

Theofanis Stavrou, John Lampe (Hrsg.)

Redefining Southeastern Europe

Political Challenges
and Economic Opportunities

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Redefining Southeastern Europe: Political Challenges and Economic Opportunities

Edited by Theofanis G. Stavrou
and John R. Lampe

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PREFACE

This volume is the result of the conference „Redefining Regional Relations in Southeastern Europe: Political Challenges and Economic Opportunities“, held in Nicosia, Cyprus on 20-22 March 1995 under the sponsorship of the Woodrow Wilson International Center for Scholars, the Modern Greek Studies Program at the University of Minnesota, the Südosteuropa-Gesellschaft in Munich, and several host institutions such as the University of Cyprus. One of the objectives of the conference was to bring together scholars from the United States and Europe, especially from the countries discussed in this volume. We aimed for as comprehensive a geographic coverage of the region as possible and for this reason we included Greece, Turkey, and Cyprus. Regrettably, the invited scholar from Turkey was unable to attend the conference but Turkey figured prominently in the deliberations. Another objective was to explore ways by which the political challenges confronting the region should not be allowed to obscure the emerging economic opportunities which could lead to interaction and cooperation among the Southeastern European states and in the process help redefine not only the economic but also the political landscape of the region. As John Lampe points out in his introduction, economic integration is the alternative to isolation of the Balkan states from each other, and of the Balkan region from the rest of Europe.

The volume is conveniently divided into two parts reflecting the two overarching themes of political challenges and economic opportunities. Several clusters highlight the issues that preoccupied the conference participants. The first three essays by R. H. Linden, Daniel N. Nelson, and Radovan Vukadinović deal with broad and complex security issues, themselves in need of redefinition in this „age of uncertainty“ and „collective security“ in Europe in general, and Southeastern Europe in particular. Throughout the conference, Yugoslavia was a constant point of reference, and this is reflected in the present volume. The essays by Predrag Simić and Dušan Reljić respectively focus on the dynamics of Yugoslav crisis and the „possibilities for reintegration of former Yugoslavia“. They are followed by case studies of countries affected in varied degrees by the Yugoslav crisis. In the case of Greece, the only country in the region enjoying stability and European Union membership, one detects hopeful signs in the evolution of Greek foreign policy in the post-Cold War environment. According to Theodore Couloumbis' contribution, Greece has been increasingly moving in the direction of playing the role of a mediator in the region, despite some challenges it faces because of political remapping in the Balkans and in Cyprus. The Re-

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public of Cyprus, which despite its political uncertainty has experienced an economic miracle during the last two decades, aspires for membership in the European Union which will also play a positive role in effecting a political solution to its own conflict. The island republic's „long march to Europe“ and the challenges it faces as a result of the attitude of Turkish leadership in Cyprus and mainland Turkey are discussed in great detail by Nicholas Emiliou. In short, each state in the region has its own sets of challenges and opportunities. Agim Nesho reminds us of Albania's agonizing efforts at reconstruction and opening up to its immediate neighbors and beyond. This is also the story of Romania as discussed by Vlad-Andrei Moga. All in all, despite divisions and rivalries, the opportunities for political dialogue and actual collaboration are expanding.

The second half of the volume deals first with economic challenges affecting the whole region – „the economic dimension of conflict“ as Franz-Lothar Altmann puts it – and the nature of economic transformation which is uneven, to say the least, as we are reminded by Ognian Hishov. Yet, despite disruptions and uneven development, regional cooperation in the Balkans has to be the way of the future, although in her essay Nada Švob-Đokić cautions against great expectations in the immediate future from this „polymorphous“ Balkan structure. Bulgaria, whose trade relations with its neighbors are judiciously assessed by Michael L. Wyzan, is a case in point. In fact Hansjörg Brey argues that, in the case of Cyprus, economic cooperation and integration between Greek and Turkish Cypriots may prove to be the way to a solution of the Cyprus conflict.

The last three essays in this volume address specific economic issues, such as the role of government and banking in development and cooperation, topics analyzed by Neven Borak and Franjo Štiblar respectively, and the question of economic relations between Central and Southeastern Europe discussed by Tamás Novák. The imperatives of the political challenges and economic opportunities speak more of the need for economic integration as an antidote to political conflict and Balkan isolation. Bringing this about is quite a different matter. It will require patience and understanding by all involved.

The road was long from the conference in Nicosia to the preparation of the manuscript in Minneapolis, to publication of the volume in Munich. But the whole project was as rewarding and enjoyable as it was challenging. I want to thank my colleagues John Lampe and Hansjörg Brey for their splendid collaboration in this joint venture and the participating scholars including those whose papers do not appear in this volume. Finally, it remains for me to thank the supporting staff of the sponsoring institutions whose tireless efforts made both the conference and this volume a reality.

Theofanis G. Stavrou

Economic Integration versus Balkan Isolation: Southeastern Europe after the Twentieth Century*

John R. Lampe

The independent states of southeastern Europe now find themselves larger in number—ten countries spread from Slovenia to Romania and Turkey—and less important individually to the Western powers than at any time during the twentieth century. Their greatest external peril lies not in excessive European or American interest but in neglect and isolation. Held back primarily but not exclusively by the wars of Yugoslav succession, the successors to the region's Communist regimes have not progressed as far in the transition to a market economy as their central European counterparts. Slovenia alone has been spared a growing exclusion, one that threatens to loosen already weak bonds such as those linking the economies of Turkey and Greece, despite the latter's membership in the European Union, to an increasingly integrated Europe. Left unchanged, current trends will cut the region off from the rest of Europe politically as well as economically but not, we should remind ourselves, geographically.

Progress toward economic integration remains the best prescription for avoiding political isolation, single-party regimes, media monopolies and the further ethnic conflict that will surely accompany them. This article explores the promise that economic integration, and the legal framework that must go with it, has held for southeastern Europe earlier in this century and still holds as we approach the next century. I will argue that simply reconnecting the five now separate economies of the former Yugoslavia, not politically feasible if attempted in isolation, or even the ten economies of the entire region will not be sufficient. More of the near neighbors must also be involved in the process, although nearer and less disparate than the unwieldy numbers involved in either the central European or the Black Sea initiatives. Both now seem dead letters to many American ob-

servers, although the progress of the Central European Free Trade Association (CEFTA) may prove us wrong.

I propose two smaller versions of these initiatives, whose close cooperation with each other would also serve the political purpose of linking central and southeastern Europe. One would revive the original *Pentagonale* of the 1980s to connect Slovenia and Croatia with Austria, Hungary and Italy. Some link to the Czech Republic and Slovakia would also be essential for this politically feasible group, but no more so than ties to the other politically feasible group of five—Albania, Bulgaria, Greece, an acceptably named Macedonia, and the Yugoslav federation of Serbia and Montenegro. They in turn would benefit by more open economic connection to Romania, Turkey and the region's most rapidly growing trade and financial center, the Republic of Cyprus.¹ These two tiers might well launch their own initiatives and their joint relations by holding the European Union and the United States to their promises to rebuild the economy of Bosnia-Herzegovina. Unless reconnected to both tiers, none of the Bosnian economy's three parts can survive with any prospect for retaining the skilled labor and urban professionals who have not already left or, perhaps more importantly, for bringing back those who have left.

This political prescription rests solidly on the region's economic history across the full course of the twentieth century. No shots were fired over the few interstate conflicts that arose because of economic issues. Initiatives to avoid dependence on too few trading partners have served the region well, and political efforts to promote regional economic integration surfaced as early as the abortive Serbo-Bulgarian customs union of 1905. Let us begin there, at the start of the century.

Politically inspired on the Serbian side in order to gain advantage in its government's trade bargaining with Austria-Hungary, the 1905 agreement admittedly foundered subsequent revisions dictated from Vienna to Belgrade. But the huge Habsburg monarchy failed to win the subsequent tariff war of 1906-11, on which Hungarian agricultural interests insisted because of competing livestock exports. The small Serbian economy carried the day by finding other markets for other products. Nor can we make the political fallout from the tariff war as dangerous an ingredient in the rising Austro-Serbian antagonism as the Balkan Wars of 1912-13.² It was those two Serbian victories and their Bosnian consequences in particular that prompted the monarchy's preventative war against Serbia and the subsequent European war in 1914.

As a result of that much wider war, the region's largest customs union, Austria-Hungary itself with a population of 51 million, was dissolved. The monarchy's economic record has been much debated ever since the breakup. The per capita value of its foreign trade was admittedly low, 25% of Germany's or France's, and declining as a share of national income during the last prewar years. Combined exchange with the indepen-

dent Balkan states barely amounted to 4% of this modest total, versus 40% with Germany and 10% with the United States. But within the borders of Austria-Hungary, as David Good has recently demonstrated, modern economic integration was more widespread and regional growth less uneven than many, including the present author, had maintained.³ I am still not convinced that Croatia-Slavonia was reducing its disparity or marketing much agricultural produce in the face of Hungarian competition, but the Vojvodina was clearly succeeding in both regards. Also, as my own work has pointed out, Bosnian exports per capita, primarily to the rest of Austria-Hungary, exceeded the Serbian figure by more than 50%.⁴

The interim decades that followed World War I saw the levels of foreign trade and investment reduced for all of Europe, not just for the successor states to the Habsburg monarchy. Population losses limited the entire continent's capacity for economic growth. Southeastern Europe, now including the first Yugoslavia and an enlarged Romania, recorded trade totals per capita that were only 25% of the figure for Czechoslovakia.⁵ Beyond generally reduced demand, transport troubles and increased American or Canadian competition cut into prewar markets for Balkan agricultural goods in Western Europe. The small size of manufacturing enterprises and domestic markets discouraged incorporation as well as foreign investment. A round of currency stabilizations in the mid-1920s generated little of the lending that prewar Balkan governments had received from European capital markets, despite overvalued exchange rates intended to attract new loans. The high rates worked instead to limit exports and to prompt higher tariffs in order to protect domestic goods from cheaper imports. Still, wider interregional trade with Italy, despite its Fascist government, and with Czechoslovakia made up for reduced connections to the crippled economies of Austria and Hungary, the core of the former Habsburg customs union.

Trade within southeastern Europe amounted to only 9% of the five states' total turnover by 1929. But when the onset of the Great Depression cut prices for agricultural exports in half, the first thought among the region's governments was not to turn to state controls and bilateral clearing agreements as they later did. The First Balkan Conference of government representatives, convened in Athens in 1930, consciously devoted its agenda to economic issues and concentrated on the Yugoslav and Romanian proposal to create a customs union for southeastern Europe. A Yugoslav delegate pointed out that the combined agricultural exports of the 44 million people represented there were nearly matched by those of free-trading Denmark, with 3.5 million. And his country, like all the others except Greece, had enjoyed export surpluses with the rest of the region for the period 1926-30. Even Greek representatives agreed to go along with the proposal. It came to naught, but only because of the spillover from West European and Czech protests against the proposed Austro-German customs

union, a protocol for which was signed and then hastily abandoned in 1931.⁶ Subsequent efforts to revive the Balkan project or to make something of the much belated economization of the Little Entente (Yugoslavia, Romania and Czechoslovakia) failed to make even comparable progress.

During the rest of the 1930s, the region's governments damaged their capacity for multilateral free trade by creating state agencies to control agricultural exports and signing politically dangerous clearing agreements to barter such produce to Nazi Germany. That was however not the only damage done, nor the only precedent set for the Communist economic regimes imposed after World War II. State-financed military production shot up late in the decade, as it did among all the Nazis' European neighbors. Much of the scarce capital available for investment was thereby diverted into the branch of manufacturing with the smallest potential for export development. For Yugoslavia in particular, such investment tilted the concentration of heavy industry toward the Bosnian and Serbian interior, making both areas vulnerable to future cuts in military spending and meanwhile stirring resentment in Croatia and Slovenia. Only the latter problem arose before World War II intervened. Both would reappear in the 1960s and blossom like poisonous plants during the 1980s.

It took the Tito-Stalin split of 1948 to reactivate such regional concentration, now primarily in Bosnia-Herzegovina. To the north, a similar process was under way in eastern Slovakia. All across southeastern Europe inordinate proportions were invested in military production or, especially in non-Communist Greece and Turkey, military procurement. The Communist economies further mobilized inordinate overall investment—30% of national product or more—to cover as many domestic needs as possible and to use foreign trade only as a means to obtain necessary imports through bilateral clearing agreements, now within the Soviet orbit. Yugoslavia had stepped outside that orbit but was also slow to emphasize exports until trade with Italy was normalized in 1955. Even then, each of the Yugoslav republics favored the development of its own set of the oversized and politically managed industrial enterprises typical of the Soviet bloc economies. Like them, they also concentrated on hard-to-export producers' goods. By the 1960s, however, Yugoslavia's further concentration on military production had begun to wane, leaving Bosnia-Herzegovina, the republic most dependent on arms manufacture for employment, at a disadvantage that would deepen with further spending cuts in the 1980s. Its efforts to bid for a proportional share of federal funds for less developed republics and regions were unsuccessful in the face of priority given to Kosovo. The 1984 Winter Olympics in Sarajevo only raised false expectations. Despite industrial assets per worker that had risen from 82 to 95% on the average, by 1988 the republic's Gross Material Product per capita had fallen to 68% of the Yugoslav average, down from 83% in 1953.⁷

Elsewhere across southeastern Europe, with the sole exception of

Albania, the two decades that ended in 1979 with the second Oil Shock witnessed an unprecedented increase in foreign trade, industrial production and industrial exports.⁸ For the period 1970-78, Bulgarian and Romanian exports were increasing by 10% a year in real value, Greece's by 13%, and Yugoslavia's still by 5%. European Economic Community (EEC) members had by comparison expanded their exports by 8% annually during the halcyon years from 1960 to the first Oil Shock in 1973. Within southeastern Europe, Bulgaria and Greece traded twice the turnover per capita for Romania and Yugoslavia, five times the figure for Turkey and ten times the tiny Albanian total. Industrial production accounted for 50% of Gross Domestic Product (GDP) by 1978 in Bulgaria, Romania and Yugoslavia versus 25% in Greece and Turkey. As a result, primary goods had fallen to 20% of export value for Romania and Yugoslavia, 35% for Bulgaria and Greece. Turkey's non-processed share was still 75%. The narrow range of comparable agricultural exports that had previously helped to constrain the potential for trade within southeastern Europe had therefore broadened considerably.

Although interregional trade constituted just 6% of the six countries' total by 1978, less than the 9% for 1929, we should recall the several-sided political differences that inhibited economic relations until the 1960s. The differences persisted, but their direct effect on economic relations receded, at least to the extent permitted by inconvertible currencies with exchange rates again overvalued and the Soviet-style practice of bilateral trade agreements. The thaw in Greek-Bulgarian trade and tourism began by the late 1960s, ironically under the right-wing Colonels' regime in Athens. Greek trade with Yugoslavia had faced no serious obstacles since the end of the former's civil war in 1952. During the 1970s, Greek exports to Romania, Bulgaria and Albania shot up sixfold in value, while Turkish imports from Romania and Bulgaria rose twenty-fold.

We may only speculate on the political consequences of this economic momentum. It seemed sufficient to encourage a series of inter-governmental meetings throughout the 1980s, despite the distinctly more difficult environment accompanying the second Oil Shock, the slowdown in West European growth, and the gathering crisis in the economies of the Soviet bloc. These contacts culminated in what amounted to the First Balkan Conference of the postwar period. The foreign ministers of now six states met in Belgrade early in 1989 in order to discuss how greater joint endeavors might benefit all of them.

By the end of 1989, however, political bankruptcy in the face of accumulating economic failures had swept the Zhivkov and Ceausescu regimes from power in Bulgaria and Romania, threatened the Alia regime in Albania, and pushed Yugoslavia's Communist party (SKJ) to the brink of dissolution. The federal party's collapse in January 1990 and a series of multi-party elections held only in the individual republics set the final

stage for the wars of Yugoslav succession. As is too well known, they began in Slovenia and spread at far greater human cost to Croatia in 1991 and the next year in still more tragic proportions to Bosnia-Herzegovina.⁹ The economic consequences are less well known, but must be emphasized, despite the imprecision of available data, if the urgent need for wider regional reconnection is to be understood. Without such reconnection, all of southeastern Europe and some of central Europe will be drawn into the subsistence mentality and illegal business that characterizes all parts of the present Bosnian economy and too much of the Serbian, Croatian and Macedonian economies.

Beyond the numbers of dead, displaced or departed, Bosnian economic output had by 1994 been reduced by perhaps 67% from the 1989 level. The same frightening fraction probably holds for Serbia-Montenegro, with the Croatian loss not far behind at 50%. The informal or illegal economy already accounted for 30% of Serbia's GDP in 1992. The trade and financial sanctions imposed on Serbia by the international community made sure that this fraction would increase significantly over the next two years.

Those sanctions and Greece's subsequent embargo on legal trade with what was now the Former Yugoslav Republic of Macedonia transformed over 50% of that fledgling states' foreign trade into illegal business. Only Slovenia has managed to divert the 50-60% of its trade that all the former Yugoslav republics used to conduct with each other into legal trade with a variety of European partners. Even Slovenia's trade with neighboring Austria and Italy has proved to be disappointingly small, respectively 8 and 15% of total turnover. An initial 14% with Croatia in 1992 dropped to 8% by 1995.¹⁰

Like all neighbors of the war-torn republics from the former Yugoslavia, the Slovenian economy has born the burden of trade diversion. The bystanders' governments have all offered estimates of how much trade has been foregone or rerouted at higher cost because the main land arteries connecting central and southeastern Europe have been largely blocked to legal commerce since 1992. Estimates for the neighboring economy most grievously affected, Bulgaria's, run as high as \$4 billion. The Bulgarian economist, Roumen Avramov, casts doubt on any of these numerical estimates, arguing that they are open to exaggeration for domestic political purposes (or minimization by international authorities fearing demands for compensation). Avramov also points out that these estimates exclude the most powerful economic effect of warfare and sanctions across a major trade route—the diversion of capital and income as well as trade into a grey economy based on illegal business and wide open to political or criminal control.¹¹ That was unquestionably the primary effect on the Bulgarian economy from the trade diverted to it by the international sanctions on Serbia and the Greek embargo on the Former Yugoslav Republic of

Macedonia. The Macedonian minister of interior recently resigned over the failure of all concerned to follow tracks from the attempted assassination of President Gligorov to the smuggling interests that were the most likely suspects. The president's successful efforts to come to terms with the Papandreou government and to crack down on domestic corruption as well threatened to restrict the Macedonian role as an enterprise zone for illegal trade.

The warfare and wider circle of economic corruption and restriction that block the central trade arteries of southeastern Europe have had a predictable affect on foreign investment. The limitations that prevail from Albania to Romania because of Serbian conditions, and from Slovenia eastward because of Bosnian conditions, have discouraged any large-scale commitment. The Austrian investments that have come to Slovenia and the Greek ones to Bulgaria are small-scale individually and in sum. Direct foreign investment in Bulgaria since 1991 has amounted to barely \$500 million, and the Slovenian total is even less.¹² German investment has been conspicuous by its absence, even in Croatia after early recognition suggested to some observers (but no economists) that this was the opening move in a new economic penetration of southeastern Europe. According to Wolfram Schrettl of Berlin's Deutsches Institut fur Wirtschaftsforschung, the entire region has received a scant 1% of Germany's direct foreign investment since 1991.¹³ For that matter, the Golden Triangle of Hungary, Poland and the Czech Republic have received only 9% in a total that does not include the massive sums spent on the reintegration of the East German economy.

This discouraging start to the last decade of the twentieth century does not however mean that it must end that way for southeastern Europe. Its midpoint in 1995 has after all brought an end to the Greek embargo, the Bosnian war and the trade if not yet the financial sanctions on Serbia. Only the first of these achievements has received economic reinforcement, in the form of the Greek business interests that pushed the Athens government toward accomodation and now reportedly fill Skopje's hotels with their representatives.

Outside the war zone, another promising trend has already appeared. Greek, and also Turkish, trade has reoriented itself since 1989 away from Germany and toward east central and southeastern Europe. All of the latter economies, with the exception of Albania and to some extent Romania, produce a variety of marketable manufactures that are increasingly exchanged for foodstuffs, including high-quality processed goods, from Greece and Turkey. Even Bulgaria's presumably obsolete metallurgical sector has found markets in those two neighbors, for use there or for transshipment to the smaller, rapidly growing Asian economies. But how can we judge the potential for further expansion of trade within southeastern Europe and the resulting benefit to the region's comparative advan-

tage? Michael Wyzan of Prague's new Open Media Research Institute calculates that the share of Bulgaria's trade turnover with both Greece and Turkey could potentially double from its presently promising level of 10% combined. If Thessaloniki became the regional center for legal trade and finance for which its superior set of institutions and infrastructure already positions it, he adds, trade with Greece could rise much more.¹⁴ Western investment would thereby find real encouragement to follow, especially if the freer movement of labor as well as goods and greater accountability for capital were facilitated across the widest possible area. Wages and particularly other costs of location in urban centers are significantly lower for southeastern than east central Europe, if protection and other illegal transaction costs are factored out.

Those costs can never be factored out until the war economies of Serbia and Croatia as well as Bosnia-Herzegovina are reincorporated into a profitable but financially accountable framework for legal business.¹⁵ The hostilities preceding the Dayton Accords of November 1995 have left far too much commercial activity and enterprise management under political control by the ruling parties, still clearly three in Bosnia, and in Croatia as well as Serbia. The leaderships of Serbia and Croatia, in the likely event that they remain unchanged, would nonetheless be attracted to the wider economic advantages and political respectability that would flow from the two regional arrangements—five southeastern European states and five east central European ones—that I propose. The Serbian side would find the connection to Greece and Thessaloniki particularly attractive, as would Croatia with Austria and Vienna. Greece is already a member of the European Union (EU) and Austria a pending one. Their political leadership would be crucial to the official negotiations needed to regularize regional economic relations and to go beyond CEFTA by establishing inescapable procedures for financial documentation. Slovenian relations with the other EU member, Italy, would also benefit by their inclusion in a wider setting. Both Slovenia and Croatia should welcome reassurances that their Austrian, Hungarian and Italian partnership would provide against any political possibility for recreating the former Yugoslavia. To the southeast, the economic linkage of Greece and Serbia with Albania, Macedonia and Bulgaria, with Turkish agreement, might help to diffuse a series of political dilemmas—Albania's connection to the Albanian populations of Kosovo and Macedonia, Macedonian anxiety over closer bilateral relations with Serbia (or Bulgaria), and excessive Greek and Turkish concentration on their own bilateral relations.

Surrounding Bosnia-Herzegovina with these two legal enterprise zones anchored in Vienna and Thessaloniki would also provide an alternative to politically controlled and illegally operated business activity. This grey economy's predominance is, beyond the memories of war, the hidden barrier that stands in the way of constructive reconnection of

Bosnia's three internal parts. Kept economically separate, even if two are incorporated into neighboring Serbia and Croatia, those variously contaminated parts will not survive as modern economies. They will serve instead to poison the commercial mainstream of southeastern Europe. No one will gain from the region's isolation in economic fact as a Balkan backwater. Isolation will only reinforce the unfortunate Balkan stereotype that belies a cultural as well as geographic attachment to the European continent.

Let it also be noted that both European Union members and the United States will find it politically difficult to honor their commitments to Bosnian reconstruction after 1996. Only if the states of southeastern Europe and their central European neighbors take the sort of independent initiative advocated above, promising their long-term commitment to regional stability, can the Western support pledged for 1997-98 stand a good chance of actually being delivered.

NOTES

*This article was prepared in response to the papers and discussion at the Nicosia conference and first presented at the conference on "The Balkans as Powderkeg or Zone of Peace, Convergence or Divergence," organized by the Oesterreichisches Ost- und Suedosteuropa Institut and held in Vienna, March 21-23, 1996.

1. For details on the Republic's trade and finance, see Demetrios Christodoulou, *Inside the Cyprus Miracle: The Labours of an Embattled Mini-Economy*, Minnesota Mediterranean and East European Monographs, no. 2 (Minneapolis, Minnesota: Modern Greek Studies Yearbook, 1992), pp. 151-206.

2. See Wayne S. Vucinich, *Serbia Between East and West, The Events of 1903-1908* (Stanford: Stanford University Press, 1954), pp. 180-88; John R. Lampe, "The Austro-Serbian Antagonism and the Economic Background to the Balkan Wars," *East Central European Society and the Balkan Wars*, Bela Kiraly and Dimitrije Djordjevic (eds.) (New York: Columbia University Press, East European Monographs, 1987), pp. 336-45; and Samuel R. Williamson, Jr., *Austria-Hungary and the Origins of the First World War* (New York: St. Martin's Press, 1991), pp. 121-63.

3. David F. Good, "The Economic Lag of Central and Eastern Europe: Income Estimates for the Habsburg Successor States, 1870-1910," *Journal of Economic History*, 54 (4) (1994):869-91.

4. See Table 9.2 in John R. Lampe and Marvin R. Jackson, *Balkan Economic History, 1550-1950, From Imperial Borderlands to Developing Nations*, (Bloomington: Indiana University Press, 1982), p. 282.

5. Zdenek Drabek, "Foreign Trade Performance and Policy," *The Economic History of Eastern Europe, 1919-1975*, volume 1, M. C. Kaser and E. A. Radice (eds.) (Oxford: Clarendon Press, 1985), pp. 379-83.

6. Theodore I. Geshkoff, *Balkan Union, A Road to Peace in Southeastern Europe* (New York: Columbia University Press, 1940), pp. 145-62, 271; Lampe

and Jackson, *Balkan Economic History*, pp. 457-61.

7. Susan Woodward, *Socialist Unemployment, The Political Economy of Yugoslavia, 1945-1990* (Princeton: Princeton University Press, 1995), pp. 139, 285-95, 349; Diana Plestina, *Regional Development in Communist Yugoslavia—Success, Failure and Consequences* (Boulder: Westview Press, 1992), pp. 180-81.

8. A useful summary of this growth is Nicholas V. Gianaris, *The Economy of the Balkan Countries—Albania, Bulgaria, Greece, Romania, Turkey and Yugoslavia* (New York: Praeger Publishers, 1982), pp. 138-75.

9. The best single study of the wars of Yugoslav succession and their origins to date is Laura Silber and Alan Little, *The Death of Yugoslavia* (London: Penguin Press, 1995). On the Bosnian war, see also Marie-Janine Calic, *Der Krieg in Bosnien-Herzegovina-Ursachen, Konfliktstrukturen, Internationale Lösungsversuche* (Frankfurt: Suhrkamp Verlag, 1995).

10. For concise reviews of economic patterns through 1993, see the sections on Albania, Bulgaria and the Yugoslav successor states in *Eastern Europe and the Commonwealth of Independent States, 1994* (London: Europa Publications Ltd., 1994) and for the subsequent period, Ivo Bicanic, "The Economics of State-Building in the Former Yugoslavia," *Occasional Paper no. 43* (Washington, D.C.: East European Studies, Woodrow Wilson International Center for Scholars, 1996), and *Economic Trends in Eastern Europe*, 5 (1) (1996) (Budapest: Kopint-Datorg). On Slovenia in particular, see the biannual *Slovenia Analysis of Economic Trends* from the Institute of Macroeconomic Analysis and Trends in Ljubljana.

11. Roumen Avramov, "The Bulgarian Economy—A Transition in the Transition," *Occasional Paper no. 46* (Washington, D.C.: East European Studies, Woodrow Wilson International Center for Scholars, 1996).

12. "Bulgarian Economic Monitor", *PlanEcon Report*, 47-48 (Jan. 31, 1996), 24, and "Slovenian Economic Monitor", *PlanEcon Report*, 43-44 (Dec. 31, 1995), 25.

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14. Michael L. Wyzan, "Bulgaria's Trade Relations with Greece and Turkey, What They Are and What They Could Be," included in the present volume, for the Nicosia conference, March 19-23, 1995.

15. See John R. Lampe, "Bosnia's Bumpy Road After 1996: The Legal and Economic Challenges," *The Washington Quarterly* (Summer, 1996):73-77. At a March 1996 meeting of the U.S. Business Council for Bosnia-Herzegovina, several representatives from American companies agreed that before they could recommend any peacetime investment, proper standards for financial documentation would have to be established and put into practice.

PART I: POLITICAL CHALLENGES

The Age of Uncertainty The New Security Environment in Eastern Europe*

Ronald H. Linden

For forty years a relatively stable, if undesired, division of Europe persisted. The political and foreign policy elites of Eastern and Southeastern Europe** could count on the persistence of certain geopolitical realities, a balance of political and military forces, and cold war restraints. After 1948, and especially after 1956, when it became clear that the West was not going to challenge Soviet hegemony in the region, the pattern of relations became relatively fixed. Although there was some diversity in the international behavior of the East European states (Romania in the 1960s and 1970s) and some periods of greater or lesser tension (those surrounding the Solidarity period in Poland), the political and military topography was fairly predictable. The realm of the unknown was usually defined as the level of Kremlin tolerance for subordinate diversity, and this range was relatively small. In contrast, the primary international challenge to the new regimes in Eastern Europe today is the high level of uncertainty.¹

The Disappearance of Alliances and Patrons.

In an uncomfortably familiar replay of the interwar period, East European states find themselves essentially alone in a rapidly changing and potentially dangerous world. Each has new freedom, and few would pine for the return of the tight strictures of the Warsaw Pact. Nevertheless, the increase in the degrees of freedom of neighbors' behavior makes designing prudent and effective international policy a much more complex task.² The influence of the two superpowers, whose military, political, and economic muscle had divided the continent, has diminished. The Soviet Union has disappeared, and Russia no longer borders any East European state except

Poland (through Kaliningrad³). Russia is consumed by domestic changes and challenges and is not in a position to reestablish its dominance over the region in the foreseeable future. However, the *unforeseeable* future can approach quickly, as we learned in 1989. The right mixture of international and domestic circumstances in Russia could produce a renewed drive to reestablish substantial influence in this region.⁴ Russian leaders of all political persuasions have made it clear that the era of obsequiousness to the West is over. For East Europeans, the memory of forty years of domination has not disappeared, and their leaders are wary of developments in Russia.⁵

On the other hand, the remaining superpower has not demonstrated its constancy. American aid to the region, roughly \$400 million per year, is puny both in relation to the estimated need and compared to the aid extended to Western Europe under the Marshall Plan.⁶ Neither the Bush nor the Clinton administration demonstrated the fortitude to force a cease-fire in the former Yugoslavia until years into the war. With the drawdown of North Atlantic Treaty Organization (NATO) forces and the dominance of the domestic agenda in American politics, the staying power of American interests in Europe is questionable.⁷

Weak New Alliances

After 1989, East European leaders made it clear that they saw their ultimate destiny as residing with Western Europe. Some also began to pursue regional alliances. The best-known, and the most successful, is the Visegrad group of Hungary, Poland, the Czech Republic, and Slovakia. But effective cooperation has been limited, concrete achievements few, and even rhetorical commitment short-lived.⁸ Czech premier Václav Klaus has been the most skeptical, worrying that the group might be "an attempt to artificially push the countries in question together again." Klaus has made it clear that the Czech Republic would pursue first and foremost its strategy of integration into Western Europe.⁹ The major substantive result of the Visegrad process, the Central European Free Trade Association (CEFTA), affects less than 5% of its members' trade, has had only a marginal effect on increasing that trade, and in any case has a limited membership.¹⁰ Regional groups such as the Black Sea Economic Zone and the Central European Initiative have yet to prove their worth even within narrow functional limits.¹¹

Diffidence of Existing Alliances

Probably no aspect of the new environment has left the East European leaders more frustrated than the stiff handshake offered by Western alliances. After years of rhetoric, bridge-building, and encourag-

ing distance from the Soviet Union, when the break occurred, the newly divorced suitors were offered only a long engagement. Of the three main targets of East European aspirations—NATO, the European Union (EU), and the Council of Europe—only the last has embraced the region and offered full membership to the East European states.

Immediately after the changes of 1989, East European leaders made it clear that only NATO membership would ensure their future security. In response, the alliance created the North Atlantic Cooperation Council, invited the new democracies into NATO's parliamentary assembly, and in early 1994—four years after the overthrow of the communist regime—offered all the post-communist states membership in the Partnership for Peace program. Many leaders, especially those in Poland and Hungary, grumbled about the hesitancy and inadequacy of the response, but all signed on. A fall 1995 NATO study specified the characteristics needed for future members but still declined to say which partners could expect to become members or when.¹² At its ministerial meeting in December 1995, NATO would say only that 1996 would be a year of "intensive consultations" and warned that "participation in this next phase would not imply that interested partners would automatically be invited to begin accession talks with NATO."¹³ As Simon Lunn, deputy secretary general of the North Atlantic Assembly, stated, "For the foreseeable future, European security will continue to be handled through existing organizations in the current untidy fashion."¹⁴

The EU has been similarly cautious. It first offered associate member status to the Visegrad states, then Romania and Bulgaria, and over the course of several summits has also specified the conditions for membership.¹⁵ The EU declined, however, to specify even a tentative date, although some influential leaders such as German chancellor Helmut Kohl have called for membership by the year 2000.¹⁶

While international institutions move slowly to mitigate the dangers of a non-ordered world (e.g., in former Yugoslavia), East European states can be expected to follow the self-help guidelines that offer them the best protection. An alliance made up of Poland, the Baltic states, and Ukraine, for example, might be the outgrowth of such a scenario.¹⁷ In the Balkans there is already evidence of realignment as a result of the collapse of both Yugoslavia and the Western community's attempt to prevent warfare there.¹⁸ The uncertainty of the present environment coupled with the lack of strong support from the West suggest, as to some within the governing coalition in Slovakia, that the best course might be neutrality or a renewed alliance with Russia.¹⁹ Such overtures will likely grow if NATO membership remains "off somewhere in the future," as U.S. defense secretary William Perry has indicated.²⁰

The cold war division of Europe meant a relatively small variation among states' domestic political behavior. For the East European states, their neighbors were basically similar (one-party socialist-economy states), similar but bigger (the Soviet Union), or like the West (multiparty capitalist states). Now the region's politics encompass a greater variety of possible outcomes, as one might expect from electoral, pluralist states. Six governments have held power in Poland and only two in Hungary; however, reform communists have returned to power in both. Revolving-door socialist-opposition regimes have ruled in Bulgaria and Albania. Former communists have held on despite splits in Romania, and new states altogether have emerged from Czechoslovakia and Yugoslavia. For foreign policy-makers these developments create an immensely more complicated environment.

Consider the international environment now facing Romania. Until 1989 it was bordered on all sides by socialist states. The USSR to the north and neighbors west and south were all communist states in which governmental forms and differences with other regimes stayed within predictable parameters. Romania's only neighbor that was not a Soviet ally was Yugoslavia, still a socialist state, with a dominant leader and with whom there was little likelihood for conflict. Overall, the possibilities for conflict or serious challenge from outside Romania's borders, while not nonexistent—as rumors of a possible Soviet invasion in 1968 showed—were very low, and the conditions were relatively unchanging.

Now, by contrast, Romania has two new neighbors to the north (Ukraine and Moldova), neither of which has much recent experience as an independent state. Both states suffer substantial regional cleavages and contain territory that in this century was part of Romania. Romanian policy under President Ion Iliescu has been cool to the idea of possible reunification with Moldova, despite pressure from nationalists in Romania and, for a time, pro-unification forces in Moldova. A change in government following the 1994 elections in Moldova led developments in the other direction: the new government of Prime Minister Andrei Sangheli moved to put some distance between itself and Romania (as well as from Moldovan president Mircea Snegur).²¹ Moldova itself remains functionally divided after brief fighting with a breakaway Trans-Dniester Republic in 1992. The potential for the reintroduction of Russian troops and increased tension with Romania remains real. The overall point, however, is that Romania now needs some things it did not need under Ceaușescu: a foreign policy toward Moldova, an attitude toward pan-Romanianism and reunification, and a policy toward Ukraine and Russia that takes account of these issues.

Romania now faces potential problems from other neighbors. Any conflict between Russia and Ukraine, for example, could have direct and unpleasant implications for Romania. To the west, Hungarian governments

of both the nonsocialist and (to a lesser extent) socialist variety have sharply defended their co-nationals living in Transylvania. Romania has been unable to secure basic friendship treaties with Hungary or Ukraine. Relations with Bulgaria remain cordial, although, due to the changing governments in Sofia, subject to fibrillations that Bucharest never had to consider before. Finally, the political and economic consequences of Yugoslavia's collapse are not just uncertain, but economically devastating and physically dangerous.²²

Legacies of the Past and Burdens of the Present

For East European states, such new complexity and uncertainty requires developing international policies *à tous azimuts*, as Charles de Gaulle once said of French defense policy.²³ Inevitably, policy-makers in such situations develop worst-case scenarios. Without a long history of freestanding cooperation with their regional partners, East European leaders are vulnerable to the fearful scenarios sketched out by political opponents, especially of the nationalist variety. Regimes find international cooperation awkward to initiate, cumbersome to negotiate, difficult to maintain, and limited in payoff. Witness Romania's attempt to initiate a historic reconciliation with Hungary²⁴ and Hungary's attempt to secure comprehensive bilateral treaties with Slovakia and Romania.²⁵ Even with coveted Western partners, the new democracies have found that attempts at cooperation can carry with them both the problems of the present and the burdens of the past. The Czechoslovak government discovered this in securing a friendship treaty with Germany.²⁶ Cooperation with the West is seen by a small but increasingly vocal minority as too costly, too painful, and too acquiescent to the demands of an unresponsive West.

Finally, developing effective policy in such circumstances is made all the more difficult because the capacity of the new regimes to recruit, train, and put in place qualified analysts, diplomats, and policy-makers is severely constrained by lack of need in recent history, by limited resources, and by continuing political struggles over the use of holdovers from previous regimes.²⁷

East European Responses: The Search for Identity

Much as they did under Soviet dominion, the East Europeans have struggled to find an appropriate response to these new uncertainties. Each new democracy has tried to create a new identity (or recreate an old one), to adopt policies appropriate to that identity, and to do so in a domestic environment that allows for criticism and debate.

Not every East European state emerged from the communist period with an equal capacity to respond to the demands of their new situation.

Hungary, for example, already had extensive trade and political dealings with a supportive West, but one byproduct of this—the highest per capita international debt in the region—did not necessarily work to its advantage. Romania, on the other hand, had virtually no debt, but by 1989 had destroyed whatever Western goodwill it had earned when it was willing to be out of step with Moscow on some foreign policy issues.

While proffering a European identity helped to jump-start democratic practices and point the way toward future associations, it has provided uneven payoffs. Key Western organizations have held East European states at arm's length, except when it comes to lecturing about the benefits of tight monetary and austere fiscal policies. The transition regimes elected in 1990 thus found their enthusiasm for Europe unrequited. This less-than-fulsome reception undermined public support for the new regimes, denied the new governments the symbolic payoff that commitment to institutional membership might have offered, and discredited many advocates of this approach.²⁸

On a policy level, the new governments found themselves caught between the demands of the Western economic environment and domestic resistance to the erosion of social welfare. Transition governments fell in Poland and Hungary partly in response to this pressure, and descendants of the old communist parties gained power. Public opinion surveys show great skepticism about foreign investment alongside continued, if somewhat soft, support for joining Western institutions.²⁹

Many East Europeans have taken refuge from uncertainty in what they perceive to be the eternal verities of the region—the myths of national history, ethnicity, and the pernicious, conspiratorial role of “the other.” This was seen most starkly and tragically in the former Yugoslavia but is present in the anti-Western rhetoric of parties and groups virtually throughout the region. In Romania, *România Mare*, a nationalist party that was at one time a member of the coalition supporting the government, published a memorandum in 1995, signed by 300 members of the military, accusing the government of “high treason” for cooperating with NATO.³⁰ In Hungary, József Torgyán, leader of the Independent Small-Holders Party (which in 1995 passed the governing Socialist Party as the most popular party in Hungary), consistently plays on the theme that the government is selling out, causing too much pain, and not following a proper Hungarian solution.³¹ Torgyán's one-time ally, István Csurka, author of a nationalist, anti-Semitic, anti-international tract in 1992, drew thousands to a demonstration in Budapest in support of his Justice and Life Party.³²

Still one cannot argue that nationalism has triumphed as the dominant ideology of the region, despite the horror of the Yugoslav example. Polish politics, for example, has been relatively free of such posturing, and the Czechoslovak velvet divorce stands in contrast to the bloodletting of Yugoslavia. Romania and Slovakia, even with nationalists in powerful posi-

tions, have not moved to dramatically reverse their countries' Western-oriented posture. Rather, nationalism competes in the marketplace of ideas against the pull of pluralism, democracy, the idea of Western Europe, and the practice of building an open market economy.³³

Foreign Policy as a Domestic Issue

The role of nationalism is important, not because nationalists rule throughout Eastern Europe—they do not—but because of a key change in the domestic environment for international policy making. During the domination of the communist party, prerogatives on all policies were held by a tightly controlled oligarchy that tolerated little public input in any policy area, least of all in foreign policy. East European regimes had to walk the tightrope between Soviet demands and their own domestic needs, labeled by James F. Brown as the tension between “viability and cohesion.”³⁴ Politically, and militarily, leaders faced a “security bind”: they needed to do certain things domestically to achieve active support, or at least passive acceptance, while avoiding doing things that would incur active concern or involvement from Moscow.³⁵

Now not even the communists can rule without parliament, nor can they ignore domestic consequences. The new regimes' willingness and ability to pursue international agreements is both pushed and potentially retarded by the willingness of society to go along. Fragile elected regimes are loathe to antagonize key sectors of the public by appearing to be too accommodating, for example, or by appearing to abandon their co-nationals in neighboring countries. Regimes that ask their publics to pay high prices (sometimes literally) for their economic movement west will be eager to keep supporters happy—and to gain new supporters—using foreign policy issues. This is made all the more difficult when the most important, if symbolic, payoff—acceptance into Western organizations—is held out of reach.

For the new regimes, the bind is more complex because of a broader range of external constituencies: they need to accommodate the EU, the Council of Europe, and NATO on civil rights, democratic practices, language laws, and minority rights, and they need to satisfy the EU, International Monetary Fund (IMF), European Bank for Reconstruction and Development (EBRD), and a host of Western governments and commercial banks on economic policy. Appeasing these external constituencies requires taking measures that are often politically unpopular, if not impossible, and economically very painful. The Romanian government, for example, is under pressure to satisfy external observers by extending language, cultural, and collective rights to its substantial Hungarian minority. Ignoring Western concerns would risk further eroding Romania's second-tier position among the East European applicant pool. But bowing to

external pressure puts the minority government of Prime Minister Nicolae Văcăroiu at risk of losing at least some of its support to more nationalistic competitors.³⁶ Similarly, the socialist government of Hungarian prime minister Gyula Horn has been accused of devaluing the issue of Hungarian minorities abroad in order to secure integration with Western Europe.³⁷ When the Hungarian-Slovak Friendship treaty was submitted for ratification in Budapest, all opposition party members, both left and right, either abstained or voted against it.³⁸

Foreign Penetration of Domestic Economies

The economic sphere particularly highlights this domestic-international bind. East European governments have opened up their economies to foreign trade, investment, and advice by Western financial organizations and governments. At Western urging, most East European states have dropped tariff barriers, eliminated restrictions on foreign investments, and increased trade substantially with Western economies. Further, private economic actors have established their own links. As a result, the region finds its economic future closely tied to West European economic fluctuations.³⁹

The combination of rapid privatization and expanding foreign penetration leaves most East European governments in the unfamiliar and uncomfortable position of having *less* control over their own economies than their socialist predecessors, while being *more* responsible to their populations for their economies' performance. In other words, they are now more like other pluralist industrial democracies.⁴⁰

From a foreign policy standpoint, this means that policy decisions that appear essentially domestic, such as raising the minimum wage or pensions, have serious external consequences. If, for example, the IMF becomes displeased, it might withhold standby loans, thus dissuading other lenders. In 1995 the Hungarian government, faced with a burgeoning budget deficit, high inflation, and substantial debt, was obliged to adopt a severe austerity program in order to reassure Western bankers and secure the loans needed to facilitate economic growth. Prime Minister Horn expressed his frustration:

People in the West, be it the EU or any other international organization, should formulate this twin demand regarding Hungary: that Hungary should advance with reforms while not spending more than it produces, but at the same time, it should also ensure political stability....Now, when these two demands clash, not only we, but the international financial institutions too, should start thinking.⁴¹

Ultimately only part of the program was adopted, and although it

was effective, Finance Minister Lajos Bokros was obliged to resign.⁴²

The New Meaning of Security

After World War II security was generally taken to mean protection of a state's physical boundaries, its territory, and its people from aggression by force of arms. This approach informed the policy stances of the two major adversaries of the cold war period and was both derived from and reinforced by the realist school of international relations.⁴³ The world's two most powerful countries saw themselves as seriously threatened only by each other and then chiefly by military means. But even before the end of the Cold War, recognition of other kinds of threats emerged as relative American dominance declined, and some analysts suggested that notions of security should be adapted as well.

Modifications of the notion of security have taken several forms. One school retains the focus on the nation-state as the central actor in world politics but argues that other kinds of threats, such as economic (e.g., blockades, embargoes) or environmental, are security issues when they affect policy prerogatives or quality of life.⁴⁴ Others take a broader view and argue that a focus on the nation-state is out of date, that human rights, environmental threats, and demographic changes should inform the globalist notion of security.⁴⁵ A third approach accepts the centrality of the state but inserts the role of individual perceptions and fears into the analysis.⁴⁶

Dangers identified by the globalist perspective, such as environmental destruction and population shifts, are indeed present in Eastern Europe, and some analyses have focused on these issues.⁴⁷ But perspectives drawn largely from the viewpoint of the major powers will be only crude instruments for analyzing the position of smaller, less powerful states for whom a much larger range of constraints limit their policy prerogatives and quality of life. Certainly focusing on external military threats would yield a skewed picture of dangers for the regimes. Central Europe in particular is now a low-risk military environment.⁴⁸ Interstate conflict over territory and resources has been remarkably absent from the region, the tragic example of Yugoslavia notwithstanding. Indeed the Yugoslav conflict, the sources of which were primarily internal, casts into relief the absence of interstate conflicts, despite the wrenching changes not just in Eastern Europe but in the European states of the former Soviet Union.⁴⁹

Our notion of security in the region should recognize something the East Europeans themselves demonstrated in 1989: that dramatic challenge and resultant changes in the security of East Europe came not from an invading army but from the steady decline in the relative standard of living and the lack of legitimacy and efficacy of the existing forms of governance.⁵⁰ The stability and security of the region now depends crucially

on the nature and effectiveness of democratic governance and the quality and vibrancy of economic progress.

Students of the behavior of small- and medium-sized states may have an advantage over those who focus on the great powers. Without struggling with the idea of decline, they instinctively link the international and domestic futures of the societies and political systems they observe. Such a link has been implicitly, and sometimes explicitly, recognized in the broad statements by the security community leadership in the West. In outlining the principles on which the Europe Agreements (which created the EU's associate membership status) are based, the European Commission said, "Association agreements should help create a climate of confidence and stability favoring political and economic reform and allowing the development of close political relations which reflect shared values."⁵¹ When the EU made its general commitment in 1993 to eventual membership for the East European states, they made it contingent upon the "stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities, the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union."⁵² And when NATO offered its Partnership for Peace program, Western leaders pointed out, "Our own security is inseparably linked to that of all other states in Europe. The consolidation and preservation throughout the continent of democratic societies and their freedom from any form of coercion or intimidation are therefore of direct and material concern to us."⁵³

Democratic security, then, is a function of the degree of participation and legitimacy the new system provides. Participatory democracy gives more people a stake in the existing system and, presumably, more of a say in policies affecting them. Moreover, the broader the democratic system and the longer it works, the greater will be the expectation of those who are "out" that they will at one point get "in," thus reducing the incentive to engage in a violent overthrow of the democratic process. As Adam Przeworski put it, "Democracy is a system in which parties lose elections."⁵⁴ At the same time, greater transparency of government and more points of access should allow for redress of grievances and the opportunity both to know more about government decision-making and to influence it. Especially in the case of ethno-national competition, effective functioning of the democratic process can work to mitigate rather than exacerbate potentially debilitating differences.⁵⁵

Internationally, creating effective democracy in Eastern Europe demonstrates to the other Europe that East Europeans are ready to join the club. The importance of creating a compatibility of major values is clear in the alliance statements quoted above and was demonstrated analytically by Karl Deutsch nearly forty years ago.⁵⁶ The more East European democracies look and act like those of Western Europe, the better are their chances

for meaningful participation in trans-European institutions, which in turn improves their chances to build and protect civil society. This is because regional organizations can broaden the context and constituency, reduce the chances for conflict, and improve the opportunities for cooperation on what had previously been bilateral issues. In this way “national” security is internationalized. After World War II the political conditions and institutional framework of post-war Europe defused German-French hostility and allowed the region to avoid a replay of decades of deadly competition by internationalizing national security. Referring to NATO, Michael Brenner writes: “The alliance is much more than an exceptionally durable version of the classic security community. Rather, it should be viewed as an evolving civic community whose pacific relations are the institutionalized norm, rather than merely the calculated preference of states.”⁵⁷

International institutions can, at least in theory, facilitate international cooperation by expanding the range of information and opportunities for negotiation, improving states’ abilities to ensure compliance, and raising the cost of noncompliant behavior.⁵⁸ There is some evidence that competing East European governments are responding to the new institutional environment. Speaking of the treatment of Hungarian minorities outside Hungary, István Szent-Iványi, political state secretary in the Hungarian Foreign Ministry, argued, “Our integration [with Europe] would increase these people’s opportunities, because a successful Hungary with greater influence and a bigger system of contacts can do more for the ethnic Hungarians living in its neighborhood financially, morally, and politically.”⁵⁹ The Romanian government would seem to agree. “Romania’s road toward Brussels passes through Budapest,” said Foreign Minister Teodor Melescãnu “but also Budapest’s road to Brussels passes through Bucharest.”⁶⁰ In the most optimistic theoretical scenario, involvement with international institutions might actually modify state behavior by helping to formulate a new collective—as opposed to a nationalistic—identity.⁶¹

Now the bad news: East Europeans have heard it all before. Under Soviet domination the bright shining future was offered through a different kind of internationalism, one provided by being “in”—Lenin, Stalin, and the Kremlin—and embodied in the “socialist commonwealth” and in the Council for Mutual Economic Assistance (CMEA) and the Warsaw Pact. Therefore one should not be surprised to find a bit of skepticism about the new internationalism, especially if joining is accompanied by serious economic dislocation and especially if full membership is denied.⁶² In such conditions, the new internationalism will find it hard to compete with the more powerful myths and apparently simpler solutions offered by nationalism.

Economic progress can help to create a constituency for the new system by giving more people a greater and more direct stake in its success.

Election results in Russia and Eastern Europe show that those who perceive themselves to be losing out as a result of economic changes are more likely to vote for parties on both the left and right whose past history or contemporary programs give cause to wonder about their commitment to democratic progress.⁶³ Although prosperity is not a guarantee of democratic stability, the post-war history of Western Europe suggests that the combination of democracy and economic progress offers the best hope for security in the broadest sense, while economic inequality and relative decline spur attacks on the ideology that is seen to have created it—what Ken Jowitt calls “democratic Zhdanovism”⁶⁴—and exacerbate intercommunal competition.⁶⁵

Old and New Threats to Security

Military

As noted, the standard threats to security in Eastern Europe have for the most part receded. There is some *terra* that for some is still *irredenta*, especially in places that were part of European Russia, such as Ukraine and Moldova. In virtually all these cases, however, the elected governments are not pursuing policies aimed at redrawing borders or reconquering lost lands, even if some parties advocate such policies. Nor does NATO’s dominance of the military geography in Europe or the reunification of Germany pose a territorial threat to Eastern Europe.

There is ample reason for fearing that Russia could, at some point in the future, constitute such a threat. From the East European point of view, the dangers arise primarily from the emergence within Russia of political forces that want to turn back the clock. Almost all scenarios of danger from the East posit the emergence of a Russian government committed to nationalist goals. As the Polish foreign minister, Władysław Bartoszewski, put it:

There is fear of Russia, of course. But this fear comes from extremist statements by such stupid people as Zhirinovskii or other unpredictable individuals. It is not fear of Russia’s official policy. It is fear of the largeness of the country and of people such as Zhirinovskii and 20 million people who voted for this fool [in 1993]. This creates a certain insecurity, and people sometimes doubt the predictability and stability of Russian politicians.⁶⁶

Even without an election victory by Zhirinovskii, nationalists of the right and left put pressure on the Russian government to be more assertive about its role in Europe and the world. After substantial gains by communist and affiliated parties in the December 1995 parliamentary elections,

Boris Yeltsin removed the most visible symbol of Western accommodation—Foreign Minister Andrei Kozyrev—despite his adoption of the requisite tough stance toward the U.S. and East European membership in NATO. East European leaders view several other Russian actions with concern: the reabsorption of former Soviet republics into the Commonwealth of Independent States, pressure on the Baltic states, the military response in Chechnya, and attempts to exercise influence over the extraction and sale of natural resources in the near abroad. These are all seen as analogues or possible precursors to restoration of Russian control over Eastern Europe.

While all the East European states reject the idea of a Russian veto over their membership in Western alliances,⁶⁷ there have been a range of reactions to a possible Russian resurgence. The Poles seem least inclined to tolerate Russian interference and most insistent that NATO make a commitment.⁶⁸ Czech leaders—ironically, given 1968—seem less worried about Russian resurgence perhaps because they lack a common border and perhaps because the nature of their complex relationship with Germany looms larger.⁶⁹ Romania is most fearful about being left out of any new security arrangements and consistently presses the U.S. and Europe not to discriminate among applicants. At the same time, the Romanian leadership is most vigorous about reassuring the Russians that their actions are not directed against Moscow and that an expanded NATO poses no threat.⁷⁰

Political

Danger from political developments, especially the emergence of nationalist governments, is currently less severe in Eastern Europe. Both the Polish communists under Aleksander Kwaśniewski and the Hungarian socialists under Gyula Horn have proved themselves eager suitors for EU and NATO. Horn's socialists have implemented a severe austerity program required by the West and allowed the establishment of a full NATO base in support of the Implementation Force in Bosnia.

But challenges do exist. In Hungary the Independent Small-Holders Party and the more extreme Justice and Life Party have challenged the government's eagerness to integrate with the West. In both the Czech Republic and Romania, extreme parties of the left and right still question their governments' moves to join Europe. The leader of the Romanian Workers Party, for example, argues that the West wants Romania to stay weak economically so that it can buy up all its assets.⁷¹ While these parties are politically on the margins, in Slovakia the coalition partner of Prime Minister Vladimír Mečiar has sharply criticized its pro-NATO orientation.⁷²

That weakening or disappearance of democracy in the region would endanger the security of the region can be seen in several ways. Consider

a counterfactual. How different would Romanian policy toward Hungary be if the nationalist *România Mare* party were able to put in place its version of Romanian democracy? Broadly put, the greatest threat to security in Eastern Europe comes from those forces within countries whose vision of their state is exclusivist and nondemocratic—or democratic in the way that democratic centralism was democratic—and who would pursue agendas based on aligning the physical state with the historical, ethnic, or even mythical nation. A review of the history of conflict among states reveals few regularities, but one that does emerge is the democratic peace. While democracies tend to go to war about as often as nondemocracies, they almost never fight one another. This result holds up over time and geographic area. Robust democracy seems to make resorting to international conflict more difficult because of its institutional constraints and the extrapolation of democratic norms to international relations.⁷³ Partial or less well developed democratic governments, however, seem more likely to engage in disputes that escalate to violent conflict than are states in which no regime change has taken place. This is due in part to the absence of trust-building experience and the tendency in newly democratizing states for elites who survived the old system to manipulate the new system in ways that lead to conflict.⁷⁴

Certainly the cases of Serbia and Croatia seem to fit this description. Indeed, the conflict in former Yugoslavia has led many to conclude that Eastern Europe is a boiling cauldron of ancient ethnic hatreds whose ferocity was only held in check by authoritarian regimes. As soon as the heavy hand was removed, the argument goes, conflict ensues.⁷⁵ But Poland, Hungary, Romania, and Bulgaria all retained powerful elites, and there is hardly an elaborate history of trust-building among them, yet peace has held. Hence, viewed comprehensively and not just through the lens of the Yugoslav developments, the post-1989 experience in Eastern Europe supports the validity of the conclusion that “the spread of democracy in international politics...can reduce the frequency of violent conflict among nations.”⁷⁶

Economic

The skewed effects of movement toward a market economy has created winners and losers both within East European societies and across the region. Rural areas, pensioners, workers at large state-run enterprises, women, and state-funded bureaucrats have particularly felt the negative impact. Unemployment hovers in the 10-15% range in most of the states, and in many, trade unions, labor, and especially rural-based parties have posed strong challenges to proposed austerity programs. It is from such ranks that communist parties and their allies have been able to make their remarkable electoral comeback in Central Europe. The fact that these

comebacks are electoral and that none of these restored parties have moved to change or quash democratic processes is encouraging. But the ranks of those who have not seen the gains of Western-inspired capitalism include many whose instincts do not seem to reveal a predilection for democratic rule. Dangers to continued pluralism and democratic security are particularly sharp when the economic agendas of extreme groups overlap with the region's many ethnic or regional cleavages.

At the international level, the region has itself already split. Central Europe is ahead of Southeastern Europe in terms of aggregate growth and standard of living. More significantly for the security of the region, the Visegrad states attract significantly more foreign investment, trade more with the West, and by most accounts are first in line for membership in the EU and NATO. Those left behind may soon see less need to align themselves with Western democratic practices at home or in foreign policy. The costs of changing the economy may be too high, especially in relation to the payoffs. Already throughout the region groups charge that their governments have "sold out" their countries to the West, that the IMF is the equivalent of the Red Army, and that their country should find its own path.⁷⁷ The Hungarian socialists, who pushed hard on this issue in the 1994 elections, now find themselves challenged on the same grounds. "Gyula Horn," said József Torgyán, "should realize that, this time, he is only responsible to the Hungarian society, and not to the Soviets or to the West."⁷⁸ A region made up of haves and have-nots may find that diverging economic paths lead to conflict.

More broadly, the sluggish pace of EU action leaves the whole region on the wrong side of trade barriers at a critical time and fosters, in the Hungarian foreign minister's words, "An economic, social, and welfare iron curtain—rather than a political and military one...with a secure, stable, and flourishing Europe on one side, and an unpredictable East and Central Europe stumbling from one crisis to another and eventually threatening the stability of West Europe on the other."⁷⁹

New Issues

Finally, issues that heretofore were not foreign policy issues, or not issues at all, now form part of the security nexus. Conflicts that have occurred, most notably in Yugoslavia, have created a flow of refugees and a scale of emigration not seen in Europe since the end of World War II. But even where overt conflict has not broken out, the degree of economic loss, personal insecurity, and fear of change have promoted substantial movement to better-off areas. Economic, political, and social refugees moving from east to west pose a threat to the health of fragile economies and the democratic practices of both new and veteran democratic governments.⁸⁰

Newly salient cross-border environmental issues, like nuclear

energy production, pointedly illustrate the domestic-international nexus.⁸¹ And the dangerous spread of organized crime, weapons proliferation, and smuggling of all sorts are broadly transnational, forcing the new regimes of Eastern Europe, and their putative Western partners, to try to find ways to deal with these new threats.⁸²

Conclusion

The dangers to the stability of Eastern Europe, both political and economic, are dangers for all of Europe in two senses. Most obviously, a return to revolution, instability, or the appearance of opportunity for Russian expansion into the region would have an enormous impact on the West European, and American, sense of security, plunging it back to cold war or interwar days. Ending the new links between the different parts of Europe and returning to substantial defense expenditures or, worse, an expansion of the kind of conflict seen in Yugoslavia would create an unavoidable political and economic crisis. This has been recognized most clearly in Bonn, which, until its own recent economic difficulties, had been Central Europe's most vigorous champion in the corridors of the EU.

The challenges to the notion of Europe appearing in Eastern Europe are evident in Western Europe as well. The cries of pain at the cost of adapting to new forms of multinational integration come not only from Hungary but also from France. The suspicion that enough sovereignty has been given away is voiced not only in Romania but in Great Britain. This dimension of the security environment within which Eastern Europe operates is not so different from that which faces Western Europe and for which effective and sensible responses are needed. It is worth recalling the speed and depth of the changes of 1989. That tidal wave, was, for the most part, peaceful. We might not be so lucky next time.

NOTES

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•• This chapter focuses on the former communist states of East and Southeast Europe and thus includes, for example, Romania and Yugoslavia but

says little about Greece and Turkey. Throughout, the term "East Europe" is meant to include both Central and Southeast European states.

1. On this point, see Regina Karp, "Postcommunist Europe: Back from the Abyss?" in Daniel N. Nelson (ed.), *After Authoritarianism: Democracy or Disorder?* (Westport, Connecticut: Greenwood, 1995), p. 104; and Judy Batt, "The International Dimension of Democratization in Czechoslovakia and Hungary," in Geoffrey Pridham, Eric Herring, and George Sanford (eds.), *Building Democracy? The International Dimension of Democratization in Eastern Europe* (New York: St. Martin's Press, 1994), p. 170.

2. John Mearsheimer, "Back to the Future: Instability in Europe After the Cold War," in Sean M. Lynn-Jones and Steven E. Miller (eds.), *The Cold War and After: Prospects for Peace*, (Cambridge: Massachusetts Institute of Technology Press, 1993), pp. 141-92.

3. This is a nontrivial exception, considering the presence of an estimated 200,000 troops in this enclave.

4. Not to mention the USSR itself, as the parliamentary vote on 15 March 1996, suggested. *New York Times* (16 March 1996), p. 3; *OMRI Daily Digest* (18 March 1996).

5. See, for example, the foreign and security policies program of the Hungarian Socialist Party, winners in the May 1994 parliamentary election, *Kihivasok es Valaszok: 1994-1998*, January 1994, in Foreign Broadcast Information Service, *Daily Report: East Europe* (hereafter FBIS: EEU), supplement (8 February 1995):47-48; Ladislav Kadlec, "Security Perspectives of Central Europe: A View from Slovakia," in Charles L. Barry (ed.), *The Search for Peace in Europe* (Washington: National Defense University Press, 1993), pp. 179-93; Janusz Onyszkiewicz, "Viewing the European Security Landscape from Poland," in Manfred Wörner *et al.* (eds.), *What Is European Security After the Cold War?* (Brussels: Philip Morris Institute, 1993), pp. 68-77.

6. Daniel Gros and Alfred Steinherr, *Winds of Change: Economic Transition in Central and Eastern Europe* (New York: Longman, 1995), pp. 453-85.

7. This is exemplified by the one-year commitment of the American contingent to the Implementation Force in Bosnia and the disinclination to back up the financial provisions of the Dayton peace accords. See the remarks by outgoing Assistant Secretary of State Richard Holbrooke, *Washington Post* (22 February 1996), p. A23.

8. See Valerie Bunce, "Regional Cooperation and European Integration in Postcommunist Europe: The Visegrad Group" (paper prepared for presentation at the conference "Europe, Central Europe and Germany: Perspectives for the Future," Bratislava, 7-9 March 1996).

9. *Prague Post* (13 June 1995), in FBIS: EEU (30 June 1995):10.

10. For a review of CEFTA, see Andrzej Rudka and Kalman Mizsei, *East Central Europe Between Disintegration and Reintegration: Is CEFTA the Solution?* (Warsaw and New York: Institute for East-West Studies, 1995).

11. For a review of regional initiatives, see Sarah M. Terry, "Intraregional Political and Economic Relations," in U.S. Congress, Joint Economic Committee, *East-Central European Economies in Transition* (Washington, D.C.: U.S. Government Printing Office, 1994), pp. 367-92.

12. See the discussion in Ronald H. Linden, "The Price of a Bleacher Seat: East Europe's Entry into the World Political Economy," in Michael Kraus and Ronald Liebowitz (eds.), *Russia and Eastern Europe After Communism: The Search for New Political, Economic and Security Systems* (Boulder, Colorado: Westview, 1996), pp. 315-36. The NATO study is "Study on NATO Enlargement," 1995.
13. "Communiqué Issued by Ministerial Meeting of the North Atlantic Council, NATO Headquarters, Brussels, 5 December 1995," *NATO Review* (January 1996):22-25.
14. Simon Lunn, "A Reassessment of European Security," in Wörner *et al.* (eds.), *What Is European Security After the Cold War?* p. 66.
15. Commission of the European Communities, *White Paper: Preparation of the Associated Countries of Central and Eastern Europe for Integration into the Internal Market of the Union* (Brussels: European Commission, 1995).
16. *The Economist* (28 October 1995):57.
17. In October 1995, Poland and Ukraine agreed to "put mutual relations onto a new quality level" and proposed the formation of a Ukrainian-Polish military unit to take part in peacekeeping operations. *Intelnews* [Kyiv] (3 October 1995), in FBIS, *Daily Report: Central Eurasia* (3 October 1995):53.
18. F. Stephen Larrabee, "Balkan Security After the Cold War: New Dimensions, New Challenges," in F. Stephen Larrabee (ed.), *The Volatile Powder Keg* (Washington, D.C.: American University Press, 1994), especially pp. xix-xxv.
19. See reports on interviews with Jan Slota, chairman of the Slovak National Party, part of Slovakia's ruling coalition, in ČTK (3 October 1995), in FBIS: EEU (10 October 1995), pp. 21-22; and in Sharon Fisher, "Tottering in the Aftermath of Elections," *Transition* (29 March 1995):22-23.
20. Interview in *International Herald Tribune* (October 5, 1995).
21. On Moldovan politics, see Dan Ionescu, "Back to Romanian?" *Transition* (25 August 1995):54-57; and Dan Ionescu and Igor Munteanu, "Likely Presidential Rivals Gear up for Elections," *Transition* (26 January 1996):50-52.
22. Romania estimates that sanctions against Yugoslavia and lost trade as a result of the war have cost it U.S.\$8 billion, interview with Romanian president Ion Iliescu, *Vocea Romaniei* (2 November 1995), in FBIS: EEU (9 November 1995):43.
23. Pál Dunay makes this point with regard to East European defense policies, see "Debunking Certain Myths of Post-Cold War Military Security in Europe," in Pál Dunay, Gábor Kardos, and Andrew J. Williams (eds.), *New Forms of Security: Views from Central, Eastern, and Western Europe* (Aldershot, UK: Dartmouth, 1995), p. 9.
24. *OMRI Daily Digest* (1 September 1995); *The Hungary Report* (8 January 1996).
25. The Hungarian-Slovak treaty was signed in March 1995 and ratified in Budapest that June. It was not approved in Bratislava until March 1996 and only with amendments to the treaty and the country's penal code, which called into question the government's commitment to broad protection of the rights of its minorities and/or dissenters. See *OMRI Analytical Brief* (27 March 1996). No treaty has yet been agreed on with Romania.
26. Jan Obrman, "Czechoslovak Assembly Affirms German Friendship

Treaty," *RFE/RL Research Report* (22 May 1992):18-23.

27. See the discussion in Joseph C. Kun, *Hungarian Foreign Policy: The Experience of a New Democracy* (Westport, Connecticut: Praeger, 1993). See also Batt, "The International Dimension," p. 179. One assistance program, the International Affairs Network, was set up by the University of Pittsburgh's Graduate School of Public and International Affairs and the Association of Professional Schools of International Affairs. Funded by the Pew Charitable Trusts, the network supports international affairs education in seven states of East Europe and the former Soviet Union. See the site on the World Wide Web at <http://www.pitt.edu/~ian>.

28. "The whole political class," said Jozsef Szajer, vice president and parliamentary caucus chief of Hungary's FIDESZ Party (the Young Democrats), "has been basing its legitimacy on joining the West, and at some point this posture must be seen to pay off or it will lose its domestic appeal." Quoted in Dana H. Allin, "Can Containment Work Again?" *Survival*, 37 (1) (1995):60. See also Tony Judt, "Nineteen Eighty-Nine: The End of Which European Era?" *Daedalus*, 123 (3) (1994):6.

29. See *Financial Times* (6 April 1993, and 21 April 1994); Mary McIntosh *et al.*, *The New European Security Architecture: Publics Assess the Building Blocks of European Security* (Washington: USIA Office of Research and Media Reaction, 1995), pp. 11-19, 27-29. In the fall of 1995 a survey in Poland showed that nearly three-fifths of those polled opposed the stationing of foreign troops in Poland as part of NATO membership and more than four-fifths opposed the stationing of nuclear weapons on Polish territory. *Warsaw Voice* (17 September 1995), in FBIS: EEU (12 October 1995):50.

30. See Dan Ionescu, "The President, the Journalists, and the KGB," *Transition* (8 September 1995):39.

31. *Nepszabadsag* (11 July 1995), in FBIS: EEU (14 July 1995):13; see also *Wall Street Journal* (8 November 1995).

32. Csurka's jeremiad can be found in *Nepszabadsag* (27 August 1992), in FBIS: EEU (3 September 1992):9. On the rally, see MTI, 22 October 1995, in FBIS: EEU (27 October 1995):23.

33. For evidence of this in Romania, see Tom Gallagher, "Nationalism and the Romanian Opposition," *Transition* (12 January 1996):30-32, 72. At his party's national gathering in December 1995, Csurka said, "The current political system is a mixture of capitalism and dictatorship, and a distorted version of market economy....The West has not helped Hungary carry out a political and economic transformation, on the opposite, what is going on...is an especially shrewd variety of colonization." MTI, 9 December 1995.

34. James F. Brown, *Relations Between the Soviet Union and Its Eastern European Allies: A Survey* (Santa Monica, California: Rand, 1975).

35. Ronald H. Linden, "The Security Bind in East Europe," *International Studies Quarterly*, 26 (2) (June 1982):155-89.

36. See Michael Shafir, "Ruling Party Formalizes Relations with Extremists," *Transition* (14 April 1995): 42-46.

37. *Uj Magyarorszag* (6 January 6, 1996), in FBIS: EEU (17 January 1996):23.

38. Kossuth Radio Network, 13 June 1995, in FBIS: EEU (14 June 14,

1995):11.

39. By 1994, Western Europe—the EU in particular—was the leading trading partner for all the East European states, accounting for one-third to more than one-half of the region's trade turnover. In addition, three-quarters of all foreign direct investment in the region came from Western Europe, more than one-half from EU countries.

40. On the vulnerability of state economies in a liberal international system, see Barry Buzan, *People, States, and Fear* (Chapel Hill, North Carolina: University of North Carolina Press, 1983), pp. 141-49. See also Eric Herring, "International Security and Democratization in Eastern Europe," in Pridham, Herring, and Sanford (eds.), *Building Democracy?* pp. 92-95.

41. Interview with Prime Minister Gyula Horn, *Kossuth Radio Network*, 8 July 1995, in FBIS: EEU (10 July 1995):13.

42. *Financial Times* (20 February 1996), p. 2; MTI, 29 and 30 March 1995, in FBIS: EEU (31 March 1995):7-8.

43. For a discussion of the history and premises of security studies, see David A. Baldwin, "Security Studies and the End of the Cold War," *World Politics*, 48 (1) (October 1995):117-41.

44. This is the main point of Richard Ullman's article, "Redefining Security," in Sean Lynn-Jones and Steven E. Miller, *Global Dangers: Changing Dimensions of International Security*, (Cambridge: Massachusetts Institute of Technology Press, 1995). This article was originally published in *International Security* in 1983.

45. See, for example, Seyom Brown, "World Interests and the Changing Dimensions of Security," in Michael T. Klare and Daniel C. Thomas (eds.), *World Security: Challenges for a New Century* (New York: St. Martin's Press, 1994), pp. 10-26; Jessica Tuchman Matthews, "Redefining National Security," in Steven L. Spiegel and David J. Pervin (eds.), *At Issue: Politics in the World Arena*, (New York: St. Martin's Press, 1994), pp. 458-70; David Forsythe, "Human Rights in a Post-Cold War World," in Spiegel and Pervin (eds.), *At Issue*, pp. 417-30; Thomas Homer-Dixon, "On the Threshold: Environmental Changes as Causes of Acute Conflict," in Lynn-Jones and Miller (eds.); *Global Dangers*; Dennis Pirages, "Demographic Change and Ecological Insecurity," in Klare and Thomas (eds.), *World Security*, pp. 314-31.

46. Robert Jervis, *Perception and Misperception in International Politics* (Princeton, New Jersey: Princeton University Press, 1976); Buzan, *People, States, and Fear*, especially chapters 1 and 8.

47. F. W. Carter and David Turnock (eds.), *Environmental Problems in Eastern Europe* (New York: Routledge, 1993); F. Stephen Larrabee, "Down and Out in Warsaw and Budapest," *International Security*, 16 (4) (spring 1992):5-33; Judith Toth, "Humanitarian Security and Involuntary Migration in Europe," in Dunay, Kardos, and Williams (eds.), *New Forms of Security*, pp. 150-65.

48. Dunay, "Debunking Certain Myths," p. 22.

49. During 1990-94, according to Peter Wallensteen and Margareta Sollenberg, there were thirty-four conflicts on territory the authors define as being part of Europe. Excluding those taking place in the Caucasus and those emerging from the disintegration of Yugoslavia, three others took place in what has traditionally been defined as the European part of the Soviet Union. None

were interstate wars. See Wallensteen and Sollenberg, "After the Cold War: Emerging Patterns of Armed Conflict, 1989-94," *Journal of Peace Research*, 32 (3) (1995):345-60.

50. "It was people in Leipzig and Timișoara who overthrew communist regimes, not NATO's tanks," Daniel N. Nelson, "Great Powers and World Peace," in Klare and Thomas (eds.), *World Security*, p. 37.

51. "Association Agreements with the Countries of Central and Eastern Europe: A General Outline," *Europe Documents*, 1646/47 (7 September 1990), pp. 2-3.

52. "Conclusions of the Presidency," European Council of Copenhagen, 21-22 June 1993, *Europe Documents*, 1844/45 (24 June 1993), p. 5.

53. "Declaration of the Heads of State and Government Participating in the Meeting of the North Atlantic Council Held at NATO Headquarters, Brussels, on 10-11 January 1994," *Europe Documents*, 1867 (12 January 1994), p. 2.

54. Adam Przeworski, *Democracy and the Market* (New York: Cambridge University Press, 1991), p. 10.

55. Renee de Nevers, "Democratization and Ethnic Conflict," *Survival*, 35 (2) (1993):31-49.

56. Karl Deutsch, *Political Community and the North Atlantic Area* (Princeton: Princeton University Press, 1957).

57. Michael Brenner, "Multilateralism and European Security," *Survival*, 35 (1993):141.

58. Robert O. Keohane, *International Institutions and State Power* (Boulder, Colorado: Westview, 1989); Robert O. Keohane, Joseph S. Nye, and Stanley Hoffmann (eds.), *After the Cold War: International Institutions and State Strategies in Europe, 1989-1991* (Cambridge, Massachusetts: Harvard University Press, 1993), chs. 6-11.

59. *Uj Magyarorszag* (5 January 1996), in FBIS: EEU (17 January 1996):22.

60. *România Liberă* (3 September 1994).

61. On this "constructivist approach," see Alexander Wendt, "Anarchy Is What States Make of It," *International Organization*, 46 (2) (1992):391-425; and Alexander Wendt, "Collective Identity Formation and the International State," *American Political Science Review* 88 (2) (1994):384-96. The question of identity has recently made a strong comeback both in security studies and the broader study of international relations. See Peter Katzenstein, "Alternative Perspectives on National Security," *Items* [Social Science Research Council] 49 (4) (1995):89-93; and Yosef Lapid and Friederich Kratochwil (eds.), *The Return of Culture and Identity in IR Theory*, (Boulder, Colorado: Lynne Rienner, 1996).

62. McIntosh et al., *The New European Security Architecture*, pp. 14-16.

63. Discussing the Polish elections that returned a left alliance to power, Kenneth Chan points out, "Polish society is no longer divided primarily along a strict post-Solidarity versus ex-communist line. Indeed, the socioeconomic cleavage has become more relevant than other divides for explaining what happened in the 1993 election." See Kenneth Ka-Lok Chan, "Poland at the Crossroads: The 1993 General Elections," *Europe-Asia Studies*, 47 (1) (1995):123-46. On Hungary, see Rudolf Andorka, "Hungary: Disenchantment After Transition," *The World Today* (December 1994):233-37. See also Vera Tolz, "Russia's Parliamentary Elections: What Happened and Why," *RFE/RL Research Report*

(14 January 1994):1-8.

64. Ken Jowitt, "Dizzy with Democracy," *Problems of Post-Communism*, 43 (1) (1996):4.

65. Milica Z. Bookman, *Economic Decline and Nationalism in the Balkans* (New York: St. Martin's Press, 1994), pp. 6-8.

66. "Interview with Polish Foreign Minister Władisław Bartoszewski," *Cologne Deutschlandfunk Network*, 2 July 1995, in FBIS: EEU (3 July 1995), p. 24.

67. See, for example, the statement by Czech president Václav Havel in an interview with *Der Spiegel* (13 February 1995), in FBIS: EEU (15 February 1995):3; and the article by Romanian defense minister Gheorghe Tinca, "Securing a Democratic Romania: No Veto on Our Choice," *Security Dialogue*, 26 (2) (June 1995): 147-51.

68. See the interview with Deputy Prime Minister Aleksander Luczak, *Polska Zbrojna* (6-8 October 1995), in FBIS: EEU (18 October 1995):56; Chief of General Staff Tadeusz Wilecki, "The Defense Cannot Wait," *Polska Zbrojna* (9 October 1995), in FBIS: EEU (12 October 1995):44-47; and the interview with Polish president Lech Wałęsa, *L'Informazione* [Rome] (18 May 1994), in FBIS: EEU (19 May 1994):15.

