and actual tourism industry entrepreneurs and their employees (poor re-qualification, specialization, education, etc.). This situation was reflected in a low quality of services within the tourism industry.

These issues were addressed in the "National Employment Plan" in the "Employment Support" section, which recommended the following measures:

- a reform of secondary education in terms of management, financing, optimization of the network of schools, and involvement of employers in the educational process with the aim to achieve an optimal balance between graduates' qualifications and the needs of the labor market;
- introduction of a modular adult education system, built on the school system. This measure would ensure greater flexibility of workforce on the changing labor market, acting as an effective factor of unemployment prevention.

Measures: Starting in 1999, qualifications and skills of graduates from tourism-related secondary schools, colleges and universities was improved in a comprehensive manner and on an ongoing basis. In addition, close attention was paid to tourism-related adult education.

Consumers

Problem 1. Consumer protection in the tourism industry

In July 1999, the Act No.159/99 on Some Conditions of Business Operation in the Tourism Industry and on the revision of the Act. No. 40/1964 of the Civil Code in the wording of ensuing regulations and of the Act no. 455/1991 on business operations (the Act on small businesses) in the wording of ensuing regulations came into effect. The legislation was tabled jointly by the Ministry for Regional Development and the Ministry of Justice with the aim:

- to improve consumer protection in the area of outgoing tourism and secure repatriation of clients of insolvent travel agencies to the Czech Republic;
- to improve consumer protection against bankruptcies of travel agencies and secure refund of money paid for services not rendered;
- to secure a contractual definition of the rights and duties of travel agencies and their clients in respect of tourism-related services;
- to set firm business conditions for the tourism industry, a sector which has a strong impact on the international reputation of the Czech Republic;
- to harmonize consumer protection with justified interests of tourism industry businesses, taking into account the current economic conditions in the Czech Republic;
- to respect the conditions for harmonization of laws of the Czech Republic with those of the European Union in accordance with Directive 90/314/EEC dated June 13, 1990, which defines tourism-related services. (On February 4, 1999, bilateral talks took place in Brussels, as part of the screening process, during which representatives of the EU Commission agreed with the draft of the above mentioned Act).

Problem 2. Standardization of accommodation services

The recommended standard of accommodation services had to be defined in detail. Already completed, the recommended standard started to be implemented and compliance therewith monitored on the basis of an agreement with professional associations, since December 1999.

4.2.6 Results - Conclusions

The tourism industry has proved to be a valuable factor of the economic transformation that started in 1989. Among other effects, its dynamic development has allowed:

- the tertiary sector to absorb a significant proportion of people laid off by the primary and secondary sectors, significantly reducing unemployment;
- until 1994 to offset the trade deficit due to foreign currency revenues generated by the tourism industry;
- to significantly contribute to creation of the gross domestic product.

The dynamic development of the tourism industry has relied on the attractiveness of Czech tourist centers on one hand, and on the specific circumstances that followed the fall of the Iron Curtain and the opening of East European borders to Westerners on the other. Foreign tourists were initially more interested in discovering a new, hitherto unknown tourist destination than in the quality of services.

Having secured extensive growth in the first fifteen years of transition in the Czech Republic, these factors have been exhausted. The Czech Republic has joined the ranks of standard tourist destinations. Among other indicators, this is suggested by unfavorable developments of incoming tourism in 1997 and 1998, when the number of foreign tourists and foreign currency revenues declined for the first time since 1993. These developments cannot be ascribed only to bad climatic conditions (floods, lack of snow, etc.). The causes of reduced interest in traveling to the Czech Republic and consequently also the causes of a decline in the foreign currency revenues in this important economic sector are much more complex, mostly due to the underestimating of the role of the public sector and the overestimating of the private sector's ability to ensure development of the tourism industry. These unfavorable developments are somewhat due to a lack of a systematic approach, as the tourism industry is highly dependent on innovation, quality of services, and creation of new interesting products. In addition, the tourism industry requires good consumer protection.

The present Concept of the Tourism Policy of the Czech Republic is an open document that will be further developed and updated to accommodate all tourism-related issues. In this regard, there will be extensive talks involving government authorities, various associations and tourism industry professionals. Individual measures will initially be discussed with the Advisory Staff of the Ministry for Regional Development, the interdepartmental tourism commission, and the applicable subcommittees of the Czech Parliament. Teams of experts will be set up to deal with specific problems. Implementation of the Czech tourism policy will include an educational campaign (seminars, workshops, etc.) organized in cooperation with tourism industry professionals.

4.3 The Polish Tourism Industry

Brief Country History and Data:

Poland is an ancient nation that was conceived around the middle of the 10th century. Its golden age occurred in the 16th century. During the following century, the strengthening of the gentry and internal disorders weakened the nation. In a series of agreements between 1772 and 1795, Russia, Prussia, and Austria partitioned Poland amongst themselves. Poland regained its independence in 1918 only to be overrun by Germany and the Soviet Union in World War II. It became a Soviet satellite state following the war, but its government was comparatively tolerant and progressive. Labor turmoil in 1980 led to the formation of the independent trade union "Solidarity" that over

Map of Poland

time became a political force and by 1990 had swept parliamentary elections and the presidency. A "shock therapy" program during the early 1990s enabled the country to transform its economy into one of the most robust in Central Europe. Solidarity suffered a major defeat in the 2001 parliamentary elections when it failed to elect a single deputy to the lower house of Parliament, and the new leaders of the Solidarity Trade Union subsequently pledged to reduce the Trade Union's political role. Poland joined NATO in 1999 and the European Union in 2004.[228]

Population (in 2000): 38.6 million
GDP/capita (in 2000): $ 4.153

4.3.1 Economic Aspects of Sustainable Development in the Polish Tourism

Studies, prepared at the request of the Polish Office for Sports and Tourism and financed by PHARE funds, were used to prepare the Strategy for the Development of the National Tourist Product. The strategy shows Poland's main tourist potential, and divides it into five categories:

- cross-border and transit tourism,
- group recreational holidays (chiefly in the mountains and the Mazury region),
- business travel,
- culture and urban tourism (Cracow, Gdansk, Warsaw)
- tourism in the countryside.

The country monitored the quality in each of these categories to protect the tourism sector.

The state guaranteed preferential treatment for the tourism sector: agencies organizing trips abroad for Poles had to pay only 7-percent VAT, and incoming tourism organizers are zero-rated. The development of modern tourist facilities,

[228] *The World Factbook*, CIA Publications, 2005 (http://www.cia.gov/cia/publications/factbook/geos/pl.html)

though, requires incentives for investment and preferential loans (money invested in the construction of a hotel yields a profit within 10-12 years). The state policy must stimulate the tourism market.

In the strategy for development of tourism, the need for medium class hotels was emphasized. Land prices were reviewed (and lowered) to encourage development (in 1992, land in Warsaw was more expensive than in Manhattan). Only five-star hotels could afford such high prices. In many countries, local authorities offer lower-priced land to hotel investment projects, but the reverse was true in Poland. Here, when a construction project was planned, local authorities consider it a gold mine. Local taxes on land and hotel real estate were lowered, encouraging investors. Authorities took into account the fact that investors offered jobs and stimulated the market.

Poland has many beautifully located health resorts with therapeutic waters, but the quality of accommodations there had to be improved; in some cases completely new facilities were built in order to attract guests.

About 4,000 farms accept tourists, and the Polish Rural Tourism Federation Gospodarstwa Goscinne (Host Farms), a union of 2,500 agrotourism farms, has prepared a catalog of reliable service providers. Approved host houses will display a board with a sun on it. This is the cheapest form of recreation for those who want to enjoy nature in peace and quiet.

Promising niches in the tourism industry include foreign camps for young people and domestic specialist events, including events for bird watchers and narrow-gauge rail line enthusiasts.

The WTO forecasts that tourism will grow 4.5 percent annually until 2020. The Polish Institute of Tourism estimates that if Poland's gross domestic product grows at a rate of 5.4 percent annually through 2010, and if consumption grows

3.8 percent a year, the demand for tourist services may increase 4 percent annually. By 2014, 70 percent of Poles will buy at least one overnight vacation.

The guidelines for tourism policy planning for the new phase of the tourism industry are outlined in the Strategy for Tourism Development 2001 – 2006. The main aims are to improve:

- the Polish tourist offer on domestic and international markets
- the volume of overseas tourist expenses up to $ 8.6 bill in 2006
- Poland's overall image as a tourism destination worldwide
- the volume of domestic tourism up to 122 million per year
- tourism infrastructure
- the employment in tourism in tourist attractive border areas
- cultural tourism in Poland, based on its rich heritage.

If the range of destinations within Poland becomes more visible on the market and if cheaper accommodations are available in hotels with suites and bungalows, Polish tourists will tend to spend their vacations in Poland, instead of going to other popular destinations. Forecasts suggest that Polish hoteliers catering to foreigners and agencies offering trips abroad will have more clients. However, the development of tourism in Poland will be determined primarily by government policies, rather than the activities of local communities. Authorities need to take steps to keep up with it.

The Polish governmental bodies responsible for tourism are:

- Office of Physical Culture and Tourism – national level
- Ministry of Agriculture and Country Development, Department of Social Affairs and Education – national level
- Departments of Physical Culture and Tourism in the Provincial Administration Offices – regional and municipal levels.

The decision-making legislation and regulations main acts adopted after 1989 for restructuring the tourism industry were: the Act on Natural Protection (16 October 1991) and the Act on Spatial Management (1 July 1994).

Within this legislative framework, the Master Plan for Tourism in country and forest areas was elaborated within PHARE – TOURIN II Programme.
The defining policy and strategy of tourism development were elaborated by the Office of Physical Culture and Tourism in the following areas:

- Basic Programme for Tourist Economy Development (19 September 1994) provides guidelines for environment friendly tourism, adjustment at tourism use to nature and landscape assets and their protection;
- Tourism and Tourism Management Development in the State Spatial Management Policy, outlines the State Spatial Management related to environmentally friendly domestic tourism, domestic tourism product and tourist infrastructure,
- Development Strategy of Domestic Tourism Product contains development of the following trade mark products: business tourism, active and oriented tourism, urban and culture tourism, agro-tourism, transit and border tourism.

Main goals of tourism management development were the following:

- raising the economy level of municipalities and regions in order to improve the economical status of the society,
- supporting activities aiming at sustainable state of economy development,
- promoting tourism development as the unemployment reduction,
- creating new job places and increasing motivation to start professional work,
- rural areas economic mobilization,
- supporting country and surroundings infrastructure changes.

The major groups involved in the decision-making process in tourism include:

- Governmental Institute of Tourism
- Tourist Sector
- Tourist-hotel Professional Schools
- Polish Federation of Agro-Tourist Hosting Farms
- Regional Tourist Federations
- Local Agro-Tourist Associations, e.g.: Agro-tourist Association "Chata" in Beskid Mountain Region

4.3.2 Tourism Development in Poland Supported by the EU

Within the framework of an EU-PHARE Program, the Strategy for Development of the National Tourist Product was developed on behalf of the Polish Tourism Industry (Robinson A., Bobinski C., 1994)[229]. The proposed strategy is based on three elements:

- creation of a state-of-the-art national tourism organization;
- development of marketable "tourist brands";
- and the early creation of a Polish Tourism Investment Fund.

All three institutions were designed to help creating better conditions for tourism investments in Poland. The financial agreements allotted to Poland the amount of €12.5 mil.

The European aid program in tourism, called TOURIN, was divided into several phases, namely: TOURIN I which was commenced in 1993 and terminated in 1996, TOURIN II which began in 1995 and finished at the end of 1997. The next phase - TOURIN III - started in 1997 with the separate budget of € 6 mil. TOURIN I contributed to institutional strengthening of tourism sector, training courses in different fields organized for the branch as well as marketing and promotion of

[229] Robinson, A., Bobinski, C., 1994. Cleared for Take-off, Financial Time Survey Poland, The Financial Times, p. 1

incoming tourism to Poland on the German and British markets. TOURIN II comprised the following projects:

a) The assistance for road users

An increasing number of tourists traveling by car should have an opportunity to use a well operating road assistance in case they need it. The existing level of road assistance service in Poland is not satisfactory. It is limited only to technical assistance and it does not comprise other services such as tourist information and reservation or legal assistance which are usually offered in Western Europe. In January 1996 the Royal Dutch Touring Club ANWB and the German automobile club ADAC started the joint project in Poland under the TOURIN program. The pilot project in Poznan region, along the Berlin-Warszawa road started in March 1997, continued and expanded by a nation-wide road assistance organization which was created for that purpose.

b) The strategy of tourism product development

Poland is an attractive country for tourists due to its geographical location, natural resources and cultural heritage. However, in order to cope with competitors, it was estimated that the tourism industry required well considered and consistent activities, for which purpose the strategy of tourism product development was prepared within the aid program of the European Union. The strategy strengthens the Polish tourism industry by creating a product which would be competitive on international markets. The implementation of the strategy should also increase tourism activity among Polish people. Polish “tourist brands" package offers for domestic and foreign tourists, are an imported part of the strategy. The task of brand creation has been entrusted to Brand Managers, to be accomplished in co-operation with the tourism industry. Brand Managers have been assigned the development of the following areas:

- business tourism
- city and culture tourism
- rural tourism

- active and special interest tourism
- transit and cross-border tourism

The Brand Managers implemented the construction of partner groups in each area (so called brand groups) which include representatives of travel companies, local authorities, accommodation and transport providers. Market analyses and business plans for tourist brands have been carried on, comprising substantial activities to be undertaken.

c) The development of rural tourism

This kind of tourism is very popular in Europe and was one of the fastest growing tourist sectors in Poland since 1989. It gives tourists a chance to spend their holidays in a clean and attractive environment and to the farmers an alternative source of income. The strategy for development of tourism industry had in view to improve the standards of accommodation and catering in rural areas, to develop tourist infrastructure (e.g. bicycle routes), to develop and prepare an offer comprising tourist attractions (e.g. shows of folk arts, crafts and workshops, sporting events, nature observation, etc.) and to develop tourist information and reservation systems. Classification and categorization systems have been prepared for rural accommodation and tourist attractions. The project included the preparation of a 5-year strategic plan for agrotourism development in Poland for the State Sports and Tourism Administration, pilot projects as well as preparation of handbooks for rural tourist services providers. Researches on development possibilities in active tourism such as water tourism, horseback riding and other forms which allow tourists to see more of the everyday rural life and work, culture and nature, were also included in the project. The establishment of a new rural tourism organization similar to Gites de France is designed to further enhance tourists' arrivals to the Polish countryside.

d) "Green Lungs of Poland" Program

The State Programme for Domestic Tourism Product Development, particularly concerned the development of Active Tourism and Tourism in Rural and Forest Areas, executed by Tourist Development Fund in 1996 – 1997. The programme consisted of three separate subprojects: (1) Main Plan of Country Tourism Development – executed by TDI Ireland, (2) Development of Public Accommodation Base Service in Country Areas – executed by DG Agroprogress International GmbH Germany/ Advisory and Educational Centres for Agriculture, Department in Krakow, (3) Active and Special Interests Tourism – executed by L&B Great Britain.

The promotion programme covered the following:

- International Tourist Trade;
- Regional Tourist Trade;
- Publications, brochures, films ;
- Internet (e.g.: http://gemini.most.org.pl/ZB/ZB/50/Eat~1.htm);
- Agro-tourist Associations (e.g.: Regional Tourist Federations; 30 Federations already existing are associated with Polish Federation of Agro-Tourist Hosting Farms);
- Eco-Agro-Tourism Programme (EAT), executed by ECEAT (European Centre for Eco- Agro- Tourism - ecological foundation registered in February 1993 in Amsterdam) in Poland, and sponsored by EEC and Dutch Government; covers Poland, Czech Republic and Hungry,

Other programmes carried out by ECEAT – Poland including: (a) Ecological Tourism at Ecological Farms (TEGE), (b) Joint Ecological Agriculture Campaign (WKRE), (c) Ecological Awareness Development – educational camps, (d) Guided Eco-Tourism – walking, bicycle and horse routes in Karkonose and Beskidy mountains, (e) Promotion of Eco-Tourism on Farms at Bilateral Biosphere Reserve Karkonose (cooperation), (f) The Protected Area Network – Bialowieza (cooperation).

e) National computer tourist information and reservation system

The goal of the project was to create a national computer system for tourist information and for the distribution and reservation of tourist services. The implementation of the project began in 1995 and it is now well advanced. A feasibility study was done and a business plan prepared. Two main components of the system are the tourist information system (TIS) and the hotel reservation system (HRS). Since 1996 a pilot project for TIS is being implemented. In April 1997 the pilot project, testing TIS in selected regions, has been finalized and preparations were undertaken for the national roll-out of the tourist information system.

In 1997 a pilot project for HRS also started and, after its completion in the fall, the system was rolled out nationally. The information and the reservation systems are interconnected and also connected to Internet. The technological solutions that have been selected allow compatibility with the already existing systems in Poland and abroad and, therefore, easy access to information and reservation to many categories of users worldwide. The national reservation system is a commercial undertaking, owned and managed by a company in which the founding stockholders are entities of the Polish Tourism Industry.

f) Capacity-building, Education, Training and Awareness-raising Program

The Office of Physical Culture and Tourism cooperated with the Ministry of the Environment and organised the Programme of Ecological Education. Ecological Education which is reflected in:

- tourist-hotel professional schools programs,
- courses for tourist guides ,
- professional conferences for tourist sector, local administration and educational personnel organized by the Office of Physical Culture and Tourism.

Since 1992, the Provincial Advisory Centres for Agriculture (Wojewσdzkie Osrodki Doradztwa Rolniczego) have been organizing training programme concerning agro-tourism, e.g.: the Provincial Advisory Centre for Agriculture – SIELINKO (Wielkopolskie Province), organized in 1998 training for country inhabitants planning to organize and already having organized agro-tourism farms; training programmes contained issues such as: agro-tourism and economy, marketing, promotion, advertising, law, financial resources, customer service, environmental protection, sanitation, nutrition, field trips; training was partly financed by governmental resources and by Agriculture Development and Food Economy Foundation (Fundacja Rozwoju Rolnictwa i Gospodarki Zywnosciowej).

In 1997, the Strategy for Training of Country Public Accommodation Base Service was elaborated within PHARE – TOURIN II Programme.
Professional training for nature-based tourism was also organised by Agro-Tourism Associations, Major Agriculture Fund, FAPA and postgraduate academic centres.

The financing for nature-based tourism development and promotion was supported through the following sources:
<u>Budgetary means:</u>

- Agriculture Restructuring and Modernization Agency (ARiMR) – subsidizes investment of credit interests,
- Ministry of Agriculture and Country Development,
- Regional Authorities, Agriculture Departments and Tourism Departments,
- Municipalities.

<u>Foreign means- credits:</u>

- PHARE, TURIN
- Polish Regional Development Agency (Polska Agencja Rozwoju Regionalnego PARD)

- Polish-American Enterprise Fund (Polsko-Amerykanski Fundusz Przedsiebiorczosci)
- European Fund for Polish Country Development (Europejski Fundusz Rozwoju Wsi Polskiej)
- LEONARD and INTERREG, EU Programme for near German border areas.

Credits for economic entity were also made available from:

- Social-Economical Initiative Fund (Fundusz Inicjatyw Spoleczno-Ekonomicznych)
- "Country Enterprise" Foundation (Fundacja "Przedsiebiorczosc Wiejska")
- National Fund for Environmental Protection and Water Management (Narodowy Fundusz Ochrony Srodowiska i Gospodarki Wodnej)
- Country Water Supply Aid Foundation (Fundacja Wspomagajaca Zaopatrzenia Wsi w Wode)
- Association of Food Producers by Ecological Methods (Stowarzyszenie Producentσw Zywnosci Metodami Ekologicznymi EKOLAND)
- Foundation for Polish Agriculture (Fundacja na Rzecz Polskiego Rolnictwa).

The state needs to create the conditions in which tourism can develop so that it can strengthen its position in the economy and help sort out local problems. The Polish Tourism Organization concerns itself with promoting what Poland has to offer as well as working with independent bodies and companies to help develop regional tourism and tourist products. The Polish Tourism Information Centers Abroad come under its control, as does marketing in general. Regional Tourism Organizations were also created and collaborated with local authorities and tourism companies.

Active tourism – including agrotourism – continued to grow fast, and Poland has a lot of such sites. Nowadays, tourists like to get back to nature, and agrotourism meets this need very specifically. Poland manages to attract around 400,000 tourists from Holland each year for this type of tourism. They normally drive in with caravans or with camping equipment, and prefer to stay in small villages.

Poland has different attractions from that of, say, the Mediterranean. A good strategy for marketing tourism in Poland was to attract more Germans on first-time visits by increasing the number of attractions and advertising them. Tourists' safety measures were taken regarding their objective, state supervised safety, but also the subjective feeling of safety of each person in general.

4.3.3 Developments in the Polish Tourism - Results

In 2004, over 700 million people worldwide traveled abroad as tourists, according to the World Tourism Organization (WTO). Worldwide, the largest number of tourists visited France (75.5 million), the United States (50,9 million), Spain (48.2 million) and Italy (41,2 million). **Poland** ranked twelfth with 17.4 million foreign tourists (33 percent more than in 2003).

Among the most popular European destinations, Poland was eighth on the list in 2003 after France, Spain, Italy, Great Britain, Russia, Germany and Austria. With $9 billion revenue generated from tourism, Poland was 11th on the WTO ranking list in 2000. In 2003, revenue from international tourism totaled $448.3 billion worldwide, marking a more than 3 percent increase from 2002.

The Polish Tourism Institute has compiled 2003 business tourism statistics and research results:

- A total of 13,024,000 out of the 58,102,000 foreigners who visited Poland in 2003 stayed here for at least one night, thus qualifying for the World Tourism Organization's definition of a tourist;
- As many as 39.3 percent of tourists came to Poland on business and recreational trips, while 27.3 percent traveled solely on business;
- Poland is visited by 4.5-5.3 million foreign visitors annually;

- Total 2003 revenues from incoming tourism amounted to $5.8 billion.

According to the Polish Tourism Institute, American, Japanese and Canadian businesspeople spent the most money in Poland $1,362 per head. West European travelers left $326 behind each, Russians $257 and Germans $216. Poland ranks 19th in Europe for convention tourism[230]. Poland still lacks detailed research on particular business tourism segments, such as incentive travel, trade fairs and individual business travel. Despite gaps in the research, the future looks bright for hotel and tourist facility developers, especially in central and western Poland. Incoming business tourism in Poland will continue to grow at a higher rate than traditional or special-purpose tourism. But only those who can guarantee services that match Western standards will profit from that growth.

Poland specializes in hotels for 50 to 100 guests located in or near historic sites, surrounded by parks and offering excellent cuisine, well-equipped conference rooms and a broad program of local attractions. Sites in Rydzyna, Sieniawa, Baranów Sandomierski, Krasiczyn and Kadyny are good examples of such facilities.

Business tourism has a bright future in Poland. It is a natural consequence of Poland's rapid economic growth and its admission to the European Union and NATO. In terms of economic growth in 2003, it scored second after Slovakia, as was shown in the report by the Organization for Economic Cooperation and Development.

The strategy assumes there is a high demand for strong product recognition in the Polish tourist sector. The development of trademark products requires information. Methods of promoting Poland's best business tourism options to the world market are a priority.

[230] MPI (Meeting Professionals International) research data, 2002

Since 1990, the state has focused on intensified spending in the tourism sector in order to earn more money from it. Countries that thrive on tourists' spending use as much as 10 percent of their tourism funds on promotion. In 2003, Poland spent $11 million to promote tourism, compared to only $1 million in 1990. But EU experts suggest that a country the size of Poland should spend at least $15 million a year on promotion.

In 2003, Poland had more than 123,000 bed places in hotel rooms, compared to 102,767 in 2001 and 97,695 in 1999. According to the Central Statistical Office (GUS), the number of hotels increased from 499 in 1990 to 1287 in 2003. The national hotel network cannot handle the growing needs of the business and tourism sectors. Many recreational centers need repairs, and there isn't enough domestic capital to develop a full-fledged hotel industry. The number of hotels is slowly increasing around the country, but too slowly to keep up with the demand.

Forecasts suggest that investments in tourist hotels will increase in Central Europe. Specialists estimate that about 1.5 billion euro should be spent to build at least 170 hotels in Poland by 2008. The increasing number of business trips to Poland created a demand for three-star hotels offering guests high standards at a lower price than four-star hotels.

State support was given to promote individual regions of the country abroad. The state helped tourism by stimulating investments, attracting loans and granting construction permits faster.

A full-fledged tourist services market did not exist before 1989. Domestic vacation programs for state enterprise employees were generously subsidized, and most people took advantage of those opportunities. Few could afford foreign trips. Large travel agencies like Orbis and Sport Tourist did not compete for clients; they simply sold whatever trips abroad were available. They were expensive, and the lack of competition resulted in no price cuts.

In 1989, Poland had several state-run travel agencies, substandard Employee Recreation Fund (FWP) accommodations, and vacation centers run by workplaces which added the social activities expenses to their production costs. In 2003 the country had about 2,500 travel agencies, and 4,000 registered companies include tourist services in their range of activities. Industry leaders such as Club Mediterranean, Germany's Neckermann, Scan Holidays, and the Scandinavian VING have entered the market, and some Polish travel agencies sell trips offered by Germany's TUI agency. In the past, Polish tourists using German agencies had to depart from Berlin, but now charter flights from Warsaw are available.

The market is always changing, and more destinations are available. Former behemoths, mainly Orbis and Sport Tourist, must now deal with rivalry from hundreds of smaller companies attracting clients with lower prices. Foreign giants are strong competitors; their large-scale operations enable them to secure huge discounts from tourist service suppliers.

In 2000, the number of foreign departures by Polish nationals had risen 6.5 times since 1987. Polish border services' statistics show that Poles made 21.1 million trips abroad in 1991, and 57 million in 2000. The number of trips out of the country depends on the population's income and the range of goods and commodities rivaling tourism. The drop in the number of departures in 1991 was certainly caused by a reduced standard of living, but it also resulted from a relative decrease in the prices and expansion in the range of televisions, VCRs and stereo equipment. Farmers represent a huge group of Poles who do not travel because they cannot leave their farms unattended. (The number of travelers is particularly high in countries where agricultural employment is relatively small.)

For these reasons, it can be argued that future increases in prosperity of tourism in Poland are likely. From another perspective, the future of tourism consumption will depend as much on the continued availability of collective provision for the locals, as on the growth and distribution of income. Foreign capital will continue to play an important role in the tourism industry in the future. This may be realized either through direct investment in particular establishments, especially four and five star hotels and agrotourism, or directly through the activity of foreign travel agencies and tour companies.

4.4 Romanian Tourism

Brief Country History and Data:

The principalities of Wallachia and Moldavia - for centuries under the suzerainty of the Turkish Ottoman Empire - secured their autonomy in 1856; they united in 1859 and a few years later adopted the new name of Romania. The country gained full independence in 1878. It joined the Allied Powers in World War I and acquired new territories following the conflict. In 1940, it allied with the Axis powers and participated in the 1941 German invasion of the USSR. Three years later, overrun by the Soviets, Romania signed an armistice. The post-war Soviet occupation led to the formation of a Communist "people's republic" in 1947 and the abdication of the king. The 45-year-long rule of dictatorship regimes, and especially that of Nicolae Ceausescu, who took power in 1965, and his 'Securitate' police state became increasingly oppressive and draconian through the 1980s. Ceausescu was overthrown and executed in late 1989. Former Communists dominated the government until 1996, when they were swept from

Map of Romania

power by a fractious coalition of centrist parties. In 2000, the center-left Social Democratic Party (PSD) became Romania's leading party, governing with the support of the Democratic Union of Hungarians in Romania (UDMR). The opposition center-right alliance formed by the National Liberal Party (PNL) and the Democratic Party (PD) scored a surprise victory over the ruling PSD in December 2004 presidential elections. The PNL-PD alliance maintains a parliamentary majority with the support of the UDMR, the Humanist Party (PUR), and various ethnic minority groups. Although Romania completed accession talks with the European Union (EU) in December 2004, it must continue to address rampant corruption - while invigorating lagging economic and democratic reforms - before it can achieve its hope of joining the EU, tentatively set for 2007. Romania joined NATO in March of 2004[231].

Population (in 2000): 22.4 million
GDP/capita (in 2000): $ 1.689

4.4.1 Structural Changes during Transition

The transition process in Romania, which started in the early 1990s, has recorded uneven developments in terms of macroeconomic stabilization and structural reforms. It was only starting with the end of 1998 and the beginning of 1999 that the country has seen acceleration in the economic and structural reform.

In order for the reader to have a complete understanding of the major structural changes that took place in the Romanian tourism, as well as in the economy as a whole, some of the characteristics of tourism as it functioned during the communist era are presented. It is important to understand that tourism was seen mainly as a leisure activity, but still under a great degree of state control, with little initiative and choice of the ordinary person. Leisure tourism was

[231] *The World Factbook*, CIA Publications, 2005 (http://www.cia.gov/cia/publications/factbook/geos/ro.html)

basically sustained from internal demand and administered entirely by a central institution, the Ministry of Tourism through the National Office for Tourism (the only travel agency existing at the time). Every year the Ministry of Tourism distributed its available places and destinations to other institutions, whose employees had to take turns in making choices upon the period and the place where they preferred to spend their holidays that year. These destinations were mostly places within Romania, as Romanians were denied the right to be issued passports and to travel abroad.

Therefore the state, represented by its employing institutions, had the possibility to estimate with high precision the figures of demand to be expected on a yearly basis, as the state was practically the one to decide who would be going on vacation and where. Most hotels and accommodation facilities in general were built under this concept, this explaining their basic endowment and their functioning. Competition was inexistent in the context of the lack of choice by the tourist. The average Romanian would benefit of a 6 to 12-day break to a seaside or mountain resort every year. Therefore outbound tourism was not practiced, important factor in explaining the present trend in the Romanian market for a high travel propensity towards international destinations.

Business tourism was practiced in a different manner than its current meaning, as people traveling for business purposes were delegated by their employers, state companies, and accommodated in special hosting facilities, property of the visited companies, ultimately of the state.

Regarding international tourism, its controlled character (special shops for foreign tourists, with imported products sold for foreign currencies, exclusive hotels and destination under permanent surveillance, etc.) hidden behind the so called “fear of espionage” from any foreigner that would show interest for the country and its natural beauties, has probably led to a dramatic decrease in visitors and excluded Romania from the list of travel spots of tour operators around the world.

It was, therefore, a complex task to include Romania in the circuit of destinations worldwide, to bring its name to the knowledge of people internationally, to change the mentality of the residents about the manner in which it should be offered and to raise interest in the various beauties this country has to offer.

Since December 1989, structural changes have followed a gradualist reform course. Land was returned to peasants, small privatization – of shops, restaurants and small businesses – was completed, while some progress was made in large-scale privatization. Foreign trade was liberalized and reoriented westwards. Other key developments included the adoption of laws and regulations necessary to bring the country into line with the European Union, for which membership has been applied. Romania introduced VAT, freed the foreign exchange market, established a National Securities Commission to oversee the Bucharest Stock Exchange and liberalized regulations concerning foreign investment.

All these reforms created the proper legal and economic environment for the development of a tourism industry according to market economy principles and have affected tourism by their complexity in form and structure. They involved:

- The introduction of competition through the setting up of 136 public companies formed from the old network of the previously centralized Ministry of Tourism; these companies, although initially still in public property, competed among themselves for the share of funds allocated from the Ministry's budget. They had to justify their activities and complete financing from internal profits. They had to be profitable to stay in operation;
- Decentralization of the domestic market, encouragement being given to the creation of new economic players through the division of former companies assets (departmental and national tourist offices, etc.) and

through the legalization of new forms of cooperation between service providers, tour operators and commercial companies;

- The promotion of forms of private management of state-owned heritage items, e.g. through management agreements, leasing, agency or commission based contracts (1,300 items were included in this circuits, organized in six joint companies receiving some of their capital from abroad);
- The setting up of more than 1,500 private travel agencies dealing with national and international tourism.

Presently, the organization of tourism activities is coordinated and assisted by a series of authorities that assure an integrated decision-making process with participation of both public and private authorities. The Ministry of Tourism as the National Tourism Administration, member of the Romanian Government, is in charge of coordinating and implementing the general tourism development strategy. A Consultative Council has been set up as well. The Council is formed by representatives of the public sector (Ministry of Tourism, local authorities, Tourism Promotion Office and Licensing and Classification Office) as well as the private sector (non-governmental organizations related to the tourism industry) and has a major role in the decision-making process. Following the Council's conclusions, the Ministry of Tourism takes the necessary measures to implement the proposals. This mechanism allows both public and private sector to be better involved in the decision-making and implementation process.

