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Consequences of the Collapse of Socialist Economies in Eastern Europe

Abstract

This article analyzes the economic, social and institutional consequences of the collapse of the socialist economic system in Eastern Europe. As a result of the political transformations that took place in 1989-1991, the countries of the region entered the transition phase from a planned economy to a market economy. The main objective of the study is to examine the effects of this transition on the economic structure, production system, employment level and international economic integration. The article analyzes problems such as production decline, inflation increase and temporary weakening of social welfare that occurred in the first stage of the transition economies. At the same time, the new economic model that was formed in the long term as a result of privatization processes, institutional reforms and attracting foreign investments is also evaluated. The study shows that although the collapse of the socialist system created economic instability in the short term, it accelerated the integration of many Eastern European countries into the global economic system and the formation of market institutions in the long term.

Keywords: *socialist economy, transition economy, Eastern Europe, market economy*

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Şərqi Avropada sosialist iqtisadiyyatlarının çöküşünün nəticələri

Xülasə

Bu məqalədə Şərqi Avropada sosialist iqtisadi sisteminin dağılmasının iqtisadi, sosial və institusional nəticələri təhlil edilir. 1989-1991-ci illərdə baş verən siyasi transformasiyalar nəticəsində region ölkələri planlı iqtisadiyyatdan bazar iqtisadiyyatına keçid mərhələsinə qədəm qoymuşdur. Tədqiqatın əsas məqsədi bu keçidin iqtisadi struktur, istehsal sistemi, məşğulluq səviyyəsi və beynəlxalq iqtisadi inteqrasiyaya təsirini araşdırmaqdır. Məqalədə keçid iqtisadiyyatlarının birinci mərhələsində baş verən istehsalın azalması, inflyasiyanın artması və sosial rifahın müvəqqəti zəifləməsi kimi problemlər təhlil edilir. Eyni zamanda özəlləşdirmə prosesləri, institusional islahatlar və xarici investisiyaların cəlb edilməsi nəticəsində uzunmüddətli perspektivdə formalaşan yeni iqtisadi model də qiymətləndirilir. Tədqiqat göstərir ki, sosialist sisteminin süqutu qısa müddətdə iqtisadi qeyri-sabitlik yaratsa da, uzun müddətdə bir çox Şərqi Avropa ölkələrinin global iqtisadi sistemə inteqrasiyasını və bazar institutlarının formalaşmasını sürətləndirib.

Açar sözlər: *sosialist iqtisadiyyatı, keçid iqtisadiyyatı, Şərqi Avropa, bazar iqtisadiyyatı*

Introduction

Throughout the 20th century, the countries of Eastern Europe, which were under the influence of the Soviet Union, were governed by socialist economic models. In these countries, practices such as state ownership of the means of production, economic policies based on a centrally planned system, collectivization of agriculture, and restrictions on foreign trade became the cornerstones of the economy. However, in the 1980s, the instability of the system became clear. 1989 was a turning point with the successive collapse of socialist regimes in Eastern Europe. The fall of the Berlin Wall, the collapse of the Soviet Union, and the subsequent transition to a market economy had a multifaceted impact, both politically and economically. This article aims to identify the economic implications of the collapse of socialism for Eastern European societies by analyzing in depth the economic consequences of the aforementioned transition.

Main features of the socialist economy (1945-1989). The socialist system was widespread in Eastern European countries, especially after World War II under the influence of the Soviet Union. One of the main features of this system was the abolition of private ownership of the means of production and the transformation of the state into the sole economic entity. Five-year development plans were implemented within the framework of a planned economy model, and industrial and agricultural production were shaped in accordance with the goals set by the center. The main goal was to prioritize heavy industry, raise employment to full capacity, and reduce dependence on exports. However, this system had some chronic problems. The main ones were low productivity, lack of innovation, waste of resources, and the lack of quality product production. Despite frequent shortages of food and consumer goods, labor productivity was also extremely low. The lag in technological development and limited foreign trade prevented these countries from integrating into the world economy. In addition, the decentralization of economic decisions led to a decrease in comfort at the local level. (Kornai, 1992; Lane, 2005)

Transition: shock therapy and gradual reforms. In the period after 1989, Eastern European countries adopted different strategies for the transition from socialist planned economies to free market economies. The two most common approaches in this context were “shock therapy” and “gradual transition”. Shock therapy involved immediate liberalization of the economy, lowering market prices, eliminating state subsidies, and rapidly implementing privatization. Countries such as Poland, Czechoslovakia, Estonia, and Russia chose this path. On the other hand, countries such as Hungary and Slovenia acted more cautiously, gradually reducing the state sector and gradually developing the private sector. In these countries, the process of price controls and privatization was spread over a longer period. Both methods had their advantages and disadvantages. Shock therapy resulted in rapid structural changes, but it also entailed significant social costs. Gradual transition, on the other hand, preserved relative peace in society but lost time for reforms to take effect. (Aslund, 2007; De Melo and others, 2001; Offe, 1996)