69. Interview with Petr Pavlik, Institute of International Relations, Prague, 15 January 1996; interview with Vladimir Handl, Institute of International Relations, Prague, 16 January 1996.

70. Interview with Romanian president Ion Iliescu, *Vocea Romaniei* (2 November 1995), in FBIS: EEU (9 November 1995):43; interview with Defense Minister Gheorghe Tinca, *Vocea Romaniei* (1 March 1995), in FBIS: EEU (7 March 1995):28-31; *Rompres* (23 April 1994), in FBIS: EEU (26 April 1994):2-3.

71. *Zitua* (18 December 1995), in FBIS: EEU (28 December 1995):51. On the opposition of the Communist Party of Bohemia and Moravia in the Czech Republic, see ČTK, October 26, 1995, in FBIS: EEU (27 October 1995):20; and (7 July 1994), in FBIS: EEU (8 July 1994):6.

72. *Narodna Obroda* (18 October 1995), in FBIS: EEU (23 October 1995):14.

73. Bruce Russett, *Grasping the Democratic Peace: Principles for a Post-Cold War World* (Princeton, New Jersey: Princeton University Press, 1993).

74. Edward D. Mansfield and Jack Snyder, "Democratization and the Danger of War," *International Security* 20 (1) (1995):5-38. Aggregate results also show a higher incidence of war for "autocratizing" states, which suggests that regime change itself is related to the incidence of war.

75. The aggregate data on which Mansfield and Snyder—and in fact most of the global studies of war—rely end in the mid-1980s and thus do not include post-cold war Europe. For a discussion of the "ancient hatred" argument, see Katherine Verdery, "Nationalism and National Sentiment in Post-Socialist Romania," *Slavic Review*, 52 (2) (1993):179-203. For critiques of the Mansfield and Snyder work and their response, see "Democratization and the Danger of War," *International Security*, 20 (4) (1996):176-207.

76. Russett, *Grasping the Democratic Peace*, pp. 92-93.

77. The charge against the IMF was made by Istvan Csurka, at the time a leader in the Hungarian Democratic Forum. See *Nepszabadsag* (27 August 1992), in FBIS: EEU (3 September 1992):9.

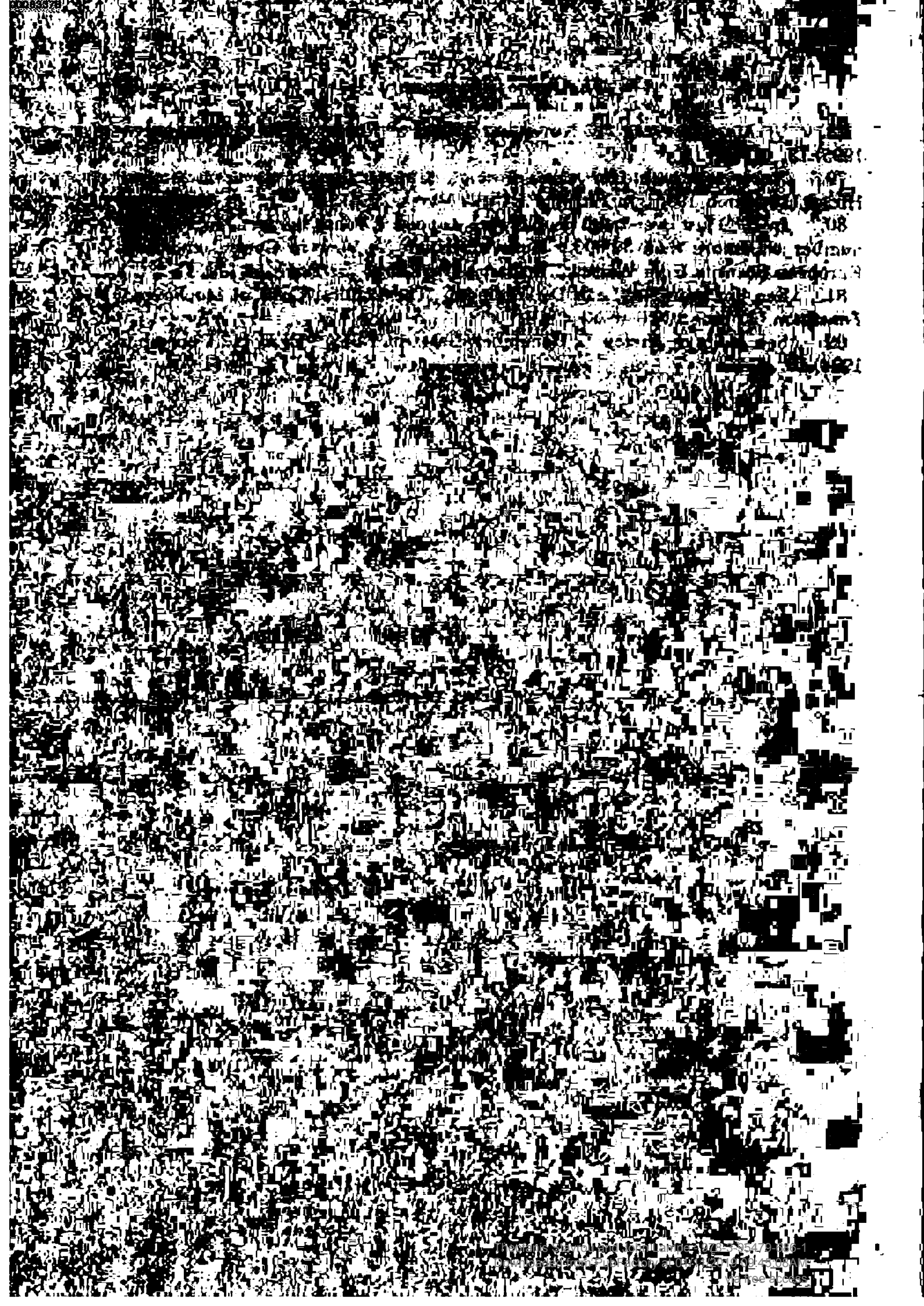
78. *Uj Magyarorszag* (13 November 1995), in FBIS: EEU (17 November 1995):13.

79. "Interview with Hungarian Foreign Minister Laszlo Kovacs," *Magyar Hirlap* (11 March 1995), in FBIS: EEU (23 March 1995):14.

80. In 1989 just over 2,400 people were stopped at Polish borders. In 1992 the number was more than 32,000. Henryk Szlajfer, "A View of Central and East European Security from Warsaw," in Barry, *The Search for Peace*, p. 170.

81. See, for example, Leah D. Wedmore, "The Political Costs of Mochovce," *Transition* (23 June 1995):46-50.

82. See *Magyar Hirlap* (2 December 1994) in FBIS: EEU (12 December 1994):10.



America and Collective Security in Europe

Daniel N. Nelson

As leaders of Conference on Security and Cooperation in Europe (CSCE) members assembled for photo opportunities and ponderous statements during their July 1992 Helsinki II summit, Bosnian Foreign Minister Haris Silajdzic noted poignantly that "This is what is killing us."¹ Two hundred thousand deaths later, the horrors of post-Cold War armed struggles are all too clear. From the Adriatic to the Caucasus, devastating conflicts have raged in Europe largely unaffected by international action. Similar tragedies are taking place on other continents, as illustrated by the genocidal slaughter in Rwanda. Meanwhile, the world imagines worst-case scenarios of nuclear war on the Korean peninsula.

At the same time, Europe is beset by West Europeans' second thoughts about consummating a political union implied by their Maastricht marriage, a right-wing and neo-fascist victory in Italian elections, the return of excommunists to power in most of Eastern and erstwhile Soviet Europe via open and fair elections, and America's abandonment of leadership in the Euro-Atlantic alliance.

This troubling time, coming only five years after declarations of Cold War victory and four years after the "euphoria, optimism, [and] confidence" at the November 1990 Summit in Paris,² requires a wrenching shift in our hopes, expectations and preparations for the twenty-first century. At issue are no less than our most deeply felt and long-standing assumptions about international politics and global affairs.

To some observers, these conditions of a new world disorder require a return to *realpolitik*—the so-called realism of states pursuing national interests through the application of power. Such engagement eschews multilateral commitments, while implying a calculus of when, where, and how to use force rooted in the vagaries of state interests—*staatsrason* or *raison d'état*.³ In its crudest form, such a position for the United States is nothing less than America first; in a more sophisticated expression, it is a *weltanschauung* wherein international affairs is a game of great powers, concerts and alliances—even to the point where the only

alternative to creeping systemic disorder is a purposeful spread of nuclear weaponry to other great powers so that geopolitical and geostrategic balances are maintained.⁴

Alternative voices advocate a policy of global disengagement for the United States—a minimalist foreign presence whereby little that happens abroad is of consequence unless an attack on the United States itself or its core security interests is imminent. The principal danger to American interests, according to the minimalist view, is to become enmeshed in European (or other regions') squabbles and turmoil because of alliance obligations. Such a proactive isolationism, suggesting that the United States "design strategies that will insulate America from the economic and political consequences of future European rivalries,"⁵ has garnered little enthusiasm. In large part, that response is because disengagement contradicts the obvious—that the world extant when George Washington and other Founders warned against entangling alliances cannot be recreated. In an environment of transnational threats and global communications, ours is no longer a choice between engagement or disengagement; aggression, genocide, ethnic cleansing and other barbarous acts harm us by their presence, not only when they reach our borders.

A third path, often disparaged, is that of collective security. Seen as a radical or utopian departure by some, and alleged to have a historical record of failure, few analysts have explored means by which Euro-Atlantic or global security could be pursued collectively.⁶ But most criticisms, including 1992 commentaries by Josef Joffe and Richard K. Betts address caricatures of collective security—straw men, rather than sensible alternatives that could be the product of diplomacy informed by both principles and real world threat assessments.

Collective security ought not be viewed as a system in lieu of alliances for common defense but, rather, as a robust companion. Collective security failures repeated by critics of the concept, for example, the oft-cited League of Nations debacle when confronted by fascism and Nazism, was less a failure than a misapplication of the concept. Collective security and common defense can and should reinforce each other at every step; security, as an indivisible commodity, must be sought both by abating threats through all non-lethal means and by heightening capacities to defeat aggression if it nonetheless occurs. When a security threat is unequivocal and originates from one principal source—as for decades of the Cold War—NATO was an adequate means by which to meet communist and Soviet dangers. Through NATO, the United States and its allies made assiduous efforts to deter aggression and meet threat with counter-threat. Now, when the sources of threat become more ambiguous and numerous, the same counter-threat is ineffective; armored regiments, aircraft carriers or even special forces have little effect against ethnic strife, human rights violations, terrorism, mass migration, and other destabilizing developments. While we need to retain a capacity to project force, we also need a capability to inject monitors, observers, negotiators, and peacekeepers into volatile situations. In the broadest sense, Europe and other continents need a regional capability to reduce threats at the earliest opportunity.

Collective security, then, is neither an unnecessary appendage to other structures nor a naive feel-good remnant of idealism. Empirical studies, indeed, have found suggestive evidence to the contrary—that “states [practicing] collective security can expect to fare better [i.e., are more likely to survive] than states adhering to any of a number of realist strategies.”⁷

The Failure at Helsinki II

The leaders of fifty-one states came to Helsinki in mid-1992 for only the third such high-level CSCE (otherwise known as the Helsinki Process) meeting. But that gathering, unlike the Paris summit of November 1990, had no upbeat script. Instead, the pallor of warfare from the Adriatic to the Caucasus hung ominously over the agenda.

In fairness, Euro-Atlantic security did not leave Helsinki completely empty handed. The summit, for example, declared that CSCE is a regional arrangement under Chapter 8 of the UN Charter, inaugurated a steering-group arrangement whereby the whole CSCE membership need not convene in a crisis, used for the first time CSCE's consensus-minus-one decision mechanism to suspend the rump Yugoslavia (Serbia and Montenegro), approved the creation of a CSCE commissioner for minorities, and agreed that Western military force could be deployed in Bosnia to ensure deliveries of humanitarian relief.⁸

Subsequently, some of these actions—particularly those undertaken by the High Commissioner for National Minorities—have proven to be extremely valuable. With a shoestring budget and a staff of volunteers and people seconded from foreign ministries and nongovernment organizations (NGOs) such modest initiatives have become one of the best bargains for European security.

But these were not measures generated by the strategic assessments of statesmen. Instead, as television vividly depicted intense suffering in Sarajevo, Western leaders were forced to recognize that they could not remain aloof. The United States, which had sought to confine CSCE to a role “principally as a consultative framework for promoting stability in Europe,” was pushed by the unconscionable acts of Serbian President Slobodan Milošević and his allies to reassess its position.⁹

As tragedies arising from their previous inaction dawned on Western leaders, the Helsinki II summit did give CSCE an enlarged portfolio. Unfortunately, those small steps were desultory and belated, failing to move toward genuine collective security with an unequivocal political endorsement or adequate resources. The Western powers took a second look at collective security during the Helsinki II meeting, but they then turned away from the tasks that would have required political will and the commitment of resources.

While people die and principles are trampled, political fears blind leaders and analysts to the palpable need for a strategic shift towards truly collective security. Helsinki II still tinkered when tragic events

demanded large scale construction of security architecture. None of the temporizing steps taken in July 1992 provided anything more than heightened visibility for a still impotent forum.

Nearly three years later, such lost opportunities have left the West with a terrible choice—to endorse the gains of aggression by approving a territorial division of Bosnia, thereby inviting a future rekindling of war, or to acknowledge that punitive military action is necessary to enforce UN resolutions and to exhibit resolve against genocide and aggression.

The Concept of Collective Security

Collective security differs fundamentally from common defense. In the latter, dominant or hegemonic powers gather allies around them, sharing not values but opposition to a clear and ominous adversary. Alliances for common defense implement strategies of containment and deterrence, and attempt to prevent war by balancing military capacities, not by reducing threats.

By contrast, collective security begins with the premise that threats may arise from within, and that avoiding them is at least as critical as countering those external threats with military capacities. Collective security arrangements are bound to include, not exclude, concern for the peace, stability and well-being of all participants.

Techniques for non-offensive defense, studies of conflict reduction by joint academic/policy centers, mediation via crisis resolution organs, collective and binding economic sanctions, and peacekeeping forces to separate disputants are all examples of collective efforts that avoid resorting to military coercion. Collective security does not deny the right of self-defense, but by dampening threats, it also seeks to minimize the need to exercise that right.

Both the League of Nations and the United Nations charters invoked images of global commitments to mediation, conflict resolution, and peacekeeping. Carrying out the UN's potential collective security role proved impossible during the Cold War. The veto power vested in five permanent members of the Security Council usually precluded action; indeed, the Security Council chamber frequently became merely another arena for the U.S.-Soviet rivalry. Despite the end of the Cold War, the veto power may still prevent effective action, especially in Eurasian conflicts. Chinese intransigence may, for instance, block forceful UN sanctions against North Korea.

The continuing obstructionist potential of the veto power is only one source of trouble. Another problem is the rising financial burden. The deployment of truce observers/peacekeepers in Cambodia, Rwanda, Somalia and other locales has virtually exhausted UN resources.

Secretary General Boutros Boutros-Ghali has reported to the Security Council on suggestions for a substantially enhanced UN capacity for military operations along the lines originally considered by Articles 42 and 43 of the Charter. But the UN's role is unlikely to expand into the

vast global security role projected in 1945—not, at least, if the states having vetoes may be parties to disputes (as Russia is likely to be), and if peace-keeping operations cannot be financed through other means. Regional organizations such as the CSCE may offer greater potential.

CSCE: Instrument or Obstacle?

CSCE originated in 1973 during the diplomatic endeavors to reduce East-West confrontation. Delegates from thirty-five states—all European nations, except Albania, plus Canada and the United States—met for more than two years to draft the Helsinki Accords (formally, the Helsinki Final Act).

Signed on 1 August 1975, the Final Act added significantly to the claim that all states must behave in ways consistent with higher standards—toward their own citizens and toward each other. Three principal areas, or baskets, of agreements enunciated principles on 1) relations between states, including mutual security assurances, 2) economic, scientific and environmental cooperation, and 3) human contacts and exchanges.

Basket 1 incorporated ten principles guiding relations between participating states, “including respect for human rights..., equal rights and self-determination of peoples, territorial integrity of states, peaceful settlement of disputes, [the] inviolability of frontiers...and military security.”¹⁰

Basket 2 detailed the elements of cooperation outside the realm of security, plus reciprocal assistance in “transport, tourism, migrant workers...and personnel training,” while Basket 3 concerned family reunification and visits across the erstwhile Cold War divide in Europe plus the “free flow of information, cultural cooperation and educational exchanges.”¹¹

Until the late 1980s the CSCE process remained an instrument of Cold War competition. Periodic follow-up sessions to gauge implementation of the 1975 Accord—in Belgrade (1977-78) and Madrid (1980-83)—were confrontational, affected by worsening Soviet-American relations. Additional inter-sessional meetings on more specific topics were begun in the late 1970s as well, although most were beset by East-West intransigence. For the West, CSCE was a cudgel with which to strike blows against human rights abuses committed by Soviet and East European communist regimes.

Human rights monitoring formed a large part of CSCE’s endeavors in the 1970s and early 1980s, and the courageous activities of Helsinki-related groups within communist states drove a wedge of conscience into Leninist authoritarian systems. But not until Mikhail Gorbachev’s new thinking on foreign policy, coincident with the third principal follow-up session of CSCE held in Vienna from November 1986 through January 1989, did CSCE’s movement into the realm of security have a chance to quicken.

Vienna could have set the Helsinki Process on track toward

becoming the Euro-Atlantic security architecture for the twenty-first century. That potential for CSCE development was not, however, achieved.

No one can doubt that the mandate produced by the Vienna follow-up meeting substantially expanded CSCE activities in the realm of confidence and security-building measures and conventional arms reductions, moving beyond the Stockholm agreements of 1986. Various described as a watershed in the CSCE process and a prelude to revolution, the Vienna meeting undoubtedly helped by its very existence to accelerate the disintegration of authoritarianism in Europe's eastern half.¹² Those evaluations are particularly relevant in the domains of confidence-building and conventional arms reductions, where the 1975 Helsinki commitments were "elevated...to a higher level of ambition," with calls for additional work on CSBMs, and a mandate for negotiations in the CSCE framework "between the Warsaw Pact and NATO...on conventional armed forces in Europe (CFE)."¹³

Yet for all that the Vienna follow-up meeting might have been, it proved to be the beginning of a disastrous foreign policy blunder. At the Vienna meetings, the democratic West lost a chance to transform CSCE into a vigorous institution. Had major Western powers been sufficiently far-sighted, there could have emerged in early 1989 a security architecture more advanced than CSCE is today, even after Helsinki II—a Euro-Atlantic security organization that could have ameliorated the threats that led inexorably to the full-scale wars now under way in both the Balkans and Caucasus. An absence of strategic vision led, instead, to a wasteful and indecisive 1989-90 debate in which the United States was joined by Britain and other Atlanticists in opposing the strengthening of CSCE.

During that two-year period of far-reaching change, Germany's foreign minister, Hans Dietrich Genscher, argued strenuously for a stronger CSCE role and a rapid expansion of its duties and resources.¹⁴ His position received vocal support from Czechoslovakia, Poland, and Hungary. The Czechoslovaks offered, as early as April 1990, a rather detailed plan for a new pan-European security institution, within which there would be a permanent Commission on Security.¹⁵ Polish Foreign Minister Krzysztof Skubiszewski, speaking to the North Atlantic Assembly on 29 November 1990, argued for a parallel development of both an enlarged NATO and an all-European security system.¹⁶ Meanwhile, prominent U.S. newspapers editorialized about the need to think anew about the potential for collective security in the form of a European Security Council.¹⁷

Unfortunately, as walls fell, playwrights became presidents, and tyrants were overthrown, American policymakers congratulated themselves for their triumph over communism and concentrated on protecting old U.S. prerogatives as NATO's dominant alliance partner. Because of that myopia, U.S. leaders lost a chance to prepare for the onslaught of unattended problems from the eastern half of Europe. President George Bush, speaking at the Helsinki CSCE summit in 1992, admitted as much when he said that, even in 1990, "we did not appreciate what awaited us."¹⁸

When the second CSCE summit was held in Paris during late November 1990, signing the CFE treaty, blessing German unification, and

broadly denoting the end of the Cold War with the Charter of Paris were the principal agenda items. And, although the United States consented to the establishment of minimal institutions for CSCE—a tiny secretariat in Prague, a Conflict Prevention Center in Vienna, and an Office of Free Elections in Warsaw—the American position on collective security remained far more doubtful than that of most of Washington's European allies.

As noted above, the new noncommunist governments in East-Central and Southeastern Europe joined with Genscher in 1989-90 to call for pan-European collective security. Varying proposals came from then Polish foreign minister Krzysztof Skubiszewski and former Czechoslovak foreign minister Jiri Dienstbier. In contrast to these larger and progressive visions, the NATO-first American position severely limited CSCE's structure, staff (until late 1992, only seventeen diplomats and support personnel), and budget (totaling a few million dollars per year).

The Bush administration's foreign policy tethered CSCE, precluding until late 1990 any metamorphosis into a post-Cold War mechanism for collective security. Although Bush spoke often of prudence, his policy exhibited a reticence towards CSCE born of the fear that an invigorated CSCE would supplant the North Atlantic Alliance. These fears were expressed behind a facade of rationality—that CSCE's consensual process would make it incapable of action, that its size alone meant cumbersome and irresolute response to crises, and that states would not submit themselves to CSCE authority.¹⁹

By 1991 the East Europeans began to back away from pan-European solutions, recognizing that the only position compatible with U.S. views was a NATO-centered policy. Given their dependence on U.S. and other NATO members' financial largesse, East European leaders began pilgrimages to Brussels, and Atlantic Clubs or similar groups sprouted from Sofia to Warsaw, all in close collusion with American embassies. Visionary statesmen in the fledgling democracies of post-communist Europe had not abandoned their convictions about the importance of collective security; rather they knew that the alternative was not feasible without Washington's support.²⁰

Without particular enthusiasm from the United States, a high-level consultative network was agreed upon in a supplemental document of the November 1990 Paris CSCE summit.²¹ Foreign ministers form the core of this network, meeting as a council at least once a year. A Committee of Senior Officials serves as CSCE's coordinating body, convening an average of once a month in 1991 and less frequently thereafter (as CSCE processes became accepted practice). Other intercessional meetings (e.g., symposia or seminars) and noninstitutional mechanisms by which member states convene to respond to specific problem areas (e.g., unusual military activities), formed the bulk of CSCE's presence prior to 1992. Thereafter, the range of other endeavors has continued to expand—seminars on the human dimension and forums on economic issues have been long winded and minimally productive. More tangibly, the high commissioner on national minorities (former Dutch foreign minister Max van der Stoep) has been highly

effective on a meager budget as an early warning and mediating office in the Hague.²² Likewise, the Forum on Security Cooperation—meant to harmonize various arms control agreements in the aftermath of German unification, the Warsaw Pact's demise, and the dissolution of multinational states—has made limited but useful progress. Major review conferences regarding the human dimension also continue, most recently in Budapest from 10 October to 2 December 1994.

Activity within and around CSCE was frequent, visible, and time-consuming. Beset by a lack of political will among its largest and most powerful members, however, CSCE's institutions have not been invested with the resources or capacity to do much more than talk, observe, and report. Opportunities lost in 1989-92 continue to be lost after the Helsinki II summit. Notwithstanding a few bright spots, such as the High Commissioner on National Minorities, the CSCE has none of the imprimatur of Washington and other Western capitals. As a consequence, although CSCE does much more in the mid-1990s than it has ever done, it has relatively little to show for all of its motion.

Policy Failure: The Obsession with NATO

Glaring by its absence is any American willingness to think beyond NATO-provided Euro-Atlantic security. Instead, U.S. policy-makers have sought to deflect attempts to develop a robust, well-endowed companion to NATO—a true Euro-Atlantic security organization that might emerge from the nucleus of CSCE. Instead, the United States continues to regard CSCE as a tertiary player in a post-Cold War Europe.

Since 1989 providing life support for NATO—revised roles, new structures, altered vocabulary—has remained far more important to the U.S. State Department and Pentagon than thinking about what might be in America's best interests as we fast approach the twenty-first century. Americans officials at NATO and the U.S. State Department have busily undertaken the recoding of the venerable Atlantic alliance during the first half of the 1990s. A new appendage created in late 1991, the North Atlantic Cooperation Council (NACC), included all NATO and former Warsaw Pact members, and was meant, somehow, to address the hemorrhaging security in the Continent's eastern half.

But few people in Eastern Europe, Russia, or other post-Soviet states were impressed with NACC. Although the East Europeans were able to see the security umbrella, NACC did not open it. This second-class association with NATO for former WTO members was a pallid and risky substitute for robust collective security that acts to prevent conflict and ameliorate threats. People in the eastern half of Europe understood that reality so clearly that they sought new bilateral and regional alliances and associational ties with every existing Western institution, while simultaneously turning up the heat for NATO membership. The Poles and Hungarians were the most vocal in lobbying for NATO membership during 1992 and 1993, but other states (e.g., Bulgaria) were not far behind.²³

At the March 1992 opening of the Helsinki Follow-Up Meeting, even as ominous signs mounted that fighting in Bosnia, Moldova, and the Caucasus would intensify, U.S. Deputy Secretary of State Lawrence J. Eagleburger spoke only of incremental changes in CSCE. He encouraged an expansion of CSCE's activities in democratic institution-building, adding to its longstanding work in human rights and arms control.²⁴ But he offered no suggestions for additional CSCE authority concerning the increasingly crucial security issues.

At NATO's Oslo meeting in April 1992, another step was taken toward ensuring that NATO alone would decide if military force would be deployed within Europe as peacekeepers and/or peace-enforcers. NATO leaders announced that the Alliance would be willing to consider a CSCE request for NATO military assets to serve in a peacekeeping role.²⁵ Although much of the press coverage of that pronouncement conveyed the sense that NATO's public relations apparatus wanted—i.e., that this was a step forward, for the first time enabling CSCE to call upon NATO—the Oslo agreement was not particularly supportive of CSCE. Given that CSCE's decision-making process remained consensus-minus-one, NATO will only rarely receive such requests and, even then, can act only when all of NATO's 16 members agree. And, of course, the agreement can also be seen as NATO's marker that deploying military force is its business, and that any future development of collective security will be limited to roles other than those already staked out by the North Atlantic alliance.

NATO's hesitant, minimal steps in Bosnia are a product of such muted enthusiasm for becoming agents of a collective security organization. A chain of command in which NATO implements decisions made by UN commanders is met with no enthusiasm in Brussels, and the "finger-pointing" among NATO members and between NATO and the United Nations has been debilitating and has undermined the effectiveness of the peacekeeping operation.²⁶

But the United States has remained tied irrevocably to NATO, which is deemed by national officials to be the *sine qua non* of American presence in Europe and the best means of ensuring Washington's interests. NATO is so deeply enshrined in these perceptions of its security and national interests that its metamorphosis has been the leitmotif of U.S.-West European relations during both the Bush and Clinton administrations, within which all other issues (responses to Balkan crises, German reunification, force reductions, etc.) are framed. At NATO's Rome summit in November 1991, after a prolonged intra-alliance strategic review, there was clear evidence that the United States had dug in its heels; NATO was to remain the single pillar of Euro-Atlantic security, with everything else in distinctly supporting roles. U.S. president George Bush declared at the Rome summit that "the NATO alliance was the guarantor of security and stability in Europe and could not be replaced, even in the long term."²⁷ More than a year earlier, Secretary of State James Baker stated the same position clearly and unequivocally—that "only NATO can continue to guarantee European security and stability."²⁸

When NATO leaders met again in Brussels in January 1994, the

survival of the Alliance was still at stake, but with added urgency. As noted above, East Europeans—particularly the Poles and Hungarians—had made NATO membership an acute issue during 1993, relentlessly arguing that their ability to remain stable, democratic and outside a renewed Russian orbit depended on entry into the North Atlantic alliance.

By the fall of 1993 the United States had developed a vague response to the NATO enlargement issue in the concept of Partnership for Peace (PFP). The meaning and significance of PFP was not entirely clear the plan was first announced publicly at a NATO defense ministers' meeting in October 1993. It vaguely connoted more than the talking-shop of the NACC, but far less than NATO membership, with which would come guarantees of Article 5 of the Washington Treaty (an attack on one is an attack on all).

By the time of the NATO summit in January 1994, the closing communiqué could include several articles on PFP, each stressing the real, active, concrete nature of Partnerships, e.g., by "creating an ability to operate with NATO forces in fields such as peacekeeping."²⁹

Threading the needle between Eastern Europe's plaintive cries for more security and Moscow's objection to enlarging NATO required a skillful rendering of words and deeds. Commitments without the mutual guarantees, a path toward NATO membership without signposts, military cooperation without a political alliance—these and many other juxtaposed phrases imply an attempt by the United States and its principal allies to offer something to Europe's eastern half without providing either anything very costly or anything very substantial.³⁰

The wars in the former Yugoslavia have spotlighted a grand failure of Western, and specifically American, post-Cold War policy. The Charter of Paris of November 1990 commits all states of the Euro-Atlantic region to "build, consolidate, and strengthen democracy...to safeguard...freedom of expression, tolerance of all groups...and equality of opportunity..."³¹ The Charter's linkage of regional peace and security to the domestic environments of all states for the first time implies a collective responsibility to ensure democracy, the rule of law and human rights so that all may live peacefully. Specifically, the Charter asserts the right of collective engagement in internal affairs of states:

We emphasize that the commitments undertaken in the field of the human dimension of the CSCE are matters of direct and legitimate concern to all participating States and do not belong exclusively to the internal affairs of the State concerned. The protection and promotion of human rights and fundamental freedoms and the strengthening of democratic institutions continue to be a vital basis for our comprehensive security.³²

But these implied responsibilities ring hollow when there is no willingness to enforce commitments. As aggression, genocide (ethnic cleansing), and other atrocities went unanswered in Bosnia, Western and U.S. priorities became clear. Such a willingness will not come from

Washington as long as national interests define security and national power augmented by alliances are thought to be the premier means of ensuring it.

Only a clouded vision, or none at all, would see security to be well served by the hand-holding function of NACC, the competitive lapdog behavior encouraged by PFP as former Warsaw Pact members try desperately to be first to sign up or first to hold maneuvers with NATO forces, or by post-hoc battlefield policing by UN blue helmets. Soothing talc in Brussels or carnage cleanup in Bosnia are inhumane substitutes for the ultimate security of conflict prevention.

Roots of Blindness

How can such a misguided policy be explained? Individual self-interest may provide some of the answer, as careers are endangered by the slippage of NATO's preeminence. There was also some talk in Washington among policymakers, members of Congress, and think-tank experts of letting the Europeans—particularly the French—demonstrate in the Yugoslav catastrophe their incapacity to resolve crises without NATO, and especially without U.S. leadership.³³ This desire to demonstrate NATO's indispensability led to some observers to suspect that U.S. policy regarding CSCE was a calculated effort to ensure its failure in the growing conflicts of Europe's eastern half. In conversations with many of the key policymakers in the United States and Europe, I have found little corroboration for such a conspiracy thesis. Nevertheless, the thought that Europe's indecisiveness and disunity would become apparent, absent American resolve, was a hope that many in Washington have been unable to conceal.

The most often cited rationale for minimalizing CSCE was the danger of linking national security to a large, amorphous forum when American national interests were not threatened by turmoil in the Balkans or Caucasus. To take a pass on Yugoslavia, as one senior Bush adviser told me in the spring of 1992, was a direct consequence of judging that U.S. national interests were unaffected by ethno-nationalist warfare, and that involvement in multilateral efforts would needlessly intermingle American concerns with those of other states.

Hence, U.S. officials made no effort to heighten CSCE's profile, and let the European Community and, ultimately, the United Nations try to deal with the political and security dimensions of the growing Yugoslav crisis. Not until 1994, when the failure of multilateral institutions had been amply demonstrated, did the great powers act in concert as a "contact group" in an effort to bring an end to the vicious Bosnian conflict.

Thus stated, the U.S. position regarding the broad issue of collective security, and its specific applicability in Yugoslavia, has the ring of rationality. But underlying that mindset is the deeply troubling ideology of political realism. Political realism, or *realpolitik*, is an appealing concept for those who seek assurances amidst what some writers have called the new world disorder. As uncertainties and dangers of the post-Cold War environment become evident, interest in older, comfortable paradigms

such as *realpolitik* has grown.

Realists argue that, after the demise of a bipolar concentration of power, nation states will return to a general struggle for power, defined primarily in military terms, as they pursue national interests. National interests require that states seek "military capabilities sufficient to deter attack by potential enemies," and that peace and stability "result through the operation of a balance of power propelled by self interest."³⁴ Realist tenets emphasize power as the fundamental commodity of international relations, national interests as the guiding principles of policymakers, and balances of power as the means by which to pursue such interests without war.

That reasoning is at the core of both America's aloofness toward collective security and of the U.S. decision to take a pass on Yugoslavia. Not until the body count and graphic horrors of ethnic cleansing made it impossible to turn away did American policy move perceptibly. America's power and interests are thought to be embedded in a tried and trusted NATO, while any proportional diminution of the U.S. role (e.g., in a larger body without a preponderant American military weight) would throw national interests into the cauldron of collective decision-making, which the United States does not control.

Both Washington's passivity toward the Yugoslav tragedy and the aversion to CSCE are direct consequences of the belief that America's status as the world's last superpower renewed an old standard for foreign policy commitments—clear national interests. According to realist reasoning, unless such unequivocal interests are at stake, commitments of American political, economic or military resources should not be undertaken. By this logic, based on the two crucibles of political realism (power and interests), one uses power only when interests are threatened; to do so when clear national interests are not threatened would damage security.

But this policy assumes that, as the century draw to a close, unambiguous national interests exist, that such interests can be defended by national power alone, and the exercise of power in the name of national interests will produce security. Even after one of the most exhaustive and exhausting reviews of U.S. defense strategy and force structure ever conducted, the Clinton administration's own Bottom Up Review came up with a vision of American power projection that is unguided by any clear national security strategy and increasingly unaffordable.³⁵ Defining national interests and matching power to those interests have become an extremely murky enterprise.

The Clinton administration has adopted Bush administration policies and the same disjointed realist logic. Against Saddam Hussein, the U.S. led and dominated the coalition forces. The adversary was malevolent, and the war's result was sold to the American public as an unqualified victory. Power used to protect interests (oil, allies such as Saudi Arabia, etc.) seemed to beget security. But as that victory has proved to be far less glorious, and the policies that led to the original crisis were traced to the White House, the linkage between power, national interests, and a twenty-first century understanding of security grew tenuous.

The Bush administration's spurious syllogism has gone unchallenged by Bill Clinton. Clinton, too, has signed on to the old adage that national interests must guide security policy, and that power must be the principal instrument of such policy. By accepting these norms, neither Bush nor Clinton have been able to provide a strategy for post-communist Europe. Threats in the region, from turmoil and collapse in nascent democracies to economic dislocation, migration and the spread of warfare, are transnational and systemic, affecting not the lives of Americans today, but the potential for Americans to live in peace and prosperity in the future. Husbanding military resources by avoiding peacemaking commitments, for example, does less to conserve power than to erode the bases for strength.

Mistaking woodenheadedness for realism, George Bush's foreign policy stayed the course and headed for rocky shoals. Bill Clinton has failed to take any corrective action. By eschewing collective security, we have become increasingly less relevant to Europe's future, more isolated with our missiles and our marines, and unable to offer meaningful alternatives to recurrent strife throughout the Continent's eastern half.³⁶ And, by denying to ourselves any tool for trying to ameliorate threats, we are left with an unpalatable choice—launching a costly great power intervention after the killing has begun or taking a seat from which to watch the slaughter.

CSCE could have been far more, and could have been a path to avoid Yugoslav-style wars. The U.S. adherence to a misplaced political realism, evident in both the Bush and Clinton presidencies, has led both to CSCE's stunted development in the post-Cold War era, and to unmitigated tragedy in southeastern Europe. Were we to realign U.S. post-Cold War strategy dramatically, backing unequivocally a fully institutionalized Euro-Atlantic collective security system, we might yet avoid worst-case scenarios in Moldova, Kosovo, and Macedonia, as well as in the Caucasus, Crimea, and other potential hot spots. The time for accomplishing that task, however, has become exceedingly short.

Scenarios for Collective Security

The genesis of regional collective security can only follow one of two routes. Either an existing institution must metamorphose, becoming an organization to dampen threats effectively, or a new companion entity must be inaugurated.

NATO's functional and territorial expansion—thereby adding to an alliance for common defense both the geography and responsibilities of a more all-inclusive regional collective security organization—has been advocated strongly by American analysts.³⁷ Indeed, that route has become the default option for U.S. and Western policy. No one has had the political will to create a Euro-Atlantic collective security system, so the metamorphosis of NATO, the European Union, the Western European Union, and the Council of Europe—an amalgam of allegedly interlocking

institutions—has become the pragmatic alternative. As all struggle to broaden and/or deepen, they may yield some of the results sought through a more idealistic collective security organization.

At the moment, however, NATO remains the only credible security architecture. No matter how real the Soviet and Warsaw Pact threat was for several decades, NATO unquestionably succeeded in keeping the United States engaged in Europe, while contributing to West European integration by minimizing fears of a resurgent Germany.

For NATO, however, winning in the short term has meant losing in the long term. Gone is an unambiguous adversary that gave NATO a clear *raison d'être*, and an unarguable threat with which to forge unity and diminish domestic opposition to military spending. Since 1989 NATO has struggled to come to grips with the end of at least one phase of its career; the purpose for which it lived is no more.

After Europe's tectonic political shifts in the late 1980s and early 1990s, NATO has sought to repackage and reinvent itself. After strategic reviews, defense planning papers, conferences, North Atlantic Council sessions and Alliance summits, NATO has been trimmed, broadened, and stretched. Military forces available to Supreme Allied Commander Europe have decreased significantly, while restructuring has meant an abandonment of forward deployment.

Beyond those specifically military changes, NATO has had to confront the immense political challenge of how to behave toward erstwhile Warsaw Pact adversaries. NATO's response to that challenge has been to drift toward expansion, with no one at the helm. Not wanting NATO's preeminence in the security domain to be subordinated to any other organization, the U.S. and Western Europe have offered first the NACC and then, in January 1994, Partnership For Peace (PFP).

The drift toward danger is evident in several respects. Military cooperation under the auspices of PFP implies an obligation to improve the capability and compatibility of East European forces. But such NATO-ization is expensive, and no one knows from whom the money is to come.

Second, Partnerships will not create partners, at least not within Europe's eastern half. PFP fosters an unseemly contest among these states for Western attention and resources, and competition rather than collaboration. If one state were to gain rapid advancement into NATO circles, its neighbors would not be sanguine, suspecting that NATO's guarantees could become a shield for pressures and intimidations.

Also damaging is the continued absence in PFP of clear markers on the path toward NATO membership. President Clinton reassured Poles while at Warsaw in early July 1994 that they will be at the head of the line.³⁸ But will NATO's security guarantees be provided first to those who behave best or to those who need it the most? Specific criteria and the relative weight of each factor for entering NATO are unstated.

Finally, none of the former Warsaw Pact countries have been offered any security guarantees with PFP, but all must fulfill new responsibilities. For NATO and for the proto-democracies in Eastern and

post-Soviet Europe, the gap between expectations and responsibilities is unhealthy. For regional security, that gap constitutes a real and present danger.

All of this means that PFP has fostered a security race, the losers of which will exhibit a security envy pushing them toward other patrons—Russia, Germany or possibly other states such as France, Italy, and Turkey that have served such a role in the past century for one or more states in Eastern and Southeastern Europe. NATO leaders have said repeatedly that NATO is open to more members—not if, but when. The pertinent questions, however, are who and why, not if or when.

The terrible mistake is being made of again drawing lines in Europe, despite rhetoric to the contrary. Rather than seeing security as indivisible and collective, it appears that the Western powers will offer guarantees to those they like best, not to those whose peace and prosperity are most endangered. Furthermore, the Western governments continue to imply that the route to the secure environs of NATO lead through PFP's scheme for military cooperation.

Yet that is only one component of security. NATO's role in the twenty-first century should not mix and confuse the roles of an alliance for common defense and an organization for collective security. NATO should be NATO. Rather than attempting to transform into a larger, indistinct organization that mixes roles, ends and means, NATO should retain its West European and North American focus—where membership and capacity to fulfill responsibilities are coextensive, and where interstate conflicts are no longer plausible.

A credible military defense for North Atlantic democracies is a substantively different enterprise than is threat abatement for the Vancouver to Vladivostok hemisphere. Proliferation, mass migration, terrorism, and other transnational threats are palpable but unaffected by most unilateral or multilateral military contingencies. Air, naval, or ground forces can do little to mitigate these perils and offer only a blunt and rarely successful response to such new threats.

For threat abatement, NATO must have the help of a strong companion organization in which membership is universal. Such an organization would extend confidence building, early warning, and other conflict resolution mechanisms, as well as undertaking observer and peacekeeping missions. Those are the roles of a fully-institutionalized regional collective security organization, not an alliance that exists to plan for power projection and war fighting. The United Nations, overtaxed financially and slow to act, cannot fulfill such regional missions—and need not in Europe, where ample regional resources exist.

NATO's future role ought to be to ensure that threat abatement works—to provide the essential guarantee absent when previous experiments with collective security ended in tragedy. Neither half of the security equation will alone suffice; alliances to enhance military capacities meant to deter or defeat threats and collective security organizations designed to minimize and mitigate threats need each other.

Generating a new Euro-Atlantic collective security organization

will thus depend on NATO and its principal members. The metamorphosis of NATO itself is not the answer. The devastation in both the Balkans and Caucasus, and the dangers at other flashpoints such as Moldova and Crimea, as well as the sheer cost of trying to halt ethno-nationalist warfare once it has produced martyrs and monuments to fuel more atrocities, may foster heightened political will in the mid and late 1990s to build other institutions.

And, as the peril of new threats that cannot be mitigated by NATO or its appendages becomes more acute, a forum such as a CSCE summit might provide the starting point for developing a follow-on organization. Prolonged negotiations are inevitable, but the start should be soon.

The precise outline of a Euro-Atlantic collective security organization lies beyond the scope of this analysis. Universal membership would be essential, but the consensual nature of CSCE decisions could not continue. Actions in the realm of security must be taken by a smaller subset of the total membership, and decisions within such a commission ought to be valid if supported by a majority.

Many tasks and responsibilities related to security in Europe need to be vested in a permanent commission on security. That commission should subsume many of the confidence building efforts, arms control and harmonization negotiations, transparencies and observations that reveal neighbors' military plans, and other tasks. Some capacity to deploy peace-keeping forces should also be present—to keep feuding factions apart while adjudication, arbitration, or other conflict-control mechanisms are utilized. Small numbers of such units should be maintained and dispersed in multinational garrisons throughout Central Europe.³⁹ Contingents from all member states, proportional to their population, could be assigned to the Euro-Atlantic organization, with accompanying financial and material assets.

These desiderata aside, the purpose of supporting collective security is neither to replace the UN's global efforts nor to supplant NATO. NATO has a place, albeit a much smaller place, in Euro-Atlantic security in the post-Cold War era. UN blue helmets must be available to police truces and the aftermath of carnage in many continents. But the larger needs of EuroAtlantic security are not for defensive alliances or for cease-fire monitoring and disengagement undertaken by the United Nations. Rather, the principal need is one of conflict prevention and the reduction of transnational threats.

For these tasks, no institution exists, and no one is prepared. Small, disjointed NGO efforts, and courageous solo endeavors (e.g., the CSCE High Commission for National Minorities) will not suffice. Nothing that NATO might begin to do, and nowhere to which NATO might expand, will help diminish ethnonationalism, covert proliferation, mass migration, or other threatening phenomena.

The most difficult path is all that remains—a fundamental realignment of priorities in U.S. and West European security policies, away from protecting NATO by adding to it, and toward addressing the kinds and intensity of threats confronting the region. For that goal, there must be

strategic vision in Western capitals, of which little has been present thus far.

NOTES

1. This comment by Silajdzic was repealed by Bosnian diplomats to the author in Washington, D.C. in July 1992, and later by American diplomats involved in the Helsinki summit. Silajdzic is now Prime Minister of Bosnia-Herzegovina.

2. Max Kampelman, "Foreword," in Lori Fisler Damrosch (ed.), *Enforcing Restraint: Collective Intervention in Internal Conflicts* (New York: Council on Foreign Relations Press, 1993), p. vii.

3. Arguably the most prominent of the neorealists, at least insofar as he has articulated a view on post-Cold War security, is John Mearsheimer. His article "Back to the Future: Instability in Europe After the Cold War," *International Security*, 15 (Spring 1990):5-56, is widely cited. Kenneth N. Waltz and other members of an earlier generation of realist theorists have also commented on the post-Cold War epoch, emphasizing the state, its power and interests. See, e.g., Kenneth N. Waltz, "The Emerging Structure of International Politics," in U.S. Senate, *Relations in a Multipolar World: Hearings before the Senate Foreign Relations Committee*, Part 1, 101st Cong., 2d sess, 26, 28, and 30 Nov. 1990.

4. That extreme formulation can be found in Mearsheimer.

5. Those views can be found in Christopher Layne and Benjamin C. Schwarz, "Should NATO Close Shop?" *Christian Science Monitor*, 10 March 1994, p. 19. A more detailed treatment of the subject is contained in Christopher Layne and Benjamin C. Schwarz, "American Hegemony—Without an Enemy," *Foreign Policy*, 92 (Fall 1993):5-23.

6. A recent example of such criticism is Josef Joffe, "Collective Security and the Future of Europe: Failed Dreams and Dead Ends," *Survival*, 34/1 (Spring 1992):36-50. A more balanced treatment is Richard K. Betts, "Systems for Peace or Causes of War? Collective Security, Arms Control and the New Europe," *International Security*, 17 (Summer 1992):5-43.

7. One intriguing, simulation-based study that gives rise to these conclusions is Thomas R. Cusack and Richard J. Stoll, "Collective Security and State Survival in the Interstate System," *International Studies Quarterly*, 38 (March 1994):33-59.

8. For a compilation of all agreements approved by CSCE Heads of State and Government during the Helsinki Follow-Up Meeting, see *Final Document From the 1992 Helsinki Follow-Up Meeting* (Washington: Helsinki Commission of the U.S. Congress, 1992).

9. Robert Mauthner, "Ministers Prepare For European Security Summit," *Financial Times*, 2 Oct. 1990, p. 2.

10. *The Conference on Security and Cooperation in Europe: An Overview of the CSCE Process, Recent Meetings and Institutional Development* (Washington: Commission on Security and Cooperation in Europe, Feb. 1992), p. 1.

11. *Ibid.*, p. 2.

12. Sen. Dennis DeConcini and Rep. Steny Hoyer, "Letter of Transmittal,"

in *From Vienna to Helsinki: Reports on the Inter-Sessional Meetings of the CSCE Process* (Washington, D.C.: Com. on SCE, April 1992), p. iii.

13. *Ibid.*, p. 4.

14. Hans-Dietrich Genscher offered several explanations of a pan-European security framework. See, for instance, his speech at the Tutzing Protestant Academy on 31 January 1990. Hans-Dietrich Genscher, "German Unity Within the European Framework," in *Statements and Speeches*, 13 (2) (1990) (New York: German Information Center). Another example was Genscher's speech at the CSCE Conference, 11 April 1990, in *Statements and Speeches*, 13 (8) (1990) (New York: German Information Center).

15. For a report on the Czechoslovak proposal, see Edward Monimer, "Prague Suggests New Security Set-Up," *Financial Times*, 4 April 1990, p. 2.

16. Krzysztof Skubiszewski, minister of foreign affairs of the Republic of Poland, "Poland and European Security," statement given to the North Atlantic Assembly, London, 29 Nov. 1990, (mimeo, distributed by the Foreign Ministry, Republic of Poland).

17. E.g., see "How to Make Europe Secure," *New York Times*, 18 June 1990, p. A18.

18. Author's notes.

19. Those arguments were used by Bush administration officials in the National Security Council and in the Dept. of State during the author's conversations with them in 1990 and 1991. While serving as senior foreign policy adviser to House Majority Leader Richard Gephardt, I repeatedly sought explanations for the Bush administration's refusal to offer more than a limited acknowledgement of CSCE's potential role.

20. Author's interview with former Czechoslovak foreign minister Jiri Dientsbier, Prague, Czech Republic. 2 May 1994.

21. That supplementary document provides details about how the Committee of Senior Officials will work as well as organizational matters concerning the Conflict Prevention Center, a secretariat in Prague, and what was then called an Office of Free Elections in Warsaw. The Charter of Paris for a New Europe, with supplemental document, reprinted in Stefan Lehne, *The CSCE in the 1990s: Common European House or Potemkin Village?* (Vienna: Austrian Institute for International Affairs, 1991).

22. During the summer of 1993, the author served as a consultant to the CSCE's High Commissioner on National Minorities.

23. The flavor of the Polish pro-NATO campaign can be surmised from press accounts such as Juliusz Urbanowicz, "Suchocka to NATO: Let Us In!" *Warsaw Voice*, 12 September 1993, p. 4.

24. For an analysis of Eagleburger's opening speech at the Helsinki Follow-Up Meeting, see Commission on Security and Cooperation in Europe, *Digest*, March 1992, p. 2.

25. For a brief discussion of this peacekeeping potential, see Heinz Ganner, "The Future of Institutionalization: The CSCE Example," in Ian M. Cuthbertson (ed.), *Redefining the CSCE: Challenges and Opportunities in the New Europe* (New York: Institute for East West Studies, 1993), pp. 240-41. Interviews at

NATO Headquarters, Brussels, and at the NATO Defense College, Rome, by the author corroborate this view.

26. E.g., see Roger Cohen, "Finger-Pointing by NATO Allies Delays Help for a Bosnian Town," *New York Times*, 22 January 1994, p. A1. By the spring of 1994 NATO leaders, such as U.S. Ambassador Robert Hunter, were asserting that they already had a sufficient UN mandate and that NATO could initiate attacks, not merely do so at the request of the UN. See Gillian Tett, "NATO Air Strike Ultimatum to Serbs," *Financial Times*, 23-24 April 1994, p. 2. Various internal documents underscored NATO's uneasiness about acting as the UN's army. See, for example, the report of the Defence Planning Committee, Document DPC-D (93)6, "Peacekeeping: The Implications for Defence Planning," 11 May 1993; and an eleven-page working paper from the NATO defense planning staff from the same period (but undated), "With the U.N. Whenever Possible Without When Necessary."

27. President Bush quoted in *Financial Times*, 5 November 1991, p. 3; Baker's comments in R. C. Longworthy, "Uncertainty NATO's New Foe," *Chicago Tribune*, 19 June 1990, p. 1.

28. The Poles left no stone unturned in trying to find evidence that everyone was ready for NATO membership, including the Army's officers. See, for instance, a report on a survey of Polish officers in "We and They in NATO," *Rzeczpospolita*, 7 Sept. 1993, p. 1.

29. "Declaration of the Heads of State and Government Participating in the Meeting of the North Atlantic Council," *Europe: Documents*, No. 1867 (Atlantic Document no. 83, 12 Jan. 1994), p. 2.

30. Author's conversations with delegations from NATO member states and East European observers at the NATO summit, Brussels, Belgium, January 1994.

31. Lehne.

32. *Ibid.*

33. Author's discussions with members of Congress and senior committee staff, June-December 1991.

34. These succinct summaries of realist views in international politics are those of Charles W. Kegley and Eugene R. Wittkopf, *American Foreign Policy: Pattern and Process*, 3rd ed. (NY: St. Martin's Press, 1987), p. 76.

35. Those are among the judgments made in Andrew F. Krepinevich, *The Bottom-Up Review: An Assessment* (Washington: Defense Budget Project, February 1994).

36. The French, of course, have long been anxious for a Europe that provided for its own defense and security. It comes as no surprise, therefore, that French leaders have been most vocal in noting the "obsolescence, or...wholly inadequate" nature of current instruments for defense and security, and that the "split between the United States and Europe...is slowly becoming fact" requiring soon a "Council of Greater Europe" and a "real European security council." These comments, by French National Assembly president Philippe Sequin on 25 January 1994, were reported in *Atlantic News*, (2591) (26 January 1994).

37. Two excellent examples of creative thought on this issue are Jeffrey Simon, "Does Eastern Europe Belong in NATO?" *Orbis* 37 (Winter 1993):21-35;

and Ronald D. Asmus, Richard L. Kugler and F. Stephen Larrabee, "Building a New NATO," *Foreign Affairs*, 72 (September-October 1993):28-40. Another recent example, written by two British NATO parliamentarians, suggests explicitly two "new core functions" for NATO—"crisis management outside the treaty area" and "projecting stability to former adversaries." See Bruce George and John Borawski, "Sympathy for the Devil: European Security in a Revolutionary Age," *European Security*, 2/4 (Winter 1993):482.

38. See Ruth Marcus, "Clinton Assures Poles of NATO Membership, Eventually," *Washington Post*, 8 July 1994, p. 16.

39. A recent Polish idea, clearly meant to bring a permanent NATO presence onto Polish soil, was Grzegorz Kostrzewa-Zorbas, "NATO Regional Peacekeeping Center in Central and Eastern Europe: A Proposal," *European Security*, 2 (Winter 1993):585-602.

The Possibilities for Creation of a New Security System in the South of Europe

Radovan Vukadinović

When pointing to a possible process of creation of a security system in the Balkans, with the existing Balkan specifics and complexity, one should bear in mind the solutions that have already been accepted in Europe—the ones achieved in inter-bloc relations (the CFE—Treaty on Conventional Military Forces in Europe, 1990)¹—as well as measures that are being developed within the Forum for the Security Cooperation of CSCE.

Former member states of the Warsaw Pact and NATO have dealt with the problem of balancing their conventional military forces by accepting the Agreement on Conventional Forces in Europe (CFE). Out of the vast number of solutions offered in this document—all of which were designed to eliminate the possibility of sudden attack—two issues might be contemplated for solutions to the problem of Balkan security.

Firstly, in the frame of huge distributions of military forces and the creation of regional balance within five NATO members: Portugal, Norway, Spain, Greece, and Turkey have all been supplied with a considerable quantity of military equipment and weapons from American and NATO bases in Germany and the Netherlands. It is significant that, by this new balancing, the Mediterranean countries have gained military strength, as the majority of these supplied ended up there. Leaving aside the question of what this means for a Mediterranean balance (between the south and north coast), it has become apparent that the military growth of Greece and Turkey have resulted in a new situation, not only in the Balkan region, but, most of all, in their bilateral relations.

Gaining from the effort to withdraw arms from the CFE zone, which means central Europe, both of the Balkan countries have become the main beneficiaries of NATO military supplies. It is expected that the Turkish military arsenal in 1995 will be 25% more up-to-date than it was in 1992. In respect to the need for maintaining a Greek-Turkish balance and bearing in mind the fragility of Greek-Turkish relations, the Greek army has been modernized as well, with the result that both

countries have increased their level of military strength.²

Considering not only the state of bilateral Greek-Turkish relations, but also the new development of relations in the Balkan region, it is not difficult to agree with those who believe that this policy of "cascading with NATO weaponry" has led to new complications. Namely, arms have been removed from areas of Europe where chances are slim that they would actually be used to areas very near to actual conflict and areas that have the potential for new conflicts. It is also obvious that, considering the existing situation in the Balkans, if there was an escalation of conflict in, for example, Macedonia, Greece and Turkey would find themselves on opposite sides of the conflict.

This fact has certainly not been considered by NATO planners (or perhaps has been) when they were disposing of arms from the CFE zone. Nevertheless, this is one of the primary problems that will have to be solved at the Balkan level when conditions for the creation of a new security system in this part of Europe emerge.

Another set of solutions that could transpire from a balanced lowering of tensions in ex-bloc relations, is not related to east-west relations, but rather to relations within one country—the former Czechoslovakia. After the disintegration of ČSSR, the Czechs and Slovenes agreed that the military should be divided and balanced in a proportion of 1:2. This very move, by which the two countries have emerged from former federation, deciding to solve the question of their bilateral relations in the area of security by creating a special bilateral security system, could eventually be implemented by the countries that have emerged from the former Yugoslavia. Any such organization should probably be connected with the Forum for the Security Cooperation, but it should be noted now as a possible solution for balancing national military forces.

The kind of relations that will be created in the Balkans, the criteria that will be set for keeping armed forces, and questions of which kinds of arms will be tolerated—all of these can be solved with existing European solutions, and this is where the CFE, although created to help newly-forming relations between ex-bloc countries, will certainly be able to offer useful proposals.

The CSCC (OSCE) Forum for the Security Cooperation was formed in 1992 and in its starting program stated not less than fourteen different activities in the field of arms control. By this it became the most significant form of negotiations on military and security issues that involve the OSCE countries.³ Along with possibilities for a dynamic approach to problems of security cooperation, the Forum has set the grounds for flexible enlargement of the topics that could be discussed. Neither security nor its realization are viewed as something fixed and unchangeable, but rather as part of the ongoing changes in contemporary international relations.

Setting security cooperation as a prime task, the Forum has opened the possibility for numerous conferences and exchanges of information on questions of security. At several seminars that have been organized by the Forum, topics and possible solutions were prepared for meetings on the ministerial level. But this wide platform of topics that penetrate questions

of security cooperation have been set and, if accompanied by relevant political willingness, would make possible movement towards mutually acceptable solutions.

Thus far, through Forum activities, several topics were vividly discussed and government support for them has been requested. Examination of each of these problems can be useful in the Balkan conflict:

a) The harmonization of commitments in the field of arms control produced some very interesting suggestions drawn by members of the so-called Vishegrad Group. It was suggested that the main parts of the CFE agreement should be implemented by countries that have not been, nor are at present, members of NATO. This would mean that questions regarding the national level of military strength, the supplying of information and notification, verification, control mechanisms and areas of implementation should be part of all new efforts that aim for encompassing countries that have not signed the agreement.

This has a special significance in the Balkan region, where neither the former Yugoslavian countries, nor Albania, have signed the CFE agreement. In the process of drawing the Balkans closer to Europe, the commitment of these countries to the notion of balanced conventional arsenals would be of great importance, and the CFE could be used as an instrument which has already proven its worthiness.

b) The behavior pattern in the field of security is a set of measures that are being suggested as a basis in dealing with security issues. Primarily with regard to the Balkan situation, it can be assessed that the vast majority of European solutions could be directly accepted and incorporated in a Balkan security system. This applies, for example, to the Polish proposition of behavior of countries in conflict and the rules that should be followed in conflict situations. In joint EU and NATO propositions for Balkan countries, the principles of early warning, crisis management, activities of peace forces within CSCE or together with UN forces, control of military behavior, use of military force and its compatibility with military doctrine, and monitoring, should all be stressed. The joint Austrian-Hungarian proposition of a security concept should be viewed as a landmark for all CSCE countries in their mutual relations. It calls for general security, cooperative security, and the wholesome of the concept. The relations between security, disarmament and environmental protection are considered, as well as the rights of national minorities.

c) Stabilization measures that are being drawn from NATO suggestions from April 1993 are aimed at lowering tension and preventing the eruption of armed conflict on a regional level. Active cooperation of all parties involved in the dispute is demanded, and it is recommended to use:

- open measures to ensure the transparency of the situation and of military activities in the region,
- refraining from some activities (cease fire, setting of demilitarized zones, no flight zones, deactivating of some weapons, treatment of paramilitary forces)
- measures to create mutual trust-monitoring, liaison teams, hot-line communications, joint crisis management teams,

- monitoring implementation and evaluation, which includes monitoring teams of third party and OSCE (if possible), verification of weaponry, etc.

These stabilization measures, as suggested within the Forum, are partly being applied in the Balkan conflict, and other measures could easily be incorporated into a Balkan security system.

d) Contacts between military establishments and military cooperation are being proposed as a way of creating an appropriate atmosphere for development of new relations in the field of security. Numerous visits of military delegations, exchange of monitors in military maneuvers, joint maneuvers, seminars, etc., are all aimed at overcoming the gap between former blocs and the protagonists of military force.

This is all, on a small scale, being done in the Balkan area (military cooperation between some Balkan armies), but with a cessation of hostilities, such activities could be developed to a fuller extent. Certainly, the recent Bulgarian suggestion of a meeting for all the joint chiefs of staff of all the Balkan countries, where the military situation, military doctrines, and the general possibilities for military cooperation in the Balkans should be assessed, refers to this.

A special item has been on the Forum agenda are possible OSCE contributions to military security and stability in the southeast of Europe through arms control, disarmament, and measures towards increasing the level of mutual trust and security. The Forum senior officials have pointed out the necessity for immediate analysis of the situation whereby Serbia and Montenegro are not OSCE members. Because of this, it was decided to inform them about all discussions and proposed measures.⁴

The conclusion, accepted by all participants, was that all the measures provided for in the CFE Treaty should be extended to the area of the former Yugoslavia,⁵ and that efforts should be made towards a situation where each of the newly created states should maintain the smallest possible military force, sufficient only for defense. The main obstacle to this is the existence of a large number of paramilitary forces. Thus, there is a demand for a special criteria for control of mobilization possibilities and military movement. A balance of weapons of smaller calibers that are in use in the Balkan region, which is not stipulated in the CFE agreement, is also called for.

Bearing in mind the reality of the situation, and partly connecting disarmament in the Balkans to a cessation of the conflict, top officials have suggested that the process should progress in three phases.

During the first phase, agreements among the former Yugoslavian countries and Albania should be made. These agreements should incorporate the main contents of CFE and parts of CSBM. In the second phase, this process should encompass the immediate neighbors of the former Yugoslavia and Albania, who would strengthen their measures for security and mutual trust (CSBM) with this area. Finally, the whole CSCE should become a specific support body and a forum for an official negotiation process.

By this initiative on activities in the Balkans, the Forum has

expressed its wish that this part of Europe should move from confrontation to cooperation, and that, accordingly, the process of disarmament is becoming a political process, where it is expected that the OSCE countries will offer political support for all new efforts. It is significant that, in the case of the Balkans, the Forum has chosen a regional approach, which has been a clear factor in conflicts and emerging relations there. On the other hand, it is evident that the Forum will have to the wholesome of its activities into smaller segments, and that it will seek grounds for efficiency primarily on regional levels (Balkans, Caucus, Vishegrad Group, Baltic). This by no way means that security will become dividable, but rather that it will reach a level where, in certain matters of cooperative security, it would be easier and more competent to discuss them on a regional level.

Measures for Strengthening Mutual Trust and Security—CSBM

The conflict in the former Yugoslavia has meant that the entire structure built into the system of the OSCE for strengthening mutual trust and security has been in difficulty. Aspirations towards a greater level of mutual trust and security were confronted with conflict in south Europe, and the impotence of all respected bodies, including the OSCE, to actually do something to restore peace to the area. Such was the situation when it was decided within the OSCE to dismiss the Advisory Committee to the Center for Conflict Prevention and to pass the matter on to the newly formed OSCE committee for Political Consultations and Decision Making, situated in Vienna, and to the Forum for the Security and Cooperation.

The majority of their tasks, as set in basic OSCE documents (such as CBM measures and later CSBM), have primarily been designed as incentives for the implementation of these measures, and their eventual spread.

Bearing in mind the nature of the Balkan area, it can once again be stated that these measures (CSBM) are extremely suitable,⁶ and that the Balkan states can clearly benefit, like all the other countries, in their acceptance. This primarily reflects

- announcement of military maneuvers of certain types,
- annual exchange of military information,
- creation of a constant communication network.

In relations between some Balkan states, these CSBM measures have already been implemented⁷ and given the conditions of peace emerging in this area, there should be no problem applying CSBM.

Out of the catalog of measures for strengthening of security that could lead to the creation of a European security system, or a regional Balkan system, there exists a considerable network of subjects and issues which have already been suggested, or even implemented. This means that the Balkan countries do not have to invent or suggest new solutions, since the framework for a security system is already in existence.

But, nevertheless, there is a vital need for a quick peace in the territories of the former Yugoslavia, in order to create the conditions for a gradual implementation of these measures, and to begin to create a Balkan

security system. In this case, it is important to bear in mind all the positive and acceptable solutions already modeled in the European security system, and only in the case of specific Balkan circumstances would it be necessary to insist on other principles and measures. This refers primarily to a need for 1) a strict respect given to the principle of firm and unchanging borders after a peaceable solution has been reached, 2) accenting peaceful solutions to the conflict, 3) a special approach to post-war problems, 4) balancing of the decrease in military forces, 5) solving the problem of paramilitary forces, and 6) control of arms disposal, etc. This will probably lead to discussions on demilitarization of certain areas as well.⁸

As far as obstacles to accepting, at least, some starting measures are concerned, the conflict in the former Yugoslavia is certainly at the top of the list. Without a quick solution to this problem, there can be no talk of creating some integral Balkan security system. All of the measures of partial character that could strengthen the security on a bilateral or trilateral level could, at the same time, have negative impacts on other Balkan countries that do not participate in them or do not accept them.

The current position, with some Balkan countries having commitments towards the CFE (Greece, Turkey, Bulgaria, Romania), and others not (newly created former Yugoslavian states, Albania) results in a situation where the CFE member states are insisting on the creation of a unique system of obligations that would be binding for all participants. Since Yugoslavia, or what is left of it, has not as yet become an OSCE member, and Macedonia has only the status of an observer, this part of the political issue has significance in the fields of security.

The fact is that some countries at this moment reject any solutions that would link them with the Balkans or with Serbia. Slovenian policy is to emphasize that it does not belong to the Balkan area, and instead it is trying to approach the Vishegrad group. Croatia, with painful war experiences, also finds it difficult to contemplate belonging to a security system where the main actor of the Yugoslav crisis, Serbia, would also have a place. Nevertheless, all this should be put aside, since in this geographically integral region it would be impossible to build a security system only to a certain point, excluding or eliminating the rest of the actors. Besides, by using the term southeast Europe, the doors are being opened wide for accenting the primarily European significance of reaching a solution.

In illustration of possible levels on which the architecture of security in the Balkan area and in the south of Europe should be built, we see three possible levels.

First, within the starting phase, all of the Balkan countries should be involved in contributing, according to their possibilities, a fast solution to the conflict in the former Yugoslavia. This implies the creation of peace in Bosnia and Hercegovina, achieving a political solution regarding the new entities, and in Croatia, the peaceful reintegration of its territories. This could be followed by mutual recognition of all the new states and gradual normalization of relations. It is obvious that this process would need a strong political will on the part of all parties to the conflict, and the strong support of the international community.

Second, after the peace is achieved, although this does not mean that stability would automatically take place in this part of the Balkans, all of the Balkan countries should plead for implementation of all the measures existing in the current security structure (CFE, CSBM, and those resulting from the actions of the Vienna Committee). Starting from the assumption that, by then, all of the former Yugoslavian countries will be OSCE members, there will be no so-called uncovered areas, which will ease the implementation of the mentioned measures. During this process of accepting OSCE standards, there will be time and space to discuss the needs for creating and promoting certain measures that will have specific weight in the Balkans, measures that will result from Balkan specifics, as well as from the conflict in the former Yugoslavia.

Third, based on Chapter 5 of the Helsinki Final Act (which creates possibilities for creation of regional arrangements), and on the new way of thinking within the OSCE itself, the Balkan countries may wish to create their own, regional security system. Such a system should be primarily integral—that is, the borders of the Balkan region (including Slovenia or not), territorial parameters, as well as anything that would help identify actors, should be precisely established.

On top of all of the proposed measures, the Balkan states, following their specifics and historic inheritance, should found a body that would be perpetually active, that would coordinate the activities, and represent a center for all efforts aimed at solving security problems. Whether it is called a Crisis Prevention Center or perhaps a Committee for Balkan Security does not really matter. The significant thing here should be the existence of a body that will systematically monitor the development of security relations in the Balkans, that will react in proper time, and have in consideration the creation of a permanent security system. Beyond this, the system should, naturally, be firmly connected with all efforts in creating a unique European security system.

To many today, this path may seem a distant and unrealistic one. However, one should bear in mind the fact that the first step should eventually be made, and that Balkan countries, for their own sakes and for the sake of Europe, should not be left aside from supporting positive European trends. Creation of a security system in this part of Europe can finally bring closer and integrate these parts into European space, and help European security become efficient, integral, and indivisible.

NOTES

1. The CFE Treaty is reprinted in *SIPRI Yearbook 1991: World Armaments and Disarmament* (Oxford, 1991), pp. 461-74.
2. *SIPRI Yearbook 1994* (Oxford, 1994), pp. 574-75.
3. See V. Y. Ghebali, "The CSCE Forum for Security and Cooperation Opening Gambits," *NATO Review* (June 1993):27.
4. *Basic Reports*, British American Security Information Council, 37 (11 April 1994).

5. I. Gyarmati, "The Future of Arms Control in the Balkans," *Studia Diplomatica*, 47 (1994):57.
6. R. Vukadinović, *In Search of Security for the New Balkans* (Vienna, 1994), pp. 11-15.
7. F. S. Larrabee, "Balkan Security after the Cold War: New Dimensions," in F. S. Larrabee (ed.), *The Volatile Powder Keg: Balkan Security after the Cold War* (Washington, 1994), p. xxvii.
8. This is part of the proposal of the Contact Group Z-4 for a peaceful solution of the Serbian question in Croatia.

Dynamics of the Yugoslav Crisis

Predrag Simić

States use mediation as a foreign policy instrument. Their intervention as mediators is legitimized by the goal of conflict reduction, which they typically proclaim. The desire to make peace, however, is intertwined with other motives best described within the context of power politics.... Mediators are seldom indifferent to the terms being negotiated. Even when they seek peace, they try to avoid terms not in accord with their own interests, which usually allow a wider range of acceptable outcomes than the immediate interests of the parties.¹

The disintegration of the Yugoslav federation in the bloody ethnic conflict and the failure of international mediation (1991-95) opened one of the most complex international crises in Europe since the end of bipolarism. And while the international public was shocked by ethnic violence, policy-makers kept busy with the complex geopolitical consequences of this war, which threatened to spill over the international borders of Yugoslavia and enflame the entire European southeast. Although the Yugoslav crisis became internationalized ever since the first hostilities broke out in June 1991, and despite the fact that all relevant organizations in Europe (CSCE, EU, WEU, NATO, etc.) have been involved in crisis-management, international mediation failed in yielding the expected results. Quite the contrary, mechanisms for conflict prevention and management developed during the Cold War proved largely inadequate in the case of the Yugoslav crisis.

Those were some of the reasons why this crisis, according to prevailing opinion, became a threat to international security as defined in Chapter VII of the Charter of the United Nations. This opinion was initially supported by the following three arguments: first, the conflict could spill across the international borders of former Yugoslavia, and become at least a Balkan, if not a European war; second, it could become a precedent for similar conflicts in central and eastern Europe, especially in the former Soviet Union; third, it endangers the basis of international security since, in the increased instability of the post-bipolar period, any local conflict in

Europe poses a threat to international order. Although these fears did not come true, the Yugoslav crisis continues to be considered a threat to international security because it jeopardized the political cohesion of the EU and NATO, as well as relations of the West with Russia and the Islamic world.²

Therefore, various international factions in the 1991-95 period made repeated attempts at mediation and arbitration which could be classified into the following six phases:

In the first stage, which preceded the outbreak of armed conflicts, the EC and the U.S. tried to quiet the conflict between the Yugoslav republics, stabilize the federal government and thus preempt the crisis. Characteristic of this stage was that attempts at mediation were sporadic, without clear understanding of the causes of the crisis, without adequate instruments, without broader coordination of the leading international (i.e., Western) factions, and without consensus as to how it should be resolved.

The second stage started with the war in Slovenia in June 1991 and ended with the failure of the Lisbon conference on Bosnia-Herzegovina (Cutillero plan) in March 1992. Although the EC led the international mediation in this phase, in December 1991 the U.S. and the UN quietly entered the Yugoslav scene. Although their efforts stopped the war in Croatia (Cyrus Vance plan), the EC-sponsored recognition of Slovenia and Croatia in December 1991 triggered requests for self-determination in another two Yugoslav republics—Bosnia/Herzegovina and Macedonia.

The third stage started with the active participation of the U.S. in the Yugoslav scene in March/April 1992 and ended in April 1993 with the failure of the Americans to convince their European allies of the need for NATO air strikes on Bosnian Serbs after they refused the Vance-Owen plan. In this phase all international initiatives concerning Yugoslavia were made through the UN Security Council and International Conference on Former Yugoslavia (ICFY).

In the fourth phase, the EC (now the European Union) assumed again the leading role and tried to end the war in Bosnia/Herzegovina on the basis of the so-called Kinkel-Juppe initiative and the Luxembourg plan which established 51%:49% formula for division of this former Yugoslav republic. At the same time, Germany tried for the first time to end the war among Bosnian Croats and Muslims by proposing a federation of Bosnia/Herzegovina (Petersburg initiative). This attempt fell through in December 1993 after Bosnian Muslims, supported by the U.S., refused to accept the Owen-Stoltenberg plan.

The fifth phase (February 1994-January 1995) began with the NATO military involvement in Bosnia/Herzegovina and the reappearance of Russian diplomacy in the Balkans. The five major international factions involved in the management of the Yugoslav crisis—U.S., Russia, United Kingdom, France and Germany (the latter three nominally representing the EU)—came together in the so-called Contact Group, which at the end of April assumed the coordination of their diplomatic initiatives. This phase ended with the failure of the U.S. to persuade the Bosnian Serbs to

accept the Contact Group plan for Bosnia/Herzegovina.

The sixth phase started with the proposal of the French foreign minister Juppe for a triple summit (Yugoslavia, Croatia and Bosnia/Herzegovina), for mutual recognition of the former Yugoslav republics, and for making public the Z-4 (Zagreb 4) plan on UNPAs (Krajinias) in Croatia prepared by the so-called Mini Contact Group (U.S., Russia, and ICFY representatives)

The armed conflict in Yugoslavia thus escalated into probably the most complex crisis on the continent since the end of the Cold War. This crisis reflects not only the conflicting interests of the former Yugoslav republics, but also of the leading factions of post-bipolar Europe. Any attempt to answer for the failure of the international mediating efforts should first consider the internal and external causes of this crisis.

Why Yugoslavia Fell Apart

Like most multiethnic states, Yugoslavia relied on a double consensus: on the consensus of ethnic groups which made it³ and, on the consensus of winners in World War I and II, which supported the creation of this state within the international order as defined in Versailles and Yalta. In spite of deep economic, cultural, religious and political divergences among the southern Slavs ("Yugoslavia" means "the State of the Southern Slavs"), the new state creatively responded to the competing claims of self-determination in southeastern Europe and, with the exception of a short period (1941-45), for seventy-three years managed, relatively successfully, a complex ethnic and political balance in the Balkans. However, one should note that two major Yugoslav ethnic groups—the Serbs and the Croats—had different perceptions of a common state. While Serbs basically opted for a unitarist goal, i.e., creation of a new Yugoslav nation, a large part of the Croat political elite saw Yugoslavia merely as a necessary step towards a fully independent Croat nation-state. These differences, often promoted by outsiders, were the source of permanent political crisis in the Kingdom of Yugoslavia that led to its collapse and dismemberment under Nazi attack in 1941 and brutal inter-ethnic war during World War II.⁴ Although it rendered possible the reintegration of Yugoslavia, the communist victory in 1945 suppressed rather than redressed the traumas of ethnic violence and genocide during the war.

Towards the end of the 1980s, the collapse of communism and the disintegration of bipolarism in Europe undermined the cornerstones of the second Yugoslavia. On the home front, self-management socialism has been in crisis ever since the early 1970s. In addition, bureaucratic decentralization made possible by the 1974 constitution created eight competing communist nomenclatures, which largely relied on national mobilization to provide legitimacy to their power. Profound crisis in the country has weakened the international position of Yugoslavia,⁵ while geopolitical changes in Europe after 1989 marked the end of the European architecture created in Versailles and Yalta and, according to influential Western

circles, rendering buffer states like Yugoslavia superfluous, if not contrary to what used to be considered a desirable international order in the Balkans since the end of bipolarism.⁶ For the first time since 1950 the U.S. ceased support to the socialist Yugoslavia, encouraging instead the country's democratic and market transformation,⁷ while in Central European political circles emerged revisionist ideas that Yugoslavia is an artificial creation and even a diplomatic error of World War I allies. The unification of Germany was a triumph of the principle for the right of peoples to self-determination (Principle No. 3 of the Helsinki Act) over other CSCE principles. This outcome was also helped by the assessment that only ethnically homogeneous states may successfully carry out painful market and democratic reforms in Eastern Europe. In the tide of the revolutions of 1989, almost nobody was ready to face the ugly consequences of unrestricted implementation of the right of nations to self-determination—fragmentation of states, civil wars, ethnic cleansing, etc.—which soon became the main security threat to post-bipolar Europe.

Under such circumstances all Yugoslav peoples faced two options, to remain within Yugoslavia or create their own independent state, to which their ruling elites responded in accordance with their own perceptions of the national interest. For example, while the more developed and ethnically homogeneous Slovenia did not want to wait for other republics to meet the requirements for association with the EC, nor did it want to be burdened with Kosovo or other ethnic conflicts among the Yugoslav peoples, undeveloped and ethnically heterogeneous Bosnia/Herzegovina considered Yugoslavia as a condition for survival. The go-it-alone approach of the most developed republics was also encouraged by analyses of west European experts, particularly in Germany and Austria, who at the time assessed that certain Yugoslav republics would join the Community as independent states rather than as Yugoslavia. Slovenia, according to those experts, could do so by the end of the century if it seceded from Yugoslavia, while the other republics could not count on that possibility until the next century, when the last group of European countries would be admitted. Unlike Slovenia, the main pressure in this direction in Croatia came from the powerful and revisionist political emigrés. Since the Yugoslav federation was a complex system of checks and balances, departure of any republic disturbed the entire ethnic balance, forcing the others to follow.