At the local level, the County Councils are responsible, as local authorities, of public administration. In line with the adopted law for regional development, regional agencies and committees will be set up. These will have an important role for sustainable development in terms of tourism sector. The institutional reform in this sector began with the creation of two independent bodies, namely Tourism Promotion Office and Licensing and Classification Office. Both of these offices have regional representatives. The Tourism Promotion Office regional representatives play an important role in stimulating cooperation between private and public sectors in order to implement programs for tourism promotion.

4.4.2 Present Trends – Causes

Romania was formerly a successful tourism destination. From the mid 1960s there was rapid development of tourism facilities, particularly on the Black Sea coast. In the 1970s Romania was a high volume destination, attracting large numbers of tourists from main European demand generating markets such as Germany and the UK. In the 1980s tourist suffered as a result of Romania's isolationist policy.

Trends in Domestic Demand

After 1990, Romanian tourism has suffered major changes both in tourists' habits and in the existing infrastructure following certain trends:

- Declining domestic demand: 22 million tourist nights (2003), compared with over 40 million in the late 1980s. Less and less Romanians can afford to participate in tourism as a result of the decrease in the nationals' buying power and the discordance between prices charged and services rendered;
- Markets motivated by cheap prices and not the strength of the product; moreover, the trend of the last years is for the alignment of prices to international levels without improvement in supply characteristics;
- Decreasing popularity of destinations within the country (from 66.75% in 1990 to 28.6% in 2003) and an increase up to 10 times of the number of tourists going on trips abroad (from 1.55% in 1990 to 19% in 2003). Most travel agencies offer tourist packages abroad for similar, or even lower, prices as compared to national destinations, but higher quality. Countries such as Greece, Turkey, Egypt, are popular destinations among Romanian tourists offering services that show hundreds of years of practice in this industry, for reasonable prices;

- Decrease of Romanian tourists circulation towards some European countries as a result of the restrictive visa granting policies imposed by those countries on Romanians, and of the increase in the insurance and visa taxes required;
- Decrease in the duration of average stay of each tourist and increased preference for short trips and weekend activities, which are more financially accessible;
- 90% of tourist facilities are still in public ownership.

Trends in Foreign Tourists Demand

Over the last decade, foreign tourist arrivals in Romania, as well as their impressions of the visit from the point of view of their expectations and the value for money received on the tourist product bought, have followed certain patterns such as:

- Declining international demand: 2.7 mill tourist nights (2003), compared with 4 million in 1990 because of political instability, poor quality of supply and lack of diversification of tourist product;
- An outdated tourism product, with an inadequate provision of recreation and leisure, the physical condition of which reflects the lack of maintenance and investment of over a decade;
- Service standards which do not meet the expectations of international tourists;
- Insignificant increase in foreign tourist nights recorded in the registered accommodation structures across the country although the number of foreign tourists who arrived at the borders increased significantly. That means that many of these tourists are transit tourists, day-trippers, or they choose to accommodate in private structures, which are not comprised in tourism statistics;
- Increase in foreign tourists arrivals by road (family tourism) and by plane (business tourism);

- Decrease in demand for seaside resorts in favor of other forms of tourism, especially religious and cultural, as a result of poor service quality and health damaging sun radiation;
- A widespread negative image of Romania in tourist generating markets, and inadequate resources devoted to marketing and promotion.

The main causes for the decrease in the number of foreign tourists have been elaborated in a study carried on by the Institute for Tourism Research, Bucharest in 2002, for each component of the tourist supply. Questionnaires have been distributed to a sample of 1,657 foreign tourists accommodated in various structures: hotels, motels and camps. The results for each type of facility and service are presented below:

Table 4.10: Questionnaire results on causes of decline in foreign tourists arrivals in Romania

Causes	No. of answers	% of total
A. Hotels	**171**	**10.3**
• old structures	58	3.5
• poorly equipped rooms, not clean, without clean bed-sheets, electricity shortage	105	6.3
• high prices	8	0.5
B. Restaurants	**200**	**12.1**
• Services below international standards	92	5.6
• Food quality: inconsistent, non-diversified, breakfast not served as Swedish buffet	75	4.5
• Low prices	14	0.8
• Under-qualified personnel, not multilingual	19	1.1
C. Entertainment, in general	**25**	**1.5**
• Lack of information on organized trips	13	0.8
• Lack of clubs, game halls and other entertaining facilities	7	0.4
• Lack of folkloric shows	5	0.3
D. Transport	**124**	**7.5**
• Old buses and degraded roads	53	3.2
• A lot of bureaucracy in Otopeni, Bucharest international airport	19	1.1
• High fares for air transport	36	2.2
• Feeling of insecurity during air		

transport	16	1.0
E. Information availability, advertising	**317**	**19.2**
• Little information on Romania and insufficient publicity abroad	317	19.2
Causes	**No. of answers**	**% of total**
F. Trips	**10**	**0.6**
• Insufficient offer as regards adventure tourism or the Danube Delta, with qualified guides	10	0.6
G. Other aspects	**811**	**48.9**
• Feeling of insecurity because of frequent robberies, presence of beggars and the permanent hunt for tips of some employees	64	3.9
• Poor imagine of Romania abroad, social and economic instability, slow rhythm of privatization compared to other Eastern European countries	55	3.3
• General lack of cleanliness	62	3.7
• Poor services	138	8.3
• Poor organization of tourism activities	167	10.1
• Physical condition of facilities is continuously deteriorating	167	10.1
• High prices for low quality service	232	14.0
• Commercial aspects	7	0.4
Total	**1657**	**100.0**

Source: Institute for Tourism Research, Bucharest, 2002

The presentation above reflects firstly that tourism is a complex activity, closely interrelated to the other fields of society: commercial activities, entertainment, transport, marketing, public administration. It also presents many of the shortcomings of Romanian tourism, which in the same time represent directions towards which action needs to be taken.

First and foremost we can distinguish the **lack of information about the country** across its borders, which received 19.2% of the total number of answers. This shows that there is a certain demand and interest about the country from foreign tourists, a real potential for increasing foreign tourist arrivals. It also indicates the first direction in which efforts and funds should be concentrated in the years to come.

Other shortcomings encountered with relatively high frequency in the answers of the interviewed sample are:

– high prices for low service quality (14%), i.e. discordance in the value obtained for the money paid,
– poor organization of tourist activities (10.1%),
– poor quality of services (8.3%) and accommodation (6.3%),
– services under international standards (5.6%) and
– continuously deteriorating facilities (5.2%).

Poor service quality proves to be the main drawback in the present analysis. This corroborates with the discrepancy between quality and price in a poorly organized, physically and morally obsolete infrastructure.

SWOT Analysis on the Romanian Tourism

The SWOT analysis in tourism is a systematic evaluation of the strengths, weaknesses, opportunities, and threats affecting tourism development in each study area in order to identify the most promising tourism development opportunities at a regional and community level. The SWOT analysis provides information that is needed for communities and entrepreneurs to:

- build on regional and community strengths;
- overcome weaknesses that currently constrain tourism development;
- approach tourism development to minimize the potential impact of threats, and
- make the most of available opportunities.

The analysis assists planners to determine the distinct Comparative Advantage of the country in relation to other states by assessing its **S**trengths, **W**eaknesses, **O**pportunities and **T**hreats (SWOT). This is done through an assessment of the present condition, characteristics and utilization of the region's natural, human and other resources (Lickorish, 1991)[232]. **Strengths** refer to current environmental and ecological features or attributes that enhance or aid in the development of the tourist region, e.g. scenic views, rich soil for agriculture, mineral reserves for gold extraction, pasture land for livestock. Other indicators of Strength can be accessibility to a major port, proximity to major growth centers, inexpensive power, irrigation system or a skilled labor force. **Weaknesses** refer to present human, financial or physical attributes and natural resources that limit or inhibit tourism progress or development, e.g. lack of infrastructure support, lack of markets, presence of natural hazards, erosion prone areas or adherence to traditional tourism practices. They can also relate to lack of health or education facilities and lack of a skilled labor force. **Opportunities** refer to economic, social, political, technological and competitive trends and events that could significantly benefit a region in future. This relates to private sector projects, government line agency programs (e.g. low-income housing, infrastructure, social-forestry programs), grants for agrotourism projects, declaration of a Tourist Zone, establishment of a major Industrial Estate or Duty Free Port. Passage of a new law or technological breakthrough that could benefit the tourist region are also opportunities. **Threats** relate to political, economic, social, technological and competitive trends and events that are potentially harmful to a region's present or future development or economic progress. These may include environmental degradation from existing or proposed manufacturing or processing facilities; damage to flora & fauna; irreversible land degradation from mining or mineral exploitation; pollution of river systems from solid waste or siltation; depletion of coral reefs/fish sanctuaries; destruction of marine habitats or destruction of historical/human interest features.

Romanian tourism is an important part of the national economy and a supportive sector in the alignment process of the national economy to European markets for a number of reasons:

[232] Lickorish, L. J., Jenkins, C. L., 1991. *An Introduction to Tourism*, Butterworth – Heinemann, Oxford, 1999, p. 140

– It generates foreign currency as revenues from international tourism;
– It is indirectly involved in the export of domestic goods within the country, when they are bought by foreign visitors;
– Contributes to the state financial resources through the taxation system;
– Creates interrelationships between different sectors of economy using infrastructure and services provided by transport, banking, commerce and other sectors;
– Important factor in the creation of a country image abroad;
– Generator of employment opportunities, particularly useful in the context of high unemployment created by the closing down of several non-productive state-owned companies;
– Influential factor in conservation and protection of the environment;

Romanian tourism supply offers diverse and attractive tourism destinations. The various relief, as well as its history, offer a complex and valuable tourism potential. Romania offers tourism all year round and for different age categories. Its natural potential provides a type of holiday for each type of tourist. According to the available resources and participants, the main forms of tourism in practice are leisure tourism (mountain resorts, seaside resorts, and spas), business tourism, convention tourism, weekend tourism, day tourism.

The natural potential involves beautiful landscapes, diverse relief, moderate climate (rarity of calamities, absence of excessive temperatures), therapeutically efficient natural factors (mineral waters, curative mud, flora and fauna, etc.).

The cultural potential impresses through valuable monuments, artistic and religious objects, museums and private collections, folklore and ethnography elements, proofs of a rich history influenced by roman, Turkish, Byzantine, Hungarian and French époques, but still maintaining traces of the old dacic civilization.

Romanian tourist areas might be classified into fairly low polluted tourism destinations. Industrial effects upon environment, that are not absent throughout the country, are generally placed at distances from tourist attractions, which have not been affected by the environmental issues raised in the last decade. The Ministry of Tourism has initiated and the Romanian Government has approved the necessary legislative framework in the tourism sector. All the laws and regulations related to this sector include special provisions for the protection of the environment[233]. The law protects natural resources and they are grouped into "protected areas" which benefit from special conditions for development and preservation.

There are, in addition, specific standards within the legislation in tourism promoted by the Government. These refer to the conditions required for the tourism activities in order to avoid damage to nature and to ensure its preservation and protection. These conditions apply for all activities: transport, accommodation, catering, therapeutic treatment and so on.

Setting up Codes of Practice, Standards or Guidelines by industry itself is at an incipient stage in Romania. However, some trade associations (i.e., National Association of Travel Agencies, Romanian Association of Mountain Guides) have successfully promoted their own Codes of Practice. The Hotel Industry Federation has also started to promote its own Guidelines for specific activities. All these codes are voluntary.

Industry has reacted positively to these codes and standards. Encouraging signs are visible in the tourists' attitude too. Promotion campaigns should be carried out in order to create a true culture in this matter.

[233] Source: http://www.un.org/esa/agenda21/natlinfo/countr/romania/eco.htm

Major tourism components and their behavior under the different aspects of a tourist business and industry as a whole, both at macro and microeconomic levels, are presented in the following SWOT analysis.

1. Competitiveness through business improvement			
Strengths	**Weaknesses**	**Opportunities**	**Threats**
Large, established labor pool, willing to work in tourism The newly established tourism enterprises provide competitive services	Lack of enterprise culture in the tourism industry Lack of management culture development Lack of take up of IT/innovation by smaller tourism enterprises and private owners in the industry Poor quality work force; skills do not keep up with new practices	World market growth for tourism propensity due to increases in discretionary incomes levels and leisure time (gray tourism)	Low motivation of under-qualified to retrain Resistance to change of present administrative bodies Discouragement of privatization by present managers with the intention to bring structures to bankruptcy so they can subsequently purchase them for lower prices

At the microeconomic level, i.e. of enterprises engaged in tourism activities, some initiatives have been recorded in the tourism industry. Private initiative has been partially allowed on existing structures through their rental or sale by state institutions, while other private owners have been granted licenses for building and operating new tourist structures. This has been beneficial for both tourists and state organizations, because the new businesses offer higher quality tourist products and services, they overtake some of the expenses of non-operating structures from Ministry administration, and they contribute to state revenues through tax payments.

Although weaknesses and threats exceed in number the strong points of tourist businesses and the opportunities existing in the market, the development of entrepreneurship and initiative in this industry has been successfully exercised so far. Positive results and profits motivate further developments and encourage new comers to inscribe the tourism industry in Romania among profitable investment directions.

2. Competitiveness through business investment and market building			
Strengths	**Weaknesses**	**Opportunities**	**Threats**
Inward investment success Profitable industry; reasonably high rates of return Relatively low priced tourism products	Low investment in R&D New, inexperienced strategic body to market the country effectively	World market growing interest for destinations in Central and Eastern Europe Development of foreign investments partnerships	Decline in the number of Romanians that take part in national tourism Decline in the buying power of nationals Increasing marginalization of the country as a destination for foreign tourists in comparison with the other Central and Eastern European countries Increased competition from other destinations, internationally

The rhythm of privatization in Romanian tourism industry has been slow, under the set of gradual transformation policies implemented, and foreign investment has not been up to the market expectations. Although there is a world market growing interest for destinations in Central and Eastern European countries, Romanian tourism industry modernization process has not been moving at a fast enough pace with other countries in this region to align its product to their standards. These countries have recorded fantastic profit increases of up to 200% for the last five years (Poland, Czech Republic, Hungary) (Cooper C., Fletcher J., Gilbert D., Wanhill S, 1998)[234]. The funds allocated for creating awareness of their national tourist product exceed by far Romania's efforts in this direction.

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[234] Cooper, C., Fletcher, J., Gilbert,D., Wanhill, S., 1998. *Tourism: Principles and Practice*, Longman, p. 478

3. Competitiveness through learning			
Strengths	**Weaknesses**	**Opportunities**	**Threats**
Good learning potential of nationals Strong and experienced school / tourism college links	Existing deficit of manager skills Lack of detailed analysis to evaluate training needs and needed funds Owners/managers resistant to investing in training	Available developments in training infrastructures	Older workers excluded from training opportunities in the industry Companies and ministries reluctant to allocate funds for training State investments in training do not result in significant economic impact

Training in tourism at international standards and according to market economy principles is a new concept for Romanian entrepreneurs and employees. It requires a change of mentality on employee's side from the previous "working for my boss" to the "working for the client concept". They have to get used to the idea that the success and ultimately the existence of the business and of their jobs depend on the degree of satisfaction they can provide for clients.

On the managers' side, no previous training, qualifications from the established educational institutions in tourism, should be considered sufficient for the competitive render of tourist service. These institutions are going through a reform process themselves, and may provide inappropriate information for trainees, that needs updating. The new coming employees need to be familiar with the standards of operation of the specific tourist business. This involves a change in mentality at the managerial level as well, through the institutionalization of operating standards in their units and through the allocation of funds for learning and training employees in the respective business culture.

4. Competitiveness through infrastructure			
Strengths	**Weaknesses**	**Opportunities**	**Threats**
Good rail infrastructure, access to rail services from most locations Growing IT penetration in infrastructure Good basic infrastructure: buildings, etc	Infrastructure generally did not keep pace with the increase in travel demands Problems of transport and scarcity of transport means in rural areas, although there are lines in operation (agrotourism) No national strategy for communications / IT	Expansion of international airports across the country Developments in identifying major sites with tourism potential Spread of ski cable network	Delays on economic key sectors improvements Environmental costs of inadequate use of industrial resources damaging tourism Lack of resources to develop infrastructure Discouraging lending policy of financial institutions Delay of implementing environmental legislation for traditional industries affects tourism

The master plan for tourism designed in the late ‘70s was concentrated on massive infrastructures, adapted to all tourist needs at that time. Generally, investments in infrastructure were well designed, such as the seaside resorts, the road and rail network, which still benefit tourism industry. Since then, though, investments in tourism infrastructure have not kept pace with the increase and the growing expectations of demand. Although strategic plans for tourism infrastructure modernization have been set after 1990, action is delayed. The lack of action has negative implications upon the environment, while also depriving Romanian tourism from benefiting of the growing interest of world demand for the Central and Eastern Europe.

5. Competitiveness through a stronger national image			
Strengths	**Weaknesses**	**Opportunities**	**Threats**
Harmonious alternation of rural / urban settings Diversity of social and ethnic mix in some country areas World class cultural heritage	Investment in tourism not secured by state protection High unemployment and economic exclusion Perceived poor image, internationally Lack of information about the country	Tourism development including varied relief and natural beauties Total solar eclipse maximum visibility point (1999)	Nationals reactions to economic conditions damaging to tourism: lack of tourist protection, robbery, crime fear

The necessity of creating awareness for the Romanian tourist product and for promoting the country's image abroad are as new of a concept as the transition period to the market economy itself. Romanian tourism needed foreign attention for two fundamental reasons: to attract foreign investments for improving infrastructure and services, and to attract foreign tourists to a new, unpolluted and unexplored tourism destination.

Until 2003, the taxation system had done little to encourage investors to consider Romania. Taxes on profits were high; there were few facilities for foreign investors and even fewer guarantees. On the tourists side there is also a lack of guarantee, of safety due to frequent robberies and to some employees' excessive hunt for tips. It takes a good organization and a strong marketing strategy to be able to obtain sound results in the advertising campaign with the funds available at present.

6. Competitiveness through partnership			
Strengths	**Weaknesses**	**Opportunities**	**Threats**
Successful support with funds from international organizations (IMF, World Bank, EU-Phare Plan) Improved regional economy in areas successful for tourism	Poor decision making and coordination activity by national authorities Poor marketing of the country and its tourist attractions internationally	Use of European strategic plans and funds	Limited availability of funding for the whole industry Lack of decision and quickness of action

So far, international organizations have granted substantial amounts to the development of tourist industry in Romania. Further cooperation depends on the successful completion of present projects in due time.

For the development needs of the Romanian tourism industry a **Special Fund for Tourism Promotion and Development** has been proposed by the Ministry of Tourism and approved by the Government and Parliament. In this way, the Ministry of Tourism can provide tangible assistance by co-financing projects proposed by industry (i.e., creation and tourism product development, promotion of environmental awareness among local residents and business in tourism areas, educational programmes for visitors and tourists, promotion of codes of conducts in this matter, environmental preservation and protection etc.).

4.4.3 The Macroeconomic Strategy for the Romanian Tourism

Tourism is one of Romania's export industries which has the potential to compete effectively with other countries, and significantly increase its foreign exchange earnings and contribution to the national economy. This necessitates overcoming many constraints and requires resources to be invested in tourism and related sectors. However, if problems are not addressed, it is expected that tourism earnings will decline by 25% in real terms over the next decade.

Countries with a natural and human potential similar in richness and variety to Romania's have managed to make tourism an important source in their economic growth and development. Table 4.11 presents Romania's position among the Central and Eastern European countries according to a number of synthetic indicators (2003):

- tourism revenues/inhabitant,
- tourism revenues/tourist,

- percentage of revenues from tourism export in total exports of goods of the country,
- the balance of payments from tourism, and
- the accommodation capacity offered.

Table 4.11 Tourism contribution to national economies of CEE countries (figures in USD)

	Revenues / inhabitant	Revenues / tourist	Tourism revenues in total exports of goods (%)	Tourism revenues in total exports of services (%)	Balance of payments from tourist activities	Accommo-dation capacity in registered units
Albania	2	178	n.a.	10.26	2	3,780
Bulgaria	56	136	9.30	33.31	278	114,164
Czech Republic	278	174	13.26	42.75	1,245	211,654
Slovakia	115	687	7.25	26.07	290	36,243
Hungary	164	83	13.86	40.34	653	87,076
Poland	174	349	9.27	77.75	1,200	99.102
Romania	25	220	7.60	38.42	-121	171,797
Armenia	n.a.	n.a.	0.4	3.45	-2	n.a.
Azerbaijan	29	980	26.55	-	76	4,000
Estonia	237	666	19.21	40.25	263	8,495
Lithuania	33	588	4.58	25.57	-14	9,136
Moldova	13	1,781	7.92	55.34	1	5,298
Russia	29	466	5.51	34.65	-7,287	449,072
Ukraine	4	241	1.69	6.71	-19	n.a.
Croatia	331	1,196	34.21	61.66	813	205,234
Slovenia	545	1,474	13,0	53,47	666	33,878
Total	66	287	12.0	48.26	-12	1,621,882

Source: World Tourism Organization, 2003

A Medium and Long Term Tourism Development Strategy has been released by the Ministry of Tourism and approved by the Romanian Government in 1998. The document is based on the recommendations included in the **Tourism Master Plan** for Romania produced by EC institutions within EC-PHARE Tourism Development Program. The **Master Plan Strategy** addresses the need to increase foreign exchange earnings and the contribution of tourism to the economy by *product upgrading and diversification*, *positive image creation* and *active marketing and promotion*.

Sustainability is the basic concept of this strategy. Sustainable development is the overall objective of the Tourism Development Strategy. This includes:

- product development
- legal framework improvement
- institutional reform
- human resources development
- marketing and promotion improvement
- tourist protection and safety of travels and
- natural environment protection ,which includes:
  - Territorial and Urban Planning process to ensure that tourism interests are represented and protected;
  - Co-operation with Ministry of Environment to address environmental impact, management and pollution control;
  - upgrading;
  - sewage collection and treatment facility improvements in coastal resorts;
  - protection and conservation of beaches and of coastal landscape;
  - raising environmental awareness;
  - ecotourism and agrotourism.

Tourism targets were prepared based on market research and the recommendations contained in the Master Plan, which include a program of *product upgrading to enable Romania* in the future *to sell itself on the strength of product rather than predominantly on price*. Marketing and promoting strategies and an action program to achieve the targets are detailed for international and for domestic tourism.

► **International tourism**:

- Arrivals increase by 1% per annum from 1998 to 2006 and 2.8% per annum from 2000 to 2006;
- Tourist nights in registered accommodation increase by over 2% per annum from 1998 to 2006 and 8.9% per annum from 2000 to 2006;

- Expenditure per tourist night in registered tourist accommodation increases in real terms from $23 in 1992 to $60 in 2006.

► **Domestic tourism**:
- Domestic tourism is expected to decline as real prices increase and buying power decreases;
- Tourism targets indicate a significant capacity of tourist accommodation that is surplus to requirements, particularly on the Back Sea coast and in the spas. However, in Bucharest and some cultural and historic cities and tour circuits locations, there is the need for new capacity.

The above mentioned strategy refers also to measures for promoting eco-tourism and nature-based tourism. These measures have been translated into a proper legislation.

For the eight regions of the country, the Ministry of Tourism has identified major projects aiming to promote sustainable development in Romania. Areas and locations with tourism potential are identified for a long-term product development strategy. However, in the short to medium term, efforts will be focused on priority areas and resorts, to **avoid the dispersal and dilution of resources**. The first phase priority is to improve and consolidate the product in areas that are currently most popular with international tourism and where the tourism facilities and infrastructure generally exist. These areas are:

1. Bucharest;
2. priority Black Sea coast resorts (Mamaia and Neptun) and Constanta town;
3. priority health spa resorts;
4. Brasov-Sinaia mountain resorts for winter and summer tourism;
5. Sibiu area for cultural, circuits and hiking;
6. North Moldova region for cultural and circuit tourism;
7. Danube Delta for ecotourism;

8. key entry towns, business centers and transit points.

Micro-projects implemented by either local consortia or trade associations are encouraged by the Ministry of Tourism and, where possible, supported from different funds. Examples of micro-projects co-financed by Ministry of Tourism from EC-PHARE Programme funds include:

- Lala Reservation - Center of Ecological and Tourism Surveillance;
- Environmental action pack for Romanian hotel and restaurant industry;
- Specific training in environmental protection conservation and ecology;
- Marking tourist tracings in the mountain area;
- Monitoring lake water pollution levels and protection works and depollution;
- Environmental protection camp in different mountain places;
- Depollution, sign posting, protection works in scientific reservations;
- Afforestation works;
- Depollutions actions in Danube Delta.

Transport Strategy addresses solutions to existing problems, and also measures necessary to meet the needs of future tourism targets. The strategy focuses on the implementation of a high capacity transport corridor linking Nadlac frontier to Sibiu, Brasov, Bucharest and Constanta, and Bucharest to Giurgiu frontier in the south. The surface capacity links to key ports and airports.

Economic Recommendations to address key issues facing the tourist industry include:

- Removal of price control by state institutions;
- Reduction of VAT on tourism products and services from 19% to 10%;
- Setting up a tourism upgrading and development investment fund;
- Abolition of the visa charge for foreigners coming to Romania for tourism purposes;
- Development of incentives targeted at tourism priorities.

Future economic impact of the plan, by 2006, is:

- 63% real rise in total tourism output;
- foreign exchange earnings increase by almost 80% in real terms[235];
- net revenue to Government increases more than five fold in real terms.

Privatization actions refer to already existing structures and to land title granting for new entrepreneurs interested in this field, and they include:

- implementation of a law on restitution of buildings confiscated by the communist regime, so legally transferable title can be established;
- clarification of the process to obtain land title;
- creation of an efficient Stock Exchange.

Tourism privatization recommendations include:

- vesting full authority to privatize companies in state ownership;
- breaking the commercial companies into smaller parts (in some cases, whole seaside resorts have been organized into one commercial company);
- privatize the assets and the restructured companies in their entirety;
- concentrating on privatization in the priority tourism areas;
- liquidating assets which are non-performing and which have no future within the Romanian tourism industry;
- ensuring investors have access to adequate resources to upgrade the asset;
- identifying the country's leading hotels and market them aggressively as individual assets, or in small "chains" for sale to competitive bidders.

Training and human resources actions in tourism are targeted to create over 100,000 new jobs (direct and indirect) by 2006. Training is needed at all levels. A major need is *understanding* the opportunities and constraints of tourism in a market economy.

[235] In real terms = besides the absolute increase due to inflationary factors

Training for tourism in Romania is conducted by four entities:

1. Department for Economics at the National University (autonomous institution);
2. Lycees with tourism profiles (under Ministry of Education supervision);
3. National Institute for Tourism Training and Management (INFMT) which is controlled by the Ministry of Tourism;
4. Ministry of Labour and Social Protection which operates a number of skill programmes for tourism at County level.

INFMT is the major center for training in Romania. It comprises an integrated complex with the training school, Park Hotel and Tourist Hotel in Bucharest. It also has a branch which operates in Constanta, the major city on the Black Sea coast, a traditional tourism destination in the country. **On the job training** has an important role in re-skilling and upgrading of the workforce because of the magnitude of training required and the appropriateness of the technique. In Romania, short courses have been developed to strengthen the INFMT provision of supervision and industry practitioners train within these courses. Mobile training teams for advising managers on commercial operating systems are in place. Flexible part-time college training is also available for workers who cannot take extended periods away from work. The current system is constructed for easy accessibility.

Whilst the overall structure for education and training for tourism is appropriate, it needs also include the following: the role of the Lycees strengthened and extended, focused tourism courses at university level, INFMT qualifications to be recognized by the Ministry of Education, INMFT to be restructured, with responsibility allocated to a representative Board of Directors.

Competent management training has also been developed in Romania. There are specific curricula related to tourism management, tourism and economic and social planning, economic impacts of tourism, socio-cultural impacts of tourism on a host country, tourism policy and alternatives for development, the legal framework for tourism development, tourism planning and tourism marketing.

There are several projects implemented by Non governmental Organizations mainly, co-financed by Ministry of Tourism, to raise the awareness of the tourists and host population on sustainable tourism issues. Such projects are:

- Pilot project for rural tourism development. This is a project implemented by the National Association of Rural, Ecological and Cultural Tourism addressed to rural areas in order to stimulate local people for tourism related activities, to protect nature and preserve cultural heritage, and to promote holidays in the countryside. A major component was to create a friendly environmental attitude and operation in travel and tourism.
- Setting up an Ecological Center in the Rodnei Mountain. This is a project implemented by Transilvania Business Center having as objective to create a center for ecological actions in the given area and to promote the center among other associations and tourism developers. The main activities were oriented to cleaning paths and the lake waters, restoration of tourist identification panels and notices of the Lala Lake reservation, improving sign posting, monitoring pollution levels in lake and press conference and campaigns. The project aimed to encourage walking tours and trekking as a natural based tourism and was addressed to the tourists, which love to walk along the mountains.
- Environmental Action Pack. The project was implemented by the Romanian Hotel Industry Federation, and the objectives were to create a national awareness through communication of environmental issues to industry operators and staff, recruit volunteers and facilitators, involve new staff and reward establishments and individuals for their efforts, performance and achievements; to give a better understanding

of the environmental issues for the new generation of hotel and restaurant industry students; and to create a national positive attitude for the air quality, saving energy and water supplies, waste and sewage disposal management.

The Ministry of Tourism includes a **Strategy for Development and Regulation Departmen**t which has a rich data bank on different issues related to sustainable tourism. INFMT has been assisted through the EC-PHARE Programme in developing and upgrading the capability to provide useful information and documentation on sustainable tourism. The Institute has a branch in Constanta, the most important city on the Black Sea coast. In Brasov, the most developed mountain area has been set up a Resource Center for Tourism, which can provide technical assistance for tourism developers. The Tourism Promotion regional offices play an important role in providing the necessary assistance to the industry and local key-factors in designing and implementing suitable actions and measures for a sustainable tourism development.

The marketing and promotion strategy is especially designed to encourage travels and holidays to unspoiled places, meaning that the message is addressed toward the environmentally conscious tourists.

The lack of modern **technologies** creates temporary difficulties in implementing projects and programmes aiming at protection against unsustainable development. Priorities lie particularly in efforts to upgrade sewage collection and treatment facilities, acquire adequate equipment and technology for the industrial pollution control, and upgrade the facilities for recycling.

Environmental management systems are applied in hotels and other tourist establishments. The Romanian Hotel Industry Federation has succeeded in implementing a project to review environmental practices and to develop a national environmental policy for hotel and restaurant industry in order to create a quality environment management programme and to involve operators and industry staff in this efforts.

4.4.4 Strategy Implementation

Recommendations at **organizational** level include:

- Ministry of Tourism to be restructured and become actively involved in the land use and urban planning process. Cooperation with other Ministries whose areas impact tourism, with relevant tourism sector associations and organizations are priorities;
- A Romanian Tourism Corporation should be established with the responsibility for marketing and promotion of the country abroad, statistics and market intelligence. The commercial sector should be actively involved in RTC;
- Regions, counties, municipalities and local communities should become more involved in the development of the tourism sector. This should be achieved by strengthening the county tourism function, and encouraging Tourism Action Groups where the level of tourism justifies it.

Recommendations at **legislative level** relating specifically to tourism have been proposed in respect of:

- Redrafting the proposed Draft Tourism Law;
- Revising accommodation registration, classification, and fire and safety requirements;
- Enacting special legislation for tourism agencies.

General legal provisions which impact tourism are required in respect of coastal and mountain protection, monuments and historic area conservation, environmental protection (including the use of National Parks and Protected Areas for tourism), revised regulations relating to casino development, operation and taxation.

Recommendations are made on using **culture** to enhance the tourism product and spread the economic benefit of tourism. The recommendations involve close cooperation between the Ministry of Tourism and the Ministry of Culture, together with regional, county and local interests. In addition to handicrafts, performing arts, festivals, customs and folklore, recommendations cover:

- Encouraging the development of village tourism in appropriate tourism areas and the establishments of networks of tourism villages;
- Enhancing exhibits, presentation and interpretation at priority museums and galleries and increasing the importance of their role in the tourism product;
- Development of theme tourism products especially based on the Dracula myth.

Natural environmental measures to protect and enhance the natural environment include:

- Ministry of Tourism becoming actively involved in the territorial and Urban Planning process to ensure that tourism interests are represented and protected. Local tourism sector involvement should also be encouraged;
- Ministry of Tourism cooperating with the Ministry of Environment to address environmental impact and management, pollution control and upgrading;
- Raising environmental awareness;
- Protecting and enhancing beaches;
- Sewage collection and treatment facility improvements coastal resorts.