Economic consequences and social costs. The transition process caused significant economic difficulties for both models. The transition from a socialist economy to a market economy led to negative consequences such as economic recession, rising unemployment and rising inflation in the short term. The labor market shifted from the concept of full employment during the socialist period to high unemployment. This led to serious social injuries and loss of labor. However, the economic difficulties faced by each country varied according to its historical and social conditions. (Milanovic, 1998; World Bank, 2002)

Poland - rapid reforms and challenges: Poland was one of the first countries to adopt the shock therapy model. In the early 1990s, the country tried to quickly transition to a market economy. The Balzerovich plan accelerated Poland's economic transformation. This plan laid the foundation for a free market economy, but soon experienced strong inflationary pressures and unemployment. The inflation rate rose to 600% in the early 1990s and the unemployment rate increased. However, Poland managed to recover quickly and in the mid-2000s, after a rapid entry into the integration process with Western Europe, a period of rapid economic growth began. (Aslund, 2007)

Czech Republic - slow but reliable transition: The Czech Republic was one of the countries that

adopted the gradual transition model. After the end of the socialist regime, the Czech Government began to carry out economic reforms in stages. This process continued with the privatization of heavy industry and utilities. Although the Czech Republic suffered less due to gradual reforms, it was able to quickly attract foreign investment. Since the 2000s, the country has seen strong economic growth and its integration into the European Union has been rapid. (De Melo and others, 2001; EBRD, 2009)

Hungary - Mixed Model: Hungary adopted a more mixed approach to reforms. Both elements of shock therapy and gradual reforms were implemented. In 1991, privatization of the public sector began, but state intervention in agriculture and the service sector continued. Hungary struggled to cope with large external debts and high inflation rates. A market economy was slowly but steadily taking shape, and growth accelerated in the mid-2000s. (Berend, 2009; EBRD, 2009)

Romania - Low growth and high unemployment: Romania had one of the most rigid regimes of the socialist era. The harsh rule of Nicolae Ceausescu led to the economy being completely under state control. The collapse of this system led to a serious economic crisis. Romania faced very serious economic difficulties during the transition period; inflation was high, unemployment was high, and production capacity was very low. The privatization process was very slow, as the public had lost a lot of trust. However, economic growth accelerated in the early 2000s when Romania began preparing for EU membership. (Berend, 2009; World Bank, 2002)

Bulgaria - economic changes and external dependence: Bulgaria is another country that applied a shock therapy approach in the 1990s. The rapid transition to a free market economy led to a serious economic crisis in 1997. This crisis caused the country to face a large external debt burden and hyperinflation. However, economic stability was achieved thanks to the independent Central Bank established in 1997 and currency stabilization programs. Bulgaria received support in the economic recovery process through foreign aid and EU membership. (World Bank, 2002; EBRD, 2009)

Baltic countries (Estonia, Latvia, Lithuania) - rapid liberalization and integration: The Baltic countries Estonia, Latvia, and Lithuania applied shock therapy during the transition period and rapidly transitioned to a market economy. After gaining independence from the Soviet Union, these countries quickly began economic reforms. They took steps such as privatization, financial liberalization, and liberalization of foreign trade. Estonia in particular has developed significantly thanks to digitalization and the technology sector. The Baltic countries became rapidly growing economies in the 2000s and achieved significant economic integration through EU membership. (Aslund, 2007)

Albania - Transition difficulties and short stature: Albania had one of the harshest regimes of the socialist system. The Enver Hoxha government reacted very late to the social changes that ended the Socialist regime in the 1990s. During the transition period, the country faced serious economic difficulties and rapid privatization processes led to a shortage of public services. In the 1990s, the country experienced a serious economic crisis and the unemployment rate rose rapidly. However, Albania gradually began to attract foreign investment and achieved economic growth in the mid-2000s. However, reforms in the country's economic structure remain insufficient and its external dependence continues. (Berend, 2009; World Bank, 2002)