The Yugoslav republics divided according to their attitude to this dilemma: 1) Slovenia and Croatia, which wanted to secede from Yugoslavia,⁸ escape from the Balkans and join the central European group of states; 2) Serbia and Montenegro, which advocated firmly integrated federation having in view security concerns of the numerous Serb population in Bosnia and Croatia,⁹ separatist demands of ethnic Albanians in the Serbian province of Kosovo, as well as their own political interests; and 3) Bosnia/Herzegovina and Macedonia, which took a compromise attitude, fearing both of the country's breakup and of remaining in the Serbian-dominated Yugoslavia. The Yugoslav People's Army (JNA) represented a special power-factor, which advocated not only the preservation of the country's unity, but maintenance of its socialist system. Almost all actors in

the crisis soon took extreme stands, grossly overestimating their power and making the conflict intractable from the very beginning.

In the complex system of relations among the Yugoslav nations, the central one is the relationship between the two biggest ethnic groups, the Serbs and the Croats. At the time when the conflict between national political elites made the breakup of the Yugoslav community inevitable, the Serbian leadership came out with the demand that all Serbs should live in a single state, which would encompass Serbia, Montenegro and Serbian-populated areas in Croatia and Bosnia/Herzegovina. The Croatian leadership pursued the demand for Croatia within its historic borders, which would encompass Croatia and all of Bosnia/Herzegovina.¹⁰ Since Serbia and Slovenia reached consensus (January 1991) on the latter's separation from Yugoslavia,¹¹ the focus of the crisis shifted to Serbian-populated areas in Croatia, and then to Bosnia/Herzegovina. Unlike the ethnic conflict between the Serbs and the Croats during World War II, when the local Muslim population¹² largely sided with Zagreb, in 1991/92 Muslims acted independently, demanding independent Bosnia/Herzegovina, which gave the conflict a triangular character, with inevitable shifting coalitions of various partners. Similar strategic configuration was created in the so-called southern triangle (Serbs-Albanians-Macedonians) due to Albanian aspirations toward Kosovo and western Macedonia, but so far it has not escalated into an open armed conflict thanks to the power balance on the south of the Balkans.

In short, the thesis that Yugoslavia was a tragic mistake and the victory of militant nationalist forces at the first post-war free elections in all Yugoslav republics left no room for doubt that the country was heading toward an extremely complicated civil war. This fact was underlined in CIA report that leaked into the public in November 1990.¹³ Since it was obviously not the intelligence failure and since there were enough reasons to assume that civil war will cause great destruction in Yugoslavia and deep geopolitical disturbances in Southeastern Europe, it is surprising that Western governments stood idle until it became too late. To try to answer why this happened, it is necessary to review strategic priorities of the EC and the U.S. by the end of the 1980s and early 1990s.

The EC: Barefoot in the Balkans

The Yugoslav crisis broke out at a delicate moment, when the collapse of bipolarism forced all international structures on the continent to redefine their roles. That was one of the reasons why almost no one among them was prepared to deal with the new security threats and risks. The disintegration of the WTO and the Soviet Union and the unification of Germany created a new situation, the international community focused its attention on the changes in central/eastern Europe and the former USSR. Under such circumstances, Yugoslavia did not enjoy priority in the strategic thinking of the U.S., which at first took the stance that this crisis was a problem in Europe's backyard and as such should be left to Europe.¹⁴

Thomas Pickering, then U.S. ambassador to the UN, stated bluntly that the UN had no role in Yugoslavia unless other international organizations had failed.¹⁵ Since the CSCE soon reached the limits of its influence in the Yugoslav crisis,¹⁶ the leading role in international mediation was relinquished to the EC, whose good offices became accessible to all sides in Yugoslavia by mid-1991.

The EC at the time had strong reasons to mediate. The war in Yugoslavia threatened to destabilize all of southeastern Europe, two EC members, Italy and Greece, border on Yugoslavia, the two other neighbors, Austria and Hungary, were strong candidates for EC membership, while all central/east European countries expected the EC to assume the leading role in the crisis management on the continent. After its failure in the Gulf war, the Community had to try to repair its image in the first armed conflict in Europe in more than four decades. However, the role of a mediator found the Community without proper foreign policy instruments¹⁷ and amidst the preparations for the Maastricht summit, i.e., in a sensitive moment of transformation from economic community to political union. This could explain the belated reaction of the Community to the American warnings that Yugoslavia was at the brink of civil war and the initial underestimation of the complexity of the crisis. Despite its desire to assert itself as the leading political factor on the continent, the EC at the time did not have appropriate instruments for crisis prevention and crisis management, so that early mediating efforts did not go beyond offers of generous financial assistance (4 billion ECU) in an attempt to bribe Yugoslav republics to stay in the federation.

Initially the EC supported unconditionally the unity of Yugoslavia trying to deter secessionist republics from their goals. The EC Declaration on Yugoslavia of 26 March 1991 reads: "In the view of the Twelve, a united and democratic Yugoslavia stands the best chance to integrate itself harmoniously in the new Europe", while the Statement on Yugoslavia dated 8 May 1991 underscored the following: "...only dialogue between all the parties concerned will provide a lasting solution to the present grave crisis and ensure a future for a democratic and united Yugoslavia."¹⁸ At the time, however, an opposite thesis emerged, that preservation of the Yugoslav federation was impossible, while the Yugoslav republics had to be treated as separate entities which would enter into relationship with the Community one-by-one. According to this opinion, only the most developed and ethnically homogenous Yugoslav republic, Slovenia, at the time fulfilled the requirements for association with the EC. Other Yugoslav republics would not become candidates for association with the EC until the next century.¹⁹ Although these ideas reflected different positions within the Community on the integration of the former communist countries into the EC, they encouraged a go-it-alone approach for Slovenia and hardened positions for other republics.

However, at the time two main Western actors, the EC and the U.S., had already been trapped by the contradiction in the CSCE principles: inviolability of borders (3rd principle of the Helsinki Act), territorial integrity of states (4th principle) and non-intervention in the internal

affairs of another state (6th principle) against the right of peoples to self-determination (8th principle). While countries concerned by geopolitical balance in the Balkans such as the United Kingdom, France, Greece, Romania, Spain and Turkey supported the first set of CSCE principles, other countries such as Germany, Austria, Belgium, Czechoslovakia, Denmark, Hungary and Italy took the opposite side. The position of the Twelve soon polarized around these principles, since for Germany, which just united due to the recognition of the right to self-determination, this principle was the priority, while for most other European countries, aware that a peaceful dissociation of Yugoslavia was not possible, preservation of Yugoslavia in one form or another was a precondition for peace on the continent.

First realizing and then taking advantage of the contradictory position of the Twelve, Slovenian *real-politik* defined a clear strategy based on the following assessments: 1) Slovenia was militarily prepared for armed conflict, since it disposed of considerable stocks of armaments and well-trained police forces and territorial defense;²⁰ 2) the proclamation of Slovenia's independence rushed the secession of Croatia and the Serbian-Croat conflict, moving the focus of the war away from Slovenia; 3) the ability of Slovenia to resist the intervention of the federal army and the perspective of the Serbian-Croatian conflict made the interests of Slovenia and Serbia complementary; 4) Slovenia could count on EC impatience as it was in a hurry on the eve of Maastricht to attain visible results in the management of this conflict, as well as on influential circles in the *Arbeitsgemeinschaft Alpen-Adria* (above all in Bavaria, Austria, and northern Italy); and 5) these moves enabled Slovenia to side with the Western position on the conflict in Croatia and Bosnia/Herzegovina, thus consolidating its international position and at the same time avoiding any commitment toward Croatia and other secessionist republics.

Unlike Slovenia, the Serbian leadership based its policy on the wrong strategic assumption that the EC and U.S. will not allow the disintegration of Yugoslavia. Therefore, in the first stage of conflict, they left the initiative to the federal government and JNA, which tried to prevent the secession of Slovenia by force. When limited military action in Slovenia fell through, the Serbian leadership demanded that the federal army withdraw to the Serbian-populated territories in Croatia (Krajina) and Bosnia/Herzegovina, but the JNA general staff refused, continuously trying to preserve the country's unity by force. At the time the federal rump Presidency probably made another strategic mistake when it failed to admit that it was unable to control the situation in the country and to appeal to the UN Security Council demanding that it undertake mediation in the crisis. Instead, it declared a state of emergency in the country, trying in vain to end the civil war by military force. This, however, favored the secessionist republics' propaganda which claimed that they were victims of aggression by the Serbian-Bolshevik federal army.²¹ In this way the republics managed to mobilize both the local and international communities in support of their cause. Despite pressures by the new nationalist elites, the Yugoslav option at the time was not completely rejected in any Yugoslav republic.

Only the destruction of Vukovar and the ruthless siege of Dubrovnik by the federal army in the fall of the same year unified the Croats around the policy of the ruling Croatian Democratic Union (HDZ) and prompted the international community to recognize secessionist republics.

The EC reacted to the first armed conflicts in Slovenia by sending a ministerial *troika* to convince Yugoslavs to accept the Luxembourg formula (cease-fire and return of troops to barracks, three-month suspension of the Slovenian and Croat declarations of independence, and restoration of the federal presidency). When the conflicting parties agreed to this plan, there was cause for optimism in Brussels, as reflected in Jacques Poos's statement: "This is the hour of Europe." Forty-eight hours later, however, hostilities were renewed, prompting the Community at the ministerial conference at the Hague (July 5) to suspend economic assistance and introduce an embargo on arms deliveries to Yugoslavia. Only during the next mission of the *troika* was the so-called Brioni formula accepted and the war in Slovenia came to an end. Despite the break-up of hostilities in Croatia in August, the Brioni formula remained one of the rare successes of European diplomacy in Yugoslavia. But already the EC mediation in the Yugoslav crisis was facing the problem that eventually led to failure of all previous peace initiatives in Yugoslavia—the sides conflicting were more interested in winning the war than in accepting a political compromise. Military predominance, first of the federal army and then of the armies of Krajina and Bosnian Serbs, was the reason why both Croatia and Bosnia/Herzegovina placed emphasis on the propaganda war, trying to cause Western military intervention in Yugoslavia and rejecting any proposed peace initiative that could permanently preserve the territorial *status quo*. Defeat in the media war left Krajina and Bosnian Serbs only with the military option, which is why they refused peace initiatives that required a change in the situation created at the battlefield.

Becoming early aware of the importance of international support, limits of foreign mediation and the different interests of external actors, the warring parties tried to take advantage of military, diplomatic and propaganda instruments to manipulate the international community and thus influence the views of international mediators.²² Some of the most atrocious episodes in the Yugoslav civil war have been the consequence of the logic of psychological warfare, aimed as much to the direct opponent, as to the international community. Specifically, the violence was aimed at severing historic ties among the Yugoslav peoples in order to prove that living together was impossible (that the idea of a Yugoslav community was finally dead), and that the only alternative to ethnic conflicts was creation of ethnically homogeneous national states.²³ On the other hand, the long duration and complexity of this conflict have made Yugoslavia over time the scene of conflict between different interests and convictions, and hence a catalyst of broader change in post-bipolar Europe. In short, internationalization of a basically local and anachronistic ethnic conflict gave civil war in Yugoslavia two important and contradictory dimensions, local and international, which could be used to explain the failure of the international mediation in armed conflicts in the 1991-94 period: "The very fact that since

the outbreak of the war (June 25, 1991) all propositions to reach a compromise for putting an end to the conflict have originated from the activities of the international mediators, while nothing similar and/or credible has come from warring parties—which preferred inviting foreign intervention, chiefly with the aim of crushing their enemies—may serve as confirmation of the lack of real goodwill on the part of the Yugoslav leaders to start out along an alternative route, and not the road of war.”²⁴

These reasons made the Yugoslav crisis intractable for foreign military mediators, and were among the main reasons for mass violence during the war in Croatia and, particularly, in Bosnia/Herzegovina. Faced with such a situation, the EC countries soon divided over their approach to the Yugoslav crisis and sided with different parties in the conflict, which had grave consequences for the political cohesion of all foreign mediators in Yugoslavia. Although the war started in Slovenia in June 1991, the turning point did not occur until August of the same year under the impact of two events: 1) on 15 August an unsuccessful coup in Moscow announced the end of the Soviet Union, which for a time removed Russian influence in the Balkans and changed the entire international framework of the Yugoslav crisis; and 2) at the time a profound cleavage occurred in the policy of the EC members toward this crisis, above all between Germany and France. For the first time since the World War II united Germany went its own way convinced that it only understood the problem in Yugoslavia. Moreover, on the one side in Yugoslavia, there were Slovenes and Croats, nations with historic, religious, and cultural ties with Germany, while on the other there were Serbs, traditionally considered by German public opinion as troublemakers in the Balkans.²⁵

By early June 1991, German political parties reached a consensus regarding the definition of the war as Serbian aggression, and demanded that the crisis be ended by recognition of secessionist republics and internationalization of the crisis which the international community would regard in accordance with Chapter 7 of the UN Charter. The depth of the French-German cleavage over the war in Yugoslavia was illustrated by the reaction of the French foreign minister Roland Dummas to information that his German colleague Hans Dietrich Genscher would propose to Bundestag to recognize Slovenia and Croatia: “By doing so, you will return French-German relationships twenty years back.”²⁶ That was probably the reason why the EC missed its last chance for military intervention to prevent further tragedy in Yugoslavia. A compromise was found in convoking The Hague Conference on Yugoslavia and setting up the Badinter Arbitration Committee. Both initiatives fell through, however, because of the intransigence of the conflicting parties in Yugoslavia that used the Hague conference as a stage for war propaganda, soliciting international support for their war goals. Assuming the role of arbiter, for which they lacked the mandate of the conflicting parties, the EC and Badinter Commission, by the end of 1991, in a very innovative way interpreted the norms of international law regarding sovereignty, secession, and succession of states,²⁷ which finally alienated Serbs from the mediation efforts of the EC.

The conflict within the Community broke out at the ministerial meeting in Brussels on December 16/17 (a day after the Maastricht conference) when the German foreign minister ultimately demanded recognition, threatening that Germany would otherwise recognize them unilaterally, which would lead to the collapse of the nascent Common European Foreign and Security Policy (CFSP). Attempting to preserve unity within the Community, Roland Dummas proposed principles of recognition, and invited the Yugoslav republics which so wished to submit an application to the EC. In this way the Community missed its last chance to spare the rest of Yugoslavia, in particular Bosnia/Herzegovina, from tragic war. Without waiting until January 15, 1992, the deadline for submission of requests by the Yugoslav republics for recognition, without taking into account the findings of the Badinter commission (according to Badinter only Slovenia and Macedonia fulfilled the required conditions), and disregarding U.S. demands, Germany recognized Slovenia and Croatia on December 23, thus presenting the Community with a *fait accompli*.

The failure of the Hague conference, the escalation of war, and the approaching Maastricht conference led to a shift in EC policy—from the role of mediator to the role of arbiter. The price of the EC failure was first felt at the Lisbon conference on Bosnia/Herzegovina, where the Community no longer had the power to put into operation the solution that, even after a three-year war, proved to be the only realistic solution (at the time Cutillero and later Owen-Stoltenberg and the Contact group plans were based on similar premises). Thus the Community was temporarily pushed to the sidelines of the war in Yugoslavia, while the U.S. assumed the leading role, after a rather inexplicable shift in its policy in spring 1992, when it started to lead international policy on Yugoslavia in a new direction.

The Olive and the Branch: The U.S. and the Yugoslav Crisis

Longstanding U.S. support for the second Yugoslavia as the balancing factor between east and west, and Washington's cautious stand in the first stage of the Yugoslav crisis were reasons why Belgrade remained convinced until early 1992 that the U.S. would oppose the breakup of Yugoslavia. This assessment considerably affected Belgrade's policy, as illustrated by the fact that with the centennial anniversary of Serbian-American diplomatic relations and other moves in early 1992 Slobodan Milošević's regime tried to send a message to Washington that it expected U.S. help in the dénouement of the crisis.²⁸ However, the U.S. policy toward Yugoslavia started to change during the 1980s due to its failure to keep pace with changes in Eastern Europe, leading to open confrontation with Serbian leadership over the policy toward ethnic Albanians in Kosovo,²⁹ but also because of a statement by Serbian leaders that they would not hesitate to resort to force in solving inter-republican disputes.³⁰ According to experts on U.S. policy toward Yugoslavia, by underestimating the depth of the constitutional crisis in Yugoslavia, Washington in the

mid-eighties missed the opportunity to intervene in the inter-republican disputes and by preemptive diplomacy prevent it.³¹

When the constitutional crisis in Yugoslavia escalated in 1991, U.S. policy was motivated by contradictory goals. On the one hand it wanted to encourage democratic and market-oriented reforms by supporting not only reforms initiated by the federal government but also by the national movements in the Yugoslav republics, on the other hand it feared that a predominance of militant nationalism could lead to the disintegration of the country. These dilemmas were obvious in Washington's attitude toward the Yugoslav crisis. While Congress as early as the late 1980s considered that the end of the Cold War eliminated the need for a buffer state like Yugoslavia and that nationalist movements should be supported,³² the administration kept a cautious stance until the beginning of 1992. When the war started in the summer of 1991, the Bush administration thought that intervention would bear great risk and little benefit for the U.S. and therefore it relinquished the initiative to the EC. However, within the administration there developed a reasoning that the Europeans should not merely be allowed to handle the Yugoslav crisis, but they should be pushed to do so. Then Secretary of State James Baker stated that reasoning strongly: "Many, if not most, senior and sub-cabinet-level officials argued, further, that Europe would fail the test, and so would be painfully reminded of its continuing need for a strong American presence. In that light, the test would be a useful one".³³ Nevertheless, by the end of 1991 the U.S. became involved in the Yugoslav crisis through the former Secretary of State Cyrus Vance, whose plan brought a long-awaited truce in Croatia, which is still in force.

However, even though it was apparent that conflicting parties were tired and ready for compromise, the U.S. torpedoed the Lisbon conference on Bosnia/Herzegovina, encouraging the Sarajevo government to reject the Cutillero plan. American diplomacy in Bosnia in spring 1992 caused numerous controversies, particularly after the statement by the former U.S. ambassador to Yugoslavia that he personally encouraged Muslim leader Alija Izetbegović to reject the Cutillero plan.³⁴ Thus U.S. missed its last chance to preserve an ethnic balance in Bosnia/Herzegovina and prevent the later tragedy. Accepting the thesis that recognition was the only way to prevent war, the EC and the U.S. recognized Bosnia/Herzegovina on 6-7 April 1992, despite the fact that the Muslim-dominated government in Sarajevo did not control a large part of the territory, that there was no consensus among the three constituent ethnic communities, that the referendum on independence was contradictory to the Yugoslav Constitution, and against the advice of the Badinter Arbitration Commission.³⁵ Recognition of Bosnia/Herzegovina on 6 April, i.e., on the anniversary of the Nazi attack on Yugoslavia in 1941, added insult to injury. Bosnian Serbs took it as a clear message that they could achieve independence only by force. Due to the fact that the Bosnian Serbs controlled most of JNA forces in Bosnia, and that they had already reached a compromise with the Croats on territorial division in May, they soon outgunned Sarajevo government forces and took almost two-thirds of the territory of this former Yugoslav republic.³⁶

Mass-scale war crimes against civilians and ethnic cleansing, reported by the Western media as committed solely by the Serbian side, have aroused the American public, which strongly pressed the administration and the Congress to do something to stop further civilian suffering. Bosnian-Serb refusal to accept the secession of this republic caused anger and frustration in Washington, which soon took the lead in Western policy toward Yugoslavia, defining the crisis as Serbian aggression against an internationally recognized state (even though secession itself dismantled the country that was one of the founding members of the UN) and used all its weight in the UN and NATO to force Serbs to accept the independence of Bosnia/Herzegovina. "The indictment rested fundamentally not on the violations of the laws that Serbs committed on a lavish scale, but on the decision to use force in the first place. In the U.S. view, the war itself was a crime. Although Serb's violations of *ius in bello* have been seen to confirm and compound their violation of *ius ad bellum*, the presumed existence of the aggression itself has played a decisive role in shaping the policy of the U.S. government."³⁷ Despite the strong moralizing tone of U.S. politics, it is somewhat paradoxical that the U.S. so far was not prepared to do much to stop the war in Bosnia/Herzegovina, least of all to engage its land forces in peacekeeping or peacemaking operations. An obnoxious propaganda war and diplomatic and military pressures on the Serbs sent confusing signals to the government in Sarajevo and the Bosnian-Serb Republic—to the former that NATO military intervention in Bosnia is imminent and to the latter that only by force of arms could they attain their goals, since the West remained deaf to their legitimate security concerns, which were not difficult to meet at the beginning of the war.

Since Bosnian-Serbs refused the Vance-Owen plan in spring 1993, openly challenging American policy, the U.S. administration became for the first time trapped by its own policy toward Bosnia, since the only logical answer to the Serb's decision would be NATO military intervention in Bosnia. When Secretary of State Warren Christopher, in spring 1993, tried to solicit an agreement from his European allies for air strikes against the Serbs, he faced resolute opposition in London and Paris, after which the U.S. temporarily withdrew from the Yugoslav scene. It is worth noting that, like the EC policy, the U.S. policy towards Yugoslavia made a full circle, from initial support to the sovereignty of Yugoslavia, the endorsement, early in 1992, of the secession of the Yugoslav republics, and furthermore when the U.S. undertook the protection of their newly acquired sovereignties.

Balkan Security Issues after Bosnia

The failure of American mediation in Bosnia, the outbreak of war between Muslims and Croats and the approach of 1 November 1993 (the date the Maastricht agreement would come into force) prompted France, Germany, and the UK to assume a more active role. The French and German foreign ministers launched an initiative by which territorial

concessions of Bosnian Serbs in favor of the Muslims would be rewarded by partial lifting of sanctions against Serbia and Montenegro. The Kinkel-Juppe initiative was accepted at the EC ministerial conference of 22 November, with the addition of the demand for an agreement (*modus vivendi*) in UNPA areas in Croatia. According to Lord Owen, co-chairman of the ICFY, the shift from the policy which supported the integrity of Bosnia/Herzegovina to its territorial division was the consequence of the fact that Washington had destroyed his plan for preservation of Bosnia as a multiethnic state. The Owen-Stoltenberg plan reflected a new approach of the Community and proposed territorial division and creation of three national states in Bosnia/Herzegovina. At the same time, Germany tried to create new bonds between the Muslims and the Croats. Both attempts failed since the Muslims believed that the return of the U.S. to the Bosnia-Herzegovina scene would bring them more favorable conditions.

The next stage of the war started early in February 1994 with an explosion in the Sarajevo marketplace. Although it was never established who fired the mine that killed many civilians,³⁸ the West immediately accused the Bosnian-Serbs of responsibility for this massacre. NATO gave an ultimatum to Bosnian Serbs to dislocate their heavy weaponry at a distance of 20 kilometers from Sarajevo under the threat of NATO air strikes. This was setting a precedent in many ways: NATO for the first time formally acted out-of-area sending the first ultimatum in its history. The Sarajevo crisis, which threatened to escalate into war between NATO and the Bosnian Serbs, was unexpectedly resolved by Russian deputy foreign minister Vitaly Churkin. With these moves, the U.S. and Russia took the lead in international mediation in Bosnia. Such casting of roles was confirmed during the Gorazde crisis in April when NATO planes bombed the positions of the Bosnian Serbs and lost its first aircraft in combat. In this way, the international mediation became a kind of Concert of powers, reflecting the new balance of powers in Europe. The newly created Contact Group included diplomats from the U.S., Russia, the United Kingdom, France, and Germany (the last three represented the EU as well as their national interests). Although the Contact group managed for the first time to reach a consensus on the relevant international factors in the solution of the Yugoslav crisis, it also burdened the negotiating process with the relations of its individual members, since all three sides embarked on this assignment starting from their own political interests and security concerns.

The war in Bosnia occasioned the first significant debate over foreign policy of the post-Cold War period. Unlike previously, when in the Congress an interventionist Republican party was pitted against a non-interventionist Democratic party, in the case of Bosnia, the identity of the participants changed. Debate over the American role in the Yugoslav war stirred the emotions of the participants, who felt that U.S. failure to intervene on the Muslim side would be tantamount to a defeat of all values on which the U.S. wanted to base a new system of international relations since the end of bipolarism: "...the United States promised to stay in Europe after the Cold War in order to help keep peace and sustain the democratic revolution; but a war of aggression has been waged and won by a most

undemocratic regime. The United States proclaimed principles of peaceful change for a new era; but those principles have been wantonly disregarded. We said 'never again'; but again the intolerable has happened in Europe."³⁹

In Russia, which is painfully recovering from the breakup of the Soviet Union, the Yugoslav crisis also came into the focus of internal political disputes, becoming the first test of its new international role and one of the places where Moscow should check the expansion of NATO. However, support extended by Russia to Bosnian Serbs has been limited by outbursts of Serbian nationalism and power relations between Russia and the West. According to Russian foreign-policy experts, in their policy toward the Yugoslav crisis the West should answer three questions and Russia only one question. The West, above all the U.S., must answer the following: 1) does it want to continue punishing the intransigence of the Serbs at the cost of continuation of the war or would it will be willing to accept a compromise solution; 2) is it ready to accept Russia as an unavoidable factor in conflict management and; 3) is it willing to commit itself militarily to peacemaking in the former Yugoslavia. Russia, however, must find ways to help the Serbs without sending them wrong signals, i.e., it must avoid stirring up war. According to Alexei Arbatov, the U.S. have found in small Serbia a replacement for the Soviet Union, which justifies the preservation of the NATO at the time when disappearance of WTO and the USSR have made this organization superfluous.⁴⁰

Finally, through participation in the Contact Group, the EU has retained its place in international crisis-management in the Yugoslav crisis, avoiding conflicts among the Twelve (now Fifteen) that seriously jeopardized its political cohesion in 1991 and showed the Europeans' limited ability to handle security problems on the continent without an American and Russian presence. Since the focus of difference in the approach to this crisis has been transferred to the relations between Washington and Moscow, the EU obtained a relatively comfortable position, which allowed its leading members to increase their own role in crisis-management and to have another chance at influencing the course and outcome of the war in the Balkans. The European influence is visible in the strong military presence of France and the UK in UNPROFOR, as well as the EU (German) administration in Mostar, which could end only if the blue helmets withdraw because of the lifting of the arms embargo against the Sarajevo government. The threat of withdrawal of its troops from Bosnia has enabled France and the UK to check the U.S. lift and strike strategy in Bosnia.

In essence, international crisis-management in the former Yugoslavia is polarized between two definitions of the conflict and hence between two possible strategies for its solution.

The first is based on the assessment that Serbia is waging an aggressive war against the other former Yugoslav republics to form a Greater Serbia. The only way to stop that tendency, according to this opinion, is to use NATO armed force against the Serbs which leaves two options: "The first option, and the politico-militarily more consistent one, is to state that the war objectives are 1) destruction of the Serbian state, 2) complete occupation of the respective region, 3) establishment of a military

government, and 4) maintenance of a strong military presence for decades⁴¹ The problem is that such military intervention would imply: 1) between 500,000 and 1,000,000 soldiers immediately engaged to avoid a Westmoreland-type request for more and more soldiers; 2) that nations participating in this effort must be prepared to accept a Northern Ireland-type of engagement once the war is over; 3) that major losses would have to be accepted; 4) that it would be virtually impossible to reach consensus for such an action not only between the West and Russia but also among the Western countries themselves and would risk conflict within NATO as air-raids against Bosnian and Krajina Serbs in 1994 proved; and 5) that military action would probably provoke large-scale war due to the central position of this country in the Balkans (both attempts in this century to punish Serbia, in 1914 and 1941, eventually ended in failure).

The second and much more limited option for military deployment would be a strategy of containment, i.e., to enforce the no-fly resolution by the UN, or to destroy ground targets in Serbia, in order to achieve a more equal balance of power between Serbs and Bosnian Muslims.⁴² The effects on the ground war would, in all likelihood, be limited, given the limitations of air power under the specific conditions of the Balkans as had been argued above: "But the main problem, even with the decision to enforce the no-fly resolution, is that decision inherently includes becoming a party of the war."⁴³ The main obstacle to this option is the presence of peace-keepers in the territory. In the case of UN military action against one side, they would probably become combatants and risk being taken hostages. To avoid this, UNPROFOR would probably have to withdraw early, thus leaving highly-dependent civilians without protection. Even the attempt to replace UNPROFOR by NATO in early 1995 in order to create a more credible military threat caused fierce conflict within NATO and doubt that Germany wanted to enforce its military presence in the Balkans at the expense of the UK and France.

The second strategy starts with the assumption that war in ex-Yugoslavia is a mixture of everything: a war between states, a civil war, a secession war, an ethnic conflict, a conflict between nations, to some extent a religious war, and, certainly, a war which includes much hate. Since military intervention would endanger NATO's cohesion and risk a spill-over of the war to the southern Balkans which could end in war between Greece and Turkey and broader Balkan conflict, and since Slobodan Milošević's regime in Serbia proved resistant to external pressures, it has been proposed that the West, using sticks (threat of military intervention) and carrots (gradual lifting of UN sanctions) encourage Belgrade to continue the isolation of the Bosnian Serbs and start a process of reforms in the country as the only way toward predictable, manageable and, above all, stable security order in the Balkans. In a recently published discussion paper, former British *chargé d'affaires* in Belgrade, Michael Robinson, states: "There are arguments for turning a blind eye to what happens in Serbia in the interest of a Bosnian settlement. But if nothing is done to encourage a stronger and more democratic and pro-European centre, Serbian politics will become increasingly unstable, with demographically significant minorities within

Serbia and Montenegro—particularly ethnic Albanians—to most likely target of such volatility. The present state of flux in the nationalist community offers a window of opportunity for a concerned Western effort beyond Bosnia to persuade not only Milošević but the people of Serbia as a whole that they stand to gain more from working with the international community than against it."⁴⁴

Both strategies revealed that, after three years of war in ex-Yugoslavia, major powers found themselves trapped between strong public pressures to do something about the bloodshed in Bosnia and limited geopolitical interests in the region which is at a safe distance from the main areas of security concerns in Europe and Mediterranean. This dilemma also revealed that the West and Russia, for that matter, are mostly interested in ending the high-level war in Bosnia, but also that they are not ready to commit themselves to providing long-term political strategy and solutions to Balkan security problems after the breakup of Yugoslavia. This reactualized the old assumption that the Balkans are without a self-stabilizing ability and heavily exposed to extra-Balkan influences. Therefore, the main question—What after Bosnia?—remains unanswered as far as international policy toward the Balkans is concerned, opening various options for the conflicting parties. The lack of an answer to this question, however, is leaving conflicting parties with the option of war only, trapped between an inability to win the war and achieve the nationalist aspirations that they proclaimed and acceptance of a compromise solution that would expose them to the pressures of the nationalist genie they released from the bottle and which might eventually destroy them.

Except for Slovenia, which successfully left the Balkans, in other republics the prevails a belief that the end of war would entirely marginalize their current position as clients of the leading European powers, and reduce the likelihood of a kind of Marshall Plan for the Balkans, as the necessary prerequisite for economic and political recovery. Achieving a *modus vivendi* without a lasting solution for the current (Croatia, Bosnia) and potential sources of crisis (Kosovo, Macedonia) would leave these countries on the one side in a political and economic vacuum, in which their regimes would face frustrated nationalist ambitions, mutual revanchism, and numerous security concerns, and on the other without access to European political, economic and security structures. Fear that the end of war might make them the backwater of Europe and mutual threat perceptions still fuel the war logic in the Balkans, in spite of the fact that after three years of conflict the ruling regimes, academic and business circles are quite aware of its long-term devastating consequences for national economies which increasingly assume catastrophic proportions.

In short, the rebalkanization of the Balkans caused by the breakup of Yugoslavia, is returning Balkan geopolitics to the situation before World War I, when small Balkan irredentists tried and managed to embroil the major European powers in their conflicts only to become victims of European power-politics. Therefore, the only comprehensive solution to the problems caused by the violent disintegration of Yugoslavia would be a simultaneous search for a *modus vivendi* in actual and potential crisis spots

and a definition of long-term and credible strategies for reintegration of the region into Europe which would be attractive not only to the ruling regimes but also to whatever remains of the middle class in an effort to re-define national interests toward negotiated compromises and democratic and market-oriented reforms. Otherwise, the only alternative will be a neither-war-nor-peace situation, with long-term destructive consequences for stability in Europe, transatlantic relations, and relations of the West with Russia and the Islamic world.

NOTES

1. I. William Zartman and Saadia Touval, "Mediation, The Role of Third-Party Diplomacy and Informal Peacemaking," in *Resolving Third World Conflict: Challenges for a New Era* (Washington, D.C.: United States Institute for Peace) quoted in Special Features Service 110, USIS, pp. 2-3.

2. Zbigniew Brzezinski, "The Plan for Europe," *Foreign Affairs*, 74 (1) (1995):27.

3. The first Yugoslavia (1918-41) was made up of three nations, Serbs, Croats and Slovenes, while the second (1945-91) was the communist federation of six nations, Serbs, Croats, Slovenes, Muslims, Montenegrins, and Macedonians.

4. During World War II in Yugoslavia more people were killed in the civil war than by occupying forces (only in Yugoslav Auschwitz, the concentration camp Jasenovac in the puppet Independent State of Croatia, about 700,000 Serbs, Jews, Gypsies, and anti-fascist Croats were killed). According to Lord Owen, for Western allies "the crucial issue was how to encourage Yugoslavs to use their energy against Hitler's and Mussolini's forces rather than for mutual killing." "The 1993 Churchill Lecture Delivered by the Rt. Hon. Lord Owen on 25 November 1993" (Guildhall, London 1993), p. 11.

5. "With the end of the Cold War and the reduction of interbloc confrontation in the second half of the eighties, Yugoslavia lost its key role in Western strategic thinking. The country was no longer the element of balance between east and west that no one could renounce. To the extent that reform processes in Moscow's former satellite states attracted attention in the West, interest in Yugoslavia gradually diminished. Yugoslavia was no longer the problem of global importance for the two super-powers, but at best a European issue at the periphery of the continent. The important fact was the pace of reforms in the east. What lasted nine months in Poland took only nine weeks in GDR and only nine days in Czechoslovakia. Yugoslavia lagged enormously behind in this process of democratic transformations." Jens Reuter, "Yugoslavia's Role in Changing Europe," in D. Müller *et al.* (eds.), *Veränderungen in Europa—Vereinigung Deutschlands—Perspektiven der 90er Jahre* (Belgrad: Institut für Internationale Politik und Wirtschaft, 1991), pp. 115-16.

5. On this point, see Christopher Cviic, *Remaking the Balkans* (London: Pinter for RIIA, 1991).

7. Certain Western authors believe that the Reagan administration, with its insistence on democratic and market-oriented reforms that disregarded the frail ethnic balance of the country, inadvertently encouraged its disintegration. In this regard particular attention is drawn to the National Security Decision Directive 133 (*US Policy Toward Yugoslavia*) that was adopted in March, 1984 and partially declassified in 1990. On this point, see Sean Gervasy, *Balkan*

Roulette, How U.S. and Germany Helped Dismantle Yugoslavia (forthcoming); and Robin Allison Remington, "Balkan Triangle, Washington, Moscow and Belgrade," in Sharyll Cross and Marina A. Obrotova (eds.), *The New Chapter in the United States-Russian Relations: Opportunities and Challenges* (Westport and London: Praeger, 1994), pp. 153-67.

8. The nationalist right in both republics advocated escape from the Balkans and approach to the central European group of countries, above all Austria and Germany, with which they have shared a common historic, religious, and cultural heritage and with which they cooperated since 1978 within the *Arbeitsgemeinschaft Alpen-Adria*. However, while for Slovenia the main motive was its assessment that it will be more quickly integrated into Europe if relieved of the burden of ethnic conflicts in Yugoslavia, in Croatia the main pressure came from the revanchist rightist circles and the powerful Croatian emigration.

9. The return to power of the revanchist Croatian right in 1990 raised fears amongst the Serbian population in Croatia and Bosnia/Herzegovina of a repetition of the 1941-45 genocide. Instead of undertaking confidence and security measures which would eliminate these fears, the new Croatian authorities only fueled the fear of the Krajina Serbs with a series of nationalist excesses.

10. Except for the parties of the radical right, Serbia never presented aspirations towards the Yugoslav republic of Macedonia, making its recognition only dependent on solution of the problems between Athens and Skoplje. By contrast, militant Croatian right-wing parties put claims even on the western parts of the Serbian province of Vojvodina.

11. This was confirmed by the decision of the rump federal presidency in August 1991 to withdraw JNA from Slovenia, which *de facto* implied recognition of this republic's secession.

12. Bosnian Muslims are predominantly descendents of Serbs and Croats Islamized during the Ottoman occupation. During the 1960s, Tito's regime gave them the status of the sixth Yugoslav nation, in order to counterbalance competing Serbian and Croatian aspirations towards Bosnia/Herzegovina.

13. However, this assessment was based on the wrong assumption that conflict would break out in Kosovo rather than in ethnically homogeneous Slovenia. On this point, see David Compert, "How to Defeat Serbia?" *Foreign Affairs*, 73 (4):32-33.

14. John Newhouse, "The Diplomatic Round," *The New Yorker* (24 August 1992):61.

15. See *Washington Post* (4 July 1991).

16. By excluding Yugoslavia from its membership, CSCE probably made a mistake that deprived it of influence on events in this country. This was soon confirmed by the Belgrade's decision to deny hospitality to CSCE missions in Kosovo, Sandjak, and Vojvodina. On this point, see Eric Remacle, "CSCE and Conflict Prevention. The Yugoslav Case," paper presented at the Second European Peace Research Conference, Budapest, 12-14 November 1993.

17. At that time the EC did not have its own foreign policy organs, while in the ministries of foreign affairs of the countries that presided over the Community at the beginning of the armed conflict did not have enough experts on the Balkans: "Luxembourg (chairing the Council in the first half of 1991) had none; the Netherlands (second half) gave one person one month to read up on Yugoslavia before the Dutch chairmanship started; Portugal (first half of 1992) appears to have had very little expertise in the matter, whereas Great Britain

(second half of 1992) was the only chair state to have considerable resources to draw on in its ministry of foreign affairs and thus have a good chance of getting a balanced opinion to advise decision-makers." Håkan Wiberg, "Making Peace in Former Yugoslavia: Problems and Prospects," *Eurobalkans*, 17 (Winter 1994/95):22.

18. Quoted in *Review of International Affairs*, 995 (July 1991):19.

19. See Wolfgang Wessels, "Deepening Versus Widening? Debate on the Shape of the EC-Europe in the Nineties," in W. Wessels and C. Engels (eds.), *The European Union in the 1990s - Ever Closer and Larger?* (Bonn: Europa Union Verlag, 1993), pp. 17-56.

20. On this point, see Anton Bebler, "The Yugoslav War of 1991-92," paper presented at the meeting of Bertelsman Foundation Working Group on Central and Eastern Europe, Gütersloh, 1993.

21. "It was democracy vs. Communism and, of course, this definition of the situation tilted the sympathy of a significant part of West-European, and especially German public opinion towards the Croats and Slovenes, pressuring West-European governments towards a change of policy. This, naturally, stimulated the stubbornness of the 'break-away' republics, especially Croatia." Koen Koch, "Conflicting Visions of the State and Society in Present-Day Croatia," in Martin van den Heuvel and Yan G. Siccama (eds.), *The Disintegration of Yugoslavia* (Amsterdam-Atlanta: Rodopi, 1992), p. 197.

22. "For example, when Lord David Owen, chief negotiator to the Balkans for the European Community, gives a press conference or an interview in New York at the United Nations, the Muslims and Serbs respond to it within a matter of hours, and the news media have to deal with that." Jan Vanden Heuvel, "Looking in the World in Motion," in *The Media and Foreign Policy in Post-Cold-War World* (New York: The Freedom Forum Media Studies Center, 1993), p. 34.

23. On this point, see Pavle Jevremović, "An Examination of War Crimes Committed in the Former Yugoslavia," *International Problems* (Beograd), 1 (1994); and Predrag Simić, *The Former Yugoslavia: The Media and Violence*, RFE/RL Research Report, 3 (5) (1994), pp. 40-47.

24. Stefanoi Bianchini, "On the Treshold of 'An Epochal Transformation'," *Balkan Forum* (1994):103-104.

25. On this point, see Hubertus Czernin, "Söhne der lüge," *Profil*, 30 (22 July 1991); Hans Stark, "Dissonances franco-allemandes sur fond de guerre serbo-croate," *Politique Étrangère*, 2 (92); and Heinz-Jürgen Axt, "Hat Genscher Jugoslawien entzweit? Mythen und Fakten zur Außenpolitik des vereinten Deutschlands," *Europa Archiv*, 12 (1993).

26. Quoted in Pierre Laski, "Les Douze arrivent à saturation," *Libération*, 8 Octobre 1991.

27. On this point, see Yehuda Z. Blum, UN Membership of the "New" Yugoslavia. Continuity or Break? *The American Journal of International Law*, 86 (1992):830-33; Milenko Kreća, *The Badinter Arbitration Commission—A Critical Commentary* (Beograd: Jugoslovenski pregled, 1993); and Peter Radan, "Secessionist Self-Determination: The Cases of Slovenia and Croatia," *Australian Journal of International Affairs*, 48 (2) (1994).

28. On this point, see Ranko Petković, *One Century of the American-Yugoslav Relations* (Beograd: Vojnoizdavački zavod, 1992).

29. See Steven J. Voehrel, *Yugoslavia's Kosovo Crisis: Ethnic Conflict Between Albanians and Serbs* (Washington D.C.: CRS, 1989).

30. The turning point occurred in the summer of 1989, after the changes in the Constitution of Serbia which limited the autonomy of Kosovo and Vojvodina and, in particular, after the speech of Slobodan Milošević on the 600th anniversary of the battle of Kosovo, after which the Bush administration took the stand that Milošević's policy was leading towards civil war.

31. In his recently published article, the former U.S. Ambassador to Yugoslavia writes: "By 1989 the world changed dramatically. The Cold War was over and the Soviet Union was breaking up. The East European Countries had already slipped Moscow's leash, and Poland and Hungary had achieved quasi-Western political systems, with Czechoslovakia soon to follow. In such circumstances, Eagleburger and I agreed that in my introductory calls in Belgrade and the republican capitals, I would deliver a new message: Yugoslavia no longer enjoyed the geopolitical importance that the United States had given it during the Cold War. Then, Marshal Josip Tito had made Yugoslavia a model for independence from the Soviet Union as well as for a brand of communism that was more open politically and less centralized economically." Warren Zimmerman, "The Last Ambassador," *Foreign Affairs* (March/April 1995):2.

32. For example, senator Dennis de Conchini at the time stated: "A united Yugoslavia is perhaps less important to our national interests, since there does not seem to be any Soviet threat which might make a buffer state like Yugoslavia necessary," quoted in "Crude Meddling in Yugoslavia's Internal Affairs," *Politika* (25 January 1991).

33. Newhouse, "The Diplomatic Round...", p. 61.

34. *The New York Times* (28 August 28, 1992), p. 8.

35. That Constitution had conferred the right to self-determination but made it dependent on the mutual agreement of the nations composing Yugoslavia. "It was based, that is to say, on the notion of a concurrent majority of the constituent nations, not on simple majoritarianism; to move to secession without the consent of the Serbs was a plain violation of its terms." Robert W. Tucker and David C. Hendrickson, "America and Bosnia," *The National Interest* (Fall 1993):16.

36. According to estimates by Professor Ile Bočnjaković, from Sarajevo, the war took a total of 275,000 lives: 139,000 Muslims (50.5%), 96,000 Serbs (34.9%), 28,000 Croats (10.2%) and 12,000 Yugoslavs (4.4%). Compared with the pre-war population count, 7.5% Muslims, 7% Serbs, 3.7% Croats and 6.3% Yugoslavs were killed. About 1.3 million former residents of Bosnia/Herzegovina became refugees, of which 543,000 (43.4%) were Muslims, 388,000 (31%) Serbs, 222,000 (17.8%) Croats and 97,000 (7.8%) Yugoslavs. While this republic had 4,384,436 inhabitants before war broke out (43.7% Muslims, 31.4% Serbs, 17.3% Croats and 7.6% Yugoslavs), total war losses reduced the population to some 2,880,000 persons, about 2,050,000 in the territory of the Muslim-Croat federation and about 830,000 in the territory of the Bosnian Serb Republic. R. Čuk, "Podaci o žrtvama rata," *Politika* (Beograd) (August 12, 1994), p. 2. UNPROFOR estimates are slightly lower.

37. Tucker and Hendrickson, "America and Bosnia...", p. 16.

38. On this point, see David Binder, "Anatomy of a Massacre," *Foreign Policy*, 97 (Winter 1994-95):70-78.

39. Gompert, "How to Defeat Serbia?" p. 30.

40. Arbatov presented this opinion at the conference "CSCE as a Security Tool in Europe: Which Role for the CSCE?" held in Brussels, June 2-4, 1994.

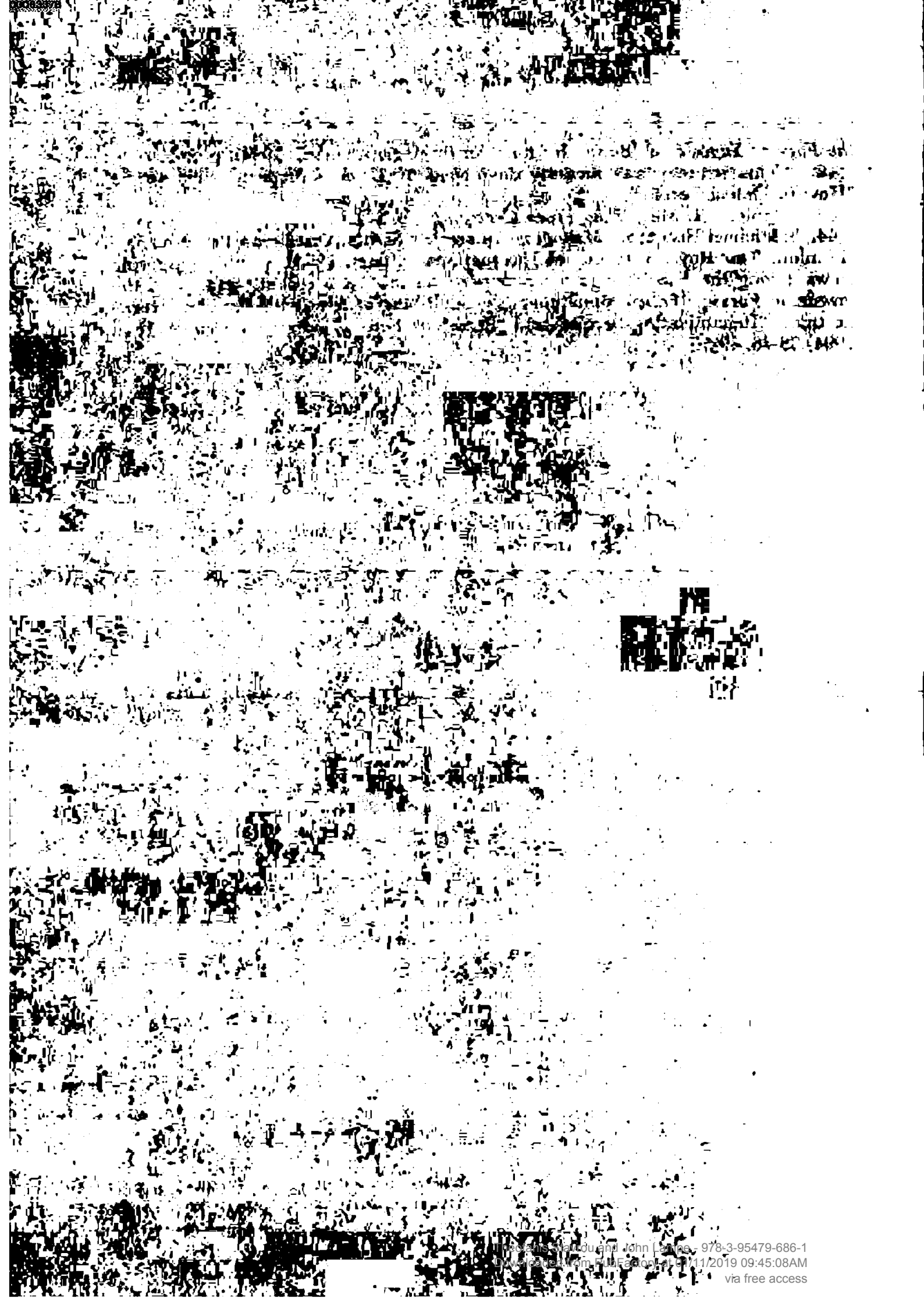
41. Holger H. Mey, *View From Germany: Germany, NATO, and the War in*

the Former Yugoslavia (Bonn: Institute for Strategic Analyses, 1994), p. 241.

42. This strategy was recently developed by David Compert in his article "How to Defeat Serbia?"

43. Holger H. Mey, *View From Germany...*, p. 241.

44. Michael Robinson, *Managing Milosevic's Serbia*, Discussion Paper no.54 (London, The Royal Institute of International Affairs, 1995), p. vii. Opposing views among the U.S. foreign-policy experts on this issue recently expressed the magazine *Foreign Policy* simultaneously publishing articles with the characteristic titles, "Rehabilitating Serbia," and "Punishing Serbia," *Foreign Policy*, 96 (Fall 1994):38-48, 49-56.



Political Disintegration and Possibilities for the Reintegration of Former Yugoslavia

Dušan Reljić

"If Serbs were asked to declare what they prefer—to be fat and living in Croatia or to be emaciated and independent, I am positive that they would choose the latter"—Foreign minister of the self-styled Krajina Milan Babić
"Nationalism is war"—French president Francois Mitterrand speaking to the European parliament

In a few months the fratricidal war in former Yugoslavia will have raged longer than World War II had lasted in this region. The danger of a spillover to the southeast is still imminent. Thus, contemplating modes of reintegration for the region appears to be an exercise in futility. Yet without a new framework, the former Yugoslav area cannot be pacified, and Europe and the world will remain uneasy, to say the least.

Federal Yugoslavia is buried in history and there is no return to it, but the political and economic nexus of the Yugoslav area is a fact that even the most radical ideologies cannot obliterate. Genuine stability can only be established if structures intrinsic to the region are reintegrated.

The population of the Federal Republic of Yugoslavia (Serbia and Montenegro) will have to labor until the year 2012 to recover the level of living standard enjoyed in 1990.¹ In Slovenia, the most developed part of the former Yugoslav Federation, the 1993 Gross National Product amounted to only 82.1% of the 1989 level. In war-torn Croatia, it reached just 46.0% of the 1989 figure.² The disintegration of the Yugoslav federation caused havoc in the economies of its constituent republics. It produced material and financial disruptions to all the new independent states irreparable in the near future.

Among the immense new handicaps are the destruction and human losses caused by the war and the drain of human resources generated by the emigration of hundreds of thousands of the young generation's best and brightest.

In any foreseeable future, the Yugoslav area will remain a high-risk zone marginally attractive to foreign investors. This will, in turn, deprive the economies of new states of desperately needed foreign capital.

Presently, the Yugoslav area breeds primarily poverty and social anomie.³ It is a wasteland excluded from European integration, not only politically and economically, but also in terms of civilization processes⁴.

The final stage for the Yugoslav catastrophe was set in the late 1980s. At the time, economic indicators did not appear to lead to disaster. Quite the contrary, the last federal government under prime minister Ante Marković introduced reforms that jump-started the national economy into something of a boom.⁵ Of all eastern and southeastern states, Yugoslavia came closest to future membership in the European Community. Yet, within a short time the reformist Marković government was sent into oblivion by the leaders of ethnic chauvinist movements in the federal republics. The powers of anti-reformism, provincialism, and national totalitarianism emerged victorious.⁶

Their political programs were not based on pragmatic plans for market-oriented economic changes and civil political reform but on "talismatic pronouncements."⁷ These consisted essentially of promises to save the biological survival of the nation which, in the irrational ideology of the ethnic chauvinism movements' leaders, was jeopardized by demonic designs of other Yugoslav nations.

Two important mechanisms provided for the homogenization of the Yugoslav nations into ethnic chauvinism movements. The first was the invention of histories of eternal antagonism between the nations reaching back into the dark ages.⁸ It thereby became easier to interpret the u-turn from building a modern Yugoslav nation (in the political, not ethnic sense) towards mutual extermination as the inevitable return to a quasi-natural state of relations between Serbs, Croats, Moslems, and others. The second was dehumanization of the adversary nation and turning it, in the perception of the masses, into hordes of satanic creatures.⁹

At the same time national romanticism, much along nineteenth-century German and other western European prototypes, was promoted by the authorities to become the officially approved cultural model.¹⁰ Almost absolute command over mass media was essential for establishing direct rule of power centers in the republics over homogeneous, autistic masses.

Despite the drastic change of the dominant political paradigm in the post-Yugoslav states, power structures stayed much in place, especially in the hard core of power in the Balkans, the security forces. The state apparatus of the Yugoslav republics remained mostly intact during the metamorphosis from Communist to ethnic chauvinist status. The nominally new leaderships¹¹ in the Yugoslav republics, in reality emanating from the Communist party nomenclature, simply phased out their traditional basic legitimization claim that they were the guarantee of social justice, and adopted a new self-styled role as the warrant of national justice.

This somersault into a new political legitimization posture could not appear credible because, after all, there were no young, politically untarnished new leaders around. The collective transformation from permissive communism to authoritarian nationalism within the ranks of leadership in the Yugoslav republics was bound to be ridiculed by public opinion, had a rational political dispute been permitted. But this was not to be and,

therefore, the venom of ethnic chauvinistic hatred was injected into the psychology of the masses to make them politically blind, deaf and mute.¹² At the same time, the grip of a rigid state apparatus on a feeble society with little democratic tradition was excessively increased.

The key factor in the disintegration of the former Yugoslav society and state was the "unwillingness and the inability of the political elite to lead the process of modernization and system transformation—nationalism served as an instrument of the Communist elite to survive and to profit from the new situation."¹³

Regimes based on fear and hatred are not capable of rational behavior.¹⁴ When economic cooperation and regional integration are discussed as ways out of the Balkan political conflicts, it appears unavoidable to conclude that no political preconditions exist for this option.¹⁵ Even if by some miracle the post-Yugoslav states would decide to enhance cooperation with the outside world, it is doubtful that their national economies and political cultures, deformed by war and authoritarian rule, could be mutually compatible or world competitive.¹⁶

The impetus for a solution has to be introduced from the outside. But why should the outside world care, especially after the Yugoslav nations preferred to vote for mutually assured annihilation¹⁷ and for remaining submissive to their respective leaderships after so much destruction and killing? And why should the national leaderships accept foreign mediation if it runs counter to their interests?

Apart from the general moral outrage at the ongoing carnage in former Yugoslavia, there are other, more compelling reasons for outside intervention, especially from the West.

One reason is that providing reintegration mechanisms for a self-sustained recovery in the Yugoslav area is cheaper than spending Western tax-payers' money on peacekeeping forces and humanitarian aid.

Another is that other southeastern European states are negatively affected by the Yugoslav war in their transition towards market economy and political pluralism. Trade, traffic, economic cooperation, and all other forms of communication in the region are severely damaged by the conflict. The shortest land connections between western and central Europe and Greece, Turkey, and the Middle East have been severed by the Yugoslav war.

A third reason has to do with broader security interests. Although the Yugoslav war is still only a regional conflict, European and world stability are also at stake. Albania and Bulgaria could be drawn into the new phase of war if it would spread south. Greece and Turkey appear poised to participate in a Balkan shoot out.

The French-German relationship,¹⁸ the new Russian-American partnership, the future of NATO, even domestic U.S. politics—all have been adversely influenced by the conflict in former Yugoslavia. Russian foreign minister Andrey Kozyrev was not overstating when he repeatedly warned that this conflict contains the potential for triggering World War III.

Furthermore, if one is to indulge in the newly fashionable theories

about "conflicts of civilizations," there is a potential in the Yugoslav war even for such Armageddon-like scenarios.

NATO secretary general Willy Claes recently voiced his belief that Islamic fundamentalism poses a greater threat to the West than Communism ever did¹⁹. There is almost no Western diplomat who does not, in private conversations, point out that for European standards, an intolerable degree of influence by Moslem fundamentalism is already established in Bosnia and Herzegovina.

The fate of Yugoslav Moslems is also an issue in the intra-Islamic competition for prestige and power. Moderate and radical political streams in Turkey clash on the Bosnia issue. Even fundamentalist states like Iran and Saudi Arabia compete for influence in Bosnia and the neighboring Islamic communities.

Two conflicting approaches have emerged regarding how to put an end to the dismemberment of Federal Yugoslavia. One, originally promoted by German diplomacy under former foreign minister Hans-Dietrich Genscher, was to stop the disintegration at the borders of the six constituent republics. The right to self-determination was proclaimed to be equal to the right to create separate national states as long as they pledged to treat national minorities decently. Through Germany's pressure on other European countries to recognize the separatist republics, it has eventually become the general Western approach, adopted finally by the U.S.²⁰ as well. It is also, at least nominally, the platform of the five-power Contact Group for Bosnia and Herzegovina.

Bonn's chief argument for the arm wrestling of its partners to opt for recognition of the breakaway republics was to preclude the "radicalization of the right to self-determination by the Serbs"²¹ and in this manner prevent further conflict and fragmentation in the region.²²

In the meantime, the initial German/Western approach has been abandoned both in the Contact Group plan for Bosnia and Herzegovina and the Z-4 plan for Croatia. Territorial partition of the two former Yugoslav republics affected by war is the essence of the plans, although thinly veiled by rather fantastic proposals, how to organize the future states to keep the pretense of preserving existing intra-Yugoslav borders. The warring sides reject these plans exactly because of their hermaphrodite character. The Serbian side feels cheated out of exacting a price for its military victory, the self-styled Serb states in Bosnia and Krajina, whereas the Croat and Moslem sides refuse to accept the loss of their sovereign states, recognized by the international community.

The other basic approach was rarely elaborated in explicit terms. Professor Svetozar Stojanović, chief adviser to the former president of FRY Dobrica Ćosić, was one of the few important figures to state publicly that "only a radical reorganization of the state structure in the Balkans" could end the conflict. This concept of radical reorganization means nothing less than new borders, including the recognition of Albania's claims to some parts of Kosovo. In the eyes of the Western public, this plan amounts to the creation of Greater Serbia, Greater Croatia, and Greater Albania, and possibly the disappearance of Bosnia, Herzegovina, and FYR Macedonia as

sovereign states.

Bearing in mind the depth of foreign involvement in the Yugoslav conflict after four years of war, reorganizing the Balkans entails a modern remake of the San Stefano and Berlin congresses of 1878. In other words, a deal has to be struck between great powers exerting their influence to uphold the interests of their particular client-states in the region.

The five powers determining now the future of the Yugoslav area have publicly rejected this radical approach, but have privately incorporated decisive elements of it in the two existing peace plans and in their own political maneuvering in the area.

Surprisingly enough, it was Germany, the foreign power that had insisted on preserving the former internal borders of the Yugoslav federation to prevent further conflicts, that initiated the creation of new state entities²³ obliterating the former borders. The U.S., having vowed not to accept the fruits of aggression, took over this German suggestion and gave life and guidance to the Moslem-Croat Federation in Bosnia and Herzegovina and its Confederation with Croatia,²⁴ and this after Croatia did its best to grab as much as possible of Bosnia, after Bosnian Serbs, supported by Belgrade, launched their attack on the Bosnian Moslems.

In practical terms, the U.S. and Germany accepted and promoted the creation of new state entities in the Yugoslav area.²⁵ Furthermore, by signing a military cooperation treaty with Croatia and providing military support to the Moslem government in Sarajevo and the Moslem-Croat Federation of Bosnia and Herzegovina, and by establishing a visible military presence in Albania and Macedonia, the U.S. also marked its new areas of influence in the Balkans. Russia's recent military treaty with the FRY rounded off this new set of dependencies.

Presently, the political stage in former Yugoslavia is dominated by extremist chauvinist leaders. They are involved in subordinate relationships with outside powers. But events have proven that neither the U.S. and Germany on one side nor Russia on the other can exert full remote control over the will of their protégés. Foreign influence still prevents the worst possible outcome, a total war in the Balkans, but outside powers cannot impose a settlement.²⁶ Both foreign protectors and their Yugoslav clients have arrived at an impasse that could easily perpetuate the present Balkan entropy. A new approach appears appropriate.

In dealing with post-Yugoslav states, the outside powers, incomprehensibly, have never addressed the roots of the war, the militant, anti-democratic character of the newly established regimes and their almost total grip on society. Foreign support to civil and democratic political alternatives in the new states is almost non-existent.²⁷ And civil rights and individual human rights seem to be a marginal issue when foreign officials deal with post-Yugoslav leaders.

A strategy to drain the roots of war would reject existing regimes as the sole representatives of the new states and treat them for what they are, authoritarian and anti-democratic aliens in the international community.²⁸ The new strategy would take up proposals developed by civil political groups in post-Yugoslav states and grant them equal importance. Newly

formed dependencies on foreign protectors could help overcome the resistance of the autocratic regimes to foreign intervention in what they consider to be internal affairs.

For example, the Belgrade chapter of the European movement has identified in its charta of Rights and Freedoms²⁹ ways and means for reintegrating the area. For instance, the authors propose that every holder of citizenship of former Yugoslavia would enjoy the same rights in all successor states. Discriminatory laws and practices against new foreigners should be abolished, and constant international control over human rights issues introduced....These and other proposals pursue a roll-back strategy against ethnic chauvinism by demanding supra-national rights and freedoms, modeled on EU legislation.

Civil political parties, groups, institutions and media in post-Yugoslav states, no matter how marginally relevant at this stage, deserve support from the international community. Peaceful change and reintegration in the region depend on the emergence of alternative political options to the present hegemony of authoritarian ethnic chauvinists.

Somewhere in the halls of the Palais Des Nations in Geneva, the London Conference on former Yugoslavia still survives. Through an effort of the participating foreign powers and by drawing on the expertise of civic political parties and personalities in the post-Yugoslav states, this forum could be the birthplace of a reintegration project for the area. Rather than attempting simplistically to slice former Yugoslavia into grotesque new entities, the new plan should provide a general solution.

The starting point must be the rehabilitation of the rights and freedoms of the individual and the limitation of the power and importance of the nation-state.

NOTES

1. Jens Reuter, "Die Wirtschaftskrise in der BR Jugoslawien", *Südosteuropa* 8 (1994).

2. Handelsblatt, Düsseldorf, 20 July 1994.

3. According to an estimate by a World Bank economist, the Balkans and Poland would together need some U.S.\$2.2 billion to bring the poor from far below to just to the poverty line. Branko Milanović, "A Cost of Transition: 50 Million New Poor and Growing Inequality," in *Transition* (The World Bank, October 1994).

4. In 1994 more than 2.1 million citizens of Serbia did not consume the minimum necessary food. Almost 90% of the population was poor or threatened by poverty. Aleksandra Pošarac, "Poverty in Serbia 1990-1994," Institute of Economic Sciences, Belgrade (Vreme, 9 January 1995). Pošarac concludes that if the establishment of civil society has free, independent, self-conscious, and autonomous citizens as a precondition, then at this moment the inhabitants of Serbia do not qualify for this category.

5. More than 50,000 private enterprises were established in 1990. Foreign investment in that year exceeded the sum of all external capital inflow since

1978, when foreign investments were permitted for the first time in post-war Yugoslavia.

6 See Dušan Janjić, "Nationalism, Minorities and the Chances of a New Community," in Predrag Simić (ed.), *Crises and Reform* (Belgrade: 1994), p. 108ff.

7. Glen Bowman, "Xenophobia, Fantasy and the Nation..." *Balkan Forum*, 2 (1994, Skopje).

8. A popular tune in the official ideology both in Serbia and Croatia varies the motif about the alleged role of the respective nation as the *antemurale christianitatis*, i.e., the Serbs have to defend Europe from Islamic danger or the Croats perform an even more difficult task protecting Western civilization from both the Orthodox and Islamic vandals.

9. Thus in the official propaganda, the names Serbs, Croats or Moslems were replaced by terror-causing codes *Četniks*, *Ustašas* and *Mujahedins*. *Četniks*, and *Ustašas* were members of, respectively, Serb and Croat military formations in World War II that indulged in extermination of the other nation. The usage of *Mujahedin* for Moslems is a new invention obviously influenced by Islamic extremist activities in the Middle East.

10. "The unavoidable sister of brutality is sentimentality, of course in its most turgid form," German-Jewish author Ralph Giordano in *Die zweite Schuld*, (München: 1990), p. 53.

11. With the single exception of Bosnia-Herzegovina, where the transformation from the one-party to the one-nation state progressed under far more complex circumstances.

12. Obviously, Fascist and Nazi totalitarian movements served as models.

13. Janjić, p. 111.

14. A tragicomic example is the constant campaigns against dissident media. In spite of the fact for instance that *Naša Borba* in Serbia or *Feral Tribune* in Croatia certainly have no power to overturn the government, such media are constantly satanized and presented as hate objects. Diversity and dissent are natural enemies to ethnic chauvinist regimes that have an inherent tendency towards totalitarian control over society.

15. See Jelica Minić, "Economic Co-operation and Regional Integration—The Way out of Political Conflicts," *Balkan Forum* 4 (1994, Skopje).

16. According to the State Institute for Macroeconomic Analysis in Zagreb, the shadow economy participated with 34% in the Croatian 1993 GNP (Vjesnik, Zagreb, 23 August 1994); the Federal Statistical Institute in Belgrade estimated that this proportion was 54.4% in the FRY (Vreme novca, June 1994). This income is not taxed by the state, but to a large part by organized crime through extortion and racketeering.

17. "Ethnic cleansing was already set out as a political agenda in the 1990 republican elections in so far as what the victorious political programme sketched out in theory would subsequently be given body on the ground...", notes Bowman, "Xenophobia, Fantasy and the Nation...", p. 139.

18. Long before the conflict started, German chancellor Helmut Kohl, whenever speaking of Yugoslavia, would inevitably state that the "static of Europe rests on the stability of Yugoslavia." Having this in mind, it is still difficult to

comprehend why Bonn opted for accelerating the Yugoslav disintegration by taking sides.

19. Later he claimed to have been wrongly understood.

20. For details, see Jonathan Eyal, *Europe and Yugoslavia: Lessons from a Failure*, (London: 1993); Michael Thumann, "Between Ambition and Paralysis: Germany's Balkan Policy 1991-1994," *Eurobalkans*, 16 (1994, Athens); Daniel Vernet and Jean-Marc Gonin, *Le reve sacrifie* (Paris: 1994)

21. "The Question of the Recognition of Yugoslav Successor States," a paper by the German Foreign Ministry (Bonn, 10 March 1993).

22. The basic flaw of this approach consisted in endorsing the cause of one set of chauvinist leaders and proclaiming their claim to the right to self-determination of their nation in the form of creating new national states to be justified. The refusal of other ethnic chauvinist leaders to acquiesce to the status of minorities for their nation in hostile new states was rejected and declared illegal. Such manifest one-sidedness could only contribute to the outbreak of war: Croatian, Slovenian, and Moslem leaders understood that their separatist campaign would be tolerated and supported by the most important western European nation. The Serbian leadership could further infuriate its followers with the argument that the Fourth Reich is promoting its old fascist allies in the Balkans and, for the third time in this century, attempting to eradicate Serbia.

23. Franjo Tuđman and Alija Izetbegović were invited to Bonn to discuss the creation of a Confederation in early 1994.

24. Before the war Croatian president Tuđman never omitted to point out to the natural geostrategic connection between his country and Bosnia and Herzegovina.

25. Rumors about an American proposal for the creation of a confederation between Macedonia and Albania caused much uproar in Skopje in the first days of March. No matter how unsubstantiated, this speculation exposed the fears of an uncertain future that now rests much in the hands of foreign powers.

26. They could, with the massive use of ground force, an unimaginable option.

27. The private Soros foundation has done more for democratic institutions in the Balkans than any foreign state. Therefore it is a favorite object of hate, especially in the Belgrade and Zagreb regime media.

28. Although victorious in formally democratic elections, the governments in Belgrade and Zagreb lack genuine democratic legitimacy. They are twin-like in their disregard of the parliament and constant manipulation of the legislature, their disrespect of law, their terror over society through secret services controlled only by the national leaders, their Goebbels-style propaganda in the state-controlled media, their constant harassment of the few independent media and other visible characteristics of anti-democratic political behavior.

29. See Konstantin Obradović, "European Movement in Serbia—the Charta of Rights and Freedoms," in Simić (ed.), *Crises and Reform*.

Greece in a Post-Cold War Environment

Theodore A. Couloubis

Following Mikhail Gorbachev's *perestroika* policies, we have witnessed the momentous events that led to the reunification of Germany, the desegregation of the former Soviet Union, the dissolution of the Warsaw Pact and the Comecon, and the general collapse of the system of applied Marxism-Leninism on the European continent.

Despite the historic peace breakthroughs on the Israeli-Palestinian, South African, Northern Ireland and even the Bosnian questions, George Bush's optimistic vision of an emerging new world order of like-minded states was soon challenged by a long chain of crises, especially in Africa, the Balkans, and in some of the former Soviet republics on the Black Sea and Caucasus regions. This, in turn, gave rise to a number of pessimistic assessments raising nightmarish images of a "new world disorder," a "return to history," "from Sarajevo to Sarajevo," and so forth.

Foreign policy analysts in Greece and elsewhere were quickly divided into schools of optimism and pessimism. The optimists highlighted global order, consensus among the powerful permanent members of the UN Security Council, and collective international action undertaken against violators in places such as Iraq, former Yugoslavia, Somalia, and Haiti as well as limited humanitarian assistance and action in Rwanda, Burundi, Bosnia and elsewhere.

In contrast, the pessimists viewed the world as moving back into a state of multipolar anarchy in which the strong do what they can and the weak suffer what they must. The optimists counseled the employment of political/diplomatic and economic leverage and placed special emphasis on Greece's institutional connections with multilateral mechanisms such as the EU, NATO, and the WEU. The pessimists, on the contrary, emphasized the military dimension and recommended policies of temporary regional alliances and the taking of bold and decisive steps including the preemptive use of force in favorable but fleeting conditions.

The optimists could be labeled as multilateralists and internationalists who are guided by the philosophy of Jean Monnet. The pessimists, in turn, could be labeled as unilateralists and nationalists who are still inspired by the teachings of the Prussian general and theoretician Karl von Clausewitz (1780-1831).

As the post-Cold War international realities unfold, it appears that

the truth lies somewhere between the optimistic and the pessimistic projections. A new global bipolarity seems to be emerging, dividing the world into a trilateral (North America, Europe, and Japan), advanced and stable north and a transitional, developing, and unstable south, which now includes portions of the former Soviet Union and the post-communist Balkans.

Future political relations will focus mainly on a north-south axis, but the global concert of powers will not automatically energize itself in every instance where there are threats to peace and/or violations of international law and norms. The stable north will more than likely continue to react to escalating conflicts in the unstable south according to criteria of interest, cost, and capability.

There will be zones of vital interest, such as the Gulf, where the likelihood of collective and decisive military responses against aggressors will be quite high.

There will also be zones of moderate interest, e.g., Bosnia, where peacekeeping, peacemaking, and peacebuilding will be the order of the day.

Finally, in a classic triage fashion, there will be zones of indifference and benign neglect, such as the Sudan, Sri Lanka, Afghanistan, or Rwanda in which the international community will stand by helplessly and watch the bloody struggles for the survival of the fittest and the most ferocious.

This article will address two questions that are related to Greece's, and to a certain extent to Cyprus', foreign policy profile in the post-Cold War era. The first question relates to an assessment of the comparative stability/conflict quotient in the Balkans as old and newly born post-communist states navigate in the treacherous waters of transition to democracy and to market economy. The second question addresses Greek foreign policy *vis-à-vis* Turkey and assesses the cost/benefit ratios of mapping out a realistic strategy (and tactics) of tension reduction and conflict resolution which could, hopefully, lead to a historic reconciliation modeled on the Venizelos-Ataturk rapprochement of the early 1930s.

Only a short decade ago it was fashionable for scholar practitioners such as Henry Kissinger and Jeanne Kirkpatrick to differentiate clearly between authoritarian regimes (e.g., Latin American and southern European varieties of military dictatorships) and totalitarian regimes (e.g., Communist systems such as those of the Soviet Union, Eastern Europe, Asia, and the Caribbean). They viewed the former as less objectionable than the latter, despite their equally atrocious human rights records, because authoritarian regimes were considered reversible (in that under certain conditions they could evolve to democracy) while totalitarian regimes were pronounced permanent and irreversible. The post-*perestroika* collapse of European communist regimes exploded in the face of the Kirkpatrick/Kissinger thesis but has not necessarily destroyed its logic.

A number of political scientists have been recently asking themselves whether the processes of transition and consolidation of democratic institutions experienced by Southern European countries such as Portugal,

Spain, Italy (after World War II), Greece, and Turkey could be considered as useful models for partial emulation by post-communist societies.

Before proceeding to respond to this question, we should define for working purposes the concepts of transition and consolidation. Transition to democracy is normally a short-lived span of time involving the constitutional specification and the establishment of institutions which are designed to safeguard the separation of powers, the development and functioning of two or more political parties, the holding of frequent elections (at least every four/five years), the functioning of representative parliamentary bodies, the protection of human rights and freedoms, and the development and operation of a genuine and pluralist press and other mass media.

The concept of consolidation of democracy is of special relevance to post-communist countries that are currently undergoing the difficult task of transition to democracy as well as to market economy. Democratic institutions may be considered to have been consolidated when at least three important preconditions are satisfied: 1) the development of consensus among the political parties and groupings in a given country concerning the structure and the characteristics of democracy (e.g., presidential republic, parliamentary republic or constitutional monarchy); 2) the successful rotation of power between parties and/or coalitions of the right and the left without military intervention and/or civil conflict; and 3) the maintenance of an overall inter-party agreement regarding the external orientation (strategy) of a country. In the case of Greece, for example, the choice made in the late 1970s and subsequently accepted by the whole spectrum of its political forces was that the country ought to seek membership in the European Community and maintain membership in NATO over the alternative option (vocally promoted in the 1970s by the Socialist and Communist parties) that Greece would have been better off as a non-aligned/neutral state.

Based on the discussion so far, we can propose two working hypotheses regarding the path toward democracy of post-communist countries in southeastern Europe (excluding from consideration three constituent states of former Yugoslavia, i.e., Croatia, Serbia, and Bosnia).

First, five post-communist countries, Albania, Bulgaria, the Former Yugoslav Republic of Macedonia (FYROM), Romania, and Slovenia are well into the stage of their transition phase, but we cannot, unfortunately, speak at this time about consolidated democratic institutions in any of the five. In the case of Bulgaria, however, the rotation power between right and left has moved the country one notch closer to consolidation.

Second, the transition and consolidation processes in metacommunist countries, unlike the case of transition/consolidation of southern European states, face the special and nearly insurmountable problem of drastic and simultaneous changes taking place not only in the political system but also in the economic system. Perhaps resurrecting some old Marxist dialectics, we can appreciate how difficulties of economic transition can spill over and complicate political developments. In sum, the creation of a civil society which is the *sine qua non* of every consolidated,

pluralist democracy presupposes the substantive functioning of a free market mechanism not only on the level of trade and consumption but also on the level of production which, in turn, calls for an effective privatization campaign, a most difficult task indeed.

The major threat facing post-communist regimes in southeastern Europe and elsewhere stems from extreme nationalism (chauvinism) and its Siamese twin, populism. The ideological vacuum that was created in the wake of the collapse of communism in Europe has been filled in the past four years by new or recycled politicians that have resorted to romantic, atavistic and attention-catching strategies. In their attempts to mobilize the disoriented masses, they have employed simplistic and divisive slogans. By waving the flags of ethnic separatism and irredentism these new elites are returning to anachronistic visions regarding a "greater" Albania, Bulgaria, Croatia, Romania, Serbia, "Macedonia" and so forth.

By employing Manichean tactics subdividing peoples and governments into angels and devils, these new politicians feed the fires and passions of political polarization. Polarization, in turn, blows up the bridges of consensus on fundamental questions of regime-type and external orientation, leading finally to internal conflicts (coups, revolutions, and civil wars) and intervention by foreign antagonistic (regional or global) centers of power. The first victim of uncontrolled polarization is democracy itself. The war in former Yugoslavia, especially the tragic butchery in Bosnia, is a recent example of the fate of a people without long democratic traditions undergoing acute economic crisis and being at the mercy of imprudent and populist politicians.

It behooves post-communist political leaderships in the Balkans to avoid the fate of Bosnia and, worse still, the potential of a wider war that might begin in places such as Kosovo, Vojvodina or elsewhere and escalate to involve countries such as Albania, Serbia, Croatia, Hungary, FYROM, Greece, Bulgaria, and Turkey.