Measures to protect and enhance **historic buildings and monuments include:**

- A flexible policy on the commercial use of historic buildings, to reduce the risk of vacancy and dereliction;
- Reevaluation and maybe increase in the entrance fees for tourists to view cultural heritage sites, with income used as a contribution towards restoration and maintenance should be evaluated.
- Strengthening regulations, monitoring enforcement;

- Increased coordination and cooperation with other Ministries and at regional and local level;
- Introduction of environmental awareness and codes of practice.

Environmental funding for the protection of natural and built environments is not realistically attainable. However, recommendations are made on generating more revenue to offset some of the costs.

4.4.5 Results - Conclusions

In elaborating the tourism development strategy, the Ministry of Tourism has considered the good practice and experience of many countries and destinations recognized as models to be followed.

The Ministry of Tourism has benefited from **European Union assistance** through PHARE-programs with a total budget of 10 million euros during the last six years. The objective of the program was to assist the tourism industry to make the transition from operating in a centrally planned to operating in a market environment. It is understood that EU includes "model destination" countries for Romania.

The strengthening of the role of private sector and non-governmental organizations, in addition to decentralization are two key words of the reform in the Romanian tourism industry. Setting up the Consultative Council besides the Ministry of Tourism, gathering both local authorities and trade associations, was the first step to a better cooperation with the above mentioned entities. Local tourism development planning process is made with the consultation of the Ministry of Tourism. The improvements of the legal framework are also discussed with local authorities and tourism sector associations. Further developments (i.e. regional development agencies and committees created by law) will allow a better partnership at decentralized level between all the institutions interested in a sustainable tourism development.

Romania has concluded agreements in the field of tourism with more then 35 countries worldwide. These comprise specific provisions aiming to encourage cooperation on different issues related to sustainable development: exchange of information and experience, documentary visits, round tables and seminars, training, marketing and promotion etc. At the same time, Romania is an associated member of the European Union. The European Agreement provides the broader concept for the necessary framework for sustainable development promotion.

Romania is a member of the Black Sea Economic Cooperation (BSEC), a regional organization committed to engage in economic co-operation and to encourage the free movement of goods, capital, services and labour of eleven countries riparian to the Black Sea. It is also member of the Central European Initiative (ICE), another regional organization of some Central and Eastern European countries. In both organizations, the Romanian Ministry of Tourism is an active member in the tourism committees.

Tourism has the potential to make a significantly greater contribution to the development of Romania. Realization of this potential will require the commitment of Government, and the full support and cooperation of all involved in the tourism industry and related sectors.

4.5 Bulgarian Tourism

Brief Country History and Data:

Map of Bulgaria

The Bulgars, a Central Asian Turkic tribe, merged with the local Slavic inhabitants in the late 7th century to form the first Bulgarian state. In succeeding centuries, Bulgaria struggled with the Byzantine Empire to assert its place in the Balkans, but by the end of the 14th century the country was overrun by the Ottoman Turks. Northern Bulgaria attained autonomy in 1878 and all of Bulgaria became independent in 1908. Having fought on the losing side in both World Wars, Bulgaria fell within the Soviet sphere of influence and became a People's Republic in 1946. Communist domination ended in 1990, when Bulgaria held its first multiparty election since World War II and began the contentious process of moving toward political democracy and a market economy while combating inflation, unemployment, corruption, and crime. Today, reforms and democratization keep Bulgaria on a path toward eventual integration into the EU in 2007. The country joined NATO in 2004[236].

Population (2000): 7.8 millions
GDP/capita: $ 1,376

4.5.1 Tourism in Post-Communist Bulgaria – Situational Analysis

Bulgaria has a unique position among the Eastern bloc countries as a cosmopolitan international holiday destination. At the macro level, tourism is an

[236] *The World Factbook*, CIA Publications, 2005 (http://www.cia.gov/cia/publications/factbook/geos/bu.html)

important generator of foreign exchange, but it also assists in financing the development of social tourism at home. Resource conflicts arise because of the ideological commitment to social tourism and the necessity to spread and develop the international tourist base inland. At the micro level, tourism operations are severely constrained by the inflexibilities of the centralized system. Limited reforms have decentralized decision-making powers, but much more radical reform is required if Bulgaria is to compete in the international tourism market.

Since November 1989, Bulgaria's tourism industry has been subjected to severe stress. Travel patterns in the former USSR and the Eastern bloc were crucially altered and tourism demand for this region has dramatically declined. In addition, political change within Bulgaria led to a period of stalemate and then to a program of political and economic reform which, while increasing in momentum, has left the bulk of state assets, including those in tourism, in state hands.

Conscious of the scarcity of its mineral and energy resources Bulgaria has made considerable efforts to develop a specialization in international tourism. In this respect it was the leader among the Soviet Bloc countries. The decline of the communist political and economic system, and the loss of the ex-socialist states, especially the USSR, as economic partners, created an extremely difficult situation for the Bulgarian economy as a whole and for its tourism industry in particular.

Since the end of the 80s the country has been in a serious crisis. An unprecedented dimension of the crisis is the parallel transition from a centralized to a market economy. One of the popular beliefs in this period, typical of many ex-socialist countries, is that *tourism is a priority sector* during the transition, along with sectors such as agriculture, commerce, the consumer goods industry and communications. A priority sector is defined by the volume of its present or expected contribution to the national economy and especially to foreign currently earnings. As measured per capita, Bulgaria is one of the most indebted countries in the world with US$9 billion owed to different foreign creditors - mostly private banks.

In the scientific literature the most recent and quite exhaustive analysis of Bulgarian tourism was presented by Harrison (1993)[237]. The other papers written by Carter (1991)[238] and Pearlman (1990)[239] are based on data prior to the situation in 1989. The article by Vodenska (1992)[240] contains information up to 1991, but still before the organizational changes in the tourism sector at the end of 1991.

The assumption that tourism is a priority sector during the transition to a market economy did not prove to be correct for Bulgaria. After the 1989 political changes, among the economic sectors, only commerce had a real boost. The expected development in tourism did not occur - in fact, just the opposite, Bulgaria's share in world tourism revenues reduced sharply from 0.30% in 1985 to 0.16% in 1992. Bulgaria does not publish official statistics on its tourism currency earnings. The then Chairman of the Committee for Tourism stated that in 1993 the currency revenue amounted to an equivalent of US$500 million (an exaggerated figure, according to some experts), while neighboring Turkey and Greece earned more than US$2.5 billion. The number of foreign visitors to Bulgaria in 1992 went down to half that of 1988, the number of tourists decreased by a third and overnight stays by a quarter. A slow recovery was noticed in the second half of 1993 and continued throughout 1994. The data for the period 1989-2003 though, is rather disappointing (see Figure).

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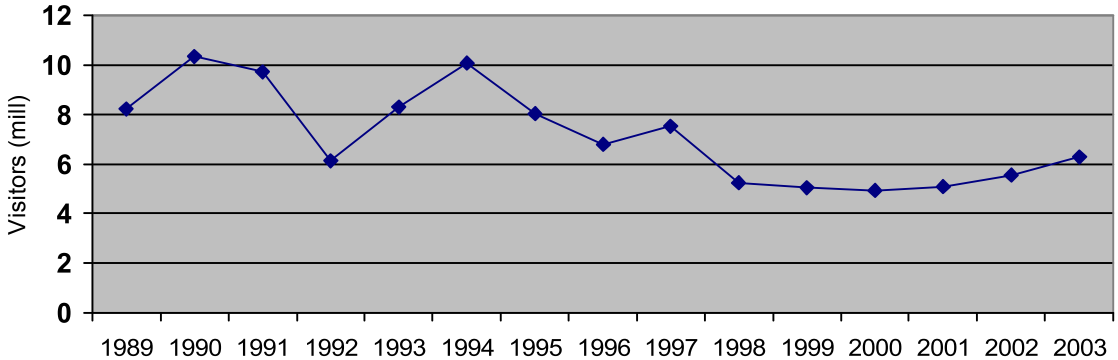
[237] Harrison, D., 1993. *Bulgarian Tourism: A State of Uncertainty*, Annals of Tourism Research, Vol. 20, Issue 3, pp. 519-534

[238] Carter, F. W., 1991. *Bulgaria*, Tourism and Economic Development in Eastern Europe and Soviet Union, ed. D. R. Hall. Belhaven, London, 1991, pp. 220-235.

[239] Pearlman, M. V., 1990. *Conflicts and constraints in Bulgaria's Tourism Sector*, Annals of Tourism Research, Vol. 17, Issue 1, pp. 103-122.

[240] Vodenska, M., 1992. *International tourism in Bulgaria: problems and perspectives*, Tijdschrift voor Econ. en Soc. Geogr,, Vol. 83, pp. 409-534.

Figure 4.3 Foreign Visitors Arrivals in Bulgaria 1989-2003



The contribution of the tourism sector to Bulgarian GNP has been estimated as 3.0-3.5% for the same period, the same level as its share of employment. This picture indicates that tourism is not behaving as a priority sector in post-communist Bulgaria, despite politicians' claims. In fact, there is a serious *fallback in its market position and in investment,* while the quality of the services has not improved significantly.

All this is against the background of a dramatic change in foreign tourist flows to the country *by region of origin.* The East European tourists who represented 80% of overnight stays in 1990, disappeared abruptly. Visitors from adjacent countries increased dramatically, but as a rule their stays are short or in transit, so the economic effect is diminished. The West European share of the market stayed relatively stable (Germany and UK being the major tourist generators), although in terms of overnight stays and of revenues this sector also tended to decrease.

Return of tourists from the CIS countries observed during this period continued, while generally visits from the Balkan states stagnated or even decreased (especially visits by Greek tourists). At the same time the number of arrivals from Western and Central Europe also stagnated, but in the German market there are signs of recovery. The major visit generators to Bulgaria are, in descending order: Yugoslavia (former), Turkey, Romania, former Soviet Union states, Greece, Germany and UK (the UK share though, has been decreasing). These countries account for over 92% of the visits paid to Bulgaria. The number of *holiday and recreation trips* - 2.7 million in 1995. On average, just over a quarter of the visits were recreational tourist trips. In terms of the volume of real tourist flows and of income contribution, the losses reach a third of West European trade (Germany and UK being the major markets). Besides Germany, the expanding markets were the Netherlands, Sweden, Norway, Czech Republic and Slovakia and Yugoslavia. In terms of the share in bed-nights and income from these countries, however, the increase is rather modest.

Another major change is that the country became a generator of significant outgoing visits – from 2.4 million departures in 1990 to 5.4 million in 2003, 2.3 million of them being solely for tourist purposes. Most of the trips abroad are not recreational (shopping tours, visiting friends and relatives, sight-seeing, etc.) but the number of longer recreational holidays to Greece, for instance, is rising. In 1991 Bulgaria ranked 55th among world tourism spenders with an expenditure of US$189 million. Bulgarians mainly visit adjacent countries - Turkey, Greece, Romania and F.Y.R. of Macedonia. These trips are usually short and relatively evenly spread throughout the whole year. The main reason for the restriction to this *neighborhood pattern of the visits abroad,* is the dramatic increase in transport charges and especially airfares, as well as Schengen visa requirements for trips to EC countries. These factors, affecting all Eastern Europe, caused shrinkage in the geographical extent of the trips.

Except for some business and transit trips from Middle-Eastern countries, Bulgaria is not a destination for markets outside Europe. As one would expect, it is mainly the flows from Germany and the UK that are economically more important, while the visits originating from neighboring states are short and mostly not for tourism purposes. This shrinking to a *vicinity* model for the majority of international visits to Bulgaria can also be illustrated by the transport pattern - 89% of visitors in 1990-2003 came by car and only 3.8% by air. A recent inquiry showed that only 2% of the foreign tourists in the Bulgarian Black Sea region came from the affluent segment of the market.

4.5.2 Trends and Strategies for Restructuring the Tourism Industry

Bulgaria emerged on the international tourism market in the early 60s as a typical *sun, sea and sand destination.* This characteristic has not changed – in 1990-2003 four-fifths of foreigners' overnight stays and 61% of the available hotel beds were concentrated on the Black Sea coast in the easternmost periphery of the country. This is a stretch of nearly 400 km of sand and rocky shores with several hotel concentrations in the regions of the towns of Varna and Bourgas. The Black Sea coast is a mature recreational region of international magnitude; however its development has been impeded by the years of slow modernization and inefficient management. At the same time the interior and the western part of the country are rich in cultural and mountain attractions. There is a certain vacuum in the tourist development off the Black Sea coast and in the eastern part of the country due to a relative scarcity of tourist attractions in the hinterland of the coastal region. Although situated in Southern Europe, Bulgaria offers very good skiing conditions. There are also about 1100 heritage and natural sites including 11 national parks, 160 orthodox monasteries, 19 settlements, architectural conservation areas and 200 museums. Nine of the outstanding sites are listed in the UNESCO World heritage. Up to now this heritage wealth has been used only for domestic and educational forms of tourism. Its potential importance as an international tourism product is paradoxically hampered by the restitution of land and buildings to previous owners, as well as by the illegal trade and smuggling abroad of valuable historic and artistic objects. While the state cannot afford to subsidize the heritage sites, it is important to make them self-financing through tourism.

Business visits tend to be concentrated only in three or four of the bigger towns with hotels of a high standard. During the last seven years the number of businessmen has markedly decreased as a result of the stagnation of economic reforms and the slow progress made with privatization.

Curative visits to spas, rural tourism, game hunting and tourism associated with international meetings, are numerically insignificant compared with seaside tourism. Those who spend a holiday on the coast seldom undertake sight-seeing tours inland. Only a couple of winter resorts in the Rila and Rhodope mountains managed to provide some sort of alternative to the preponderant summer recreation flows towards the Black Sea coast, which is a mature recreational region of international magnitude.

Unfortunately the State Committee for Tourism, absorbed by the privatization program, does not see the importance of education and training for the industry. It has even omitted to mention education in the draft of the recently prepared Tourism Law (1999). For Bulgaria the need to develop and restructure its tourism industry in order to adapt it to the market economy is inescapable. Therefore, it is obvious that serious efforts are necessary; with the emphasis on education, training and retraining. In 1989 Rakadjiyska had already pointed out the necessity for short training and retraining courses as a priority in the Bulgarian tourism industry[241]. The existing loosely related educational units should be linked in a network, to capitalize on their considerable past achievements and to exploit the new prospects for Europeanization with education for quality.

At the end of 1998 the Bulgarian Government proceeded to the implementation of a survey asking foreign investors in Bulgaria to identify the sectors of the Bulgarian economy that would provide good opportunities for new entrants. Seven out of every ten respondents pointed to tourism. In fact, the tourist industry in Bulgaria already is a source of tax revenues from 2 to three times greater than its share of national income. This underscores the profitable nature

[241] Rakadjiska, S., 1989. *Tourism training and education in Bulgaria*. Annals of Tourism Research, Vol. 2, pp. 100-104.

of tourism industry firms at a time when most state-owned enterprises have posted deficits. The results show that the Bulgarian tourism industry is characterized by a number of shortcomings and problems, which in turn create opportunities for investments:

- Most of the Bulgaria's tourism facilities are worn out. Their aesthetic and functional condition is unattractive by international standards, mainly as a result of deficient maintenance and renovation policies.
- Seaside tourism in Bulgaria relies on a relatively short season and faces stiff competition from other destinations. Measures to extend the tourist season by way of constructing swimming pools, tennis courts, sports centers, entertainment facilities, yacht clubs, etc., have to be taken.
- The national and regional transportation infrastructures are inadequate and act as the main obstacle to the development of the tourism sector. Particularly noticeable are the low quality of airline services and the poor condition of the roads across the country.
- Marketing need to be upgraded, especially with American and European tour operators, and consulting services also need to be consistent with the international standards.
- Existing standards of quality assurance and quality management are inadequate. The absence of well established hotel and restaurant classification standards poses an obstacle to the profitable activities of the facilities. Even new tourism facilities do not meet international standards of categorization and quality of service, and the range of services is rather limited.

As far as the tourist facilities are concerned, the situation for the Bulgarian tourism has recorded little progress since 1989:

Lodging Facilities

Bulgaria's tourist facilities are still mostly state-owned. There are more than 500 hotels with 114,000 beds which will remain within the state sector or which are in the process of being privatized, plus 40 campgrounds with 14,900 campsites, 240 mountain chalets with 16,000 beds, and rest houses which can accommodate around 65,000 people. There are 38 well-appointed hunting lodges throughout the country. In addition there are now a number of small private hotels and other private accommodations with an estimated 10,000 beds. This gives a grand total of 235,000 beds to serve international and domestic tourists. Few beds are at the top end of the market, with just seven hotels in the 5-star category. Many of the hotels are in the 2-star category and thus are not yet in line with current international standards.

The Black Sea resorts account for 66% of Bulgaria s hotel beds. The resorts themselves are well laid out and attractive, some with gardens and walks and other near natural wooded areas. The international hotel chains Sheraton, Kempinski and Princess are present in Bulgaria with a Hilton under construction. In November 1998 a new secure hotel reservations system on the Internet started operating. This greatly helped Bulgarian hotels to market themselves to international travelers by making it easy to make reservations and payment by credit card. Participating hotels offer discounts of 10 to 40 per cent from their rack rates.

Conference Facilities

Bulgaria is well-equipped with national and municipal conference centers plus conference facilities in many hotels. In 1997 over 750 conferences were held in Bulgaria of which 328 had international participation. The principal facilities are the Congress Center in the National Palace of Culture in Sofia and the Palace of Culture and Sports and the Festival and Congress Center in Varna. Conference facilities can be found in the three main international hotels in Sofia, the Sheraton Sofia Hotel Balkan, Princess and Kempinski Hotel Zografski. Other conference facilities are in the Imperial Riviera Complex Golden Sands resort (16 km north of Varna), Burgas, Globus, Kouban, Amphora, Pomorie (Sunny Beach Resort, 30 km north of Burgas), Grand Hotel Varna (7 km north of Varna), Dobrudja (Albena Resort), the Sofia and Rodina hotels in Sofia, and the Riga Hotel in Ruse.

Hot Mineral Springs and Spas

Bulgaria has over 500 curative natural mineral waters, as well as many rich deposits of curative peat and mud. The clean air with high iodine and bromine content combined with hot water springs offer ideal climatic conditions for the year-round operations of spas in the mountains and by the sea. However, many facilities need modernization and refurbishing.

The mineral waters of Sandanski town, near the foot of the Pirin mountains in extreme southern Bulgaria near the Greek border, have long been known for their help in treatment of bronchial asthma and other respiratory diseases. The Sandanski Spa Hotel has a modern health and balneotherapy center offering all the usual treatments and baths. Major seaside spas are the 4 star Dobrudja Hotel in Albena resort, the Ambassador s Health and Balneological Center and the Riviera Holiday Club in the Golden Sands Resort, which lies 17 km north of Varna on the Black Sea coast and is well known for its 3.5 km fine sandy beach. North along the Black Sea coast, just 10 km from Varna, is the Spa Center with several curative hot springs with slight mineralization. A mud bath center near Pomorie, 20 km north of Bourgas, is situated close to numerous vineyards, gardens, a mud lake and salt flats.

Winter Sports

Winter sports are currently the second most important Bulgarian tourist attraction. The Pirin, Rila and Rhodopes mountains and Mount Vitosha (whose Aleko ski slopes are less than an hour from Sofia) are the locations of important resort hotels. The main ski slopes are at Pamporovo, Borevetz, and Bansko to which skiers come from all over Europe.

Each of the bigger winter resorts has outdated facilities which need to be refurbished. Investments will be sought by hotel owners, tourist agencies and municipalities.

Over the past 30 years tourism in the Rhodopes Mountains has been mainly concentrated at the Pamporovo ski resort, where major hotels were built in the 1960s and 1970s. The first private hotels which sprang up in the villages around Pamporovo and Smolian, were encouraged by projects of the European Union, the British Know-How Fund, and the U.S. Agency for International Development. Some local hotels were given preferential credits by the Bulgarian-American Enterprise Fund. Financial support was also received from the British Know-How Fund for alternative tourism projects. With the help of the Fund, tourist information centers have been opened in 1998 in Smolian, Momchilovtsi and Devin.

Summer Resorts

Bulgaria s Black Sea resorts include Albena with 40 hotels, Golden Sands with 61 hotels and one campsite, St. Constantine & Elena Resort with 17 hotels and 41 villas, Sunny Beach with 107 hotels, the comparatively smaller tourist centers and holiday villages Elenite, Dyuni, Riviera, and Roussalka (Mermaid), and the picturesque towns of Pomorie, Neseber and Sozopol. Yacht clubs and marinas offer a wide range of marine sports. There are six yacht clubs in Albena Resort and almost the same number in Sunny Beach and St. Constantine & Elena Resort. Golden Sands Marina possesses more than 100 yacht slips, rental yachts, a yacht shop, refueling, battery recharging and water-recharge equipment. The resorts also offer bowling alleys, horse-riding bases, tennis courts, swimming pools, squash courts, and mini-sport complexes for children. Numerous indoor sports facilities include tennis tables, billiards, and fitness centers.

Bulgaria does not have any golf courses at present, although various ideas have been proposed to build golf courses provided land ownership questions can be first solved.

Cultural Tourism

An extremely wide range of cultural tourism possibilities are available throughout the country. Apart from the capital and its national cultural heritage, cities and towns such as Plovdiv, Veliko Turnovo, Arbanssi village, Bozentzi, Varna, Tryavna, Kotel, Zheravna and Melnik are of substantial architectural and historical interest. Ancient Thracian tombs are to be found in many places and the collection of Thracian gold in the National History Museum in Sofia is famous worldwide. The Etar open-air ethnographic museum has artisans who practice traditional arts and crafts.

The numerous Bulgarian monasteries are representative of Orthodox religious art and architecture. The oldest and most famous is Rila Monastery dating from the 10th century. Its churches and other buildings are richly decorated with frescoes, icons and paintings. The famous Chiprovski and Klisurski monasteries are in the Montana District.

Seven of the most noteworthy cultural and historic monuments have been included in the UNESCO s List of World Heritage sites, including the Rila Monastery, the Horseman of Madara, and the Thracian tomb in the town of Kazanluk.

Nature Tourism and Hunting

Bulgaria boasts the highest and largest unspoiled mountain ranges in Southeast Europe. There are several national parks within the territory of Bulgaria and 89 protected areas and nature reserves under protection. Vitosha National Park, opened in 1934, is part of the 498,000 hectares of parks and protected areas. All of the national parks including Pirin, Vratchansky Balkan, Central Balkan, the Sinite Kamani (Blue Rocks) formations, Shumen Plateau, Roussenski Lom (canyon-like valley), Strandja, and Golden Sands National Parks are open to visitors. Bulgaria s mountain regions offer excellent opportunities for nature-oriented activities holidays such as mountaineering and rock climbing, hiking and walking, caving, orienteering, trekking, montain biking and camping, horse riding, rafting, canoeing, fishing and hunting. The accommodations offered by small hotels, hunting lodges and private homes in the mountains may be made by booking in advance. Camping is allowed within the perimeters of the chalets.

Bulgarian hunting lodges and farms attract between 2,000 - 2,500 foreign hunters annually, most of them repeat visitors. The busy hunting farms in the region of Shumen and Turgoviste also boast a rich variety of wildlife outside the hunting season.

Tourist services

Currently there are over 30 tourist information offices throughout the country whose role is expanding into a national information system. The number of tour operators and travel agencies specializing in incoming tourists has grown considerably since 1990. Many of these companies are small businesses run by experienced professionals. There will be a need for additional operators for incoming tourism as the privatization program of the resorts accelerates.

4.5.3 Future Prospects

Government Tourism Infrastructure Promotion Plans

The Marketing Strategy and Action Plan for Bulgarian Tourism, 1997 - 2000 prepared under the European Union Phare Program, forms the basis for the future marketing programs of the Ministry of Trade and Tourism. The overall marketing objective identifies tourism earnings rather than the number of arrivals as a priority for development and marketing. To achieve the overall marketing objective the following strategies have been defined:

- Reposition Bulgaria as a tourist destination offering a varied product mix of culture, nature and activities in addition to the traditional sun, beach and ski products.
- Select and concentrate on the most promising and profitable markets and segments that fit in with the positioning strategy.
- Renovate and diversify the product.
- Develop strong local involvement and participation in tourism at a regional level.
- Maintain traditional markets and segments and open new market segments gradually in line with the upgrading, renovation and diversification of the product.
- Aim cultural tourism, nature and activities such as skiing outside major resorts and conferences at an upscale clientele.

So far, very little progress has been recorded in implementing this vision.

Privatization

A prime objective of Bulgaria s government is continued privatization of state-owned tourist facilities. In April 1998 a consortium of advisory firms led by KPMG Bulgaria was selected by the Privatization Agency of the Government of Bulgaria to be the privatization agent in the sale of the Sandanski Interhotel, Riga Hotel in Ruse, Moskva Park Hotel and Sofia Hotel in Sofia, Mak Tours two hotels and motel in Blagoevgrad, St. Petersburg Hotel in Plovdiv and Elenite Holiday Village on the Black Sea. The privatization agent is looking for key partners, investors, and entities with interest to purchase these properties.

In 1998 a sale of the tourist club Riviera, 10 km north of Varna, to a management-led group became the majority shareholder at a price of $11 million. The hotel complex has 530 beds in six hotels and sold for an average of just $21 per bed. Thirty-five properties in the Golden Sands Resort were also sold, including 25 hotels with 5,712 beds. The privatization proceeds were about $19 million, which largely went to retire old debt of the resort, which finished 1998 with a profit. Prospective investors in Golden Sands, widely believed to be the most attractive seaside resort, are waiting for the sale of standalone facilities to be completed subsequent to which restructuring of the entire resort s ownership will be made.

The shares of 54 tourism industry companies are offered on the Sofia Stock Exchange, with trade being most dynamic in the case of the tourist complexes Albena PLC and Golden Sands PLC, which rate among the first five most liquid companies on the Exchange.

Major Tourism Infrastructure Projects

The great majority of significant tourism infrastructure projects are in the private sector. The new owners of privatized facilities, in order to improve the standard of services, must restore, rebuild, modernize and refurbish their properties. However, some of the largest tourism projects are in the public sector. Projects in the regional tourism development plans will be financed by the owners of privatized state-owned properties, through the national and municipal budgets through a target subsidy, and from the revenues obtained from sales of the state-owned properties.

Government Infrastructure Projects Winter Ski Resort Projects

The Ministry of Trade and Tourism indicated this past winter that they will facilitate winter sports facility development by foreign investors. By mid-1999 new architectural plans for Borovetz and Pamporovo winter resorts will be ready. A short-term program includes replacement and refurbishing of the old ski-lifts. There is also no lack of interest in the development of winter sports on the part of foreign companies. Talks with the Austrian companies Dopplemayer and Girak and the French Poma, which specialize in the construction of skiing facilities, are proceeding. These firms are ready to construct ski-runs, lifts and rope-lines. The possibilities of granting concessions for ski runs, lifts, rope-lines and jumps are under consideration, following the example of concessions already being granted for the Black Sea beaches.

Seaside Resort Projects

The Ministry of Regional Development and Public Works is planning a major $60 million water theme park, Bulgaria s first, at the Black Sea resort of Sunny Beach. The design contract has already been awarded. The design calls for building a new eight-floor and six-floor hotel, a bohemian center and a hydrotherapy center, and parks. Part of the new amusement facilities are to be rope-lines to man-made islands, water scenes entertainment, water skiing, and quay picnic area, green beaches, a patisserie and a mini-zoo for children. New opportunities are being explored to build marinas in the area.

Private Sector Infrastructure Projects

Seaside Resort Projects

A $500,000 project covering 4,440 square meters at the village of Sinemoretz, 130 km south of Bourgas along the Black Sea, is being studied by landowner Bulsky Ltd. The project will consist of a three-floor 340 square meter concrete and brick club building and a village of 10 partially wood two-story bungalows with 60 beds and a swimming pool.

Albena Black Sea resort, the first privatized sea resort, 30 km north of Varna, is the first Bulgarian resort featuring timesharing. A hotel chain with French participation has already established a French club hotel, A Club Paladienne. Nouvelle Frontier is to open next year. Preparatory work in cooperation with an British company for establishment of a British club hotel is under way, and in the year of 2000 a Dutch club hotel may open.

Mountain Resort Projects

A $1.5 million project for the construction of a sport and entertainment center near Bankya, 7 km north of Sofia, is underway. The center is located in a natural park, which takes up an area of one hectare with numerous mineral water spas, and which is owned by Sofia Municipality. In 1997 a private company Bankya - Klimati formed a 60/40 joint venture with the city to develop the center. The specialized center will offer a wide range of cures, treatments and sports equipment using modern facilities, as well as entertainment for all visitors.

Best Prospects

All of the above projects are best prospect infrastructure projects. The best opportunities exist for companies that specialize in hotel management, theme park development, fast food establishments, sports facilities, environmental consulting, pollution control, sewerage and waste management, and water supply services have the best opportunity to participate in the upgrade and expansion of Bulgaria's tourist infrastructure. In addition, companies may have excellent opportunities to participate in the upgrade of major infrastructure facilities that tourism depends on, including the three main airports in Sofia, Varna and Burgas, and the road and telecommunications networks.

Companies also may take the advantage of opportunities for renovation and upgrading of hotels and infrastructure facilities, public utilities, repair and maintenance, modernization and reforming the major tourist centers and assistance in the implementation of the public sector asset restructuring programs.

Market Access

Import Climate

There are no specific barriers to investment in Bulgaria's tourist infrastructure or in the import of products to be used for tourist infrastructure development. However, there have been criticisms of lack of transparency in the privatization process and complicated investment procedures, a lack of transparency of regulations, a high tax burden and restrictive taxation policies, government bureaucracy and corruption.

In a survey initiated by KPMG Bulgaria, 84 percent of foreign investors responding pointed to the legal system as one of the most serious problems for their operations. Time-consuming bureaucratic procedures were identified as the second major deterrent to foreign investments. Examples were procedures for the granting of licenses, granting concession rights, and purchasing farm land, and unfair competition in government tender procedures.

Technical Requirements

A committee of experts has published the appraised values of the ski resorts in the Official State Gazette. According to the committee's requirements, the new owners of a privatized property will be required to commit to upgrade the facilities, improve the quality of the services and participate in the repair and maintenance works of the resort's infrastructure.

Financing

Bulgaria sorely lacks abundant financing, and investors or exporters should be prepared to provide their own creative solutions to financing. More than $18.5 million in foreign investment was made in 1998 in the tourism sector. The European Bank for Reconstruction and Development introduced a new credit line of $ 35.7 million for the development of Bulgaria's private sector tourism infrastructure. Other possible sources of financing include the European Investment Bank, the Bulgarian-American Enterprise Fund, and the Overseas Private Investment Corporation. Eximbank issues credit guarantees only where there is a sovereign guarantee or equivalent security. The Bulgarian-American Enterprise Fund has a program focusing on direct investments in small privately run hotels to help private landowners convert their properties into bed-and-breakfast style hotels.

Incentives

The Foreign Investment Law and laws governing privatization offer various incentives for investors such as duty-free import of equipment and other necessary items to support an investment in kind, as well as some temporary tax incentives.

The representatives of the tourism industry elaborated a strategy for the development of tourism in Bulgaria, strategy presented at the discussion "Sustainable Development of Bulgarian Tourism, 2005-2010." The input for the elaboration of the strategy was given by the major associations in the fully private tourism branch, with the intention to submit it to the Council of Ministers and underlie, if approved, the state policy in the sphere. The basic principles in the draft strategy are that the industry should develop along the line of the public-private partnership. The actual current structure of Bulgarian tourism (mainly large-scale sea tourism) should be diversified by other forms (eco, cultural, spa tourism). Apart from the basic services (hotel accommodation, food) additional ones (animation, etc.) should also be developed, in order to extend the tourist season. The proposals underlying the draft strategy include principles such as:

- Attention should be paid not only to foreign tourists, but also to the local ones,
- To concentrate the management of the tourism industry in the hands of one body, if possible - independent ministry,
- Integration of tourism industry organizations,
- Tax-relieves, state incentives and special funds.

There is an overwhelming opinion that it is neither possible, nor necessary to eliminate the dominant role of sea tourism that accounts for some 80% of the sector’s total revenue. The idea is that alternative forms of tourism should be developed, to complement sea tourism. Many tourism experts share the view that coastal tourism is not operating at full capacity. The average annual hotel occupancy rate at Bulgarian Black sea coast is hardly 35%. The major worries are over the growing concentration of hotels in the big resorts and the chaotic nature of developments along the Black sea coast.