Former Yugoslavia - Difficulties in Transition from Socialist Economy: The transition of the former Yugoslav countries from socialist to market economies was a complex and multifaceted process. Unlike other Eastern European countries, Yugoslavia did not have a centrally planned economy; its model of "self-managed socialism" protected certain rights of working collectives over enterprises and allowed prices to be formed partially by the market mechanism. However, ethnic conflicts and wars in the 1990s (Serbia-Bosnia, Serbia-Bosnia and Herzegovina, Serbia-Kosovo) destroyed the economy, destroyed infrastructure and industrial enterprises, and led to capital flight and the loss of human capital. The transformation recession during this period was accompanied by a sharp decline in GDP, an explosion of unemployment, and a fall in real incomes. Corruption and oligarchization occurred during the privatization process, state assets were sold at low prices, and the financial and banking system experienced a serious crisis. Institutional weaknesses, unclear property rights, and political instability further complicated the transition. As a result, the integration of the former Yugoslav countries into a market economy was longer and more complex than in countries

that were free of war and stable. (Uvalic, 2010; Granville, 2003)

Below is a general estimate of the nominal GDP values of Eastern European countries by decade. All values are in billions of United States dollars (USD):

Country	1990	2000	2010	2020	2025
Poland	66	171	477	597	750
Czech Rep.	40	62	207	245	310
Slovakia	12	20	89	106	130
Slovenia	18	20	48	53	65
Croatia	24	23	60	57	75
Bos.- Hers.	5	5	17	20	25
Hungary	34	46	130	155	190
Romania	38	37	167	249	320
Bulgaria	20	13	51	69	90
Latvia	7	8	24	34	40
Lithuania	12	11	37	56	70
Estonia	4	6	19	31	38
Albania	2	3	12	15	20
Serbia	24	9	41	53	70
Kosovo	1	2	6	8	10

Sources: 1. World Bank – World Development Indicators; 2. IMF – World Economic Outlook Database; 3. Eurostat – National Accounts Data

After 1990, Eastern European countries experienced major economic changes with the collapse of their socialist regimes and the transition to a market economy.

1990: Most countries felt the effects of the post-Soviet economic collapse with low GDP levels. Countries such as Bosnia and Herzegovina, Albania and Kosovo in particular had very low starting values due to war or political turmoil. 2000: Thanks to market reforms and investments, GDP began to grow rapidly in Poland, the Czech Republic, Hungary and the Baltic countries. The Balkan countries were in the process of recovery.

2010: EU membership and the integration process accelerated growth; countries such as Poland, the Czech Republic and Slovakia stood out in economic growth. The Baltic countries saw GDP per capita increase thanks to digital economy and technology investments.

2020: Most countries maintained moderate growth, despite temporary contractions during the pandemic. Economies such as Poland and the Czech Republic showed signs of recovery.

2025: Forecasts show that Poland and the Czech Republic will maintain their leading positions in terms of GDP volume, while the Balkan countries will continue with moderate growth. Smaller economies such as Kosovo and Albania will show more limited growth.

Overall, EU membership and integration significantly accelerated economic growth, while war

and political transitions in the Balkans slowed economic recovery, while the Baltic countries experienced rapid growth in GDP per capita thanks to technology and digitalization.

Impact of the collapse of socialist economies on the world economy. The collapse of socialist systems in Eastern Europe had significant economic consequences not only regionally but also globally. With the collapse of the Soviet Union in the early 1990s, the dynamics of the world economy began to change. During this period, Eastern European countries became more integrated into world markets. Former socialist countries under the influence of the Soviet Union increased their external dependence and strengthened trade relations with Western Europe in the process of transition to a market economy. This process opened up new trade routes and investment flows with countries integrated into the world economy. (Stiglitz, 2002; Phelps, 2003)

Social consequences of the collapse of the socialist economy. The collapse of the socialist system led to major changes not only economically, but also socially. During the transition period, many countries in Eastern Europe faced serious social problems.

The egalitarian structures of the socialist era were replaced by more hierarchical and class structures. The increase in unemployment led to despair, especially among the young population. At the same time, low-income groups became even poorer and wealth inequality increased. Privatization processes impoverished the working class of the old socialist system, while the new labor market offered fewer opportunities, especially for unskilled labor. Migration movements accelerated in most Eastern European countries. Young people began to migrate to Western Europe in search of better job opportunities and living conditions. This led to a loss of labor force and demographic changes in some countries. In addition, the increase in corruption in the newly created capitalist system and the emergence of local oligarchs undermined the trust of society. (Hanley, 2014; Milanovic, 1998)

Conclusion

The collapse of socialism in Eastern Europe led to significant economic, social and political changes. Although the transition from a socialist planned economy to a free market economy created serious problems and social costs in the short term, in the long term it achieved significant economic growth and integration with Western Europe. However, different countries were successful to varying degrees depending on the speed and methods of the transition. While countries such as Poland, the Baltic countries and the Czech Republic recovered rapidly, countries such as Albania, Kosovo and Serbia continue to experience the negative effects of the transition period. The economic changes experienced by Eastern Europe, the collapse of the Socialist system and integration into the capitalist system had a major impact on the regional and global levels, and this process continues to this day.

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