Chapter 20
Trade Openness and Unemployment in Transition Economies: A Dynamic Heterogeneous Panel Data Analysis

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ABSTRACT
Liberalization of foreign trade and foreign exchange regimes of the countries in transition from planned economies to liberal economies, which are called transition economies in the literature, constitutes one of the crucial pillars of the process. The effect of foreign trade liberalization process on the workforce markets, however, has been a matter of ongoing dispute in the literature. For this reason, the long-term relationship between trade openness and unemployment in 17 transition economies between years 1998-2014 is researched in this study, using dynamic heterogeneous panel data analysis methods. As a result of the econometrical analysis, it has been found that there is a significant relationship between trade openness and the rate of unemployment and that trade openness has a reducing effect on unemployment.

INTRODUCTION
Transition economy is the technical term used for the economies in transition from centrally planned economy to liberal economy. Transition economies shift to an environment where the prices are determined by the free market instead of a central organization during the process of economic liberalization. In this process, removal of trade barriers, privatization of state-owned enterprises and trade liberalization policies will be applied. Though it may differ from country to country, this process either came to
fruition or is still going on in China, former Soviet Union countries, former Warsaw members and many other developing countries.

The Central and Eastern European countries and former Union of Soviet Socialist Republics (USSR) countries take the dominant place in the International Monetary Fund (IMF) classification of transition economies. These countries and their classifications are as follows (Güler, 2012):

1. Central and Eastern European States: Albania, Bulgaria, Croatia, Czechia, Macedonia, Hungary, Romania, Slovak Republic, and Slovenia,
2. Baltic States: Estonia, Latvia, and Lithuania,
3. Former Soviet Union States: Russian Federation, Azerbaijan, Belarus, Armenia, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Uzbekistan, Tajikistan, Turkmenistan, and Ukraine.

When the emergence process of transition economies - the definition and scope of which are given above – is analyzed; it can be seen that the breakthrough in Poland (the workers’ strike in 1988, the change of the system of government and Poland’s break from the influence area of the Soviet Union) had evolved into a gigantic movement. Following this example; other European countries’ progress in the same direction, some with bloody conflicts (Romania) and some with peaceful means (Hungary), achieved similar results and they also switched to the market economy after the collapse of communism. The process did not stop there. With the Baltic States gaining their independence, which can be counted as European states rather than Soviet Republics, the Soviet Union became a federal structure. The final link in this chain was the establishment of the Commonwealth of Independent States (CIS), which took the place of the USSR after the gathering of the presidents of Russia, Kazakhstan, and Belarus on December 30, 1991. The CIS also fell apart later, and the member states applied for integration with the western institutions, just like the former members of the Warsaw Pact. All the economies which involved in this process are termed transition economies in the literature (Kutlu & Eşkinat, 2014, p. 197).

International institutions –World Trade Organization (WTO), IMF and the World Bank in particular – have engaged in promotive practices and gave training services and technical assistance in order to liberalize the foreign trade and exchange regimes of the transition economies which have adopted the western economy models (Seyidoğlu, 2015, pp. 231, 850). The purpose of these aids was the transition of the countries to an open market. These practices achieved significant results, as all of the transition countries adopted the free market economy model and started using the arguments of this model.

With the liberalization of foreign trade, which is one of the most important arguments of this model, a rapid increase was observed in the trade openness ratios of the transition economies. A country’s openness ratio is generally calculated as the ratio of the foreign trade volume to the GDP. Another indicator that approximates trade openness is the foreign dependency ratio, which is the ratio of exports to the GDP. In the most general sense, it can be said that the higher these ratios are, the more open that economy is. To improve the trade openness, barriers to foreign trade -customs duties, quotas, non-tariff barriers, etc.- must be removed.

The liberalization process in the transition economies (especially the ones that are focused in this chapter), which has started post-1990, is going on rapidly. Though the economic growth of these countries varies, it is observed that the growth is bigger than the pre-1990 period. The growth rates, which were usually negative at the start of the 1990s, were seen to improve as the result of the rapid foreign expansion efforts in the second half of the 1990s and have passed the average rate of 5% before the last global economic crisis. Economic growth is associated with the increase in employment in the economic literature.