There is a common opinion that in the coming few years, the phenomenon with the Black sea coast construction will be repeated in the mountain resorts, around Bansko, Borovets and perhaps Velingrad. Ski tourism currently accounts for some 10% in terms of revenue and number of tourists.

Currently, a total 20 municipalities, occupying 9% of the country's territory, account for 80% of the bed capacity in Bulgaria. Many local people now are willing to invest in tourism. But when doing it by bank credits and savings, they insist that they are given guarantees about what will happen. They cannot develop their business without public-private partnerships. Any investment in tourism should be supported by the appropriate infrastructure, achieved with the active implication of the state and/or the municipalities.

4.6 Conclusions

This chapter presents the particularities of tourism and its strategic evolution during the first fifteen years of transition for each of the four countries in this study: the Czech Republic, Poland, Romania and Bulgaria.

The priority given to tourism by the state, in all countries studied, seemed to decline in the transition period, especially in the first years. The Czech and the Polish governments, unlike the Romanian and the Bulgarian ones, adopted broadly liberal tourism policies and allowed market forces to take the lead in the transformation of tourism. In this process, most tourism establishments were transferred to private ownership. Other than enabling legislation for privatization, there was little pro-active state intervention in tourism in any of the four countries. There were few state funded development projects, and except for small scale programs of subsidized loans, there were no significant changes in either the legislative or financial framework within which the newly privatized firms operated. In effect, there was a near institutional vacuum and an incomplete shift to market economy.

The four countries analyzed provide contrasting case studies of divergent pathways of transformation, in terms of their general economies and tourism in particular. Three main dimensions of the transition process have significance for tourism:

1. the broad package of stabilization and market-creating reforms which constitute the 'shock therapy' economic transition applied in the Czech Republic and Poland versus a slow-paced, gradual set of reforms in Romania and Bulgaria,
2. the re-internalization of the national tourism destinations in each country,
3. the strategies for privatization.

These have fundamentally changed the macro-economic climate for tourism, radically redistributed property rights and exposed the sector to globalization. Within this context, the results obtained in the tourism industry after 1989, and in particular in the popularity of tourism destinations in these countries, both for domestic and international tourism, are largely divergent. These results are statistically analyzed and associated with the transition strategy implemented for the tourism industry and the economies as a whole, in Chapter 5.

CHAPTER 5
COMPARATIVE ANALYSES OF THE REFORM STRATEGIES IN THE TOURISM INDUSTRY

5.1 Introduction

In this chapter, the hypotheses are formed from the research questions developed in Chapter 2 and they are statistically tested. The propositions come form three research literature streams: (1) of 'Shock Therapy' and 'Gradualism' theories, (2) on the particularities of tourism in former communist countries and (3) the studies of transition in the tourism industry, addressing the three research questions. The research model which tests these propositions is developed in section 5.2.

In continuation, the design procedures used to empirically test the hypotheses are presented. Several archival databases are used. Section 5.3 describes the population and data collection, as well as the sample of countries tested. Section 5.4 presents a detailed statistical analysis used into the measured variables.

The chapter attempts to develop a comparison of results obtained by the countries that adopted a shock therapy set of policy for the transition of their economies and the countries that implemented a gradual approach to transition. This comparative approach, realized with the use of various statistical techniques, has in view to identify factors that would confirm or infirm the hypothesis that the shock therapy approach was more effective in restructuring the tourism industries of the countries in transition, than the gradual approach. Such factors are the market share of each country in the total tourist arrivals in CEE countries, the share of receipts from tourism in the region's total receipts, the productivity of employees in travel and tourism or the efficiency of investments realized in the tourism sector.

The purpose of the statistical analysis is to identify if, based on the differences between the evolution of tourism indicators in the countries analyzed, they can be grouped according to the transition strategy adopted. If countries can form homogenous groups based on this criterion, and if the results in tourism are better for the countries that implemented a shock therapy approach to transition, then we can conclude that the application of the shock therapy transition model, at a certain pace, was more efficient in restructuring the tourism industries, than the gradual transition model.

In this respect, a sample is chosen from the population of all former communist countries in Central and Eastern Europe and a longitudinal study is conducted for the period 1989-2003 through the use of a set of macroeconomic indicators constructed in order to assure a satisfactory representation of the economic characteristics of tourism both for the group of countries that applied shock therapy and for countries that implemented a gradual approach to transition.

5.2 Hypotheses and Research Model

Hypotheses are formulated based on the research questions addressed. One of the research questions addresses the influence of the set of transition policies adopted by countries and the time period over which they were implemented.

- "Is economic performance for a country influenced by the set of policies adopted and their speed of implementation during the transition period?"

The question is theorized by the following proposition:

Proposition 1: Policy characteristics and their speed of application influence the economic performance of a country.

Question two addresses the issue of convergence of countries into homogenous groups.

- "Are the results of these policies converging across countries over time as countries compete for tourism market share in the region?"

The question is theorized by the following proposition:

Proposition 2: Based on the differences between the evolution of tourism indicators in countries in transition, countries form homogenous groups according to the transition strategy adopted.

Finally, the last research question

- "Which set of policies was more effective in reforming the economy, in general, and, particularly, the tourism industry sector during the transition period?"

is addressed by the following proposition:

Proposition 3: The shock therapy transition model, applied at a certain (rapid) pace, was more efficient in restructuring the tourism industries of countries in transition than the gradual transition model.

Based on the literature reviewed and the research propositions formulated, the research model is developed. The research model takes into account the components of the two transition models:

1. Shock Therapy: simultaneous reforms in (1) institutional structure, (2) price liberalization, (3) privatization, (4) monetary policy and financial system, (5) fiscal policy and (6) international trade
2. Gradual Reform: three rounds of economic reforms

   First round: Liberalization of prices, External trade and currency arrangements, Privatization of small-scale units

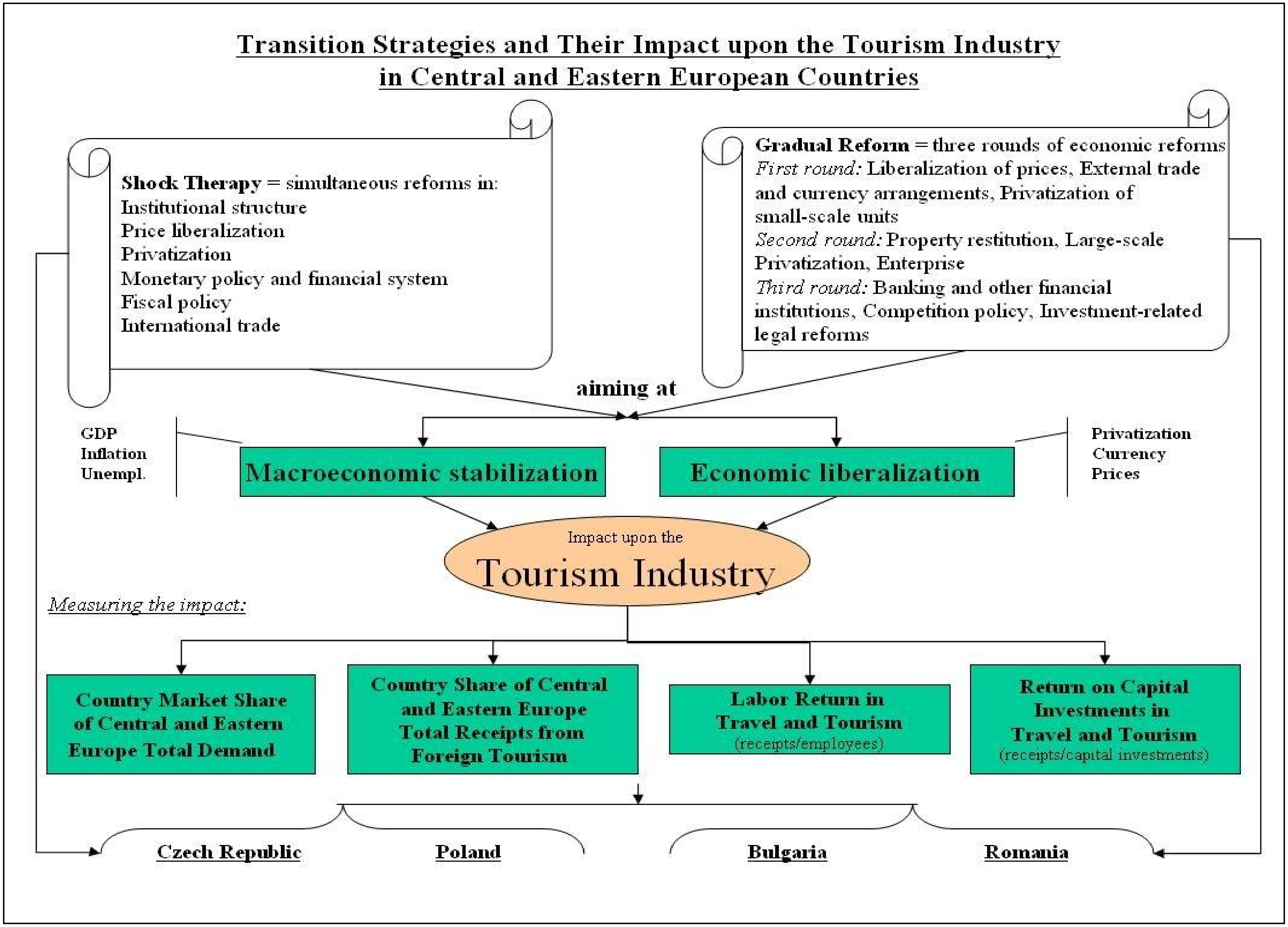
   Second round: Property restitution, Large-scale Privatization, Enterprise

Third round: Banking and other financial institutions, Competition policy, Investment-related legal reforms

and the fact that both models had in view the achievement of macroeconomic stabilization and economic liberalization.

Then it proceeds into measuring the impact of these strategies upon the tourism industries of a sample of countries in transition for which the type of transition strategy implemented is identified from the supporting literature. The impact is measure with the use of four constructed indicators (ratios). The sample and the indicators are analyzed in section 5.4. The research model is captured in detail in Figure 5.1.

Figure 5.1 Research Model



5.3 Population Selection and Data Collection

The population used includes countries of various sizes (in terms of population and/or land mass), similar levels of development (in terms of per capita income) that belong to the same region (Central and Eastern Europe [242]) and have been through similar political developments (communist regimes) for more than four decades. For an objective and representative comparison of the economic results of each of the two transition strategies applied – shock therapy and gradual reform, a representative sample was chosen. The objectives in mind when choosing the sample were:

a. to assure the application of the maximum number of reform policies that characterize each transition strategy in the countries of the same group
b. to minimize the probability of conclusions based on random characteristics of the countries in each group, such as geographic characteristics or size of the country.

For the reasons mentioned above, and as supported by the statistical analyses performed, Poland and the Czech Republic belong to the group of countries that applied mostly policies that characterize the "Shock Therapy" transition reform method, as they are defined in the reference literature and extensively discussed in sections 2.4 and 3.3 of the present thesis. Respectively, countries that applied a majority of transition policies that characterize the Gradual Reform method make up the second group and are Bulgaria and Romania. The countries in each group are also different in size and have not been through any major historical (e.g. war) or physical (e.g. earthquake, floods) catastrophe for the past fifty years, including the past 15 years of transition. By including these representative examples of countries of the Central and Eastern Europe region for each

[242] According to the definition given by the World Tourism Organization, Central and Eastern Europe includes the following 20 countries: Armenia, Azerbaijan, Belarus, Bulgaria, Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, Latvia, Lithuania, Poland, Republic of Moldova, Romania, Russian Federation, Slovakia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan

transition reform method, the risk of random characteristics that would have led to similar results is minimized.

In this context, the relationships between tourism and the transition process are strongly intertwined. On one hand, change in tourism – despite the sector having its own production and consumption characteristics and sector-specific policies – is influenced by the broad impact of the economic, social and political transformation in Central and Eastern Europe. On the other hand, tourism contributes to the transformation, being relatively open to international competition and to shifts in consumer expenditure and being a leading industry in privatization and market liberalization.

More specifically, tourism directly impacts on economies in transition through its net contribution to the national income and to employment. The economic impacts are influenced by the particular models of privatization pursued, the integration of firms in national and regional economies, and the productive, labor market and capital features of national economies. All these factors are important in the transition economies because of the way they have been transformed in the process of transition and are analyzed in the following section.

In order to assure a satisfactory representation of the economic characteristics of tourism both in the group of countries that applied a shock therapy set of transition policies (Czech Republic, Poland) and in countries that followed a gradual transition approach (Romania, Bulgaria), a set of macroeconomic tourism indicators is selected and data is gathered from official national (e.g. tourism authority from tourism/ministry of tourism) and international public and private sources (e.g. World Tourism Organization, World Travel and Tourism Council, OECD, EBRD).

Since changes in policies over time are crucial to testing the hypotheses, a longitudinal study is conducted. The time period selected is 1989 to 2003. The study begins with 1989 because this year represents the last year of communism before the period of transition started for the countries of Central and Eastern Europe and ends with 2003, the most recent year for which all data are available. This time series is sufficient to conduct any time series statistical method in that it provides at least fifteen data points for each country. Data are available in hard copy form. They are manually introduced into an 'Excel' sheet and grouped according to the following indicators:

1. Foreign tourists arrivals in each of the countries of the present study;
2. Foreign tourists arrivals in the Central and Eastern European Countries;
3. Receipts from tourism by country – includes foreign tourists' spending on goods and services in each country;
4. Receipts from tourism in the Central and Eastern European Countries;
5. Employees in travel and tourism industry – includes jobs with face-to-face contact with visitors (airlines, hotels, car rental, restaurant, retail, entertainment, etc.);
6. Travel and tourism capital investment – includes investments made in travel and tourism by providers (the private sector) and government agencies (the public sector) in facilities, equipment and infrastructure for tourists;

In order to be able to have a comparable set of data, a set of index-ratios is constructed, for each of the four countries, based on the above indicators. The main ratios that, according to the statistical analysis performed, illustrate the differences in performance results obtained by the two groups of countries are:

1. **Arrivals Ratio:**

   CMS - Country market share of Central and Eastern European total demand = (Foreign tourists arrivals in the country) / (Foreign tourists arrivals in Central and Eastern Europe)
2. **Receipts Ratio:**

CSR - Country share of total Central and Eastern European tourism receipts = (International tourism receipts of the country) / (International tourism receipts in Central and Eastern Europe)

3. **Labor Ratio:**

   LR - Labor return in travel and tourism = (International tourism receipts of the country) / (Employees in travel and tourism industry)

4. **Capital Ratio:**

   RCI - Return on capital investments in travel and tourism = (International tourism receipts) / (Travel and tourism capital investments)

The statistical techniques used to test the formulated propositions are: analysis of variance, discriminant analysis and analysis of correlation. In order to predict future results of the tourism activity and identify a possible positive or negative evolution in the next five years (up to 2008) according to the policies applied in restructuring the tourism industries in these countries, a series of forecasting models is developed for the constructed indicators. Analysis is done using the "Statgraphics" software. The results of the statistical analyses are presented in section 5.4, while the detailed charts and figures are included in the Annex.

5.4 Statistical Analyses

The purpose of this section is to apply a set of statistical techniques in order to describe the nature of each country's policies with regard to the economic development (results) recorded for the tourism industries in the four countries examined. The data is examined in order to gain inside into its characteristics. The description of the data, such as the values for the four indicators previously described, is handled using the techniques described below.

5.4.1 Analysis of Variance

In order to analyze simultaneously the difference in performance of the tourism industry in the four countries included in the present study, the analysis of variance is performed for the four ratios constructed. The analysis of variance is used to test the significance of mean differences between the sets of data for each country by analyzing the variances between groups. This analysis indicates the difference between the dependent criteria (the ratios) among countries, where each country takes the function of an independent variable. The F-test employed gives an indication of the difference in performance of each ratio in the countries included in the study (and implicitly in the results of the application of each transition strategy – shock therapy and gradual reform – in the tourism sector).

The ratios used, and for which the difference in results recorded for the tourism sector according to the transition strategy employed is proved by the F-test with a statistically significant coefficient of over 95%, are:

1. **Arrivals Ratio: CMS** - Country market share of Central and Eastern European total demand
2. **Receipts Ratio: CSR** - Country share of total Central and Eastern European tourism receipts
3. **Labor Ratio: LR** - Labor return in travel and tourism
4. **Capital Ratio: RCI** - Return on capital investments in travel and tourism

The values for the ratios for each country are taken for fifteen years (1989-2003).

One-way ANOVA – CMS by country

The procedure is used to perform a one-way analysis of variance for CMS for the four countries. The F-ratio, which represents the ratio of the between-group estimate to the within group estimate, tests whether there are significant differences among the means. The null hypothesis in this case states that there are no differences in means for the CMS ratio values of the four countries.

H_0: $\mu_{CMSCZE} = \mu_{CMSPOL} = \mu_{CMSROM} = \mu_{CMSBUL}$

H_1: at least one of the μ_{CMS} is different than the others

Figure 5.2:

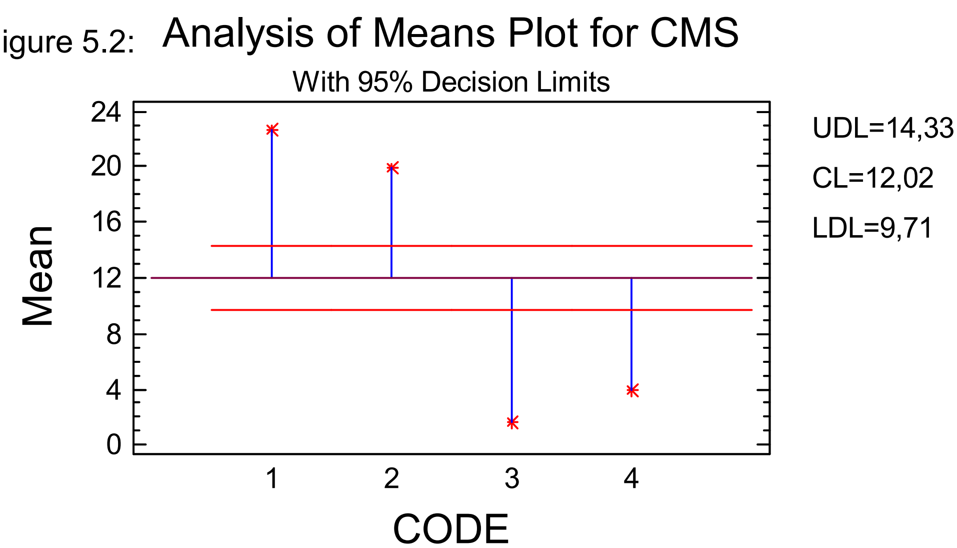


Table 5.1 ANOVA Table for CMS by Country

Analysis of Variance

Source	Sum of Squares	Df	Mean Square	F-Ratio	P-Value
Between groups	5209,87	3	1736,62	105,59	0,0000
Within groups	920,985	56	16,4462		
Total (Corr.)	6130,86	59			

In the table above the F-ratio equals 105.59. Since the P-value of the F-test is less than 0.05, there is a statistically significant difference between the mean CMS ratio from one country to another, at the 95% confidence level, and therefore the null hypothesis is rejected. Given that, a Multiple Range Test is performed in order to determine which means are significantly different from which others. The means for the CMS ratio are computed with Fisher's Least Significant Difference (LSD) procedure, with 95% intervals, in order to group the analyzed countries into homogenous groups. They are summarized in the table below.

Table 5.2 Multiple Range Tests for CMS by Country

Method: 95,0 percent LSD

Country	Count	Mean	Homogeneous Groups
3 (Romania)	15	1,59133	X
4 (Bulgaria)	15	3,98667	X
2 (Poland)	15	19,8633	X
1 (Czech Rep.)	15	22,6273	X

Contrast	Difference	+/- Limits
1 - 2 (Czech Rep. - Poland)	2,764	2,96644
1 - 3 (Czech Rep. - Romania)	***21,036**	2,96644
1 - 4 (Czech Rep. - Bulgaria)	***18,6407**	2,96644
2 - 3 (Poland - Romania)	***18,272**	2,96644
2 - 4 (Poland - Bulgaria)	***15,8767**	2,96644
3 - 4 (Romania - Bulgaria)	-2,39533	2,96644

As shown in the table above, through a multiple comparison procedure, some means are significantly different than some others. The mean difference listed with a * denote a statistically significant difference at the 95% confidence level. As such, two homogenous groups are identified. They are:

1. The group comprising Romania and Bulgaria
2. The group comprising Poland and the Czech Republic

The groups coincide with the countries that followed a gradual approach in restructuring their tourism industry versus the countries that applied a shock therapy approach to their transition in tourism. Within each group, the means for the CMS variable shows no statistically significant differences.

In order to avoid a misinterpretation of results due to possible outliers contained in the data for CMS in all observations, a Kruskal-Wallis test is performed and the medians, instead of the means, are compared for the four sets of data. The null hypothesis in this case states that there are no differences in medians for the CMS ratio values of the four countries. The test results are summarized in the table below:

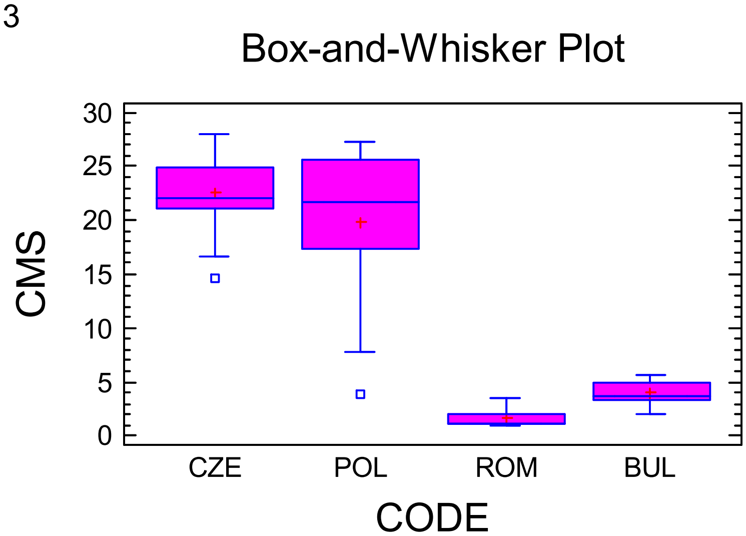
Table 5.3 Kruskal-Wallis Test for CMS by Country

Country	Sample Size	Average Rank
1 (CZE)	15	46,7333
2 (POL)	15	43,8
3 (ROM)	15	8,53333
4 (BUL)	15	22,9333

Test statistic = 48,2079   P-Value = 1,92323E-10

Since the P-value is less than 0.05, there is a statistically significant difference among the medians at the 95% confidence level and the null hypothesis is rejected. The differences in the medians are plotted in a Box-and-Whisker plot.

Figure 5.3



- the ends of the box are the upper and lower quartiles, so the box spans the interquartile range
- the median is marked by a vertical line inside the box
- the whiskers are the two lines outside the box that extend to the highest and lowest values of CMS
- the two points not connected to the whiskers that appear in the Czech Republic and Poland data sets are the outliers, the unusual lower values in the sets of data

The analysis of the median confirms the results of the difference in mean levels showing that there is a statistically significant difference between the results recorded for the country market share in the total of foreign tourists who choose destinations in the countries of the Central and Eastern Europe in the first fifteen years of transition between the countries that applied a gradual reform strategy and the countries that followed a shock therapy approach for their transformation.

One-way ANOVA – CSR by country

A one-way analysis of variance is performed for the CSR ratio of the four countries simultaneously in a similar manner with the CMS ratio. The F-ratio in this case equals 47.02 and since the P-value is less than 0.05, there is a statistically significant difference between the mean of the ratios CSR from one country to another at the 95% confidence level.

Table 5.4 ANOVA Table for CSR by country

Analysis of Variance

Source	Sum of Squares	Df	Mean Square	F-Ratio	P-Value
Between groups	6521,99	3	2174,0	47,02	0,0000
Within groups	2589,37	56	46,2387		
Total (Corr.)	9111,35	59			

The Multiple Range test, which determines how means are significantly different from one another, identified two homogenous groups of countries:

1. The group comprising Romania and Bulgaria
2. The group comprising Poland and the Czech Republic

The groups coincide with the ones found in the previous analysis of variance of the CMS ratio and refer to countries that followed a gradual approach in restructuring their tourism industry versus the countries that applied a shock therapy approach to their transition in tourism. Within each group, the means for the CSR variable shows no statistically significant differences.

The Kruskal-Wallis performed for identifying the difference in the medians (for avoiding erroneous results due to possible outliers) is presented below:

Table 5.5 Kruskal-Wallis Test for CSR by Country

Country	Sample Size	Average Rank
1 (CZE)	15	39,6667
2 (POL)	15	50,0667
3 (ROM)	15	12,9333
4 (BUL)	15	19,3333

Test statistic = 44,2716   P-Value = 1,32142E-9

Since the P-value is less than 0,05, there is a statistically significant difference amongst the medians at the 95,0% confidence level. The analysis of the median confirms the results of the difference in mean levels showing that there is a statistically significant difference between the results recorded for each country share in the total receipts from foreign tourists arrivals as related to the receipts from incoming tourism of the countries of the Central and Eastern Europe in the first fifteen years of transition between the countries that applied a gradual reform strategy and the countries that followed a shock therapy approach for their transformation.

One-way ANOVA – LR by country

A one-way analysis of variance is performed for the LR ratio of the four countries simultaneously in a similar manner with the CMS and the CSR ratios. The F-ratio in this case equals 18.99 and since the P-value is less than 0.05, there is a statistically significant difference between the mean of the ratios LR from one country to another at the 95% confidence level.

Table 5.6 ANOVA Table for LR by Country

Analysis of Variance

Source	Sum of Squares	Df	Mean Square	F-Ratio	P-Value
Between groups	1782,91	3	594,303	18,99	0,0000
Within groups	1752,98	56	31,3032		
Total (Corr.)	3535,89	59			

The Multiple Range test, which determines how means are significantly different from one another, identified two homogenous groups of countries:

1. The group comprising Romania and Bulgaria
2. The group comprising Poland and the Czech Republic

The groups coincide with the ones found in the previous analysis of variance of the CMS and CSR ratios and refer to countries that followed a gradual approach in restructuring their tourism industry versus the countries that applied a shock therapy approach to their transition in tourism. Within each group, the means for the LR variable shows no statistically significant differences.

The Kruskal-Wallis performed for identifying the difference in the medians (for avoiding erroneous results due to possible outliers) is presented below:

Table 5.7 Kruskal-Wallis Test for LR by Country

Country	Sample Size	Average Rank
1 (CZE)	15	44,8
2 (POL)	15	37,8
3 (ROM)	15	14,7333
4 (BUL)	15	24,6667

Test statistic = 26,5776   P-Value = 0,00000721866

Since the P-value is less than 0,05, there is a statistically significant difference amongst the medians at the 95,0% confidence level. The analysis of the median confirms the results of the difference in mean levels showing that there is a statistically significant difference between the results recorded for the receipts from incoming tourism per employee in travel and tourism in the first fifteen years of transition between the countries that applied a gradual reform strategy and the countries that followed a shock therapy approach for their transformation.

One-way ANOVA – RCI by country

A one-way analysis of variance is performed for the RCI ratio of the four countries simultaneously in a similar manner with the CMS, CSR and the LR ratios. The F-ratio in this case equals 11.48 and since the P-value is less than

0.05, there is a statistically significant difference between the mean of the ratios RCI from one country to another at the 95% confidence level.

Table 5.8 ANOVA Table for RCI by country

Analysis of Variance

Source	Sum of Squares	Df	Mean Square	F-Ratio	P-Value
Between groups	539848,0	3	179949,0	11,48	0,0000
Within groups	877481,0	56	15669,3		
Total (Corr.)	1,41733E6	59			

The Multiple Range test, which determines how means are significantly different from one another, identified two homogenous groups of countries:

1. The group comprising Romania and Bulgaria
2. The group comprising Poland and the Czech Republic

Table 5.9 Multiple Range Tests for RCI by country

Method: 95,0 percent LSD

Country	Count	Mean	Homogeneous Groups	
3 (ROM)	15	73,9287	X	
4 (BUL)	15	139,561	X	
2 (POL)	15	233,475		X
1 (CZE)	15	324,598		X

Contrast	Difference	+/- Limits
1 - 2	91,1233	91,5647
1 - 3	*250,669	91,5647
1 - 4	*185,037	91,5647
2 - 3	*159,546	91,5647
2 - 4	*93,9133	91,5647
3 - 4	-65,6327	91,5647

* denotes a statistically significant difference.

The groups coincide with the ones found in the previous analysis of variance of the CMS, CSR and LR ratios and refer to countries that followed a gradual approach in restructuring their tourism industry versus the countries that applied a shock therapy approach to their transition in tourism. Within each group, the means for the RCI variable shows no statistically significant differences.

The Kruskal-Wallis performed for identifying the difference in the medians (for avoiding erroneous results due to possible outliers) is presented below:

Table 5.10 Kruskal-Wallis Test for RCI by Country

Country	Sample Size	Average Rank
1 (CZE)	15	42,6667
2 (POL)	15	36,8667
3 (ROM)	15	17,2667
4 (BUL)	15	25,2

Test statistic = 19,2675 P-Value = 0,000240692

Since the P-value is less than 0,05, there is a statistically significant difference amongst the medians at the 95,0% confidence level. The analysis of the median confirms the results of the difference in mean levels showing that there is a statistically significant difference between the results recorded for the return on capital investments in travel and tourism in the first fifteen years of transition between the countries that applied a gradual reform strategy and the countries that followed a shock therapy approach for their transformation.

Conclusion: The analysis of the four indicators in each of the four countries of the study shows that Poland and the Czech Republic belong to one homogenous group of countries and record significantly higher mean and median values, throughout the fifteen years of transition included in the present study, than Romania and Bulgaria, that constitute another homogenous group of countries. To some extent, this reflects the fact that the initial situation of the first homogenous group (Poland, Czech Republic), at the beginning of the transition period, was in some respects (e.g. CMSCZ) more positive than that of Romania and Bulgaria. In addition to that, also, their evolution was important in terms of the progress recorded during the transition period in “absorbing” the foreign tourists expenditure, increasing their share in the total expenditure of the region, reducing labor force and employing it with increased productivity and providing a favorable climate for investments. Each of the two homogenous groups of countries relates to the transition method they followed for the tourism sector:

Poland and the Czech Republic to the Shock Therapy approach and Romania and Bulgaria to the gradual reform approach. Their association to one transition method or the other is extensively discussed in Chapter 4.

5.4.2 Discriminant Analysis

As shown in the previous section, by using the analysis of variance, the four countries analyzed for their economic results in the tourism industry from applying the shock therapy transition strategy or the gradual reform transition strategy are classified in two homogenous groups that present statistically significant difference between each other. From another perspective, it is useful to further verify the validity of this classification by searching the statistical determination with which we could classify the four countries in one of the two identified groups based on values of a set of independent variables. For this purpose, the multivariate technique Discriminant Analysis is used to predict the value of a dependent variable based on the values of a set of independent variables.

The Decision Process for the Discriminant Analysis

The application of the discriminant analysis is viewed from a five-stage model-building perspective (adapted model from Hair et al., 1998)[243]. Setting the objectives is the first step in the analysis. Then design is addressed and assumptions are checked to be met. The analysis proceeds with the derivation of the statistically significant discriminant function to separate the two groups. The discriminant results are then assessed for accuracy by developing a classification matrix. Finally, the interpretation of the discriminant function determines which of the independent variables contributes the most to discriminating between groups. The stages are discussed below.

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[243] Hair, J. F. Jr., Anderson, R. E., Tatham, R. L., Black, W. C., 1998. *Multivariate Data Analysis*, 5th edition, Prentice-Hall International, Inc., p. 255, 261

Stage 1: Objectives of the analysis

The analysis addresses the following research objectives:

- determining whether statistically significant differences exist between the average score profiles on the set of three variables for two a priori defined groups of countries: group 1 – countries that applied the shock therapy reform method for the transition of their tourism industries, e.g. the Czech Republic and Poland, and group 2 – countries that followed a gradual approach to the transformation of national tourism industries
- determining which of the independent variables account the most for the differences in the average score profiles of the two groups
- establishing procedures for classifying countries into the two groups on the basis of their scores on the set of three independent variables

In the present study, the analysis is a profile analysis, as it provides an assessment of differences between the two groups on the set of three best discriminant independent variables. For classification purposes, the analysis provides a basis for classification not only of the fifteen-year sample used to estimate the discriminant function, but also other previous or following years for which values of the three independent variables are identified.