It is the duty of the European Union and NATO (whose member states enjoy consolidated democratic institutions) to act quickly and effectively in order to safeguard the peace agreements in Bosnia, ending all speculation about falling dominoes leading to another great European war. Our watchword should be: "No more Bosnias." The West's duty is, further, to safeguard democracy wherever social and economic conditions permit its growth and sustainability. This obligation is rendered imperative by what we might call the democratic paradox. It has been argued, for instance, by social scientists such as Rudolph Rummel, that the incidence of war was the lowest among democracies and virtually non-existent between what Rummel calls libertarian states (i.e., free-enterprise-oriented constitutional democracies). The paradox today is that we have been witnessing the rise of internal and international conflict taking place simultaneously with the transition to democracy in regions of former Yugoslavia and the former Soviet Union. Had this phenomenon, correlating democracy and conflict, been permitted to continue for long, the very reputation and legitimacy of democratic institutions would have been seriously tarnished.

The solid foundations upon which a strong edifice of southeast European peace and cooperation can be erected include respect for the inviolability of international boundaries, the consolidation of democratic institutions, comprehensive and demonstrated protection of the human rights of all citizens in each state (without discrimination against minorities on the basis of language, religion, or other preferences) and a free-market economy (together with the mutually advantageous networks of interdependence the free market entails).

Peace and transnational cooperation will be cemented further as programs of economic aid, technical assistance, free trade and investment become linked with the peaceful and democratic behavior of recipients. The EU's and NATO's strategy of preventive diplomacy should, therefore, emphasize rewards (not only sanctions) which will contribute to the development and consolidation of an arc of peace and cooperation in the Balkans and elsewhere in the former Warsaw Pact regions. Such a strategy will isolate disorienting conceptions/slogans that allude to the development of an Islamic arc and an Orthodox arc in the Balkan region. For alliances, based on religious affinity and other exclusivist premises, would surely lead to the revival of bloody ethnic/religious conflicts and the self-marginalization of those involved. The task for consolidated democracies in the post-Cold War era is to pronounce a new doctrine of containment where the target to be contained in the place of communism will be chauvinism and its ethnic-cleansing variants.

The nations and the peoples of southeastern Europe in the post-Cold War period must resist the siren-songs of a bygone era. They must avoid nationalist and irredentist claims at the expense of their neighbors, and must shy away from policies of subregional alliances, spheres of influence, revanchist campaigns, preemptive strikes, disproportionate reprisals, all of which are remnants of a glorious but also self-destructive (albeit self-defining) past.

We should not forget that it took two world wars, and tens of millions of dead, for conditions to ripen and permit traditional European rivals (e.g., the French and the Germans) to move forward with the remarkable experiment of European integration that has gradually given birth to the European Union. In the post-Cold War Balkans we have already suffered the tragedy of carnage and destruction in Bosnia. In addition to offering our hopes and prayers, we should try to support leaders who are cautious and prudent so that the Cassandran prophesy about the Balkans becoming once again the powder keg of Europe will not become self-fulfilling.

In the twenty-two years that have elapsed since the Greek Colonels' coup and the Turkish invasion of Cyprus, the Greek and Cypriot governments have managed to keep the issue wide open by employing strictly economic and political leverage on Turkey and the Turkish-Cypriots while avoiding recourse to the threat and employment of military means.

Turkey, given its apparent military superiority in the Cyprus region, has insisted on perpetuating the post-1974 partition, being the only

country to have recognized the self-proclaimed Turkish Republic of Northern Cyprus (which unilaterally declared its independence in the Fall of 1983). Since then the Turkish-Cypriot population has been prevented from reintegrating itself into the mainstream of a single and prosperous Cypriot economy.

Third parties (e.g., the U.S., Great Britain, Germany and Russia), gauging, at times overestimating, the strategic and commercial importance of Turkey, have adopted a stance of benign neutrality on the Cyprus question, urging both sides to move quickly and decisively toward a mutually acceptable settlement of their prickly dispute.

In the view of this author, the negotiating position of Greece and Cyprus *vis-à-vis* Turkey has been enhanced since 1990 for (at least) the following three reasons:

1) the end of the Cold War and the gradual decline of Turkey's strategic importance in the security calculus of the U.S., EU, and NATO,

2) The convergence, in terms of domestic and foreign policy orientations, in the positions of Greece's political parties (center-left and center-right) following the healing of the wounds left by the Greek civil war (1946-49) and the reintegration of Greece's left (Communist and Socialist) into the political process after the restoration of democracy in 1974,

3) The new European option of Cyprus and its policy seeking accession to the EU (It should be remembered that in 1960-90, Cyprus had openly identified its UN-focused foreign policy with the non-aligned movement).

Today Greece and the Republic of Cyprus are proposing a framework for the settlement of the Cyprus question which does not in any way challenge the interests and objectives of Great Britain and the U.S. in the eastern Mediterranean given that the ultimate settlement package includes Cypriot membership in the EU and an increased role for NATO (Cyprus accession to NATO being the maximum objective and a NATO post-settlement implementation force being the minimum).

Free of cold war servitude (which among other things included a fundamental divergence of orientations, i.e., membership in NATO for Greece and non-alignment for Cyprus) the two governments can easily follow a well orchestrated and diplomatically energetic foreign policy that will be founded on two pillars. The first pillar, strictly defensive, is designed to maintain a state of sufficiency in the balance of Greek-Turkish forces in the Aegean, Thrace, and Cyprus. It involves a defensive and deterrent mission for the Greek and Cypriot armed forces designed to safeguard Greece's territorial integrity in the Aegean and Thrace, and in the case of Cyprus to prevent any further extension of the Turkish armed forces beyond the so-called green line (i.e., the line separating the occupied territories in the north from the rest of Cyprus). In sum, the first pillar involves a defense policy of two countries that want to avoid a war without losing the peace.

The second pillar covers the political/economic/diplomatic range of activity and it calls for flexibility, imagination, and energy combining the use of politico-economic instruments of leverage on Turkey and the

Turkish-Cypriot community in Cyprus with a comprehensive and long-term set of proposals designed to reach a mutually acceptable settlement in Cyprus and in the Aegean. Abandoning the single-issue, reactive policies of the past, Greece and Cyprus could now take the initiative by identifying viable and mutually reassuring avenues of conflict resolution in a multi-lateral framework provided by the EU and NATO.

Since 1974 and the tragic events in Cyprus that triggered the collapse of the Greek military dictatorship, Greek foreign policy, in deeds if not always words, has been a synthesis of power and prudence. Despite occasional bursts of emotional and populist rhetoric, especially in pre-election periods, the Greek governments (whether New Democracy or Pasok) have adopted a cautious and pragmatic set of external policies.

The fundamental premises of what has been a consensual approach to external challenges and opportunities can be summarized as follows:

1) Greece post-1974 is perceived as facing a major revisionist challenge from neighboring Turkey. This challenge calls for the maintenance of an adequate balance of military power sufficient to deter any thought of employment of military force as an instrument of Turkish policy *vis-à-vis* Greece.

2) Greece is classified in the category of politically and economically developed states which have forged, since World War II, linkages of political and economic interdependence in accordance with the general principles of democracy and the market economy. Accession to the European Community (Union) in 1981 is the center of gravity of a Greek strategy of integration within a region that has abandoned since 1945 the *modus operandi* of formulating national interests in terms of territorial expansion, irredentism, spheres of exclusive influence, unbridled ethnocentrism, economic protectionism, mercantilism, and colonialism.

3) Greece's integration into a zone of global stability (EU, WEU, and NATO) reinforces its already consolidated democratic institutions and contributes to protracted deterrence and the resultant safeguarding of the country's territorial integrity. Naturally, well-trained and well-equipped armed forces remain at the inner core of Greece's deterrence mechanisms.

4) In the case of the Balkans, and given the widely shared perception of a Turkish threat, Greece has spearheaded policies of multilateral and multifunctional cooperation, even during the confining period of Cold War bipolarity. These initiatives were an end in themselves, but they were also designed to improve Greece's bargaining power *vis-à-vis* Turkey by avoiding the creation of a multi-front diplomatic (and potentially military) confrontation. Unfortunately, Greek policies with respect to FYROM in the 1992-95 period almost managed to derail the country from its prudent course. However, the renormalization of relations with Albania (early in 1995), the growing chances of a lasting settlement of Greece-FYROM difficulties with the mutual acceptance of a hyphenated name for FYROM such as "New Macedonia," and the continuation of excellent political and commercial contacts with Bulgaria and Romania are restoring Greece to its former course as an active peacemaker in the Balkans.

5) Greece, as a consolidated democracy with an advanced economy, has every reason to remain a *status quo* power and to avoid atavistic temptations (nationalist and territorial revisionism) that have so brutally affected regions of former Yugoslavia and particularly Bosnia.

Greece can, together with its partners in the European Union and NATO, contribute to the reconstruction of war-torn former Yugoslavia by participating in peacebuilding projects, offering humanitarian assistance to refugees, promoting principles and practices of inviolability of frontiers coupled with the protection of human rights of minorities, and emphasizing the comparative advantage of economic interdependence.

A successful strategy of peace and mutually advantageous cooperation in the Balkans is likely to spill over into the troubled Greek-Turkish relationship once elites in both countries realize that a war would be catastrophic for both and that the perception of high tension in diplomatic relations ultimately hurts the multilateral nexus of relationships that each of them is involved in.

Greece and Turkey have been involved in the past twenty-two years in a costly and protracted diplomatic/economic cold war reaching at times very close to the brink of outright warfare.

With the peace process in full swing in critical areas such as the Middle East, Northern Ireland, South Africa, and former Yugoslavia, it is now time to address the complicated issues separating Greece and Turkey with the aim of devising tactics and strategies toward tension reduction and reconciliation.

If we were to move forward with this line of reasoning we should accept two major premises. The first premise is that a Greek-Turkish war is unthinkable and unwinnable because, to begin with, it would isolate both belligerents from their Western institutional affiliations. Even if, after the first battles, one of the two countries were to secure marginal territorial gains at the expense of the other, a chain of revanchist conflicts will surely follow classifying both as high risk zones with a devastating impact on their economies and societies.

The second premise is that perpetuating the current cold war atmosphere does not serve the interests of either Greece or Turkey. Among other costs both countries are being obliged to maintain disproportionately high military expenditures (on the average over 5% of their GNPs) at the expense of vital economic stabilization and development programs.

A climate of reconciliation, cooperation, and friendship cannot be restored as long as the Cyprus question remains unresolved. A genuine settlement of the Cyprus problem would exclude *enosis* (union of Cyprus with Greece) and *taksim* (partition of Cyprus into Greek and Turkish segments). A historic compromise, therefore, calls for independence of a federal, bizonal, and bicomunal state along the lines of the Makarios-Denktash (1977) and Kyprianou-Denktash (1979) agreements.

The federal state of Cyprus that will emerge after settlement will be given an excellent chance to survive and prosper if at the time of its genesis it were to become simultaneously a member of the European

Union and NATO. EU membership together with genuine collective guarantees, demilitarization (except for the British base areas), and a NATO-commanded multinational police force (until mutual confidence is securely established), will allow the troubled Cypriots to forge a long-lived unity based on all rights, duties, and freedoms that democracy provides.

Shifting to the Aegean area, we can project a rapid process of reconciliation following a Cyprus settlement. For this to happen, both sides have to abandon maximalist aspirations and accept what is mutually acceptable rather than what is individually desirable.

A much needed historic compromise between Greece and Turkey in the Aegean must rest on two general and two operational principles of foreign policy. The first general principle involves the mutual denunciation of the use of force by Greece and Turkey. The second general principle provides that the Greek-Turkish differences in the Aegean will follow the road of peaceful settlement involving time-tested methods such as bilateral negotiations and, in case of deadlocks, conciliation, good offices, mediation, arbitration, and adjudication. The two operational principles apply to Turkey and Greece respectively. For the benefit of Turkey, it must be understood that the Aegean will not be transformed into a "Greek lake." For the benefit of Greece, it must be also understood that the Aegean will not be partitioned or subdivided in a fashion that leaves enclaves of Greek territories (the eastern Aegean and the Dodecanese islands) as a Turkish zone of functional responsibility. Following a potential grand settlement, both Greece and Turkey would increase significantly their trade, tourism, investment, and joint ventures at home and abroad. Greece would also, and gladly, abandon its policy of linkage of Turkey's accession strategy to the European Union and would, in fact, seek to facilitate Turkish entry. Simply, a European Turkey will be for Greece a much easier neighbor to live with than an alienated and militaristic Turkey.

[The main body of the page contains several paragraphs of text that are almost entirely illegible due to extreme noise and heavy black speckling. The text appears to be organized into multiple paragraphs, but the individual words and sentences cannot be discerned.]

Cyprus: The Long March to Europe

Nicholas Emiliou

Introduction

The development of relations between Cyprus and the European Community¹ has, on occasion, been riddled with political difficulties. The unresolved political problem of Cyprus has dictated to a great extent the attitude and policy objectives of both the government of the Republic of Cyprus and the Community within the framework of their relations. Economic considerations have, at least since 1974, played a secondary role.

On the political level, two distinct trends can be identified with regard to the development of EC-Cyprus relations.² On the one hand, there is the effort on the part of Cyprus to encourage a more active involvement of the Community in efforts for a solution to the Cyprus problem; on the other hand, there is the reluctance of the Community to get involved in this problem. This reluctance can be attributed partly to the limitations of Community mechanisms in the sphere of foreign policy and partly to the conflicting interests of its member states. However, the establishment of the common foreign and security policy by the Treaty on European Union could gradually change the situation and encourage a more active involvement of the Community in efforts towards a solution of the Cyprus problem.

The Early Stages

Cyprus has pursued close relations with Europe since its independence in 1960. In 1961 it became a member of the Council of Europe. As early as 1962, the government of the Republic of Cyprus explored the possibility of establishing formal links with the European Community.

The decision to pursue closer relations with the Community in 1962 was connected with the first British application to join the Community, which was submitted at that time. Cyprus's economy was heavily dependent on British Commonwealth preferential trade tariffs. The prospect of dismantling Commonwealth trade preferences as a result of Britain's accession to the EC prompted the Cyprus government to seek an institutionalized trade arrangement with the Community. The British

application was effectively blocked by General De Gaulle and as a result Cyprus's interest in the Community faded, only to be revived a few years later when once again Britain applied to join the EC in August 1970.

The reasons behind Cyprus's revived interest in the Community were once again mainly economic. Britain was Cyprus's single most important export market. It was therefore necessary to find new export outlets for Cypriot agricultural and manufactured products.³ Moreover, around the same time, the Community launched its preferential trade policy towards other Mediterranean countries. These preferential trade agreements, especially with Spain and Israel, would adversely affect the competitiveness of Cypriot agricultural products exported to EC countries.⁴ In the face of new realities, it was in the best interests of Cyprus to pursue a special trade relationship with the Community.

In addition to economic reasons, there were also good political reasons for an opening on behalf of Cyprus towards the Community. In late 1963 violence broke out between the two communities in Cyprus, resulting in loss of life and property on both sides. The administration had ceased to function effectively on a bi-communal basis. "The Turkish-Cypriots had carried their separatism...to the furthest extent."⁵

The government of the Republic of Cyprus, under the pressure of Turkish threats of an imminent invasion of the island, took the matter to the United Nations. The Security Council, on 4 March 1964, recommended the creation of a peacekeeping force in Cyprus to help prevent a recurrence of fighting and to contribute to the restoration of law and order and a return to normal conditions. A mediator was also appointed to help promote a peaceful solution. The secretary-general of the United Nations, in his report to the Security Council, described the Turkish policy in this way:

The Turkish-Cypriot leaders have adhered to a rigid stand against any measures which might involve having members of the two communities live and work together, or which might place the Turkish-Cypriots in situations where they would have to acknowledge the authority of Government agents. Indeed, since the Turkish-Cypriot leadership is committed to physical and geographical separation of the [two] communities as a political goal, it is not likely to encourage activities by Turkish-Cypriots which may be interpreted as demonstrating the merits of an alternative policy. The result has been a seemingly deliberate policy of self-segregation by the Turkish-Cypriots.⁶

Despite this policy of segregation, only 25,000 Turkish-Cypriots, under pressure from their leadership, moved into the Turkish quarters of towns or to large Turkish villages. The Turkish-Cypriot enclaves were scattered all over the island and covered only 5% of the territory of the republic. The government of Cyprus remained in control of the state. The Turkish and Turkish-Cypriot side have ever since denied the legitimacy of the government of Cyprus and refused any form of cooperation with it.

Following these events, the government of Cyprus engaged in an

intensive political and diplomatic campaign aiming at safeguarding the independence of the Republic of Cyprus and the legitimacy of its government. Thus, the effort of the Cyprus government to reach an association agreement with the Community also aimed at strengthening its international standing.

Negotiations between Cyprus and the Community began in early 1972 following the mandate adopted by the Council of Ministers on 30 December 1971.⁷ The association agreement was signed on 19 December 1972 and came into effect on 1 July 1973.⁸ The agreement was based on Article 238 of the EC Treaty. Agreements under this provision are usually not limited to trade but extend to other sectors of the economy as well. The EC-Cyprus Association Agreement provided for the gradual abolition of all customs duties and quantitative restrictions in trade between Cyprus and the Community. The final aim was the establishment of a customs union between the parties in two stages. The first stage would have been completed by 30 June 1977, and the second, whose negotiating process would have started eighteen months before the completion of the first stage, would have initially covered a five-year period and would in substance become a transitional period for the completion of a customs union.⁹

The Cyprus crisis in the summer of 1974 had direct consequences on the development of EC-Cyprus relations. The Turkish invasion of 1974 upset in every respect the social, political, and economic life of Cyprus. Ever since, EC-Cyprus relations have been influenced and to a great extent defined by the developments relating to the political problem of Cyprus. The first period of EC-Cyprus institutionalized relations, from 1972 to 1984, was a period of stagnation. The second period, from 1985 to 1992, was a period of normalization. The third period, from 1993 to the present, is a period of development of EC-Cyprus relations.

The Years of Stagnation: 1972-1984

During the first period, under the influence of Britain and the U.S., the Community adopted a reserved attitude towards Cyprus, trying to keep equal distance from both communities in Cyprus.¹⁰ Thus, when the first stage of the Association Agreement was completed, the Community was reluctant to proceed into the second stage envisaging the establishment of a customs union. Some EC member states led by Britain, for purely political reasons, reacted to the commencement of negotiations in the belief that they were thus exerting pressure on the two communities to show moderation in the intercommunal dialogue then under way. Some other member states, such as France and Italy, which had products competitive to Cypriot products, supported postponement of the negotiations to protect their own products.¹¹

Thus, the implementation of the Association Agreement was delayed and, instead of progressing into the second stage, the first stage was extended effectively, on successive occasions, until 1985. During the same period a number of additional protocols were signed improving slightly the

provisions of the original agreement and adapting them to the developments that were taking place. The first two of the four EC-Cyprus financial protocols were also signed during this period. The apparent unwillingness of Community institutions to set in motion mechanisms for the commencement of negotiations for implementation of the second stage of the Association Agreement created tension in EC-Cyprus relations and caused scepticism in Cyprus about the Community's intentions.

The Period of Normalization: 1985-1992

During the second period of EC-Cyprus relations an attempt was made to normalize and foster the development of these relations. The change in the Community's attitude towards Cyprus during this period can be attributed to a great extent to two important political events that took place in the early 1980s. First, the accession of Greece into the EC which took effect on 1 January 1981. The presence of Greece in the EC institutional framework undoubtedly helped to promote Cyprus's case in the Community. Despite the fact that in the early years of her Community membership Greece's priority was to improve her economic and commercial relations with her new partners, she nevertheless contributed to the promotion of EC-Cyprus relations within the framework of the association process.

The second important development was the unilateral declaration of independence (UDI) by the Turkish-Cypriots with regard to the part of Cyprus under Turkish occupation under the name "Turkish Republic of Northern Cyprus" ("TRNC"). This entity has not been recognized by the international community (apart from Turkey) as possessing the constituent elements of statehood. The Security Council of the United Nations in its Resolution 541 of 18 November 1983:

Deplores the declaration of the Turkish-Cypriot authorities of the purported secession of part of the Republic of Cyprus...considers the declaration...as legally invalid and calls for its withdrawal.

In Resolution 550/1984 the Security Council repeated "the call upon all States not to recognize the purported state of the 'Turkish Republic of Northern Cyprus' set up by secessionist acts and [called] upon them not to facilitate or in any way assist the aforesaid secessionist entity."

This illegal action was also condemned by EC member states within the framework of the European Political Co-operation (EPC), who repeatedly expressed their support for the unity, territorial integrity, and sovereignty of the Republic of Cyprus and the legality of her government.¹² These two events contributed to a change of heart towards Cyprus and a realization on the part of the Community that it had to take a firmer stand towards the Turkish side with regard to the Cyprus problem.

As a matter of fact, on 21 December 1983, following a demarche by the government of Cyprus, the Community decided that all Cypriot products imported into the Community ought to be accompanied only by official

documents issued by the competent authorities of the Republic of Cyprus and exported through ports designated by those authorities. On 21 February 1984, the commission sent the new specimen seals and signatures to the competent authorities of the member states but did not, however, take any binding measures.

However, some member states (especially Britain, the Netherlands and Germany) occasionally allowed imports from the occupied area of Cyprus into their territories. Thus, despite the fact that the ban on imports from the occupied part of Cyprus was probably the only specific measure taken by the Community in the form of 'sanctions' in respect of the illegal UDI by the Turkish-Cypriots, it did not take the form of a legally binding measure and moreover it was systematically violated by certain member states.¹³

The new situation created by Greece's accession and the proclamation of the illegal "TRNC" created the feeling that the Community had to do something about Cyprus. The mid-1980s was a good time for the Community to act, having overcome its budgetary crisis and completed negotiations for the Single European Act for the Iberian accessions. Furthermore, the international political climate was improving and a new period of detente appeared on the horizon, a fact that allowed the Community leeway for political maneuvering.

In light of the accession of the two Iberian countries, the Community initiated discussions on a new Mediterranean policy towards non-member Mediterranean countries. The negotiations for the new Mediterranean policy gave Greece the opportunity to press for the promotion of EC-Cyprus relations. Linking the two issues, Greece made clear that it would not agree to the new Mediterranean policy unless the council issued a mandate to the commission to begin negotiations with regard to the second stage of the EC-Cyprus Association Agreement.

Indeed the move of the Greek government proved effective. Thus, on 20-21 October 1985, at an informal meeting of the foreign ministers in Luxembourg, a compromise agreement was reached to promote simultaneously the new Mediterranean policy and the negotiating mandate for the EC-Cyprus Association Agreement. The final form of the mandate was officially approved by the Council of Ministers on 25 November 1985, based on the proposals of the commission.¹⁴ This decision was of great political importance for Cyprus. The decision to proceed with the negotiations put an end to a long crisis between Cyprus and the Community. At the same time, the acceptance of the sovereignty of Cyprus and the fact that the government of Cyprus legitimately represented the whole of the island was accepted and reiterated.

The arduous negotiations that followed lasted for almost two years. On many occasions, it was felt that an agreement would never be reached. The Community adopted a rigid negotiating line and proposed limited concessions and preferences for Cypriot products. The most difficult issues were: 1) the transition to the customs union and whether this would be automatic, as the Cyprus government wished, or after an agreement, as the Community insisted; 2) the abolition of the rules of origin demanded by

Cyprus; and 3) the exemption of some sensitive products from the Agreement.¹⁵ Finally, after difficult negotiations a compromise was reached. The Protocol was signed on 19 October 1987 and took effect on 1 January 1988.¹⁶

This Protocol governs the second stage of Association Agreement and aims at the establishment of a customs union between the parties. This stage is divided into two phases. The first phase, from 1988 to 1997, involves, *inter alia*, a further reduction of customs duties and the abolition of quantitative restrictions. The transition from the first to the second phase will be decided by the Association Council. The second phase will last four or five years. It will involve: 1) the abolition of the rules of origin and the free movement of goods covered by the customs union; 2) the adoption of measures stemming from the EC Treaty *vis-à-vis* competition, State aids, indirect taxation etc; 3) the enactment of measures concerning the free movement of agricultural products covered by the customs union on the basis of reciprocity and the adoption by Cyprus of the common agricultural policy mechanisms with regard to the same products; and 4) the application of measures which should have taken effect in the first phase but which were not fully applied during that period.

The agreement for the transition to the second stage of the Association Agreement and the increased interest of the Community in the Cyprus problem¹⁷ enhanced the image of the Community in Cyprus, encouraged the island's European orientation, and led to the realization that Cyprus could derive great political and economic benefits by further developing her relations with the EC. In light of the above developments, the Greek government beginning in 1987 began to encourage the Cypriot government to submit an application for full membership in the Community.

The Greek government believed that the Community was in a better position than any other power to exert pressure on Turkey to show moderation on the Cyprus problem. Given Turkey's desire to strengthen its relations with the Community, this would not have been impossible. Moreover, accession of Cyprus to the Community would be the only realistic guarantee that any solution to the island's political problem would be viable and functional. The basic principles and freedoms underlying the Community edifice such as free movement of goods, persons, services and capital, respect for human rights and democratic procedures would serve as safety valves between the two communities of Cyprus and would guarantee the viability of any solution. The Greek government considered that the best time for Cyprus to submit its application would be during the Greek presidency of the Council of Ministers in the second semester of 1988.

The Greek government communicated its views to the government of Cyprus in late 1987. These views were received favorably. However, the early 1988 presidential elections in Cyprus brought a new administration into power. Although supporting Cyprus's European orientation, the new president of Cyprus, G. Vassiliou, was reluctant to submit an application during that period. In early 1988 there were new UN initiatives in the offing and a new round of intercommunal talks had just started. In this

context, Vassiliou was discouraged, mainly by the U.S. and Britain, from submitting an application to join the Community lest this move upset the intercommunal talks under way. The U.S., Britain, and a number of other EC member states held the view that the Cyprus problem should remain within the framework of the UN. During a visit covering several European capitals, Vassiliou received the message that Cyprus could not expect to become an EC member as long as the political problem remained unresolved.¹⁸

The U.S. and Britain did not view favorably the prospect of accession of Cyprus to the EC even if the Cyprus problem were solved. Both of these countries would have preferred Cyprus to remain outside of the Community, so that they could influence developments in the island in a more direct manner. In addition, they are reluctant to disappoint Turkey, which has been strongly opposing Cyprus's accession to the Community. The oft-repeated Turkish position has been that the government of Cyprus did not have the authority to submit an application as long as the political problem remained unresolved. Such action, Turkey argued, would undermine efforts to find a solution to the Cyprus problem because Turkey would withdraw from negotiations.¹⁹

The reluctance of the Cyprus government to submit an application created some tension in its relations with Athens, which continued to support the need for an application. In the meantime, the intercommunal dialogue did not lead to any results, while the Cypriot government was dragged from one fruitless round of negotiations to the next. By mid-1989, there was within Cyprus itself a broad consensus between almost all of the political forces that an application for full membership in the EC should be made. The House of Representatives debated the issue on many occasions and adopted a resolution urging the government to submit an application at the earliest possible point.²⁰ Finally, the collapse of the Soviet Union and the democratization process in eastern European countries changed the character of the system of international relations from the bipolar model into a loose multi-polar dominated by the U.S. These developments increased the dangers to the national security of smaller states, such as Cyprus; their integration into a big and powerful supranational organization associating them with a wider group of states would offer security as well as political and economic advantages. Moreover, the non-aligned movement of which Cyprus is a founding member gradually declined in importance while the European Community and its ideals were in their heyday.

The emergence of all of the above factors led the Cyprus government to reassess its position and realize the importance of submission of an application for full membership in the EC. The government of Cyprus considered that the prospect of Cyprus's accession to the EC would send a clear message to the Turkish-Cypriots that the Community regarded seriously the prospect of Cypriot membership as a catalyst in the efforts of finding a solution to the political problem. A settlement in Cyprus would contribute to the efforts for peace and stability in the Eastern Mediterranean. It would also greatly facilitate the rapprochement between Greece and

Turkey and ensure the stability of NATO's southeastern flank.

The economic benefits to be derived in the case of Cyprus's membership were obvious.²¹ The government of Cyprus viewed the customs union agreement only as an intermediate stage on the road to full economic integration. As a full EC member, Cyprus would also participate in common Community policies such as the common agricultural, transport, environment, and development policies, etc. Moreover, Community membership would enable Cyprus to benefit from the EC structural funds. All of the above would speed up the modernization of Cyprus's economy and infrastructure.

On the basis of the above considerations, on 4 July 1990, the Cyprus government submitted a formal application to join the Community under Article 237 of the EEC Treaty.²² Cyprus's application was discussed in the COREPER on 12 September 1990, and in the Council of Ministers on 17 September 1990. According to the procedures, the council decided unanimously to refer the issue to the commission for its opinion. During the discussion in the council, Britain, Germany, Holland, and Belgium insisted on the adoption of a statement to the effect that the benefits of the EC-Cyprus relationship would be enjoyed by the people of Cyprus as a whole. Despite the different opinion of other member states, this statement was adopted with the modification "in the spirit of the UN resolutions." The insistence of certain EC member states's governments on such a statement can be explained in light of the position shared by some member states that Cyprus's accession to the Community should be linked with a solution to the island's political problem and their concern about the Turkish reaction.

Both the Turkish government and the Turkish-Cypriots reacted strongly to Cyprus's application, threatening not to cooperate with the UN secretary general in his efforts to find a solution to the Cyprus problem. On several occasions, the Turkish-Cypriot leader, R. Denktash, said that Cyprus could accede to the EC only when Turkey became a member and only after the Cyprus problem was resolved. In other statements, Denktash said that Cyprus's accession to the EC would amount to the island's union with Greece. On 31 August 1990, the Turkish-Cypriot leadership sent a memorandum to the Council of Ministers asking for rejection of Cyprus's application on the ground that the government of Cyprus did not represent the whole of the island, and that the application as such was unconstitutional.

The government of Cyprus rejected those allegations, emphasizing that it was the only internationally recognized government representing the whole of the island. It pointed out that an illegal regime which had violated the provisions of the 1960 constitution could not invoke its provisions in order to hinder the functioning of the state.²³ At the time of the submission of its application, the government of Cyprus invited the Turkish-Cypriots to cooperate and to join forces with it for the preparation of accession negotiations. It was pointed out that Cyprus's accession to the Community would be extremely beneficial for the Turkish-Cypriots, who would feel more secure in a European framework and would be able to

enjoy, to a greater extent than their Greek compatriots, the economic advantages that accession to the EC would bring.²⁴

In the late 1980s the prospect of Cyprus's accession to the EC became one of the main issues in the negotiations for a solution to the political problem. The Cyprus government in its consultations with the UN secretary-general and others brought up the issue of EC membership and argued that Cyprus's accession to the Community would facilitate a solution to the political problem. In two important texts on the Cyprus problem, the UN secretary-general referred to the possibility of Cyprus acceding to the EC. In his June 1989 report, he stated for the first time that special consideration should be given to the possibility of Cyprus's accession to the EC.

In his August 1992 report (known as the set of ideas),²⁵ the secretary-general proposed that "matters related to the membership of the federal republic [of Cyprus] in the European Economic Community will be discussed and agreed to, and will be submitted for the approval of the two communities in separate referenda." This suggestion would pose a most severe obstacle to the accession of Cyprus in the EC. First, this proposal is very vague; it does not clarify when and at what stage of the negotiations "matters related to the membership of the federal republic in the European Economic Community will be discussed and agreed to." It is not clear whether this question will be resolved before or after the establishment of the federal republic. It is almost certain that the question of Cypriot membership in the EC will be a point of contention between the two communities since the Turkish-Cypriot side takes the view that

...in the interest of ensuring parity in the special ties between the respective motherlands, Greece and Turkey, and Cyprus, the federation can only become a member of, or participate in, any international organization or other body if (a) both Turkey and Greece are members of, or participate in, such organization or body; and (b) such membership or participation is approved by the two federated states in separate referenda.²⁶

This view would make Cyprus's accession to the EC almost impossible in the foreseeable future since the EC does not even consider Turkey as a serious candidate for full membership for the time being at least.²⁷ Furthermore, the suggestion for two separate referenda on the issue of participation in the EC is contrary to the democratic principle. While the great majority of Greek-Cypriots, who constitute 82% of the population, may vote overwhelmingly in favor of their country's accession to the EC, Cyprus may not become a member if the Turkish-Cypriots, who constitute 18% of the total population, vote (narrowly perhaps) against accession.

Given the fact that the enlargement of the Community became an issue of great priority, the European Council in December 1991 invited the commission to study the issue and prepare a report for discussion by the European Council in its June 1992 meeting at Lisbon. In its report the commission laid down the criteria and conditions that, in its opinion, applicant countries would have to fulfil in order to join the EC, as well as the

conditions that the EC itself would have to respect in the process of its enlargement in order not to compromise its nature, objectives, and functioning. In the last part of its report, the commission set out the situation in the different applicant countries and suggested guidelines to be followed on a case-by-case basis. The report served as the basis for the Conclusions of the Lisbon European Council on the issue of enlargement.²⁸

In its report the commission stated that a State applying for membership must satisfy three basic conditions: 1) European identity; 2) democratic status; and 3) respect for human rights. Another set of criteria related to the applicant State's acceptance of the EC system and its capacity to implement it. This presupposed 1) a functioning and competitive market economy, and 2) adequate legal and administrative framework in the public and private sector.

Paragraph 10 of the commission report provided that:

Applicant states should also accept and be able to implement, the Common Foreign and Security Policy as it evolves over the coming years. An applicant country whose constitutional status or stance in international affairs rendered unable to pursue the project on which the other members are embarked could not be satisfactorily integrated into the Union. It will be necessary to avoid ambiguity or misunderstanding on this point in the context of enlargement.

In this conjunction, paragraph 17 of the report stated:

The Maastricht Treaty provides in Articles J.1-10 for the definition and implementation of a common foreign and security policy, which 'shall include all questions related to the security of the Union, including the eventual framing of a common defence policy, which might lead in time to a common defence.' Members of the Union will subscribe, in principle and in practice, to these provisions and have to implement the decisions taken under the Treaties. Applicant countries should be left with no doubts in this respect. Specific and binding assurances will be sought from them with regard to their political commitment and legal capacity to fulfil the obligations.

In Cyprus's case there are potentially serious problems with 1) the Treaties of Guarantee and Alliance, 2) the proposed demilitarization of the island, and 3) Cyprus's membership in the movement of non-aligned countries.

The commission also pointed out that membership implies the acceptance of the *acquis communautaire*. Temporary derogations and transitional arrangements of limited period could be possible, but "the principle must be retained of acceptance of the *acquis*, to safeguard the achievements of the Community." In this connection the commission was satisfied that, "...the integration of Cyprus...into the Community system would not pose insurmountable problems of economic nature." Nevertheless:

In the case of Malta and Cyprus, the adoption of the *acquis communautaire* would appear to pose no insuperable problems. However, both are very small states, and the question of their participation in the Community institutions would have to be resolved in the appropriate manner in accession negotiations.

Referring specifically to Cyprus, the commission observed:

In the case of Cyprus, there is inevitably a link between the question of accession and the problem which results from the *de facto* separation of the island into two entities, between which there is no movement of goods, persons or services. The Community must encourage all efforts to find a solution, in particular through support for the resolutions of the United Nations and the initiatives of the Secretary General. In the meantime, the association agreement should be exploited so that Cyprus is enabled to pursue its economic integration.

Following the debate on the issue of enlargement in the European Council meeting in Lisbon (June 1992), the Heads of State or government of the member states in their conclusions adopted the views of the commission stating that the negotiations for the accession of new member states should commence only after the Treaty on European Union had been ratified by all the member states and the provisions of the so-called second 'Delors Package' were approved. The European Council decided that priority should be given to the EFTA countries and pointed out that the applications of Turkey, Cyprus, and Malta would be dealt with separately and on their own merits.

In its conclusions the European Council emphasized the political importance of Turkey and suggested the reinforcement of her relations with the Community in the economic and political spheres. With regard to Cyprus, there was no reference to the political problem but the suggestion was made that at that stage the relations between the EC and Cyprus should be developed on the basis of the Association Agreement, the application for membership, and political dialogue.

For Cyprus, the results of the Lisbon summit were mixed. Cyprus did not achieve her objective to be included in the first group of states to accede to the EC. Her exclusion from that group created some disappointment at the time. However, there were two positive elements in the Lisbon conclusions. First, the reference that EC-Cyprus relations should be developed "in view of the Cyprus application" signalled the acceptance in principle of the prospect of Cyprus's future membership; second, the conclusions made clear that Cyprus's application was an entirely different matter from that of Turkey. Following the same line, the European Council in Edinburgh in December 1992 requested the council to continue the development of appropriate and specific links with Cyprus (and Malta) within the framework of the Lisbon conclusions.

In the meantime, the early 1993 presidential elections in Cyprus brought to power a new administration under G. Clerides. The cornerstone of the new administration's foreign policy was the promotion of

Cyprus's European orientation. The new government, on the strength of the positive elements of the Lisbon conclusions, intensified the efforts for EC membership and made it a priority to secure a positive opinion from the commission which would allow the Council of Ministers to decide the start of accession negotiations.

Towards Accession: 1993 to the Present

In June 1993, the European Council in Copenhagen, considering the relations between EC and Cyprus expressed its satisfaction with the commission's intention to present shortly its opinion on the application of Cyprus, emphasizing that this opinion would be examined rapidly by the council taking into consideration Cyprus's particular situation.

The commission issued its opinion on the application of Cyprus on 30 June 1993.²⁹ In its opinion, the commission, after considering Cyprus's capacity to adopt within a reasonable timescale the *acquis communautaire* including her capacity to participate in the planned economic and monetary union and the common foreign and security policy, concluded that Cyprus was ready and capable of becoming a dynamic member of the Community. The commission concluded that the island "is located in the very fount of European culture and civilization" and that it possessed beyond all doubt a European identity and character and a vocation to belong to the Community.

It pointed out that a political settlement of the Cyprus problem would serve only to reinforce the island's European vocation and enhance its social, political, and economic position. The commission expressed its conviction that "the result of Cyprus's accession would be increased security and prosperity and that it would help bring the two communities on the island closer together." In view of the above, it concluded that "the Community considers Cyprus as eligible for membership and that as soon as the prospect of settlement is surer, the Community is ready to start the process with Cyprus that should eventually lead to its accession." The commission repeated the Community's support for the UN efforts to resolve the Cyprus problem and gave the undertaking "to use all the instruments available under the Association Agreement to contribute, in close cooperation with the Cyprus government, to the economic, social and political transition of Cyprus towards integration with the Community." Finally, the commission recommended that, in the event that intercommunal talks failed to produce a political settlement, the situation "should be reassessed in view of the positions adopted by each party in the talks and that the question of Cyprus's accession to the Community should be re-considered in January 1995."

Three months later, on 4 October 1993, the council endorsed the commission's opinion and welcomed its positive message. The council invited the commission to open substantive discussions forthwith with the government of Cyprus in order to help the latter in its preparation for the accession negotiations which would follow. The council also confirmed the

Community's support for the UN secretary general's efforts to produce a political settlement of the Cyprus problem. If, in spite of these efforts, there was no prospect of a solution in the foreseeable future, the council agreed to reassess the situation in the light of the positions expressed by each side in the intercommunal talks and reexamine in January 1995 the question of Cyprus's accession to the Community.

The substantive talks between the commission and the government of Cyprus began on 26 November 1993. The primary objective of those talks, which covered a broad range of subjects, was to assist Cyprus's authorities in familiarizing themselves with the *acquis communautaire* and in harmonizing Cypriot legislation and policies with those of the Community. As a matter of fact, Cyprus has already harmonized a good deal of its existing legislation with the *acquis* and the authorities endeavour to make sure that newly enacted legislation is in conformity with Community law and policies. There were several rounds of substantive talks over fifteen months. The talks were successfully completed in February 1995.

The interest of the Community in promoting a settlement of the political problem led to the appointment by the council of an observer in the intercommunal talks. The observer was required to report "to the council on the implications of political developments in Cyprus for the Union's *acquis communautaire*, including the progress of the United Nations secretary general's good offices mission for Cyprus." The observer submitted his first report in April and the second in June 1994. He submitted his last and final report in January 1995, in view of the reassessment of Cyprus's application by the council. The observer reported that despite the lack of tangible results, "overtures made by President Clerides in October [1994] were notably courageous."³⁰ He also noted that "the parties involved in the Cyprus problem have taken on board the significance of the EU's recognition of Cyprus's suitability to join the Union and its decision to embrace Cyprus in the next enlargement."

In June 1994, the European Council at Corfu discussed EU-Cyprus relations and concluded that an essential stage in Cyprus's preparations for accession could be regarded as completed. It also decided that the next phase of enlargement of the EU would involve Cyprus and Malta. This position was reaffirmed by the European Council at Essen in December 1994. The effect of these declarations was to clearly disassociate the issue of Cyprus's accession to the EU from the solution of the Cyprus problem. This view was confirmed by the then president of the commission, Jacques Delors, in a statement made on 8 December 1994 on the eve of the Essen summit.

On 5 July 1994, the Court of Justice of the European Communities, following an application of Greek-Cypriot exporters of agricultural products, ruled that the EC-Cyprus Association Agreement did not authorize EC member states to accept, when importing agricultural goods, movement and phytosanitary certificates issued by the so-called 'TRNC' which was "an entity not recognized."³¹ In its ruling, the court explained that the movement certificate system as means of proof of origin for a product rested on the principle of "institutional trust" and cooperation between the

relevant authorities in the exporter state and the importer state. It then stated that that system could only work if the administrative procedures were "strictly respected." The court said that this was not possible with the northern part of Cyprus:

such cooperation is excluded with the authorities of an entity such as that established in the northern part of Cyprus which is recognized neither by the Community nor by the Member States; the only Cypriot State they recognize is the Republic of Cyprus.

The same was true for phytosanitary certificates:

it would be impossible for an importing State to address enquiries to the departments or officials of an entity which is not recognized, for instance concerning contaminated products or certificates that are incorrect or have been interfered with.

The court concluded: "Clearly only the authorities of the Republic of Cyprus are in a position to take action following complaints connected with the contamination of plant products exported from Cyprus."

The court rejected the argument put forward by the commission and Britain that non-acceptance of certificates from the northern part of the island amounted to the exclusion of a whole category of Cypriots from the benefits of the Association Agreement between the EC and Cyprus. It was argued that "factually," it was practically impossible or at least "difficult" for exporters in the northern part of Cyprus to obtain certificates other than those issued by the Turkish-Cypriot community. The argument was based on Article 5 of the Association Agreement according to which the Agreement had to be implemented in a non-discriminatory manner to the whole population and all Cypriot companies. However, that provision, the court stated, could not

in any event confer on the Community the right to interfere in the internal affairs of Cyprus. The problems resulting from the *de facto* partition of the island must be resolved exclusively by the Republic of Cyprus, which alone is internationally recognized.

Clearly, this decision has important legal and political implications for Cyprus's relations with the Community and especially her future accession to the European Union. In particular, there should no longer be any legal doubts that the Community must negotiate only with the Republic of Cyprus and that any internal problems of the island are problems of the Republic of Cyprus alone in which the Community has no right to interfere, at least in the context of the Association Agreement.

Given the lack of any visible progress towards the solution of the Cyprus problem, the council in early 1995, pursuant to its decision of 4 October 1993 and taking into account the observer's report, reassessed the question of Cyprus's accession to the EU. At its meetings of 6 February

and 6 March 1995, the Council of Ministers:

1) reaffirmed Cyprus's suitability for accession to the EU and confirmed the Union's will to incorporate Cyprus in the next stage of its enlargement;

2) decided that accession negotiations with Cyprus will commence at the latest six months after the conclusion of the Intergovernmental Conference of 1996;

3) confirmed the EU's continued support for the UN efforts for a comprehensive settlement of the Cyprus problem;

4) committed itself to adopting concrete proposals for a specific strategy in preparation for accession including a structured dialogue between the EC and Cyprus.

This resolution was adopted in the framework of a 'package deal' within the Council of Ministers relating to the general framework for developing future relations of the EU with Turkey and Cyprus. In exchange for setting out a timetable for opening accession negotiations between the EU and Cyprus, Greece lifted her long-standing veto on the EC-Turkey customs union agreement.

The Turkish government and the Turkish-Cypriot leadership were infuriated by the council's resolution of 6 March 1995. On the same day, the Turkish foreign minister stated that:

Turkey disagrees with the decision taken by the Council on the membership negotiations with Cyprus. The Council's decision is an unfortunate step which could lead to the permanent division of the island. The opening of accession negotiations before a negotiated settlement is reached will lead to the talks being held exclusively with the Greek-Cypriot side. In such an undesirable eventuality, Turkey will be left with no option but to take steps towards achieving a similar integration with the Turkish Republic of Northern Cyprus.³²

These remarks provoked strong reaction by the president of the council, then Foreign Minister A. Juppe of France, who stated that no third country could interfere in the internal affairs of the EU and that no such interference would be tolerated.

The council resolution of 6 March was hailed by the Cyprus government as the single most important development in the twenty-one years following the Turkish invasion. The importance of this resolution for the Cyprus government is twofold. First, it has set in train the process that will eventually lead to Cyprus's accession to the EU in the not so distant future. Secondly, it will have a considerable impact on the efforts for a solution to the Cyprus problem. In other words, if Turkey realized that her reaction could not stop the process of Cyprus's accession to the EU then she would be faced with a policy dilemma for the first time since the invasion. If Turkey chose to continue her policy of no-solution of the Cyprus problem, she would, in essence, condemn the Turkish-Cypriots to remain in their present poor economic conditions thus depriving them of the substantial economic benefits which would result from Cyprus's accession to

the EU. If, on the other hand, given the fact that the process leading to Cyprus's accession has irrevocably commenced, Turkey chose to cooperate in finding a solution to the island's political problem, then the Turkish-Cypriots together with all other Cypriots, would be able to enjoy the benefits that EU membership would bring.

In accordance with the council conclusions of 6 March 1995, the sixteenth EU-Cyprus Association Council on 12 June 1995 adopted a resolution on the establishment of a structured dialogue between the EU and Cyprus and on certain elements of the strategy concerning Cyprus's preparation for accession. The structured dialogue "on various issues and various levels, of a quality equivalent to that which was offered to the countries of Central and Eastern Europe" will involve: 1) meetings on the occasion of the European Council between the heads of state or government; 2) meetings and talks at ministerial and other levels on issues falling within the common foreign and security policy and justice and home affairs; and 3) meetings and talks at ministerial or other level, if necessary and according to need, on subjects of common interest such as the environment, tourism, and shipping. Moreover, the existing political dialogue between the EC and Cyprus on common foreign and security policy issues will be upgraded and expanded. Finally, the specific strategy for preparing Cyprus for accession will include, *inter alia*: 1) continuation of efforts to familiarize Cyprus authorities with the *acquis communautaire* and to harmonize Cypriot legislation with it; 2) examination of the possibility of extending to Cyprus the trans-European shipping and telecommunications networks; 3) Cyprus's participation in Community programs such as MEDIA II, certain training programs (LEONARDO, SOCRATES, YOUTH FOR EUROPE), ARIANNE, RAPHAEL, KALEIDOSCOPE, and the Fourth Framework Programme of Scientific and Technical Research, MATTHAEUS; 4) the possibility for Cyprus to benefit from funds under the Community's future Mediterranean policy; and 5) extended cooperation between EUROSTAT and Cyprus's statistical and research departments.

During the same Association Council meeting, the fourth financial protocol between the EC and Cyprus worth 74 million ECU was signed covering the period until 31 December 1998. The objective of this protocol is to promote the development of the Cypriot economy and assist the effort of harmonization of Cypriot legislation with the *acquis communautaire*.

Within the framework of structured dialogue between the EU and Cyprus, President Clerides was invited to the European Council meeting at Cannes on 26/27 June 1995. This invitation underlined the special status of Cyprus as a future EU member. The Cannes European Council affirmed that EC-Cyprus accession negotiations will begin six months after the conclusion of the 1996 Intergovernmental Conference. Finally, the Council of Ministers in its meeting of 17 July 1995 defined the precise modalities of the EU-Cyprus structured dialogue, thus providing the opportunity to Cyprus authorities to understand better the functioning of the Union and exchange views with their EC counterparts on important issues of common interest.

Conclusions

As already stated, EU-Cyprus relations can be divided into three phases. The first period, from 1972 to 1984, was marked by the Community's reluctance to promote its relations with Cyprus. The second period, from 1985 to 1992, was a period of normalization of the relations of the two parties. During that period the Community adopted a more positive attitude towards Cyprus. This change in the Community's attitude can be attributed, to a significant degree, to Greek participation in the Community organs following Greece's accession in 1981. It was during that period that the customs union agreement was signed, the European Political Cooperation through numerous statements expressed support for the independence and sovereignty of the Republic of Cyprus, condemned the illegal UDI by the Turkish side, and the application for full membership was submitted by Cyprus. But even during this period the Community's interest did not go beyond expression of support for certain guiding principles for a solution to the Cyprus problem and the UN initiatives. The Community avoided getting more actively involved in the process of finding a solution to the Cyprus problem; whenever it attempted to take up an initiative of its own, the EC was discouraged by the U.S. and Britain.

The third period, from 1993 to the present, is a period of rapid development of EC-Cyprus relations. The positive opinion by the commission on Cyprus's accession, the Corfu European Council's decision that Cyprus will be involved in the next enlargement of the EU, the decision of the Court of Justice on the issue of illegal exports from the northern part of Cyprus, the resolution of 6 March 1995 setting a clear timetable for the commencement of accession negotiations and the adoption of a structured dialogue and a preaccession strategy by the Association Council of 12 June 1995 reflect the breakthrough in EU-Cyprus relations during that period. But perhaps the most important development during that period is the realization by the Community that Cyprus's European future cannot remain hostage of the Turkish army, as was eloquently stated by the EU commissioner for external affairs Hans Van den Broek.

Thus, despite a variety of difficulties and delays, relations between Cyprus and the EC have been developing and improving, bringing Cyprus to the verge of full Community membership.

In the economic sphere, the EC-Cyprus Association Agreement has been functioning in the mutual interest. Particularly for Cyprus, the Association Agreement and the prospect of membership in the Community have contributed to the rapid development and modernization of her economy.

The key element in EU-Cyprus relations is the political element. Cyprus's political problem has repeatedly proven to be a formidable obstacle to the smooth progress of those relations. This was the case when Cyprus was trying to move to the second stage of the Association

Agreement and, more recently, in her attempts to promote her application to accede to the Community.

Even now, the Community appears to not have an integrated common policy on the Cyprus problem. This is due to significant differences of opinion between the its member states. On the one hand, Britain's Atlantic orientation has been dictating British efforts to keep Cyprus outside the Community sphere. On the other hand, Greece tries to bring Cyprus as close to the Community as possible.

On the political level, there is a tension between the policies of those countries that support Cyprus's European orientation and those favoring a solution of the Cyprus problem outside the Community framework. Cyprus, supported by a number of EC member states, believes that more active Community involvement in Cyprus would enhance efforts for a peaceful, just, functional, and lasting solution of the political problem. Cyprus's accession to the EU will guarantee the viability of any solution and the state itself.

Certain quarters in the U.S. and Britain do not share the above view, mainly because Turkey objects to it. They still consider that the Cyprus problem should be resolved within the Atlantic framework taking into account the political and geostrategic interests of the NATO alliance. Despite this negative attitude, Cypriot and Greek insistence at the negotiation table has transformed the issue of Cyprus's accession to the EU into a major parameter in the efforts towards a solution to the island's political problem.

Cyprus's accession into the EU would serve the interests of all the parties involved in the political problem. It would offer security to both Cypriot communities and would foster mutual trust. It would serve as a guarantee for the respect of human rights and democratic principles for the people of Cyprus. It would also strengthen the economic development of Cyprus, the benefits of which would be enjoyed by both Cypriot communities. Finally, it would contribute to the improvement of relations between Greece and Turkey and foster long-term stabilization and peace in the southeastern Mediterranean.

Given Cyprus's key geographic position and the fact that the island has been for many centuries the extreme outpost of Western values and civilization, her membership in the EU would give the West the opportunity to enhance its role in that part of the world and contribute to the cause of peace, security, and cooperation.

NOTES

1. The term European Union (EU) is used with respect to events that took place after November 1993 when the Treaty on European Union came into force.

2. See Kranidiotis, 'Relations Between Cyprus and the European Community,' *Modern Greek Studies Yearbook* (University of Minnesota), 8

(1992):165.

3. See Tsardanides, "Η Συμφωνία Σύνδεσης Ευρωπαϊκής Κοινότητας—Κύπρου" in Hephæstos and Tsardanides, *Οι Σχέσεις της Κύπρου με τις Ευρωπαϊκές Κοινότητες, 1972-1990* (Athens: Papazisis, 1991), pp. 29-30.

4. Shlaim, "The Community and the Mediterranean Basin," in Twitchett (ed.), *Europe and the World: The External Relations of the Common Market* (London: Europa, 1976), pp. 77-120.

5. Hitchens, *Cyprus* (London: Quarter Books, 1988), p. 55.

6. UN Document S/6426, 10 June 1965.

7. See *Fifth General Report of EC*, para. 440.

8. See Council Regulation 1246/73 on the conclusion of an Agreement establishing an Association between the European Economic Community and the Republic of Cyprus, to which the text of the Agreement is annexed, OJ 1973 L 133/1.

9. For a detailed discussion and analysis of the EC-Cyprus Association Agreement, see Lycourgos, *L'association avec union douanière: un mode de relations entre la CEE et des Etats tiers* (Paris: PUF, 1994).

10. See Tsardanides, "Το Κυπριακό Ζήτημα στην Ευρωπαϊκή Πολιτική Σενεργασία," in Kazakos and Stephanou (eds.), *Η Ελλάδα στην Ευρωπαϊκή Κοινότητα: Η Πρώτη Πενταετία* (Athens: Sakoulas 1987), pp. 367-81.

11. See , Tsardanides, "Η Συμφωνία...", p. 145.

12. See, e.g., EPC Statement of 16 November 1983, *EC Bulletin* 11-83; conclusions of the European Council, Brussels 19-20 March 1984, *EC Bulletin* 3-1989.

13. On 5 December 1989, the commission's Directorate General for Agriculture issued an official recommendation (the 'Legras letter') which banned the importation of Cypriot products not accompanied by certificates of origin and phytosanitary certificates issued by the competent authorities of the Republic of Cyprus. This statement was challenged before the Court of Justice of the European Communities by a Dutch company representing Turkish-Cypriot interests (Case C-60/90 *Sunzest* [1991] ECR I-2917). That application was rejected as inadmissible by the Court on the grounds that the commission's statement was not a "decision" of the commission but simply transmitted the advice of a commission department with no effect in law. Finally, on 5 July 1994, following an application by Greek-Cypriot exporters of agricultural products, the Court of Justice effectively banned the imports into Community member states of agricultural products not accompanied by the appropriate export certificates issued by the authorities of the Republic of Cyprus (Case C-405/92 *R v. Minister of Agriculture, Fisheries and Food, ex parte S. P. Anastasiou (Pissouri) Ltd. and Others* [1994] ECR I-3087).

14. *Nineteenth General Report of the EC*, para. 335.

15. See Kranidiotis, "Relations...", pp. 172-73.

16. Official Journal of the EC, 31 December 1987, L 393/1.

17. On three occasions between 1988 and 1991 the Community tried unsuccessfully to get involved in the process of finding a solution of the Cyprus problem. The first attempt was made by EC commissioner Claude Cheysson who

proposed that Turkey should withdraw from the new town of Famagusta and allow the opening of Nicosia airport. Both of these areas would then come temporarily under UN control. In exchange, the government of Cyprus would allow the free export of products from the occupied area through the port of Famagusta and Nicosia airport and issue the requisite export certificates. In addition, Greece would withdraw its reservations on the fourth Financial Protocol between the EC and Turkey. Turkey rejected these ideas. On another occasion, in late 1988 the big four EC member states (France, Germany, Italy, and Britain) decided to closely follow developments on the Cyprus, and intervene whenever necessary. The Greek government reacted strongly against this initiative on the ground that it was undertaken on an intergovernmental basis outside the Community framework. The third EC initiative was launched in early 1991 by the Luxembourg presidency of the council. However, the lack of a clear plan of action and the strong American reaction against the idea of a Community initiative undermined this effort and led to its failure.

18. See, e.g., Cyprus Press Information Office Press Release, 14 October 1988.

19. See, e.g., statements by the Turkish-Cypriot leader R. Denktash on 15 September 1990, Cyprus Press Information Office Press Release, *Turkish Bulletin* 15 September 1990.

20. See the Resolution of the House of Representatives (Cyprus), 23 June 1989.

21. See Kranidiotis and Kokkoni, *Οι Προοπτικές από την Ενταξη της στην Ευρωπαϊκή Κοινότητα* (Athens: EKEM, 1990).

22. Article 237 of the EEC Treaty has been repealed by the Treaty on European Union. Accession of new member states is covered by Article O of the Treaty on European Union.

23. See Loukaides, "The Cyprus Application to the EC and the Treaty of Guarantee," *Cyprus Law Review*, 4011 (1989).

24. See Cyprus Press Information Office Press Release, 4 July 1990.

25. Report of the Secretary-General on his Mission of Good Offices in Cyprus (Set of Ideas on an Overall Framework Agreement on Cyprus), UN Document No S/24472, 21 August 1992.

26. See Report of the Secretary-General on His Mission of Good Offices in Cyprus of November 1992, pp. 15-16, para. 40.

27. See EC Commission Report on the Criteria and Conditions for Accession of New Members to the Community: *Europe and the Challenge of Enlargement*, Brussels, 24 June 1992 (Supplement 3/92—Bull. EC), point 29.

28. Point I, 2 of the "Conclusions of the Presidency." Reference to this report is also made in the commission's opinion on the application of the Republic of Cyprus for membership to the EC.

29. *EC Bulletin* 1993, suppl. 5/93.

30. The failure to make progress has clearly been attributed by the UN secretary-general in his report to the Security Council of 30 May 1994:

"For the present, the Security Council finds itself faced with an already familiar scenario: the absence of agreement due essentially to a lack of political

will on the Turkish-Cypriot side.”

31. See Case C-405/92, EPC Statement of 16 November 1983.

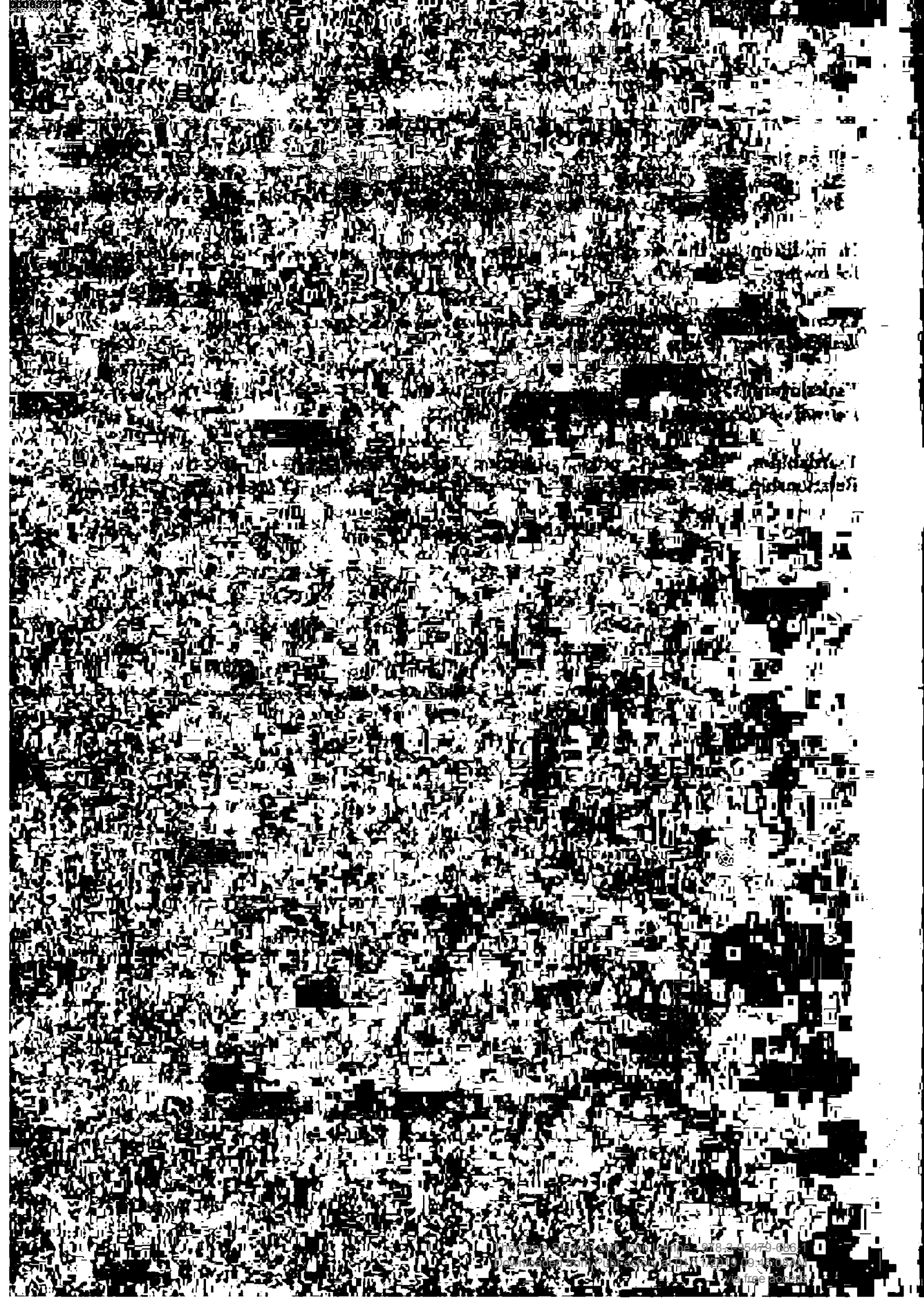
32. See *Europe*, no 6435 (n.s.), 8 March 1995, p. 5.

In addition to the works cited above, the reader may wish to consult the following:

Lycourgos, *L'association avec union douanière: un mode de relations entre la CEE et des Etats tiers* (Paris: PUF, 1994)

Tsakaloyannis, “The European Community and the Greek-Turkish Dispute,” *Journal of Common Market Studies*, 14 (1980):35

Tsardanides, “The EC-Cyprus Association Agreement: Ten Years of a Troubled Relationship, 1973-1983,” *Journal of Common Market Studies*, 17 (1984):353.



The Reconstruction of Relations between the Albanian State and the Southeastern European Countries

Agim Nesho

The collapse of communism in Albania and the reconstruction of a democratic society were associated with difficult and complicated processes and phenomena. The distinguished western expert, A. Smolar¹ describes this comprehensive transformation as follows:

We have to deal with an extremely intricate process of interdependent and simultaneous change linked to the passage from external dominance to full sovereignty, from communist party dictatorship to a liberal, parliamentary democracy, from a command economy to a free market system, from a society stifled by Statism to a democratic civil one.

Hence, such a transformation would necessarily give rise to the need of reconstructing Albanian policy towards new bonds, alliances, conceptions, and priorities while in the course of building relations with different states. After a long period of total isolation, a total opening to the outside world was the clearest indication of a new strategy for Albania, whose society needed progress, free circulation of people, goods, culture, and ideas. This attitude, as time went by, would be limited and develop under the circumstances of the following political factors and conditions:

1) the lack of an established class in Albanian society to carry out the above changes with a firm and clear vision which would echo national interests.(this deficiency was an outcome of long-time rule by severe dictatorship and a leadership which had totally monopolized the country's governance);

2) the existence of pressing issues in the Balkans and crises in the former Yugoslavia which required maturity in handling the international relations of Albania;

3) the Albanian national issue (that is, the problem of Kosovo) and the impact of interested external and domestic forces over Albanian policy.

After World War II, Albania belonged to the group of so-called eastern countries and its relations with the remaining Balkan countries were defined more by ideological influences than from the standpoint of

geopolitical international relations. The break with the Warsaw Pact oriented Albanian policy towards total isolation and away from Balkan and wider European integration.

The implementation of the policy "neither east nor west" served the purpose of retaining a relative independence from superpower blocs. While defining alliances and priorities of its own policy, Albania preserved its independence (at the expense, of course, of isolation) and it chose a system of powerful and distant allies, upholding, however, a cautious policy towards neighbors and other nearby countries. This experience seems to have been metaphysically transferred to new political circumstances at home and to a new political configuration, especially given that the two principal factors which play a crucial role in defining the foreign policy and international relations of Albania are:

- 1) the impact of the external factor, which prevails over Albanian state policy;
- 2) the lack of a nationwide strategy in our foreign policy, which views the international relations of our country from the point of view of benefits for political parties and their survival in power.

After the paradigm shift in Albania in 1991, Albanian foreign policy witnessed two trends: the first one, dating back to the period 1991-92, was characterized by the domination of a pro-European line that was an outcome of the substantial and continuous assistance that the European countries extended to Albania for managing its crises and establishing the proper infrastructures of a democratic state. In this framework, Italy and Greece turned out to be major partners and useful allies for accomplishment of Albanian integration into Europe, while not underestimating, however, the major assistance provided by Germany and France, more for economic than for political and geostrategic interests. While successfully applied, this political line ensured ever-increasing political stability and provided the proper guarantee for performance of political, economic, and social reforms at home.

This political platform, enshrined in the government of Stability which was established in June 1991, was made possible by the consensus of all major domestic political forces. The political stability of that period provided the necessary grounds for major investments and expansion and strengthening of relations with the Balkan countries and beyond. Meanwhile, this stability narrowed the scope and opportunities for the democratic party, as the former opposition party of Mr. Sali Berisha, for getting total control of power in its own hands. Under the name of the final destruction of communism, the above-mentioned coalition was dissolved and at the same time new political platforms and allies came to the fore. This new trend predestined the return to the old strategy "neither east nor west" by stretching Albanian priorities and alliances *in extremis* from the U.S. superpower to western European and, with less emphasis, all the way to the far east as a member of the World Islamic League. From outer appearances one could create the image that this trend expressed increasing U.S. influence in Albania and the somewhat declining role of Europe.

The new orientation of Berisha's government may be explained by the following political, psychological, and traditional factors:

- 1) fearing the impact in political and economic aid from Italy and Greece, he opted for its reduction;
- 2) he returned to the traditional idea of relying on a powerful and distant ally as a security means for governing;
- 3) linkage to the Islamic countries was presented as a form of pressure *vis-à-vis* Europe for increasing the level of economic aid, justifying this with the image of Albania as a bridge between the west and the Middle East.

For a long time Albania has lacked a democratic state and widely-accepted democratic principles necessary for educating the people with that spirit. Albania has shifted from a semi-feudal state to a socialist state after World War II, facing a ruthless dictatorship and a totally-centralized state authority.

To retain themselves in power as long as possible, all the ruling classes in Albania have manifested mentalities of regionalism and tribal policies. Certainly such elements show that the present Albanian leadership, which retains these traits, is closer to an eastern mentality on questions of state and society. The new orientation of Albanian policy since 1992 has established the following priority of relations with the states of the Balkans, i.e., Albania—Macedonia—Bulgaria—Turkey, which would provide the possibility of restricting and controlling any escalation of conflict in the former Yugoslavia, in the southern Balkans, while safeguarding the interests of the two principle NATO partners (Greece and Turkey) as well as counteropposing the so-called Orthodox axis (Greece—Serbia).

By admitting this formula in exchange for broad political support for the governing party of the country, under conditions of major economic and restructuring difficulties, (Albania?) accepted the role of a potential by nationalistic state, which might be employed at every single moment as a counterbalancing force in the southeastern region.

On the other hand, the idea of participation in the World Islamic League would also serve as a possible scenario for a greater Albania which would stem from the partition of the Balkans among the civilizations defined with religious criteria, a scenario much talked of at the end of 1991, wherein the Moslem religion would serve as the main element of Albanian external linkage and protection.

Conceived in this way, the relations of Albania with the Balkan countries would be built into a framework of conflict and collaboration including its positive and negative points, but at the same time Albania would experience a political and economic imbalance which would hinder expectations for a speedy European integration. Although Albania does not present any danger of becoming a fundamentalist bastion in the Balkans, it may compromise the secular vision of a newly-born democracy.

The National Issue and the Kosovo Problem

The Kosovo question is one of the main points of Albanian foreign policy. Unfairly divided from the borders of the motherland by the diplomacy of the major powers, Kosovo will be present in Albanian foreign policy until its final settlement. The democratic processes in eastern Europe and the collapse of the bi-polar balance after the end of the Cold War has led to the escalation of nationalism, especially from federalist countries such as the former Yugoslavia. As for the people of Kosovo, the disintegrating processes coupled with the emergence of new states in the former Yugoslav republics represents the most ideal time for a correct settlement of the national issue and establishment of proper conditions for the reunification of Albania. This strategy was associated with a comprehensive and detailed plan which would contain

- 1) establishment of a Kosovo republic and institutionalization of the country's life with Albanian administration,
- 2) internationalization of the Kosovo issue,
- 3) establishment of a pro-Kosovo democratic regime to support the national question with priority.

The reunification of Albania with Kosovo was sanctioned in the first Charter of the Democratic Party of Albania. These priority demands were motivated even more by the struggle against the old regime and by accusing Hoxha of allegedly betraying the national question and subjecting it to communist ideology. This political naiveté on the one hand pointed out the amateurism and inefficiency of Albanian leadership and on the other hand the determination of settling the national question by every way and means. The Albanian diaspora in the U.S. also made pressures and offered its support in this respect. From the point of view of its composition, this diaspora represents the political groupings that left Albania immediately after the end of World War I and that had in their own programs the reunification of the country and the establishment of an Ethnic Albania; and these were the parties of Balli Kombetar and Legality, the economic groupings from Kosovo which have long been established in the U.S. The support provided to Mr. Berisha to come to power comprised a major commitment for reactivation of the Kosovo question on the part of Albania, hence Albanian foreign policy by informing international institutions of the violence and genocide exercised in the region of Kosovo, attempted to mediate in world diplomacy for maximum demands and full autonomy. For the sake of even a minimum fulfillment of these demands, Albanian diplomacy during the last two years has offered four different attitudes:

The protracted war in Bosnia and Hercegovina, the homicides and massacres of the population over two years, involved international bodies to more realistically solve this conflict and prevent the escalation of the conflict to the south, which might have had unimaginable catastrophic consequences for all Balkan peoples and far beyond. Certainly, this commitment of international institutions for a settlement of the crises and even the Geneva Summit in June 1994, where the status of autonomy for Kosovo was

defined and suggested, influenced the most recent stands of Albania as announced from Mr. Berisha in July 1994, stating that Albania would attempt to observe human rights and freedoms and invites both parties to sit down and talk with the mediation of a third party. This attitude reflects at last a realistic orientation in Albanian stands and leaves in the shade political pressures on the Albanian leadership and is also conditioned by the deterioration of the political and economic situation within the country and by some other things, among which one may mention the following:

1) fluctuations in the attitudes of the allies of the Berisha regime on the Kosovo issue, which are directly reflected in the foreign policy of the Albanian state,

2) lack of a national strategy from all the country's political forces on the Kosovo issue,

3) lack of marginal nationalistic sentiments in Albania as an outcome of Albanian isolation and the national ideology of the Hoxha regime in the form of a nationalist socialism. The devastation and hatred towards anything inherited from the past, and Albania's opening to Europe enabled the triumph of the idea of European integration over nationalistic sentiments. This also explains the lack of a unified domestic position of Albanian society on the national question.

Mr. Rugova is guiding the national question with maturity—his "gandist" policy is designed to avoid severe bloodshed and the fueling of a conflict that would involve most of the Balkan countries. Convinced that the Kosovo issue cannot be settled with the intervention of the major powers, the people of Kosovo have endeavored to present their own demands for a major autonomy in the form of a UN protectorate or towards an independent country between Albania and Serbia. The idea of a protectorate has not found support in any international body since it is an old international form used in former colonial conflicts whereas the existence of a "Second Albanian Republic," independent from Serbia and Albania would leave the final conflict and its solution open. The idea proposed in Geneva is more rational and acceptable. Belgrade accepts these negotiations with bilateral compromise, i.e., Kosovo should give up the separatist idea and Belgrade should lift the state of emergency and restore autonomy within Serbia. The idea of negotiations is perhaps more rational and more acceptable in the European context and for the settlement of the crises in the country. What is required today from the Albanians in Kosovo is not to give up their correct demands concerning the respect of human rights and dignity, but to be more reasonable in their ways of approaching and solving this question by avoiding unnecessary conflicts. On the other hand, Serbia should acknowledge and consistently observe the rights and freedoms of an entire autonomous people in Kosovo, recognize their rights for tuition and culture, give up violence against them, respect international law and principles, and recognize their legitimate right for self-determination in the future.

Relations between Albania and Greece

Historically speaking, Albania and the Hellenic people have cherished the purest feelings of friendship between them. The ancient Greek culture and civilization has been one factor in the development of intellectual thought in the Albanian national renaissance. It is common knowledge that from the historic point of view, since ancient times there have never been conflicts and wars between the two people. In 1987, the government of Mr. Papandreou abrogated the law on the state of war with Albania as a positive step in the amelioration of relations between the two countries. These relations experienced vigorous development and the Greek minority in Albania was viewed as a bridge of bonds. The shift of the socio-economic system in Albania after the year 1990 lined Greece up among priority countries that helped Albania during the transition crises. It is worth emphasizing that Greece managed to receive a flux of over 350,000 Albanian emigrants that left Albania under the circumstances of deep despair and suffering. The revenues from their work have served and continue to serve as a means of subsistence for over one million people in Albania. Since our economy continues to be paralyzed, the economic aid extended by Greece, both for the speedy integration of Albania towards Europe and from the bilateral point of view is quite substantial. All these friendly actions and messages produced a strong bridge of spiritual and material bonds between Albania and its natural ally, Greece, which at the same time increased its own influence among pro-Greek circles in Albania.

Relations between the two countries were redimensioned and displayed contradictions after Papandreou's victory last October. That victory was viewed with skepticism by the political circle in power in Albania since it represented a left-wing victory in a country with influence on present-day Albanian politics, while it was viewed positively by the opposition in Albania, the latter winning 54% in the last local elections.

The victory of socialist parties in a series of eastern countries; major errors in domestic, economic, and social policy in these two years; and the presence of a pro-opposition Greek faction with European views in Albania proved to be a turning point in Greek-Albanian state relations while the ever-increasing impact of Greek policy in the country's social life was considered a real danger in the forthcoming elections at home.

The redimensioning started with the disapproval and restriction of tuition rights for the Greek minority, rights gained from the time of dictatorship and protected by international norms and principles enshrined in the Convention on Human Rights of the Council of Europe and CSCE Helsinki Final Act. Greece and other democratic forces in the countries could not fail to react. The execution of the policy of tensions with Greece was made by the Albanian government at a time when European policy was criticizing the persistence of nationalism in the policy related to the FYROM question and the influence of nationalism in the policy of the Greek government which contravened the principles of the European Union. At the same time, the existence of certain chauvinistic Greek

circles insisting upon a Northern Epirus and on territorial claims on Albania were offered as accusations of the Greek state itself towards its stand on Albania. The means to carry out such a policy were found in the incident in the Greek-Albanian border and with the trial of five Albanians for espionage. Aggravation of these relations would bring the following consequences. in the domestic area:

1) control and consolidation of Berisha's authoritarian regime, which included an attempt to diminish Greek influence in southern Albania, prepare the ground for the forthcoming elections, and attack the opposition forces;

2) drawing the attention of the Albanian public away from the grave domestic political climate created by the imprisonment of the president of the Socialist Party of Albania and main opposition leader, the imprisonment of journalists and escalation of pressures against the free press, and increasing violence against individuals and associations with different political convictions (this policy has taken advantage of a tense situation at home);

3) increase of nationalistic feelings and utilization of this policy to realize approval of the constitution by anti-constitutional forms so as to introduce in Albania a presidential republic;

and in the external area:

1)) the conflict in southern Albania is used to justify the giving up of demands of the Albanian government on the Kosovo question;

2) it enables avoidance of Italy and Greece as natural Albanian allies which would serve for Albanian integration into a united Europe while redimensioning the priority of relations with Europe and by entrusting diverse distant allies with Albanian policy.

The recent visit of the Greek foreign minister Mr. C. Papulias to Tirana not only established a greater hope for improvement of relations between the two countries but also unleashed the idea of a Balkan conference which would enable the easing of tensions in the region and create opportunities for greater cooperation.

Problems of Albania in its Relations with the Former Yugoslav Republic of Macedonia (FYROM)

Different from Albania's other neighbors, the policy with the former Yugoslav Republic of Macedonia came to evidence in the course of political shifts in the former Yugoslavia. Historically, the Albanian people have been rather cold in their relations with their neighbor. The new administrative division brought evidence of the intensification of relations between the two countries.

Albania views the former Yugoslavia Republic of Macedonia (FYROM) with interest on the following grounds:

1) as a country wherein allies have vital interests in the region and

are seeking support to realize them,

2) as a counterbalance to the policy with Greece which is an ally of the Slav-Orthodox axis and presents itself as a stumbling block for the fulfillment of national intentions and the Kosovo issue,

3) for the preservation of the vertical line connecting it with Turkey which would enable interruption of the Serbia-Greece axis,

4) to utilize it as a means of pressure and assistance in its own policy with the former Yugoslav Republic of Macedonia, where 40% of the population are Albanians, for the future solution of the Kosovo issue and the national question.