Stage 2: Research design

For the application of the discriminant analysis technique, several issues are considered, such as: selection of the dependent and independent variables and the sample size. In this case, the dependent variable is qualitative (nominal or non-metric) and is a classification: group 1 (countries that applied shock therapy transition method) or group 2 (countries that applied gradual reform transition method). The groups are mutually exclusive and dichotomous, i.e. each country can belong only to one group. The independent variables (metric) that lead to the classification of countries into one of the two groups are three indicators (ratios) chosen that have the maximum effect on whether one country will be classified in group 1 or group 2. The independent variables are selected by identifying the variables of the theoretical model that is the underlying basis of this research and contribute to the giving light to the research question of whether the shock therapy transition method was a more effective method than gradualism in reforming the tourism industry of Central and Eastern European countries.

The sample size comprises indicators for the four countries for fifteen years (60 observations), which is considered very satisfactory as it exceeds the minimum size recommended of five observations per independent variable and twenty observations per group, with equal relative size of each group (30 observations). No validation sample is used, as the predictions of the discriminant function are highly significant, as will be seen in the 'results' section below.

Stage 3: Assumptions

The data is examined for multivariate normality of the independent variables and equal dispersion and covariance matrices for the groups defined by the dependent variable. The independent variables are also examined for multicollinearity so that the variables add significant explanation to the set. Another assumption is that all relationships are linear.

Stage 4: Estimation of the discriminant model

The computational method used in deriving the discriminant function is the simultaneous method. All independent variables that meet the non-multicollinearity criterion are considered concurrently and the discriminant function is computed. These are:

1. **CMS** - Country market share of Central and Eastern European total demand = (Foreign tourists arrivals in the country) / (Foreign tourists arrivals in Central and Eastern Europe)
2. **LR** - Labor return in travel and tourism = (International tourism receipts of the country) / (Employees in travel and tourism industry)
3. **RCI** - Return on capital investments in travel and tourism = (International tourism receipts) / (Travel and tourism capital investments)

The functions with P-value less than 0.05 are statistically significant at the 95% confidence level.

Stage 5: Interpretation of the discriminant function

The function is interpreted for the significance in the discrimination and a cutting score against which the discriminant scores are compared is determined. Because the groups are equal in size the cutting score is found halfway between the two group centroids. A classification matrix is constructed for interpreting the results.

Discriminant Analysis – Results

The two-group discriminant analysis is designed to develop a discriminating function, which can help predict the classification group based on the linear combination of the independent (quantitative) variables.

Indicators for the four countries for fifteen years (60 cases) were used to discriminate between the two groups. The predictor variables that best discriminate between group 1 and group 2 and meet the assumptions described in stage 3 are the independent variables: **CMS** (country market share of Central and Eastern European total demand), **LR** – (labor return in travel and tourism) and **RCI** (return on capital investments in travel and tourism).

The prediction (discriminant) function (D) has the following form:

$$D = b_0 + b_1X_{CMS} + b_2X_{LR} + b_3X_{RCI}$$

where:

- D is the weighted combination of the three indicators to be used in predicting the likelihood that one of the countries belongs to group 1 or to group 2,
- the b_0, b_1, b_2, b_3 are the discriminant weights (classification coefficients), b_0 is a constant and

- the X_{CMS}, X_{LR} and X_{RCI} are the values of the corresponding ratios for the four countries for fifteen years of observation (in each computation of the value of D, they are used for one country for one year).

The classification coefficients for the D function are:

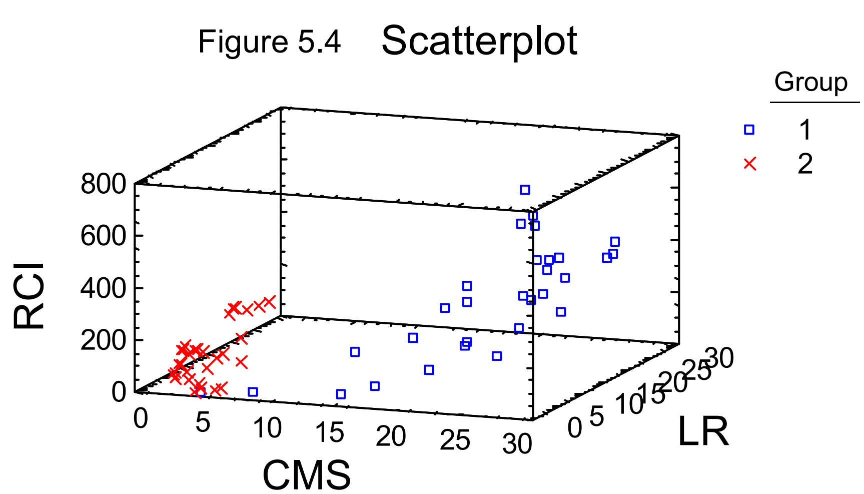
Independent Variables	Coefficients
CMS (b_1)	0,294831
LR (b_2)	-0,0626527
RCI (b_3)	0,000712013
CONSTANT (b_0)	-2,78579

Therefore, the function used to classify the countries into one of the two groups is:

$$D_{\text{(group 1, group 2)}} = -2.78579 + 0.294831\ X_{CMS} - 0.0626527\ X_{LR} + 0.000712013\ X_{RCI}$$

This function is used to predict which of the groups (group 1 or group 2) new observations belong to. The 60 observations used for the three predictor variables are plotted in a three-dimensional scatterplot:

Figure 5.4



The group centroids are:

Group	Centroids
1	2,33881
2	-2,33881

and with the groups being equal in size, the cutting score is zero. Discriminant scores greater than zero (positive scores) indicate a predicted membership of the country in group 1, while negative scores imply predicted membership in group 2.

Among the 60 observations used to fit the model, 58 or 96.67% were correctly classified. They are summarized in the classification matrix below:

Table 5.11 Discriminant Analysis – Classification Matrix

Actual Group	Group Size	Predicted Group 1	Predicted Group 2	Prior Probability
1	30	28 (**93,33%**)	2 (6,67%)	(50%)
2	30	0 (0,00%)	30 (**100,00%**)	(50%)

Percent of cases correctly classified: 96,67%

This classification matrix shows that if one country belongs to group 1 (application of shock therapy transition model), then if given the best discriminant ratios CMS, LR and CSI, the country will be classified into group 1 with statistical determination of 93.33%, compared to a probability of 50% before performing the discriminant analysis. And, respectively, if another country belongs to the group of countries that followed a gradual approach for restructuring their tourism industry, and given the values of the indicators CMS, LR and CSI, this country will be classified as belonging to group 2 with a statistical determination of 100%.

<u>Conclusion:</u> The results obtained from the discriminant analysis for the performance results of the tourism industries in the four countries analyzed

confirm, with a statistical significance that ranges between 96.67% and 100%, the classification of countries into homogenous groups based on the criterion of the nature of strategy approach adopted by each of the countries in reforming their tourism industry: shock therapy for the countries in group 1 (Czech Republic and Poland) and gradual reform for the countries in group 2 (Romania and Bulgaria).

5.4.3 Correlation Analysis

In order to determine the nature of tourism through the various relationships existing between the four analyzed indicators (ratios) in each of the countries studied, a correlation analysis is performed for these indicators, in each country. This analysis helps quantifying these relationships and interpreting their type, strength and meaning. This section presents, in the first part, the relationships found between indicators based on the statistical analysis and proceeds, in the second part, to the interpretation of these relationships with the additional use of information from selected literature and previous research.

In this section, the indicators (variables): CMS (country market share of Central and Eastern European total demand), CSR (country share of total Central and Eastern European tourism receipts), LR (labor return in travel and tourism), RCI (return on capital investments in travel and tourism) are examined for each country, for the period 1989-2003 (fifteen cases), for identifying the possible existing correlations between each two of them. The relationships are determined by using the product-moment Pearson coefficient, for the data variables that fulfill the assumption of normality, and by using the Spearman rank correlation between each pair of indicators (variables) in case the data does not fulfill the normality condition. The Spearman coefficients are computed from the ranks of the data values rather than from the values themselves and, consequently, they are less sensitive to outliers than the Pearson coefficients. For testing the statistical significance of the estimated correlations the P-values are estimated, with P-values below 0.05 indicating statistically significant non-zero correlations at the 95% confidence level.

1. *Czech Republic*

A set of summary statistics is computed for the four selected data variables. It includes measures of central tendency, measures of variability, and measures of shape. The results are presented in the table below:

Table 5.12 Summary Statistics

	CMS	CSR	LR	RCI
Count	15	15	15	15
Average	22,6273	12,2967	17,1927	324,598
Median	22,05	13,03	21,24	390,36
Standard deviation	3,82922	2,95173	8,53134	192,794
Minimum	14,7	4,37	1,54	20,63
Maximum	27,96	16,53	25,31	622,57
Range	13,26	12,16	23,77	601,94
Stnd. skewness	-0,773418	-2,30576	-1,17936	-0,559807
Stnd. kurtosis	0,040444	2,26199	-0,860587	-0,931944
Coeff. of variation	16,923%	24,0043%	49,622%	59,3946%

Of particular interest here are the standardized skewness and standardized kurtosis, which indicate whether the sample comes from a normal distribution. The values of these statistics outside the range of -2 to +2 indicate significant departures from normality, which would tend to invalidate many of the statistical procedures normally applied to this data. In this case, the variable CSR shows standardized skewness values and standardized kurtosis values outside the expected range. In this case, the Spearman rank correlations are used.

The following pairs of variables have P-values below 0.05 and are considered significantly correlated at 95% confidence level (see table 5.13):

- CMS and LR
- CSR and LR
- CSR and RCI
- LR and RCI

The interpretation of these correlations is presented in the following section.

Table 5.13 Correlations – Czech Republic

	CMS	CSR	LR	RCI
CMS		0,3821 (15) 0,1528	**0,6929** (15) **0,0095**	0,2964 (15) 0,2674
CSR	0,3821 (15) 0,1528		**0,7464** (15) **0,0052**	**0,6821** (15) **0,0107**
LR	0,6929 (15) 0,0095	0,7464 (15) 0,0052		**0,7464** (15) **0,0052**
RCI	0,2964 (15) 0,2674	0,6821 (15) 0,0107	0,7464 (15) 0,0052	

2. Poland

From the summary statistics computed for each of the selected indicators (variables) the condition of normality is fulfilled (standardized skewness and standardized kurtosis are within the range of -2 to +2) and the Pearson product-moment correlations between each pair of indicators is computed. The results are presented in the table below:

Table 5.14 Correlations - Poland

	CMS	CSR	LR	RCI
CMS		**0,5465** (15) **0,0350**	**0,7775** (15) **0,0006**	**0,8614** (15) **0,0000**
CSR	0,5465 (15) 0,0350		0,2945 (15) 0,2867	0,3924 (15) 0,1480
LR	0,7775 (15) 0,0006	0,2945 (15) 0,2867		**0,9362** (15) **0,0000**
RCI	0,8614 (15) 0,0000	0,3924 (15) 0,1480	0,9362 (15) 0,0000	

The following pairs of variables have P-values below 0.05 and are considered significantly correlated at 95% confidence level:

- CMS and CSR
- CMS and LR
- CMS and RCI
- LR and RCI

The interpretation of these correlations is presented in the following section.

3. *Romania*

From the summary statistics computed for each of the selected indicators (variables) the condition of normality is fulfilled (standardized skewness and standardized kurtosis are within the range of -2 to +2) and the Pearson product-moment correlations between each pair of indicators is computed. The results are presented in the table below:

Table 5.15 Correlations - Romania

	CMS	CSR	LR	RCI
CMS		-0,2977 (15) 0,2811	**-0,6499** (15) **0,0087**	**-0,7511** (15) **0,0012**
CSR	-0,2977 (15) 0,2811		**0,6396** (15) **0,0102**	**0,6006** (15) **0,0179**
LR	-0,6499 (15) 0,0087	0,6396 (15) 0,0102		**0,8597** (15) **0,0000**
RCI	-0,7511 (15) 0,0012	0,6006 (15) 0,0179	0,8597 (15) 0,0000	

The following pairs of variables have P-values below 0.05 and are considered significantly correlated at 95% confidence level:

- CMS and LR
- CMS and RCI

- CSR and LR
- CSR and RCI
- LR and RCI

The interpretation of these correlations is presented in the following section.

4. *Bulgaria*

From the summary statistics computed for each of the selected indicators (variables) the condition of normality is fulfilled (standardized skewness and standardized kurtosis are within the range of -2 to +2) and the Pearson product-moment correlations between each pair of indicators is computed. The results are presented in Table 5.16:

Table 5.16 Correlations – Bulgaria

	CMS	CSR	LR	RCI
CMS		0,0931 (15) 0,7413	0,0549 (15) 0,8460	0,0976 (15) 0,7293
CSR	0,0931 (15) 0,7413		**0,5610** (15) **0,0296**	**0,5320** (15) **0,0412**
LR	0,0549 (15) 0,8460	0,5610 (15) 0,0296		**0,8995** (15) **0,0000**
RCI	0,0976 (15) 0,7293	0,5320 (15) 0,0412	0,8995 (15) 0,0000	

The following pairs of variables have P-values below 0.05 and are considered significantly correlated at 95% confidence level:

- CSR and LR
- CSR and RCI
- LR and RCI

The interpretation of these correlations is presented in the following section.

Interpretation of Results

The correlation analysis identified several relationships between the four indicators in each country. These relationships show either positive or negative correlation and will be interpreted in this section by the use of additional information from selected literature and previous research. It is useful to analyze the aggregate results for each type of correlations by identifying the countries in which it occurs and their strengths and type. The table below presents the relationships found in different countries. The four indicators (variables) are listed on the head row and head column, while the countries in which the relationship between different pairs of variables is identified are listed in the cells, with the appropriate type [positive (+) or negative (-)] and strength of correlation.

Table 5.17 Correlations Chart

	CMS	CSR	LR	RCI
CMS				
CSR	Poland (+0.55)			
LR	Czech Republic (+0.69) Poland (+0.78) Romania (-0.65)	Czech Republic (+0.75) Romania (+0.64) Bulgaria (+0.56)		
RCI	Poland (+0.86) Romania (-0.75)	Czech Republic (+0.68) Romania (+0.60) Bulgaria (+0.53)	Czech Republic (+0.74) Poland (+0.94) Romania (+0.86) Bulgaria (+0.90)	

From the table above, some correlations indicate various characteristics for the tourism in different countries and its evolution during the first fifteen years of transition and are discussed below. Of particular importance for the present study are the correlations between CMS and CSR, CMS and LR, and CMS and RCI.

1. *CMS and CSR*

The CMS (country market share of Central and Eastern European total demand), ratio defined as:

$$\text{CMS} = \frac{\text{(Foreign tourists arrivals in the country)}}{\text{(Foreign tourists arrivals in Central and Eastern Europe)}}$$

and the CSR (country share of total Central and Eastern European tourism receipts) ratio, defined as:

$$CSR = \frac{\text{(International tourism receipts of the country)}}{\text{(International tourism receipts in Central and Eastern Europe)}}$$

are positively correlated at 95% confidence level only in the case of Poland. This may be due to one or more of the following reasons:

- The profile of foreign tourists who visit Poland comprises a strong market segment of business tourists[244] who are considered a more stable category of tourists, i.e. less sensitive to elements such as pricing (Cooper et. al, 1999)[245], seasonality or competitive destinations.
- The arrivals of foreign tourists from adjacent countries was stabilized or decreased in Poland, during the period 1994-2003, with parallel growth being recorded for West Europeans and overseas markets. This had immediate consequences upon the receipts from incoming tourism, as receipts per tourist arrival from Western European countries have been much higher than the ones of tourists from neighboring ex-communist countries.
- The average occupancy rates in Poland are stable and increasing as foreign tourists arrivals increase
- Package groups had a declining trend in market share, whereas independent travel has been increasing dramatically (from 53% in 1993 to 80% in 2003) constituting a higher income generator factor.

At the same time, the correlation is not statistically significant in the Czech Republic, Romania or Bulgaria for reasons such as:

- They still rely to a large extent on arrivals of foreign tourists from the former communist neighboring countries, whose expenditure in the countries visited does not always increase when the number of tourists

[244] WTO, 1998. *Tourism Market Trends*, p. 112
[245] Cooper, C., Fletcher, J., Gilbert, D., Wanhill, S., 1999. *Tourism Principles and Practice*, second edition, Longman, p. 282

increases.

- The main purpose of visit of foreign tourists was leisure (recreational) holidays, which is a type of tourism sensitive to pricing and international competition, with business tourism playing a less significant role.
- Revenues from incoming tourism were based, to a large extent, on package groups; the more a country relies on this type of tourism the less it records increases in receipts from incoming tourism.
- The most widely used accommodation by foreign tourists were one and two stars hotels and private rooms.

2. CMS and LR

The CMS (country market share of Central and Eastern European total demand), ratio defined above and the LR (labor return in travel and tourism) ratio, defined as:

$$LR = \frac{\text{(International tourism receipts of the country)}}{\text{(Employees in travel and tourism)}}$$

are positively correlated at 95% confidence level in the case of the Czech Republic and Poland and negatively correlated in the case of Romania. This is explained by the process of privatization of former national tourism assets adopted in these countries, according to the strategy of transformation they followed (shock therapy or gradual reform).

Positive correlation means that as the market share of foreign tourists arrivals rises in the countries, the receipts per employee in travel and tourism will also rise. The immediate argument is that in a largely privatized tourism sector the sovereign owners have a long-term incentive for accepting total responsibility concerning the efficient performance of their property (Larçon, 1998)[246]. In the first years of transition (1989-1995), the Czech Republic and Poland, adopters of a shock therapy approach to transition, went through a rapid privatization

[246] Larçon, J. P., 1998. *Entrepreneurship and Economic Transition in Central Europe*, Kluwer Academic Publishers, Massachusetts, p. 38

process in the tourism sector, with up to 80% of the tourism assets being privatized by the end of 1995[247]. This lead to a 'rationalization' of the work force employed in tourism activities (airlines, hotels, car rental, retail, entertainment, etc.) that resulted in a higher efficiency of the use of work force by the new owners reflected by higher revenues from foreign tourists per employee.

On the other hand, in Romania, by the adoption of a gradualist approach to transition, the privatization process started late, in 1992, three years after the Revolution in 1999, and tourism assets had been privatized up to only 13.3% by 1994. The fear of unemployment in the country is one of the causes to this slow progress, which lead to retaining much of the work force in the privatized or semi-privatized units, and all work force in the tourism assets still in state control. This may explain the negative correlation between the two indicators, where the evolution of the market share of the country, although increasing, is not followed by an analogous increase in employee productivity reflected by the LR ratio.

3. *CMS and RCI*

The CMS (country market share of Central and Eastern European total demand), ratio defined above and the RCI (return on capital investments in travel and tourism) ratio, defined as:

$$RCI = \frac{\text{(International tourism receipts of the country)}}{\text{(Capital investments in travel and tourism)}}$$

are positively correlated at 95% confidence level in the case of Poland and negatively correlated in the case of Romania. This means that with an increase in the market share of foreign tourists visiting Poland, the efficiency of capital investments in tourism increases, as reflected in the receipts from the tourists visiting the country. In Romania, the decrease in the market share of Central and Eastern European total demand between 1989-1996, is associated with an

[247] Williams, A., Balaz, V., 2000. *Tourism in Transition*, I. B. Tauris Publishing, London, p. 93

increase in receipts from incoming tourism, while the increasing market share trend existing between 1997-2003 takes place in the context of a decrease in receipts from incoming tourism at almost constant level of investment in travel and tourism, therefore of decrease in RCI.

In Poland, research and field studies confirm a strong positive impact of both foreign and local capital investments on companies and the economy. Capital investments in the tourism sector stimulate the transfer and the circulation of capital and technology as well as the improvement of employee qualifications and the companies' market reorientation. The newly established firms broadened their trade contacts, increased competitiveness of their services and improved the quality of the publicity and sales network. This is reflected in the increase in popularity of the tourism destinations in Poland and the higher amounts of expenditure per tourist. Increased attractiveness for foreign direct investment of Poland also generated a stronger business tourism segment which contributed to increased revenues from foreign tourists arrivals.

During the period 1989-1996 foreign tourist arrivals in Romania did not record significant changes (a slight average annual decrease of 4% in incoming tourism). But with a delayed start in the transition process and the lack of a sustainable strategy for tourism, reform did not keep pace with the increased popularity of other destinations in Central and Eastern Europe, thus loosing market share (CMS decreased). At the same time, a trend to realign prices to international level, but still under the level of sensitivity of demand, generated increased levels of receipts from foreign tourism (RCI increased). From 1997, with arrivals in the Central and Eastern European region declining, Romania has maintained and slightly increased its market share in the region. The increased competitiveness of destinations and its relying mostly on holiday tourism led to a shift in the profile of foreign tourism who visit the country, with package holidays increasing in popularity and the one and two star hotels recording the highest occupancy rates. This resulted in a decrease in the overall receipts from incoming tourism and, with constant figures of capital investment during the whole period, to a decrease in the RCI ratio.

5.4.4 Forecasting Models

The forecasting models described below are meant to give a further insight into the results expected by the tourism industries of the four countries analyzed, having in view the different transition strategies they applied and the results obtained for the four constructed tourism indicators in the first fifteen years of transition. The goal is to predict future results of the tourism activity and identify a possible positive or negative evolution, according to the policies applied in restructuring the tourism industries in these countries.

For each of the four countries and indicators a time series plot was first developed for the fifteen years of observations collected (1989-2003) in order to determine the appropriate forecasting method to be used. Then, forecasting models were calculated with the use of the program StatGraphics for the five year period 2004-2008 for all the four indicators - CMS, CSR, LR and RCI - for one country in each of the two groups. In the group of countries which adopted a shock-therapy approach to transition in tourism, forecasts are computed for the Czech Republic, while for the group of countries that followed a gradual approach to transition in tourism, forecasts are computed for the four indicators of Romania. Specifically, these are the countries in each group with the highest expected results in the future.

The future values of the ratios are computed by using the data that covers the fifteen time periods considered. The goal is to identify the best forecasting model for future data based on previous data collected. A number of forecasting methods are tested with the use of various statistics such as: the root mean squared error (RMSE), the mean absolute error (MAE), the mean absolute percentage error (MAPE), the mean error (ME) and the mean percentage error

(MPE). Each of the statistics is based on the one-ahead forecast errors, which are the differences between the data value at time t and the forecast of that value at t-1. The first three statistics measure the magnitude of the errors. A better model gives a smaller value. The last two statistics measure bias. A better model gives a value close to zero. The results of fitting different models to the data are compared by using the following tests:

RMSE: Root Mean Squared Error

RUNS: Test for excessive runs up and down

RUNM: Test for excessive runs above and below median

AUTO: Box-Pierce test for excessive autocorrelation

MEAN: Test for difference in mean first half to second half

VAR: Test for difference in Variance first half to second half

The five tests are run on the residuals to determine whether each model is adequate for the data. A value of $p >= 0.05$ indicates that the error is not significant. The model with the lowest value of AIC (Akaike Information Criterion) is selected for generating forecasts. The data is displayed graphically with the predicted values from the fitted model and the residuals (95% prediction limits for the forecasts).

A detailed presentation of selected results of the analysis is presented in Annex The forecasting models used for the two countries are summarized in the table below:

Table 5.18 Forecasting Models

Country	**Indicator**	**Forecasting Model used**
Czech Republic	CMS	Exponential trend: exp(-64.6946 + 0.0339675 t)
	CSR	Brown's linear exponential smoothing with $\alpha = 0.6338$
	LR	Brown's linear exponential smoothing with $\alpha = 0.7239$
	RCI	Holt's linear exponential smoothing with $\alpha = 0.9917$, $\beta = 0.1352$
Romania	CMS	ARMA (3,2)
	CSR	Holt's linear exponential smoothing with $\alpha = 0.9999$, $\beta = 0.0496$
	LR	Holt's linear exponential smoothing with $\alpha = 0.9999$, $\beta = 0.0496$
	RCI	Holt's linear exponential smoothing with $\alpha = 0.9999$, $\beta = 0.0496$

The forecasted results for the indicator CMS for the Czech Republic and Romania are presented below. Assuming the forecasting models are adequate, as no tests are statistically significant at the 95% or higher confidence interval, the forecasted data for the ratio CMS indicate an increasing trend in the country market share of foreign tourists arrivals in both countries for the period 2004-2008.

Figure 5.5

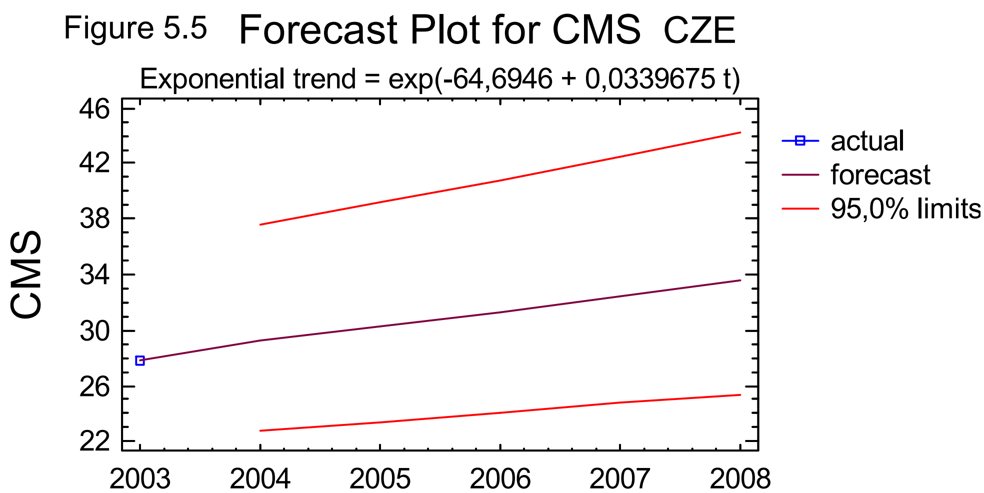
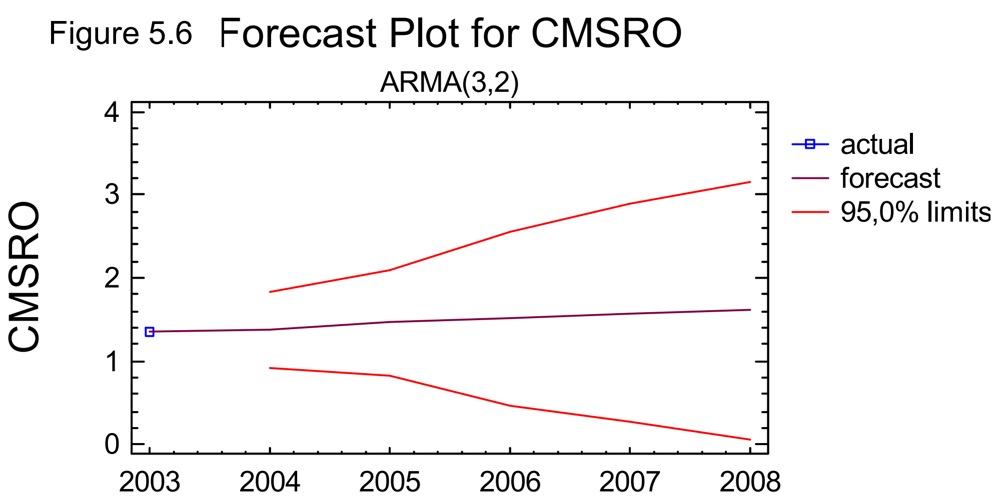


Figure 5.6



The forecasted results of CMS for the Czech Republic indicate a more dynamic increase in the market share of this country than the one forecasted for Romania. It may be inferred that, in the long run, the market share of foreign tourists arrivals will record increases in both countries, independently of the transition strategy adopted for reform of the tourism industry, but with a more considerable positive evolution for the Czech Republic, which implemented a set of reform policies based on the shock-therapy approach.

5.5 Conclusions

A variety of methods, archival datasets and variables are used to test three research questions. First, the **analysis of variance** is performed for the four ratios constructed in order to determine the convergence of results of tourism policies. This analysis shows that the four countries belong to two homogenous groups, each of which relates to one of the two transition strategies countries followed during transition.

In order to further verify this classification, the statistical determination with which another country could be classified correctly into one of the two homogenous groups according to its transition strategy is developed by using the **discriminant analysis**. The results obtained from the discriminant analysis for the performance results of the tourism industries in the four countries analyzed confirm, with a statistical significance that ranges between 96.67% and 100%, the classification of countries into homogenous groups based on the criterion of the nature of strategy approach adopted by each of the countries in reforming their tourism industry: shock therapy for the countries in group 1 (Czech Republic and Poland) and gradual reform for the countries in group 2 (Romania and Bulgaria).

Correlations between the four analyzed ratios are identified and interpreted through the use of **correlation analysis**. They reveal a more stable, positive evolution and prospects of tourism in the countries that applied a ‘top-down’ shock therapy approach to transition than for the countries following a ‘bottom-up’ gradual transition strategy.

Last, **forecasts** for the next five years are developed for the countries with a more positive evolution of tourism in each of the two homogenous groups: Czech Republic and Romania. Forecasts are constructed by identifying the best fitted forecasting model based on historical data and by computing the expected results for the next five years. The forecasted results reveal that, in the long run, the constructed indicators that summarize the results of the tourism sector will record increases in both countries, independently of the transition strategy adopted for reform of the tourism industry, but with a more considerable positive evolution for the Czech Republic, which implemented a set of reform policies based on the shock-therapy approach.

CHAPTER 6
CONCLUSIONS AND
TOPICS FOR FURTHER RESEARCH

Economic transition is part of a transformation process involving major challenges at the political, economic, social and psychological level. In fifteen years from the collapse of communism, most countries of Central and Eastern Europe, with the exception of those affected by war, have re-established a democratic political life, moved from centrally planned economies to market economies and opened internationally their society and economy. Most of these countries after years of severe economic depression have now recovered and are increasing their participation to European business sphere and world trade.

There are a number of issues that dominate the debates on transition over these fifteen years and there are various approaches to these issues. The main issue seems to be that of the most appropriate strategy to be adopted for restructuring the economies in Central and Eastern European countries. Two main reform strategies emerge from the scientific literature: the radical strategy of fast and comprehensive changes (very often called ***shock therapy*** or *big bang)* on the one hand and the evolutionary way of ***gradual*** (step-by-step) changes on the other.

The shock therapy model highlights the independence and mutually supportive and interactive character of economic relationships, implying that reforms should be introduced simultaneously in a "top-down" manner (practically enforced by the state). The gradual approach to transition implies a gradual change in the economic system congruent with society and responding to economic and social needs. According to the gradual theory, change must be "bottom-up" so the people do not reject the reforms or are unable to adjust.

The 'shock-therapy' economic reforms were based on a particular version of liberal capitalism, with four main constituents: market liberalization, privatization, currency convertibility and trade liberalization. These were combined with macro economic stabilization measures, involving limiting the money supply and budgetary controls. They were applied in Poland and the Czech Republic. The result, in the first phase of the transformation (1990-1993), was a decrease in production and living standards with consequences for domestic tourism and for the ability of entrepreneurs to restructure existing tourism establishments or to invest in new ones. Economic recovery has started in the second phase (1994-1997) when new markets were created and domestic tourism began to increase (although highly uneven in the society). The 'gradual reform' program is based on a sequence of economic measures taken step by step, namely in three rounds, taking in view the social and political immediate consequences they might have upon the population. The slow rate of privatization and the absence of a coordinated strategy for reform in tourism led to stagnation and in many cases caused a decrease in the living standards and the economic performances.

The present study identifies the application of the above theories to countries in Central and Eastern Europe, and particularly to their tourism sector. It integrates these countries' policies formulation and implementation processes into a broader theoretical background of the Shock Therapy and Gradualism theories. These theories provide a basis for comparison between countries by their characteristics, policies and performance in implementing transition policies.

The transformation from a strongly collectivist and partially closed (internationally) model of tourism to one increasingly shaped by market relationships and integration into an expanding global system of tourism involved complex changes. The main dimensions of change have centered on the role of the state, re-internationalization of tourism destinations, privatization, consumption and uneven territorial development within the countries. These are strongly interrelated, both directly and through their insertion into broader processes of societal transformation.

While the tourism sector has its own production and consumption characteristics and specific policies, reforms in tourism are incorporated in the broader context of economic, social and political transformations taking place in the Central and Eastern European countries. Tourism contributes to the overall transformation, being open to international competition and to shifts in consumer expenditure.

The priority given to tourism by the state actually seemed to decline, especially in the first period of transition. Some governments (e.g. in the Czech Republic and in Poland) adopted broadly liberal tourism policies and allowed market forces to take the lead in the transformation of tourism. Other governments (e.g. Romania and Bulgaria) simply just slowed down the control over the tourism industry, without undertaking coordinated measures for its restructuring. The pole position of tourism in privatization in the first group of countries meant that most tourism establishments were transferred to private ownership. Other than enabling legislation for privatization, there was little pro-active state intervention. There were few state funded development projects and, except for some relatively small scale programs of subsidized loans, there were no significant changes in either the legislative or financial framework within which the newly privatized firms operated. Major tourism projects were implemented with funds from the European Union, most of them in Poland and the Czech Republic, through the Phare Programs.

Regarding privatization in tourism, the process of converting public into private property rights was a complex one, but rather there were changing forms of intersection between new and old practices. Most establishments were sold via public auction as part of the Small Privatization program. This was broadly transparent and fair and it created a relatively dynamic sector with relatively new owners. Large hotels and other major tourist assets were privatized via coupon privatization or direct sales. As would be expected, there were large number of failures amongst small tourism firms. This reflected a combination of factors: a lack of experience among many owners, a lack of capital, difficulties in securing loans from the financial sector, and overpaying for enterprises. The net result was to create a high degree of instability in the ownership of small firms, and it often took several transfers of ownership before effective proprietors were found who had both the resources and the commitment to develop these tourism assets.

While the creation of new forms of property rights has mainly been viewed as the outcome of struggles between national interests and capitals, it had also been influenced by foreign intervention. In the analyzed countries, there are examples of both greenfield investments and acquisitions by foreign capital. It is likely that foreign capital will play an increasingly important role in the tourism industry in the countries in the future. This may be introduced either through direct investment in particular establishments, or indirectly, through the activities of foreign travel agencies and tour companies.

In the **Czech Republic**, following a shock-therapy approach to transition, the tourism industry has proved to be a valuable factor of the economic transformation that started in 1989. Among other effects, its dynamic development has allowed:

- the tertiary sector to absorb a significant proportion of people laid off by the primary and secondary sectors, significantly reducing unemployment;
- until 1994 to offset the trade deficit due to foreign currency revenues generated by the tourism industry;
- to significantly contribute to creation of the gross domestic product.

The tourism industry in the Czech Republic has grown very rapidly in the first fifteen years of transition. Its development is demonstrated by the multitude of foreign tourists arriving in the Czech Republic and the number of their Czech counterparts traveling abroad. The dynamic development of the tourism industry has relied on the attractiveness of Czech tourist centers on one hand, and on the specific circumstances that followed the fall of the Iron Curtain and the opening of East European borders to Westerners on the other. Foreign tourists were initially more interested in discovering a new, hitherto unknown tourist destination than in the quality of services. By elaborating a strongly coordinated tourism policy, with the involvement of various associations and tourism industry professionals, the Czech Republic secured extensive growth in the first fifteen years of transition.

In **Poland**, the strongest model country given in the transition literature for the application of the Shock Therapy approach, studies prepared at the request of the Polish Office for Sports and Tourism and financed by Phare funds, were used to prepare the Strategy for the Development of the National Tourist Product. The strategy shows Poland's main tourist potential, and divides it into five categories:

- cross-border and transit tourism,
- group recreational holidays (chiefly in the mountains and the Mazury region),
- business travel,
- culture and urban tourism (Cracow, Gdansk, Warsaw),
- tourism in the countryside.

The country monitored the quality in each of these categories to protect the tourism sector.

As a result, Poland ranked eighth on the list in 2003 among the most popular European destinations, after France, Spain, Italy, Great Britain, Russia, Germany and Austria, with $9 billion revenue generated from tourism. The profile of foreign tourists who visit Poland comprises a strong market segment of business tourists who are considered a more stable category of tourists, i.e. less sensitive to elements such as pricing, seasonality or competitive destinations. The arrivals of foreign tourists from adjacent countries was stabilized or decreased in Poland, during the period 1994-2003, with parallel growth being recorded for West Europeans and overseas markets. This had immediate consequences upon the receipts from incoming tourism, as receipts per tourist arrival from Western European countries have been much higher than the ones of tourists from neighboring ex-communist countries. The average occupancy rates in Poland are stable and increasing as foreign tourists arrivals increase. Package groups had a declining trend in market share, whereas independent travel has been increasing dramatically (from 53% in 1993 to 80% in 2003) constituting a higher income generator factor.

In **Romania**, the transition process, which started in the early 1990s, has recorded uneven developments in terms of macroeconomic stabilization and structural reforms. It was only starting with the end of 1998 and the beginning of 1999 that the country has seen acceleration in the economic and structural reform. Since December 1989, structural changes have followed a gradualist reform course. With major reforms implemented as late as 1996, land was returned to peasants, small privatization – of shops, restaurants and small businesses – was completed, while some progress was made in large-scale privatization. Foreign trade was liberalized and reoriented westwards. Other key developments included the adoption of laws and regulations necessary to bring the country into line with the European Union, for which membership has been applied.

The rhythm of privatization in Romanian tourism industry has been slow, under the set of gradual transformation policies implemented, and foreign investment has not been up to the market expectations. Although there is a world market growing interest for destinations in Central and Eastern European countries, Romanian tourism industry modernization process has not been moving at a fast enough pace with the other countries in the region to align its product to competitive standards. Tourism has the potential to make a significantly greater contribution to the development of Romania. Realization of this potential will require the commitment of Government, and the full support and cooperation of all involved in the tourism industry and related sectors.

Following a gradual path to transformation of its economy, and of the tourism sector in particular, **Bulgaria** has recorded very poor results in tourism after the 1989 political changes. Among the economic sectors, only commerce had a real boost. The expected development in tourism did not occur - in fact, just the opposite, Bulgaria's share in world tourism revenues reduced sharply from 0.3% in 1985 to 0.16% in 1992.

The Marketing Strategy and Action Plan for Bulgarian Tourism was developed as late as 1997 - 2000 under the European Union Phare Program. It forms the basis for the future marketing programs of the Ministry of Trade and Tourism. The overall marketing objective identifies tourism earnings rather than the number of arrivals as a priority for development and marketing. The key to achieving the overall marketing objectives is the repositioning of the country as a tourist destination offering a varied product mix of culture, nature and activities in addition to the traditional sun, beach and ski products.

The four countries analyzed provide contrasting case studies of divergent pathways of transformation, in terms of their general economies and tourism in particular. The main dimension of the transition process which differentiates the countries and has significance for tourism is the broad package of stabilization and market-creating reforms which constitute the ‘shock therapy’ economic transition applied in the Czech Republic and Poland versus a slow-paced, gradual set of reforms in Romania and Bulgaria.

The focus of this dissertation is on government strategies (policies) toward transformation and achieving better economic results, with a focus on the results in the tourism sector. The study includes an examination of the issues surrounding the 'top-down' shock-therapy transition measures in comparison with the 'bottom-up' gradual reform process adopted by various countries in Central and Eastern Europe, and the results recorded in one economic sector -tourism- over a fifteen year period of transformation.

For this purpose, various statistical analyses are employed in order to identify if, based on the differences between the evolution of tourism indicators in the countries analyzed, they can be grouped according to the transition strategy adopted. In this respect, a representative sample of four countries is chosen from the population of all former communist countries in Central and Eastern Europe (20 countries, according to the definition of the World Trade Organization). The sample is chosen based on two criteria:

a. countries who meet the criteria of the application of the maximum number of reform policies that characterize each transition strategy.
b. countries that are different in size and have not been through any major historical (e.g. war) or physical (e.g. earthquake, floods) catastrophe for the past fifty years, including the first 15 years of transition.

A longitudinal study is conducted for the period 1989-2003, through the use of four macroeconomic indicators (ratios) constructed in order to assure a satisfactory representation of the economic characteristics of tourism both for the group of countries that applied shock therapy and for countries that implemented a gradual approach to transition. The ratios are:

1. **Arrivals Ratio:**

   CMS - Country market share of Central and Eastern European total demand = (Foreign tourists arrivals in the country) / (Foreign tourists arrivals in Central and Eastern Europe)

2. **Receipts Ratio:**

   CSR - Country share of total Central and Eastern European tourism receipts = (International tourism receipts of the country) / (International tourism receipts in Central and Eastern Europe)

3. **Labor Ratio:**
   LR - Labor return in travel and tourism = (International tourism receipts of the country) / (Employees in travel and tourism industry)
4. **Capital Ratio:**
   RCI - Return on capital investments in travel and tourism = (International tourism receipts) / (Travel and tourism capital investments)

In order to determine the convergence of results of tourism policies, an analysis of variance is performed for the four ratios constructed. The analysis of the four indicators in each of the four countries of the study shows that Poland and the Czech Republic belong to one homogenous group of countries and record significantly higher mean and median values, throughout the fifteen years of transition included in the present study, than Romania and Bulgaria, that constitute another homogenous group of countries. Their evolution was important in terms of the progress recorded during the transition period in "absorbing" the foreign tourists expenditure, increasing their share in the total returns from tourism of the region, reducing labor force and employing it with increased productivity and providing a favorable climate for investments. Each of the two homogenous groups of countries relates to the transition method they followed for the tourism sector: Poland and the Czech Republic to the Shock Therapy approach and Romania and Bulgaria to the Gradual Reform approach.

In order to further verify this classification, the statistical determination with which another country could be classified correctly into one of the two homogenous groups according to its transition strategy is developed by using the discriminant analysis. The results obtained from the discriminant analysis for the performance results of the tourism sectors in the four countries analyzed confirm, with a statistical significance that ranges between 96.67% and 100%, the classification of countries into homogenous groups based on the criterion of the nature of strategy approach adopted by each of the countries in reforming their tourism industry: shock therapy for the countries in group 1 (Czech Republic and Poland) and gradual reform for the countries in group 2 (Romania and Bulgaria).

Correlations between the four analyzed ratios are identified and interpreted through the use of correlation analysis. This analysis helps quantifying the relationships between the four analyzed indicators (ratios) in each of the countries studied and interpreting their type (positive or negative correlation), strength and meaning. The identified correlations confirmed a better, more stable situation of the tourism sector in countries that followed a shock therapy approach to transition than in countries that implemented a gradual approach.

Last, forecasts for the next five years (up to 2008) are developed in order to confirm the tested hypotheses. The goal is to predict future results of the tourism activity and identify a possible positive or negative evolution, according to the policies applied in restructuring the tourism industries in these countries. The forecasted results of the constructed ratios for the Czech Republic and Poland indicate a more dynamic increase in the results of the tourism sector of these countries (market share, receipts from tourism, labor productivity and increased return on capital investments) than the one forecasted for Romania and Bulgaria. It may be inferred that, in the long run, the market share of foreign tourists arrivals will record increases in all countries, independently of the transition strategy adopted for reform of the tourism industry, but with a more considerable positive evolution for Poland and the Czech Republic, which implemented a set of reform policies based on the shock-therapy approach.

The overall analysis reveals that countries can form homogenous groups based on the criterion of the transition strategy adopted. As the results in tourism are better for the countries that implemented a shock therapy approach to transition than for the countries that adopted a gradual approach, then **it can be concluded that the application of the Shock Therapy transition model, at a**

rapid pace, is more efficient in restructuring the tourism industry, than the Gradual Reform transition model.

A topic for further research into the applicability of the two transition strategies could be the enlargement of the present study with statistical data that refer to more sectors of the economy. As such, manufacturing and trade sectors could be examined by using the methodology applied in the present study, by constructing various indicators (ratios) for macroeconomic results recorded in the post-communist transition period. Even for the tourism sector, the analysis of other constructed indicators could be used to confirm the suitability of one transition strategy over the other.

For countries grouped using the methodology of this study, evaluation of where a country is with regard to the region and world economic trends, and where a country is with regard to its group, helps **government policy makers** in their decision toward positioning their national industries and products. Better policies lead to more effective performance and ultimately to better economic results.

ABBREVIATIONS

BPR: Business Process Re-engineering

CEE: Central and Eastern Europe

CEFTA: Central European Free Trade Agreement

CMEA: Council for Mutual Economic Assistance

CMS: Country Market Share

CSR: Country Share of Receipts

CZ: Czech Republic

EBRD: European Bank for Reconstruction and Development

EFTA: European Free Trade Association

EU: European Union

FCC: Former Communist Countries

FDI: Foreign Direct Investment

FSU: Former Soviet Union

GNP: Gross National Product

GDP: Gross Domestic Product

IMF: International Monetary Fund

JV: Joint Venture

LR: Labor Return

MEBO: Management and Employee Buy Out

MPS: Material Product System

NATO: North Atlantic Treaty Organization

NGO: Non Governmental Organization

OECD: Organization for Economic Cooperation and Development

Phare: A EU grant assistance program for CEE

RCI: Return on Capital Investments

SME: Small and Medium Enterprise

SOE: State-owned Enterprise

TQM: Total Quality Management

TSE: Tourism Satellite Account

UN: United Nations

UNECE: United Nations Economic Commission for Europe

UNCTAD: United Nations Conference on Trade and Development

WB: World Bank

WTO: World Tourism Organization

WTTC: World Travel and Tourism Council

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APPENDIX

1. List of Countries in Central and Eastern Europe
2. Constructed Ratios
3. Cumulated Statistical Data
4. Results of the Statistical Analyses
5. Data Representation and Analysis

APPENDIX 1 – LIST OF COUNTRIES IN CENTRAL AND EASTERN EUROPE

According to the definition given by the World Tourism Organization, Central and Eastern Europe includes the following 20 countries:

1. Armenia
2. Azerbaijan
3. Belarus
4. **Bulgaria**
5. **Czech Republic**
6. Estonia
7. Georgia
8. Hungary
9. Kazakhstan
10. Latvia
11. Lithuania
12. **Poland**
13. Republic of Moldova
14. **Romania**
15. Russian Federation
16. Slovakia
17. Tajikistan
18. Turkmenistan
19. Ukraine
20. Uzbekistan

APPENDIX 2 – CONSTRUCTED RATIOS

1. Arrivals

$$CMS = \frac{\text{(Foreign tourists arrivals in the country)}}{\text{(Foreign tourists arrivals in Central and Eastern Europe)}}$$

2. Receipts

$$CSR = \frac{\text{(International tourism receipts of the country)}}{\text{(International tourism receipts in Central and Eastern Europe)}}$$

3. Labor

$$LR = \frac{\text{(International tourism receipts of the country)}}{\text{(Employees in travel and tourism)}}$$

4. Capital

$$RCI = \frac{\text{(International tourism receipts of the country)}}{\text{(Capital investments in travel and tourism)}}$$

APPENDIX 3 – CUMULATED STATISTICAL DATA

	Country Market Share of Central and Eastern Europe Total Demand (%)				Country Share of Central and Eastern Europe Total Receipts from Foreign Tourism (%)				Receipts / Employee in Travel and Tourism (thousand $)				Return on Capital Investments in Travel and Tourism (%)			
Year	Czech Rep.	Poland	Romania	Bulgaria	Czech Rep.	Poland	Romania	Bulgaria	Czech Rep.	Poland	Romania	Bulgaria	Czech Rep.	Poland	Romania	Bulgaria
1989	14,70	3,75	3,43	5,13	4,37	2,38	0,24	0,46	1,54	0,52	0,18	1,15	20,63	4,87	3,06	16,27
1990	16,61	7,76	3,27	3,62	8,64	7,38	2,19	6,60	3,45	1,14	1,40	1,20	45,72	13,14	26,67	13,77
1991	19,41	13,69	2,46	4,61	9,55	37,46	1,94	0,59	7,63	7,32	1,70	1,32	72,72	128,47	33,53	6,28
1992	24,01	17,38	2,05	2,65	13,81	50,28	3,21	2,64	10,03	9,82	2,13	4,96	122,88	169,31	58,99	51,09
1993	21,76	21,69	1,29	3,01	11,71	45,51	1,99	3,11	9,17	9,95	1,89	7,68	160,83	172,86	40,61	81,46
1994	24,28	25,79	1,17	5,56	12,59	39,39	2,65	2,32	15,01	9,82	3,65	4,72	306,49	239,02	73,79	90,76
1995	22,05	25,67	1,06	4,68	14,38	33,52	2,87	2,37	23,64	15,41	4,04	7,10	488,04	316,20	121,26	150,61
1996	21,05	24,03	0,94	2,11	16,53	34,26	2,55	1,72	24,20	18,67	4,75	5,54	622,57	410,23	131,25	104,10
1997	21,47	24,90	1,06	3,45	14,45	34,38	2,22	1,55	22,28	18,48	3,95	4,89	506,53	377,27	127,76	94,32
1998	21,83	26,36	1,08	3,57	13,03	27,35	0,89	3,32	23,84	18,31	2,29	8,05	526,67	355,37	57,78	254,21
1999	24,21	27,23	1,09	3,39	11,61	23,36	0,97	3,57	20,93	15,26	2,07	7,77	394,12	253,29	52,92	238,97
2000	24,83	24,52	1,13	3,63	12,43	23,48	1,50	4,13	21,24	16,05	3,32	8,46	398,64	287,74	74,81	249,77
2001	27,96	19,53	1,26	4,37	13,59	18,87	2,19	4,71	25,13	15,53	4,94	9,10	433,50	264,56	97,89	245,10
2002	27,48	17,65	1,22	4,83	14,55	21,05	3,03	6,24	24,49	16,07	6,34	10,67	379,27	231,96	106,07	247,04
2003	27,76	18,00	1,36	5,19	13,21	24,01	2,80	6,11	25,31	20,10	6,25	11,80	390,36	277,83	102,54	249,67

APPENDIX 4 – RESULTS OF THE STATISTICAL ANALYSES

Summary Statistics - CMS

Code	Count	Average	Median	Standard Deviation	Minimum	Maximum
CZE	15	22,6273	22,05	3,82922	14,7	27,96
POL	15	19,8633	21,69	7,03033	3,75	27,23
ROM	15	1,59133	1,22	0,821478	0,94	3,43
BUL	15	3,98667	3,63	1,01065	2,11	5,56
Total	60	12,0172	5,375	10,1938	0,94	27,96

Code	Range	Standardized Skewness	Standardized Kurtosis	Coefficient of variation
CZE	13,26	-0,773418	0,040444	16,923%
POL	23,48	-1,81495	0,538112	35,3935%
ROM	2,49	2,48283	0,944972	51,622%
BUL	3,45	-0,265097	-0,679674	25,3507%
Total	27,02	0,911439	-2,70698	84,8267%

Means Table with Standard Error Intervals - CMS

Code	Count	Mean	Standard Error	Lower Limit	Upper Limit
CZE	15	22,6273	0,988699	21,6386	23,616
POL	15	19,8633	1,81522	18,0481	21,6786
ROM	15	1,59133	0,212105	1,37923	1,80344
BUL	15	3,98667	0,260948	3,72572	4,24761
Total	60	12,0172	1,31601	10,7012	13,3332

Summary Statistics - CSR

Code	Count	Average	Median	Standard Deviation	Minimum	Maximum
CZE	15	12,2967	13,03	2,95173	4,37	16,53
POL	15	28,1787	27,35	13,103	2,38	50,28
ROM	15	2,08267	2,19	0,858125	0,24	3,21
BUL	15	3,296	3,11	1,95385	0,46	6,6
Total	60	11,4635	6,175	12,427	0,24	50,28

Code	Range	Standardized Skewness	Standardized Kurtosis	Coefficient of variation
CZE	12,16	-2,30576	2,26199	24,0043%
POL	47,9	-0,509716	-0,0407175	46,4997%
ROM	2,97	-1,25845	-0,0283658	41,2032%
BUL	6,14	0,583895	-0,612781	59,2794%
Total	50,04	4,60869	2,24847	108,405%

Means Table with Standard Error Intervals - CRS

Code	Count	Mean	Standard Error	Lower Limit	Upper Limit
CZE	15	12,2967	0,762132	11,5345	13,0588
POL	15	28,1787	3,38318	24,7955	31,5618
ROM	15	2,08267	0,221567	1,8611	2,30423
BUL	15	3,296	0,504482	2,79152	3,80048
Total	60	11,4635	1,60432	9,85918	13,0678

Summary Statistics - LR

Code	Count	Average	Median	Standard Deviation	Minimum	Maximum
CZE	15	17,1927	21,24	8,53134	1,54	25,31
POL	15	12,83	15,41	6,17943	0,52	20,1
ROM	15	3,26	3,32	1,80475	0,18	6,34
BUL	15	6,294	7,1	3,31458	1,15	11,8
Total	60	9,89417	7,725	7,74147	0,18	25,31

Code	Range	Standardized Skewness	Standardized Kurtosis	Coefficient of variation
CZE	23,77	-1,17936	-0,860587	49,622%
POL	19,58	-1,46994	-0,0591862	48,1639%
ROM	6,16	0,416766	-0,528379	55,3604%
BUL	10,65	-0,379458	-0,541848	52,6626%
Total	25,13	2,05718	-1,35809	78,2427%

Means Table with Standard Error Intervals - LR

Code	Count	Mean	Standard Error	Lower Limit	Upper Limit
CZE	15	17,1927	2,20278	14,9899	19,3954
POL	15	12,83	1,59552	11,2345	14,4255
ROM	15	3,26	0,465984	2,79402	3,72598
BUL	15	6,294	0,855821	5,43818	7,14982
Total	60	9,89417	0,999419	8,89475	10,8936

Summary Statistics - RCI

Code	Count	Average	Median	Standard Deviation	Minimum	Maximum
CZE	15	324,598	390,36	192,794	20,63	622,57
POL	15	233,475	253,29	119,388	4,87	410,23
ROM	15	73,9287	73,79	39,4368	3,06	131,25
BUL	15	139,561	104,1	98,4833	6,28	254,21
Total	60	192,891	140,93	154,992	3,06	622,57

Code	Range	Standardized Skewness	Standardized Kurtosis	Coefficient of variation
CZE	601,94	-0,559807	-0,931944	59,3946%
POL	405,36	-1,00549	-0,018686	51,1355%
ROM	128,19	-0,128455	-0,799723	53,3444%
BUL	247,93	0,028256	-1,40655	70,5663%
Total	619,51	2,44802	-0,322757	80,3523%

Means Table with Standard Error Intervals - RCI

Code	Count	Mean	Standard Error	Lower Limit	Upper Limit
CZE	15	324,598	49,7791	274,819	374,377
POL	15	233,475	30,826	202,649	264,301
ROM	15	73,9287	10,1825	63,7461	84,1112
BUL	15	139,561	25,4283	114,133	164,99
Total	60	192,891	20,0094	172,881	212,9

ANOVA Table for CMS by Country

Analysis of Variance

Source	Sum of Squares	Df	Mean Square	F-Ratio	P-Value
Between groups	5209,87	3	1736,62	105,59	0,0000
Within groups	920,985	56	16,4462		
Total (Corr.)	6130,86	59			

Multiple Range Tests for CMS by Country

Method: 95,0 percent LSD

Country	Count	Mean	Homogeneous Groups
3 (ROM)	15	1,59133	X
4 (BUL)	15	3,98667	X
2 (CZE)	15	19,8633	X
1 (POL)	15	22,6273	X

Contrast	Difference	+/- Limits
1 - 2	2,764	2,96644
1 - 3	*21,036	2,96644
1 - 4	*18,6407	2,96644
2 - 3	*18,272	2,96644
2 - 4	*15,8767	2,96644
3 - 4	-2,39533	2,96644

* denotes a statistically significant difference.

Variance Check

Cochran's C test: 0,751323   P-Value = 4,7527E-8

Bartlett's test: 3,47875   P-Value = 0,0

Hartley's test: 73,2417

Levene's test: 10,5324   P-Value = 0,0000135715

Kruskal-Wallis Test for CMS by CODE

Country	Sample Size	Average Rank
1 (CZE)	15	46,7333
2 (POL)	15	43,8
3 (ROM)	15	8,53333
4 (BUL)	15	22,9333

Test statistic = 48,2079   P-Value = 1,92323E-10

ANOVA Table for CSR by Country

Analysis of Variance

Source	Sum of Squares	Df	Mean Square	F-Ratio	P-Value
Between groups	6521,99	3	2174,0	47,02	0,0000
Within groups	2589,37	56	46,2387		
Total (Corr.)	9111,35	59			

Multiple Range Tests for CSR by Country

Method: 95,0 percent LSD

Country	Count	Mean	Homogeneous Groups
3 (ROM)	15	2,08267	X
4 (BUL)	15	3,296	X
1 (CZE)	15	12,2967	X
2 (POL)	15	28,1787	X

Contrast	Difference	+/- Limits
1 - 2	*-15,882	4,97401
1 - 3	*10,214	4,97401
1 - 4	*9,00067	4,97401
2 - 3	*26,096	4,97401
2 - 4	*24,8827	4,97401
3 - 4	-1,21333	4,97401

* denotes a statistically significant difference.

Variance Check

Cochran's C test: 0,928271   P-Value = 0,0

Bartlett's test: 5,74198   P-Value = 0,0

Hartley's test: 233,152

Levene's test: 18,3304   P-Value = 2,07929E-8

Kruskal-Wallis Test for CSR by CODE

CODE	Sample Size	Average Rank
1	15	39,6667
2	15	50,0667
3	15	12,9333
4	15	19,3333

Test statistic = 44,2716   P-Value = 1,32142E-9

ANOVA Table for LR by Country

Analysis of Variance

Source	Sum of Squares	Df	Mean Square	F-Ratio	P-Value
Between groups	1782,91	3	594,303	18,99	0,0000
Within groups	1752,98	56	31,3032		
Total (Corr.)	3535,89	59			

Multiple Range Tests for LR by Country

Method: 95,0 percent LSD

CODE	Count	Mean	Homogeneous Groups
3 (ROM)	15	3,26	X
4 (BUL)	15	6,294	X
2 (POL)	15	12,83	X
1 (CZE)	15	17,1927	X

Contrast	Difference	+/- Limits
1 - 2	*4,36267	4,09258
1 - 3	*13,9327	4,09258
1 - 4	*10,8987	4,09258
2 - 3	*9,57	4,09258
2 - 4	*6,536	4,09258
3 - 4	-3,034	4,09258

* denotes a statistically significant difference.

Variance Check

Cochran's C test: 0,581281   P-Value = 0,000646258

Bartlett's test: 1,76272   P-Value = 9,24616E-7

Hartley's test: 22,3461

Levene's test: 4,63178   P-Value = 0,00579786

Kruskal-Wallis Test for LR by Country

CODE	Sample Size	Average Rank
1 (CZE)	15	44,8
2 (POL)	15	37,8
3 (ROM)	15	14,7333
4 (BUL)	15	24,6667

Test statistic = 26,5776   P-Value = 0,00000721866

ANOVA Table for RCI by Country

Analysis of Variance

Source	Sum of Squares	Df	Mean Square	F-Ratio	P-Value
Between groups	539848,0	3	179949,0	11,48	0,0000
Within groups	877481,0	56	15669,3		
Total (Corr.)	1,41733E6	59			

Multiple Range Tests for RCI by Country

Method: 95,0 percent LSD

Country	Count	Mean	Homogeneous Groups
3 (ROM)	15	73,9287	X
4 (BUL)	15	139,561	X
2 (POL)	15	233,475	X
1 (CZE)	15	324,598	X

Contrast	Difference	+/- Limits
1 - 2	91,1233	91,5647
1 - 3	*250,669	91,5647
1 - 4	*185,037	91,5647
2 - 3	*159,546	91,5647
2 - 4	*93,9133	91,5647
3 - 4	-65,6327	91,5647

* denotes a statistically significant difference.

Variance Check

Cochran's C test: 0,593029   P-Value = 0,000396733

Bartlett's test: 1,65726   P-Value = 0,00000468838

Hartley's test: 23,8991

Levene's test: 5,13011   P-Value = 0,00331921

Kruskal-Wallis Test for RCI by Country

Country	Sample Size	Average Rank
1 (CZE)	15	42,6667
2 (POL)	15	36,8667
3 (ROM)	15	17,2667
4 (BUL)	15	25,2

Test statistic = 19,2675   P-Value = 0,000240692

Correlations – Czech Republic

	CMS	CSR	LR	RCI
CMS		0,3821	0,6929	0,2964
		(15)	(15)	(15)
		0,1528	0,0095	0,2674
CSR	0,3821		0,7464	0,6821
	(15)		(15)	(15)
	0,1528		0,0052	0,0107
LR	0,6929	0,7464		0,7464
	(15)	(15)		(15)
	0,0095	0,0052		0,0052
RCI	0,2964	0,6821	0,7464	
	(15)	(15)	(15)	
	0,2674	0,0107	0,0052	

Correlations - Poland

	CMS	CSR	LR	RCI
CMS		0,5465	0,7775	0,8614
		(15)	(15)	(15)
		0,0350	0,0006	0,0000
CSR	0,5465		0,2945	0,3924
	(15)		(15)	(15)
	0,0350		0,2867	0,1480
LR	0,7775	0,2945		0,9362
	(15)	(15)		(15)
	0,0006	0,2867		0,0000
RCI	0,8614	0,3924	0,9362	
	(15)	(15)	(15)	
	0,0000	0,1480	0,0000	

Correlations - Romania

	CMS	CSR	LR	RCI
CMS		-0,2977	-0,6499	-0,7511
		(15)	(15)	(15)
		0,2811	0,0087	0,0012
CSR	-0,2977		0,6396	0,6006
	(15)		(15)	(15)
	0,2811		0,0102	0,0179
LR	-0,6499	0,6396		0,8597
	(15)	(15)		(15)
	0,0087	0,0102		0,0000
RCI	-0,7511	0,6006	0,8597	
	(15)	(15)	(15)	
	0,0012	0,0179	0,0000	

Correlations – Bulgaria

	CMS	CSR	LR	RCI
CMS		0,0931	0,0549	0,0976
		(15)	(15)	(15)
		0,7413	0,8460	0,7293
CSR	0,0931		0,5610	0,5320
	(15)		(15)	(15)
	0,7413		0,0296	0,0412
LR	0,0549	0,5610		0,8995
	(15)	(15)		(15)
	0,8460	0,0296		0,0000
RCI	0,0976	0,5320	0,8995	
	(15)	(15)	(15)	
	0,7293	0,0412	0,0000	

Forecasting – CMS – Czech Republic

Number of observations = 15

Start index = 1989

Sampling interval = 1,0 year(s)

Forecast Summary

Seasonal adjustment: Multiplicative

Forecast model selected: Exponential trend = exp(-64,6946 + 0,0339675 t)

Number of forecasts generated: 5

Number of periods withheld for validation: 0

Statistic	Estimation Period	Validation Period
RMSE	2,11555	
MAE	1,5625	
MAPE	7,36217	
ME	0,0866582	
MPE	-0,449186	

Trend Model Summary

Parameter	Estimate	Stnd. Error	t	P-value
Constant	-64,6946	12,2164	-5,29574	0,000145
Slope	0,0339675	0,00612041	5,54988	0,000094

Forecast Table for CMS – Czech Republic

Model: Exponential trend = exp(-64,6946 + 0,0339675 t)

Period	Data	Forecast	Residual
1989	14,7	17,5807	-2,88073
1990	16,61	18,1882	-1,57816
1991	19,41	18,8166	0,59342
1992	24,01	19,4667	4,54329
1993	21,76	20,1393	1,62069
1994	24,28	20,8351	3,44486
1995	22,05	21,555	0,494985
1996	21,05	22,2998	-1,24976
1997	21,47	23,0702	-1,60024
1998	21,83	23,8673	-2,03734
1999	24,21	24,692	-0,481983
2000	24,83	25,5451	-0,715116
2001	27,96	26,4277	1,53227
2002	27,48	27,3408	0,139169
2003	27,76	28,2855	-0,525484

Period	Forecast	Lower 95,0% Limit	Upper 95,0% Limit
2004	29,2628	22,7488	37,642
2005	30,2738	23,3979	39,1704
2006	31,3198	24,0527	40,7827
2007	32,402	24,7135	42,4824
2008	33,5215	25,3808	44,2732

Forecasting Model

(E) Exponential trend = exp(-64,6946 + 0,0339675 t)

Estimation Period

Model	RMSE	MAE	MAPE	ME	MPE	AIC
(E)	2,11555	1,5625	7,36217	0,0866582	-0,449186	1,76529

Model	RMSE	RUNS	RUNM	AUTO	MEAN	VAR
(E)	2,11555	OK	OK	OK	OK	OK

Forecasting – CSR – Czech Republic

Number of observations = 15
Start index = 1989
Sampling interval = 1,0 year(s)