Albania was the first to recognize the former Yugoslav Republic of Macedonia without getting however any message from it or without observing human rights and freedoms for Albanians and their acknowledgment as a constituent element, thereby accepting in silence its geostrategical position in the Balkans and its specific role in the prevention of the escalation of the conflict as an interlapping area of interests of several countries. This was also the reason that Albania rapidly lifted its own veto in the CSCE for the recognition of the rights of the Albanian population as a constituent element while realizing the message that the U.S. defense secretary Mr. Perry expressed during his visit to Tirana that "the U.S. has major interests in the former Yugoslav Republic of Macedonia." The only Albanian interest in Macedonia is the consolidation and increase of awareness of Albanians at large on the rights belonging to them there. Its population represented in the parliament and in the government of the former Yugoslav Republic of Macedonia, which has the largest and most powerful party, might react in case of an outburst of a conflict in FYROM and it might require the establishment of an Albanian state together with Kosovo as its first stage. This interest was clearly expressed in the interferences from the Party of Rugova and Democratic Party of Berisha in the splitting of the Party of Democratic Prosperity, the Albanian party in the former Yugoslav Republic of Macedonia, in two parts and providing support to the most radical party. This long-term strategy is within the designed projects on the partition of former Yugoslavia in three parts, Great Serbia, Great Croatia, and Great Albania. This Albanian policy would continue to be supported for the sake of this scheme, otherwise no political and economic interest justifies the commitment and total support of Albania towards the former Yugoslav Republic of Macedonia.

Relations with Turkey

For Albanian policy, the Turkish state represents a major and powerful ally in the Balkans. Turkish policy has always viewed Albania as an area of its own influence. This occurrence is accentuated given the interests that the Albanian lobby in Turkey presents. It has been established and strengthened due to the transfer of Albania at the beginning of the century. The position of Albanian policy of "neither east nor west" comes closer to its important strategic position as a link between east and west.

Albania seeks to use its ally's political and military potential so as to feel relieved from other influences, compensating this friendship through its accession to the Islamic League and Initiative of the Black Sea. The idea that Turkey has started to display interest in Albania on account of its empire dominions is viewed with neglectfulness in Albanian policy and it does not feel any danger from western civilization on the part of eastern culture but quite the opposite it tries to consolidate and disseminate it. This attitude also indicates the quintessence of the present Albanian state which, in the absence of a vigorous national awareness to follow the course towards European civilization of which it is an integral part, configures Albanian civilization as a mixture of different civilizations.

Conclusions

The lack of experience and political amateurism on the part of the Albanian leadership as well as a lack of political credibility at home have brought as a consequence the lack of a clear-cut political line in Albania's international relations in the Balkans.

The lack of new ideas for the development of transition in the country's governing, as well as the continuation of tension in the political and economic situation at home, may result in the accentuation of nationalistic tones damaging Albanian relations with the countries of the Balkans and beyond.

The Berisha government's handling of the national issue (Kosovo) may be used as a means of pressure to control the crises in the country and to seek a broader international participation.

Ultimately, the idea of Balkan cooperation is an idea to be backed up; it is indispensable for Albania and the other countries in the region. It would also have its own impact in establishing a much-needed *détente* for the Balkans, which has unfortunately been fueled with conflicts. It would also emancipate Albanian foreign policy and permit it to return to the concept of integration and cooperation among European states.

NOTES

1. A. Smolar, "Democratization in Central-Eastern European and International Security," Part II, London 1155 II, p. 25, 1991-92.

The first part of the paper discusses the importance of the research and the objectives of the study. It highlights the need for a comprehensive understanding of the subject matter and the role of the researcher in this process. The second part of the paper focuses on the methodology used in the study, detailing the data collection and analysis techniques. The third part of the paper presents the results of the study, which show a significant correlation between the variables under investigation. The final part of the paper discusses the implications of the findings and offers suggestions for future research.

The methodology employed in this study was a combination of qualitative and quantitative approaches. Data was collected through a series of interviews and surveys, which were then analyzed using statistical software. The results of the analysis indicate that there is a strong positive relationship between the variables studied. This finding is consistent with previous research in the field and has important implications for practice. The study also identifies several areas for further research, including the need to explore the underlying mechanisms of the observed relationships.

In conclusion, this study has provided valuable insights into the relationship between the variables under investigation. The findings suggest that there is a significant positive correlation between the variables, which has important implications for the field. The study also highlights the need for further research to explore the underlying mechanisms of these relationships. The authors would like to thank the participants and the funding agency for their support and contribution to this research.

Romanian Options for Reconstructing Southeast Europe

Vlad-Andrei Moga

Democracy, Free Market Economy, and European Integration

As a central European country close to the Balkan area and to the Black Sea, Romania is deeply concerned, as it has always been, about developments in the region. Before 1989, the world lived in a system of stability—a cold stability, sometimes a terror stability. After 1989 we witnessed the following systems: 1) Stability vs. explosive instability in the border area of the old east-west blocs; 2) instability with risk of chaos—especially in some parts of the former USSR; and 3) stable instability nowadays.

The classic conflicts are more and more rare. The Yugoslav crisis and the present Chechen conflict—used only as examples—could be regarded as exceptions. The world is facing other kinds of wars: economic wars, psychological wars, image wars, press wars, disinformation wars, diversion wars, minority wars. To quote Gheorghe Tinca, minister of defense of Romania, “a country can be defeated nowadays in ten minutes without its even being necessary to fire one single bullet.”

We live in a situation in which the so-called “enemy” may be nobody and anyone at the same time, including sometimes even ourselves.

It has been said that the best security guarantees are democracy and the free market economy. With all due respect, it should be reminded that in 1938, for example, Czechoslovakia and Romania had them both, which did not save them from the Nazi and Communist horrors of the next fifty years to come. Democracy and the free market economy are necessary and reassuring, but we need also a stable environment and...some friends.

Therefore Romania tries to do its best in building a democratic society and a free market economy, in building good relations with its neighbors, in promoting its European and Euro-Atlantic political, economic, social, cultural, and security integration, in promoting good relations with the world's major powers and with all the countries so interested.

*Good Relations with its Neighbors***A Longstanding Tradition**

A good climate with respect to its neighbors has always been regarded as very important. Full respect and honest cooperation are the fundamental premises on which Romania has always built its relations with neighboring countries. The basic idea of our common security is to seek security with other countries rather than against them.

The collapse of communism added to the liberties but also to the problems Romania had up to 1989.

Russian Federation

For the first time in more than 300 years, Romania has no common border with Russia. Yet we can hardly start talking of our neighbors without mentioning Russia. Its huge potential makes it, and will continue to make it in the future, a main pole of attraction. The important thing for this pole of attraction is not to behave as a black hole fagocitating everything. Romania has, and will continue to have, strong economic ties with Russia. It is just normal to be so. It is also normal that these relations should be good ones as well as the general relations.

Concerning security matters, Romania seeks integration into the European and Euro-Atlantic structures. As early as December 1989, Romanians, as a single person, turned back towards Europe, towards that Europe of theirs from which they were separated for fifty years. Common history and culture make them feel at home in Europe. At home do they want to live and feel secure. It is their definite and sovereign wish. Do its similar wishes and other countries' in the region, pose problems for Russia's security? In the Romanians' opinion: On the contrary! A secure, stable, peaceful, democratic, and prosperous central Europe means only advantages for the new democratic Russia. It may fully contribute to the stability of the CIS space and to the strong implementation of democracy and prosperity of the future desired world ring of stability in which a stable democratic and responsible Russia is a most welcomed and desired partner.

Ukraine

Relations with the young democratic Ukraine need a lot of good care, good will, and reciprocal comprehension as both partners inherit some faults of others.

During the recent visit to Romania of the first deputy minister for foreign affairs of Ukraine, Boris Tarasiuk, the reciprocal wish for concluding a Basic Treaty between the two countries was expressed. Experts from both ministries for foreign affairs will soon start to work on it. The already existing good economic relations represent an encouraging starting point—the largest Romanian investment abroad is in the Krivii-Rih

(Krivoi Rog) mineral exploitation and steel industry.

Republic of Moldova

Relations with the Republic of Moldova are of a special nature and there again the more close the cooperation, the more it has to be accompanied by full respect for the people of the Republic of Moldova's options.

Romania's relations with the Republic of Moldova are special, priority, and privileged. Based on common history, on common people, language, culture, and religion, they aim to promote an economic and cultural integration. Some of the concrete developments in this respect are presented in Appendix I.

Recently (20-22 February) an important ministerial Romanian delegation, headed by Prime Minister Nicolae Vacaroiu, visited the Republic of Moldova. Important businessmen were also members of the delegation. Closer political, cultural, and economic cooperation and integration was discussed. An example is the envisaged cooperation for one of the power units of the Cernavoda nuclear electric power plant unit which could respond to the Republic of Moldova's energy needs. The aim is, as prime minister Nicolae Vacaroiu put it, "To do so that the world should understand that the two Romanian strong states live together in this period of history." The Basic Treaty between Romania and the Republic of Moldova is now being negotiated by experts and there is a common wish to see it concluded as soon as possible.

However, the main problem for achieving stability in the region remains the presence of the Fourteenth Russian Army in the Transdnistr Region. Its withdrawal, included in the Russian-Moldovan Treaty, urged by the OSCE and recently by President Clinton, will most certainly contribute to defusing tension in the area.

Hungary

A new improvement in relations with Hungary came in 1993. The visit of Dr. Geza Jeszenszky, then Hungary's foreign minister, to Romania, "solved problems and cleared many misunderstandings" (from the declaration of Dr. Geza Jeszenszky at the press conference at the end of the visit).

Military cooperation between the two countries could be regarded as an example to be followed. The Open-Sky inspection program, inaugurated in Europe by Romania and Hungary, is already an old but very fruitful story. A new development was witnessed during the visit (5 September 1994) of Teodor Melescanu, minister of state, minister of foreign affairs, to Hungary when the treaty between the two countries was discussed with his colleague the minister of foreign affairs, His Excellency Mr. Kóvács László. "We have reason to believe," declared Mr. Teodor Melescanu after the meeting, "that the Treaty could be signed in May 1995."

Both countries do their best to reach significant improvements with the Stability (Balladur)—European Pact. Romania and Hungary have

already signed, on 1 February, in Strasbourg, the Minority Charta. Experts from the ministry of foreign affairs of both countries worked very hard during the last months and the treaty is almost ready to be signed.

It is, however, necessary to underline the recent declarations of the World Union of Magyars: "It is not allowed that the solutions for the minorities should be subordinated to other international political processes." The only solution, they say, is to have "internal self-determination and territorial administrative autonomy granted." (*"Romania Liberă"*—6 March 1995, p. 9). The UDMR, the ethnic Hungarians party in Romania, repeatedly declared that they regard the provisions of the Minority Charta as an insufficient starting point.

A Special Chapter—The Balkans

As for the Balkan region, Romania, a central European country close to the area, regards it with special attention. Not only the long traditional historic, economic, religious, cultural and other links matter, but the present and future do as well.

Present Situation

Up until 24 September 1994, when the Security Council decided to partially lift the embargo on Yugoslavia, any idea of cooperation in the Balkans was more or less frozen and will continue to be so because of existing conflicts and because of the absence of one of the most important actors of the play.

Unhappily, the Yugoslav crisis, which began because of a very complex mixture of causes such as the friction of the European powers, the end of the Cold War, extreme nationalism, distortion of national feelings used as ideological support for the achievement of political interests, and so on, once unleashed developed from a symptom into a cause of a generalized crisis. It became a reason in itself. Whether we like it or not, we have to admit that without its settlement we cannot speak of Balkan security and one may even question European security.

Looking over the entire Balkan area, at present, the following hot spots can be identified: 1) the problems created by a future reduction of UN forces in Croatia, which is supposed to take place on 31 March; 2) the crisis in Bosnia—the armistice expires on 30 April; 3) the Macedonia problem; 4) the separatist tendencies in Kosovo, Sandjack, Voivodina, and Kraina; and 5) the Greek-Turkish dispute.

Eventual Developments

As things are viewed from Romania, some of the possible directions in which the Balkans may evolve as far as security is concerned might be: 1) an internal balance of forces—which would, by its own desired presence imply; 2) an external balance of forces; 3) the assertion of some sub-regional

centers of power (Greater Serbia, Croatia, Greece, Turkey), followed by; 4) the temptation to "organize" systems of influence in the Balkans; and 5) the institutional solution—congruent with the European Security mechanism.

The last one is regarded as the only efficient and desirable one. It has to be based on measures meant to increase confidence, to provide fair solutions for national minorities, in accordance with European standards, to improve economic development and integration.

Priorities

Experience shows also that Balkan conflicts tend to develop sometimes into global ones. Therefore the domino effect should by all means be avoided. The implication of the major powers, the U.S. and Russia, as well as France, Germany, and Great Britain is to be regarded as useful in terms of improving stability in the area.

There is more to be done from the UN, OSCE, NATO, WEU, or EU, even though they have, with no exemption, been submitted to a harsh test by the present Yugoslav crisis. Peacekeeping, diplomacy, and other kinds of actions, although apparently not very efficient, must continue to be used and improved.

New developments and a new data base of the play, however encouraging or discouraging they may seem to be, still impose the same old priorities, namely the diminishing and extinction of present conflicts and the prevention of other potential conflicts.

To achieve these ends it is necessary to support simultaneously 1) the creation of a framework for direct contacts, 2) all efforts meant to implement and maintain cease fires and bring peace, and 3) measures to enhance humanitarian aid with a scrupulous respect for the implemented embargo, i.e., on Bosnian Serbs.

Necessary Steps

Some signs of the burning daylight seem to appear. But there is still a long way to go and it reveals mostly that the parties directly involved in the present conflictual situation as well as neighboring actors should contribute to solving these difficult problems, and the sooner the better.

Some of the problems worth mentioning might be: 1) reciprocal recognition of the successor states of the former Yugoslavia; 2) to trace the official frontiers between the new sovereign states emerged from the former Yugoslavia; 3) to have these new borders accepted and recognized by the successor states of the former Yugoslavia; 4) to have the borders of the new states fully accepted and recognized by the neighboring states of the former Yugoslavia; 5) the implementation of an agreement aimed at controlling arms in the area. It should be noted here that the former

Yugoslavia has not been included in the treaty for the reduction of conventional arms; 6) the accession or the readmission of all the successor states of former Yugoslavia as full members to international institutions and forums; 7) the reestablishment of normal relations between the successor states. It is not to be forgotten that the people of the area have lived together ever since, and especially during the period immediately after, World War I and the interdependent links are still very strong in spite of the rivers of blood between them; 8) the economic reconstruction of the successor states which, perhaps with the exception of Slovenia, have had their economies very seriously damaged if not, in some cases, even destroyed. Special programs of assistance with the participation of the international community will have to be implemented; 9) the difficult problem of refugees, the special programs needed for resettling these most unhappy persons; 10) the same, perhaps even more explosive, problem of the minorities in the area, a problem which has already added to the instability both within the conflict zone as well as at its periphery.

On the occasion of the International Conference on "Building a New Future in the Balkans" (Sofia, 21-23 October 1994), the president of the Assembly of Deputies of the Romanian Parliament, Adrian Nastase, said:

Within the peace process, it is necessary to involve more the neighboring countries of the former Yugoslavia. On the one hand, these countries could act as an incentive in the process of rebuilding the confidence among the newly emerged states in the former Yugoslavia and on the other, they could offer guarantees regarding the inviolability of the former external borders.

Romania as a central European country, as a Balkan state, may become an important center of stability in the area. We have no territorial interest either in the Balkan region or elsewhere, and at the same time, we foster very good traditional relationships with all the Balkan countries. Despite the difficulties we are facing, Romania has had a constant and ascending development in the process of transition towards a market economy and democracy. We possess a significant economic and military potential, we hold an important geostrategic position and, first and foremost, we strongly wish to take part in the settlement of the conflict by diplomatic means.

The good relationships which we foster with other Balkan countries could enable us, as it also did in the period between the two world wars, to curdle the others' efforts in order to establish stability and security in the Balkans.

At the end of his speech, President Adrian Nastase suggested a Balkan Interparliamentary Conference in Bucharest.

Considering the good relations Romania has with Albania, Bulgaria, Greece, and Turkey on the one hand, and with all the other new Balkan states on the other hand, efforts should be enhanced towards producing stability and prosperity in the area.

Future Plans for Cooperation

Yet one cannot just wait and see until the end of the conflict to think about future cooperation. It is imperative to be prepared for the happy "day after." Political future and more practical matters have to be taken into account.

Concerning telecommunications, railroads, river and maritime navigation, the Danubian vector is ready to play its important role in the area, i.e., to link the Black Sea to the North Sea.

It is needless to insist on the necessity of solving the problems caused by the *embouteillage* at, for example, at Giurgiu-Ruse on the Romanian-Bulgarian border, because of traffic restrictions across former Yugoslavia. Projects for one or even two other bridges across the Danube are to be implemented.

Energy

Pipelines for gas and oil, new electric power connections between the Balkan States and between them and the rest of central and western Europe are of stringent necessity.

Culture and religion

The famous Balkanic cultural and religious puzzle existed, exists, and will exist in spite of any other will.

The multicultural and multireligious integration which the European Union is "en train de faire" is for the Balkans an old story with bad but also, and mostly, good aspects. Many other problems could be added among which environment, for example, would not be the last one.

The Black Sea Economic Zone

Economic cooperation within the Black Sea Zone should be taken into account, especially since exchanges are to take place anyway, with or without our approval. It would most certainly be better to benefit from an institutionalized formula of them rather than of a chaotic one. The general secretariat in Istanbul, the Agreement for implementing the Bank for Commerce and Development in Thessaloniki, the Interparliamentary Assembly even without Bulgarian and Greek participation are useful and necessary steps in this direction. It is to be expected that the Second Summit in Bucharest at the end of July will add to the development of institutionalization.

The Six Axes

Quoting my distinguished colleague, Dr. Liviu Muresan, a governmental expert, I would add Romania's six strategic axes for development:

1) The Rhin—Main—Danube Canal ending in Constanta (the main harbor of the Black Sea and eventually, in the near future, the second of Europe, opened on 25 September 1992), waits to prove its enormous utility.

2) From north to south, from the Baltic States and Poland to the Black Sea and the Rhin—Main—Danube Canal.

3) South Russia—Ukraine—Dobroudja focusing also on Constanta.

4) The Central Asian Republics through the Caucasus to the Black Sea. It should be mentioned that during the Crans-Montana Forum in April 1994 in Bucharest, six leaders from the Central Asian Republics referred to Romania as "the first Western European country" on their way towards Europe.

5) The Middle-East—Europe Axis, through Romania.

6) The Japan—China—Suez Cannal—Black Sea axis. For 30 years Rotterdam and Hamburg harbors were the main European gates for Japanese goods. Later the choice was Trieste. Following the crisis in former Yugoslavia, Japan made its final option for the Black Sea and Constanta. Needless to say, it is a known fact that China regards Romania as its best traditional partner in central Europe.

All these possibilities, and we have mentioned only a few of them, do not belong to Romania, but to all Balkan and Black Sea area peoples, and must be used to their common benefit.

A Step-by-Step Approach

Attacking these targets step by step could not only make them become true but it could also create more solid, reliable, human, regional and states relations.

Building a new house requires not only commitment and hard work but also a little help from your friends. The Balkan and the Black Sea areas need financial support and also openness on the part of the developed countries for possible full integration into their community.

Strengthening democracy and a free market economy would not only bring into this area Western Europe's stability and prosperity but also close the gate to the new forms of totalitarianism be they Euro-Asiatic or Fundamentalist-Islamic.

Europe: The Only Future

At the end of these remarks, one might observe that, in fact, the Balkan and Black Sea area's problems ought to be regarded on a larger scale. Like the other countries of the region, Romania sees its future inside

Europe. Like the others, Romania has, as early as the beginning of its modern history, adopted the European model for its political system, for its institutions, for its legislation. Like Bulgaria, Romania is now an associate member of the European Union and of the Western European Union. One day it will be a full member of the European Union and of the Western European Union, like Greece, and of NATO, like Greece and Turkey.

Instead of the much talked about clash of civilizations, instead of the false dichotomy, Catholicism-Orthodoxy, instead of the great fear of Christian-Muslim incompatibility, instead of endless east-west problems, efforts should be concentrated towards closer cooperation, towards constructive cooperation with full respect of each one's specificities, towards building the Europe of our dreams. This Europe, which in the century to come, when its population will barely represent 5% of the world population, will have to face enough challenges posed by north-south disparities.

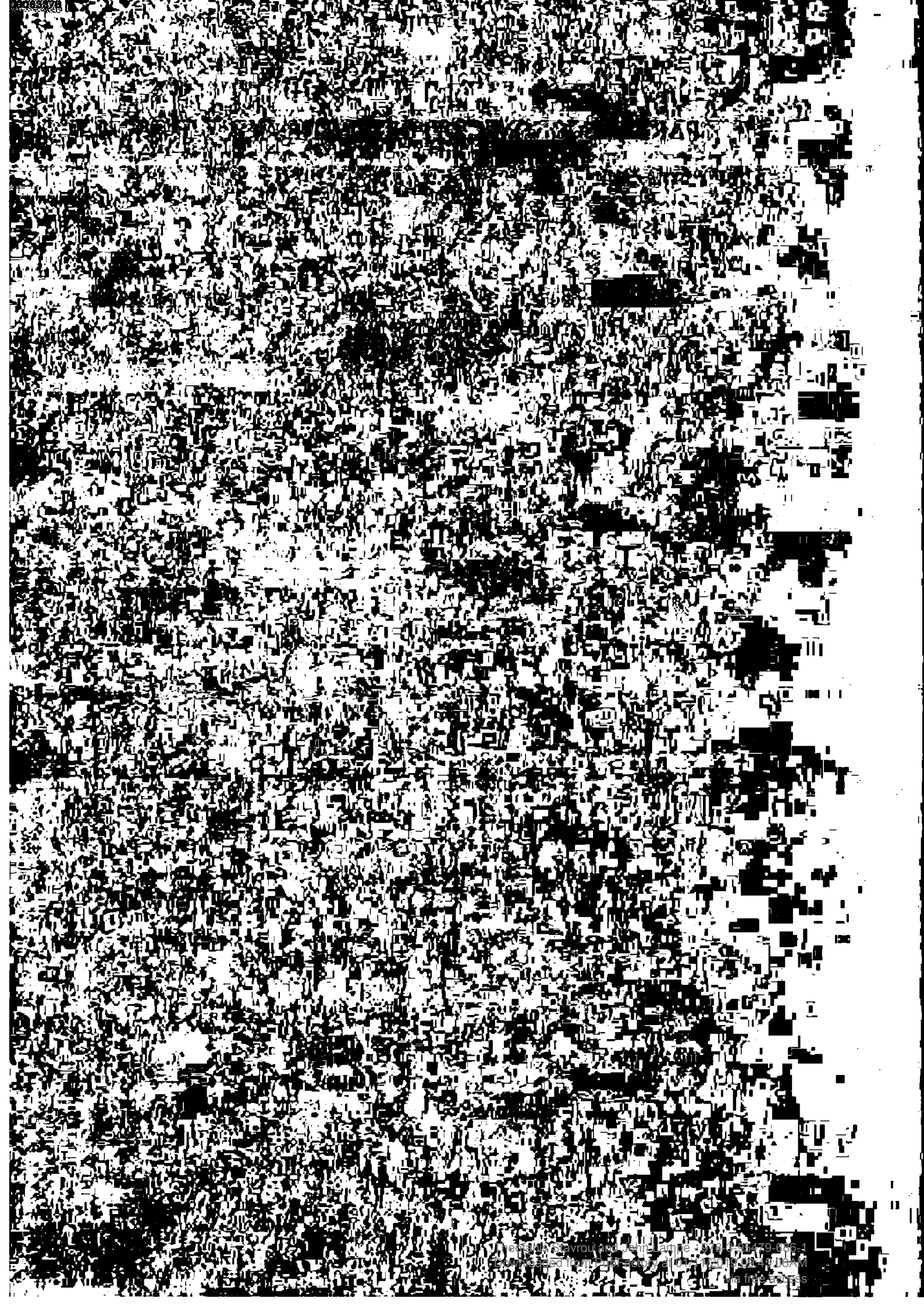
The Balkans should cease to see themselves as a European appendix. Enough that others say that, in fact, Europe is just an Asian appendix. It is our common duty to envisage future cooperation with the aim of making a decisive step towards European integration. There are good reasons to hope this is possible. From the historic point of view, a long-standing tradition of cooperation, understanding, the melting pot of cultures, civilizations, and religions witness not just confrontation, as wrongly seen from outside. The lesson to be learnt from the past is the need for direct contacts between the parties directly involved in different problems or conflicts.

The harmonization of political views being obviously necessary, there is also a need to regulate the chaotic development of economic relations in the area and to prove to ourselves and to the rest of Europe our capacity to do so. Communications, energy, culture, religion, and the Black Sea Zone's problems are pressing for common and firm solutions. A step-by-step approach might be the answer. Constructive cooperation with full respect of each country's specificities might pave the way to the Europe of our dreams.

NOTES

- 1) Romania was the first state to recognize the independence of the second Romanian state;
- 2) Transports of books, medicine and exchange of scholars, professors, and priests immediately started to be organized;
- 3) Many Romanian individuals contribute of their own will to these actions in various ways;
- 4) In 1993, Romania offered 20 million lei's worth of fuel quantity for the agricultural programs of the Republic of Moldova;
- 5) One million lei's worth of aid following the floods in summer 1994 was offered;
- 6) A special additional budget was allows in 1993 by the Romanian parliament to the Romanian government, worth 6 million lei, in order to finance priority projects of assistance for the Republic of Moldova;
- 7) The International Committees regularly meet to discuss and propose common plans. In July 1994, eleven Romanian ministers met with practically the whole government of the Republic of Moldova.

PART II: ECONOMIC OPPORTUNITIES



The Economic Dimensions of Conflict, Competition, and Cooperation in Transition Europe

Franz-Lothar Altmann

Introduction

Transition Europe, of course, embraces all the former socialist countries from Albania or Czechia in the west to the former Soviet Republics in central Asia. Conflicts, competition, and attempts at reestablishing cooperation can be observed all over that region, and just one article could not suffice to deal with all the different conflicts and cooperation ideas that have come up in recent times, either still existing or having disappeared. Since at this conference we are dealing only with southeastern Europe, I will restrict my remarks to this area, to analyze economic consequences and effects, in particular due to the ongoing conflict in the territory of former Yugoslavia. But, of course, occasionally I will also allow myself to mention similar developments in other parts of the region which formerly embraced the CMEA countries or member countries of the Warsaw Pact.

In order to achieve some kind of structured discussion of the topic, first I would like to distinguish between bellicose and non-bellicose conflicts, whereby in the former case I will furthermore distinguish between direct impacts of bellicose conflicts on the respective warring parties and indirect impacts on neighboring countries. Compared with the part of this article which deals with the economic consequences of conflicts, the part which is supposed to deal with competition and cooperation must unavoidably become substantially smaller since, as an outcome of the conflict situation in the Balkans, real competition or even cooperation have not so far had chances to develop. All I will try to address here will be competition in a rather narrow, specific sense, plus the notion of possible regional cooperation.

The Economic Dimensions of Bellicose Conflicts

Direct Impacts of the War in Former Yugoslavia

Certainly Bosnia-Herzegovina was most affected by direct war damages. Its population has shrunk by one third since 1992 when the total number of inhabitants was approximately 4.4 million. In August 1994 only 2.9 million lived in the war destroyed republic of D/II of which according to a demographic study 1.2 million were Muslims, 892,000 Serbs, 511,000 Croats, and about 230,000 members of other nationalities.¹ More than 1.3 million people became refugees and live abroad. This number in the meantime has increased, and UNHCR now (beginning of 1996) speaks of some 2 million refugees that have to be repatriated in Bosnia and Herzegovina, of which half a million are so-called domestic refugees. Out of approximately 275,000 dead about 50% are Muslims, 35% Serbs and 10% Croats. In spring 1995, 79% of the 2.9 million remaining inhabitants lived in government² controlled territories, the rest in those parts of the republic held by the Serbs, which represented roughly 70% of the territory of Bosnia-Herzegovina.

Since by far most of the war happened on former Muslim dominated territory, the economy of the internationally recognized Republic of Bosnia-Herzegovina is also hit most, estimates anyhow set the still functioning capacities of those industrial plants that are still on government controlled soil at best at about 25% of their prewar level, but it is not completely clear how this compares with former all-Bosnian industrial performance. In February 1996 the Bosnian Press Agency reported that the Federation had 650,000 unemployed and only 210,000 persons "taking part in production."³ Estimates on how much capital is needed for reconstruction of B/H range from U.S.\$6 billion as immediate help to U.S.\$60-80 billion for complete reconstruction. The latter sum becomes plausible if one considers the dimension of destruction in the country (B/H). The Sarajevo government recently published figures of 673 villages, 917 mosques, 275 catholic and 34 orthodox churches completely destroyed. For its part, the EU also in February said that the reconstruction effort in Bosnia is threatened by donors' failure to deliver on their pledges of aid. Although more than U.S.\$700 million was promised for reconstruction work in the first three month of 1996, only U.S.\$62.5 million has arrived so far coming exclusively from the EU. Meanwhile, U.S. president Clinton said he would ask Congress for U.S.\$820 million for Bosnia.

There is no question that Serbia-Montenegro or Rump-Yugoslavia must be regarded as the major participant in this war although no warring actions in fact took place on the territory of Serbia proper or of Montenegro. But the Bosnian Serb population never would have started the Bosnian war had not Belgrade, i.e. Milošević (referring to the fatal memorandum of the Serb Academy of Sciences), invented and advocated the idea of reunification of all Serbs in one state, and then even more supported strongly the self-proclaimed Republica Sipska by constant deliveries of heavy military

equipment. Although Milošević now tries to present himself as the dominant peacekeeping personality, one must not overlook the former direct involvement of Serbia proper, so that impacts of the Bosnian war on the economy of Serbia-Montenegro can certainly be seen as direct outcomes or results, although of course no direct war damages can be found either on the territory of Serbia or of that of Montenegro.

According to the Serb minister of industry, Fodor, the Serb industry today only works at 30-40% of the 1989 level. This is not only a result of the sanctions imposed on Serbia on 31 May 1992, because already earlier the breakup of the Yugoslav domestic market, which covered about 30% of the GDP of Serbia/Montenegro and the loss of the former lucrative markets in Eastern Europe (another 20% of GDP) as well as economic wrong decisions and structural developments had oppressed industrial production in Serbia and triggered an inflation which in January of 1994 peaked at a monthly rate of 300 million percent.⁴ The total number of 2.1 million employed (agriculture and private sector not included) is misleading because several hundreds of thousands in fact are enforced holidays due to the regulation that an enterprise which is in difficulties resulting from the sanctions must not be closed nor is it allowed to dismiss its workers. Approximately 1.5 million people are employed, half officially and half illegally, in the private sector. Compared to this 3.7 million working population Serbia has to deal with 2.2-2.3 million recipients of social support (770,000 unemployed and 1.3 million pensioners) plus more than 700,000 refugees who must be nourished from the scarce production. It goes without saying that an immense capital flight also occurred, and desperately needed foreign direct investment is zero. According to the minister of education, Radulovic, the economic shortcomings amounted to some U.S.\$45 billion since 1991,⁵ other sources quote U.S.\$35-40 billion which is about four times of the annual GNP.⁶ Some 300,000 well trained young people were exiled, a brain drain which must and will have its negative impact in full scale only when the time of reconstruction comes. At the same time it is estimated that some 100,000-300,000 young men are hiding against conscription in Serbia. The country is able to survive only because it has a sufficiently large agricultural production, great resources of raw materials, and trade relations that still function due to large-scale violations of the sanctions.

In particular the latter became indispensable for the Serb economy. It is estimated that some 50,000 people per day are crossing the borders to Bulgaria, Hungary, Macedonia, and Romania purchasing merchandise worth U.S.\$3 million.⁷ Taking into account that in 1993/94 the average monthly income was not higher than U.S.\$10-15, a trip to neighboring Hungary or Romania could be already profitable if only the gasoline tank was filled with petrol paying U.S.\$1 per liter and selling it back in Serbia for two! Of course, such petrol trade also occurred in greater quantities providing profits of up to U.S.\$36,000 per gasoline truck. The estimated profit resulting from smuggling one truckload of cigarettes is about half of what gasoline brings. It seems as if the Serbs do not have too great a difficulty coming up with the hard currency necessary for these imports.

Exports of food and textiles, in particular to Macedonia, from where those goods are re-exported even to EU countries, provide enough hard currency incomes to cover the necessary imports.

The private black or secondary economy had to be extended just for pure survival purposes, and the Serb/Montenegro state is only partially trying to tighten controls. Even more, regime critics quote a new class of state protected riches profiting from war and sanctions and who thus are discriminating against the principles of market economy and helping to equate it with wild Manchester capitalism and organized crime. It is questionable whether this is the right education and training for an adequate market or private entrepreneurship behavior.

Croatia, which until fall 1995 was in a state of war, exhibited all the special problems that such a situation causes, such as high shares of defense-related expenditures in the state budget (33%) and great reluctance of foreign investors. Until recently 25% of the country was *de facto* occupied dividing it into a northern, main part of which another the eastern part was also occupied, and a southern tier along the Dalmatian coast which under normal, prewar conditions had provided a constant and high amount of hard currency income from tourism for the population and the state. The cutoff of the main traffic connections between north and south of the Croat territory by the secessionist Krajina Serbs brought tourism to an almost complete stop which by the way also hit the Krajina Serbs (Plitvica) themselves very hard. An important side aspect already in socialist times was that much of the Dalmatian tourist business was middle- and small-scale private entrepreneurship which now could not receive substance subsidies like state owned firms. A high burden for the state budget is certainly the high number of refugees (some 400,000) and of pensioners (700,000) in addition to the (officially registered) 244,000 unemployed.⁸ Only one quarter of the population is employed, but like in Serbia, so here black economy is greatly supporting survival. Extreme endeavors are now needed for reconstructing the heavily destroyed infrastructure. Croatia claims total war damages of U.S.\$18-23 billion which is more than a one year GNP (U.S.\$16 billion).⁹ Estimates are that 25% of industrial capacity and 25% of the agricultural land were destroyed.¹⁰ Due to the war conditions and insecure expectations, foreign direct investment remained very low although in principle Croatia should be an interesting place to invest, particularly in services (tourism) and manufacturing. In total, however, some U.S.\$320 million have been invested in Croat privatized enterprises between 1991 and 1995 despite the war situation,¹¹ and the first foreign private credit of U.S.\$35 million for the tourist sector has been launched recently by Oesterreichische Raiffeisen Zentralbank.

Direct Impacts of the Yugoslav War on the Neighbors

One can take two examples of neighbors, one direct, Bulgaria, and one which does not have common borders with the territory of former

Yugoslavia, Ukraine.

Bulgaria already calculated that the embargoes against Iraq and Libya had cost the country some U.S.\$2.5 billion. Now as a direct neighbor of Serbia/Montenegro, Bulgaria had, like other countries, (Hungary or Romania), direct responsibility for the strict enforcement of the UN embargo. Estimates on the losses of Bulgaria from the embargo oscillate between U.S.\$1.4 billion¹² and more than U.S.\$3 billion.¹³ These losses are caused on the one hand by the complete interruption of trade with Rump-Yugoslavia which equals to a yearly loss of U.S.\$480 million, but what counts even more are the enormous costs which the transport deviations entail: 60% of all merchandise which Bulgaria traded with Western Europe was conveyed via the embargo region. Hardest hit are industry, the international traffic, tourism and energy as well as agriculture. Due to the complicated transport situation investment risks increased, and FDIs fell considerably.¹⁴

Like Bulgaria, Macedonia too is suffering heavily from the embargo it is committed to support. 80% of its trade had formerly been performed with the other former republics of the Federation, 60% with Serbia alone. This already extremely difficult situation was further aggravated when Greece imposed its unilateral embargo on Macedonia. I will come back to this issue a little later. Interrupted transit routes isolating the country almost completely have caused losses of altogether at least U.S.\$4 billion according to a recent interview of Minister of Finance and Vice Premier Zuta.¹⁵

Ukraine is an example of a country non-bordering on the crisis region. It too is claiming huge losses from the embargo amounting to an alleged total of U.S.\$4 billion by the end of 1994. The country is arguing that the heaviest losses were sustained by Ukraine's inland water transportation enterprises, especially the Danube Steamship Line which has lost all its clients. Losses were also sustained by smelting plants oriented toward exporting their products to Austria.¹⁶

Negative impacts, of course, can also be stated for the other countries of the region whether they were neighbors of the crisis region or not. For Greece as well as for Turkey the transportation route via Serbia was, and still is, of utmost importance since 40% of Greece's exports in Western Europe had been conveyed on the land route through former Yugoslavia. Only Hungary was perhaps able to gain a little bit from the embargo; the Budapest airport registered a distinct intensification of frequentation, because it became the nearest gate to the rest of the world for Belgrade.

The Economic Dimensions of Non-bellucose Conflicts

The Impacts of Separation

The most striking example of a large scale dissolution is the former USSR. For the three Slavic successor states (Russia, Belarus and Ukraine) the consequences of disintegration seem to be similar to those faced by all

former Soviet republics, and to some extent they also seem to be characteristic of those with which the former CMEA member states had to deal. However, some very substantial differences certainly exist.

In the former USSR the slow progress of stabilization, transformation and state formation led to a chaotic vacuum in which the republics have turned autarkically inwards. As a consequence intra CIS trade which formerly was of substantial importance for the participating republics collapsed. Some figures may underline this.

In 1990 Russia's total trade equaled 23% of its GDP. Interstate imports covered 47% of all imports and exports to the other republics accounted even for 70% of all Russian exports. In Ukraine foreign trade was equal to one-third of the GDP, and interstate imports and exports covered in a very balanced way 70% of the total foreign trade. The situation was or rather is now even worse for Belarus, where foreign trade made up 49% of the GDP, and imports from the other republics covered 75% of all imports, whereas on the export side even 90% of all deliveries went to the rest of the Union. Although exact figures are not available for respective comparisons, mainly because prices underwent considerable changes, it can be assumed that the rather low figures of Russian trade decline which were officially given for the near abroad trade are certainly understating the real decline. This conclusion becomes evident when one looks at some index numbers for selected branches that were given in an interesting study by the Vienna Institute for Comparative Economic Studies.¹⁷ There one can find that Russian CIS exports/imports declined between 1989 and 1992 in crude oil by 43/42% respectively, in paper by 36/7%, in trucks by 47/48%, in tractors by 65/48%, and in consumer goods by 55/79%.

A similar picture can be drawn for Moldavia which before the breakup of the Soviet empire transacted 90% of its foreign trade with the rest of the former USSR. Now deliveries from other parts of the former USSR have become difficult and costly. Industrial production decreased between 1991 and 1992 by 28%, and agricultural production, of which a large part has traditionally been delivered to the rest of the Union, by 18%. The conflict with Transdnierster caused additional damage since in 1991 the share of this breakaway part of Moldova was 36% in industrial production (for some products even 100%), 87% in the production of electrical energy and also 26% in the production of consumer goods. The breakaway part of Moldova is now even requiring special taxes for the transport of Moldovan merchandise through its territory which lies like a belt between the rest of Moldova and the CIS.

Disintegration plus Embargo: The Case of FYROM

Macedonia, or correctly still called the Former Yugoslav Republic of Macedonia (FYROM), has suffered finally from three components: disintegration, UN-embargo against Serbia, and unilateral trade embargo from Greece.

Before the breakup of former Yugoslavia the economic ties of

Macedonia with the other republics of the Federation were extraordinarily intensive. More than 80% of its foreign trade was with the rest of the Federation, 60% trade with Serbia alone. Thus, the embargo and the sanctions hit Macedonia threefold: 1) through the cut of 60% (trade with Serbia); 2) with the other 20% (rest of former Yugoslavia, mainly war-inflicted Bosnia and Croatia); and 3) because again the main traffic routes from Macedonia to the north and the west are crossing Serbia, cutting off the new republic almost completely, in particular when finally Greece started its boycott and complete embargo against what it called the Republic of Skopje. The Greek trade embargo became so decisive because Thessaloniki in fact had been the major sea port for Macedonia with an easy traffic connection through the Vardar valley.

An example may be the case of oil imports. Before the embargo the oil refinery of Skopje received 70% of its raw material deliveries via Thessaloniki. In 1993 this was roughly one million tons worth U.S.\$125 million. Transport costs for one ton of oil soared by U.S.\$50 due to the fact that it now had to take the Bulgarian port of Burgas as entry.¹⁸ One hundred trucks were commuting daily on winding roads in poor condition between Burgas and Skopje to secure the basic needs of the Macedonian economy. But also the Greek contribution to the supply with other basic products, food included, had always made up some 40% of Macedonian imports.

The utilization of industrial capacities in FYROM fell to a level of 30-50% of previous performance depending on the respective sectors, and it is amazing that no total economic collapse occurred. It was obvious that 1995 was to become the decisive year since every year Macedonia lost some U.S.\$3 billion in exports due to the international embargo on Serbia and U.S.\$15 million per day in export revenues due to the Greek blockade.¹⁹ A rigorous financial and monetary policy was implemented bringing in fact annual inflation down to 52% and reducing the budget deficit to a figure of 3.5% of GDP. As a result the rate of exchange of the Macedonian denar remained stable.

It could not be expected that greater amounts of FDI would find their way to Macedonia under these very unfortunate circumstances. In early 1995 the country ranked only 150 among 167 countries concerning economic attractiveness.

It is, however, interesting that Greece too was indirectly suffering from the embargo it had imposed on its northern neighbor. Not only had Greece to reorient its own exports (in 1993 Greece exported merchandise worth U.S.\$300 million to Macedonia), but also the Greek drachma came under pressure on the international markets after the embargo announcement. Furthermore, the Athens Central Bank had to intervene with some U.S.\$100 million, a sum which is not so insignificant for a small country like Greece.²⁰

The Greek-Albanian Conflict

Another example of a non-bellicose conflict in the area is the recent dispute with accompanying actions between Tirana and Athens. Without question this conflict is detrimental to both. Albania is heavily dependent on the transmittances of its 500,000 compatriots working abroad of which some estimated 200,000-300,000 try to make their living in Greece. These transmittances enable the Albanian population to live above their own production capacity and are covering the constant hard currency deficit in Albania's current account. On the other hand, Greek agriculture needs cheap labor, and farmers are certainly against a complete expulsion of the illegally working Albanians. In addition, Greek industry is very much interested in intensifying contacts with the Albanian economy, and disregarding the political tensions; in fact some Greek FDI can already be found in Albania. In principle it should not be too difficult to come to an agreement where both sides acknowledge some basic demands by the other side. Albania should give in with regard to their Greek minority and allow, for example, school education in the Greek language where a sufficient number of Greek students exists, and Greece could very easily legalize the stay of up to 300,000 Albanians whom the Greek economy needs anyhow.

Some Reflections on the Economic Dimensions of Competition

If one limits this issue to the Balkans only, it immediately becomes obvious that the question of competition is too premature to be really of importance. Asking where and with whom the above mentioned troubled countries can compete, one can only see one direction, the EU markets. So far, however, only Bulgaria, Romania and Slovenia (as one of the successor countries of former Yugoslavia) are objects in the discussion on future EU membership. Albania has just entered negotiations about a possible association treaty, but like other countries in the area, which are successor countries of former Yugoslavia, it is economically so weak that one cannot speak in terms of competition but rather in terms of development aid. Of course, some competition can arise from the fact that these countries cannot offer other products besides some raw materials or food products, and insofar they will become competitors on the neighboring, western markets, in particular with the southern member states of the EU and also with some of the already associated countries of the former East. But one must realistically see that already now even these associated countries have quite substantial problems with marketing their products. The EU cannot as yet open completely its so-called sensitive markets (agricultural products, textiles and steel) due mainly to the understandable resistance from the EU-countries of the southern tier.

That means that chances are rather slim for the latecomers to compete with these more or less easy products on the only larger market which is of vital interest to them, the EU. Even more problematic is certainly competition with industrial products, because here too the already

EU-associated countries are trying hard. Some of them, but not the southeastern European ones (Bulgaria and FDIs are a condition-sine-qua-non for rapid modernization as long as domestic saving is extremely small and thus investment capital is not sufficiently available. As a consequence, the first real competition in the immediate future will be for FDI.

Chances and Perspectives of Regional Cooperation

Regional cooperation in southeastern Europe has never played an important role. Even during CMEA times the so-called socialist cooperation and division of labor was mainly bilaterally oriented, i.e., not like a spider web but rather like a wheel with all spokes leading to the hub in Moscow, on the one side, while on the other one could also find a single partner, Poland or Bulgaria or one of the other partners. Intra-Balkan trade made up just some 5% of the total foreign trade of the Balkan countries in the 1980s. The very last attempt of a series of Balkan cooperation conferences was then interrupted by the events of 1989/90.

However, there are still some more or less promising cooperation groupings which will be presented here briefly.

Central European Initiative

The first serious attempt derived from the working group Alps-Adriatic (1978), which existed only on a province level between bordering provinces in Austria, Hungary, Italy and Yugoslavia. It was later, in November 1989, lifted to state level and renamed The Initiative of Four (countries). When Czechoslovakia joined in May 1990, the name was changed into Pentagonale, and had to be changed again into Hexagonale when Poland became a member in July 1991. On 1 December 1991, the meeting of the foreign ministers in Venice took place for the first time without the Yugoslav representative (so one could have spoken again of a Pentagonale), but at the same meeting quick acceptance into the group of Slovenia and Croatia, which had already declared themselves independent states, should have changed the name to Heptagonale, which would have been appropriate. However, the general understanding was that too often a change of the name due to the alternating number of members would be rather annoying. Therefore, a new denomination was sought and found, Central European Initiative (CEI).

This regional cooperative group established several working fields: transport and traffic, environmental protection, information, telecommunications, promotion of small and medium size firms, culture and tourism, scientific and technical cooperation, energy and migration. In some fields substantial work has already been initiated, particularly in transport concepts, energy (pipelines) or environment, but many of the projects just beginning had to be put on ice due to the outbreak of the Yugoslav war. Therefore, today the list of cooperative fields looks rather comprehensive, but there are not too many actual activities because among other problems,

the financing of common activities still seems to be extremely complicated.

But, anyhow, the relevance of this initiative, which originally was launched by Italy, decreased substantially due to political developments in Europe. Until the late 1980s the East-West divide needed the inter-regional dispute as a bridging instrument, today also for the former Eastern countries the main point of orientation is Brussels, which brings us to the fact that larger interregional projects in energy or traffic are no longer discussed on the level of the CEI. This and the already mentioned financial problems have led to the establishment of a Permanent Secretariat for Projects of the CEI at the London based European Bank for Reconstruction and Development (EBRD).

Today the Central European Initiative has already ten members. In addition to the founding members, Austria, Hungary and Italy, we also find such different partners like Poland, Croatia, Slovenia, Bosnia-Herzegovina (since July 1992) and FYROM (since July 1993). The Czech and the Slovak Republics were admitted individually as members in January 1993 after having been one single member before. At the Trieste summit meeting of July 1994, Belarus, Bulgaria, Romania and Ukraine participated for the first time as associated members. At the time, the full members did not follow the proposal of Czech prime minister Y. Klaus to change the status of the latter (associated members) into full membership in the near future. One can speculate whether this proposal was a tricky attempt to dilute the whole issue of regional cooperation rather than to foster it, if one remembers the otherwise clear anti-position of Klaus in similar discussions. However, at the same meeting at least accord was reached to establish a Free Trade Zone in this region as soon as possible.

This had already happened, although with a distinctly smaller number of countries, in the framework of CEFTA which was initiated by the Višegrád Four (Czechia, Hungary, Poland and Slovakia) and was enlarged to a group of Five by accepting Slovenia as full member in the beginning of 1996.

Black Sea Economic Cooperation

The necessity of regional cooperation seems to be obvious which explains the existence of some more interest groupings in the region of middle and southern Europe, like the Danube Cooperation, a loose collaboration of countries along the river Danube in some fields of common interest (traffic, tourism, environmental and water protection, etc.) or the Carpathian Region Cooperation. On a more comprehensive scale, however, only the idea of intensified cooperation of the Black Sea Shore Countries might have some chance to develop.

When in 1990 the European Community had practically turned down Turkey's application for full membership, the latter summoned a meeting of the deputy foreign ministers of Turkey, Bulgaria, Romania and the (then still) Soviet Union at Ankara in order to propose intensified cooperation among countries of the Black Sea region. A number of

declarations were announced, particularly the July 1991 Declaration of Moscow on Economic Cooperation which aimed at free exchange of goods, capital and services. Already Greece and (the former) Yugoslavia, although not being Black Sea countries in the geographical sense, participated as observers. The signing of this document had to be postponed several times because half a year later (end of 1991) this group no longer had four but six (former USSR republics) plus three, i.e., seven members, where among some of which (Armenia and Azerbaidshan: Russia and Ukraine) serious, even bellicose, conflicts had emerged. Nevertheless when at the end of July 1992 this document was signed in Istanbul, Albania had also already joined the club. One can only conclude that the whole intentional declaration must be understood as very superficial in order to get approval by all. In December 1992 Poland too applied for the status of observer.

In fact, the eighteen-paragraph document is very general. The only specific aspect is the stress on the intended multilateralism for future economic cooperation. The text often makes reference to the CSCE process, the Charta of Helsinki and the Charta of Paris underlining that it is supposed to be a model of cooperation that should have its place in the new European architecture to which it should also contribute. It should not be seen as a substitute for the rapprochement to and the later full inclusion into Europe, but as a regional instrument for the European idea.

The Black Sea Cooperation (BSC) has two institutionalized organs, the Council of Foreign Ministers which meets once a year, and a Parliamentary Assembly. But it has neither a seat (headquarters) nor a secretariat. Since the ratification of the Basic Declaration some activities followed that might indicate the potential, but the implementation and realization of practically all programs stagnate. Of course one finds all the imaginable areas of possible cooperation if one reads the list of preferential sectors: finances and banking, transport and traffic, communication, tourism, exchange of statistics, science and technology, environmental protection. But even the establishment of a Black Sea Foreign Trade and Investment Bank, concluded at the meeting of the foreign ministers in Sofia in December 1993, has not been realized until today, although all details were settled: seat in Thessaloniki, capital distribution (Greece, Turkey and Russia each 16.5%; Bulgaria, Romania and Ukraine each 13.5%; Albania, Armenia, Azerbaidshan, Georgia and Moldova each 2%), and board of directors (Turkish president and a Bulgarian vice-president).

The only more promising event in BSC activities in recent times was a meeting held on Chalkidiki (Greece) at the end of May 1994 when representatives of the EU, of the BSC, and of the five republics of central Asia tried to launch concrete cooperation between the EU and the BSC in the field of energy (New Energy Realities in the Black Sea Region). This only indicates that BSC needs a push from outside in order to move ahead, at least as long as its institutional framework is so weakly formed.

However, it must be mentioned that at least business itself seems to become more aware of the crucial necessity of the regional cooperation in practice. In early February 1995, the Greek American Chamber of Commerce and the Association of Northern Greek Industries held a

conference devoted specifically to entrepreneurial cooperation in the Balkans. During the conference an Inter-Balkan Council of Entrepreneurs was formed which would examine chances for cooperation in trade, industrial production and construction. Furthermore an Entrepreneurial Center for the Balkan and the Black Sea was founded, and for the first time, the Preparation Committee for the Black Sea Bank met. It is of some interest that not least the Russians seem to be interested in economic cooperation in the Balkans. After having established a Greek-Russian Chamber of Trade and Industry, an intensification of the economic (and to some extent also political) axis Athens-Sofia-Belgrade-Moscow is again on the agenda. This should, however, not disquiet Western Europe but rather be viewed as one more necessary attempt at self-aid for the troubled region.

To sum up, regional cooperation in southeastern Europe is due to the unfortunate political disparities and trouble spots in the region, still more wishful thinking than reality. But it could and should be an area where western institutions and organizations could exert very helpful assistance through targeted financial and expertise support. When the Economic Commission for Europe of the UN called for a coordinated all-European support program, the fostering of regional cooperation could very well be understood as one core issue.

NOTES

1. Onasa, 9 August 1994.
2. I intentionally do not speak of Muslim territory because still some Croats and even Serbs are cooperating with the Muslim dominated government in Sarajevo, and also at least on paper the Croat-Bosnian federation exists.
3. Onasa, 22 February 1996.
4. Djordje Popov, "Die Wiedereinordnung der BR Jugoslawien in die Weltwirtschaft nach der Aufhebung der Sanktionen." Forthcoming in *Südosteuropa*.
5. *Neue Zürcher Zeitung* (FA), (24 December 1994).
6. Tanjug, 30 June 1994.
7. *Politika*, cited by AFP, 26 November 1993.
8. Jens Reuter, "Die wirtschaftliche Lage in Slowenien und Kroatien," *Südosteuropa*, 8 (1995):457.
9. NfA (M.E.), 19 February 1996.
10. Ibidem, p. 454.
11. NfA, 4 March 1996.
12. Radio Bulgarien (German), 15 March 1995.
13. Veneta Momchava, "Bulgarien und das UN-Embargo gegen Serbien und Montenegro," *Südosteuropa-Mitteilungen*, 4 (1993):314. See also N. Slatinski, chairman of the Committee for National Security of the Bulgarian Parliament, in BTA (English), 6 September 1993.
14. Momchava, "Bulgarien und das UN-Embargo gegen Serbien und Montenegro," p. 315.
15. *Neue Zürcher Zeitung*, 12 March 1996.

16. *Interfax*, 14 March 1995..
17. Helen Boss and Peter Havlik, "Slavic (Dis)union—Consequences for Russia, Belarus and Ukraine," *Economics of Transition*, 2 (2):233-254.
18. N/A, 22 February 1995.
19. *Neue Zürcher Zeitung*, 19 July 1995.
20. *Blick durch die Wirtschaft*, 28 February 1994.

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Economic Transformation in Southeastern Europe Slows Down— The Gap to the Vishegrad Group Deepens*

Ognian Hishow

In the communist era countries with different historical backgrounds, economic development levels and specific industrial and agrarian structures were compelled to unify in a monolithic political and economic bloc—the Comecon. Despite huge efforts undertaken by the centralized planning system to enhance the level of the backward socialist system members, at the end of the eighties there occurred significant qualitative and quantitative differences between the old industrialized central European members and the most agrarian southeast European economies and societies. Yet these differences have been veiled by the planning system, which stimulated a faster industrialization of the latter countries, especially Romania and Bulgaria. Thus statistics seemed to prove the superiority of the Comecon over the West concerning growth ratios as well as rising the nations standard of living.

This situation changed radically after the demise of communism. East European economy suddenly faced the cold wind of international competition and has been challenged to adjust as quickly as possible. Better prepared seem to be the central Europeans. Among their group, to which we could include Hungary, Poland, Slovakia and the Czech Republic, the latter seems to have coped with the system and economic transformation best. Despite its considerably earlier start of cautious economic reforms, Hungary, which had been the economy with the most market elements during the late socialist era, appears now less trusted in the market powers than its Czech neighbors. This is also valid for Poland—a country which has made great efforts to get rid of soviet communism but whose less efficient economic structures are a heavy obstacle to a swift transformation.

During the last Comecon decade Bulgaria showed a higher national income per capita than Poland,¹ whereas Romania was somewhat behind. Since 1990 Bulgaria and Romania have launched a comprehensive transformation, but the pace of changes appear to be slower than in East Central Europe. Thus the country-ranking shifted—Bulgaria fell behind Poland, and Romania again occupies the last place among the east Europeans. As a result of the timid reforms, of deep conservatism and for traditional reasons a yawning gap between the western-catholic and Byzantine-orthodox members of the former CMEA is threatening to become permanent. Rising doubts by the Bulgarians and Romanians as to whether they can rely on the support of the West have been amplified psychologically by respective statements of Western politicians, such as that of NATO's secretary-general Willi Claes. Claes is not sure the members of the Byzantine world are able to acquire the democratic qualities that are a prerequisite for genuine changes.² Whether this doubt is reasonable cannot be answered yet. Besides the Byzantine world is bigger, this article emphasizes the results obtained by the southeast and east European partners who have association agreements with the EU according to the assumption that their chances to join the Western structures are more favorable. These countries have been until now Bulgaria, the Czech Republic, Hungary, Poland, Romania and Slovakia. It places special emphasis on the reform efforts in both Romania and Bulgaria as representatives of the southeast Europeans. Nonetheless, it considers also the transformation achievements of other countries in the region.

GDP-Growth

The starting positions of the former small soviet bloc countries were different. According to the unequal transformation pace up to now a further diversification can be expected.

While Poland's economy has grown for at least three years, the Czech's and Hungary's have on average shrunk slightly, and the decline in Bulgaria's and Romania's production has been severe (Chart 1). The somewhat larger yearly GDP shrinking in Slovakia in comparison with the Czech Republic can be explained by the division of the former federal state, by unfavorable heavy industrial structures, and by economic policies of more gradualism. Distortions as well as inefficient branch- and firm-structures in Romania and Bulgaria are also responsible for the current difficulties in the transformation. In the past a core of the economic policy in these countries has been the development of basic manufacturing branches. They employ a big share of the labor power and demand huge quantities of raw materials, energy and infrastructure resources. Now they have become the most important receivers of state subsidies and credits—at the expense of other possible productions and companies with better

TABLE 1
GDP per Capita 1994 and GDP Growth Rate 1991-1995

Country	GDP/capita, \$	GDP Growth Rate					
		1990	1991	1992	1993	1994	1995**
Bulgaria	1.210	-9.1	-11.7	-15.0	-4.2	-1.0	0.0
Hungary	3.010	-3.5	-11.9	-4.5	-2.3	1.0	2.0
Poland	2.160	-11.6	-7.6	1.5	3.8	4.0	5.0
Romania	1.062	-5.6	-12.9	-13.6	1.2	0.0	0.0
Slovakia	1.671	-3.0	-15.8	-8.7	-4.1	-2.0	2.0
Czech Republic	2.526	-2.0	-14.7	-7.1	-0.3	2.0	3.0

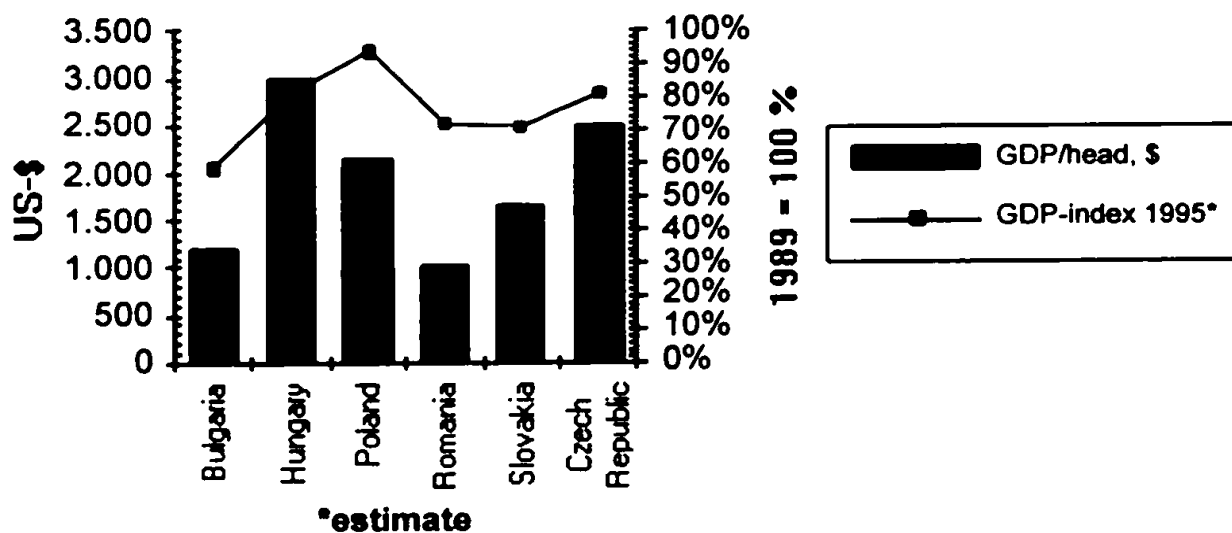
*Percent change on year earlier

**Estimate

Source: DIW Berlin; IFO Institute Munich; The Vienna Institute for Comparative Economic Studies

CHART 1

GDP per Head 1994 and real GDP 1995* as % on 1989



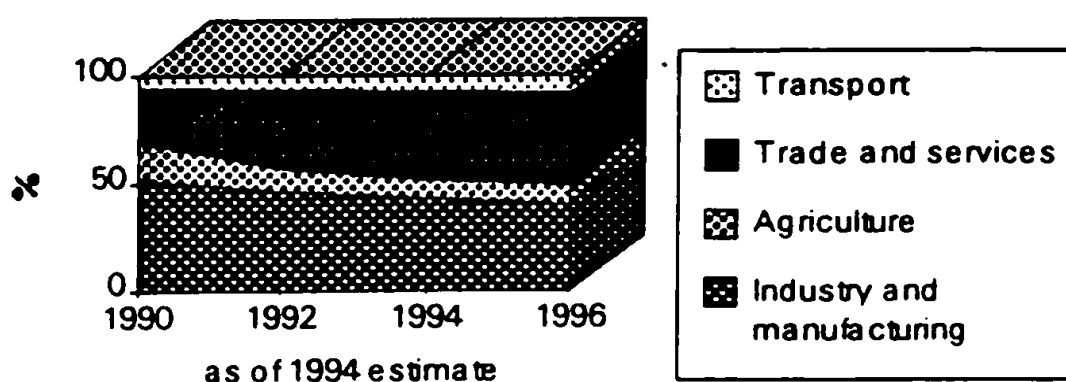
Source: Statistisches Bundesamt

perspectives. These other branches contain increasing growth potential and are bound to pull the economy out of its crisis. But they have yet to be promoted sufficiently.

However, structural changes in southeastern Europe can be forecasted: the share of services in the GDP is expected to rise at the cost of the manufacturing share as the Bulgarian example has proved (Chart 2). This tendency is observed in Romania and in the other former socialist economies, and can be understood as a "structural normalization." Western industrial countries have relatively small industrial and agricultural shares of their GDP, e.g., Germany 39% and 1%, respectively, and the U.S. 29% and 2%.³

CHART 2

Structural changes of Bulgaria's GDP



Source: IMF

While Poland, the Czech Republic, and Hungary started a consistent reform program which aimed at the swift introduction of more market elements in their economies, Romania and Bulgaria have been timidly longer to launch similar changes. They lost precious time and caused a lag in their steps of transformation compared to the Vishegrads. While production decline in the central European countries could still be braked, Bucharest and Sofia were ambivalent about how to create the transformation. Bulgaria strongly felt the pressure of its external debt and creditors of the London Club, and it introduced a price liberalization in the spring of 1991—roughly a year later than the so-called Balcerowicz plan had been introduced in Poland. Romania hesitated somewhat longer and reluctantly agreed to shock therapy.

There are different reasons for the reform delay in both countries. The imperfect party structure in Romania appears as a main obstacle to the

reforms. There are no proper coalitions there. Not only do the former communists represented after the revolution by the Front for National Salvation of president Ion Iliescu (now renamed as the Party for Social Democracy) have a hostile attitude towards privatization and "capitalism," but the strong Romanian nationalist opposition battles also against the "dictation of the foreign agents"—and especially against the international financial entities, such as the IMF and the World Bank. Iliescu and his ruling Party for Social Democracy depends in the Romanian parliament on the backing of the extremely nationalist right wing Party of National Unity, whose leader Silvio Funar rejects "foreign interference." On the other side the democratic opposition, united predominantly within the Democratic Convention, is not strong enough to persuade voters to support consistent reforms. It is difficult to judge why their reform proposals are timid. They should have to include not only privatization, but stronger monetary policy and intensive enterprise restructuring.

In Bulgaria the conviction in the necessity for reforms has prevailed since the collapse of the old system. However, Bulgarian policy has not been able to utilize the initial confidence in the market powers to boost privatization and reduce the influence of orthodox communists, who still exercise strong influence, especially in the countryside. Similar to Romania, the Bulgarian political landscape is dominated by the communists. Nevertheless, in Bulgaria one meets, at least until now, a dual parliament structure with only left- and right-wing political entities and without a center oriented party. Similar to some central European countries, there has been strong anticommunist opposition, even if only as of 12 December 1989. It is institutionalized through the Union of Democratic Powers (UDF), which temporarily (1991-92) has been the ruling party.

For these reasons both south European countries went backwards in comparison to their Vishegrad competitors. Whether they can join this group in the next years seems unlikely.

In Yugoslavia⁴ the industrial output decreased between 1989 and 1993 at an average monthly rate of 2.4%. At the beginning of 1994 the industrial output index declined at 28.1% compared with 100% in 1989. Meanwhile it seems that in Yugoslavia the bottom has fallen out of the industry, and industrial output is likely to rise as a result of a launched program of economic recovery. This program has been introduced since February 1994. A further important macroeconomic stabilization effect seems to be the elimination of the hyperinflation with the launching of the program. Since January 1994 the general price level has been kept at a constant level in the first half of that year.⁵

TABLE 2
Main Economic Indicators of Some Economies in Transition

Country	Industry, %*			Inflation, %**			Unemployment %		
	1992	1993	1994	1992	1993	1994	1992	1993	1994
Bulgaria	-16.8	-8.5	-5.0	85	70	120	16	16	18
Romania	-21.9	1.3	2.0	210	256	200	8	10	12
Poland	1	4	16.7 ^b	43	35	30	14	16	15
Slovakia	-14.5	-13.9	-8.0	10	25	20	10	15	17
Czech Rep.	-13.8	-10.0	-8.2 ^b	11	20	10	3	4	6
Hungary	-5	-2	7.5 ^b	23	22	20	12	12	12
Russia	-18.0	-16.2	-10	2500	840	700	0.8	1.5	-
Ukraine	-14	-15	-12	1400	4500	4000	-0.4	-	-
Belarus	-9.4	-10.0	-34.7 ^a	1100	1700	2000	0.5	1.4	1.7 ^a
Yugoslavia	-15	-16	26.8 ^c	9300	1165 ^d	0.1 ^e	24.3	24.7	n. a.

*Real change on year earlier; **consumer prices, change on year earlier;

^aMarch; ^bSeptember; ^cJan.-June; ^dbillion times; ^eJan.-Jun.

Source: Die Lage der Weltwirtschaft und der deutschen Wirtschaft im Frühjahr 1994, *DIW-Wochenbericht*, 16-17 (1994); Die wirtschaftliche Lage Rußlands. *DIW-Wochenbericht*, 19 (1994); Die wirtschaftliche Lage Weißrußlands. *DIW-Wochenbericht*, 25 (1994); *Yugoslav Survey*, 2 (1994).

Restructuring Measures

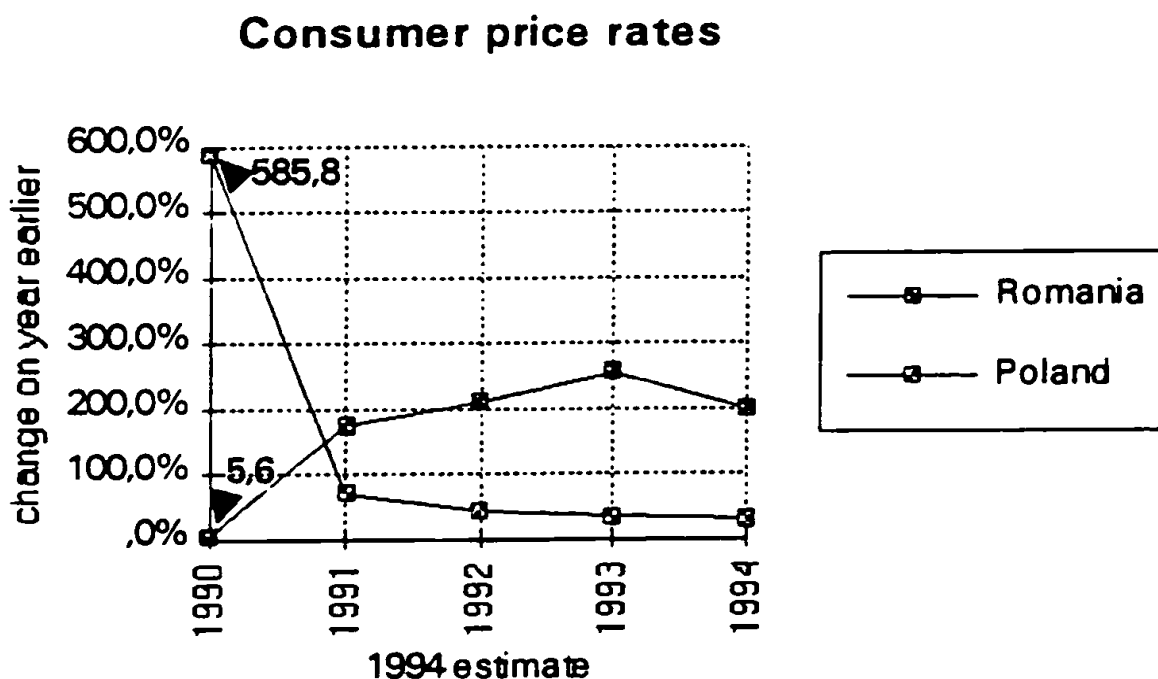
Inflation, Fiscal Policy and Money Supply

Since the demise of the old centralized planned system, reducing the high rate of inflation has been one of the main economic policy goals in southeastern Europe. The respective efforts have not yet been sufficiently successful. The desirable inflation rate in Romania has been exceeded many times. Throughout 1993 the increase in prices reached 295% as compared to December 1992. The monthly average increasing rate was at 12.1%.⁶ In 1994 a lower monthly average can be expected, 9.5%, similar to the 1992 figure of 9.6%. While in 1994 the government expected a rate of about 75%, the National Bank reported a considerable higher one. As compared to 1989 the consumer price index of 1994 figured an increase of 9.5. This unsatisfying result is caused by the gradual and procrastinating price liberalization. Some prices, such as basic foods, medicaments, heating etc., have been valid until 1993 when the last price controls were lifted. Another reason was the delay in freeing the leu-exchange rate, which was accomplished on 1 April 1994. The full liberalization of the exchange rates

was another key provision of an agreement between Bucharest and the IMF for a 3. standby credit totaling \$700 million, to be realized in 1994 and 1995. The freeing of the leu led to hikes in prices of energy and gasoline. Other rises in price followed for most goods and services, resulting in an overall increase of 14-15%.⁷

The higher costs of the gradual approach to transformation and liberalization are apparent when a typical gradualistic country is compared with a shock therapy one (chart 3). While in 1990 the inflation on the base of the consumer prices increased in Romania only by 5.6%, Poland showed a figure of 585.8%. Poland has suffered hyperinflation since 1989 when the last communist government hesitated to introduce comprehensive reforms. After the Balcerowicz plan went into effect in 1990 inflation in this country could come under control. In the following years the inflation rate, the rise in consumer prices, remained moderate. In Romania inflation skyrocketed in 1991 and it has resisted to slow down for several years. As a result this country recently showed the highest price rates among the former small CMEA members⁸ (chart 3). Rapid shrinking income in real terms provoked a decrease in demand for food items and durable consumer goods. Thus the price elasticity of demand remains low.

CHART 3



Source: National Bank of Romania; IMF

Bulgaria too should not be content with the results of the financial stabilization efforts. Unlike the Czech Republic, and similar to the other

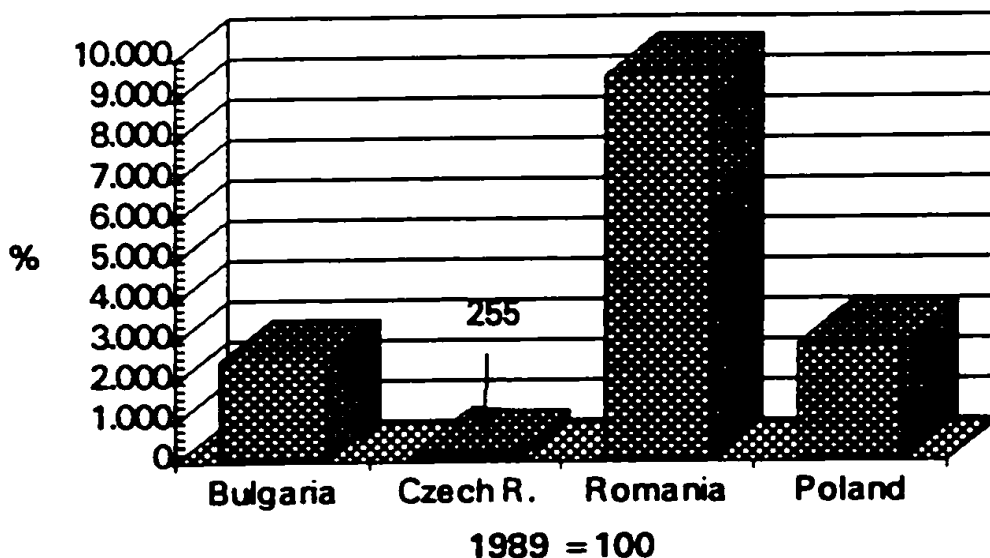
former Comecon partners, the Bulgarians missed tightening the budget spendings and rising the revenues to date. The initially introduced policy of hard budgetary constraints were abandoned in 1993. The country struggles with high budgetary disequilibrium which erodes its inflation control program. Among the eastern European partners that have association agreements with the EU it had the highest difference between revenues and budget spendings in 1993, 15% of GDP. Slovakia and Hungary followed far behind with 7% and 6%, respectively. Romania and Poland recorded a deficit of 2%⁹ and 4%, respectively. (The Czech Republics budget had a small surplus). Indeed, Bulgaria liberalized prices considerably quicker and more consistently than Romania, Russia, and even Hungary. The first price hike in 1991 helped to surmount the important money overhang within the Bulgarian economy. But the ambivalent attitude of the Bulgarian political class towards the ensuing steps of the macroeconomic policy slowed its pace and caused further sacrifices for the population. Especially the reluctance of the Lyuben Berov cabinet to accept rapid privatization and further budgetary constraints, created a negative impact on the relationship between Sofia and international financial institutions. They are the most important financial partners of the country, because private investors are skeptical, Bulgaria, in the medium term, will be able to offer desirable standards of stability and security for private capital inflow. Thus loan packages from the IMF, the World Bank, the European Bank for Reconstruction and Development and other institutions of the EU exert a decisive influence on the country's monetary and financial stability. In general, the Bulgarian anti-inflation package was, until 1995, somewhat more successful than those in Romania, Russia, and the Ukraine. Yet it failed to bring inflation definitely down, which supposes dangers for price and currency stability and has meant high price indexes since 1989 (chart 4).

The Berov government lifted some of the fiscal restrictions of its predecessor the UDF cabinet, which collapsed in late October 1992. It introduced a wage indexation in the public sector which reduced the spending side maneuverability of the fiscal policy. The idea of enhancing the standard of the entire tax system has been rejected, and at the same time the finance minister claimed to relax the IMF requirements on financial policies in Bulgaria.¹⁰ However, it also achieved some improvements, especially in making tax collecting more effective. In 1993 the ratio between planned and collected taxes rose to 83.7% compared to 75.2% in 1992.¹¹ During the same year the volume of the subsidies on the state budget declined slightly and was about 10% of GDP. Romania also cut subsidies drastically, although they still show a lower level, 5.5% of GDP in 1993, followed by Slovakia with 4.8%. But in general subsidies in southeastern Europe are not much higher than in some EU countries. In 1991 Ireland's subsidies (including those from the EU) amounted to 6.6% of GDP; in

Greece they were over 5%.¹²

CHART 4

Consumer price index 1994



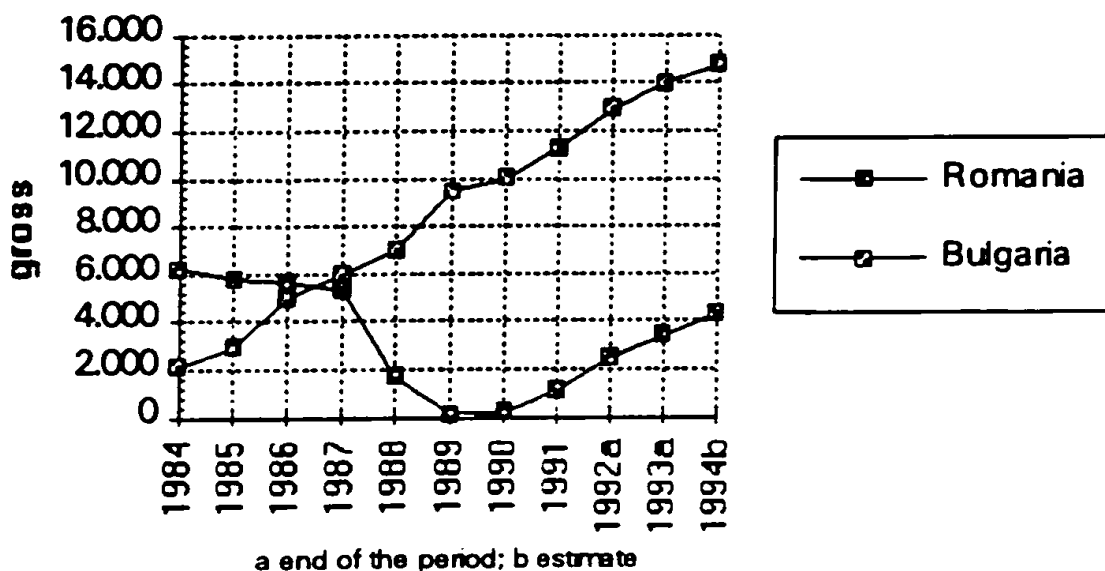
Source: NBR, DIW Berlin, IFO Munich, Statistisches Bundesamt

A heavy heritage from the communist era to be managed by the Bulgarian governments now is a huge external debt, which amounts to more than the GDP. Together with internal indebtedness it is one of the most important inflation sources for the economy. Although Bulgaria started later than Poland and Hungary to take large-sized credits from western governments and banks, it appeared as a very diligent borrower. Between 1985 and 1989 the external debt rose four times and as a whole Sofia accumulated more debt than it was able to serve. In early 1990 it was compelled to announce suspension of external payments. This step entailed dramatic consequences concerning the confidence of international creditors.