Forecast Summary

Seasonal adjustment: Multiplicative
Forecast model selected: Brown's linear exp. smoothing with alpha = 0,6338
Number of forecasts generated: 5
Number of periods withheld for validation: 0

Statistic	Estimation Period	Validation Period
RMSE	2,71363	
MAE	2,15949	
MAPE	20,3993	
ME	0,413164	
MPE	6,74732	

Forecast Table for CSR
Model: Brown's linear exp. smoothing with alpha = 0,6338

Period	Data	Forecast	Residual
1989	4,37	2,17936	2,19064
1990	8,64	2,38368	6,25632
1991	9,55	8,62164	0,928361
1992	13,81	10,6191	3,19094
1993	11,71	15,8574	-4,14745
1994	12,59	13,0755	-0,485505
1995	14,38	13,2694	1,1106
1996	16,53	15,2915	1,23851
1997	14,45	17,9218	-3,47185
1998	13,03	15,0789	-2,04887
1999	11,61	12,645	-1,03501
2000	12,43	10,6733	1,75672
2001	13,59	11,8246	1,76542
2002	14,55	13,6926	0,857412
2003	13,21	15,1188	-1,90878

Period	Forecast	Lower 95,0% Limit	Upper 95,0% Limit
2004	15,8025	10,6643	20,9408
2005	16,4863	8,19022	24,7824
2006	17,1701	5,23709	29,103
2007	17,8538	1,86522	33,8424
2008	18,5376	-1,88457	38,9597

Forecasting Model

(I) Brown's linear exp. smoothing with alpha = 0,6338

Estimation Period

Model	RMSE	MAE	MAPE	ME	MPE	AIC
(I)	2,71363	2,15949	20,3993	0,413164	6,74732	2,12991

Model	RMSE	RUNS	RUNM	AUTO	MEAN	VAR
(I)	2,71363	OK	OK	OK	OK	OK

Forecasting – LR – Czech Republic

Number of observations = 15
Start index = 1989
Sampling interval = 1,0 year(s)
Forecast Summary

Seasonal adjustment: Multiplicative
Forecast model selected: Brown's linear exp. smoothing with alpha = 0,7239
Number of forecasts generated: 5
Number of periods withheld for validation: 0

Statistic	Estimation Period	Validation Period
RMSE	3,80256	
MAE	3,14797	
MAPE	34,4124	
ME	0,417205	
MPE	19,3978	

Forecast Table for LR
Model: Brown's linear exp. smoothing with alpha = 0,7239

Period	Data	Forecast	Residual
1989	1,54	-1,1368	2,6768
1990	3,45	0,146011	3,30399
1991	7,63	3,73959	3,89041
1992	10,03	9,91358	0,116416
1993	9,17	12,6623	-3,49229
1994	15,01	10,2473	4,76269
1995	23,64	17,9538	5,68618
1996	24,2	29,4932	-5,29316
1997	22,28	28,1163	-5,83635
1998	23,84	23,1793	0,660673
1999	20,93	24,5903	-3,66026
2000	21,24	20,0916	1,14844
2001	25,13	20,6368	4,49319
2002	24,49	26,6264	-2,13641
2003	25,31	25,3722	-0,0622445

Period	Forecast	Lower 95,0% Limit	Upper 95,0% Limit
2004	26,0916	18,8914	33,2918
2005	26,811	14,1417	39,4803
2006	27,5304	8,50196	46,5588
2007	28,2498	2,07678	54,4228
2008	28,9692	-5,05756	62,9959

Models

(I) Brown's linear exp. smoothing with alpha = 0,7239

Estimation Period

Model	RMSE	MAE	MAPE	ME	MPE	AIC
(I)	3,80256	3,14797	34,4124	0,417205	19,3978	2,80468

Model	RMSE	RUNS	RUNM	AUTO	MEAN	VAR
(I)	3,80256	OK	OK	OK	OK	OK

Forecasting – RCI – Czech Republic

Number of observations = 15

Start index = 1989

Sampling interval = 1,0 year(s)

Forecast Summary

Seasonal adjustment: Multiplicative

Forecast model selected: Holt's linear exp. smoothing with alpha = 0,9917 and beta = 0,1352

Number of forecasts generated: 5

Number of periods withheld for validation: 0

Statistic	Estimation Period	Validation Period
RMSE	92,5941	
MAE	57,6451	
MAPE	16,356	
ME	-12,5904	
MPE	-4,28546	

Forecast Table for RCI

Model: Holt's linear exp. smoothing with alpha = 0,9917 and beta = 0,1352

Period	Data	Forecast	Residual
1989	20,63	20,5119	0,118119
1990	45,72	57,9418	-12,2218
1991	72,72	81,4956	-8,77557
1992	122,88	107,29	15,5896
1993	160,83	159,338	1,49165
1994	306,49	197,605	108,885
1995	488,04	356,973	131,067
1996	622,57	555,912	66,6579
1997	506,53	699,914	-193,384
1998	526,67	560,104	-33,4339
1999	394,12	574,434	-180,314
2000	398,64	418,927	-20,2866
2001	433,5	419,398	14,1016
2002	379,27	455,864	-76,5937
2003	390,36	392,117	-1,75693

Period	Forecast	Lower 95,0% Limit	Upper 95,0% Limit
2004	402,35	233,4	571,3
2005	414,326	39,0486	789,603
2006	426,301	-199,867	1052,47
2007	438,277	-476,885	1353,44
2008	450,253	-787,631	1688,14

Model Comparison

Data variable: RCI

Number of observations = 15

Start index = 1989

Sampling interval = 1,0 year(s)

Models

(J) Holt's linear exp. smoothing with alpha = 0,9917 and beta = 0,1352

Estimation Period

Model	RMSE	MAE	MAPE	ME	MPE	AIC
(J)	92,5941	57,6451	16,356	-12,5904	-4,28546	9,32312

Model	RMSE	RUNS	RUNM	AUTO	MEAN	VAR
(J)	92,5941	OK	OK	OK	OK	OK

Forecasting – CMS - Romania

Number of observations = 15

Start index = 1989

Sampling interval = 1,0 year(s)

Forecast Summary

Forecast model selected: ARMA(3,2)

Number of forecasts generated: 5

Number of periods withheld for validation: 0

Statistic	Estimation Period	Validation Period
RMSE	0,185486	
MAE	0,106624	
MAPE	8,34237	
ME	-0,0170612	
MPE	-0,551363	

Forecast Table for CMS

Model: ARMA(3,2)

Period	Data	Forecast	Residual
1989	3,43	3,49363	-0,0636284
1990	3,27	3,27338	-0,0033808
1991	2,46	2,77052	-0,310515
1992	2,05	2,01873	0,0312731
1993	1,29	1,28609	0,00390733
1994	1,17	0,916813	0,253187
1995	1,06	0,801032	0,258968
1996	0,94	1,14123	-0,201229
1997	1,06	1,12249	-0,0624949
1998	1,08	1,03001	0,0499907
1999	1,09	1,18082	-0,0908152
2000	1,13	1,2211	-0,091104
2001	1,26	1,1856	0,0743972
2002	1,22	1,30806	-0,0880627
2003	1,36	1,37641	-0,0164109

Period	Forecast	Lower 95,0% Limit	Upper 95,0% Limit
2004	1,37309	0,915471	1,83071
2005	1,46252	0,822534	2,10251
2006	1,50986	0,470483	2,54924
2007	1,57135	0,266027	2,87667
2008	1,60698	0,0670517	3,14692

Data variable: CMS

Number of observations = 15

Start index = 1989

Sampling interval = 1,0 year(s)

Models

(P) ARMA(3,2)

Estimation Period

Model	RMSE	MAE	MAPE	ME	MPE	AIC
(P)	0,185486	0,106624	8,34237	-0,0170612	-0,551363	-2,56955

Model	RMSE	RUNS	RUNM	AUTO	MEAN	VAR
(P)	0,185486	OK	OK	OK	OK	OK

Forecasting – CSR - Romania

Number of observations = 15

Start index = 1989

Sampling interval = 1,0 year(s)

Forecast Summary

Seasonal adjustment: Multiplicative

Forecast model selected: Holt's linear exp. smoothing with alpha = 0,9999 and beta = 0,0496

Number of forecasts generated: 5

Number of periods withheld for validation: 0

Statistic	Estimation Period	Validation Period
RMSE	0,932036	
MAE	0,678545	
MAPE	36,1815	
ME	0,109515	
MPE	-2,48081	

Forecast Table for CSR

Model: Holt's linear exp. smoothing with alpha = 0,9999 and beta = 0,0496

Period	Data	Forecast	Residual
1989	0,24	0,240205	-0,0002052
1990	2,19	0,239747	1,95025
1991	1,94	2,28628	-0,346275
1992	3,21	2,01933	1,19067
1993	1,99	3,34823	-1,35823
1994	2,65	2,06112	0,588878
1995	2,87	2,75013	0,119867
1996	2,55	2,97612	-0,426125
1997	2,22	2,63505	-0,415046
1998	0,89	2,28446	-1,39446
1999	0,97	0,8854	0,0846001
2000	1,5	0,969448	0,530552
2001	2,19	1,52572	0,664284
2002	3,03	2,24865	0,781352
2003	2,8	3,12739	-0,327387

Period	Forecast	Lower 95,0% Limit	Upper 95,0% Limit
2004	2,88126	1,18064	4,58188
2005	2,96249	-0,839912	6,76489
2006	3,04372	-3,3187	9,40614
2007	3,12495	-6,1885	12,4384
2008	3,20618	-9,40414	15,8165

Model Comparison

Data variable: CMSRO

Number of observations = 15

Start index = 1989

Sampling interval = 1,0 year(s)

Models

(J) Holt's linear exp. smoothing with alpha = 0,9999 and beta = 0,0496

Estimation Period

Model	RMSE	MAE	MAPE	ME	MPE	AIC
(J)	0,326418	0,202619	13,3681	-0,0521416	-0,467091	-1,97249

Model	RMSE	RUNS	RUNM	AUTO	MEAN	VAR
(J)	0,326418	OK	OK	OK	OK	OK

Forecasting – LR - Romania

Analysis Summary

Data variable: LRRO

Number of observations = 15

Start index = 1989

Sampling interval = 1,0 year(s)

Forecast Summary

Seasonal adjustment: Multiplicative

Forecast model selected: Holt's linear exp. smoothing with alpha = 0,9999 and beta = 0,0496

Number of forecasts generated: 5

Number of periods withheld for validation: 0

Statistic	Estimation Period	Validation Period
RMSE	1,02552	
MAE	0,754944	
MAPE	25,5831	
ME	0,175209	
MPE	3,72245	

Forecast Table for LRRO

Model: Holt's linear exp. smoothing with alpha = 0,9999 and beta = 0,0496

Period	Data	Forecast	Residual
1989	0,18	0,180109	-0,000109343
1990	1,4	0,360815	1,03919
1991	1,7	1,63225	0,0677509
1992	2,13	1,93571	0,194294
1993	1,89	2,37533	-0,48533
1994	3,65	2,11133	1,53867
1995	4,04	3,94744	0,0925641
1996	4,75	4,34217	0,407829
1997	3,95	5,07237	-1,12237
1998	2,29	4,21686	-1,92686
1999	2,07	2,46137	-0,391373
2000	3,32	2,22181	1,09819
2001	4,94	3,52613	1,41387
2002	6,34	5,21621	1,12379
2003	6,25	6,67198	-0,421978

Period	Forecast	Lower 95,0% Limit	Upper 95,0% Limit
2004	6,5612	4,69002	8,43239
2005	6,87237	2,6886	11,0561
2006	7,18353	0,182989	14,1841
2007	7,49469	-2,75286	17,7422
2008	7,80585	-6,06922	21,6809

Model Comparison

Data variable: LRRO

Number of observations = 15

Start index = 1989

Sampling interval = 1,0 year(s)

Models

(J) Holt's linear exp. smoothing with alpha = 0,9999 and beta = 0,0496

Estimation Period

Model	RMSE	MAE	MAPE	ME	MPE	AIC
(J)	1,02552	0,754944	25,5831	0,175209	3,72245	0,317058

Model	RMSE	RUNS	RUNM	AUTO	MEAN	VAR
(J)	1,02552	OK	OK	OK	OK	OK

Forecasting – RCI - Romania

Analysis Summary

Data variable: RCIRO

Number of observations = 15

Start index = 1989

Sampling interval = 1,0 year(s)

Forecast Summary

Seasonal adjustment: Multiplicative

Forecast model selected: Holt's linear exp. smoothing with alpha = 0,9999 and beta = 0,0496

Number of forecasts generated: 5

Number of periods withheld for validation: 0

Statistic	Estimation Period	Validation Period
RMSE	29,1557	
MAE	19,346	
MAPE	31,5672	
ME	2,42222	
MPE	2,04109	

Forecast Table for RCIRO

Model: Holt's linear exp. smoothing with alpha = 0,9999 and beta = 0,0496

Period	Data	Forecast	Residual
1989	3,06	3,06222	-0,00222048
1990	26,67	5,56691	21,1031
1991	33,53	30,2214	3,30859
1992	58,99	37,2473	21,7427
1993	40,61	63,7838	-23,1738
1994	73,79	44,259	29,531
1995	121,26	78,8983	42,3617
1996	131,25	128,468	2,78208
1997	127,76	138,6	-10,8399
1998	57,78	134,574	-76,7936
1999	52,92	60,7916	-7,87163
2000	74,81	55,5343	19,2757
2001	97,89	78,3776	19,5124
2002	106,07	102,425	3,6447
2003	102,54	110,788	-8,24765

Period	Forecast	Lower 95,0% Limit	Upper 95,0% Limit
2004	106,85	53,6514	160,048
2005	111,159	-7,78692	230,104
2006	115,468	-83,5596	314,495
2007	119,777	-171,564	411,117
2008	124,086	-270,387	518,558

Model Comparison

Data variable: RCIRO

Number of observations = 15

Start index = 1989

Sampling interval = 1,0 year(s)

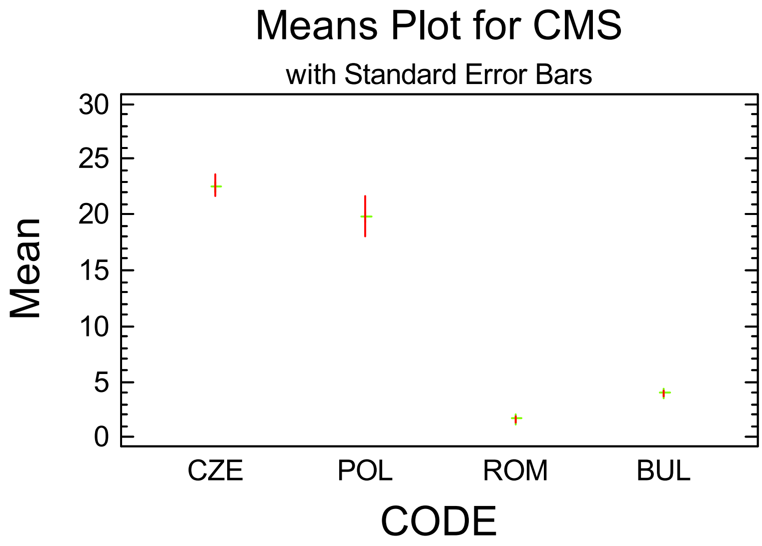
Models

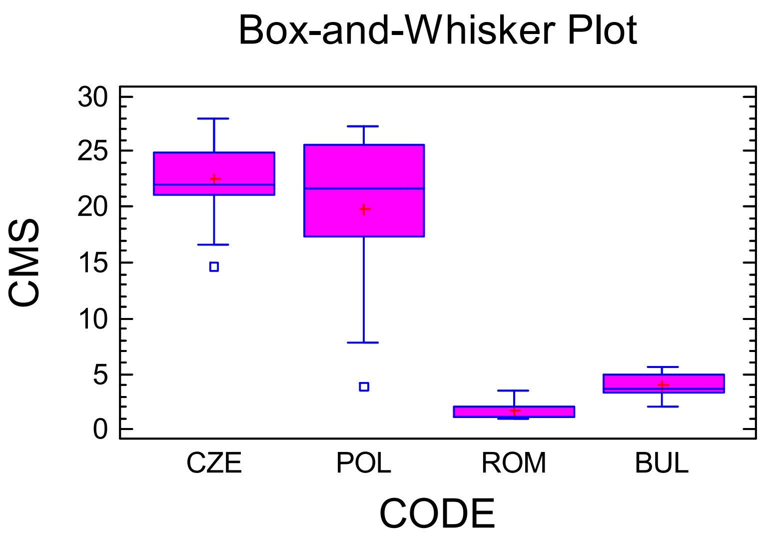
(J) Holt's linear exp. smoothing with alpha = 0,9999 and beta = 0,0496

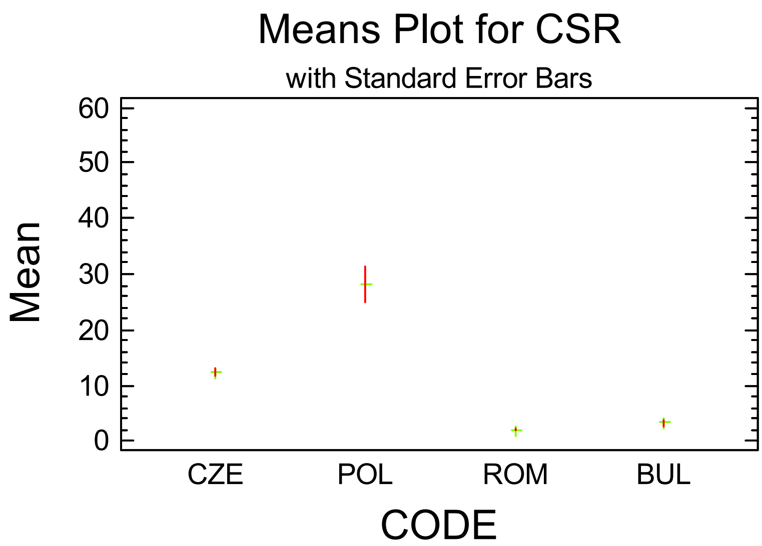
Estimation Period

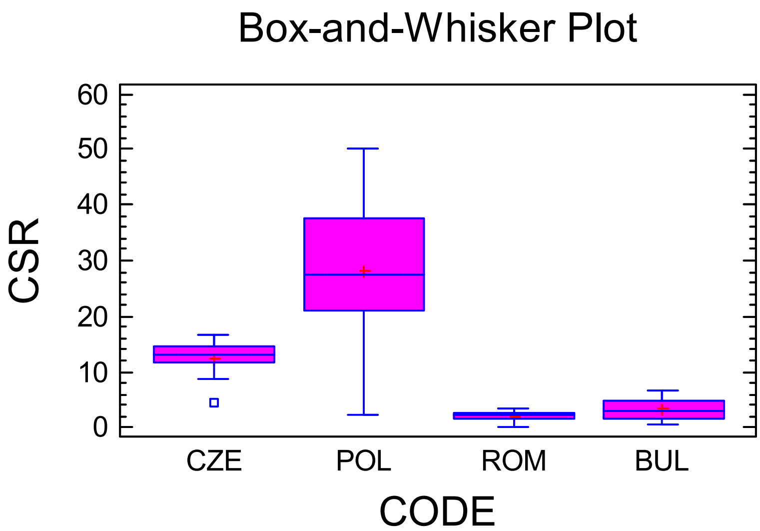
Model	RMSE	MAE	MAPE	ME	MPE	AIC
(J)	29,1557	19,346	31,5672	2,42222	2,04109	7,01197

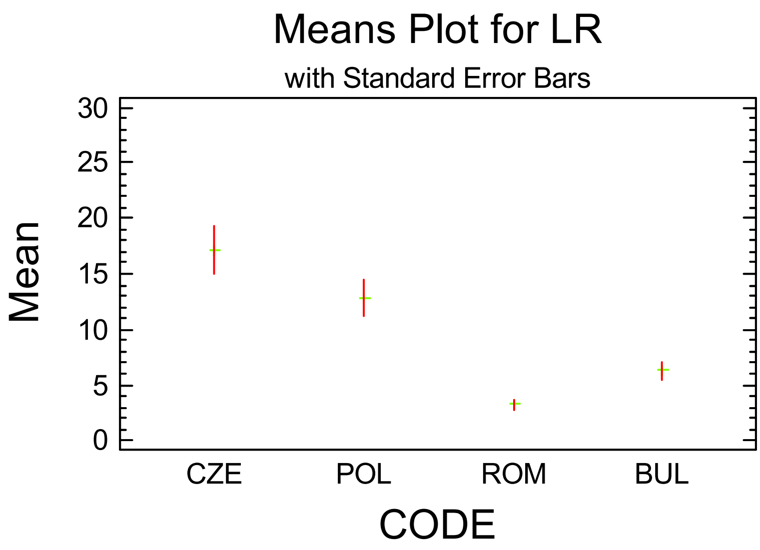
Model	RMSE	RUNS	RUNM	AUTO	MEAN	VAR
(J)	29,1557	OK	OK	OK	OK	OK


Means Plot for CMS
with Standard Error Bars
Mean
30
25
20
15
10
5
0
CZE
POL
ROM
BUL
CODE

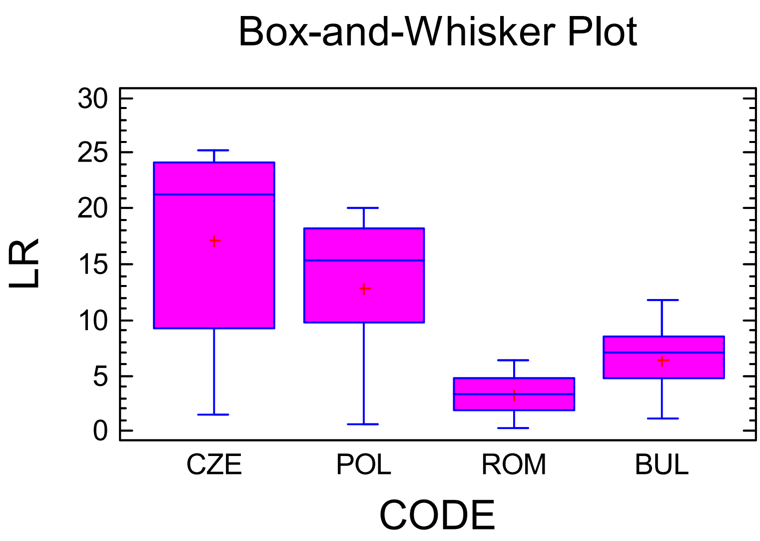

Box-and-Whisker Plot
CMS
30
25
20
15
10
5
0
CZE
POL
ROM
BUL
CODE


Means Plot for CSR
with Standard Error Bars
Mean
60
50
40
30
20
10
0
CZE
POL
ROM
BUL
CODE

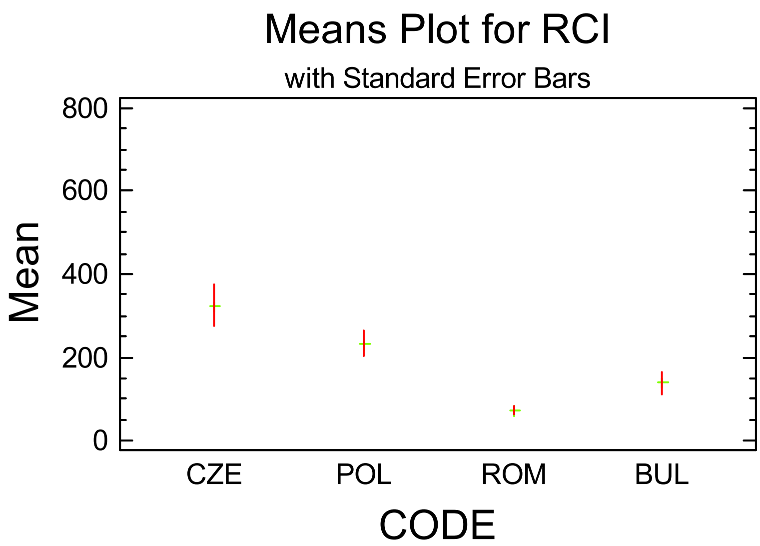

Box-and-Whisker Plot
CSR
60
50
40
30
20
10
0
CZE
POL
ROM
BUL
CODE

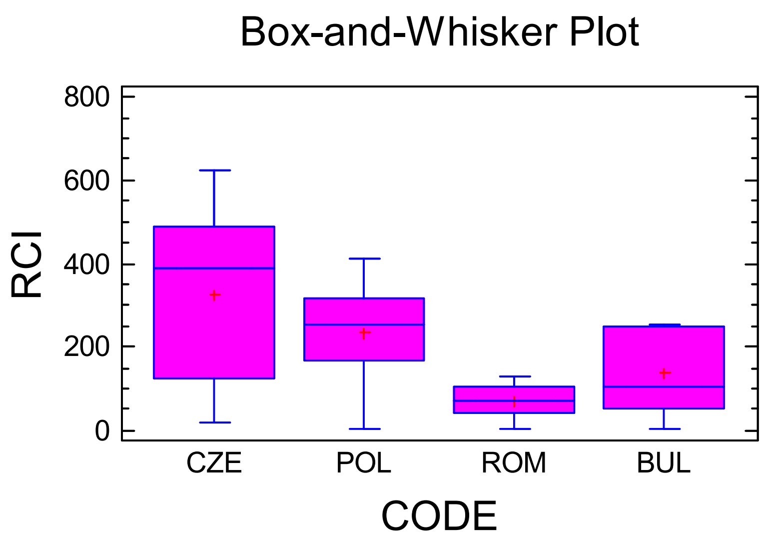


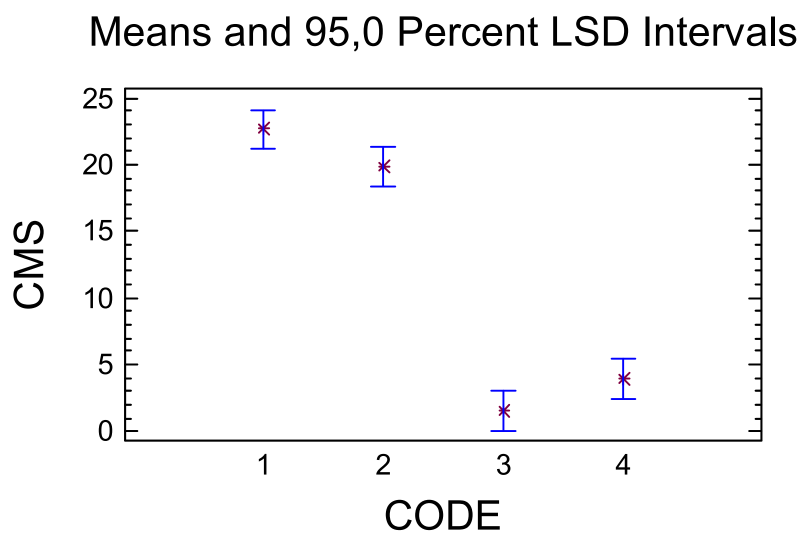
Means Plot for LR
with Standard Error Bars
Mean
30
25
20
15
10
5
0
CZE
POL
ROM
BUL
CODE



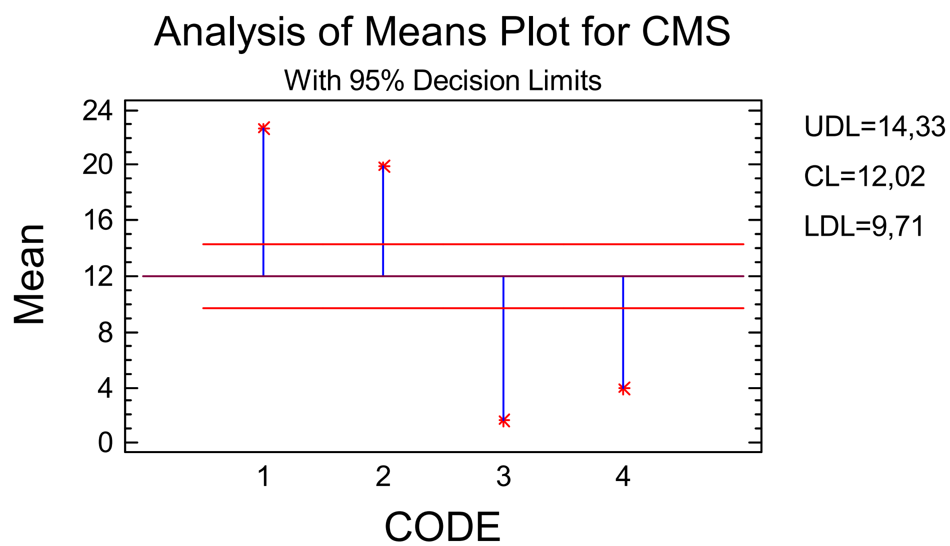
Box-and-Whisker Plot
LR
30
25
20
15
10
5
0
CZE
POL
ROM
BUL
CODE

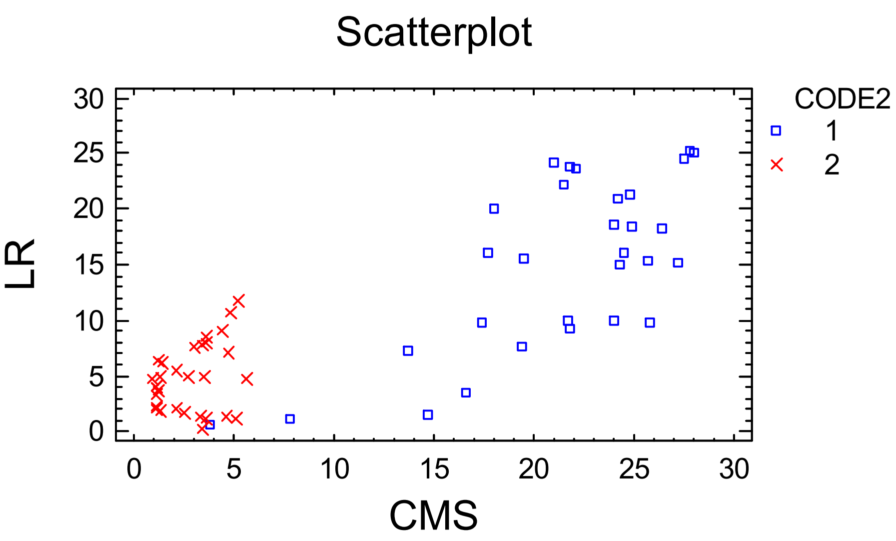

Means Plot for RCI
with Standard Error Bars
Mean
800
600
400
200
0
CZE
POL
ROM
BUL
CODE