In 1990 Romania remained on the verge of a payment collapse and some agreements with the IMF appeared as an urgent necessity to overcome external payment difficulties. Following the exhausted foreign exchange reserves in the second half of 1990 only agreements concluded with the Fund helped to avoid bankruptcy. Since 1990 the process of taking credits quickened, and between 1991 and 1993 external debt augmented nearly 3 times.

CHART 5

External debt growth, million US-\$



However, Romania's external debt problem can be seen as not so dramatic, whereas Bulgaria is classified by the World Bank as belonging to the group of severely indebted countries. The other economies in transition are Albania and Poland. A large proportion of the Romanian external debt is of public descent—the biggest borrowers in 1993 remained the IMF (31.0%), EU (15.3%), IBRD (12.0%) and a range of western governments, whereas more than 80% of the Bulgarian debt is composed of credits from private borrowers. According to the criteria used until now such classification is valid for debtors whose external debt-GDP-ratio, debt service-export-ratio and interest payment-export-ratio exceeds 50%, 30% and 20%, respectively. As the current statistics show, Bulgaria as well as partially Albania respond to this criteria (table 3). Meanwhile, in 1994, Bulgaria achieved a great success by obtaining a comprehensive agreement with its commercial creditors, who agreed to write off U.S.\$3.8 billion of the debt.¹³

Monetary policy in both Romania and Bulgaria reflect the general ambivalence of stabilization measures in general. Bucharest relaxed its tighter monetary policy and enabled easier supply of the firms with credits. Additional liquidity, the expansion of the broad money M2,¹⁴ is reported to have risen by 120% in 1993, while GDP stagnated. Several things contributed to this: Cash transactions between companies rose to a great extent entailing higher money demand. Household deposits rose extraordinarily because of massive interest rate capitalization of the Savings Bank.

TABLE 3
External Indebtedness Indicators, %

Criterion	Minimum			
	World Bank Requirements	Bulgaria 1994	Romania 1993	Albania 1993
Debt:GDP ratio	50	102.0 (1992)	13.6	43
Debt: Exports ratio	275	360	58.5	525
Debt service: Exports ratio	30	58	5.8	89.5* (1992)
Interest payment: Exports ratio	20	32*	5.0	50*

*Estimate

Source: World Bank; National Statistic Institute, Sofia; National Bank of Romania; Pashhko, G., "Albania: The Transition From a Command to a Free Market Economy," *Südosteuropa*, 5 (1994).

The foreign exchange increased and the parallel leu depreciation boosted money deposits in lei terms, etc. The average nominal lending rate of the National Bank remained low, between 136% in January and 98% in June 1994. The same was valid for the commercial banks and it is the main reason for the negative real interest rate of both lendings and deposits.

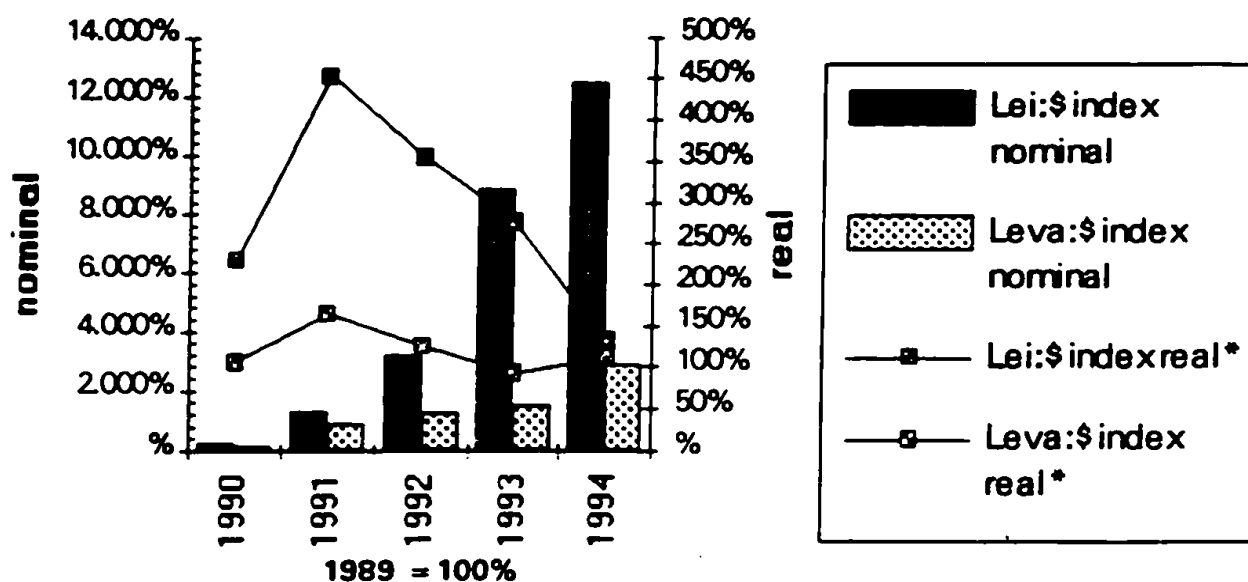
An underdeveloped banking sector in both countries and weak competition between the banks causes additional unfavorable influence on the interest rate. In both countries the emergence process of a two-tier banking system is proceeding slowly. Up to 31 December 1993 there were only four bigger state commercial banks operating in Romania. They hold approximately 77% of the aggregated balance sheet of the commercial banks, whereas twelve smaller state commercial institutes hold about 23%. Only two private banks play a significant role, and the share of private capital within the banking structure is deficient, although there are five foreign bank branches operating in Bucharest. A similar picture can also be observed in Bulgaria. The slow pace of establishing new banks reflects in both countries the National Bank's constrained possibilities to create a sound banking system.

High inflation rates in Romania and Bulgaria exerted significant pressure on the exchange rate of the national currencies and caused their devaluation against the hard international currencies (Chart 6).

In Bulgaria the nominal leva/U.S. dollar ratio, which remained relatively constant during 1992 and the first half of 1993, could not resist and

CHART 6

Leu and Lev Devaluation Against the US-\$



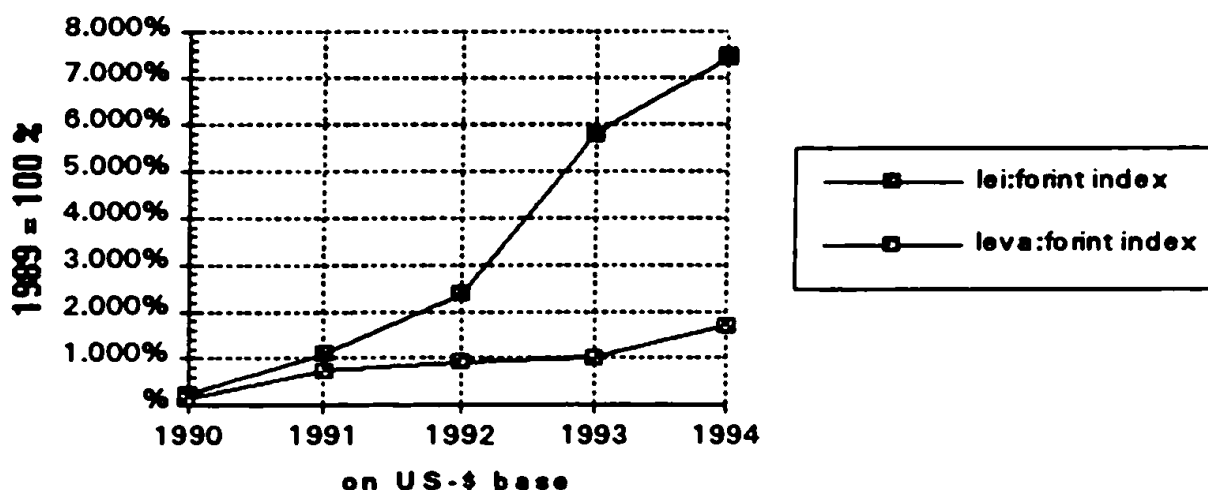
* deflated with the consumer price index

Source: National Bank of Romania; Bulgarian National Bank

skyrocketed, especially in November 1993 and in 1994. The leu has continuously fallen in nominal terms of the U.S. dollar since 1989 (Chart 6, left-hand scale). The development of both currencies is a result of an ambiguous attitude toward currency policy in these countries. While in Romania they have maintained a multiple exchange rate, an overvalued official rate and a market one which differ from each other considerably, in Bulgaria the Central Bank interfered periodically in the interbanking exchange market to back up the lev/dollar ratio. Nevertheless, this ratio shifted permanently, especially in 1994 when some bigger lev devaluations became necessary. By considering the inflation index the devaluation between 1989 and 1994 hasn't been as huge in Romania because of the decline of the U.S. dollar purchasing power in this country. In Bulgaria a periodical exchange rate adjustment occurred which has ensured a relatively proper real exchange rate since 1991 (Chart 6, right-hand scale). Both currencies fell against the Czech koruna and the Hungarian forint (Chart 7).

CHART 7

Nominal Leu and Lev Devaluation Against the Forint



Source: UN Monthly Bulletin of Statistics Nr. 1-6/1994; Statistisches Bundesamt

Privatization

A juncture of a comprehensive economic restructuring is the reduction of the state share of the economy. Swift advances depend on the consensus within the political landscape, and on the intention of the government to persuade the parliament and the political parties to endorse its privatization efforts. In a recent report the EBRD estimated that 65% of Czech GDP is now produced in the private sector. Hungary, Poland, and Slovakia follow closely behind with 55% each.

Thus the privatization advances in Romania and Bulgaria are far from satisfactory. The private sector share on GDP in Bulgaria was, at the end of 1994 below the results of the central European economies in transition. In 1994 the respective figure was estimated to barely exceed the 35%-frontier. The private sector contribution to the GDP is expected to extend to at least 40% in 1996 and to employ twice as many persons compared to 1993.¹⁵ Also Romania has until now a relatively small private sector. Only 35% of the GDP were privately produced in 1994.¹⁶ The contribution of the private sector to GDP was scarcely 30% in 1993 in comparison with 26% during 1992. That means that the Romanian privatization pace between 1989 and 1994 has been only half of that in the Czech

Republic, and about two-thirds of the pace of the other economies in transition associated with the EU, except Bulgaria.

The uncertainties within the institutional frame of the privatization might be responsible for the delay. There are several responsible entities in Romania. The National Agency of Privatization was founded in 1990 and is the oldest one. It announced, at the beginning of 1994, 7,841 assets of state companies for sale. A total of 37.2% of them with 13,353 employees have been sold in the first half of 1994 with a field of activity as follows: industry 154 assets, agriculture 85, transport 5, construction 12, trade 1,670, tourism 738, services 123 and various other activities 134.¹⁷ Small companies, especially in retail sales, prevailed and the average assets value amounted to less than U.S.\$20,000.

The State Ownership Fund was set up in 1991 in order to sell some 70% of the state-owned commercial firms within a 7-year period. Even if its first privatization activities have been timid, in 1993 the pace had accelerated and 292 companies with 80,575 employees were sold in that year. These results are far from satisfactory, even if the average value of these enterprises amounted to about U.S.\$200,000. According to the information available so far, in 1994 2,368 companies were selected for sale, of which 35 were of large size and 403 were of medium size. These companies represent 12 to 13% of the total assets of the state-owned enterprises.

The five private ownership funds are organized by territory and are joint-stock commercial companies. They are determined to privatize about 30% of the assets of the state owned enterprises. Apart from these entities various institutions and ministries are competing with the above-mentioned state and private institutions for responsibilities in privatization.¹⁸

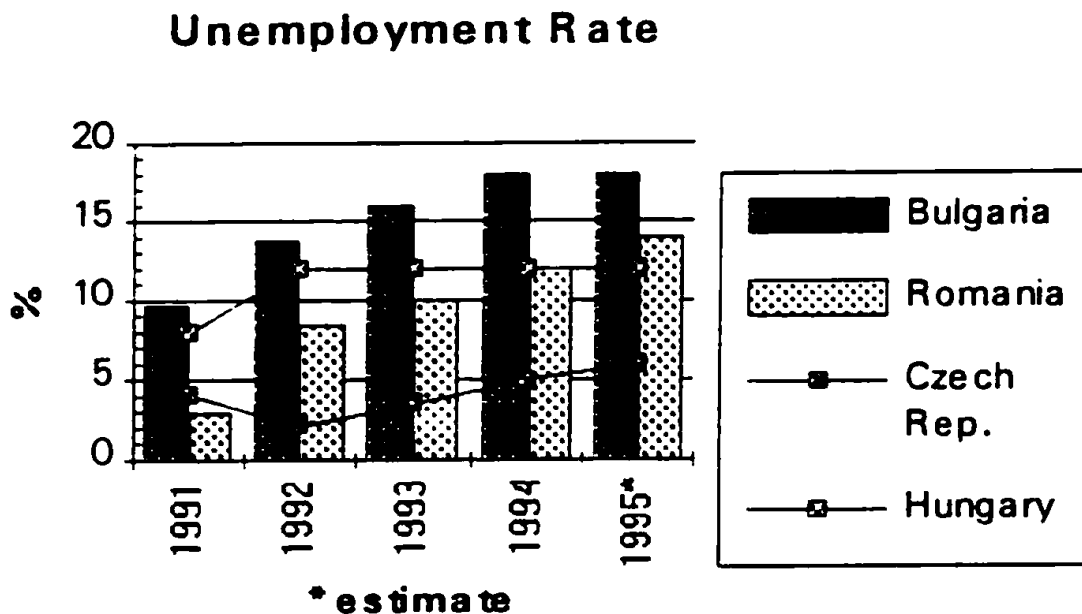
In 1994 the private sector accounted for 60% of Romania's agricultural output, 48% of retail sales, 41% of services, 28% of imports and 26.5% of exports. It employed about 37% of the countries labor power. The respective data for Bulgaria in 1994 are: retail sales 70%, agricultural output 59%, construction 23% and industry 3.3%.

Employment and Income

The economic crisis provoked a contraction of total employment and a rise in the unemployment rates in all countries in transition. For the first time since the end of World War II the population of those states have been confronted with nominal unemployment. Because of a lack of or only a marginal social net in comparison with the western countries, many of those workers who lost their jobs are forced to search for alternatives in self-employment. This tendency boosts the expansion of the private sector and supports even if only deficiently the economic transition. Jobs created within the private sector relieve the situation in the labor market. Yet the

newly created jobs have been less than those lost as a result of the transformation. Each country tries to cope with the labor market policy considering the threats provoked by a too high unemployment rate. The results have been contradictory (Chart 8).

CHART 8



Source: DIW Berlin; IFO-Institute Munich

In Bulgaria there is a tendency to stabilize the unemployment rate on a high level. Romania's unemployment rate is expected to rise in 1995, while the Hungarian figure remains lower and constant. Although the number of people officially recorded as employed in the Czech Republic fell about 12% between 1989 and 1993, the government recorded only a slight rise in the unemployment rate. Whether the Czechs will be able to sustain the "employment miracle" in future, when the big privatization is accomplished, and reconstruction of the heavy industry is launched, appears questionable. However, labor force problems in Romania and especially in Bulgaria remain difficult.

A positive effect of the labor force contraction in the countries who exert a shock therapy is that they could keep their labor productivity, in real terms, on a constant level during the last years. In addition, the labor costs, the real wages, stayed behind this productivity as the Bulgarian example proves. They are now very low. In U.S. dollar terms the average monthly net wages in Bulgaria remain about \$100 and will probably remain

stagnant in the next years. Even in Yugoslavia, wages remain higher although they suffered from the division of its previous single market and integrated economy, as well as the UN embargo (Table 4).

TABLE 4
Net Average Monthly Wages In Bulgaria And Yugoslavia, U.S.\$

Year:	1990	1991	1992	1993	1994	Yugoslavia 06/94
Nominal Wage:	127.11	49.95	82.23	117.14	84.55	111.30

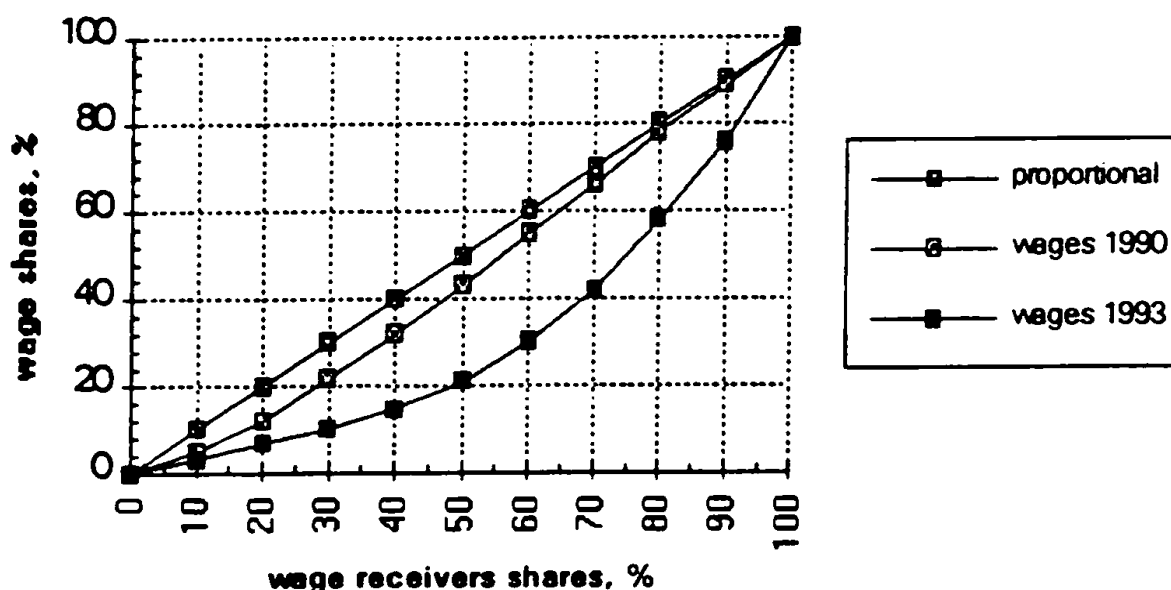
Source: Bulgarian Academy of Sciences; *Yugoslav Survey*, 2 (1994).

Whether such favorable conditions and effects will be able to enhance the economies export competitiveness is doubtful. Unfortunately productivity in crucial sectors such as industry fell, but this effect of the transformation is common in all East European countries. The labor productivity index in Romania's industry stayed in 1993 at 68% compared with the level in 1988.¹⁹

Not only real wages decreased but until now an unknown process of wage polarization among the receiver of labor income has been launched in the post-communist world. The formal—deceptive—equality within the society undergoes changes, and the share of high wage receivers declines. Meanwhile the share of small- and medium-labor income receivers grows which is an indication for adjustment processes in the economy and better labor power allocation by wages. The Bulgarian example proves that such dynamic development occurs, and it seems to be normal for a market economy (Chart 9). A proportional distribution is only theoretically possible. Nonetheless, the former socialist distribution has been reluctant to consider the productivity differences indicated in the wage income. Socialist planners have tried to keep the distribution curve near the theoretical one (still 1990). The more convex curve in 1993 means an “unequal” distribution caused by the market allocation of the labor power. Thus 60% of all wage receivers received about 30% of the wage sum. In Germany (particularly in the former West Germany) about 60% of the households got in 1992 about 35% of the net retained income.²⁰ Apparently such frame of distribution is for a post-communist economy, in this case Bulgaria, nothing unusual. Analyzed by branches, a tendency is occurring to keep income at a socially necessary level despite the different rates in which their activities are diminishing. Only in sectors in which state enterprises do not prevail, differences in productivity and payoffs are clearly reflected by respective level of pays.

CHART 9

Wages Distribution in Bulgaria



Source: Agency for Economic Coordination and Development Sofia

In Romania wages lost their purchasing power to a similar scale as in Bulgaria, and in most other reform countries. The real net wage was in 1994 only two-thirds of that of 1989. The polarization within the wage receivers is in this country a reality too. While in the past workers in some industrial sectors and in construction had the biggest wages, now employees in industry, agriculture and in state-owned service enterprises are confronted with bigger decreases of their income than those in the banking sector and private service firms.

TABLE 5
Net Nominal Wages in U.S.\$ and Real Net Wage Index in Romania
(1989 = 100)

Indicator:	1990	1991	1992	1993	1994
Nominal Wages, \$:	95.50	38.81	43.05	48.21	102.53
Wage Index, %:	105.6	87.4	76.1	66.3	66.3

Source: NBR; The Vienna Institute for Comparative Economic Studies.

Also the situation of the pensioners has deteriorated since 1990, because the average net pension in U.S. dollar terms is deficient and provides

only a subsistence income. In Bulgaria it was \$43.57 in 1993, whereas the average nominal pension/wage ratio is about 1/3. In real terms the pensions declined to similar scale as the wages did.

Institutionalized Multilateral Cooperation (Intended EU-Accession)

After the breakdown of the former CMEA, East European centralized economies have been confronted with the necessity to survive in a new economic environment without plans and coordination between the governments but with more competition and defiances. This new international framework is perceived by the post-communist entrepreneurs, who were spoiled by centralized planning in the past, as a heavy obstacle in managing the transformation. Especially in Romania and Bulgaria, both leaders and population expect more support from outside, and feel the west treats them worse than the Vishegrad group.

Both Bulgaria and Romania, as well as the Vishegrad group, have signed association agreements with the EU and each country aspires to become a full member. The membership is expected to be realized more or less in the coming years. On the other side, the EU does not hurry with the accession of the East-Europeans and has established preconditions to be fulfilled by the candidates. Even the satisfaction of the Maastricht criteria is not an accession guarantee, because the EU treaties do not contain a membership right. The budgetary implications of a possible EU enlargement are to be taken into consideration. Besides, the requirements on the candidates concerning their fiscal and money policy are hardly to be satisfied in the short term. For the last year before the accession decision, some of the Maastricht criterias for the economic and currency union insist that

1. the consumer price index must not exceed more than 1.5 percentage points the average inflation rate of the three best members,
2. the long-term government bond yield should not be higher than 2 percentage points of the three best's average,
3. budget deficit and outstanding public debt should not exceed 3% and 60% of the GDP, respectively.

Another effect of the examination is that the candidate becomes for two years a member of the narrow European Currency System. This should not provoke too much tension. Thus it is evident that scarcely none of the post-communist countries are able to satisfy such requirements now. However, the gap between the average EU level and the level of the post-communist candidates is still deep. On the other side there are also remarkable differences within the Union. They originate from the accession of the south European countries, Spain, Portugal, and Greece. As they became members, their economic indicators were comparable with those of the reform countries in Eastern Europe now.

TABLE 6
GDP Per Person in South and East European Countries 1960 - 1992
as % of the EU Average (at Purchasing Power Parity)

Country	1960	1970	1980	1989	1992
Greece*	32	45	51	49	
Portugal*	33	43	49	49	
Spain*	51	65	65	69	
Bulgaria					30
Czech Rep.					42
Hungary					34
Poland					29
Romania					16
Slovakia					33

* Germany = 100%

Source: *IFO-Schnelldienst*, 15 (1994); *The Economist*, 5-11 November 1994.

Leading within the group of reform countries is the Czech Republic, whereas Romania appears as the most backward member. Now the Czech Republic is deemed to be in a position comparable with Greece and Portugal in the early seventies. The other former CMEA-members considered (except for Romania) are comparable²¹ with these countries level in the early sixties. But even ordinary members cannot respond to them and that is why the Union has prepared a scheme of the two speeds convergence. It can be expected that in future some of the former CMEA-economies will outdo traditional EU members and satisfy the strong currency union criteria earlier, obviously the Czech Republic. Inflation is the biggest macro-economic worry there now, but it tends to be reduced and approaches the normal standard in the industrialized countries.

As Table 7 shows, only two (*italics*) large countries, France and Germany, responded in 1991 to the requirements of the currency union. The Czech Republic can rush to the club of the proper economies in the next years. The other East Europeans have to intensify their reform efforts and especially Bulgaria and Romania have to undergo a toilsome transformation process. This is necessary because at present East Europeans appear as competitors mainly in agriculture, steel, textiles and particularly construction, which are perceived by the EU as sensitive branches. Thus the EU is reluctant to accept applicants who threaten to become an additional burden for the EU budget, as this can be expected in the case of most post communist economies. If the EU would have

TABLE 7
Satisfaction of the Maastricht Currency Union Criteria, 1991-94

Country	Inflation Rate %	Government Bond Yield %	Budget Deficit % Of Gdp	Public Debt % Of Gdp
Belgium	3.2	9.3	6.4	129.4
Britain	5.9	9.9	1.7	43.8
Denmark	2.4	10.1	1.7	66.7
France	3.2	9.5	1.5	47.2
Germany	3.5	8.6	3.0	46.2
Greece	18.9	23.0	17.9	96.4
Ireland	3.2	9.2	4.1	102.8
Italy	6.4	12.9	9.9	101.2
Luxembourg	3.1	8.2	-2.0	6.9
Netherlands	3.9	8.9	4.4	78.4
Portugal	11.4	17.1	5.4	64.7
Spain	6.0	12.4	3.9	45.6
Bulgaria	100.0	49.1a	15.0	140.0
Czech Republic	10.0	9.5a	0.0	24.9c
Hungary	23.0	27.0	7.0	62.7
Poland	30.0	35.0a	5.4	64.5c
Romania	200.0	97.6b	0.0	13.6c
Slovakia	20.0	n.a.	4.0	n.a.
max 1991	4.4	10.6	3.0	60.0

a: Rate of discount in 1993;

b: NBR average lending rate in June 1994;

c: External debt based 1992

Source: IFO-Institute Munich; World Bank; Statistisches Bundesamt; NBR

approved an immediate enlargement by the Vishegrad Group, plus Bulgaria and Romania, it would have to provide bigger agriculture and regional funding. Only the Vishegrad group would have caused an extension of the current budget spending between 23.8% and 44.4%.²² The EU summit in Essen, Germany in December 1994 discussed a blueprint about bringing the six East European countries into the Union. It describes how the applicants need to prepare for membership without explaining how the existing members will pay for enlargement. The plan suggests using the existing aid program for the region amounting to 1.1 billion ecus. According to the EU Commission there are 7 billion ecus to be committed for the eastward enlargement during the next five years. But the EU's southern

members threatened to block the approval until their northern counterparts approve another 5.5 billion ecus for North Africa and Middle East programs.²³

Thus the financing of the enlargement is a reason for the existing members to be at loggerheads. On the other side, the backlog of the East Europeans is so huge, that it seems doubtful whether a swift equalization of the output and income level between the east and west part of the continent can be reached. Bulgaria's and Romania's economies should have to grow with a remarkable pace—at least with a constant 6% rate—to approach within the next thirty years the current per-head output of Greece (Table 8). If both countries could sustain a growth rate of 6% they can expect to achieve the 1992 EU average per-head level in the next forty five to fifty years. Somewhat bigger is the gap between the advanced EU members, namely Germany in 1992. It must be taken into consideration that the EU is expected to grow with a rate of between 2% and 4% in the next decades. Apparently very long periods are needed to shorten the distance. In general all East European countries including Russia and the CIS should have to prepare for a long lasting race with the West.

TABLE 8
Years Needed by East European Countries to Reach
the GDP-per-Head Level in the EU in 1992
Depending on Two Growth Rate Variants

Country	Greece (1992)		Germany (1992)		EU Average (1992)	
	Growth Rate		Growth Rate		Growth Rate	
	4%	6%	4%	6%	4%	6%
<i>Bulgaria</i>	43.0	28.9	72.7	48.9	66.9	45.0
<i>Czech R.</i>	27.5	18.5	57.2	38.5	51.4	34.6
<i>Hungary</i>	22.2	14.9	51.9	34.9	46.0	31.0
<i>Poland</i>	33.1	22.3	62.8	42.3	57.0	38.4
<i>Romania</i>	48.1	32.4	77.8	52.4	71.9	48.4
<i>Slovakia</i>	33.6	22.6	63.3	42.6	57.5	38.7

Source: Statistisches Bundesamt

Consequences of the Isolation of Southeastern Europe by the EU

The new situation in the world and especially in Europe after the demise of the communist system in the former East Block revealed the dependances and feedbacks between it and its West European counterparts. There is evidence that the process of European integration cannot be kept on track without a proper economic recovery of the southeast part of the

continent. One important feature of the new situation is a rising wave of migration and asylum launched since 1990. It isn't a coincidence that the bulk of asylum seekers and migrants in Central Europe now comes from the eastern part of the continent. This means a considerable difference from the seventies and eighties, when the Middle East, Africa and occasionally Asia were the most important regions of origin. The main destination of these people in the early nineties was Germany, which received on average about 60% of all asylum applicants in Western Europe.

TABLE 9
Asylum Seekers in West European Countries (Persons)

Country	84	85	86	87	88	89	90	91	92
B	3,650	530	7,650	6,000	5,200	8,100	12,950	15,173	20,000
DK	4,300	8,700	9,300	2,750	4,650	4,600	5,300	4,609	17,500
D	35,300	73,850	99,650	57,400	103,100	121,300	193,050	256,000	438,100
F	15,900	25,800	23,400	24,800	31,600	58,750	49,650	46,545	30,000
GB	3,850	5,450	4,800	5,150	5,250	15,500	25,250	44,736	24,000
NL	2,600	5,650	5,850	13,450	7,500	1,390	21,200	21,600	24,500
A	7,200	6,700	8,650	11,400	15,800	21,900	22,800	27,308	1,628
S	12,000	14,450	14,600	18,100	19,600	30,350	29,350	27,351	82,000
CH	7,450	9,700	8,550	10,900	16,750	24,400	35,850	41,629	18,000
Europe	104,250	170,500	205,600	189,450	290,600	349,500	442,350	578,400	750,000
D:EU %	33.86	43.31	48.47	30.30	35.48	34.71	43.64	44.26	58.41

Source: UNHCR

As well Germany accepted up to 250,000 Bosnian and Yugoslavian civil war refugees and victims of ethnic cleansing. Among the European applicants the group of South East European countries of origin have risen rapidly since 1990, replacing step by step Poles and Hungarians coming in the late eighties. Although in Romania, Bulgaria, and Albania there are no battles and ethnic conflicts except occasional political tensions, more people are fleeing after opening and paving the way to a democratic development.

In 1994 applications for asylum in West European countries declined as a result of a tough controls adopted in the summer of 1993 in Germany, and in several other countries as well. The effect is a rising pressure on Germany's neighbors Holland, Belgium, and recently the Scandinavian peninsula. Besides the Yugoslav war, a main reason for East Europeans to apply for asylum is the economic misery in their home countries. After abolishing the restrictions for traveling abroad, particularly Romania, Bulgaria, and Albania have been abandoned by many hundred

TABLE 10
Asylum Applications in Germany by Regions of Origin (Persons)

	<u>1984</u>	<u>1990</u>	<u>1993</u>
Total, of which	35,287	193,063	322,599
Europe	11,553	101,631	232,678
Europe: all countries	32.74%	52.64%	72.13%
South East Europe (SEE)	5,803	89,353	214,201
SEE: Europe	50.23%	87.92%	92.06%
SEE: all countries	16.45%	46.28%	66.40%

Source: Statistisches Bundesamt

thousands of citizens fleeing unemployment and lacking prospects with dreams of welfare in the West. While Albanians penetrated illegally mainly in Greece and to some extent in Italy, Romanians and Bulgarians went primarily to Germany. There Romanians replaced even the Turks and Yugoslavs from the first position on the list of asylum applicants, and Bulgarians followed closely behind (see Table 11).

TABLE 11
Asylum Seekers in Germany 1993 (Person)

Country	Asylees	Share (%)
Romania	73,717	22.85
Rump Yugoslavia	72,476	22.47
Bulgaria	22,547	6.99
Bosnia-Herzegovina	21,240	6.58
Turkey	19,104	5.92
Algeria	11,262	3.49
Vietnam	10,960	3.40
Armenia	6,469	2.01
Afganistan	5,506	1.71
Russia	5,280	1.64
Other	74,038	22.95
Total	322,599	100.00

Source: Statistisches Bundesamt

The development discussed above is exacerbated by the economic effects of the political transformation especially in South Eastern Europe, where this process is at a slower pace and the expectations of the population haven't been satisfied sufficiently yet. The economic aspects provide the base for a lasting emigration potential from the region unlike the past, as the wish to emigrate was mostly motivated by dissatisfaction with the existing political system. Now the economic differences deepen, and a lack of prospects for many people able to emigrate compel them to try to go to Western Europe and Germany as well. Forecasts prove that income disparities between East and West will endure for a long time (see also table 8). The social security systems in the South European countries of transformation are not yet accomplished and, nonetheless, they will not be able to compensate income losses and decreases in the standard of living in the medium term. On the other side an improvement of the employment situation cannot be expected because of deficient capital investment needed for the restructuring of the economy and growth. As of the middle of 1993, the capital inflow amounted up to \$4.7 billion in Hungary, \$2.7 billion in Poland, and \$1.9 billion in the Czech Republic. In Bulgaria there is a figure of \$230 million as of the end of 1993. According to statistics from the Romanian Agency for Development, the total foreign equity investment in 1993 amounted to \$670.5 million. And in South Eastern Europe not only are the dimensions of the investment demand bigger, but the local conditions for the necessary foreign investments are less favorable than in the Vishegrad countries. This development will boost the wish to emigrate or to abandon the economically and socially unstable southeast part of our continent for a long time, even by violation of the legal framework and conditions. How great this emigration potential is cannot be estimated now with certainty; doubtless it seems to be considerable and it threatens not only the chances of the East to rebuild and promote its transformation. As recent negative examples in Germany show, overwhelming immigration threatens the social freedom and stability in the West itself.

NOTES

• The author is grateful to Lynda Fish for reviewing the text. Only the author bears responsibility for its contents. The views expressed here do not necessarily express the views of the Federal Office for the Recognition of Foreign Refugees, Germany.

1. The National Income is a notion of the central planned economy statistics. It comprises the value of all goods and services supplied within a year by the primary and secondary and parts of the tertiary sectors of the economy.

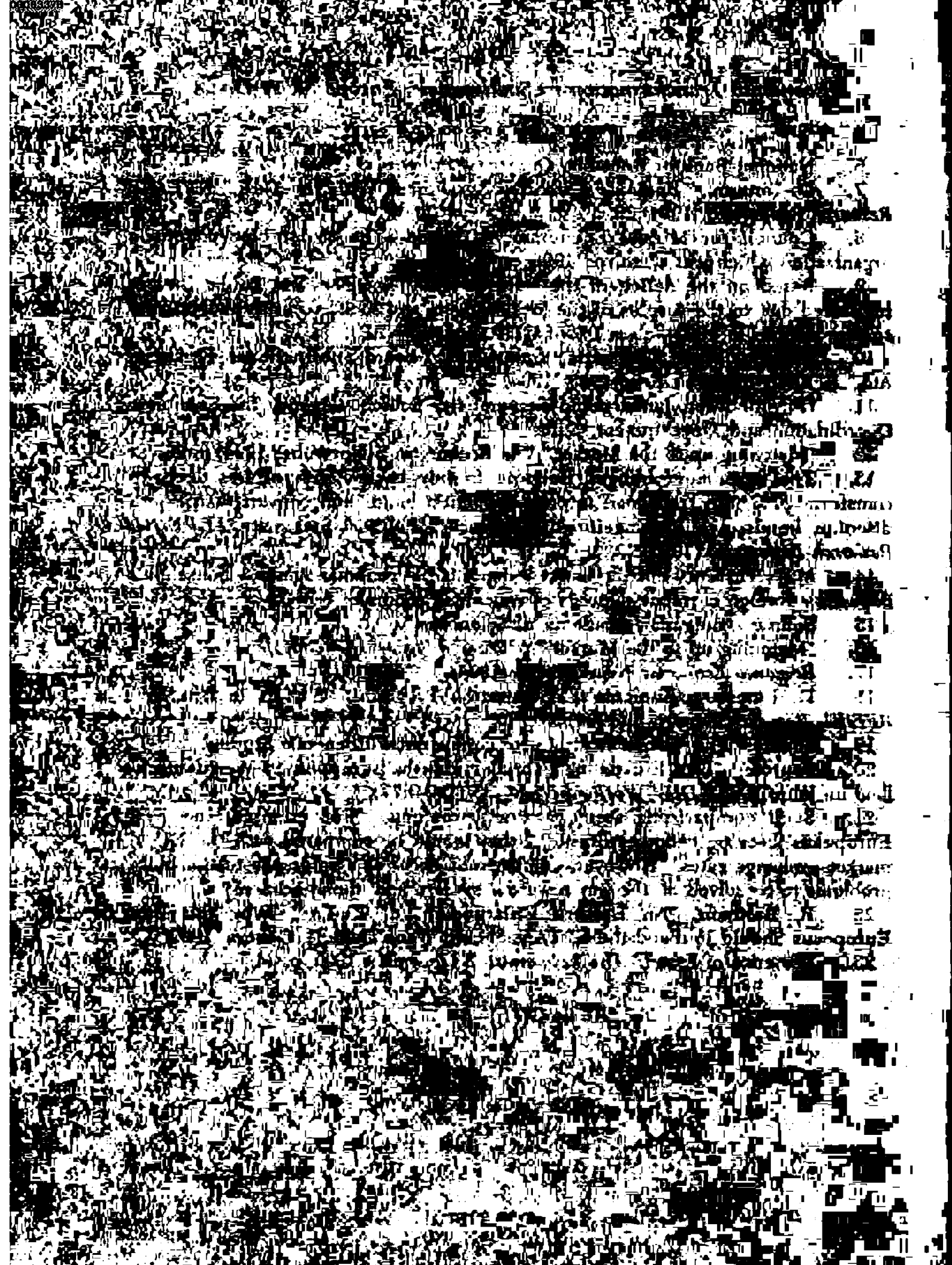
2. *The Economist*, 1-7 October 1994, p. 37.

3. Source: Statistisches Bundesamt.

4. Serbia and Montenegro.

5. *Yugoslav Survey*, 2 (1994)

6. National Bank of Romania, *Quarterly Bulletin*, 3 (1993).
7. D. Ionescu, "Romania's Standby Agreement With the IMF," *RFE/RL Research Report*, 18 (1994):26.
8. Council for Mutual Economic Assistance—The soviet bloc economic organization which was dissolved 1990.
9. Based on the deficit of the state budget. The National Public Budget registered due to the surplus of the local budgets and social security budget a far smaller deficit in 1993—circa 1% of GDP (Source: NBR).
10. K. Engelbrekt, "Bulgaria Ambivalent Toward International Financial Aid," *RFE/RL Research Report*, 18 (1994):28.
11. Only between January and September. Source: Agency for Economic Coordination and Development, Sofia
12. "Matching up to the Market," *The Economist*, 5 November 1994, p. 26.
13. The agreement obliges Bulgaria to buy back 12.5% of the debt, to transform 27% into front-load interest reduction bonds and convert 60.5% into discount bonds; see K. Engelbrekt, "Bulgaria's Political Stalemate," *RFE/RL Research Report*, 25 (1994):22.
14. $M2 = \text{currency outside banks} + \text{deposits of economic agents} + \text{households deposits} + \text{foreign currency deposits of residents}$. (Source: NBR).
15. Source: Bulgarian Academy of Sciences.
16. "Matching up to the Market," p. 26.
17. *Romania Economic Newsletter*, 4 (1994).
18. D. Ionescu, "Romania's Privatization Program: Who is in Charge?" *RFE/RL Research Report*, 5 (1994):33.
19. Source: The Vienna Institute for Comparative Economic Studies.
20. Source: "Das Einkommen sozialer Haushaltsgruppen in Westdeutschland im Jahre 1992," *DIW-Wochenbericht*, 45 (1994):778.
21. Such comparisons aren't without problems. For example, the East Europeans' backlog becomes drastic if they would be compared with the EU at market exchange rates. However, comparisons occur as a reference to the bulky problems to be solved on the way toward a modern and liberal economy.
22. R. Baldwin, "An Eastern Enlargement of EFTA: Why the East Europeans Should Join and the EFTAs Should Want Them?" Geneva, 1992.
23. "Essence of Essen," *The Economist*, 3 December 1993, p. 34.



Regional Disruptions and Regional Cooperation in the Balkans

Nada Švob-Đokić

Introduction

The identity of the Balkans has undergone a drastic change in the course of the twentieth century. Territories have been cut and divided among old and new states. New states have emerged and the dissolution of the old ones has engendered conflicts and wars. The restructuring of the Balkans has taken place mostly through wars that invariably brought into play the confronted interests of the Western and Eastern countries: the Austro-Russian coalition against the Ottoman Empire, the orthodox (Serbo-Russian) coalition against the Austrian Empire, the breakdown of Yugoslavia along the borders between east and west, ancient Byzantine and Roman Empires, Catholicism and Orthodoxy.

The history of the Balkans has produced examples also of efforts to overcome differences and harmonize interests. The best such example perhaps was the establishment of Yugoslavia in 1918, as a kingdom within the framework of the Versailles peace arrangements, and in 1943 as a republic within the framework of the post-World War II bloc divisions. The kingdom of the Serbs, Croats, and Slovenes functioned between the two world wars; the Yugoslav federation, established in 1943, acknowledged the existence of other nations in the same territory (Macedonians, Muslims/Bosnians, Albanians, etc.) and proclaimed the provision of equal rights for all within the frameworks of the socialist system. As the system crumbled, the federation broke down in 1990, and issues such as the equality of nations, the established borders among the republics, and the formation of new states were reopened, unfortunately through yet another war.

The nature of this war remains to be clarified. It started as the intervention of the federal army against the separatist republics (Slovenia and Croatia), to become the war between the newly recognized states on one side (Croatia, Bosnia-Herzegovina) and the self-proclaimed Federal Republic of Yugoslavia on the other (Serbia and Montenegro); the war then

partly degenerated into a series of ethnic conflicts among the Serbs, Muslims, and Croats in Bosnia-Herzegovina and Croatia. Ted Robert Gurr calls the similar type of wars "ethno-political conflicts in transitional states,"¹ which stresses the need to clarify this new type of conflict, having in mind the overall systemic change that has engendered them.

A new shaping of the world that seems to hold a great deal of attraction for both policy-makers and academics nowadays has proceeded in the Balkans through most tragic developments, largely created or supported by the incompetent, cynical, and disorganized representatives of the international community. New developments have been eagerly analyzed, but they nevertheless remain far from being fully grasped either by particular ethnic groups or by national authorities, or, for that matter, by the international community (mainly the UN and the European Union). New peace processes have been initiated, but their outcome is uncertain. Analytical tools and scientific methodologies have been quickly improved and adjusted, but the increased knowledge thus gained has hardly made possible a thorough understanding of the ongoing processes. Rational and sometimes well-elaborated policies have been hardly implemented, and when implemented they have sometimes produced unexpected results. In this respect the situation in the Balkans reflects the post-bipolar world being transformed into a multicentered structure through a "hegemonic transition" (Barry Gills). Many actors of this transformation are not quite aware of their proper interests and aims, particularly because these are undergoing a transformation as well.

The Notion of Regionalism

Multilateralism, regionalism and bilateralism are standardized types of international relations, both economic and political. Bilateralism is confined to the role of a particular state, and is very much linked with the promotion of particular, quite clear and neatly regulated interests that are more or less successfully harmonized between two partners. Multilateralism is practically linked with the globalization of the world economy and with ever more intense international exchanges. The notions of multilateralism and globalism are very strongly influenced by the ideas of liberalism, liberal economy, and liberal exchange, which are supposed to prevail over the particular interests of particular nation-states. The role of states is therefore suppressed by global developments, and although the states are making serious efforts to follow global development trends, they at the same time try to preserve the traditional national interests, often endangered by the global drive. Nevertheless, the states are the main actors of both bilateral and multilateral arrangements.

Regionalism is a twofold notion, reflecting either the idea of a large geographical area divided among a number of states (e.g., Europe), or a number of smaller functional and geographical entities within one single state. Regional arrangements among states are sometimes perceived as a form of reaction and resistance to global liberalism. The idea of regional

integration is closely connected with that of protectionism, trade blocs, regional strongholds opposing the processes dominating the global economy, etc. The interaction between the global and the regional is sometimes taken to be the source of dominant developmental trends in the world today. The localization of development processes requires the identification of a smaller and much more functional unit that does not necessarily imply any kind of interstate arrangements and that is at the same time open to global communication and exchanges. Such a unit is also called a region, representing a part of a country and therefore being a constitutive unit of either a state or a region in that wider sense. Regional development, inter-regional cooperation and exchanges are in this sense very typical of Europe, in which the tradition of neat differences between its different geographical parts, different peoples, cultures, and histories is very much pronounced.

It is important to note that regionalism and multilateralism are not confined to just one type of economy or society, and that trade and exchange are far from being limited to one or a few particular types, governed by a set of particular regulations. They are diversified, unstandardized, and barely controllable, which makes them adaptive to all parts of the world. This explains the polymorphous nature² of contemporary regionalism. Our understanding of polymorphous regionalization may very much depend on the understanding of the term "region." When reference is made to a region linking different states, processes of integration are stressed. If relations between different regions within a single country are discussed, then regional inequalities resulting from economic growth (particularly in the less developed countries) may become one of the causes of disintegration of the state. In contrast, differences among the states belonging to a given region may stimulate regional cohesion. In any case, the state stands at a divide between the integrative, or interstate/outer and the potentially disintegrative, or intrastate/inner regionalism.

For purposes of this analysis, the two aspects of regionalism, outer or interstate and inner or intrastate, should be clearly distinguished. In the case of outer regionalism, regional regulations are compulsory and require a great deal of adjustment and adaptation. They are subject to an interplay of multiple, sometimes vague, economic, political, and social interests. Regionalism fails if there are no fast results, and the history of regional integrations is sometimes said to be the history of failures. Regionalism cannot be confined to the economic and trade sphere only, and that is why it is extremely vulnerable. In the process of harmonization of interests of the subjects of regional integration, the display of differences cannot be avoided. Moreover, differences need to be respected and tolerated. Inner regionalism, on the contrary, represents the affirmation of differences, and therefore avoids harmonization. The emphasis is on the identification of particular interests and on interest-based cooperation and exchange. Henk Overbeck calls such an expression of general interest a "hegemonic or comprehensive concept of control."³ Inner regionalism tolerates the power and influence of the central state, as well as the imposed regulations, as long as they do not prevent regional development.

Both inner and outer regionalism challenge the position and role of the national, either central or federal, state. One of the essential functions of the national state has been to secure the existence of society and the functioning of production in a certain geographical space. This role has been contested by both outer and inner types of regional integration, particularly at the time of systemic and transitional crises. The role of the state is diminishing, and some states are disappearing from the world scene. The reemergence and reorganization of the state and its role in development and exchange is becoming a crucial developmental issue in the contemporary world. It follows that the next important issue is the type of interrelations among states, be they more or less developed. The present-day outer regional integrations, such as the European Union, are able to absorb either states or regions and eventually reshape the world so as to preserve and develop regional integrations based on inner regional development. If they prove successful and develop further, the world may not remain divided along north/south lines any longer. After the fall of the east/west division, this may herald the fall of the next major division of the contemporary world. The further successful development of regionalism may therefore create a completely new global situation, as it is the most dynamic process in the world today.

Regional Cooperation versus Regional Disruptions in the Balkans

Outer/Interstate Regionalism

The tendency to bring different Balkan countries together was particularly strong after World War I. The previous elimination of the Turkish domination (Balkan wars 1912, 1913) and the breakdown of the Austro-Hungarian Empire (end of World War I in 1918) made it possible to set up new states. Yugoslavia was established in 1918 as a kingdom of the Serbs, Croats, and Slovenes. The borders between Albania, Greece, Bulgaria, and Yugoslavia were partly readjusted. These Versailles arrangements did not particularly stimulate cooperation among the Balkan states, which never felt at ease with their neighbors and remained largely preoccupied with the establishment of their inner cohesion. The strong involvement of France, Great Britain, and Russia encouraged tendencies to ally with non-Balkan countries, while the low level of economic development never stimulated either trade or any kind of economic cooperation among these states. After the World War II, which produced a further readjustment of borders and territorial divisions, the Balkans were clearly divided between the Eastern and Western blocs. These divisions were particularly marked in the southeastern parts, as Bulgaria was very strongly allied to the Soviet Union, while Greece and Turkey were members of NATO. The central Balkan states were successful in creating for themselves rather curious types of international positions: Albania excluded itself from all formal arrangements and was strongly supported by China; Yugoslavia was a founder and organizer of the Non-Aligned Movement.

The position of Rumania witnessed strong tendencies of autonomous foreign policy, too.

Regional cooperation among the Balkan countries began in the late eighties, and was mostly understood as the need to follow the global tendencies supporting regional integrations. Yugoslavia took the lead. The first conference of foreign ministers of the Balkan countries took place in Belgrade, in February 1988. A program of multilateral cooperation in economic areas, transport, ecology, and tourism, as well as in sports and cultural activities followed. Meetings were held in Sofia, Athens, Plovdiv, Bucharest, Ankara, etc., and plans to establish joint organizations, such as The Balkan Economic Cooperation Research Institute in Athens, were elaborated and discussed.⁴

The second conference of ministers of foreign affairs was held in Tirana, October 1990. Further development of regional cooperation was definitely accepted as the most relevant target. The incentives to institutionalize the Balkan cooperation were rather strong. Parallels between regional integrations in Europe and in the Balkans were emphasized.

Regional cooperation in the Balkans was discussed and planned at the moment when most of the Balkan countries had very serious internal problems: the socialist countries were at the brink of transitional changes and most of them had already launched economic reforms; the socialist system was falling apart and signs of the disintegration of Yugoslavia were clearly visible; Albania was experiencing an emigration crisis; and disorders in Rumania were in full swing. Nevertheless, the ministers of foreign affairs of these same countries paid a lot of attention to historical aspects of inter-Balkan relations and tried to emphasize the need to support positive changes and turn to the challenges of the twenty-first century. Security and inter-ethnic relations were identified as the most important fields of cooperation among the Balkan states.

The issue of regional cooperation in the Balkans, of course, fits into the wider European and global cooperation context. In this context, two main approaches dominate the rare discussions of regional Balkan cooperation: the paradigm of an autonomous regional security and cooperation system⁵ and the paradigm of a loose, occasional and highly specialized cooperation⁶. In both cases only the theoretical concepts of such paradigms have been considered, while there is little practical cooperation and trade.

All Balkan countries, including the newly emerged states of ex-Yugoslavia, have signed a number of bilateral agreements on cooperation between each other, and it could be said that most of them are trying to establish closer links and overcome historical divisions. Such cooperation remains, however, bilateral. Partners are treated individually, and not exactly as regional partners. The major switch from bilateral to regional cooperation has not yet occurred.

The tradition of divisions and disruptions is still strong and very real. The long list of inter-state problems is practically inexhaustible. At the moment, Greece has open disagreements with Macedonia, Albania and Turkey; Bulgaria has problems with Turkey, Greece, Macedonia; the regional hegemon, Turkey, has unsolved and open problems with most of the

Balkan countries, and displays readiness to become more directly involved in the crisis in ex-Yugoslavia; Rumania has disagreements with Hungary, Serbia, Turkey; FR Yugoslavia is in war conflict with both Bosnia-Herzegovina and Croatia, and has open disagreements with Albania and Macedonia; Bosnia is in war; Croatia has either war conflicts or unresolved problems with FR Yugoslavia, Bosnia and Slovenia, etc.

In each particular disagreement or crisis, the Balkan countries rely on non-Balkan allies. They just do not depend on each other for the solution of their major problems. The Balkans are not a cohesive region, or its inner cohesiveness lies in the character and fate of borderline areas. This region has been a borderline area between east and west, north and south, in civilizational, religious, economic, and any other sense for centuries, and its identity is its diversity. Unfortunately, a model that would enable the full respect for such diversity has not been found either on the regional level, or on the level of individual countries. The Balkans are a polymorphous region that could support only a very flexible type of cooperation and exchange. It is open, and absolutely inclined to ally and cooperate with countries that are outside the region.

Such a polymorphous structure of the Balkans explains the absence of a hegemonic state or a hegemonic regional project. The levels of development of the Balkan countries are comparable, their histories and positions much more similar than they appear at first sight. None of the Balkan countries is able to define its particular hegemonic role or impose a comprehensive political, ideological or economic concept of harmonization over its neighbors. The rather strong outer influences and alliances result in a dispersion of power. The real economic and political power of any country has never been equal to its military strength.

The outer regional cooperation in the Balkans has never developed institutional frameworks, although a number of multilateral and bilateral agreements have been signed. But they have hardly been implemented at all. The cooperation schemes have taken the form of federal arrangements or free trade arrangements. They might have been proposed as a way out of serious crises and a means to stimulate regional cooperation. A recent example is the federation between Muslims and Croats in Bosnia. The Washington Agreements⁷ signed by the Bosnian and Croatian presidents on 18 March 1994 clearly define Bosnia as a federation of the three peoples living in it (Muslims, Croats, and Serbs), and envisage the confederation between the Bosnian and Croatian states. This political move has so far had very positive effects on preventing further confrontations and suggesting a kind of orderly regulation that seems to be applicable. Another federal proposal was launched by the Serbian side. Serbia has approached Greece and Macedonia, and also Rumania, Bulgaria, and Albania, suggesting the establishment of a Balkan federation.⁸ So far the responses of the countries concerned have been very weak or openly negative. It seems that the Balkan countries are not ready to rush into any kind of federal arrangements, particularly not now that the results of the collapse of the former Yugoslav federation are so visible.

Regional cooperation among the Balkan states thus remains a rather

abstract idea. The dynamics of integration of the Balkan countries within either the central European or the Mediterranean cooperation scheme might be more realistic and much less compulsory. Both these schemes are supportive of a more open, flexible, and interest-oriented cooperation, rather than cooperation based mainly on geographical or historical reasons and motives.

The Central European Free Trade Agreement (CEFTA) can illustrate the type of regional cooperation that might be attractive for some Balkan countries. The Czech Republic, Hungary, Poland, and the Slovak Republic have signed the agreement in order to strengthen their regional cooperation and thus improve their cooperation with the European Union. Slovenia has already established very good relations with the CEFTA countries and has increased its trade with these countries by 50% in only one year.⁹ The gravitation model shows that the increase of Croatia's trade with the CEFTA countries could amount to about 35% if liberalization is pursued. Further regional cooperation with the Central European countries is very much acceptable to Slovenia, Croatia, Bosnia-Herzegovina, and other Balkan states that incline to the West.

Mediterranean cooperation is much more abstract and less institutionalized. It is inspired by the broad concepts of common heritage and the historical role of the Mediterranean. The identification of areas of cooperation (e.g., environmental protection, culture, sports, etc.) is easy, but incentives to trade and interest-led exchanges are weak.

Both the central European and Mediterranean regional cooperation schemes are at the same time attractive and non-compulsory for the Balkan countries. Like the regional cooperation of the Balkan countries itself, they do not provide for close and effective links among these countries, but they may help to widen cooperation and introduce the Balkan countries to European and global arrangements.

In this respect, there exists a certain similarity among all the European peripheral regions (Balkans, Mediterranean, Central Asia). Multilateral cooperation, particularly regional, often directly opposes the autarky of the semi-developed but at the same time interdependent countries.¹⁰ Any viable regional cooperation is focused on real regional problems and interests, and therefore developed in the specialized economic and infrastructural areas, such as environmental protection, transport, energy, trade, etc. Such regional cooperation is hardly institutionalized. It is mainly project-oriented. Except for the central European regional arrangements, it is not designed as long-term cooperation, propped by the clear aim of further integration into larger regional organizations. Such cooperation may represent a valuable input in any security arrangement or system, but it cannot stimulate or influence any security arrangement essentially.

The polymorphous character of such cooperation is thus revealed, as well as the reluctance of partners to be too much committed to each other. It has become quite evident by now that the Balkan countries and peoples have no strong reasons to insist on closer mutual cooperation. These countries would therefore hardly follow global trends in strengthening their

regional cooperation, and would probably prefer to stick to small, polymorphous and dispersed structures, following only their short-term common interests. Resistance to other types of regional alliances might be historically induced and should be respected in all future arrangements that should increasingly be based on a specific cooperation matrix adjusted not only to the functional economic development of the region but to its ethnic structures and historical experiences as well.

Inner/Intrastate Regionalism

The identification of regions within the states and interest in regional development and policies are rather new phenomena in the Balkans. Concepts of regional development might fit the general polymorphous structure of the region, while the "geography of weak and strong regions" now reveals the developmental realities in the states that have always represented composites of peoples, cultures, economic potentialities, etc.

Neither the socialist nor the market economies in the Balkans were able to overcome or suppress considerable inner regional differences in levels of development. The narrowing of regional differences was, however, an important developmental goal for most of the Balkan countries, notwithstanding their political, social, or economic systems.

The pursuance of this goal was openly stressed in ex-Yugoslavia, for example, where north-south relations between different regions emerged to be a relevant problem, particularly when the notion of the region equaled the notion of a federal republic (e.g., Slovenia) or autonomous province (e.g., Kosovo). The inter-regional or inter-republic income redistribution included assistance to the less developed regions, which were defined as the Republics of Bosnia-Herzegovina, Montenegro, Macedonia, and the Autonomous Province of Kosovo.¹¹ Such redistribution was resented by the more developed republics and regions, particularly because it was compulsory and very often invested in projects that did not pay off.

In the particular Yugoslav case, the formal and functional differences between the republics/national states constituting the federation and the regions within these republics were not quite clear. In Croatia, for example, more locally adjusted development and structural differences among regions led to an open acknowledgment of regions such as Dalmatia, Istria, Slavonia, etc. In Macedonia or Bosnia this was not the case, and the republics as political and administrative entities stood formally for regions. This situation did not change much during and after the dissolution of ex-Yugoslavia. The establishment of independent, sovereign states, the overall drastic fall of the GNP in all of them, as well as the direct and indirect effects of the war, are now causing increased centralization in all the states that emerged from ex-Yugoslavia. The issues of regional development and regional identity are considered to be an internal problem rather than an internal advantage. A heated political debate in Croatia, for example, over the regional position of Istria has lasted for more than four years now, and

is spreading to other regions too.

The concept of a newly formed national state can hardly be harmonized with the ideas of inner regions as functional entities. Regions are even taken to be the cause of internal disintegrations. The dissolution of ex-Yugoslavia was partly caused by structural and economic differences among the republics, which felt that the federal state was no longer functioning as a representative of multiple interests. Although the federal state tried to balance such interests, it could not harmonize them within the existing socialist system. This experience is now wrongly projected to the new situation. Instead of a systemic support for the diversity of regions and local development, regions are being divided into smaller administrative units and put under the control of the new centralized state, e.g., in Croatia.

The Balkan countries may need more time to accept the modern notion of inner regionalism as one of the guiding principles of their development. This is a touchy issue in the context of over-all regional instabilities and ethnic divisions. The general polymorphous structure of the Balkan states and the Balkan region offers, however, a sound basis for practicing inner regional development and outer regional cooperation within the framework of clearly defined interests and flexible cooperative approaches.

Conclusion

The specific feature of the Balkans is its polymorphous structure and the concentration of diversities (geographical, historical, ethnic, civilizational, and cultural) in a comparatively small space. The long history of strong influences of non-Balkan hegemonies in the region creates the impression that the Balkans have been put together by outside pressures rather than as a result of regional development itself. In this transitional and borderline area the inner links are difficult to preserve. Reactions to attempts at homogenization have so far been deep and painful disruptions. Oscillations between closer cooperation and deeper disruptions indicate that there is no need to impose any kind of hard, institutionalized cooperative schemes upon the societies undergoing rather fast changes of their proper identities.

NOTES

1. Ted Robert Gurr, "Peoples Against States," *International Studies Quarterly*, 38 (3) (September 1994):347-77.

2. Olivier Dollfus, "Towards a New World Pattern/Vers une nouvelle configuration mondiale," EADI VIIth General Conference, Berlin, 15-18 September 1993, p. 16.

3. See "The Forum. Hegemony and Social Change," *Mershon International Studies Review*, 38 (1994):361-76.

4. "Multilateralna suradnja na Balkanu," *Mednarodna politika*, Beograd, Broj 957, 16. februar 1990.

5. Aleksandar Tomov, "U pravcu nove stabilnosti Balkana," *Međnarodna politika*, Beograd, Broj 1023, 1. januar 1994, str. 6-8.
6. Ivanka Nadeva, "Možemo li da gledamo sa nadom u budućnost?," *Međnarodna politika*, Beograd, 16. oktobar 1989, str.10.
7. Dokumenti: Washington 18. ožujka 1994, *Vjesnik*, Zagreb, 21.3.1994, Poseban prilog.
8. Cf. Željko Hođonj, "Balkanska konfederacija ante portas," *Večernji list*, Zagreb, 9.12.1994. str. 15. The idea of a Balkan federation can be traced back to 1844 when Ilija Garašanin in his *Načertanije* laid the foundations of the political program expressed later as a maxim "The Balkans belong to the Balkan peoples." The first Balkan federal alliance was established in 1866-68 (Serbia, Montenegro, Greece, and Rumania allied against Turkey); the second in 1912 (Serbia, Bulgaria, Greece, and Montenegro allied against Turkey); the third in 1913 (Serbia, Greece, Montenegro against Bulgaria). The Balkan alliance agreement signed on 9 August 1954 at Bled, Slovenia, provided for political cooperation and economic assistance among Greece, Yugoslavia, and Turkey, and was preceded by the agreement on friendship signed in Ankara in 1953.
9. Krešimir Jurlin, *Utjecaji bilateralne liberalizacije trgovine sa zemljama grupe Višegrad i Slovenijom*, IRMO, Zagreb, listopad 1994, p. 9.
10. Martin Nicholls and Henry Potter, "Regional Initiatives in the Former Soviet Bloc: A Review of Multi-country Trade Groups, Environment Initiatives and Infrastructure Projects," *Communist Economies and Economic Transformation*, 6 (3) (1994):316.
11. Dinko Dubravčić, "Economic Causes and Political Context of the Dissolution of a Multinational Federal State," *Communist Economies and Economic Transformation*, 5 (3) (1993):259-72.

Conflict Resolution by Economic Cooperation and Integration? The Case of Cyprus

Hansjörg Brey

Without any doubt, the Cyprus question is of one of the most complex and most protracted conflicts in southeastern Europe.¹ And Cyprus has been a kind of laboratory of peacekeeping and peacemaking efforts of international bodies and national peacemakers alike. The United Nations, the European Union, the Council of Europe, the United States, and others have been extensively engaged in the issue.² More than twenty years after the invasion and occupation by the Turkish military of northern Cyprus, all efforts to find a solution to the conflict are deadlocked. Anyone who is surprised or disappointed about the uselessness of UN resolutions concerning the conflict in former Yugoslavia would have had his illusions destroyed long ago had he observed the role of the international state community in the Cyprus conflict. Noticing the modest engagement of western governments in the containment of the Yugoslav crisis, we reach a conclusion from yet another point of view: how should we expect western governments to engage in the solution of a relatively minor conflict like the one in Cyprus?

Focusing on Cyprus and the countless efforts to solve the Cyprus problem through intercommunal talks, proximity talks, or high level meetings, I agree with the analysis of Hadjipavlou-Trigeorgis and Trigeorgis that most of the efforts to solve the Cyprus conflict so far "have been highly formal and legalistic, rigid, and narrow in approach."³ The authors call for an evolutionary approach that identifies fields of common interests rather than emphasize competitive and antagonistic interests. It is my argument that interests common to the Cypriot conflicting parties can be identified in the field of economic cooperation. Similar suggestions have supposedly been made by UN secretary-general Boutros-Ghali in his more recent efforts toward a permanent peace for Cyprus focusing on confidence building measures in the economic field.

The Main Characteristics of the Cyprus Conflict

In order to make comparison with other conflicts easier, I will now try to briefly characterize the Cyprus conflict, bearing in mind, of course, that it is impossible to outline here the history of the conflict:

1) There is no consensus on a definition of the problem. The Greek-Cypriots view the problem as one of foreign invasion and occupation, and violation of international law and human rights since 1974. Thus, the Greek-Cypriots emphasize inter alia:

- a) the unlawfulness of the invasion of Cyprus by mainland Turkish military forces in the summer of 1974;
- b) the permanent displacement of about 160,000 Greek-Cypriots who had to leave their homes and land during that military intervention;
- c) the militarily enforced de facto division of the island since 1974; moreover, the "Turkish occupied area" covers about 37% of the island's surface, an area much greater than the share of Turkish-Cypriots in the overall population (18% in 1960);
- d) the unlawful declaration of independence of a "Turkish Republic of Northern Cyprus" by the Turkish-Cypriot leader Rauf Denktaş in November, 1983; the "TRNC" has indeed not been internationally recognized except by Turkey
- e) the occupation of the pseudo-state's area by a contingent of at least 30,000 soldiers from Turkey and the stationing of Turkish tanks and other military equipment;
- f) the planned settlement of a great number of population, mostly peasants, from Turkey on Greek-Cypriot properties. This colonization, together with a massive emigration of local Turkish-Cypriots has seriously altered the demographic structure of northern Cyprus; Turkish-Cypriots are in danger of becoming a minority there.

Contrary to this, the Turkish-Cypriot side sees the problem as one of neglect, domination, and oppression of the minority, based on its experiences from 1963 to 1974. The Turkish-Cypriot position stresses inter alia that:

- a) the Greek-Cypriots have never given up their irredentist dream of enosis, i.e., the unification with their mother country Greece;
- b) already in 1963 the Greek-Cypriot side had destroyed the basis for peaceful coexistence of the two communities; in November 1963, President Makarios had suggested a revision of the constitution of the Republic of Cyprus. This revision was considered to aim at depriving the Turkish-Cypriots of their minority rights;

- c) the injustices suffered by the Turkish-Cypriots since the intercommunal clashes of December 1963 have further proven the unwillingness of the Greek-Cypriots for peaceful cooperation based on equal rights;
- d) the intervention of the Turkish army in the summer of 1974 is considered to have been a peace operation legally justified by the Treaty of Guarantee that the Republic of Cyprus had established with Greece, Turkey, and Great Britain in 1960; after all the Greek junta had toppled Makarios in July 1974 and temporarily put a well-known nationalist terrorist, Nikos Sampson, in power. Foreign intervention was thus unavoidable in order to safeguard the Turkish-Cypriots' security.

2) Views of a desirable solution to the problem are very different on both sides of the Green Line.⁴ The Greek-Cypriot side's aspiration is a bizonal federation with a single sovereignty and a strong authority of the federal government. This option is seen by most Greek-Cypriots as a compromise to the ideal of a unitary state like the reunited Germany. The leadership of the Turkish-Cypriots has until recently accepted a loose federation or confederation as a maximal compromise to the status quo. At the end of August, 1994, even this option was abandoned by the Turkish-Cypriot parliament. According to a parliamentary decision, negotiations should not be resumed until the Greek-Cypriots have acknowledged the political equality and sovereignty of the Turkish-Cypriots.

3) Another important factor applying to the situation in Cyprus has been described as "the absence of a hurting stalemate." Neither community on the island is sufficiently dissatisfied with the status quo to make the difficult compromises necessary for resolving the conflict.⁵ Additionally, the permanent presence of the United Nations Forces in Cyprus (UNFICYP) has since 1964 facilitated a certain adjustment to the *de facto* partition.

4) So far, numerous efforts to find a substantial solution have failed. Inter alia, negotiations have centered around the following questions:

- a) the size of the two cantons forming the new federation;
- b) the powers of the federal and cantonal governments and the representation of both communities in the two houses of parliament;
- c) demilitarization, namely the withdrawal of the Turkish military from northern Cyprus;
- d) continuation of Turkey as a guarantor power for Cyprus;
- e) the so-called three freedoms, claimed by the Greek-Cypriot side: freedoms, for both communities, of movement, property, and settlement in the new federation.

Reactions to Failures

It would be unjust to put equal blame on the Greek- and Turkish-Cypriot leaders for failure to find a solution so far. In his report to the Security Council of 31 May 1994, UN secretary-general Boutros Ghali unilaterally blamed the Turkish side for a general lack of political will and for blocking an agreement on major confidence building measures by raising numerous objections.⁶ The reluctance to agree on any change of the status quo has indeed been a constant factor in Turkish-Cypriot policy.

Presently, the government of the Republic of Cyprus reacts to this stalemate mainly in two ways: First, with the moral backing of UN resolutions, the government tries to further isolate the Turkish-Cypriots internationally. On 5 July 1994, following a Greek-Cypriot initiative, the European Court of Justice declared export certificates from northern Cyprus invalid. The court's decision was perceived by the Greek-Cypriots as an important diplomatic victory, as it was supposed to put a definite end to illegal exports from the occupied areas to member countries of the EU. Concerning the prospects for a settlement with the Turkish-Cypriot side, the political mainstream in the Republic of Cyprus seems to prefer to leave the situation as it is. Hopes focus on a speedy integration into the European Union, especially after the recent setting up of a schedule for the commencement of accession talks.⁷ The process of integration is supposed to act as a catalyst for the solution of the Cyprus problem. This hope is indeed notoriously optimistic. At present it seems more likely that only the rump-Republic of Cyprus will be integrated into the EU whereas the "TRNC" will be further integrated into Turkey.

My further remarks are based on the assumption that there is still enough reason to search for a political solution to the Cyprus problem with the aim of integrating the whole island into the EU. It is my argument that, to this purpose, projects of a limited economic cooperation between the two communities are most likely to yield tangible results.

Boutros-Ghali's Initiative to Introduce Confidence Building Measures (CBM)

CBMs were for the first time put on top of the negotiation agenda in the high level talks between President Glafkos Clerides and Rauf Denktash in New York in May and June 1993. In previous documents, Boutros-Ghali had proposed a number of such desirable measures. Included among others, were reduction of military spending and troops, freedom of movement for tourists crossing the Green Line, and revision of textbooks used in schools on both sides. The general purpose of the CBM was to be the creation of an atmosphere of mutual trust between the Greek-Cypriot and Turkish-Cypriot communities through intense communication, which trust would become the basis for a future comprehensive solution of the problem.

The efforts of the UN peacemakers and intercommunal negotiations

since May 1993 focused on a package of two major projects of confidence building concerning mainly economic aspects. This package consisted of the following elements:

1) Reopening of the ghost town of Varosha, south of Famagusta, and its resettlement by members of both communities. Until 1974, Varosha had been the major tourist resort on the island and ever since the area has been kept as a kind of pawn by the Turkish-Cypriots. Both Greek- and Turkish-Cypriots should be allowed to set up businesses in the area and to sell products and services from their respective communities.

2) Reopening of the Nicosia International Airport which lies within the Buffer Zone controlled by the UN and which has not been used since 1974.

Both areas were supposed to be temporarily administered by the United Nations. A team of experts from the World Bank and the International Monetary Fund reported in December 1993 that the package would yield significant benefits to both communities:⁸

1) Greek-Cypriots, who owned most properties and hotels in Varosha, would benefit by their recovery. Rebuilding both areas would in general boost investment and the demand for skilled labor in the Republic of Cyprus.

2) The Turkish-Cypriot side would benefit from a quick and substantial improvement in the standard of living. The Gross Domestic Product was supposed to increase by as much as 20% annually during the first few years. This would be possible through increased employment, better marketing opportunities for Turkish-Cypriot products, and increased tourism. The package would also alleviate the Greek-Cypriot embargo against the "TRNC".

In order to enforce the acceptance of the package, Boutros-Ghali launched an intensive diplomatic initiative with consultations in both parts of Nicosia, in Athens, Ankara, Washington, and several western European capitals. At the end, as already mentioned, the initiative failed in May 1994.

At present, according to President Glafkos Clerides "the Greek-Cypriot side holds the view that implementation of the CBMs without finding a common basis on the main issues will not contribute to the solution, but will perpetuate the status quo."⁹ Rauf Denktash, who was the one to abandon the negotiation table on the CBMs last year, recently said that he is now ready to implement the CBMs.

The UN as well as other international institutions still see the CBMs as a significant, if not the last chance to solve the problem. At the end of January 1995, the General Assembly of the Council of Europe reaffirmed that it considers the CBM proposed by the UN secretary general to "constitute the best prospects for a settlement, on which foundation further progress can be made."¹⁰ An analysis of the logic behind the CBMs reveals much more than just the last chance to get out of the stalemate.

Advantages of Economic CBMs

Let me summarize the arguments in favor of CBMs, specifically in the economic field:

1) Generally, the CBM-proposals contain elements of an evolutionary approach to a solution mentioned earlier, as opposed to the classical static approach. Such an approach tries to satisfy the needs, concerns, and interests of both communities. According to Hadjipavlou-Trigeorgis and Trigeorgis, "the only way to test each other's intentions in practice without risking ruin is precisely first to try an integrated solution on a limited scale, with an option to expand in case of success and an option to contract/abandon with limited losses in the case of failure."¹¹ Opening limited zones of economic cooperation is exactly such an option. In the case of failure the loss remains limited.

2) In general, the willingness to change the political status quo is supposed to be much greater if such a change implies substantial gains rather than fear of severe losses. For the Turkish-Cypriot side, CBMs can offer prospects of significant economic improvement. The present economic situation in the North is indeed desolate compared to the South: GDP per capita is less than one-third (around U.S.\$3,500) in the North. Productivity is low and underemployment is notorious. The economy is highly dependent on Turkey, which provides more than one-third of the GDP in grants, loans, and other forms of transfers. In 1990, Turkey covered more than 30% of the highly deficitary budget. It must be noted that along with this financial aid from Turkey a high rate of inflation is imported as well.¹²

Analysts had already realized in the 1960s a need to balance the great income disparities between Greek- and Turkish-Cypriots for the sake of political and social stability.¹³ The Commission of the European Community in its "Avis" of 30 June 1993, concerning the Cypriot application to the EC has expressed similar concerns about the present situation. The commission is optimistic that following accession to the EU the economic backwardness of the North can be outweighed by a considerable impact for economic growth. Such an impact, according to the commission, should be based on a careful procedure and accompanied by appropriate measures.¹⁴ In its recent draft resolution on the accession process of Cyprus, the Council of EU Ministers has proposed that the advantages of an integration into the EU should be made more obvious to the Turkish-Cypriots than before.

3) If we are to think of ways to prevent the Turkish-Cypriot leadership from seeking further rapprochement with Turkey and give them incentives to agree to accession to the EU, we have to take into account the Turkish-Cypriot desires and options. Besides separate sovereignty, which is indeed unacceptable to the Greek-Cypriots, such options in the economic field are supposed to be a) higher standard of living, b) economic independence from Turkey, and c) opportunities for trade and attainment of a greater share of international tourism.

The Turkish-Cypriot side considers the Greek-Cypriot economic embargo to be a major obstacle to the economic development of the North. Without a doubt, the decision of the European Court of Justice in 1995 to ban Turkish-Cypriot products from the EU market has considerably increased the burden of the embargo on the Turkish-Cypriot side. After all, until recently, around 80% of the export from northern Cyprus went into markets of EU members. Soon after the ruling of the court, the Turkish-Cypriot parliament announced a policy of more intense cooperation with Turkey in the fields of politics, defense, and economy. It is obvious, that the increase in the embargo has induced the Turkish-Cypriot leadership to take such steps. The politics of embargo against the "TRNC" may be morally justified. Indeed, policy-makers in the Republic of Cyprus must realize that the embargo policy may be a strong weapon against the Turkish-Cypriot side. It is obviously not a means for building confidence, but rather a step backward on the way to finding an evolutionary solution. There are lessons to be learned from the UN embargo against Serbia and Montenegro and from the Greek economic embargo against the FYROM. They have accentuated social inequalities and strengthened the nationalist factors within the societies affected, but have not yielded many political results in the desired direction.

Lifting the embargo may be a painful compromise for the Greek-Cypriot side. But, if a solution of the Cyprus problem is still a priority for the Greek-Cypriots, CBMs seems to be the only viable path. Opportunities to open zones of limited economic cooperation should be reconsidered. Such economic projects should be accompanied by a whole set of CBMs, like efforts to limited demilitarization, opening the Green Line for regular visits, and the revision of textbooks used in the schools on both sides of the Green Line.

In the case of Cyprus, with a booming economy in the South, even a limited redistribution of wealth from the South to the North would certainly impose no major financial problems.¹⁵ There are certainly additional problems to be overcome. By choosing the CBMs path to an evolutionary solution, any Cypriot government will be hard pressed to find majority support in the parliament (and President Clerides has in fact never had the consent of his parliament for the CBMs). This, however, should not prevent the government from trying once more. The gains from a quite limited stake could be great. If successful, the Cyprus laboratory would probably invent a model for conflict resolution through economic cooperation to be repeated by others.

NOTES

1. For further reading on the history of the Republic of Cyprus and the genesis of the Cyprus conflict, see Michael Attalides, *Cyprus, Nationalism and International Politics* (Edinburgh, 1979); Tozun Bahcheli, *Greek-Turkish Relations since 1955* (San Francisco/London, 1990); Pavlos Tzermias, *Geschichte der Republik Zypern* (Tübingen, 1991); for a brief account, see Hansjörg Brey, "The

Dynamics of Ethnic Separation in Cyprus," *RFE/RL Research Report*, 3, (28) (1994):14-17.

2. The following publications concentrate on the efforts so far to find a solution to the Cyprus conflict: Norma Salem (ed.), *Cyprus: A Regional Conflict and its Resolution* (New York, 1992); Hansjörg Brey, "A Solution to the Cyprus Question: Options and Obstacles," *RFE/RL Research Report*, 3 (28) (1994):18-25.