Box-and-Whisker Plot
RCI
800
600
400
200
0
CZE
POL
ROM
BUL
CODE

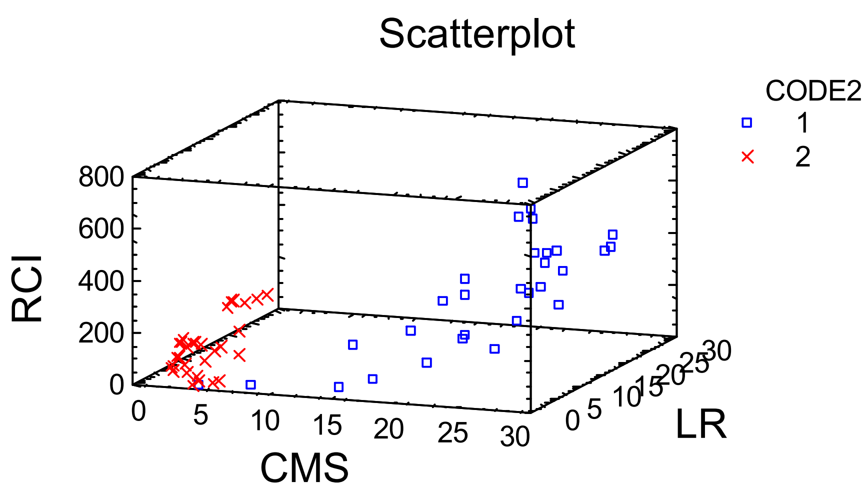


1 = Czech Republic
2 = Poland
3 = Romania
4 = Bulgaria



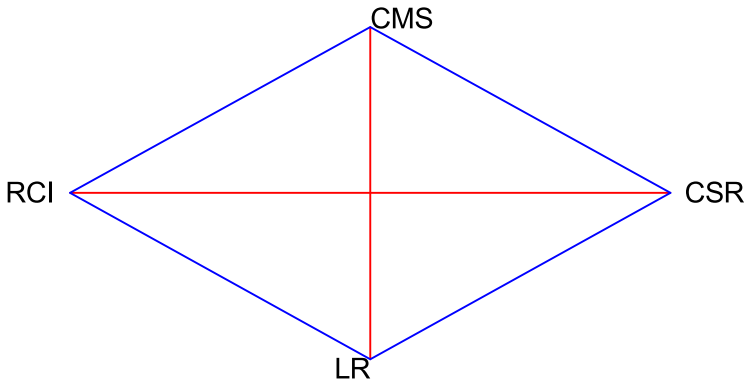


Scatterplot
CODE2
1
2
LR
CMS
0
5
10
15
20
25
30

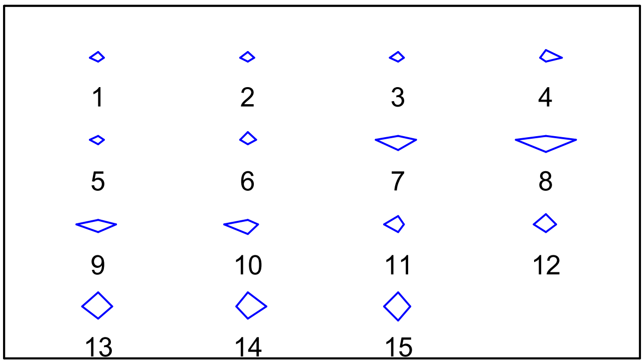


Scatterplot
CODE2
1
2
RCI
800
600
400
200
0
CMS
LR

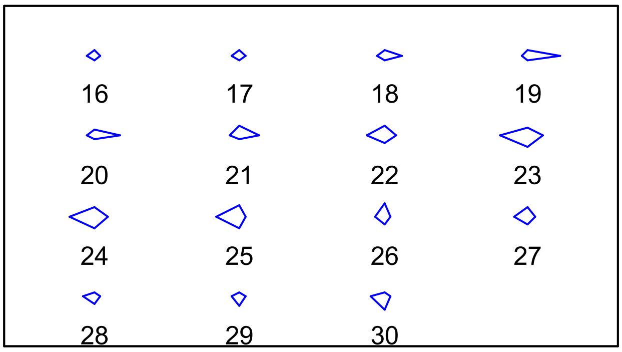
CORRELATIONS CHART



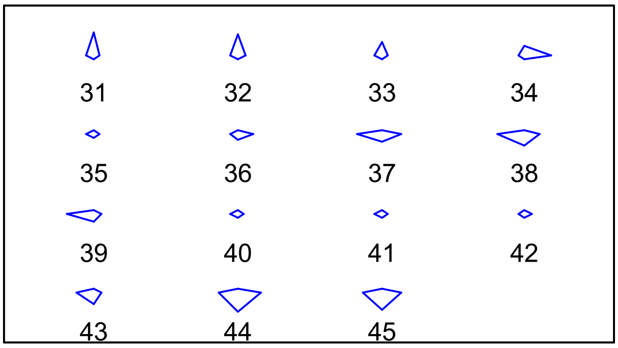
CZECH REPUBLIC - CORRELATIONS



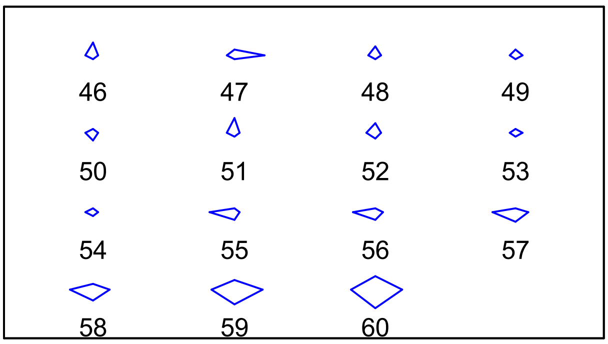
POLAND – CORRELATIONS

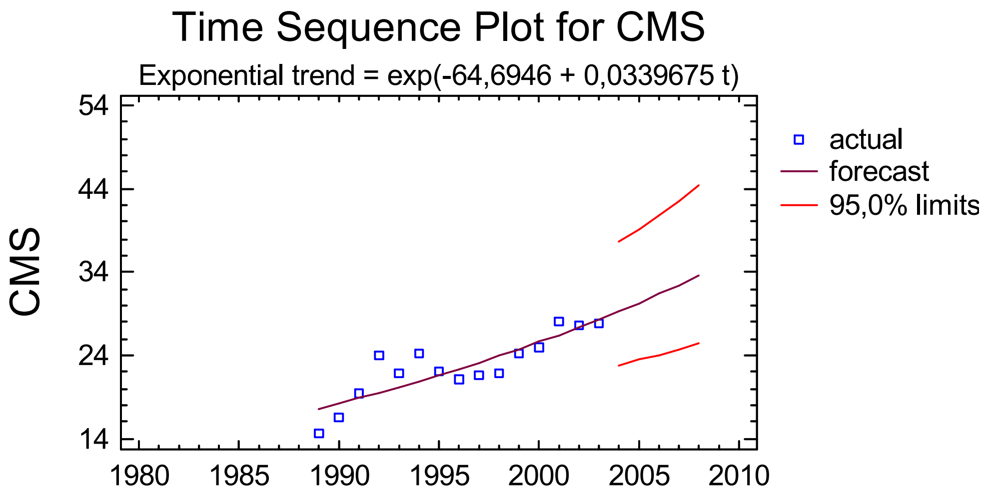


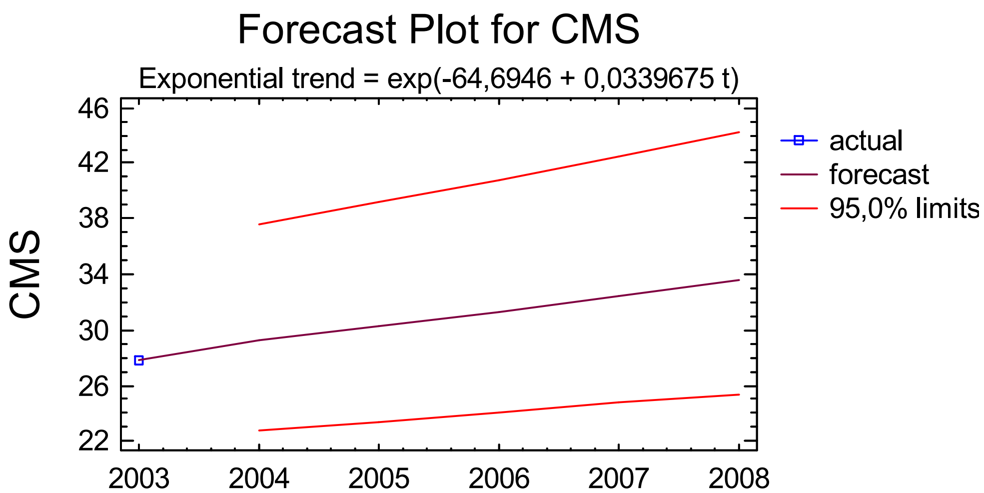
ROMANIA – CORRELATIONS

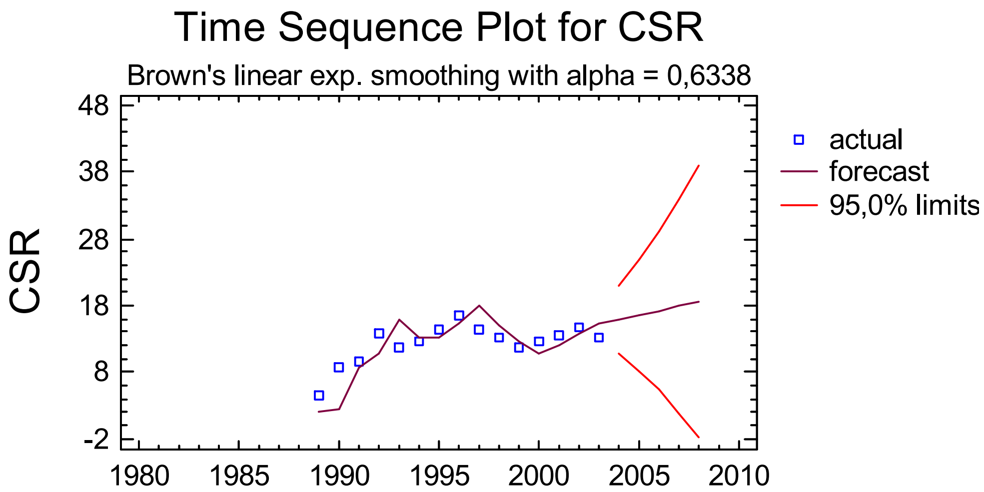


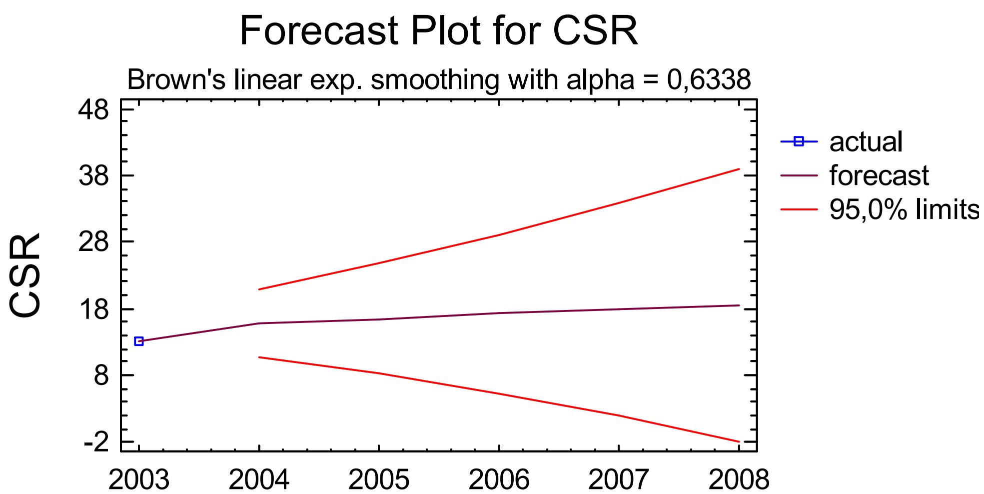
BULGARIA – CORRELATIONS

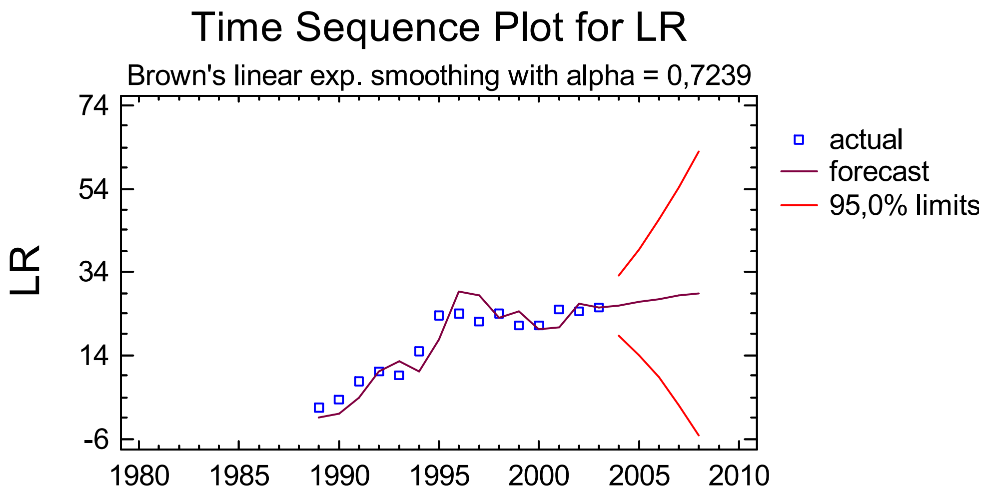


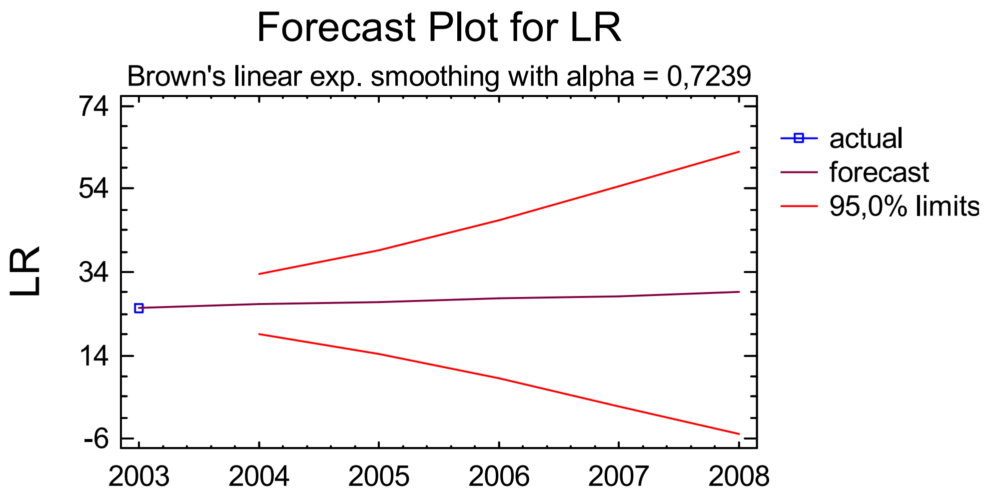

Time Sequence Plot for CMS
Exponential trend = exp(-64,6946 + 0,0339675 t)
CMS
54
44
34
24
14
1980
1985
1990
1995
2000
2005
2010
actual
forecast
95,0% limits

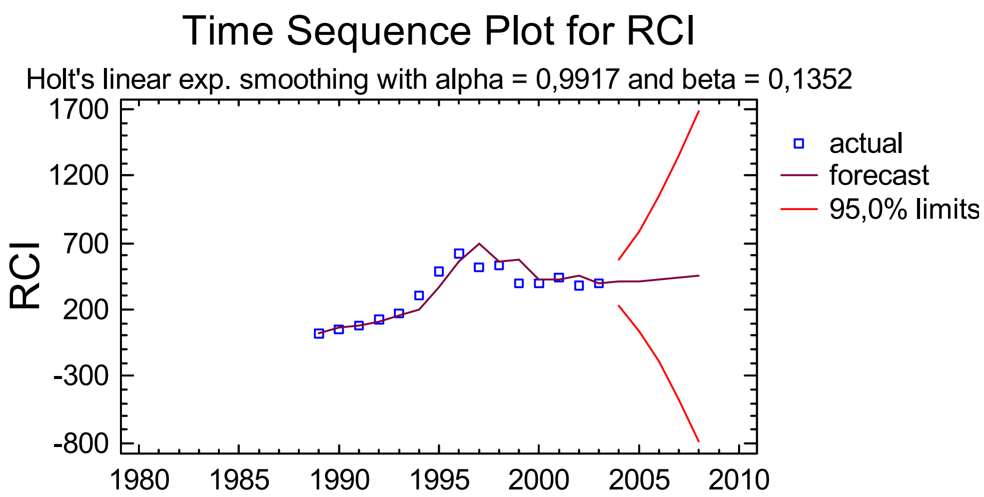

Forecast Plot for CMS
Exponential trend = exp(-64,6946 + 0,0339675 t)
CMS
46
42
38
34
30
26
22
2003
2004
2005
2006
2007
2008
actual
forecast
95,0% limits

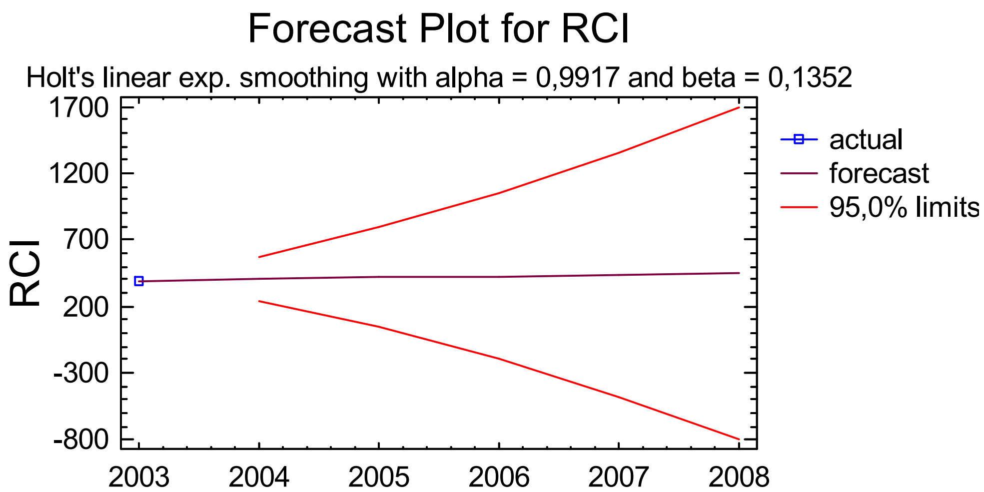

Time Sequence Plot for CSR
Brown's linear exp. smoothing with alpha = 0,6338
CSR
48
38
28
18
8
-2
1980
1985
1990
1995
2000
2005
2010
actual
forecast
95,0% limits

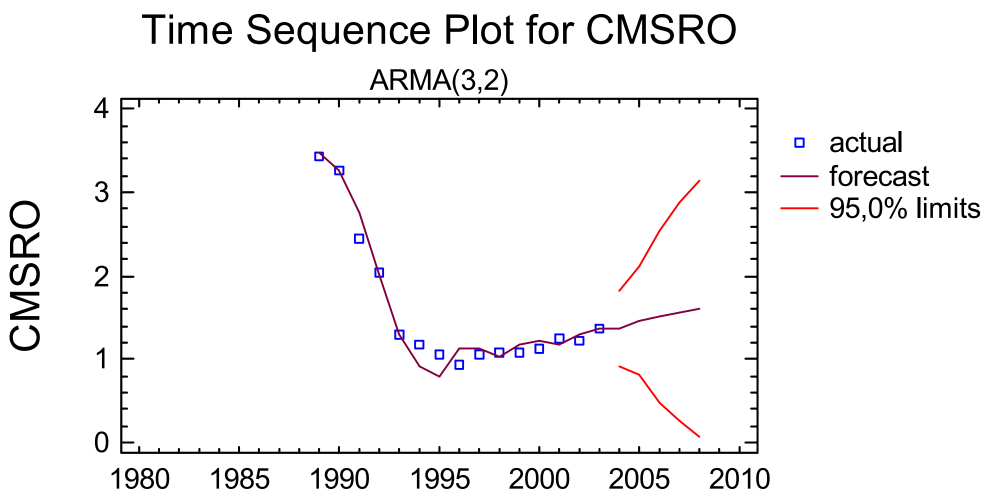

Forecast Plot for CSR
Brown's linear exp. smoothing with alpha = 0,6338
CSR
48
38
28
18
8
-2
2003
2004
2005
2006
2007
2008
actual
forecast
95,0% limits

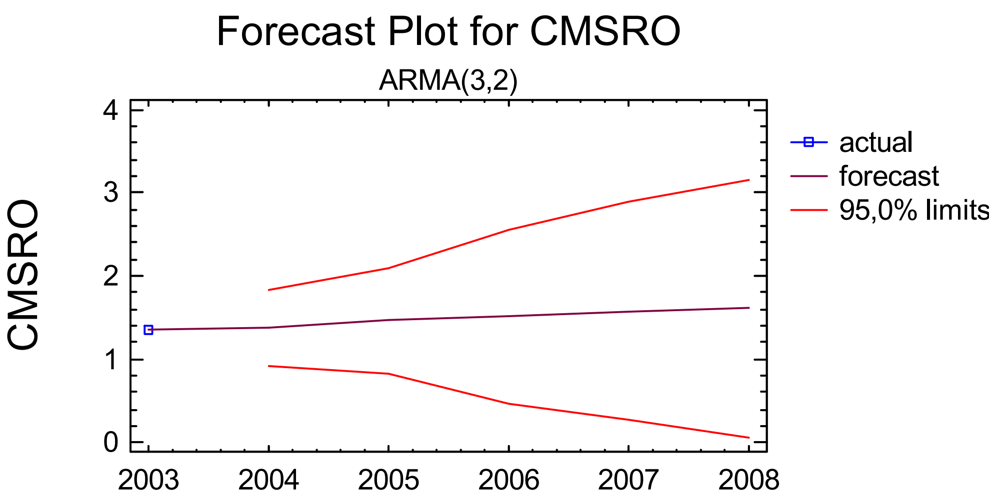

Time Sequence Plot for LR
Brown's linear exp. smoothing with alpha = 0,7239
LR
74
54
34
14
-6
1980
1985
1990
1995
2000
2005
2010
actual
forecast
95,0% limits

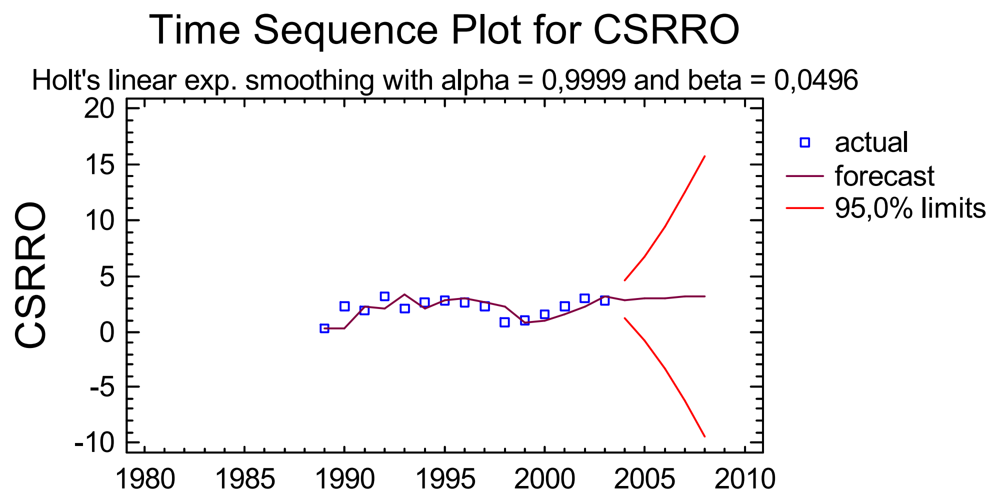

Forecast Plot for LR
Brown's linear exp. smoothing with alpha = 0,7239
LR
74
54
34
14
-6
2003
2004
2005
2006
2007
2008
actual
forecast
95,0% limits

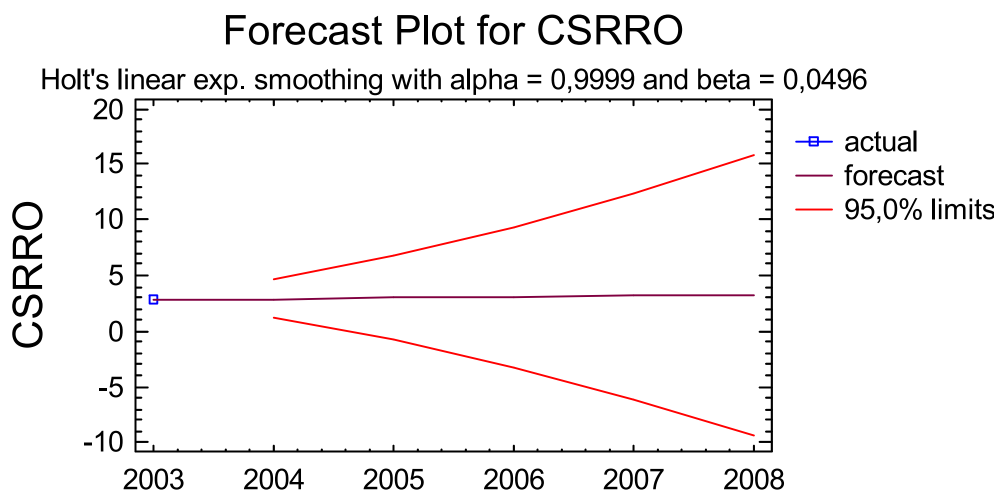

Time Sequence Plot for RCI
Holt's linear exp. smoothing with alpha = 0,9917 and beta = 0,1352
RCI
1700
1200
700
200
-300
-800
1980
1985
1990
1995
2000
2005
2010
actual
forecast
95,0% limits

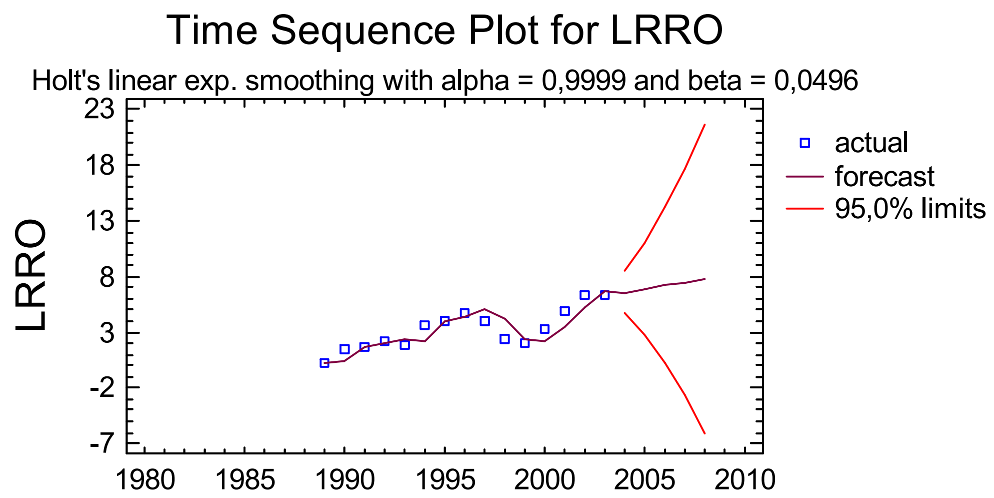

Forecast Plot for RCI
Holt's linear exp. smoothing with alpha = 0,9917 and beta = 0,1352
RCI
1700
1200
700
200
-300
-800
2003
2004
2005
2006
2007
2008
actual
forecast
95,0% limits


Time Sequence Plot for CMSRO
ARMA(3,2)
CMSRO
0
1
2
3
4
1980
1985
1990
1995
2000
2005
2010
actual
forecast
95,0% limits

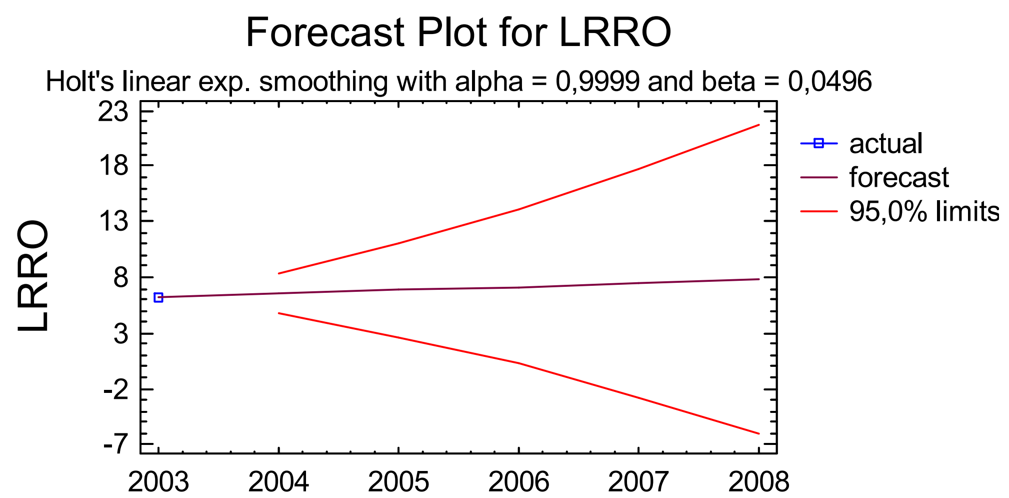

Forecast Plot for CMSRO
ARMA(3,2)
CMSRO
0
1
2
3
4
2003
2004
2005
2006
2007
2008
actual
forecast
95,0% limits


Time Sequence Plot for CSRRO
Holt's linear exp. smoothing with alpha = 0,9999 and beta = 0,0496
CSRRO
20
15
10
5
0
-5
-10
1980
1985
1990
1995
2000
2005
2010
actual
forecast
95,0% limits

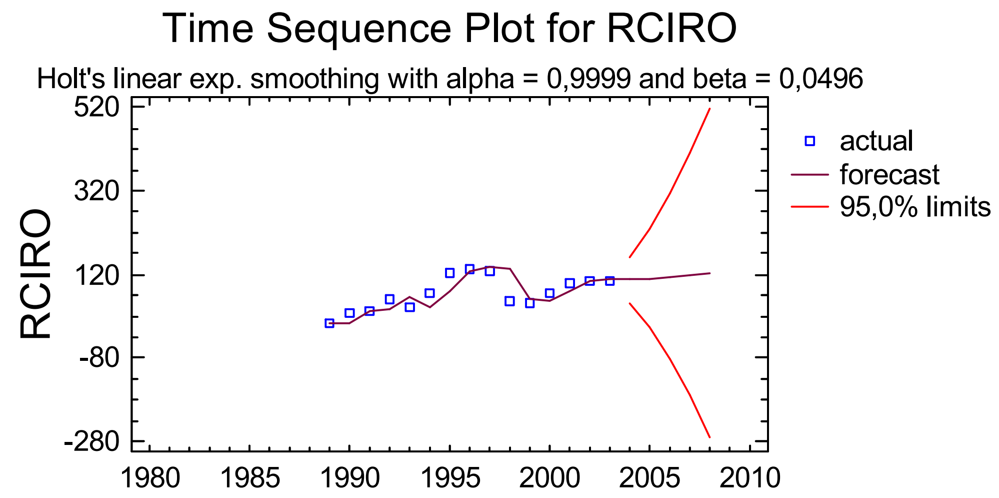

Forecast Plot for CSRRO
Holt's linear exp. smoothing with alpha = 0,9999 and beta = 0,0496
CSRRO
20
15
10
5
0
-5
-10
2003
2004
2005
2006
2007
2008
actual
forecast
95,0% limits

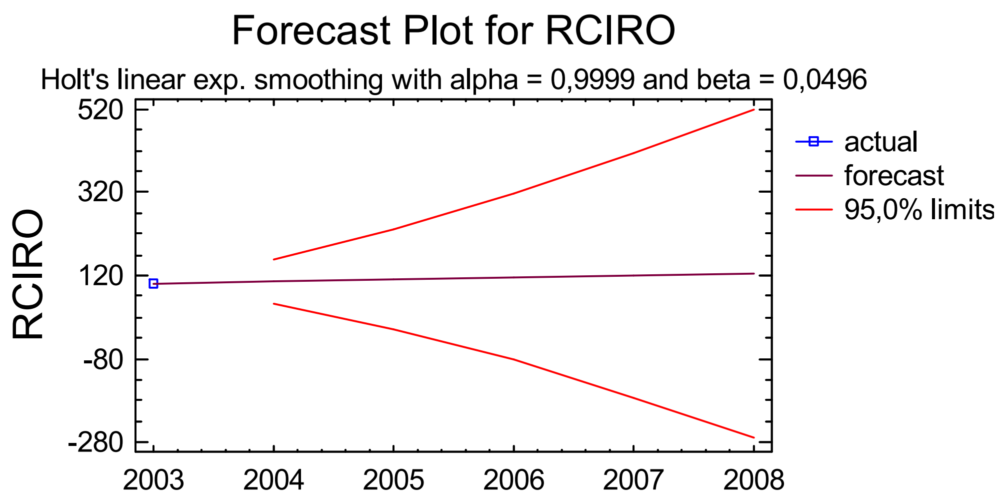


Time Sequence Plot for LRRO
Holt's linear exp. smoothing with alpha = 0,9999 and beta = 0,0496
LRRO
23
18
13
8
3
-2
-7
1980
1985
1990
1995
2000
2005
2010
actual
forecast
95,0% limits



Forecast Plot for LRRO
Holt's linear exp. smoothing with alpha = 0,9999 and beta = 0,0496
LRRO
23
18
13
8
3
-2
-7
2003
2004
2005
2006
2007
2008
actual
forecast
95,0% limits


Time Sequence Plot for RCIRO
Holt's linear exp. smoothing with alpha = 0,9999 and beta = 0,0496
RCIRO
520
320
120
-80
-280
1980
1985
1990
1995
2000
2005
2010
actual
forecast
95,0% limits


Forecast Plot for RCIRO
Holt's linear exp. smoothing with alpha = 0,9999 and beta = 0,0496
RCIRO
520
320
120
-80
-280
2003
2004
2005
2006
2007
2008
actual
forecast
95,0% limits