3. Maria Hadjipavlou-Trigeorgis and Lenos Trigeorgis, "Cyprus. An Evolutionary Approach to Conflict Resolution," *Journal of Conflict Resolution*, 37 (2) (1993):340-60.

4. See Brey, "A Solution to the Cyprus Question."

5. Brian Mandell, "The Cyprus Conflict: Explaining Resistance to Resolution," in Norma Salem (ed.), *Cyprus*, pp. 201-26.

6. Report of the UN secretary-general to the World Security Council, 31 May 1994 (Document S/1994/629).

7. Following severe pressure from Greece, the EU has decided to start negotiations on the Cypriot accession six months after the intergovernmental conference scheduled for 1996.

8. *Report of the Team of Experts on the Economic Benefits of the Varosha and Nicosia International Airport Package*; (unpublished), December 1993.

9. "Clerides: Cyprus is not a Piece of Real Estate," *Cyprus Bulletin*, 33 (3) (1995).

10. See "Draft Recommendation on Cyprus," *Cyprus Weekly*, 3-9 February 1995.

11. Hadjipavlou-Trigeorgis and Trigeorgis, "Cyprus," p. 352.

12. For an analysis of the economy of the "TRNC," see C. H. Dodd (ed.), *The Political Social and Economic Development of Northern Cyprus* (Huntingdon, 1993).

13. See Stahis Panagides, "Communal Conflict and Economic Considerations: The Case of Cyprus," *Journal of Peace Research*, 5 (1968):133-46.

14. Statement of the Commission of the European Community concerning the application for membership of the Republic of Cyprus, (= "Avis"), Brussels, 30 June 1993, §28.

15. In addition, external funding is available for such purposes, as for example the EU funds according to the Financial Protocols.

Bulgaria's Trade Relations With Its Balkan Neighbors: What They Are and What They Could Be

Michael L. Wyzan*

The manifold economic and political changes taking place in the countries of Central and Eastern Europe (CEE) and the former Soviet Union (FSU) since 1989 have had particularly large effects on their foreign trade behavior. In keeping with the theme of this volume, they have been challenged by enormous falls in trade volumes with their chief erstwhile trading partners, the member states of the former Council for Mutual Economic Assistance (CMEA), and in the post-Soviet case, other former Soviet republics. Additional challenges are presented by the UN sanctions against the rump-Yugoslavia and Iraq, major trading partners for several of these lands.

On the other hand, these states have also seen new opportunities in enhanced possibilities for trade and other economic links with their capitalist neighbors. However, these opportunities are limited by protectionism in the Western world, especially on the part of the European Union (EU).

Nowhere have these effects been more dramatic than in Bulgaria. As to challenges, the country was the most tied into the CMEA trading system of all of its European member states and suffered the biggest decline in Eastern trade among them. Today Bulgaria has the highest share of exports to the EU which that body views as sensitive (i.e., in need of special protection against imports); it has also been hit as hard as any country by the UN sanctions. As to opportunities, Bulgaria has an interesting and diverse set of neighbors: two medium-developed, dynamic, but rather unstable market economies (Greece and Turkey), a struggling fellow former CMEA member-state (Romania), and two blockaded former Yugoslav republics (rump Yugoslavia and Macedonia).

Trade with both Greece and Turkey offers opportunities to avoid the bilateral payments problems that inhere in economic intercourse with CEE and FSU states. It also allows the country to circumvent (legally) the UN sanctions on rump Yugoslavia and, in the case of Turkey, EU protectionism, although, of course, the level of protectionism in Turkey can also be quite high. To the Bulgaria-based scholar, such trade is a particularly

appealing object of examination. Data produced in Athens and Ankara are available over a longer period and are categorized in a more consistent manner than Bulgarian figures. These partner data may also be more accurate. Although such a claim is unverifiable, we shed light on the question below by reporting on the results of a detailed comparison of Bulgarian and Turkish data on their bilateral trade in 1992.

A number of interesting questions present themselves:

To what degree does Bulgarian data portray a different picture of the level and structure of the country's trade with Greece and Turkey than do the data from these countries?

To what extent is Bulgarian trade with Greece and Turkey below its potential levels?

To what extent are changes in the structure of Bulgaria's trade with Greece and Turkey consistent with expectations derived from economic theory? What do such changes indicate about the progress of economic reform in Bulgaria?

In this article, we attempt to shed some light on each of these questions. The remainder of the article is organized as follows. In the next section, we briefly describe the general trends and issues in Bulgarian foreign trade since the fall of communism. The third section compares Bulgarian and Greek data on Bulgarian-Greek trade, and Bulgarian and Turkish data on Bulgarian-Turkish trade, with a view to evaluating the reliability of Bulgarian trade data.

The fourth section has two subsections. The first examines the deviation of actual trade flows from potential ones based on empirical work by other authors employing cross-country data. The second subsection contains a statistical analysis that evaluates the consistency of changes in the structure of Bulgarian-Greek and Bulgarian-Turkish trade with economic theory; the analysis also sheds light on the progress of Bulgarian reforms. The fifth section summarizes and concludes.

Trends and Issues in Bulgarian Foreign Trade since the Fall of Communism

Bulgarian foreign trade since 1989 has seen a huge fall in trade volume and an adverse movement in the terms of trade. These phenomena, largely the result of the break-up of the CMEA trading bloc at the start of 1991, were the most severe in the region. This was the result of the country's high degree of trade dependence on the bloc, with in 1990, 80% of exports going to the CMEA and 76% of imports coming from it. Much of the decline in output during 1990-93—27.5% for GDP and 40% for industrial production—can be traced to these foreign trade shocks.

There was a large fall in 1990 in both exports and imports. Another large decline occurred in 1991, but it was masked (especially for exports) by the fact that now all trade with former CMEA partners was conducted in convertible currency. The modest trade and current account deficits registered in 1992 reached alarming proportions in 1993, largely due to the

strong real appreciation of the lev in the latter year. In 1994, the country enjoyed its first favorable annual trade and current account balances since the start of the reforms.¹ Both the increase in exports and decrease in imports can be traced to changes in the real exchange rate; the lev moved from 33 per U.S. dollar in early 1994 to about 55 by the spring and about 65 by the fall.

Like other countries in the region, Bulgaria has seen a shift in the structure of its trade away from Eastern Europe and toward the OECD, especially the EU. By 1992, the OECD accounted for 42.2% of Bulgaria's exports and 43.8% of its imports, with Eastern Europe responsible for 39.2% of exports and 36.3% of its imports. Since then the weight of the OECD in both Bulgarian exports and imports has increased to between 46% and 47% (for the EU alone, between 33% and 34%), with most of this increase occurring in 1994.²

Bulgaria was the last European former CMEA member state to sign an interim free trade agreement with the EU. The agreement was ratified with considerable delay, going into effect on 1 January 1994, instead of the expected 1 July 1993. This delay was largely the result of objections raised by poorer EU member states concerned about Bulgarian exports of food and other low-tech products. On the other hand, the period of validity of the interim agreement was unusually short, as a more comprehensive Europe Agreement came into force on 1 February 1995, the same date as those with the Czech Republic, Romania, and Slovakia. Like that signed by Romania, the interim agreement was less favorable than those reached with the Visegrád lands, but this is generally not a feature of the Europe Agreements, which involve cooperation as well as trade liberalization.

Bulgarian specialists expect that the current direction of trade, with approximately equal shares for CEE, the EU and EFTA, and the rest of the world, will persist in the future. They also point to a tendency for the share of exports to the EU consisting of sophisticated manufactured articles (e.g., machinery, electronics, weaponry) to decline in favor of processed foods, chemicals, and metals. However, this trend is not visible in with commerce with CEE and Arab countries.³

Despite Bulgaria's increasingly Western trade orientation, the EU represents a lower share of its exports than for any other nation in CEE, except for Slovakia and the Baltic states. Although this is partly the result of physical distance from the center of Europe and the country's relative paucity of export goods suitable for Western markets, two other factors deserve mention. The first is the fact that Bulgaria has a higher share of the products of so-called "sensitive sectors" in its exports to the EU than any other CEE state. The figure was 75.1% in 1993, vs. 46.2% in Poland, 39.3% in the former Czechoslovakia, 56.6% in Hungary, and 62.5% in Romania.⁴ These sectors are those for which trade liberalization is less rapid and extensive than for other goods.

Second, Bulgaria sees itself as hit particularly hard by the UN sanctions against the rump Yugoslavia in place since June 1992. It is impossible to find a reliable estimate of the losses arising from these sanctions, although the Ministry of Trade has come up with the figure of \$6.139 billion

for the period through September 1994.⁵ This is an improbably large sum, in view of the fact that GDP in 1994 was on the order of only \$10 billion.

Moreover, certain geographical regions of the country and segments of the population have earned large economic rents by smuggling fuel and other scarce goods into Serbia. Finally, trade with Macedonia has officially reached large proportions—number two in the export ranking and number six for imports during 1994.⁶ The former Yugoslav republic is a corridor for products winding up, largely illegally, in Serbia/Montenegro. Indeed, a controversial study by the then semi-official Agency for Economic Coordination and Development estimated direct losses from the lengthening of transport links, unpaid exports, and reorientation of production to new markets through June 1993 to be only \$230 million.⁷

Before proceeding any further, a few words are in order on the quality of Bulgarian foreign trade statistics. Two sets of figures are available, one based on payments statistics produced by commercial banks and other from the customs authorities. These data vary considerably in magnitude and even in whether they portray a trade surplus or a deficit for a given period. At the IMF's urging, the Bulgarian National Bank took the unusual step of including the customs-based figures in the balance of payments. This move was motivated by the fact that the banks are unable to distinguish between payments related to exports and imports and other foreign transactions, lending a substantial upward bias to trade statistics. On the other hand, the customs statistics are subject to a considerable degree of under-reporting of transactions to avoid the payment of duties.

We compare below the pictures portrayed by bilateral customs statistics from Bulgaria and two of its major trading partners. If Bulgarian and partner statistics on their mutual trade tell largely the same story, it would support the notion of relying on the customs-based trade figures.

Trade with Greece and Turkey

Issues

Trade with Bulgaria's two southern neighbors, Greece and Turkey, is a particularly interesting case study of the general trade developments described above. Greece is in the EU, but one of its least developed members, and the only one for which Bulgarian trade is not directly affected by the U.N. sanctions against rump Yugoslavia.

Greece is a major trading partner, third for exports and fourth for imports in 1994,⁸ one with which Bulgaria traditionally, but no longer, ran trade surpluses. It is a major source of direct foreign investment, having at end-1994 the largest number of projects, about 20% of the total. However, the investments are on the average fairly small, approximately \$58,000, putting it eighth in total amount of money invested. Trade and other bilateral economic activities are limited by the fact that the countries share only one border crossing northeast of Thessaloniki.

The characteristics of Bulgarian-Turkish trade and other economic

activity are in some ways similar to those of between Bulgarian-Greek economic relations. In 1994 Turkey was in seventh place in the export ranking and eleventh for imports.⁹ Trade levels have increased substantially in recent years, with trade balances heavily in Bulgaria's favor. Even more so than Greece, Turkey has a large number of tiny investments in the country. As of August 1994 Turkey was second in the number of officially registered investments, but their average value was but \$7,000.¹⁰

In trade with Turkey, Bulgaria does not face EU protectionism (e.g., sensitive sectors) or such other distortions as the Common Agricultural Policy. Nonetheless, trade with Turkey is far from free. Options for avoiding protectionist measures like port fees or additional taxes, by investing in joint venture plants in Turkey are rarely employed by less-developed and inexperienced trading partners like Bulgaria. Moreover, even before, and in anticipation of, its recent free trade agreement with the EU, Turkey unilaterally reduced its tariffs on EU products, diverting trade away from Bulgaria.

Bulgarian-Turkish trade relations during the transition period have not been complicated by the sort of political disagreements that have at times shadowed ties with Greece (e.g., over Macedonia). At the same time, economic relations with Turkey have an ethnic dimension missing in the Greek context: Turkish investments tend to be in regions with mixed Bulgarian and ethnic Turkish populations, such as K rdzhali or Haskovo.

Data

The top half of Table 1 presents official Bulgarian and Greek data on the country's bilateral trade from 1986 through 1993. During the mid-1980s the differences between what the two sides reported on that trade for a given year were astonishingly large. This was especially the case for Bulgarian exports, for which, for example, in 1988 Bulgaria reported \$326 million and Greece only \$47 million, but it is also true for Bulgarian imports. Interestingly, during 1986-90 Sofia always reported a much higher figure on a given trade flow than did Athens.

For Bulgarian-Turkish trade, the differences in the data reported by Ankara and Sofia in the mid-1980s were also large, if not to the same extent. Once again, from 1986 through 1990 Bulgaria always registered a larger flow than its partner. However, unlike in the Greek case, the proportional difference between what the two countries reported generally grew over time. Note also that Bulgarian data on trade with Turkey realistically depict a growing dollar trade volume, a pattern not reflected in Bulgarian data on trade with Greece.

TABLE 1
Bulgarian Trade with Greece and Turkey
 (million U.S. dollars)

Year	Exports Partner Data	Bulgarian Data	Imports Partner Data	Bulgarian Data	Turnover Partner Data	Bulgarian Data
Greece						
1986	34.17	271.73	58.79	102.58	92.96	374.31
1987	78.63	322.99	50.41	102.63	129.04	425.62
1988	47.06	325.87	33.85	116.13	40.91	442.00
1989	69.03	418.90	68.56	116.18	137.59	535.08
1990	108.10	210.01	52.97	82.64	161.07	292.65
1991	128.53	71.01	87.79	23.18	216.32	94.19
1992	161.00	182.00	167.17	261.24	328.17	443.24
1993	197.57	198.75	303.36	261.08	500.93	459.83
Turkey						
1985	98.75	n.a.	7.70	n.a.	106.45	n.a.
1986	41.47	76.74	15.52	43.46	56.99	120.20
1987	9.36	21.85	14.49	30.98	23.85	52.83
1988	15.71	49.93	28.15	69.10	43.86	119.03
1989	3.30	22.03	26.72	58.03	30.02	80.06
1990	31.88	92.63	10.37	70.18	42.25	162.81
1991	139.90	100.97	75.36	21.32	215.26	337.55
1992	224.53	252.70	72.09	69.00	296.62	321.70
1993	243.25	288.11	86.21	62.67	330.16	350.78

Source: Institute of Trade, Sofia; Export Research Centre, Panhellenic Exporters Association, Athens; State Institute of Statistics, Ankara.

It is useful to pause to reflect on the causes of the enormous differences in the data reported by the two parties to one and the same trade flow. Before 1992, Bulgarian trade data adhered to the classification system employed by the CMEA. During this era, Bulgarian exports transported through Greece or Turkey to a third country might wind up in Bulgarian statistics as exports to one of those two lands. A special problem with respect to trade with Greece was an apparent tendency to record goods transported on Greek ships as exports to Greece.

On the other hand, since 1992, Bulgarian data follow the Harmonized System of Commodity Description and Coding (HSCDC), and such blatant misreporting presumably is less likely. Indeed, the data in Table 1 for 1992 and 1993 reveal a greater degree of similarity between

the data produced by the two sides to each annual trade flow than in the past. In some instances, such as Bulgarian exports to Greece in 1993, the data are virtually identical. Interestingly, in that year, Greece reported a considerably higher volume of exports to Bulgaria than did Bulgaria. This may reflect the fact that Greek exports to Serbia/Montenegro and even Macedonia are recorded in Greek statistics as exports to Bulgaria. However, Turkey continues to report a lower trade turnover with Bulgaria than does Bulgaria, although as noted the differences are by now rather modest.

In terms of the product categories appearing in Bulgarian-Greek trade, Bulgarian exports are dominated by electrical energy, metals (especially copper), and chemicals (especially ammonium derivatives). In Bulgarian imports from Greece, food products (oranges, bananas, coffee, biscuits, beer) and household appliances have pride of place; Bulgaria also buys a significant share of the total Greek exports of certain vehicles.¹¹

For Bulgarian-Turkish trade, data are available for 1992 by 4-digit HSCDC from both Ankara and Sofia. This allows a comparison not only of the levels of bilateral trade reported by the two sides but also of what they list as the detailed structure of that trade. Table 2 provides an overview of the instances in which there are large differences between what the two countries report. Over all, there is considerable similarity between the stories told. Bulgarian exports are dominated by metals, chemicals, and food products, while Turkey specializes in agricultural products, textiles, and vehicles.

Still, despite the similar trade totals for 1992 (see Table 1) and the general similarity of the product categories making the top 25, there are striking differences for some sectors. For example, Bulgaria reports having exported to Turkey \$5.6 million worth of "flat-rolled stainless steel products of less than or equal to 600mm" (7220), a category entirely missing from Turkish statistics on its imports from Bulgaria. In the other direction, Turkey claims to have exported \$1.5 million in "fruits, vegetables, and other edible plant parts" (2001) to Bulgaria, while the latter does not admit to having imported anything in this sector.

The case of "iron bars and poles, for twisting" (7214) is striking. Turkey says that it exported \$2.9 million worth of them, but Bulgaria does not acknowledge importing anything in this category. In fact, Bulgaria claims to have exported \$3.3 million in such items, while Turkey admits to \$985,000 in such imports from Bulgaria. Sector 2710 ("crude petroleum and oils from bituminous minerals") also displays an interesting pattern. Turkish data show \$7.9 million in imports from Bulgaria, while Bulgarian figures report \$1.9 million in imports from Turkey. Both partners claim to have exported to each other only something between \$100,000 and \$200,000 in this category.

One explanation for these puzzles is divergence in the categorization of a given shipment, either with respect to sector or, possibly, time. Another, at least for Bulgarian exports, is that the

TABLE 2
Data Inconsistencies in Reported Bulgarian-Turkish Trade, 1992

BULGARIAN EXPORTS TO TURKEY¹

Top 25 in Bulgarian data, not at all in Turkish data:

7220 Flat-rolled stainless steel products (600mm)

Top 25 in Bulgarian data, not in top 25 in Turkish data:

7214 Iron bars & rods, for twisting

4403 Unprocessed wood

Top 25 in Turkish data, not in top 25 in Bulgarian data:

2710 Crude petroleum & oils from bituminous minerals

5403 Artificial fibers

8458 Lathes

BULGARIAN IMPORTS FROM TURKEY

Top 25 in Bulgarian data, not in top 25 in Turkish data:

2710 Crude petroleum & oils from bituminous minerals

6302 Bed, table, toilet, & kitchen linen; curtains, etc.

3923 Plastic transport or packaging articles

6902 Refractory bricks, blocks, tiles, etc.

6203 Outer garments, men's & boys', textile fabrics

1211 Plants & parts used in perfumery

8703 Passenger motor vehicles

1704 Sugar confectionery, not containing cocoa

1806 Chocolate & other food preparations containing cocoa

Top 25 in Turkish data, not at all in Bulgarian data:

7214 Iron bars & rods, for twisting

2001 Fruits, vegetables, & other edible plant parts

Top 25 in Turkish data, not in top 25 in Bulgarian data:

6305 Sacks & bags, of textile materials, for packaging

6115 Knitted pantihose

2603 Copper ores & concentrates thereof

4203 Leather articles of apparel & clothing accessories

8514 Industrial & laboratory electrical furnaces

1905 Bakery products (bread, biscuits, cakes), etc.

0604 Foliage/branches/other plant parts of trees, etc.

¹Data are classified according to the Harmonized System of Commodity Description and Coding. Sectors are ordered by the size of the relevant trade flow. Complete listing of top 25 sectors according to Bulgarian and Turkish statistics available upon request from author.

Source: Institute of Trade, Sofia; State Institute of Statistics, Ankara.

misclassification of products destined for a third country has not yet been completely eliminated. In any case, it is reassuring that these occurrences seem by now to have become relatively rare.

Analytical Issues in Bulgarian Trade with Greece and Turkey

Trade Potential

A large number of articles have appeared in recent years which employ gravity models to estimate potential trade flows among countries. This literature generally focuses on the extent to which flows between EU (and/or EFTA) and former CMEA members are below expected levels.¹² In this section, we employ the results of one of these studies to estimate the size of potential trade between Bulgaria and Greece, and Bulgaria and Turkey, respectively. This analysis is useful in putting into perspective the trade patterns discussed above.

Among the typical variables appearing in gravity models are the two countries' GDPs and populations, the distance between the countries' trading centers, and assorted dummy variables. As pointed out by Biessen and Albers,¹³ national income can be seen as capturing potential export supply for the exporting country and potential demand for the importing country. Population is expected to be negatively related to a country's participation in foreign trade: a more populous country is likely to specialize in a wider range of goods and be less dependent on trade.

Alternatively, one may follow Baldwin¹⁴ and reason by analogy with models of the discrete choice made by a family as to where to shop or where to migrate. Such models may explain that choice in terms of the characteristics of the family (e.g., income, number of family members) and/or the characteristics of the choice set (e.g., distance from current residence). It is straightforward to extend this logic by explaining the (continuous) trade between two nations with reference to GDP, GDP per capita, population, and distance.¹⁵

For the present purposes, many articles could form the basis of our estimate of intra-industry trade. We have chosen to use that derived by Biessen and Albers¹⁶, because they estimate their model for a particularly inclusive set of countries—twenty nations, including all eleven EC members, Luxembourg and Belgium having common trade data; all six EFTA members; and Hungary, Poland, and the former Czechoslovakia (CEC)—during 1991, a recent year. They also include dummy variables for whether a country was a member of the EC, EFTA, or CEC; whether the trade partners are neighbors; and whether the trade is between East and West or between the East and Germany.¹⁷

Biessen and Albers's¹⁸ estimated gravity model for 1991 is as follows:

$$\begin{aligned}
 \ln(X_{ij}) = & 6.03 + 0.99 \ln(Y_i) + 0.63 \ln(Y_j) - 0.34 \ln(N_i) + 0.10 \ln(N_j) \\
 & - 0.98 \ln(D_{ij}) + 0.54 \ln(\text{NEIGH}) + 0.41 (\text{EC}) - 0.29 (\text{EFTA}) \\
 & + 0.95 (\text{CEC}) - 0.45 (\text{CEC/WEST}) - 1.55 (\text{WEST/CEC}) \\
 & + 0.96 (\text{CEC/D}) + 0.07 (\text{D/CEC})
 \end{aligned} \tag{1}$$

where X_{ij} is exports from country i to country j (dollars); Y_m ($m=i,j$) is the gross national product of country m (billions of dollars); N_m is the population of country m (millions); D_{ij} is the distance between the trading centers of country i and j (kilometers, overland or sea); NEIGH is a dummy variable equal to two if countries i and j neighbor each other (and one otherwise); EC is a dummy capturing whether one or both partners was a member of the EC; EFTA is a dummy capturing whether one or both partners was a member of EFTA; CEC is a dummy capturing whether one or both partners was a CEC country; CEC/WEST is a dummy equal to two for exports from a CEC country to an EC or EFTA member; WEST/CEC is a dummy equal to two for exports from an EC or EFTA member to a CEC country; CEC/D is a dummy equal to two for exports from a CEC land to Germany; and D/CEC is a dummy equal to two for exports from Germany to a CEC land.¹⁹

We have substituted values into equation (1) for the three countries in 1990 for population and GNP from World Bank,²⁰ plus road distances from an atlas—using Sofia, Athens, and Istanbul as trading centers—and assigned appropriate values to the dummy variables, treating Turkey as a European country. The results are in Table 3.

A comparison of the actual trade data in Table 1 with the estimated potential trade flows in Table 3 shows that actual trade is well below its potential level. For trade with Turkey, Bulgarian exports in 1993 were 45% of what they should be, while Bulgarian imports were less than 21% of their expected level (using Turkish data). There is also a considerable gap between reality and potential for Bulgarian trade with Greece, but that gap is smaller: in 1993 exports and imports were about 64% and 73%, respectively, of potential (employing Greek data).

Two comments are in order in passing. First, as large as the deviations of actual from potential trade volumes were in 1993, these gaps are at historically low levels and may be expected to shrink in the future. Second, note that Biessen and Albers's²¹ estimated gravity model correctly predicts the trade surplus with Turkey and trade deficit with Greece that existed, at least according to partner data, in 1993 and in most earlier years.

In order to ascertain the sensitivity of the estimated potential trade levels, a more realistic Bulgarian GNP figure of \$10 billion was substituted for the World Bank's²² estimate of \$19.8 billion. The result of this substitution, as depicted in the second column of Table 3, is to cut potential Bulgarian exports approximately in half and potential Bulgarian imports by about one-third. This extreme procedure brings the estimated potential

TABLE 3
Potential Trade Flows Between Bulgaria and Greece
and Bulgaria and Turkey

	<u>Bulgaria</u>	<u>Greece</u>	<u>Turkey</u>
Population	8.8	10.1	56.1
GNP	19,800	60,499	91,443
Distance-Bulgaria	n.a.	885 ¹	581 ²

(million U.S. Dollars)

Exports	World Bank Figures	Bulgarian GNP= \$10 billion ³	Thessaloniki replacing Athens ⁴	Both Changes ⁵
Bulgaria to Turkey	538.8071	273.99	n.a.	n.a.
Turkey to Bulgaria	413.6916	269.0157	n.a.	n.a.
Bulgaria to Greece	307.7944	156.5173	849.7166	432.0914
Greece to Bulgaria	433.069	281.6165	1195.557	777.448

¹Road distance in kilometers between Sofia and Athens.

²Road distance in kilometers between Sofia and Istanbul.

³Potential exports recalculated with Bulgarian GDP set at \$9 billion, instead of \$19.8 billion.

⁴Potential exports recalculated with Thessaloniki (314 road kilometers from Sofia) replacing Athens as the trading center of Greece.

⁵Potential exports recalculated subject to both changes above.

Source: Guido Biessen and Henk-Jaap Albers, "Trade Reorientation: The Central European Case," Working Papers International Economic Relations, Law Faculty, Leiden University, no. 3, 1993; World Bank, *World Development Report 1992: Development and the Environment* (Oxford and New York: Oxford University Press, 1992), pp. 218-19.

trade flows close in line with actual trade volumes. However, substituting Thessaloniki for Athens as the trading center of Greece (third column of the table) substantially raises the estimated potential trade with Greece. Making both substitutions give estimates of such trade far in excess of what has occurred so far (fourth column).

Explaining the Structure of Trade

An issue to which relatively little attention has been devoted, at least until recently, is the structure of trade between post-communist and longstanding market economies. Aiginger, Peneder, and Stankovsky (henceforth APS)²³ argue that under communism the central and east

European countries were abundant in capital. This was the result of generally high investment/output ratios, according to official data, and the priorities characteristic of the system: investment over consumption; heavy industry over light; and new, large projects over repair and maintenance. In contrast, labor inputs during this era were scarce, as evidenced by the virtual absence of unemployment, high female labor force participation, and the use of *gastarbeiter* from the socialist Third World (e.g., Cuba, Vietnam).

The postcommunist economies now function closer to the manner of market economies. Centrally planned factor movements have disappeared, and substantial involuntary unemployment and low or negative net fixed investment have appeared in many countries, especially in Bulgaria. With this in mind, APS advance the following hypothesis:

The real test in the spirit of the Heckscher-Ohlin Theory is that there should be structural change in the trade flows: CEE countries should lose competitive strength in capital intensive industries, and gain competitiveness in labor intensive ones.²⁴

We can take the APS reasoning a step further. Changes in the factor intensity of export goods can be seen as indicative of the progress made on economic reform. This is the case not only with respect to capital and labor inputs, for which the changes may follow the pattern suggested by APS, but even more clearly for energy inputs. If Bulgarian exports continue to be energy intensive, or even increase in energy intensity, it could be taken as a sign of lack of progress on privatization, hardening of budget constraints, and/or liberalization of energy prices.

Indeed, economic reform in Bulgaria has been patchy. An established market-oriented economy was sufficient to create substantial unemployment (it peaked at over 16% in 1994 before falling to 12% in 1995) and low and probably negative net fixed investment. On the other hand, formal privatization of the leading state industrial enterprises has made little headway, financial indiscipline in state enterprises and banks has remained rife, and certain energy prices are among the lowest in the world. The empirical investigation that follows of the factor intensity of Bulgarian exports to and imports from Greece and Turkey aims to shed light on the relative strengths of these contradictory tendencies.

As noted by APS, testing empirically theoretical trade models is no easy matter. In particular, testing the Heckscher-Ohlin theory suffers such well-known problems as the fact that it is designed for a two-country world and that input prices under autarky are unobservable.

In the present context, testing the theory is fraught with additional difficulties. Before the fall of communism Bulgaria did not have a market economy and the extent to which it has one even now is questionable. Furthermore, Heckscher-Ohlin assumes that the exporting and importing countries involved in a given transaction use identical technology to produce the traded good, a troubling assumption for East-West trade. The other assumptions behind Heckscher-Ohlin include perfect competition,

constant returns to scale, and identical and homothetic consumer preferences in both countries. These assumptions are perhaps not ill-suited to analyzing Bulgarian trade.

Finally, the APS hypothesis may not be as well suited to Bulgarian trade with Greece and Turkey as it was to their work on Austrian trade with the Visegrád lands. The hypothesis was intended to apply to trade between postcommunist and highly developed market economies. It is unclear whether either Greece or Turkey, especially the latter, belongs in this category.

Everything considered, however, the Heckscher-Ohlin provides the best analytical basis for analyzing the development of Bulgarian trade with its neighbors in recent years. Not only does it remain the most widely tested and discussed trade theory, it also, when combined with the APS thesis, provides an easily testable explanation of the nature of structural change in trade. Data on the labor, capital, research and development, skill, and energy intensities of production are available from the EU by three-digit NACE, the EU's international trade classification system. These intensity estimates are based on the technology employed in Great Britain, France, Germany and Italy.²⁵ Once we adopt the Heckscher-Ohlin assumption of identical technology in Bulgaria, Greece, and Turkey, we can test the APS thesis for Bulgarian trade with the other two.

Data were obtained from the Turkish State Statistical Institute by four-digit SITC, revision 3, on trade in both directions between Bulgaria and Turkey for 1989-93. Similarly, figures were acquired on trade between Bulgaria and Greece during 1988-93 from EUROSTAT (the EU's statistical office) by three-digit SITC. The data were then reclassified according to the NACE system, revision 1, a necessary step because the factor intensity data are by three-digit NACE.

APS (1994) employ as their dependent variable a version of the so-called revealed comparative advantage (RCA).²⁶ However, in the present context this formulation has been eschewed in favor of net exports, NX_i ($= X_i - M_i$). One reason for this substitution is the fact that in many cases in our data either exports or imports in a given category are zero,²⁷ making it impossible to calculate R_i without manipulating the data in some arbitrary manner.

Second, a case can be made for analyzing separately the determinants of exports and imports. In this manner the factors influencing net exports can be broken down into those that affect primarily exports, those that largely influence imports, and those that affect both. A *strong* tendency is one felt on both exports and imports, and a *weak* tendency is one influencing only one or the other. Finally, estimated equations on large cross-sectional data sets such as this one typically do not fit well (R^2 's are low); a simpler formulation of the dependent variable should be easier to explain.

The equations to be estimated (by OLS) for net exports are of the form

$$NX_i = \beta_0 + \beta_1(KI_i) + \beta_2(LI_i) + \beta_3(RDI_i) + \beta_4(SI_i) + \beta_5(EI_i) + \beta_6(NX_{-1,i}) + \epsilon \quad (2)$$

where KI_i is the capital intensity of sector i (based on the EU data); LI_i is its labor intensity; RDI_i is its research and development intensity; SI_i is its skill intensity; EI_i is its energy intensity; $NX_{-1,i}$ is the net exports of the given sector during the previous year; and ϵ is a well-behaved disturbance. The presence of the lagged dependent variable is an innovation over the APS specification and is intended to improve the fit of the equation by capturing sector-specific attributes other than factor intensity. Similar equations were also estimated, but with X_i and $X_{-1,i}$ (exports) and M_i and $M_{-1,i}$ (imports), respectively, replacing NX_i and $NX_{-1,i}$.²⁸

The results of these estimations are presented in Table 4. The presence of the lagged values of the dependent variables means that each data set is one year shorter than it would otherwise be, so that the data on Greece cover 1989-93 and those on Turkey 1990-93. The variable YEAR, essentially a time trend, is included in a specification whenever doing so increases the adjusted R^2 .

For trade with Greece, other than the lagged dependent variable, few other regressors are statistically significant. One striking finding is the positive and statistically significant coefficient on energy intensity for both net exports and exports. The only other result worth mentioning is the significantly positive coefficient on capital intensity in the import equation.

For trade with Turkey, the findings are more interesting. Again there is a significantly positive relationship between energy intensity and net exports and exports. Here there is also a significantly negative link between EI and imports, a strong finding. Net exports are negatively correlated with capital intensity, while imports are positively correlated with this regressor. There is a significantly negative relationship between net exports and exports, on the one hand, and labor intensity, on the other. Again we have a strong result: imports are positively related to LI. R&D intensity and skill intensity are never statistically significant in any of the six runs.

These findings pertain to the entire periods covered by the respective data sets on trade between Bulgaria and the two other countries. It is also of interest to observe whether the relationships have changed over the sample periods. Chow tests²⁹ reveal that for net exports to Greece there is no significant difference ($F_{171,7} = 3.172$) between the regression pertaining to 1989 and that for 1993. For net exports to Turkey ($F_{153,7} = 41.131$), there is a significant difference between the relationship in 1990 and that in

1993. In 1990 the findings for capital intensity and labor intensity are especially weak and that for energy intensity particularly strong; in 1990 the fit of the equation is much better (R^2 equals 0.330 vs. 0.134 for 1993).

TABLE 4
Determinants of Structure of Bulgarian-Greek
and Bulgarian-Turkish Trade

Country: Period: Dep. Var.:	Greece			Turkey		
	1989-93	1989-93	1989-93	1990-93	1990-93	1990-93
	NX	X	M	NX	X	M
Constant:	140,040 1.594 ²	588.47 1.478	-217,320** ¹ -3.949	3,080.7** 3.330	-308,220 -1.694	-175,860* ¹ -2.143
KI:	-74.277 -1.313	-26.644 -0.613	71.533* 2.001	-440.95** -4.579	-260.19* -2.94	178.06** 4.503
LI:	-39.920 -1.549	-19.384 -0.979	28.494 1.757	-195.67** -4.442	-143.77** -3.551	48.873** 2.710
RDI:	-1.638 -0.729	-0.293 -0.170	1.469 1.045	2.773 0.055	1.995 0.043	-0.996 -0.048
SI:	-1.075 -0.155	-4.961 -0.932	-5.366 -1.236	7.354 0.503	-2.024 -0.151	-9.802 -1.631
EI:	95.931** 3.160	60.710** 2.608	-33.608 -1.782	402.19** 7.723	328.68** 6.887	-77.126** -3.756
Dep. Var. ₁ :	0.556** 13.229	0.632** 16.028	0.364** 7.782	0.170** 3.460	0.169** 3.321	0.070 1.524
YEAR:	-70.037 -1.587		109.1** 3.948		156.00 1.708	88.051* 2.137
R ² :	0.219	0.288	0.107	0.182	0.182	0.058
No. of Obs.:	764	764	764	532	532	532

Notes: All regressions are of the OLS type and were run with the software package LIMDEP 6.0. See text for definitions of variables.

¹Two asterisks denote that the relevant independent variable is significant at 0.01; one asterisk denotes that it is significant at 0.05.

²t-statistics are in parentheses below estimated coefficients.

Overall, the findings of this empirical exercise can be summarized as follows. First, the positive association of energy intensity with net exports is undoubtedly an indicator of the lack of progress on restructuring and privatizing heavy industry in Bulgaria. Second, at least for trade with

Turkey, the APS hypothesis is supported for capital intensity (Bulgarian net exports are negatively associated with this variable). However, the findings are the opposite of what APS expect for labor intensity, which is also negatively correlated with net exports.

Conclusions

The main findings of this paper can be summarized as follows:

Bulgarian exports to Greece are dominated by electrical energy, metals, and chemicals; foods and household appliances figure prominently in its imports from Greece. Bulgaria's exports to Turkey are comprised largely of metals, chemicals, and foods; Turkey sells Bulgaria foods, textiles, and vehicles.

Through the late 1980s the differences between what Sofia reported on Bulgarian trade volumes with Greece and Turkey and what Athens and Ankara, respectively, reported were huge. However, the differences between the bilateral trade flows registered by Bulgaria and these two trade partners have recently fallen considerably, in some cases to insignificance.

Bulgarian trade volumes with Greece and Turkey are well below their potential levels as estimated from gravity models, especially for imports from Turkey.

A statistical examination of the thesis advanced by Austrian economists that CEE nations should have shifted from specializing in capital-intensive products to labor-intensive ones was conducted using recent data on Bulgarian-Greek and Bulgarian-Turkish trade. A related issue was also addressed: whether Bulgarian exports continue to be energy intensive. Our findings support the notions that the capital intensity of Bulgarian exports is low and that their energy intensity remains high. However, their labor intensity is also low, in contradiction to the APS hypothesis.

We have seen that Bulgaria's trade volumes with its two southern, always-capitalist neighbors are well below their potential levels. We have also observed that Bulgaria continues to export its traditional, energy-intensive products from the heavy industrial and chemical branches. These two "problems" may be related, in that more attractive export goods will be produced only after the economy undergoes a thorough restructuring. No evidence of Bulgaria's specialization within the CMEA in electronic products can be found in its trade with Greece and Turkey.

On the other hand, Greece and Turkey may not mind following the lead of the EU as a whole and exporting their pollution-producing industries to Bulgaria and other CEE nations. Recall that Bulgarian exports to the EU are becoming less sophisticated, a fact that seems not to apply to trade with Arab or CEE states.³⁰ It is interesting that in this regard Turkey seems to resemble more an EU than a Middle Eastern country.

In the end, given the old vintage of most of Bulgaria's heavy industrial and chemical plant and equipment, the country's current export profile may be short lived. Joining the ranks of the modern market economies,

with their orientation toward intra-industry trade, will require substantial volumes of foreign investment. Bulgaria has not been notoriously successful in attracting such investment. Although this fact is partly the result of deficiencies in the local investment climate, it also reflects the country's physical and cultural isolation from the heart of Europe. With this mind, deepening economic cooperation with Greece and Turkey is an absolute necessity if Bulgaria is to shake off the shackles of its communist past.

NOTES

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1. Bŭlgarska narodna banka (BNB), *Annual Report* (Sofia, 1991), p. 100; Bŭlgarska narodna banka, *Informatsionen byuletin*, 3 (Sofia, 1995), pp. 44-45.

2. Natsionalen statisticheski institut (NSI/IV), *Iznos i vnos*, 4. (Sofia, 1994), pp. 5-8.

3. Aleksandŭr Dimitrov and Viktor Yotsov, "Dinamika i struktura na vŭnshnata tŭrgoviya," *Pari*, 28 April 1995, p. 8.

4. Peter Hedling and Jody Lanfrey, "East-EU Trade Relations: Towards a Better Deal?," *Östekonomiska Rapport*, 6 (13) (1994).

5. "Yugo-Embargo Losses Reach U.S.D 6,139M," *168 Hours BBN*, 4 (48), 28 November-4 December 1994, p. 8.

6. Natsionalen statisticheski institut, *Iznos i vnos*, pp. 5-8.

7. Agentsiya za ikonomicheskoprogramirane i razvitie (AECD) "Makroikonomicheska otsenka na posleditsite ot embargoto sreshty bivsha Yugoslaviya" (Sofia, July 1993) (mimeo).

8. Natsionalen statisticheski institut, *Iznos i vnos*, pp. 5-8.

9. *Ibid.*

10. The source of these figures is unpublished data from the Commission on Foreign Investment (Council of Ministers).

11. The discussion of this paragraph is based on data provided by the Export Research Centre of the Panhellenic Exporters Association (Athens), which covers Bulgarian-Greek trade by 5-digit Standard International Trade Classification (SITC) during 1993. A tabulation of the top fifteen products according to this classification sold in each direction is available upon request from the author.

12. See, e.g., Richard E. Baldwin, "The Potential for Trade Between the Countries of EFTA and Central and Eastern Europe," Occasional Paper 44 (Geneva: European Free Trade Association, 1993), who provides a bibliography and discussion of earlier work in this vein; and Guido Biessen and Henk-Jaap Albers, "Trade Reorientation: The Central European Case," Working Papers International Economic Relations, Law Faculty, Leiden University, no. 3, 1993.

13. Biessen and Albers, "Trade Reorientation...."

14. Baldwin, "The Potential for Trade...", p. 10.

15. One problem with Baldwin's logic is that it seems to imply a positive correlation between population and trade, in contradiction to both the reasoning of other authors and most empirical findings. It is also possible to derive a gravity model from Paul Krugman's frictionless model of intra-industry trade; see Baldwin, "The Potential for Trade...", p. 11.

16. Biessen and Albers, "Trade Reorientation..."

17. Biessen and Albers estimate two versions of their equation for 1991, one with (dollar) GNP's calculated at official exchange rates and the other with these variables figured at purchasing power parity exchange rates. The results are fairly similar and in any case the latter findings are presented largely for comparison with their estimates for 1980, which are based on purchasing power parity exchange rates. Accordingly, the work that follows employs their estimates derived on the basis of official exchange rates. Biessen and Albers, "Trade Reorientation..."

18. *Ibid.*

19. The data set had 342 observations and the R^2 for the estimated equation was 0.91. The coefficients were statistically significantly different from zero for all regressors but N_j , EFTA, CEC, CEC/WEST, CEC/GERMANY, AND GERMANY/CEC.

20. World Bank, *World Development Report 1992: Development and the Environment* (Oxford and New York: Oxford University Press, 1992), pp. 218-19.

21. Biessen and Albers, "Trade Reorientation..."

22. World Bank, *World Development Report 1992*.

23. Karl Aiginger, Michael Peneder, and Jan Stankovsky, "The Explanatory Power of Market-Based Trade Theories for the Trade between Market Economies and Reform Countries," *Empirica* 21 (1994):201-202.

24. Aiginger, Peneder, and Stankovsky, "The Explanatory Power of Trade Theory...", p. 202; italics in original.

25. Labor intensity is measured as the number of employees per unit of production, excluding VAT. Capital intensity is proxied by investment per employee and research and development intensity by R&D spending as a percentage of production. Skill intensity is taken to mean non-manual labor as percentage of total labor, and energy intensity measures energy costs as a percentage of production. These figures are all based averages (or weighted averages) of data from the four countries mentioned in the text, except for energy intensity, which employs data from Great Britain and Germany only. See *Ibid.*, pp. 217-18, for more details.

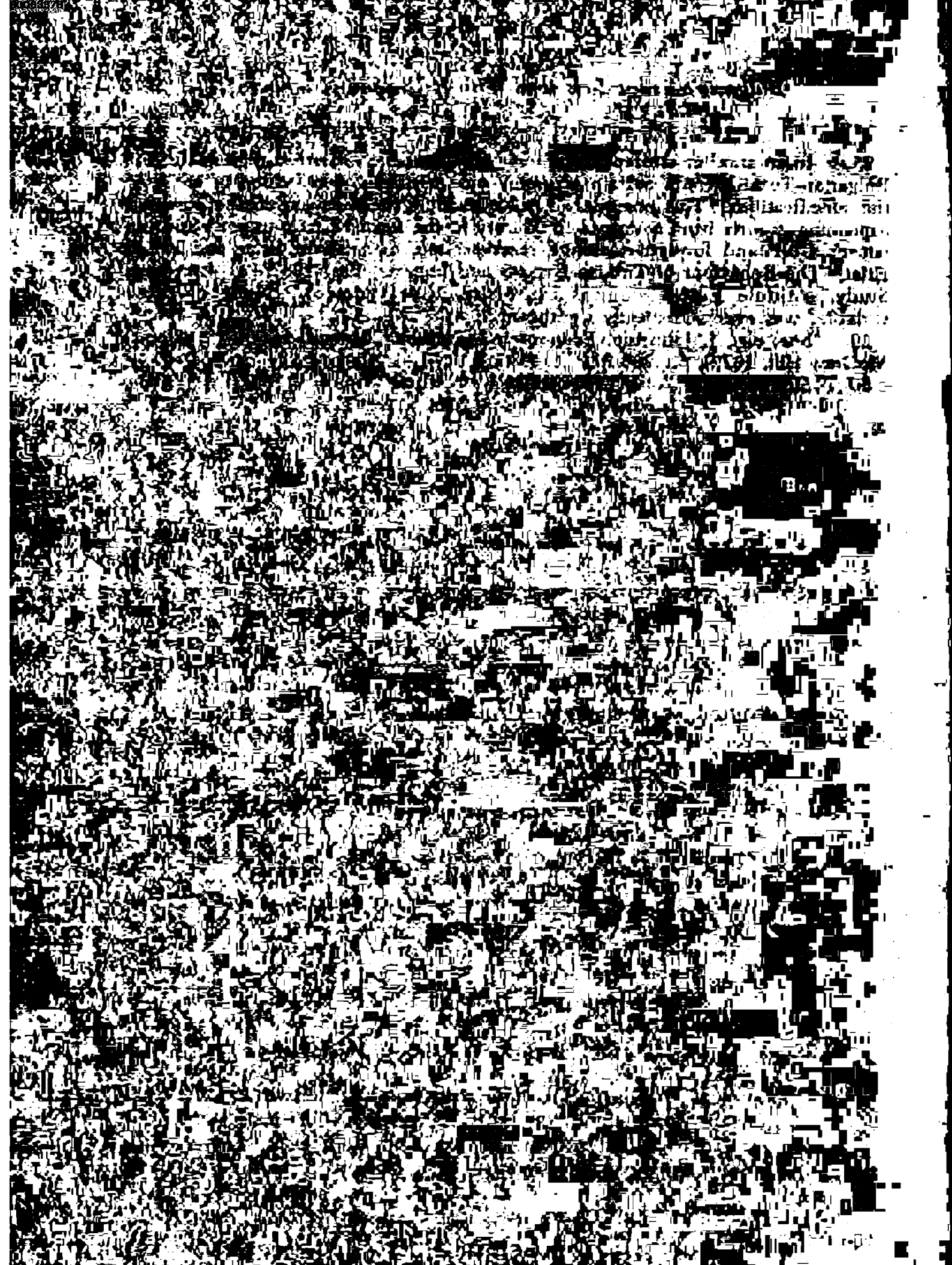
26. APS define a country's RCA in commodity (group) i as $\ln(X_i/M_i)/(X/M)$, where X_i is its imports of commodity i ; X is its total exports; and M is its total imports. For a discussion of the meaning and alternative definitions of RCA, see Rumen Dobrinski "Trade Restructuring in Central and Eastern Europe: A Comparison of Eastern and Western European Trade Structures," paper presented at the conference "Transforming Economies and European Integration" Sofia, May 1994 (mimeo), pp. 12-17.

27. Cases are included in our data set whenever net exports are non-zero, that is, whenever either exports or imports are non-zero. As pointed out by Biessen and Albers (Biessen and Albers, "Trade Reorientation...", p. 9, note 19), ideally one would include all sectors in the nomenclature, even those for which net exports are zero, and employ the Tobit estimator. In our case, time and technical limitations precluded resort to this option.

28. In another attempt to improve the fit of the estimated regressions, for Bulgarian-Turkish trade certain economy-wide variables were added to some of the specifications. This procedure involved adding the following to the equation explaining exports from country *i* to country *j*: the former's total imports and the latter's GNP and foreign exchange reserves; see, e.g., Güzin Erlat and Haluk Erlat, "The Behaviour of Turkish Exports and Imports, 1967-1987: An Empirical Study," Middle East Technical University, 1994 (mimeo). None of these variables was ever statistically significant.

29. See, e.g., J. Johnston, *Econometric Methods*, second edition (St. Louis: McGraw-Hill, 1972), pp. 206-07.

30. Dimitrov and Yotsov, "Dinamika i struktura...."



Government versus Markets: Traps of Transformation

Neven Borak

1. Introduction

The aim of this article is to demonstrate some traps of transformation due to forming basic networks between economy and politics. The different views affect the shaping and the maintaining of certain governance and management structures and political structures. In transforming societies old rules of governance are abolished. New patterns of governance, which relies on interrelations between government, parties and economic élites, emerge and take over complete control upon establishing a new legal system. Companions to such developments are varieties of illegal and socially undesirable activities with questionable economic effects. The article traces some aspects of the so-called business-politics relationship which are important for creating and maintaining new governance systems. Although known from Western experience, these aspects have a significant initial impact on transforming economies.

A number of developments and events in recent Slovene history, which we like to range among those pertaining to the process of transformation, call for additional explaining of the political and economic realities. We understand transformation as a multi-level and multi-dimensional transition process. In that context interrelations between economy and politics will be outlined. The second part of the article presents the concept of the *avant-garde* mistake. The third part introduces the paradox of revolution as a framework for discussion of distributional coalitions, found in part four, and the role of the state in forming the new economic and financial system discussed in part five. The sixth part outlines possible analytical approaches to deal with relations between voters and parties. In the final part some conclusion are given.

It will be useful to start from the beginning and to review the meanings of terms and concepts that serve as framework or foundation for discussion. With the help of a dictionary and Max Weber¹ as our main sources, we can construct a useful framework (Table 1).

TABLE 1—Reminder

vocabulary	meaning	Weber	meaning
economy	the management, regulation, and government of a household's affairs; the administration of the internal affairs of a State; a system of laws, principles, doctrines, rites, etc.; (political e.) the science of the production and distribution of wealth	economic organization	a continuously organized system of economic action
economize	to manage domestic or pecuniary affairs with economy	economic action	a peaceful use of the actor's control over resources, which is primarily economically oriented
politics	the science or art of civil government	economic corporate groups	1) a group engaged in economic action 2) an economic organization 3) an organization regulating economic activity 4) an organization enforcing formal order
(fig. policy)	conduct of private affairs	economic social action	action that takes account of the behavior of someone else
politicize	to make political	economically oriented action	1) every action which takes account of economic considerations 2) that makes use of physical force as a means
polity	the form, system, or constitution of the civil government of a state; the state; an organized community; the form of organization of any institution	politically oriented action	aims at exerting influence on the direction authority of a corporate political group
corporation	a united body; a corporate body empowered to act as an individual	corporate group	a social relationship which is either closed or limits the admission of outsiders by rules so far as its order is enforced by the action of specific individuals whose regular functions this is ('the person of authority')
institution	a society or association for the promotion of some particular object	corporate organization	an associative social relationship characterized by an administrative staff devoted to continuous purposive activity
society	a body of persons associated for some common object	power	the probability that one actor within a social relationship will be in position to carry out his own will despite resistance regardless of the basis on which this probability rests
govern (-ance) (-ment)	a system used to direct and control, to rule with authority, to regulate	political corporate group	an imperatively coordinated group enforcing its order by the application and threat of physical force on the part of administrative staff
power	ability to do or act so as to effect something; influence; right or ability to control		
will	power of carrying out one's intention or dominating others		
privatization	changing common, socially-owned or state property to private property		

Why list concepts well known to everybody? Simply because they convey the core of some traps of transformation that emerge from the interrelation between economy and politics. These traps are completely neglected by international advisory involved in potential reforming processes of previous socialist societies.

During the transformation, i.e., while old ties are coming loose and the codification of new ones and/or shaping of a new and stable legal system is delaying, certain developments, bringing forth socially and economically questionable and undesirable consequences, are on the rise.

2. *The Avant-Garde Mistake*

There is either no well-argued and cool anatomy of events, of the conduct and the functioning of major actors in terms of economic policy, or one-sided and noncomprehensive interpretations prevail. Many economic problems are generated by, among others, internally caused factors of the political-business cycle. They are manifested in the changed attitude towards the former Yugoslav markets, social gains of the former system, unemployment and development issues and towards industrial policy. The overall situation is also reflected by the fragmentation of the budget, the controversial viewpoints regarding the issue of how fast and to what extent the country should join the European integration formations, by the privatization split, and by growing tensions in the financial restructuring of the banking and the enterprises sector. These tendencies further confirm the assumption that an increase of economic efficiency as a target has been completely pushed aside and has become subject to the struggle for control over resources. The latter is manifested first in the struggle for a dominating influence over the budget and the resources, which in turn guarantee a dominating influence over the economic and political situation, and second in pressure to take over the power-related bodies. The often tried *avant-garde* mistake about the superior force of common will, and/or the belief that all options are available, and that it is only a matter of the right choice, is still present. It is a mistake to assume that will relies on common wealth, public good, or altruism. The theory of common wealth does not urge one to seek fundamental principles of political engagement, which suggest the following words of the statesman Kučan:²

In spite of such declarations based on principles that speak on behalf of the significant role of a constitutional state, it occurs that political practice clash with such declarations. Politics put into practice, seems not always to go hand in hand with declared principles. Moreover, it is prone to use criteria of profitability and political opportunity prevailing over the criteria of constitutionality and lawfulness....If we are to accept a kind of pragmatic understanding of law and tolerating voluntaristic and an inconsistent attitude of the holders of political power towards constitutionality and legitimacy, is only a step to an autocratic power, which in submitting the law to itself, declares the benefits of one group, which it

represents, for common wealth and understands its criterion of justice for justice alone.

Not all options are always available, or put on the table, and it is also not just a matter of the right choice. But, if will is linked with interest, and furthermore interest with the gain, things become more clear. We have reached a point where an economist finds his way around much better. We realize, how much the principles of economic policy are interrelated, and how the merging of economic and political principles impacts organizations, the state, power bodies and the rules of action. These rules can be either 1) rules benefiting the mafia and corruption, 2) democratic and legal institutions, or 3) a combination of the two.

Although economics regarded as a discipline is focused on the normative and positive market analyses, it is often not rational to overlook the connection between economic policies and political decisions. There is a prevailing impression that the normative approach to the economic policy is the only one that counts: the well-intentioned ruler or the social planner has the best intentions, he perfectly knows the preferential function of society, and optimizes the interests of the society through his action. Such thinking generally results in picturing a combination of optimum policies, and makes believe, especially the economists, that they are able to tell which policies seem to be the best for all, whereby political factors always range among exogenous factors. Thus, the fact that common voters are mainly concerned about their own welfare and the welfare of their families and friends has been neglected. We may say that, in doing so, they also take care of the economic prosperity in its entirety. On the other hand, politicians are in the first place concerned about their own welfare and the welfare of their fellow-people. The interests of the two groups rarely converge, and if they converge, they do so only by chance, but by all means the one who in his main concern for his own welfare has also the opportunity to take advantage of the power is in a much better position.

The well-intentioned ruler, the social planner, or the representative consumer do not exist as archetypes necessary for the normative analysis and normative advice, therefore help needs to be sought on the other side as well, i.e., in positive analysis and by forsaking the exogenous factor. A comprehensive consideration of the economic situation should simply not neglect the interconnection of politics and economy, and should not overlook the interaction of political and economic factors. In order to better comprehend the role of the state in the economic process, it is important to have an insight in these connections. According to one definition, the state must establish a constitutional framework for a sound economic system and a just legal system, and leave all the rest to the self-regulative mechanism of interests of the privately-owned economic units. According to another definition, the state should also interfere in the field of business activities, when necessary. Regardless which of the two roles of the state one likes better, it makes a difference what kind of economic and legal system the state implements: it may be that the system is based on corruption.

Aware of that, the government of the Republic of Slovenia has written as follows:³

The aim of reshaping of the economic and political systems, now under way in Slovenia, relying on fundamental principles of the new constitution of Slovenia, is to adopt a permanently market-oriented economic system, encouraging a free private initiative, safeguarding the right of private ownership, all these to guarantee the implementation of economic, social and ecological objectives. A transparent model of public services should be laid down, a system of local self-administration, economical public administration, and a system of a modern parliamentary democracy are to be introduced. The fundamental orientation of the legal system will be in promoting and encouraging a sound enterprising initiative, and in reducing the possibilities of the spread of various forms of damaging and dishonest activities of diverse entities and individuals, in the enterprises as well as in the public sector—in public services and politics. It will be committed to rendering impossible the prohibited and harmful activities and misconduct, and/or keeping them under control. Corruption is not, or cannot be only the subject of the penal legislation, the aim of which is to prevent, to investigate and to punish, giving and receiving bonuses and bribe money for more advantageous and illegal settlement of official matters. There is a large number of matters and developments which cannot be covered by legislation alone, namely widespread irregularities not based on legal regulations or being adverse to them, offering the chance for certain privileges and/or advantages that may be frequently observed in the public sector, in politics and/or in public services. The said irregularities and the damaging misconduct are likely to occur especially within legal entities, but also in individuals, involved in laying foundations for decisions, or being directly involved in decision-making, who may be prone to them. There is a fundamental need to attain a complete transparency of the functioning of the public sector. The legal system, which is in its formative stages, aims at that goal...The reason why all kinds of inappropriate and damaging misconduct and/or criminal offenses may emerge during the transition period is that the rules of conduct and action have not been yet set clearly. Nevertheless, such offenses ought to be investigated, punished and kept under control.

Regardless of the legality of corruptibility, control over the state is also control over the differentiation processes in transforming societies. We can understand the economic differentiation as differentiation of ownership, management, and employment, and political differentiation as differentiation of state administration and political parties.

3. The Paradox of Revolution or Quid pro Quo!

The acknowledgment that common wealth or public good seems not to be the reason for action by the state elite, political parties elite and economic elite can be merely concluded from empirical and observable facts. What is surprising is that the realization came so soon. The empirical and

the observational character are connected with power, which according to Galbraith⁴ can be illustrated by a double triad of power. Galbraith defines three kinds of power: the power based on force and fear from punishment (condign power), the power founded on the reward for being subordinate (compensational power), and the power based on persuading those who one wishes to subdue (conditional power). In the same background there is another triad: personality, ownership, and organization. Both triads are interrelated in many ways. We may say that in the past the prevailing relation between personality, meaning the ability of leadership and family ties, and power used to be practiced by physical force, where nowadays it is conditional and relies on the ability of persuasion. Ownership, together with earning capacity, is connected with compensational power, i.e., for purchasing acquiescence, and also encourages conditional acquiescence. The most important source of power which is connected with conditional power is organization. Organization combines all three instruments and forms of power and is directly linked with the other two sources of power, personality, and ownership, and therefore may punish, may give rewards, and may persuade. It can differentiate.

Aside from the fact that it cannot be considered a drive for asserting one's own will and power, common wealth or public good too is not a decisive reason for one to subordinate to the will of the holder of power. In his search for an answer to the question of how an individual reacts when confronted with the assertion of someone else's will and power, for example to the revolutionary's and the counterrevolutionary's, and with a choice of which of the two sides he should subordinate to, Tullock⁵ named such conduct the paradox of revolution. The first step is certainly to evaluate the general desirability of the predicted changes which is defined by equation (1) in Table 2. This equation relies on the public good for all people. An inactive individual participates (P_{in}), if everybody else participates (PG), depending on the probability of success of the changes (L_v). In that case there is no personal interest/benefit other than the benefit of improved government. Equation (2) defines the total payoff of the individual who decides to participate actively in the changes. His participation may slightly increase the probability of change to succeed, and he has a chance of reward (R_i). Hence, he can expect a reward in case of success and punishment in case of failure (P_i). The activity of those being in favor of change are illustrated in equations (3) and (4). Thus, equation (3) expresses the opportunity cost (G_r) of the individual who decides to participate on the side favoring change, and equation (4) the payoff (P_d) for cooperation with the other side, with reward (D_i) and punishment (P_p). In both cases public good (PG) was left out, for the simple reason that due to the participation of an individual, which is true for the majority of individuals, the probability of failure or success of change is very small. Hence it follows that it is the benefit/interest that gains importance. The paradox of revolution lies in the fact that the action of an individual on behalf of himself (selfishness) can, as a byproduct, also contribute to the common wealth, so that we can place Tullock's concept alongside Smith's concept of the

invisible hand, or referring to economic federalism, alongside Tiebot's concept of the invisible foot.

TABLE 2

Equations of paradox⁶

desirability of changes:	(1) $P_{in} = PG \cdot L_v$
propaganda:	(2) $P_r = PG \cdot L_v + R_i \cdot L_v - P_i \cdot (1 - L_v)$
planning and realization of changes:	(3) $G_r = R_i \cdot L_v - P_i \cdot (1 - L_v)$ (4) $P_d = D_i \cdot (1 - L_v) - P_p \cdot L_v$

4. *Distributional Coalitions, Corruption and Spontaneous Privatization*

Any change may bring benefits to some groups and losses to others. In case of success, common wealth refers only to successful groups. Thus, we come to pressure groups, which influence formation of special relations between institutions and policies, on one side, and economic efficiency on the other side. Olson⁷ tells us that organized groups of producers are committed to seeking special interests/benefits for their members, benefits which are not available to others. Such groups cause a lower economic growth rate than would exist without them. A society with a large number of such groups will probably have lower growth rates than societies with less groups of this kind. But if such an organization includes the majority of the population, the conflict between its interests and the general interests disappears, and with it also the reasons for a lower growth rate. Corporative institutions rely on solidarity. Hence, it follows that the relation between economy and politics should also rely on it. Since solidarity expresses relationships among people, the relation between human capital and development comes to the fore, the latter relying less on market mechanisms at higher levels of technology. A community where solidarity is considered a higher value than individuality may become unsuccessful if institutions and patterns of behavior relying on individuality are introduced. That leads us to Zysman's⁸ thought of the relation among changes (economic development) and distributional coalitions. The separation of costs and benefits from changes takes place in the course of the economic and political processes. Market positions represent the source of political power, therefore the state influences the functioning of the market. The stability of the market depends on the stability of the said separation. The state may maintain long-term acceptable distributional relations by imposing a certain distribution, by allowing the distribution to take place on the

market, by minimum interferences and compensations, or else the state takes care of the division by negotiations with society groups. Virtually, those who lose must be compensated, or else they will be left out of the political process. In other words, they must be either offered a bribe or punished.

Proceeding from the empirical realization, that a large increase in the state's activities can not be explained by the well-intentioned ruler, that maximizing the social function of welfare, and that the increasingly regulating mechanism, increase of government subsidies, and various forms of restrictions of competition do not go along with the concept of social welfare function, Becker⁹ had a recourse to the analysis of competition rivalry for political influence among groups having common interests. He showed that political equilibrium depends on the success of pressure groups, the size of these groups, and the final expenditures in the forms of taxes and subsidies. The increase of final expenditures reduces pressure from the group obtaining subsidies, and increases pressure on taxpayers, although their resistance dramatically decreases. Politicians and the state act according to the outcome of the competition among groups with common interests, i.e., the winning groups that constitute them and could remove them from power. Regardless of the kind of political system, Zysman's division is set by altruism, selfishness, envy, and the morals of the stronger groups with common interests, which brings us back to Galbraith's three sources of power. Aside from that, more efficient collecting of taxes and granting of subsidies, reducing the resistance of tax-payers, gradation of pressure from the side of potential receivers, and increasing technical division of labor make the significance of the size of individual groups in their influence on political process relative.

A general prerequisite of the theory of public choice is that groups with common interests exercise pressure on political groups to influence formation of political goals, in a way that would maximize their own benefits, and not the social preferential function or common wealth. On the other hand, political groups aim to increase their power by monitoring enterprises, regardless of their form of ownership, in order to achieve their goals. The adjustment mechanism relies on subsidies and bribes.¹⁰ While managers monitor enterprises, politicians use subsidies and bribes to subordinate them to their political goals. The same holds true in the reverse case. While politicians monitor enterprises, managers bribe them, so that enterprises would pursue other goals. Corporate structuring and privatization of enterprises may increase the chances of restructuring of enterprises, provided that limitations are imposed on corruption, whereby introducing hard budget limitations induces reduction of budget subsidies to inefficient enterprises. In such situations, potentially good enterprises are given a much greater chance to reduce the pressure from political factors.

Due to the disbalance between private and social preferences, insufficient regulations and control, unconventional underground businesses, i.e., dishonest spontaneous privatization, may grow.¹¹ Certain circumstances may encourage owners of enterprises to destroy the net assets/capital of their enterprises, i.e., declare bankruptcy, in order to

increase their own profits, yet not necessarily by means of illegal procedures. That may be due to the possibility of representing overestimated value of assets, for example by showing goodwill, the value of long-term bonds and certain investments which are difficult to assess. That facilitates the representation of false capital adequacy, thereby postponing regulatory interferences by supervising authorities. Different from the case of excessive risk-taking, where owners provided with a state guaranty do make decisions with regard to the probability of profit realization, in the case of spontaneous privatization, owners try to maximize profits by diverse means of transferring resources from society directly to owners who exceed the loss due deliberately induced failure. Searching for new owners the government can deliberately induce this transfer with prescribed valuation procedures.

Spontaneous privatization is a constituent part of the Slovene transformation. Procedures used include unpayable transfers of capital, false distribution of profit, unjustified write-offs of debts, unjustified costs, false revalorization reserves etc.¹² It is important to realize that this kind of privatization could not possibly occur without the involvement of the executive and judiciary branches of the ruling power.

5. The State, the Economy and the Financial System

The financial system is one of the most important elements of the economic system. An established belief prevails that the role of the financial system is mediating among units with financial surpluses and the cells of financial deficits. The narrowness of such an understanding neglects the second important task of financial regulation, the distribution of risks. Since the beginning of the seventies, a second viewpoint has steadily been gaining ground, as well as a belief that the essence of financial systems and financial companies is the manner of dealing with risks and the control over risks. In general the field of financial services covers collecting deposits, crediting, issuing debtors' and owners' securities, the securities trade, investments management, counseling, insurance, operations with foreign currency, and with derivatives. The units with excess savings can always invest surplus directly to deficit units so that they accumulate mortgages, ordinary shares and other securities. It is a general characteristic that the smaller part of finances flow in that way, and the bigger part of currents run through financial agents/mediators/brokers. The modern theory of banking and financial mediating emphasizes that such delegating occurs due to information limitations encountered by savers-investors. Thus the financial mediators specialize in producing information services. They have access to information on debtors, mediate incentives to lenders, and control the debtors. A basic limitation of lenders and borrowers which is being solved by the help of mediators is insurance against liquidity risk. And for this reason in particular the state plays an important role in financial mediating as a whole. It offers various forms of insurance to reduce the range of risks for economic agents due to information imperfections,

regulates obligatory ways in the dealings of financial mediators, and controls their activity. This is why financial flows are channeled towards the state and its direct (budgetary) and indirect (off-budgetary) financial mediating. The crucial problems encountered by financial mediators and their regulator (the state) are 1) improving the quality of investments, capital adequacy, 2) increasing dependency on floating interest rate on the liabilities side, and 3) intertwining of balance and off-balance operations. The basic changes occurring in the banking system are shown in Table 3. These changes bring new elements to the relationships between the economy and politics.

TABLE 3

Relationships Between Economy and Politics through Bank Mediation

TRUE UNIVERSALITY		EASTERN UNIVERSALITY	
<i>(Traditional Banking Activities)</i>		<i>(Traditional Banking Activities)</i>	
Cash and Reserves	Insured Deposits	Forced Cash And Fx Reserves	Insured Deposits
Loans (Ceilings of amounts and lending rates)	Other Funds Debts	Government Guaranteed Loans	Other Public Funds Debt
<i>(Securities Activities)</i> Government Financing Equity	Capital (Related to credit risks, interest rates, exchange-rates other market risks and equity financing)	<i>(Securities Activities)</i> Debt-For-Equity Swaps Government Rehabilitation Bonds	Capital (Government Owned)

Zysman¹³ enumerates three different types of financial systems with various consequences due to connections between politics and economy (enterprises, banks and other mediators). The first system is based on capital market with resources allocated by prices established on competitive markets where the enterprises and the mediators operate. The second is the credit-based system with critical prices controlled by the state. The third is the credit-based system dominated by the financial institutions. The state may appear in all three roles simultaneously, even though this

brings it into conflicting situations. One such conflicting situation is connected to its debt financed by subordination of financial mediators and financial regulation. The second interesting conflicting situation emerges when the state decides for a monetary policy of the target quantity of money aiming not only to stability of prices, but also to subordination of financial mediators.

The three systems mentioned are an important series of connections between enterprises and the state and between the state and the banks (other financial mediators) and their governance. According to Zysman¹⁴ the model of adjustment in the first type of financial system is company-led, in the second type state-led and in the third type negotiated. Another classification relates to corporate governance structures: pure outsider system, pure insider, and ultra insider system. The pure outsider system is the closest to the financial system based on the capital market. Individuals are direct owners of enterprises and banks and indirect owners through investment funds (institutionalized investors). There is a free market of shares and no crosswise ownership. The pure insider system is suitable for both types of credit financial system. Typical of this kind of system are inimical takeovers which affect the response of the managers of enterprises and force them to act according to the demands of the owners. Crosswise ownership between banks and enterprises is allowed in this type of regulation. The banks perform the role of commercial and investment banking and the control over enterprises. The capital market is not well developed. This type of system does not foresee hostile takeovers against the will of the managers. In the ultra insider system crosswise ownership among enterprises is allowed. Banks are the core of crosswise ownership. Hostile takeovers are practically unknown. In each of these types of regulations the state and the parties intertwine. The state may pursue a number of policies within two extremes: from *laissez-faire*, where it provides for macropolicy only, the policy of competitiveness and foreign trade policy, and leaves all the rest to market mechanisms, to a partial or a complete ownership over corporations, regulation of credit system, and to directives of central planning. The parties seek support for their objectives, and open and concealed ways of financing their own activities.

A special type of takeover should be mentioned here, the so-called EFSAL approach.¹⁵ After the first wave of changes following the multi-party elections, putting forward privatization first and then restructuring, a wave of soberness followed, bringing an awareness that the restructuring of enterprises should not be delayed. On the outset the reform program had at its disposals three alternatives: 1) the so-called market solution leaving enterprises without outside (government) help after hyperinflation, the breakup of Yugoslavia and collapse of previous Yugoslav external markets and of Yugoslav internal market; at the very beginning such a view was a flagship of new political parties; 2) the so-called politically driven takeover of enterprises understood as purely removal of existing managerial structures and imposing outside control over enterprises; and 3) restructuring of existing enterprises without significant market prospects. At the end, the restructuring strategy was, as in other Central and East European

Countries shaped by the World Bank. It included a mixture of political and economic tasks, performed by this institution, that interfered with the internally induced process of changing the existing rules. Such a process was established in Slovenia in mid-1992, when an emergency activity was channeled in order to stop the increase in the number of money-losing enterprises and banks by the help of the so-called prebankruptcy restructuring of enterprises and banks. A continuity with understanding of the time before the political changes took place was thus established, which dictated a financial and production restructuring of economy in those times, including privatization. Such an awareness was promoted by the presence of the World Bank in former Yugoslavia, especially its studies on the mechanisms of generating and allocation of losses and their macroeconomic consequences. The change of emphasis did not remain without consequences. The process of a state reorganization of economy is more pronounced than privatization. It is a consequence of a financial crisis, which cannot be abolished in a centralized way by the economic units themselves. An intervention in creditor-debtors relationships among enterprises (mutual indebtedness), between enterprises and banks (bad loans and financing of current activities), between enterprises and the state (government credits and guarantees for enterprise restructuring, the unresolved question of state succession), between the state and banks (transfer of bad loans to enterprises to the government, old foreign currency savings of households and their monetary system counterpart—claims towards Yugoslav central bank or to the new state, the government as the most important debtor in economy), is a form of forsaken expectations according to which privatization and an entirely decentralized operation should save the accumulated problems. The EFSAL approach introduced by the World Bank to central and east European states is meant for solving internal indebtedness of enterprises and bad outstanding loans of banks by the help of an active role of banks' incentive for restructuring of enterprises. Even though there are certain modalities from state to state, the adopted approach is based on two government institutions, the development fund and the agency for bank rehabilitation, which are taking control of enterprises and forcing them to restructure. This actually means an implementation of government force to trigger changes in enterprises. In practice this resulted in actual stratification of rules adopted for dealing with different groups of enterprises and banks and of the transformation process as whole. At the heart of the problem was the debt overhang problem. Two main features of the whole process are partially giveaway privatization and giveaway government debt as vehicles transferring previously incurred losses from the business to the government sector and transferring net wealth to new owners. Yet the restructuring results for enterprises and banking sectors expecting high outside pressure from which newly established investment funds, from banks as senior creditors, and from bankruptcy legislation are still ambiguous. Ambiguity is generated by differentiation of newly created institutions and applied rules on the one side and by possibilities of development of either state ownership or internally governed enterprises, both generated from previous social ownership, on the other.

6. *Voters and Parties*

The relationships between economy and politics and their influence on governance structures and élites are numerous and mutually intertwined to a great extent. In a democratic society they are verified in voting cycles when the voters and the parties are confronted. From this viewpoint one can observe the following questions,¹⁶ which are gaining weight in new democracies as well, and which can no longer be neglected.

1) What is guiding the voters? How do economic and social events influence their behavior? Do they take into account experiences with previous parties and their results, or are the voters oriented only towards the future?

2) What is guiding the political leaders and parties? How do they behave: in an opportune or a pragmatic way on the one hand, which means that they adapt their behavior each time to win the greatest possible number of votes or, on the other, in a ideological, visionary manner, that is, they are bound to realize certain economic and social goals, even at the risk of losing part of the voters?

3) What kind of economic system (structure) prevails? How are the economic policy instruments allocated, and how are the economic and political roles arranged among the most important parts of the state? What is their system of control? Can parties influence the economic conditions as a whole, do they want to influence the whole at all, or are they inefficient economically and politically? Which instruments are important to certain parties (taxes, transfers, subsidies, monetary policy, and the like)?

4) To what influences (economic and political shocks) are the economy and politics exposed? Are there external exogenous events operating, or are the events and phenomena of endogenous nature dependent on political processes?

5) Are the parties capable and efficient in realizing their goals, do they feel responsible to their voters, or are they inclined to change their goals and voters?

There are two predominant approaches in the analysis of these questions. The first arises from the rationality of the voters, the second from the behavior of the parties. As far as the rationality of the voters is concerned, the central question is the formation of their expectations regarding economic policy and party programs. The voters are rational when their expectations are rational, when they have access to all necessary information, and when they evaluate their parties according to expected results. If the expected requirements are not fulfilled, the voters are irrational. Regarding parties, their ideological or opportunistic nature is the gist of their behavior. They are opportunistic when they decide for a policy which would maximize the possibility of their election, regardless of their behavior in the past, faithfulness to their program and also regardless of economic conditions. They are ideological when following their set goals regardless of political reason.

The enumerated factors allow for at least five hypotheses for the study of political and economic cycles, that is the influence of politics on economic conditions. The first type can be named the opportunistic cycle, based on opportunistic parties and irrational voters. Voters evaluate past achievements and election promises of the parties, they look into the past, they therefore have a memory which, on the other hand, ascribes greater weight to recent events and behavior of the parties. The parties lead a policy of maximizing the number of voters in future elections and, when in power, they adjust their current economic policy to that end. The second type is the ideological cycle. Its parties can be identified ideologically, and the voters are irrational. Parties differ according to their objectives and according to the weight ascribed to their identical goals. Voters decide for those parties which are most suitable to their preferences. The economic policy changes in ideological cycle, when the parties in power change, and not due to adapting to the desired election results. The third type represents ultra rational voters and parties. Voters have identical information as the parties, they look forward only, and do not have memory obstacles in assessing the circumstances. With such voters, parties are politically inefficient, because each of their maneuvers is foreseen and evaluated by the voters who adapt their behavior to that and annul the results expected by the parties. Therefore the parties themselves are forced to be ultra rational and renounce the first two cycles mentioned above as a tool for realization of their goals. The fourth type concerns the changes (shocks) conditioned externally, and are independent from internal economic and political circumstances. The reactions to them are various. With the opportunistic parties they depend on the rationality of the voters. The ultra rational voters will immediately conclude that it is not the responsibility of the parties, therefore these events will not cause their popularity to be reduced, while economic and political reactions will depend on the party in power. The irrational and not well informed voters will ascribe the changes to the party in power and will not vote for it anymore. If the parties are ideological parties, the rational voters will weigh which party can better absorb disturbances, which may lead to a simultaneous change of the economic and political regime and policy. The fifth type relates to ability and effectiveness and not to ideological characteristics or pragmatism of the parties. The effectiveness is in both cases a characteristics of both types of parties which cannot afford an ineffective activity.

7. Conclusion

These approaches do not exhaust all possibilities for analysis of transformation processes in previously socialist societies. Their common foundations are the theory of élites, the power and network of the élites, the regulatory mechanism built by the élites, and their influence on economic and political differentiations. What differentiates post-socialist societies from capitalist states are unfinished differentiations (economic—into owners, managers and employees and political—into parties and

government administration). Contrary to capitalist states that introduce modernization impulses into post-socialist societies, these societies are in the stage of disintegration. At the same time, capitalist states are in the process of reintegration based on supra-national entities like economic and security blocks that strengthen their dominant position.

NOTES

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3. The Government of the Republic of Slovenia, "Basic Questions of Anti-Corruption Laws," *Gazette of the National Assembly of the Republic of Slovenia*, 20 (17):61, 67 (in Slovene).
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5. Gordon Tullock, "The Paradox of Revolution," *Public Choice*, 11 (1971):89-99.
6. Presented equations are slightly adapted although the usage of terms such as "equations" in the original paper is puzzling.
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14. *Ibid.*, p. 286.
15. Neven Borak, *Searching for Culliver* (Ljubljana: Znanstveno in publicisti no sredi e, 1994) (in Slovene); "Searching for the Bank Model," paper presented at the 16th Meeting of EURO Working Group on Financial Modeling, November 24-26, 1994, Pecs; Kemal Dervis, Marcelo Selowsky and Christine Wallich, *The Transition in Central and Eastern Europe and the Former Soviet Union* (Washington, D.C.: The World Bank, 1994).
16. William Nordhaus, "Alternative Approaches to the Political Business Cycle," *Brookings Papers on Economic Activity*, 2 (1989):1-49.

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Economic Relations between Central and Southeastern Europe: Considering Reorientation towards the European Union

Tamàs Novák

Introduction

If we take into consideration economic relations among former CMEA countries it is quite clear that they are now at a much lower level than their cooperation with the EU. The common features of trade reorientation of central-eastern European countries mainly determines the relations among them. This is best reflected in the limited achievements of preferential trade agreements that took shape during past years, e.g., Hungary concluded trade agreements with Poland, Slovakia, the Czech Republic and Slovenia, while among other countries these institutionalized links are generally missing (see Appendix)

The slow realization of the importance of cooperation can be attributed to several factors, but the most important reason is undoubtedly mutual distrust and disrespect.

Today, with the reintegration of southeast European countries into the world economy, the questions and possible future perspectives of regional cooperation, or I could instead say regional trade, have again been spotlighted. Some say the establishment of strong regional cooperation may substitute for reintegration into the world economy and the quest for becoming integrated into the EU. Others say there is no need for regional cooperation, instead the countries should concentrate on creating stronger ties with the EU. Anyway, we should be aware that throughout history trade links among these countries never developed naturally, but only under the ruling hand of a non-regional great power.

Under these circumstances the impetus for establishing closer ties within the region should be initiated and promoted outside the region (e.g., creation of the Vishegrad group, and the conclusion of CEFTA agreement). Outside initiatives are also important to get southeastern

European countries to realize that they should pursue modernization by themselves, since, for the time being, external financial assistance can hardly be expected. However, until now, neither real economic developments nor political initiatives gave much hope for this expectation.

If we consider just the strictly southeastern European (former socialist) countries, it is clear that the starting situation of their economies and the economic performances since then are more unfavorable than in the Visegrad countries. We may say that, if the transformation to a market economy and the general development level of the economies are criteria for joining Europe, then, in this sense, these countries are far from even the central European countries. In spite of this evaluation these countries made significant steps in the economic and also in the political fields, especially compared to their desperate starting situation. Their steps are respected by western Europe as well as granting membership in European political organisations and strengthening links with the EU.

The structure of this study is as follows:

In the first part I try to enumerate pro and contra arguments in connection with regional cooperation, then I analyze intra-regional trade developments and future trade potential in southeastern Europe (using "case studies"), while in the last part I formulate some conclusions and questions. In the Appendix I present major trade agreements concluded with the countries in question, outline trade regimes, and give some details on geographical distribution of individual countries' foreign trade.

Problems of Cooperation. Pros and Cons

It is quite natural to think of cooperation among neighboring countries. These countries—because of geographical proximity and common historical ties—generally share cultural, ethnic, and even economic and social values and interests. This is sometimes considered to be useful; however, many times bad experiences related to this common past make any kind of cooperation difficult. These problems and difficulties become evident in times of dramatic political and economic changes when a new economic and political identity should be created. Southeast Europe, with the weakening and slow disappearing of socialist rule, has had to face too suddenly the challenges of approaching the developed world, and especially the European Community (Union). They were not prepared for drastic economic restructuring since initial steps were not made during the seventies and eighties.

When less-developed countries are to catch up with the west, or more exactly to start on the long and arduous path towards modernization, a natural, but—from the point of view of cooperation possibilities—mostly unfavorable phenomenon, appears. This is the phenomenon of strong competition among the best performing countries of the group and those likely to become the best students of the west. (This is most obvious in the Visegrad group, especially in the case of the Czech Republic.) The reason for this attitude is the fear that if a region or a subregion is considered to

be homogenous, western judgement on the region would be determined by the worst-performing country. It is true that a lack of modernization, or slow pace of modernisation, can influence negatively the life of other countries. That can partially explain the attitudes of certain countries. However such behavior does not promote a spirit of cooperation, but gives rise to hostile thinking in partner countries.

One of the problems which raises further doubts about integration is that, during the past decades, the industrial structure of the countries in the region generally were not developed in accordance with revealed comparative advantages. That is why parallel capacities were built, causing these countries to be competitors today rather than cooperators in foreign trade. This results in a simple regional cooperation which offers only limited advantages to these countries.

The countries in question are facing more-or-less the same transformation challenges. However the starting situation among southeast European countries is different. Their development levels were quite different at the beginning of the transformation process and these differences have not yet disappeared. The same could be said about the attitudes towards modernization and/or towards Europe. These attitudes were mainly developed in the past ten to twenty years, e.g., the Romanian or Albanian attitude, which were developed during the eighties under total autarchy, are different from the Bulgarian one (Bulgaria was bound to the former Soviet Union in its foreign trade at the highest rate of all the COMECON countries). The Yugoslav attitude and experience was different from the above-mentioned ones since this country, due to political reasons, had the closest connections with western Europe. And, of course, the experiences and attitudes of the Yugoslav republics were also quite different from one another's, which is best illustrated by the developmental differences between, e.g., Slovenia and Macedonia. Just in these few sentences we illustrate the complexity of the situation and the significant differences which are present in the central and southeast European region.

After this evaluation our conclusion could be that individual countries should follow different ways because their different situations requires different treatments and the contradictions are close to unbearable. Different development levels may imply that the speed of catching up with Europe cannot be the same for each of these countries. Intentions for integration on the regional and European levels are, therefore, justified only if they are supported by the realisation of fairly swift and successful economic development and by closing the gap between the western world and east-central Europe. If the perception is that individual countries can approach Europe more successfully than parts of any kind of integration, there would not be grounds for integrational aspirations. Sooner or later all the countries in the region will face this dilemma. Perhaps in southeast Europe the situation is a bit similar, since some of the measures necessary to transform economic systems have not yet been taken. The different economic policy measures taken by the countries and the difference in the ways they are conducting their transition and making their stabilization policies makes cooperation difficult. Significant instability and unsettled

questions exist concerning foreign trade regimes or privatization issues or promotion of foreign investments, which are supposed to be essential in the process of modernizing an economy.

Under these circumstances a kind of coordination is imaginable. Of course, countries will follow their own national interests, and their attitude towards cooperation will be determined by the attractiveness of other alternatives. One very pressing issue could be the intention of some countries to join with central European countries and neglect southeast ties, which could cause tensions similar to those experienced within the Vishegrad group.

Another reason why regional cooperation is not necessarily viewed as an attractive solution is bad experiences remembered from the COMECON era. This era represented a very bad image of products produced in the region. Besides, the structures of industry which were not competitive offer only limited scope for cooperation. The socialist era ruined most of the natural trade connections among these countries.

Ethnic tensions also can pose long-term obstacles to regional cooperation, and are obvious in many cases. However, in my opinion ethnic tensions might be cured most successfully by strengthening economic cooperation, especially at the micro-level, e.g., by promoting joint ventures among countries.

The experiences of development in other regions show that modernization and fast development do not necessarily require traditional integration patterns. For example, the far eastern region achieved its enviable development without taking part in any classical regional cooperation.

And thus we are now facing the question of how and in what shape integration could really help the catching up of these countries with the EU.

The key question is whether the current levels and perspectives of regional convergence are so hopeless that it is better to build relations with the EU by individual countries and to compete with each other within the region, or whether it is possible that the forms of cooperation (association agreements with the EU, forms of cooperation—CEFTA, Central European Initiative—and possible new joining countries) are worth nothing and elaboration of alternatives is needed?

Many think that joint efforts could help in approaching the European Union, which I think is the ultimate aim of all the east-central European countries. This belief is endorsed and supported by the European Union. According to this judgement, countries with similar backgrounds (in spite of significant differences in their development strategies) could help make stronger mutual relations. A strong intraregional trade is considered to be a useful method of helping the country's development and preparing them for closer cooperation with the EU. According to this approach the interests of countries in the region are generally the same, and in an economic sense market agents of the region have knowledge and extensive understanding of each other (and of ways of doing business) that could promote cooperation.

This is partly true, but the motives of the EU behind this "region

promotion" policy can be found elsewhere. The EU knows very well that several products coming from east-central Europe could become quite competitive in western markets. One reason for this is low production costs. Especially so-called sensitive products may threaten the positions of western products. They would like to divert the trade of these type of products to the eastern European region. And this is not very healthy from the point of view of modernization. It is generally accepted that the modernization of underdeveloped countries should be linked to one of the most-developed trading centers of the world. From this it clearly follows that the development of intra-regional trade among the east-central European countries cannot be a goal in itself, but is rather a result of successful integration into the developed world economy.

Closer regional cooperation—because of an underdeveloped regional market, a low level of intraregional trade, a lack of financial resources, weak infrastructural ties, and a similar export structure—would conserve noncompetitive structures and exclude these countries from the mainstream of European developments. Besides, because of above-mentioned facts, the southeast European region never (or more exactly only during Ottoman times) was an organic economic region. In fact, these countries have never relied upon each other, but rather on different powers, the Austrian Empire, Russia, Germany, or France, so natural ties, in spite of geographical proximity, did not lead to cooperation with neighboring countries, but rather with countries outside the region. Thus intra-regional ties can only be supplementary factors to successful modernization.

Another important consideration worth mentioning is that the European Union supports regional grouping only if it is not able to form a common foreign economic policy, in other words if it is unable to enhance successful cooperation and to effectively protect against European protectionist foreign trade. In fact, common economic policy against the EU would strengthen negotiating power. It is hardly imaginable that the EU would be interested in this development. This policy is obvious if we look at the past. European powers continued their power-balance policy in the region while trying to spread their sphere of influence to other countries.

The association agreements concluded by Romania and Bulgaria with the EU, providing favorable trade conditions for extra-regional trade, could push other countries to liberalize their intra-regional trade in order to eliminate further trade diversion. Perhaps these association agreements could promote the development of intra-regional connections in other countries, in light of experiences gained during the past few years by central European countries, since after the conclusion of these agreements the balance of trade with the EU has worsened significantly, which was caused especially by declining exports and increasing imports.

And finally, I would like to raise the question of, or more exactly to speculate on, power and emphasis shifts in the EU's policy towards the Mediterranean region, which obviously can influence the future of south-east European countries. Today it seems that there is potentially a competition between the Mediterranean (Turkey, Cyprus, Malta) and east-central

European countries in joining the European Union. And here perhaps the rivalry of Germany and France for the leading role in the EU appears on the scene. France may be eminently interested in allowing the Mediterranean countries (and perhaps the Balkan countries too?) to enter into the EU, since this area can be considered a French sphere of influence rather than a German one. With closer ties to this region, France perhaps can counterbalance the excessive German role in Central Europe. If this consideration holds some truth, then disinterestedness from western Europe towards this region could change significantly, which may influence a positive impact on regional connections. In this sense we cannot exaggerate the importance of Serbian recovery.

Areas Where Cooperation is Required

If we are considering cooperation in the region, we should make clear what we are thinking about. We have seen that creating close integration is very difficult and its outcomes are uncertain for many reasons. In spite of this, some kind of higher-level cooperation is imaginable if it could strengthen the joint power of these countries, but today the outlines of the future are quite vague.

A lower level of cooperation is obviously highly welcome. An especially important field could be the micro-sphere. Joint ventures could be the vehicle of creating vivid economic relations between the countries.

Another important field could be infrastructural cooperation. Countries of the region are trying to take part in different cooperation and regional organizations. The two most important organizations which have attracted countries from the southeast European region are the Central European Initiative and the Black Sea Economic Cooperation. (There is clear interest in CEFTA also.) Unfortunately these organizations have not yet enhanced modernization because of the divergent interests of the countries involved and a lack of financial means. The projects formulated in the Central European Initiative could be especially important in the infrastructural development of the region. Its main sponsor would be the EBRD, but because of mainly organizational problems the realization of the projects is making very slow headway. The most important projects are 1) Trieszt Budapest-Záhony highway, 2) Wien-Budapest-Belgrad Highway and Railway, 3) Balticum-Adria Highway and Railway, and 4) Central Europe-Balkans intraregional telecommunication network

The Black Sea Economic Cooperation is an organization in which Greece, a member of the EU, and Turkey take part and which has ambitious aspirations in the Black Sea region. These aspirations perhaps a little bit frightens some neighbors. Naturally the orientation toward this region cannot substitute for an approach to the EU, but could contribute to the modernization of participating countries.

Some Words on the Experiences of the Vishegrad Countries and Future Possibilities of CEFTA.

It is important to evaluate the chances and perspectives of CEFTA which is the first free trade agreement in this region and which one or two countries from the region are perhaps intending to join. This would be quite natural, since the two most important factors of its creation are important in southeast Europe as well. The first is that the objective of all the participants is to join the European Union, which is also true for southeast Europe. The second is that all participants wish to halt declining trade among the region's countries by granting the same conditions in their mutual trade as were granted in EU and EFTA agreements. The aim of a free trade area is not to create preferential conditions for intra-regional cooperation but to eliminate discriminating barriers from already existing relations. This is not an easy task at all, since the differences between the countries' practices are too great (which is also true of Balkan countries as well).

For example, the scale of markets is very different. Furthermore, the methods of market protection also differ as far as tariff and non-tariff barriers are concerned. According to the treaty, the countries involved agreed on establishing a free trade area covering all agricultural and industrial products. The tariffs and non-tariff barriers to trade should be eliminated gradually, by January 1, 2001, and some benefits could be as follows:

1) Eliminating discrimination against traders in the region could provide benefits in terms of better allocation of resources as well as increased competition among entrepreneurs of the region.

2) Trade diverting effects caused by Association agreements should be compensated within the region. Of course, deeper integration could cause further trade diverting effects—but in a reverse direction. Caution is necessary during the implementation of the treaty, since in this case domestic producers would give preference to trading in regional markets where competition is weaker than in western Europe. During economic restructuring this may threaten adjustment to market forces.

3) The CEFTA was created in order to improve economic relations, but it was also supposed to contribute to political co-operation. Political co-operation could promote the creation of a common political stance during negotiations with the EU.

4) Currently the intraregional trade among CEFTA countries is artificially low. The CEFTA agreement could help in the restoration of a normal level of trade among the participating countries.

5) The message of the EU has been that higher levels of regional cooperation prove the readiness (or maturity) of these countries to join the EU. A bloc mentality was supposed to improve the chances of Central European countries in joining the EU. Experiences with regional cooperation could prepare these countries for participating in larger economic integration.

Foreign Trade Developments in Southeast Europe, Emphasizing Intraregional Reorientation

In southeast European former socialist countries the transition or the reform process to a market economic system began in the early nineties. The socialist countries had a quite different heritage because of their past system. In spite of these differences, economic performances, except Slovenia and Croatia, have similar features.

Essentially, all the countries in the region have liberalized foreign trade in spite of the differences in tariff and non-tariff barriers structures. Export promotion cannot be considered a significant economic policy tool. However, from 1993 we can see traces of strengthening protectionist tendencies due to the general tendencies in world trade during the past two years. We may assume that these protectionist tendencies appeared first in the most advanced transition countries, not surprisingly in the Vishegrad group. These tendencies also can be observed in Bulgaria and Romania. In Macedonia and Albania this trend has yet been seen, which is quite understandable. But as Hungary has experienced, these protective measures are mainly effective against regional partners. Besides, foreign investors demand additional protective measures.

But in spite of these new tendencies, foreign trade regimes in the region are more liberal than in the beginning of the reform processes. And of course it contributed significantly to—although different—successes in foreign trade. This more liberal attitude also positively influenced the number of foreign trade actors, making foreign trade less concentrated. The growing number of trading companies is essential and perhaps the first important step in the way of strengthening regional ties. Micro level business cooperation is the natural way of regional cooperation. This is especially true when a key country, Serbia-Montenegro, is isolated from the main trading partners of Europe.

Creating micro cooperation now is essential for further deepening any kind of cooperation in the future.

The evidence for this is that the main direction in trade reorientation of southeast European countries is the European Union. Keeping this fact in mind, I now examine the trade reorientation of four (central) southeast European countries concentrating on intraregional trade developments.

Romania

At the end of the eighties about 50% of Romanian foreign trade was conducted with the CMEA countries while this ratio for the year 1992-93 fell below 20%. The volume of foreign trade in this region has decreased at various rates in the case of different countries.

The most obvious development is that the geographical reorientation of Romanian foreign trade among former CMEA countries has become significant. It is enough to mention that, e.g., the value of foreign trade

with Poland in 1988 was about U.S.\$893 million while in 1993 this amount was not more than U.S.\$100 million. The same decline can be traced in the case of the Czech Republic and Slovakia. The decreasing trend characterized Hungarian-Romanian foreign trade also for a while, but this trend reversed drastically during 1992, both in exports and imports. (In the first seven months of 1994 the volume of foreign trade between the two countries did not decrease in comparison to the same period of 1993, but Hungarian exports decreased by 20% while imports from Romania increased by 20%.)

The above decreases were in part due to the reorientation of interests of former socialist countries towards trade with the developed world and partly to Romanian domestic trade policy. At the beginning of the economic transformation they in fact stopped export promotion, which created an almost unsolvable problem for exporters. Besides, there was no intention and interest for cooperating in the field of trade with Central European countries and this was the case from the other side also. The overall result was the significant decrease in foreign trade with former CMEA countries which was just partly compensated by increased trade with the EU.

The trade reorientation among former CMEA countries is related to political connections, coincidence of interests and geographical proximity. For today Hungary, Bulgaria, and Yugoslavia have become the most important trading partners in this region (disregarding the former SU). There is a general attitude today that Romania should cooperate with its neighbors. Bulgaria is a natural partner, and both countries are now participating in the Black Sea Economic Cooperation and micro-level business connections are prospering. It has also been realized that stronger intraregional connections do not mean alternative solutions to strengthening connections with the EU, but they are certainly essential in creating favorable local conditions and can help trade diversification, which could contribute to economic growth.

The trade with Yugoslavia shows a tendency to increase in spite of the embargo imposed on Serbia. (In fact, the volume of trade is not much higher now than in 1988, but since then the total volume of foreign trade has decreased by at least 50%.) The reason is simple: Romanian products do not face strong competition in the Yugoslav market, and good relations (even political) are important for both countries. Romanian entrepreneurs are encouraged to be present in Yugoslavian markets (or more exactly they are not punished for doing this) in order to create good conditions for business after sanctions are lifted.

Now there is a strong intention to increase trade even with central European countries. It was expressed by the will of joining CEFTA. (However, it is a closed agreement.) This interest is seen to meet Hungarian economic and political interests. Improving relations are important for both countries, thus an increase in the volume of foreign trade is expected to be an economic policy target in the future also.

The countries of the former Soviet Union are still important in Romanian foreign trade. Russia is today the second most important trading

partner after Germany. The relative importance of CIS/Russia trade in the former CMEA trade has decreased more significantly in comparison to Hungary or Bulgaria, but the decrease was less significant than in the case of Poland and the Czech Republic. For Romania Moldova, a member country of CIS can be considered especially important (its relative importance compared to, e.g., Russia is quite high). This is mainly due to geographical proximity and certain ethnic ties between the two peoples.

Summarizing, we can assume that Romanian policy recognized the importance of the Balkan region and this policy option decides the emphasis in foreign trade strategy as well. Central European countries may become the focus of foreign trade policy when joining CEFTA. In fact, approaching CEFTA is connected to economic and, of course, political relations with Hungary. Since Hungarian and Romanian trade interest meet at a certain point, Hungary may become a more and more important trading partner. The most important change has been experienced in trade connections with Yugoslavia. This phenomenon can implicate long term consequences. The same is true for trade connections with Bulgaria.

In Romania custom tariffs remain the main instrument of trade policy. Beginning with 1 January 1992, a new import custom tariff has been implemented. This tariff includes 5018 tariff lines. The global level of protection is about 17.8% calculated as a simple arithmetic average. According to GATT and IMF experts, the level of tariff protection is still high compared to that of the main partners of Romania. However, taking into account the reductions and exemptions of custom duties, including the trade with the EU, the real level of protection is only about 10%.

By a special law, Romania has several free trade zones (e.g., Sulina, Constanta-Sud, Braila, Galati) extending trade facilities such as unrestricted goods imports and reexports, custom duties and VAT exemption, and exemption from profit tax for the duration of company's operations in a free trade zone.

Exchange rate policy is one of the least clearly defined and most volatile parts of macroeconomic policies in post-communist Romania. Under the successive stabilization programs, exchange rate policy has been assigned the role of controlling the balance of payment developments and building international reserves and assisting the control of inflation and avoiding a vicious spiral of inflation-depreciation by directly holding down the prices of imported raw materials and intermediate inputs.

As a consequence of these somewhat contradictory policy objectives, the authorities have not sought to set the exchange rate at a market clearing level but rather have controlled it administratively. Repeatedly unsuccessful attempts to fix the rate have been followed by sharp devaluations of the official exchange rate. However, these devaluations have repeatedly lagged the "market" exchange rate, so that another devaluation was built in, validating expectations of depreciation and further undermining confidence. At the second half of 1994, after sharp devaluation of Romanian currency, the exchange rate stabilized, even the lei has appreciated. (Taking this fact into account, it is very interesting that last year Romanian exports could increase by 4%.)

Bulgaria

Bulgaria is the country which was most strongly dependent on CMEA trade. In 1989, 90% of its total trade was conducted within the CMEA area. Bulgaria's most important trading partner was the Soviet Union and it is now Russia. Russia is of utmost importance for the country because of its strong dependence on Russian energy resources. Bulgaria has tried to ease this energy dependence by building connections with the Black Sea region. However, in the short run this diversification effort can only be moderately successful, thus connections with Russia should be the focus of trade policy. On the other hand, many of the CIS countries offer significant markets for low quality Bulgarian products.

Trade connections between Russia and Bulgaria are expected to expand. A very important field is the arms industry, which is a well-grounded industry in Bulgaria. With the political system change, the value of arms trade between the two countries fell to one-seventh its previous level. But last year trade connections in this field started to expand. Russian orders are favorable for both parties, since Bulgaria can import strategically important raw materials, and in exchange can export "sophisticated" devices.

The other promising possibility for developing connections is Bulgaria's intention to make itself a reexporting center for Russian natural gas. A Bulgarian-Russian (Gas) Joint Venture was established in order to handle the trading issues. Furthermore, new pipelines are going to be constructed toward Greece, Serbia and Turkey. These considerations imply that the importance of trade connections with Russia is unquestionable.

In trade with small central eastern European countries similar conditions and implications should be considered as in the case of Romanian foreign trade strategy toward these countries. Drastic decreases in foreign trade value were experienced especially in the case of Poland and the Czech Republic. The main reason for this—besides the general disinterestedness from the part of central European countries—was the switch from a transferable ruble trade to a convertible one. However under the new conditions the new prices—because they were calculated in 1990 transferable ruble prices and the government gave insufficient export support—became very unfavorable for Bulgarian exporters. Thus uninterested exporters turned towards other regions. This tendency was not reversed, especially since the central European countries concluded the CEFTA agreement, which offers significant advantages for participants against non-participants such as Bulgaria.

According to trade strategy, regional, Balkan, trade should be promoted. Detailed plans are non-existent, but it is understood that Balkan cooperation, and thus developed trade with former CMEA countries in the region, is required. Naturally, it is not an easy task since there is not a sufficient product base to promote the process.

The reorientation of trade connections among former CMEA

countries is basically determined by the low quality of Bulgarian products. Uncompetitive products can be sold only in markets even plainer than the Bulgarian one (e.g., Russia or Macedonia). Thus it is not surprising that the value of trade with Macedonia has risen significantly. (Macedonia last year absorbed almost 6% of total Bulgarian export, in terms of value.) The Bulgarian export offensive was promoted by the isolated situation of Macedonia as well (Greece closed trade routes to Macedonia).

The same was partly true for Yugoslavia. New Yugoslavia accounted for 4% (1993) of the total Bulgarian trade. (In 1989 the former Yugoslavia accounted for only 0.9%.)

We should remark here that such reorientation among the former CMEA countries and Yugoslavia can only partly be explained by trade policy. In fact, not trade policy, but mainly the historical situation has forced the changes in the geographical structure of foreign trade. We may assume, that for today the central European and the Balkan regions are almost separated in terms of foreign trade relation, with the possible exception of Romania and Hungary. In the Balkan region this has meant that intraregional trade has had to increase. This increase up until last year was mainly due to a natural development of business connections. However, this year the realization of the importance of development in trade relations and the necessity for a kind of cooperation seems to be a general assumption in the Balkan region. Besides, it was realized that the natural area for the intensification of trade connections is the neighboring region. We may expect that in the case of Bulgaria there is a strong to medium intent for foreign trade with Balkan countries.

When we are evaluating the foreign trade developments or exchange rate policy in Bulgaria, we should not disregard that the country during the past four years (until the agreement on Bulgarian foreign debt was reached) was cut from the international financial market. During this time there was a lack of sources for importing goods, and only after drastic currency devaluation could the country participate in international trade.

One problem which makes foreign trade calculations difficult is the hectic behavior of the exchange rate. Some say that the Bulgarian lev should be pegged to a foreign exchange which would eliminate unpredictable changes. But until 1994 this was impossible since there was an insufficient level of foreign exchange reserves and it lacked the support of western countries.

The trade policy uses tariffs and non-tariff barriers also. The average tariff is around 16%, but on industrial products it reaches 22%. At the beginning of the 90s there was a decreasing trend in the level of tariffs, but after that it started to increase again. They use export quotas on six primary commodities. Occasionally export bans on agricultural products are also in force. Registration and licensing restrictions are still operative.

Croatia

The situation of the Croatian economy was essentially determined by the war, which ravaged the country's territory, by the flow of refugees from Bosnia, and by the disruption of the country by the Krajins. During the war, trade relations narrowed and the orientation and reorientation of Croatian trade cannot be viewed as decided by long-term strategy.

For Croatia connections with the former Yugoslav republics were of utmost importance in the past. Today trade relations with these countries are less significant and this tendency is continuing. Slovenia remains the most important partner in foreign trade, although its weight in Croatian foreign trade during the past few years has continuously decreased. However, it is still Croatia's most important partner in central Europe. Trade with other central European countries is much less important, but recently several steps were considered to develop relations.

This is especially true in the case of Hungary. As a neighboring country, Hungary is now becoming a more and more important partner. This was clearly expressed in several political declarations offering Hungary, e.g., seaport custom free area. The most significant sign was the Declaration of Intention, according to which Croatia indicated its willingness to conclude a Free Trade Agreement with Hungary. Foreign trade data show an intensification of trade; in 1994 foreign trade between the two countries increased by almost 60%. The lion's share of this increase in trade volume was due to a massive Hungarian export expansion. Croatia bought from Hungary mainly foodstuff and energy resources.

Trade connections with the Balkan countries (especially with Romania and Bulgaria) have experienced serious downturn. The reason for this is that these countries are maintaining good economic and political relations with FR Yugoslavia, which makes the connections between Croatia and these Balkan countries especially precarious. Besides, because of the sanctions imposed on FR Yugoslavia and the hostile political and economic relations between Croatia and Serbia, transit routes towards southeastern Europe are closed, which, even physically, makes it difficult to maintain trade connections.

Since last year Croatia has experienced significant recovery in its foreign trade. Imports, especially, have improved significantly (with all trade partners) but exports too have shown favorable signs. The main reason for this is the end of the war and a great demand for import products. It is expected that Croatian foreign trade strategy in the future will be based on stronger economic ties with central European countries. The future role of trade with the former Yugoslavian republics is quite vague now. But the natural area for Croatian foreign trade activity is this region. It is expected that steps will be made to conduct normal economic and trade relations with Serbia after lifting sanctions.

As a result of the macroeconomic stabilization program introduced at the end of 1993, the internal economic situation has improved. According to the aims of the program, solid foreign exchange reserves

should be built up in order to control the money supply, thus preserving the value of local currency. To achieve this goal, all export activities have been liberalized, thus promoting foreign exchange reserve accumulation.

In the first phase of stabilization the local currency was devalued, but after a few months it appreciated by 15%. Since then heavy Central Bank intervention can be observed. As part of the stabilization program, a 10-20% import tax was introduced in autumn 1993. For a few products a higher rate of tariffs exist. Only a few quantitative or licensing restrictions are in force, mostly for health and national security.

Export taxes range between 2% and 30%, but in most cases they are close to the lower limit. A quota and licensing system is in force for eleven product categories, mainly energy, raw materials, and foodstuff. Quantitative restrictions were substantially reduced in 1994.

Slovenia

Slovenia, as part of the former Yugoslavia, was not a member in the CMEA group of countries. The beginning of economic and political transition in the Slovenian case was thus different from the other former socialist countries. In fact, the specific historical position of Slovenia caused some positive and some negative influences for future trade and economic cooperation with the central European countries.

For Slovenia, trade with the rest of Yugoslavia was especially important. Exports (relative to GDP) to the other Yugoslavian republics decreased from 40.4% (1991) to only 7.7% (1993), and imports from 32.1% (1991) to 5.3% (1993). At the same time, trade with the central European countries remained as low as it was earlier with the exception of the Czech Republic.

The main reason for this, presumably, is that the relative importance of foreign trade of goods and services in the case of the Czech Republic is the closest to the position of Slovenia. Its slowly increasing export of goods per capita suggest future interest in export expansion. This combination, with the product structure of exports and imports, creates a good starting point for mutual trade expansion.

Lack of numerous former direct business contacts among firms within the Central-Southern European Region (CSER former socialist countries) is perhaps the most important reason why trade decline with parts of ex-Yugoslavia were not compensated by expanded trade with the CSER. The potential for more trade between Slovenia and the CSER exists because of the necessary export orientation of Slovenia.

The creation of CEFTA without the participation of Slovenia was a very unfavorable development as far as the potential increase of Slovenian trade to CSER markets is concerned. The system of Free Trade Agreements (FTA) partly can balance this negative development and clearly shows that expanding or not reducing the trade with this region is in the interest of Slovenia. Slovenia concluded FTA with the Czech Republic (December 1993), the Slovak Republic (December 1993), Hungary (April

1994), Estonia (May 1994) and is currently preparing such agreements with Poland and Romania.

Slovenia realised that the modernization of its economy and the creation of a firm basis for future growth is based on strong ties with the developed world. This orientation toward developed countries can be traced to the differences between the level of trade with CSEER countries. The Czech Republic became the most important partner in this region, followed by Hungary and Poland.

Trade expansion in the CSEER is economically and strategically important for future economic progress in Slovenia. It supports the process of successful economic catching up with the countries of the European Union, and creates better possibilities for realization of membership in the EU (according to Slovenian opinion).

During the existence of the former Yugoslavia, strong ties were established among the Republics. The most important partner was and is still Croatia. But because of unfavorable conditions created by the war in the neighboring country, the significance of this relation during the past years has decreased. However, it is expected that its importance will grow in the future. This market means a pool for Slovenian products not competitive enough in western markets. Besides there are very strong ties at the micro-level between Slovenia and Croatia. The other reason why Croatia still remains a significant trading partner is the slow growth in foreign trade with other central European countries.

Until now Slovenia was unable to conclude an AA with the EU because of reluctance on the part of certain member states, but in the near future the country will have closer ties with EFTA (which today could offer only limited possibilities, since the size of EFTA market has shrunk significantly.)

In Slovenia imports are generally tariff free. When tariffs are applied, rates range up to a maximum of 25%. The customs formality tax is 1%. Some quotas on agricultural and textile products exist, but 98% of products are free of quotas. On the export side, there are temporary export duties of 10-25% on raw materials. Permits are necessary for the export of susceptible goods. In Slovenia full current account convertibility exists, with some restrictions on capital accounts.

Exchange rate policies and manipulations are determined by the fight against inflation and by structural changes following secession from Yugoslavia. Due to the small size of the Slovene market and a divergence between the structure of domestic demand and the structure of supply adapted to the Yugoslav market, sales to Yugoslavia can only be substituted by exports. The aim has been to lower inflation and keep it under control, and to preserve the real exchange rate at a level which makes exports competitive. These conflicting goals have resulted in a periodically changing depreciation and appreciation campaign of the Slovenian tolar.

Summary

Trade connections between central Europe and southeastern Europe are today at a very low level. Slovenia is a central European country in every sense and has the tightest connections with the central European countries. However, it conducts insignificant trade with the Balkan countries, except for Croatia. For Bulgaria and Romania, southeastern Europe is becoming more and more important, and this can be traced in foreign trade data. A special feature in the case of Romania is the increasing significance of trade relations with Hungary. (This is also true *vice versa*.)

Concluding Remarks

Summarizing we should stress the following:

1) All countries in the Balkans essentially have the same goal, namely to catch up to Europe as soon as possible.

2) The west European countries and the United States are interested in a politically stabilized Balkan region which does not pose a threat to other parts of Europe. However it is now entirely clear that no financial support can be expected from these countries. They are not interested in spending money for economic revival in the Balkan region.

3) Developing regional ties seems to be the only way to create a firm basis for economic improvements. It now supports the interests of all parties. Balkan countries have no other choice, because their needs for economic support are rejected by western Europe. It is also in the interest of Western Europe and the U.S., since Balkan countries would thus be engaged with each other, instead of applying for financial support.

4) Hungary could be a bridge between central and southeastern Europe. It has great potential for developing trade connections with Romania and the former Yugoslav republics. Trade data show that the development of trade connections already has started and there is still huge potential for further improvements. When we evaluate the trade of south-east European countries with other central European countries, in most cases negligible data could be found.

5) Serbia could be the key country in the region. Its economy, after the lifting of sanctions, will have great demand for almost everything. Creating good economic relations now (or at least trying to speak with each other) will later create a strong basis for further developments. Southeast European countries should use this opportunity. According to data, in spite of the restrictions on foreign trade flows, the weight of Serbia-Montenegro in Romanian and Bulgarian foreign trade during past two years has grown significantly. This may imply a natural way to develop trade connections.

6) The countries in question, step by step, realize the necessity of a higher level of intraregional economic policy. Unfortunately, foreign trade

data clearly shows that intraregional trade today is almost negligible. Its improvement is necessary. The main reason for this can be found in economic factors. We cannot disregard the fact that the economic performance (especially of foreign trade) of the eastern central European countries, after a promising start at the beginning of transition, has, for the past two years, clearly shown signs of crisis. We may say that foreign trade data can be regarded as the most reliable indicator of the economic situation, as opposed to other macroeconomic indicators. A deteriorating foreign trade balance may imply a lack of real structural change in the affected economies. It is most obvious in the case of Hungary, where missing administrative steps (until now) meant that Hungary could not prevent serious imbalances in foreign trade. In fact, these administrative steps could not prevent, but only postpone, this type of crisis even in Poland and the Czech Republic, where domestic demand was reduced significantly at the beginning of the nineties. This means that these economies, which conduct 50-60% of their foreign trade with the EU, have been unable to improve their export performance in this region, as would have been desirable. And since modernization of the economic structure requires considerable time, this inability may be prolonged. During this period improving intraregional economic and other relations is necessary. This will in part contribute to the avoidance of economic collapse in central eastern Europe. Perhaps this consideration might be the still missing common interest of these countries for joint efforts.

7) It is time to consider the negative consequences of granting favorable economic status to countries outside the region, at the expense of interregional cooperation. There is no doubt that a regional economic modernization pool is necessary. However, this should in no way prevent cooperation with other countries. For Europeans, the EU is such a force for modernization, but it has not contributed to the economic growth of former CMEA countries. Modernisation, which is driven by investments, has not been facilitated by EU transfers toward the region.

8) It is unnecessary now to think about the creation of a new institutionalized economic organisation. It is evident that regional cooperation (e.g., the Black Sea Economic Co-operation, or the Central European Initiative) has not contributed to closer economic connections. As a first step to remedying this, it seems necessary to give preference to trading partners within the region.

However, the opposite could also be true. This depends on the question of the boundaries of a region, and how the EU views these boundaries. Different viewpoints exist. We can handle the countries which concluded AA with the European Union as a group. Another approach could be to consider southeast Europe as part of the Mediterranean region. From this perspective, the outlook of these countries is promising, since the EU today is dominated by northern countries. This shows how the question of (im)balances within the EU may determine future relations with the regions.

9) Greece could be a vehicle of regional cooperation. Its EU membership may allow better access to Community financing.

Furthermore, Greece—like former socialist countries—should find alternative routes for economic growth. Since Greece joined the European Union, its yearly economic growth is lower than for most EU countries. The result: today the per capita GDP in Greece in the ratio of Community's average is lower than it was at the time of it joined the EU.

10) Relations between Greece and Turkey are another barrier against effective, close cooperation. Until this relationship is settled, it is difficult to speak of significant joint effort in southeast Europe.

Appendix: Foreign Trade Agreements and Trade Regimes

Albania

1) Major Trade Agreements

GATT observer status, working party on accession (1992)

EC Trade and Cooperation Agreement (Sept 1993)

EFTA Free Trade Agreement (in force since July 1993)

All other OECD countries have granted MFN and/or GSP status

2) Tariff and Non-Tariff Import Barriers

Four rates of import tariffs from 0-30% *ad valorem*, excluding temporary surcharge of 5%. Quantitative restrictions

3) Export Quotas and Other Export Barriers

Eight product groups subject to export licences. Temporary export tax on six unprocessed natural-resource-based products

4) Exchange Regime

Restrictions on current account, heavy controls on capital account. Floating rate

Bulgaria

1) Major Trade Agreements

GATT working party

EU Europe Agreement signed March 1993, Interim Agreement covering trade components entered into force January 1994

EFTA Free Trade Agreement in force since July 1993.

All other OECD countries have granted MFN and/or GSP status

2) Tariff and Non-Tariff Barriers

Average tariff from 13% (1989) to 11% (1991) to 16% (1995). An average tariff of 22% on industrial goods reported in 1994. Minimum prices for tires and steel pipes. Restrictive import licences for a limited number of products. Some tariff quotas on processed foods and agricultural products

3) Export Quotas and Other Export Barriers

Export taxes on 30 items, mainly foodstuffs, have replaced most export quotas. Export quotas on six primary commodities. Occasional export bans on agricultural products. Registration and licensing restrictions still operative

4) Exchange Regime

Few restrictions on current account, heavy controls on capital account. Floating rate

Croatia**1) Major Trade Agreements**

GATT observer status, working party on accession (1993).

Terms of EC Cooperation Agreements with Yugoslavia (1980), applied to Croatia as of 1991

MFN/GSP status granted by Japan. With other OECD countries the situation is not settled

2) Tariff and Non-Tariff Barriers

A 10% import tax introduced in autumn 1993 as part of macro-economic stabilization program. No quantitative restrictions

3) Export Quotas and Other Export Barriers

High degree of liberalization, most exports tariff free

4) Exchange Regime

Few restrictions on current account, some controls on capital account. Floating rate with CB intervention

Macedonia**1) Major Trade Agreements**

GATT observer status.

Terms of Cooperation agreements with Yugoslavia in 1980 applied as of 1991

2) Tariff and Non-Tariff Barriers

Average tariff of 4.7% in 1993. Quotas on only 4% of imports (mostly agriculture). Over 90% of imports free of licensing requirements

3) Export Quotas and Export Barriers

Export quotas removed in Jan 1994. Over 90% of exports free of licensing requirements

4) Exchange Regime

Few restrictions on current account, controls on capital account.

Floating rate

Romania

1) Major Trade Agreements

GATT contracting party (1971)

EU Europe Agreement signed February 1993. Interim Agreement covering trade components in force since May 1993

EFTA Free Trade Agreement in force since May 1993

All other countries have granted MFN and/or GSP status

2) Tariff and Non-Tariff Import Barriers

Most licensing requirements eliminated in May 1992. Weighted average tariff 11.7% (1993), maximum rate 40%. Restrictions only for arms, drugs and items affecting national health. An anti-dumping duty of 30% on alcohol, vehicles, TV's and video recorders imposed between May-Oct. 1993

3) Export Quotas and Export Barriers

Export quotas on raw materials for conservation reasons

Occasional export bans on food, fruits and wood products. Reduced export licensing requirements since June 1993

4) Exchange Regime

Virtual current account convertibility (except tourism), but capital controls. Floating exchange rate

Slovenia

1) Major Trade Agreements

EC Trade and Co-operation Agreement (April 1993)

EC Commission expected to receive mandate for negotiation of Association Agreement soon

EFTA negotiations on Free Trade Agreement (possible membership)

Free Trade Agreements signed with Czech Republic (dec. 1993), Slovak Republic (Dec. 1993), Hungary (April 1994) (tariffs to be phased out by 2001) and Estonia (May 1994)

2) Tariff and Non-Tariff Import Barriers

Generally tariff free. Where tariffs are applied, rates range up to maximum 25%. Customs formality tax of 1%. Some quotas on agricultural and textile products (98% of products free of quotas)

3) Export Quotas and Other Export Barriers

Temporary export duties of 10-25% on raw materials. Permit for

export of susceptible goods.

4) **Exchange Regime**

Full current account convertibility, some restrictions on capital account. Floating exchange rate

Hungary

1) **Major Trade Agreements**

GATT contracting party (1973)

EU Europe Agreement in force (fully ratified) since February 1994.

Interim Agreements covering trade component in force since March 1992

EFTA Free Trade Agreement in force since Oct. 1993

All other OECD countries have granted MFN and/or GSP status

CEFTA in force since March 1993

Free Trade Agreement with Slovenia in force since July 1994 (tariffs phased out by 2000)

2) **Tariff and Non-Tariff Import Barriers**

About 10% of imports subject to quota or licensing in 1994. Average inveighed tariff changed from 13% (1989) to 11% (1991) to 16% (1992). Further increase in tariffs in 1995 (+8%)

3) **Export Quotas and Other Export Barriers**

Exports of fuels, wheat and industrial raw materials subject to licences (slightly less than 25% of total exports). Of the agricultural budget in 1993, 80% devoted to export subsidies. In 1992, these amounted to an estimated 13% of export value

4) **Exchange Regime**

Current account convertibility (except tourism). Some restrictions remain on capital account. Peg to U.S.\$/ECU basket. Since March 1995 pre-announced crawling peg regime

TABLE 1
Regional Structure of Slovenian Foreign Trade (%)

	<u>Export</u>			<u>Import</u>		
	1992	1993	1-5/94	1992	1993	1-5/94
EU	54.9	57.4	61.3	50.1	55.7	57.2
Italy	13.3	12.5	14.9	13.7	16.2	18.1
Germany	27.0	29.5	30.5	22.7	24.5	23.7
Republics of Former YU	22.6	16.1	14.4	19.8	10.7	8.2
Croatia	14.3	12.1	9.7	13.9	9.1	7.0
CIS	3.4	4.9	4.6	4.1	3.2	2.5
CER-including Austria	8.6	9.3	9.5	12.8	13.6	16.1
Czech Rep and Slovak Rep	1.4	1.4	1.6	1.9	2.4	3.2
Hungary	1.1	1.4	1.3	2.5	2.5	2.2
Poland	1.0	1.4	1.5	0.3	0.2	0.3

Source: Andrej Kumar, Regional Trade in Central Europe—Slovenian Perspective, Regional Business Meeting Point, 1994 Bled.

TABLE 2
Geographical Distribution of Croatian Foreign Trade

	1989	1990	1991	1992	1993	1994 /I-VII/
Total	100.0	100.0	100.0	100.0	100.0	100.0
European Union	38.2	55.0	61.3	42.8	53.5	52.9
EFTA	8.0	7.1	7.6	11.1	5.2	10.4
Other Developed	8.2	7.0	5.0	2.4	3.1	3.6
Eastern Europe	28.6	18.6	11.8	5.8	7.8	8.4
Developing Countries	16.2	12.1	12.0	3.6	4.9	5.4
Ex Yugoslav Rep				32.0	24.8	15.9
Other	0.8	0.2	2.4	2.5	0.8	1.8

Source: Croatian Economic Survey, 1994

TABLE 3
Regional Distribution of Bulgarian Foreign Trade

	<u>Exports</u>			<u>Imports</u>		
	1991	1992	1993	1991	1992	1993
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0
(former) CMEA	55.1	32.7	26.8	46.8	34.7	30.0
SU/CIS	49.8	24.9	18.9	43.2	28.6	22.6
Central- Eastern Eur.	5.2	6.3	6.8	3.2	6.0	6.4
OECD	26.3	42.3	47.6	32.8	46.5	54.8
EU	15.7	30.8	33.8	20.7	32.6	38.9
EFTA	3.4	3.8	4.3	7.8	6.7	6.6

Source: Direction of Trade Statistics

TABLE 4
Regional Distribution of Romanian Foreign Trade

	1990	1991	1992	1993	1994*
TOTAL	100.0	100.0	100.0	100.0	100.0
Former CMEA	36.4	25.7	20.4	20.9	19.4
Central-Eastern Europe	11.0	6.0	6.4	8.3	n.a.
SU/CIS	24.2	19.6	13.9	12.6	n.a.
OECD	37.0	43.3	50.5	52.4	55.4
EU	24.2	30.4	35.3	41.2	45.5
EFTA	3.8	6.4	6.1	5.3	5.5
Others	26.9	31.0	29.1	26.7	25.5

Source: Direction of Trade Statistics

*Data for 1994 refer to the period January-November.

TABLE 5
Foreign Trade Balance in Certain Countries of the Region
(U.S.\$—millions)

	1991	1992	1993	1994
Hungary	-1.194	-374	-3.600	-3.820
Slovenia	-257	250	-672	-320
Bulgaria	788	45	-28	-100
Romania	-1.358	-1.651	-1.541	260 (I-XI)
Croatia	-536	-303	-956	-500 (I-X)

Source: Business Central Europe, National Trade Statistics

Sources:

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Banking as a Basis for Economic Cooperation in Less-Developed Europe

Franjo Štiblar

The less-developed regions of Europe include the south, east, and central European countries. In the present study, among fourteen countries under discussion,¹ eleven are post-communist countries in transition. This article intends to evaluate current cooperation between countries belonging to backward Europe and its future prospects. Cooperation in banking will be the focus of the analysis.

The starting hypothesis is that large and quickly increasing gaps between these countries pose a natural obstacle for cooperation in banking, which is the most sophisticated sector of the economy. The basic underlying elements of financial cooperation (international banking) are usually trade flows, which are low among these countries with their competitive rather than compatible economies. With the collapse of communism, most of these countries replaced one center of gravity (former Soviet Union) with another (EU) thus confirming the validity of gravity model. Renewal and enhancement of regular trade flows is the only realistic maximum for cooperation in the region. Institutional alignments are out of the question.

The question arises whether there is an independent ground, above trade flows, for cooperation between banks in the region. The possibilities lie in establishing offshore financial centers (Cyprus), or supplying technical assistance in the banking field by more developed countries in the regions to less developed ones. In some cases banks from the region could be more acceptable than banks from developed Europe (or other parts of the world) as advisors because they know the region better and are less likely to exploit their dominant position. With their own experience in rehabilitation and adaptation to new market conditions (as for instance Nova Ljubljanska Banka from Slovenia), they could share their experience with the banks in the region, which are only now undertaking rehabilitation. In a more optimistic view, an active financial deepening in these countries could be used as a tool for catching up with economically and financially more developed Europe. At the same time, for backward Europe, improvements in required banking standards are a way to fulfil conditions for joining European associations, the EU above all.

This article begins with an analysis of the economic differences among fourteen countries in the region, and continues with a description of the present situation in the region's banking sector. The third section deals with future prospects for banking cooperation in the region, and the last section illustrates the possibility of cooperation from the point of view of Nova Ljubljanska Banka, the largest commercial bank in Slovenia.

Large and Increasing Economic Differences among Countries

Differences in economic development between countries of backward Europe were already significant before the transition took place. In the 1990s they just exploded thereby decreasing further chances for financial and especially banking cooperation. Practical and theoretical views maintain that most trade and financial cooperation occurs among countries with a similar level of development.²

Several indicators are calculated to measure the relevance of analyzed countries in 1992, their external position in 1992, and their economic performance in 1993. Aggregate ranking of countries is calculated as an illustration of individual positions of the analyzed countries in the group.

The data are not the most recent (1992, 1993), but the major goal of calculations is in obtaining a feeling about the situation in the region, not in the most up-to-date calculations. With that in mind, certain estimates were made where reliable figures were missing. For the purpose of the article it seemed more important to include a country in the analysis, even with only approximate figures, rather than exclude it. Data used to fill the tables came from different available sources, official (country statistics, EBRD, WIIW, UNCTAD), and also reports from different research institutes.

Two features distinguish present samples (and calculations) from data presented usually by international organizations (UN, IMF, WB, EBRD). First, economies in transition are compared with three important market economies in the region (Greece, Turkey, Cyprus). Second, post-Yugoslavian countries are taken into account (Croatia, Serbia, Macedonia, Slovenia; but not Bosnia and Herzegovina due to lack of data).

Relevance

The geopolitical and economic relevance of the countries analyzed for 1994 is measured by four indicators: area, population, GDP, and GDP per capita (Table 1). Sums of ranks by each of the four indicators gives an indication of the relevance of each country to backward Europe.

Table 1 shows a large variation in area, population (both being positively correlated) and GDP or GDP per capita. The largest countries (Turkey, Poland, Romania) are definitely not the most developed (Cyprus, Greece, Slovenia).

TABLE 1
Size and Development, 1992

	Area	Population mio	GDP Bio \$	GDPpc \$
Albania	28.7	3.3	660	200
Bulgaria	110.9	9.1	9.6	1.055
Croatia	56.5	4.8	9.6	2.000
Cyprus	9.5	0.6	6.6	11.000
Czech R.	70.0	10.3	26.1	2.534
Greece	131.0	10.3	77.9	7.576
Hungary	93.0	10.3	35.5	3.441
Macedonia	25.7	2.7	2.9	1.336
Poland	312.7	38.3	83.8	2.189
Romania	237.5	23.5	13.8	588
Serbia	88.4	9.7	16.0	1.645
Slovakia	57.0	5.3	10.0	1.879
Slovenia	20.2	2.0	12.2	6.086
Turkey	779.4	58.1	110.3	1.898

External Position

The external position of the fourteen countries analyzed for 1992 is measured by the usual six indicators (Table 2):

- openness: $(\text{export} + \text{imports}) / \text{GDP}$
- indebtedness:
 - external debt/GDP
 - external debt/export
 - debt service/export (=debt service ratio)
- foreign position:
 - foreign reserves/imports (in months)
 - foreign direct investment/GDP

Aggregate ranking is made again as a sum of the country's rankings by each individual indicator. This should indicate the quality of external position which is by our hypothesis directly related to the country's ability for economic cooperation in general, and in the banking sector in specific.

Again, results confirm a big diversity between countries with regard to their openness, external indebtedness, external liquidity and attractiveness of foreign capital. Some of the countries established from republics of former Yugoslavia lead in openness, as their inter-republic flows became automatically the international flows of goods and services with the proclamation of their independence.

Among the countries of backward Europe are some of the most critical debtors in the world (Bulgaria, Albania, Poland, Hungary, Serbia and even Greece). External indebtedness is a big problem of the region.

TABLE 2
External Position, 1992
in Percentages

	Exp+Imp GDP	Debt/GDP	Debt Export	Annuity Export	Reserves Months/ Imp.	Equity/ Invest
Albania	14	91.5	1320.0	120.0	1.0	0.60
Bulgaria	71	132.1	288.1	25.3	2.2	0.40
Croatia	89	28.0	67.5	13.0	1.6	0.20
Cyprus	58	27.8	162.4	13.6	10.2	5.0
Czech R.	54	26.5	61.0	11.9	0.8	3.76
Greece	24	53.9	279.6	53.2	2.4	2.41
Hungary	53	60.7	156.2	31.7	3.7	4.14
Macedonia	83	29.2	70.7	12.3	1.2	0.25
Poland	33	56.1	289.8	16.7	2.9	0.34
Romania	66	26.8	78.4	9.6	1.6	0.53
Serbia	22	40.6	433.3	51.4	5.0	0.10
Slovakia	70	25.7	54.4	14.3	1.1	0.72
Slovenia	79	14.5	27.5	6.4	1.5	0.92
Turkey	34	49.6	215.9	33.6	2.4	0.35

Despite moderate economic performance and critical indebtedness quite a few countries in the region are favorable destinations for foreign direct investments. Leading in this regard is Cyprus, followed by Hungary, the Czech Republic and Greece.

Economic Performance

Differences in starting positions are established. Now, it is relevant to find out whether they are presently increasing or decreasing. Only later development gives rise to a more optimistic view regarding economic (and especially financial) cooperation among countries in the region.

The usual indicators of economic performance were chosen for a single year, 1993 (Table 3): 1) GDP growth; 2) inflation rate; 3) unemployment rate; 4) current balance of payments/GDP, (external equilibrium); 5) budget deficit/GDP, (internal equilibrium); and 6) average investment rate: investment/GDP.

Again, at the bottom of the table, the countries were ranked by each indicator, and the aggregate indicator of economic performance was calculated for each country as a sum of its ranks by individual indicators.

Results indicate that in 1993, the economic performance of Cyprus was the best among all countries under discussion. It was followed by the Czech Republic. In the second group were Slovenia and Greece.

TABLE 3
Economic Performance, 1993

	GDP Growth	Inflation Rate	Unemp. Rate	BOP/GDP	Budget/ GDP	Investment /GDP
Albania	+11.0	31.0	26.3	-64.3	-22.0	10.0
Bulgaria	-4.2	72.8	16.4	-7.3	-11.1	19.6
Croatia	-3.7	1517.	17.4	+2.9	-4.1	10.0
Cyprus	3.5	5.5	2.8	2.5	-3.5	23.0
Czech R.	-0.3	20.8	3.5	1.8	0.1	24.3
Greece	0.9	15.9	8.0	-2.7	-12.0	19.9
Hungary	-2.3	22.5	12.6	-9.1	-5.7	20.2
Macedonia	-15.2	244.	28.7	-0.6	-6.8	14.2
Poland	3.8	35.3	15.7	-2.7	-3.2	12.4
Romania	1.0	256.	10.2	-5.4	-4.6	17.7
Serbia	-25.0	9993	30.0	0.0	-25.0	8.0
Slovakia	-4.1	23.2	14.4	-5.2	-6.8	30.4
Slovenia	1.3	32.3	15.5	1.2	0.4	16.3
Turkey	4.8	70.1	20.0	-0.9	-14.0	23.0

The worst economic performance was experienced by Serbia, FYR Macedonia, Bulgaria, and Albania.

Surveying indicator by indicator, growth was not yet reestablished in most countries by 1993, hyperinflation was present in some countries (Serbia, Croatia, Macedonia), unemployment was still not at its peak, only four countries experienced balance of payments surplus (Croatia, Cyprus, the Czech Republic, and Slovenia) and only two of them budget surplus (Slovenia and the Czech Republic). Domestic propensity to invest was relatively low in the region, the worst among countries of former Yugoslavia.

To summarize, the results show that not only the starting (development, external position) position differs widely among countries in the region, but also that with better economic performance of the more developed among analyzed countries, their differentiation increases further. These are not promising characteristics for good economic cooperation within the region.

Aggregate Position

The aggregate position of each country was obtained by adding together its ranks by three previously introduced criteria: relevance, external position and economic performance (Table 4).

Results have only illustrative and very approximative value, and should be interpreted with caution. But still, they are quite informative. In the overall ranking, the Czech Republic is in first place, followed by

Σ	Performance							Overall	
	Σ							$\Sigma\Sigma\Sigma$ (R)	
15	14	9	3	1	2	2	31	56 (14.)	
36	3	5	6	3	5	8	30	90.5 (11.)	
52.5	5	2	5	14	10	3	39	114 (10.)	
62	11	14	14	13	11	12	74.5	155.5 (2.)	
56	7	12	13	12	13	13	70	163 (1.)	
35.5	8	13	13	6-7	4	9	52.5	134 (5.)	
47	6	11	10	2	8	10	47	135 (4.)	
39	2	4	2	9	6-7	5	28.5	79.5 (12.)	
33	12	7	7	6-7	12	4	48.5	129.5 (8.)	
53.5	9	3	11	4	9	7	43	132.5 (6.)	
26	1	1	1	10	1	1	15	71 (13.)	
56	4	10	9	5	6-7	14	48.5	128.5 (9.)	
69	10	8	8	11	14	6	57	149 (3.)	
35.5	13	6	4	8	3	12	45.5	130 (7.)	

TABLE 4
Country Ranking

	Relevance					External Position					
					Σ						
Albania	4	4	1	1	10	1	2	1	1	2	8
Bulgaria	10	7	4-5	3	24.5	11	1	4	6	8	6
Croatia	5	5	4-5	8	22.5	14	9	11	10	6-7	2
Cyprus	1	1	3	14	19	8	10	7	9	14	14
Czech R.	7	9-11	10	10	37	7	12	12	12	1	12
Greece	11	9-11	12	13	46	3	5	5	2	9-10	11
Hungary	9	9-11	11	11	41	6	3	8	5	12	13
Macedonia	3	3	2	4	12	13	8	10	11	4	3
Poland	13	13	13	9	48	4	4	3	7	11	4
Romania	12	12	8	32	34	9	11	9	13	6-7	7
Serbia	8	8	8	5	30	2	7	2	3	13	1
Slovakia	6	6	6	6	24	10	13	13	8	3	9
Slovenia	2	2	7	12	23	12	14	14	14	5	10
Turkey	14	14	14	7	49	5	6	6	4	9-10	5

Cyprus, Slovenia, Hungary, and Greece. In 1992/93, Albania was in the worst position among the countries analyzed, followed by Serbia, Macedonia, Bulgaria, and Croatia.

The Current Situation of the Banking Sector in Backward Europe

Status of Banking and Monetary Policy

The credible and detailed figures for financial and monetary sector in the countries analyzed is very difficult to obtain. Indicators for the current situation in the banking and monetary sectors are given for only eleven countries in Table 5 (missing are Albania, FYR Macedonia, and Serbia).

TABLE 5
Financial Sector, 1992

	1a	1	2	3	4	5	6
Bulgaria	168	54	insign.	-17.5	-17.0	-20.3	-14.7
Croatia	120	40	small	.	.	-10.0	.
Cyprus	14	43	large	.	.	3.5	3.3
Czech R.	215	48	31%	3.2	10.6	-3.3	-10.6
Greece	(381)	(27)	sizable	-5.1	-1.3	3.4	.
Hungary	229	45	25%	-11.7	4.3	-0.1	-0.4
Poland	364	105	small	12.3	-17.6	-27.0	-0.2
Romania	980	24	small	33.9	20.6	.	-52.2
Slovakia	189	28	small	9.8	-6.0	-2.4	-9.1
Slovenia	63	32	9%	-10.4	11.3	5.0	-10.8
Turkey	(726)	(80)	sizable	-4.6	6.9	-1.4	.

1a: Thousands of citizens per bank

1: Numbers of banks (recent)

2: Percent of foreign capital in banks' capital

3: Credit real growth rates

4: Broad M2 real growth rates

5: Real bank deposit rates

6: Real central bank discount rates

According to a cross section of data for 1992 (number of banks is more recent) disparities are well present in the banking and monetary sectors. Larger differences are impediments to cooperation in banking.

Table 5 shows that the absolute number of banks and number of citizens per bank differs significantly among the countries under discussion. Romania, Turkey, Greece, and Poland have the largest numbers of banks, which is not surprising since they are (by size and area) the largest countries. The story is quite different with the ratio of population to number of banks. Here, Cyprus leads due to offshore banking legislation. It is

followed by Slovenia with 100,000 inhabitants per bank; in the next group are Croatia, Slovakia, and Bulgaria with 200,000 inhabitants per bank. The Czech Republic and Hungary have more than 200,000 but less than 300,000 inhabitants per bank. In the last group are Poland, Greece, and Turkey. The numbers for the last two, being among the above-average developed countries and with a tradition in financial markets, indicate that, in most of the countries in transition, just regarding their population, the number of banks is too large and would be decreased during normalization of the economic situation.

Data on presence of foreign capital in the banking sector are difficult to obtain. Estimates in the second column of Table 5 indicate that longer market orientation (Greece, Cyprus, and Turkey as the only three representatives in the sample) brings, *ceteris paribus*, more foreign capital to the banking sector. The numbers related to the commercial banking sector in the Table 5 are real bank deposit interest rates for 1992. In most countries they were negative (Poland, Bulgaria, and Croatia led the group), which is an indication that restructuring of the financial sector has not even begun. Rates were positive only in Cyprus, Greece, and Slovenia.

In 1992 the real volume of bank credits strongly decreased in Bulgaria, Hungary, and Slovenia by more than 10%. It increased in Romania, Poland, and Slovakia indicating an expansive credit policy in the banking sector.

Two further indicators are given which represent the situation in the monetary sector. Broad money (real balances) was increasing in Romania, the Czech Republic, and Slovenia by more than 10%. For Romania this was related to credit expansion; for the other two countries with increased credibility and thus propensity to save in financial instruments. Finally, the real central bank discount rates are given. Among eight countries for which data were obtained, it was positive only in Cyprus. On the other hand, it was strongly negative in Romania, Bulgaria, Slovenia, the Czech Republic, and Slovakia. However, the discount rate was not used frequently as a monetary policy instrument in these countries.

International Banking Ties

Cooperation in the banking sector among countries in backward Europe could be measured by intra-regional institutional ties (FDI, branches and subsidiaries) and/or functional ties (correspondent banking with open accounts and credit lines).

With some exceptions, strong intra-regional banking ties have not yet developed. For most countries in the sample, in fact, international banking is only at the first stage of development. And, as much as it is developed, the majority of international ties are frequently interregional and not intra-regional. It means that banks from developed Western Europe are coming to these less developed countries in the region opening offices or establishing working cooperation (capital involvement, technical

assistance) with domestic banks. At the same time, some banks from countries in the region are opening their representative offices more frequently in developed Europe than in neighboring countries of the region. Such a tendency is probably the result of a strategy following trade flows of goods (which are frequently stronger with EU countries than intra-regional) and/or of establishment of presence in the world financial centers (Frankfurt, London).³

There are exceptions to this conclusion, most notably Cyprus, with its relaxed offshore banking regulations. It became a center of banking (sometimes illegal) for many post-communist countries (Russia), among them also countries from the region under discussion (Serbia, for avoiding embargo). The more mature market economies in the region (Greece, Cyprus, and less Turkey) do invest among themselves, but also in some, usually neighboring post-communist countries (as Bulgaria). As an illustration, Slovenia's largest bank Nova Ljubljanska Banka has offices in Hungary and the Czech Republic and banks in other parts of former Yugoslavia, but with undefined status after the collapse of the former Yugoslavia. At the same time it has functional (correspondence, open accounts) relations with at least one, but usually more, banks from each country under discussion. It has also developed an institutional presence in Frankfurt and Munich, New York and London, Vienna, Milano, and Moscow which confirms the above statement.

It is clear that such a region (and former countries as Yugoslavia or CSSR) is not and will not be a special reason for closer banking ties. Mere geographical proximity, even in addition to historic ties, is no longer enough for economic integration in the present developed world in which economic determinants prevail in seeking ties among countries. Different regional economic cooperation schemes will be developed in the future as they were in the past. Especially countries on the edge of the region would probably strengthen their economic ties with neighboring countries outside the region. At the same time, almost all of them will try to increase banking cooperation with developed Europe and the EU particularly, as a new gravity center (since the former Soviet Union is no longer an economic power and thus not a gravity center).

The legislation on FDI in the banking sector in the countries under discussion differs widely. But, with some exceptions, most notably Cyprus, countries in transition are reluctant to open the doors wide to foreign banks at this early stage of restructuring their economies. The banking and financial sector as a whole is very important for retaining an independent national economy (sometimes it is compared with ownership of land and real estate). As long as national states constitute Europe (the Europe of regions remains only a distant futuristic idea), one way for these countries to protect their own national states in transition seems to be retaining majority control in their banking sectors.

Future Prospects: Banking Cooperation as a Basis for Economic Cooperation

Future Development of the Banking Sector in the World

The future development of banking and cooperation in the region will be determined by future developments in world banking. According to some, European banking will be controlled by only four to five banks after the year 2000. In such a black scenario there is no place for banks from backward Europe as independent institutions. Other less pessimistic predictions⁴ talk about winning banking strategies for 1990s in which banks will offer new products and services to their clients, and differently than before. Data shows that in recent years, bank profitability and economic efficiency constantly has been decreasing worldwide.⁵

In the future banks will have to cover three major forms of banking services:

1) processing (payments, automatic clearing, electronic transfer, asset management, credit letters collecting, brokerage, stock exchange and other capital market services);

2) core banking functions (collecting deposits and extending credits, leasing, trading, guaranties, investments, issuing insurance and credits letters);

3) advisory functions for clients (mergers and acquisitions, issuing bonds and stocks, financial engineering, business finances, personal finance planning, investment consulting, investment management).

Besides, quality in banking services will become crucial for successful banking, since it depends on credibility, responsibility, knowledge, attitude, communications, safety, understanding and personal touch.

According to the same sources, a winning banking strategy should include: maximizing non-interest income, increasing the value of assets, optimizing the volume of capital, enforced marketing of financial services, adequate management of financial risks, and control of expenditures.

It is clear from the outset that banks in backward Europe lag behind developed banks from Western Europe in most of the above listed functions and efforts. Thus, a lot needs to be done just to catch up with them.

Development of Banking in the Region

The question is how realistic a starting point is the view that banking could become one of the mechanisms for decreasing gap between backward and developed Europe?

The idea is that with a fast development of the banking sector backward Europe can establish preconditions for catching up faster in the real sector of the economy. For achieving that the above future banking functions should be established and developed even faster in backward Europe than in the banks of developed Europe. Realistically, this is not probable

because of lack of knowledge and experience (comparative disadvantages). Banks in post-communist countries learn modern banking from banks in the West through technical assistance in restructuring programs. The only advantageous fact is that banking in post-communist countries is in the process of establishing totally new foundations, which means that there will be fewer obstacles in starting new banks than in the case of existing well-established banking. But that is probably not enough.

Regardless of the catching-up idea there is an independent, additional reason for banks in the region to modernize and catch-up with Western standards; that is, the intention of most of the countries in the region to join the EU. In order for that to happen sometime in the future, one of the preconditions would be to establish banking sectors according to EU standards (EU directives on banking), which means, in many cases, more than meeting BIS standards for prudential regulation and supervision.

Related to the quest for joining the EU as a primary goal of most countries in the region is the immediate question of how important (and relevant) is the strategy to achieve this as a country block. It means 1) establishing economic (and for some even more) ties between countries in the region, and 2) negotiating entry to the EU as a stronger block-power. It is clear that present EU members would not like such a block-negotiator and that they (as a stronger negotiator) will enforce bilateral negotiations and entry to the Union. At the same time, some more developed countries in backward Europe are not willing to wait, and prefer their own (individual) negotiations hoping thereby for an earlier entry to the EU.

Trade Patterns as a Primary Reason for Banking Cooperation in the Region

Trade flows, which need to be supported by banking activities, remain a major and well-founded reason for banking cooperation in the region.

Table 6 indicates directions of trade for ten out of the fourteen countries in the sample (mostly for 1992, but also for some other years between 1990 and 1993). Based on the UNCTAD Yearbook for 1993, published in the fall of 1994, the results clearly show a relatively small share of total trade between countries in the region. The reasons for this are the political situation, the existence of large centers (EU, Soviet Union), war, and embargoes (formal or actual).

Data is given only on an aggregate level. The three categories are: Europe (European Union, Eastern Europe, and Other Europe), developed countries, and non-European less-developed countries. Two sectors which should approximately cover trade within backward Europe in the sample are Eastern Europe and Other Europe. But even within Other Europe there are not only Turkey and Cyprus but also EFTA countries.

In any case, results show that in 1992 Bulgaria directed over 78% of its exports to Eastern and Other Europe, while its imports from these two

TABLE 6
Directions of Trade, Structure in %, 1990-93

	Europe	EU	Eastern Europe	Other Europe	Developed Countries	Non-Europe LDCs
Bulgaria, 91						
Export	86.0	7.6	76.9	1.5	11.2	11.8
Import	69.3	50.9	8.1	10.3	68.3	23.4
Cyprus, 92						
Export	66.4	59.3	3.1	4.0	67.3	27.2
Import	60.3	52.4	2.5	5.4	78.6	13.8
Czech R., 92						
Export	74.0	45.1	19.7	9.2	56.9	11.3
Import	85.3	33.1	38.8	13.4	48.3	12.8
Greece, 92						
Export	76.0	64.1	6.4	5.5	76.4	15.4
Import	71.2	62.7	4.0	4.5	79.4	15.4
Hungary, 92						
Export	80.1	45.8	19.4	14.9	66.6	13.9
Import	70.0	42.8	6.7	20.5	69.4	5.5
Poland, 92						
Export	74.2	57.9	5.9	10.4	71.3	11.8
Import	70.6	53.1	4.4	13.1	72.1	10.5
Romania, 92						
Export	57.1	32.5	19.0	5.6	42.9	36.2
Import	62.8	25.2	24.7	12.9	38.3	36.5
Slovenia, 93						
Export	69.6	57.4	5.3	6.9	70.4	-
Import	73.1	55.7	5.4	12.0	74.4	-
Turkey, 92						
Export	63.6	51.0	8.2	4.4	64.2	27.4
Import	53.8	43.9	3.7	6.2	68.6	22.5
ex-Yugo., 90						
Export	80.0	45.7	28.3	6.8	58.6	13.2
Import	77.4	44.3	23.3	9.8	62.1	14.6

Source: UNCTAD Yearbook, 1993, published in November 1994.

regions counted for less than 19% of total imports. The only other country with over 50% share in trade within this region is Czechoslovakia in 1992 with 52% of imports coming from both regions. Neither export nor import from the region of other countries in the sample exceeded 1/3, with more significant numbers for Hungarian export (over 34%), Romanian import (37%), and ex-Yugoslavian export (35%) and import (33%).

Especially low shares of exports and imports within the region are observed for Cyprus (each less than 10%), Greece (exports less than 12%,

imports less than 9%), Slovenia in 1993 (export 12%, import 17%), Poland (export 16%, import 17%) and Turkey (export 12%, import 10%). All these countries are on the outer limits of the region and at the same time more developed, or under some other institutional arrangements (for instance, Greece is a member of the EU).

Practically speaking, less than one-third of trade flows within the region were significant (measured with more than 33% share) in 1992. More recently trade flows within backward Europe definitely decreased further. Among reasons for that are economic sanctions against Serbia and Montenegro, sanctions by Greece against FYR Macedonia, and the war, which disrupted transportation even between other countries in the region.

All this gives a slim prospect for developing banking on the basis of trade flows (as their support), because trade flows within the region are small and continue to decrease even further. Some bilateral trade flows are stronger and they could lead to stronger bilateral banking ties.

Are There Grounds for Cooperation between Banks beyond Servicing Trade Flows?

With weak trade ties, the question arises whether or not there is reason for establishing banking cooperation regardless of or even over intensity of trade flows. Two factors could be mentioned in that regard.

The first is establishment of offshore banking centers, following a prosperous idea practised already by Cyprus. Most of the countries from the region and many countries from outside the region (Russia, western countries, Arabic countries) established in recent years representative offices, subsidiaries, branches in Cyprus or directly invested capital in Cyprus domestic banks. The banking business is flourishing in Cyprus and the density of banks, as already observed above, is by far the largest in the region. Offshore banking is not subject to strict domestic banking regulation. Instead, regulations for it are less stringent thus making establishment of banks and their offices attractive to foreign countries.

To prevent unstable (hot) capital influencing domestic monetary policy, assets and liabilities of offshore banks are not included in domestic financial systems at all. A negative side to this is that a lot of grey and black market financial business flows are directed to these offshore banks. There is certainly a trade-off between clean prudent banking and additional earnings on taxes imposed on offshore banks. Cyprus opted for business.

But, even if Cyprus is a good example for other countries to follow, how many countries could establish such offshore centers? These centers are attractive only if they are rare. There would certainly not be enough offshore business for all countries in backward Europe.

The second way of intensive banking cooperation could be supplying the know-how and technical assistance, from banks in financially more developed countries in the region to banks in less developed countries of the region. Banks from developed Europe are penetrating aggressively

into backward Europe, especially countries in transition. But compared to banks from developed Europe: more developed countries in the region can have certain advantages: 1) they know the region better; 2) they could have already some business relations established which only need to be intensified; 3) they could be accepted as more friendly (less dangerous) in the eyes of the countries and banks which would receive technical help; and 4) many such banks in the more advanced countries in the region already went (successfully) through similar rehabilitation procedures and thus could share their own experiences in the rehabilitation of banks with banks in other countries in the region.

One bank in the region willing to share through consultancy its own experiences with rehabilitation, which is coming to a successful conclusion, is Nova Ljubljanska Banka from Slovenia's capital Ljubljana.

A Special Case: Nova Ljubljanska Banka (NLB) as Partner to Banks in the Region

Identification Card of NLB

Nova Ljubljanska Banka (NLB) was established by constitutional law in July 1994. Ljubljanska Banka, which at the beginning of 1990s was among the 250 largest banks in the world, was divided into the old Ljubljanska Banka (which ceded certain liabilities and guarantees incurred during the existence of former Yugoslavia, on behalf of or related to entities located within the former Yugoslavia's territory) and Nova Ljubljanska Banka which ceded all other assets and liabilities from the former bank. At the moment of this institutional change, one of the last steps in the rehabilitation of the bank, supervised by the State Bank Rehabilitation Agency, NLB had around 200 Million DEM of founding capital and a balance of around 3.5 Billion DEM. Its capital adequacy ratio was 9.2. Its share in the banking market in Slovenia was reduced to around 30%.

Rehabilitation of bank problems started with a new management team in early 1993. Problems appeared to a great extent to be due to the dissolution of the former Yugoslavia and due to previous relaxed banking policies in the socialist system. Rehabilitation led to positive trends: 1) positive net operating income and net operating cash flow; 2) increasing retail and commercial deposits; 3) normalization in the level of provision for doubtful debts; 4) reduction in staff level to 2,300 employees and reduction of operating costs; and 5) disinvestment of some businesses, which are not directly related to the bank core business.

Nova Ljubljanska Banka is well known for its developed international banking orientation. Despite its disinvestment efforts it retained a foreign branch in Milano, foreign subsidiaries (LBS New York, Proteus Finanz Zurich), foreign affiliates (LHB Frankfurt, Adria Bank Vienna), and representative offices (Budapest, Frankfurt, London, Moscow, New York, Paris, Prague, Trieste).

Internalization of Technical Assistance by NLB

Nova Ljubljanska Banka has correspondence relations and open accounts in practically all countries in the region. It has successfully internalized technical aid obtained from the EU, USAID, Know-how Fund, the IFC, and the World Bank. Most of it was executed in cooperation with the Allied Irish Bank.

Special fields for potential further dissemination of its own experience and knowledge are: 1) financial and strategic planning and control; 2) credit risk management; 3) treasury and balance management; 4) information technology: strategy and supervision; 5) securitization; 6) financial bookkeeping; 7) development of the retail banking sector; and 8) development of human resources in banking.

Institution Building and Functional Changes in the NLB

NLB continues to expand its range of products and services in response to developments in Slovenia and in world financial markets. Recent examples are: 1) expanding investment banking business; 2) factoring was established in cooperation with IFC and Vienna based financial enterprise; 3) LB trading company was established recently; and 4) new subsidiary, LB Maxima, has been established to provide portfolio investment management for selected newly established investment companies.

An integral component of rehabilitation was an institutional strengthening program, designed to ensure NLB's competitiveness within the international financial market place. Progress in this regard was made especially in the following areas: 1) new credit policies and procedures were introduced to preserve quality of loan portfolio; 2) management information system is being improved to support consumer-focused strategy; 3) internal policies and controls were implemented with help from the Irish Allied Bank as consultant; and 4) internal reorganization of bank has been completed.

The final step in the rehabilitation of NLB is its privatization, which should follow the official conclusion of rehabilitation procedures in 1995. With the beginning of rehabilitation in 1993 the state became the only owner of a bank through swapping government bonds for bad debts from the NLB's portfolio. Among potential future owners of NLB are foreign partners, the state, and domestic economic entities. Among foreigners there could be EBRD, IFC, and possibly strategic private foreign owner (bank). The state will retain minority share and the last third of ownership will go to public at large, enterprises, and institutional investors in Slovenia.

Transfer of NLB's Experiences to Banks in Other Countries of the Region

Major steps in transferring NLB's experiences to banks in other countries in the region would include 1) dissemination through consulting, 2) in-place cooperation, and 3) upgrading institutional and functional presence in the region as a potential strategy of the NLB for the future.

A team of consultants is in the making in NLB including people who took part in the major rehabilitation efforts of the NLB. The best way for advisory work with potential users of NLB consultancy services would be in-place cooperation, as this proved the best solution for NLB in its rehabilitation. This way NLB could upgrade or establish a new institutional presence in the region. Part of its long-term strategy is to become a central European bank with strong ties to all regions of Europe, including backward Europe.

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Notes

1. Albania, Bulgaria, Croatia, Cyprus, Czech Republic, Greece, Hungary, FYR Macedonia, Poland, Rumania, Serbia, Slovakia, Slovenia and Turkey.

2. For instance, Lindner, 1968.

3. It is interesting to note that no post-communist country in transition has established its own subsidiary in New York, the largest financial center in the world, except for Slovenia, which owns 100% of its subsidiary, Nova Ljubljanska Banka d.d., in Manhattan.

4. Bollenbacher, 1992; *The Banker* 1988; *Institutional Investor*, 1994

5. Some indicators for world banking in 1990 from *Institutional Investor* (1994) and from *Bollegraf* (1992) are:

profit/founding capital=10.4%

profit/balance sum=0.61%

balance sum/founding capital=17

the share of non-interest income of banks=12%

net banking margin=2.59 percentage points

non-interest income/balance sum=0.003

labor costs/balance sum=0.01.

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