

Policy Statement regarding the “Post-War System for South-East Europe” Plan

Prepared by the Centre for Liberal Strategies on the basis of discussions and exchanges within the South-East European regional Study Group on the Centre for European Policy Studies paper “A System for Post-War South-East Europe”,
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1. Positive Assessment

- 1.1. The Plan is widely perceived as a possible turning point in the EU approach to SEE. It is broadly considered as a potential genuine departure from the traditional “accession rhetoric”, mainstream integration philosophy and geopolitical *clichés*. The EU badly needs such a change in order to strengthen its fading credibility in the region and to present a realistic European perspective for SEE countries.
- 1.2. In order to be explicit in our overall positive assessment of the Plan, we briefly summarize the points of the proposal, which have our “unconditional” approval.
 - 1.2.1. The global, comprehensive and strategic approach of the problems faced by SEE countries.
 - 1.2.2. The intent to abandon the conventional “access to a Club” schedule of *rapprochement* and to provide tangible pieces of evidence of the European identity of the region.
 - 1.2.3. The point of view going beyond the traditional *stabilization* goal and formulating an explicit *integration* objective for the region.
 - 1.2.4. The ambitious and complex nature of the project, aiming to reshape the political and economic bases of one of the most problematic European areas.
 - 1.2.5. The recognition that stability of SEE is internal and not external problem for the EU
 - 1.2.6. We consider the Paper as the first EU document which--in details and in length--provides a seemingly realistic action plan for a European integration of the Balkan region.
- 1.3. Although the Plan intends to send a clear political signal to the region and to prepare the implementation of truly non-conformist steps, we have many remarks concerning its conceptual background, feasibility perspective and cultural insight of the region. They do not undermine our general support of the fundamentals of the Plan. Rather the contrary, we approve them and strongly encourage a further and concerted intellectual effort along the main paths outlined by the Plan. The more elaborate comments which follow are

conceived as a first contribution to the debate and to the constructive policy-making.

2. Geometry of Accession – from “5 + 2” to “2 + 5”

- 2.1. The immediate stimulus for the re-thinking of the place of SEE in the European architecture is obviously the shock of the Kosovo crisis. The events generated a rush towards new scenarios and crisis management plans which, understandably, focus on the core of the troubles – the most politically and economically marginalized countries in Europe.
- 2.2. This approach produces a clear asymmetry in the Integration logic for the countries of the region.
 - 2.2.1. The globalistic point of view of the Plan – an unquestionable asset of the project – tends at the same time to overemphasize the coherence of the region. The document considers the Five as a more or less coherent group. In fact, there are considerable differences among the Five in terms of political, institutional and economic stability. Some of the countries (like Croatia) are probably not interested politically to join the proposed NAM status as they are consistently avoiding any reference to a cultural link with the region. Through a domino effect this will undermine the possibility for a BiH NAM status as well, what endangers the whole idea. Yugoslavia is a problem on its own. Nobody at this stage can predict how the country will look like on the day after the war.
 - 2.2.2. An even more pronounced disequilibrium arises from the inclusion of Bulgaria and Romania in the Plan. It is quite obvious that those countries are not an intrinsic part of the initial idea. It seems like everything that the Plan has to say about them has been appended as an afterthought. They have been added *a posteriori* with all the ensuing consistency problems.
 - 2.2.3. The project says little about the role the European major partners, such as the USA, are called to play in this post-war system. It is unrealistic to think that the security of the countries of the region or their economic development could be secured in the near future without a strong American commitment. As the recent years have shown clearly, EU does not have the clout to impose peaceful settlements, not to mention a “European civil order”. EU still needs to show its leadership in European affairs and clearly can not do away with a strong American involvement in European matters.
- 2.3. Bulgaria and Romania need to be integrated in a consistent way to the Plan in order to add synergy to the whole project. This requires a reshaping of the accession geometry and a shift in the focus. **The formula should be changed from “5 + 2” to “2 + 5”**. This formulation has several important advantages:
 - 2.3.1. The accumulated accession experience by the two countries is a worthy asset, which can be transferred to the Five. The fact that Bulgaria and Romania are well under way in an EU-sanctioned schedule of accession might transform them in a driving force for the

whole accession process in the region. Figuratively speaking, both countries could play the role of the French-German tandem in the Western part of Europe.

2.3.2. If the actual “5 + 2” formula of the Plan is retained, new groups competing with each other, or tracks with different speed, will be created. When a strong political sign is sought, **acceleration** makes the difference. While the plan for the Five seems as a really radical one, the measures foreseen for Bulgaria and Romania are conventional and lacking imagination. In the plan offered so far, no tangible acceleration can be seen for Bulgaria and Romania. If the plan seeks to really change the rhetoric and the politics of integration, a clear break should be immediately obvious for **all** the countries of SEE.

2.3.3. Many elements of such a break are already included in the Plan for the Five. In the case of Bulgaria and Romania the effect of a perceptible change could be attained at a much lesser cost for the EU. There are two unmistakable political signals that the integration of those countries with the EU will get the same acceleration as that of the Five - a start of formal negotiations with the EU by the 1 of January 2000; at least a partial revision of the current Shengen barriers. In a more pragmatic level, both countries need assurance that the financial aspects of the Post-War System will at least preserve the amounts of money already allocated to them for the following 7 years according to Agenda 2000. The public opinion in Bulgaria and Romania is not ready to accept anything less as a credible commitment on the part of EU. Any other policy will be mere “virtuality”.

2.3.4. The Plan proposes that NAM will elect a non-voting members of European Parliament. This suggestion will give an important political dimension to the virtual membership of the SEE countries. But if the Plan really wants to go beyond the present paradigm of accession, EU could envision a new paradigm in which political integration precedes the full membership. If the countries which are in negotiations for EU membership receive the right to elect voting MPs in the European Parliament this will be a really revolutionary change with respect of the EU enlargement.

2.4. Still within the geometry of the Plan are the issues about the actual organization of the several new bodies proposed in the plan: the South-East European Agency for Reconstruction and Development, the South-East European Foundation for Democracy, the South-East European Foundation for Education. Their importance raises questions as to the regional representation in the decision making. The participation of the SEE countries in all these new institutions needs to be elaborated in at least as much detail as the integration of the New Associate Members into the European institutions. The countries of the region should be actively involved in the new regional institutions and should have a voice in both the philosophy and the management of their activities. As a first step, all these institutions should be based within the region.

3. The Economic Side

- 3.1.** The Plan contains many fairly innovative ideas in the economic area. We provide our comments on the two pillars of the project in this field – the EEA Mark II proposal; the EMA.
- 3.2.** The general feeling is that EEA Mark II is an attractive promotional idea, which, however, misses the main point. To drop tariffs is without any doubt the right policy. But to remove at once the tariffs on industrial goods in an industrially backward region may bring severe difficulties. The positive effects of such an opening may be one-sided, in favor of the more developed countries. What is more important, the agricultural goods trade - which is more relevant for the region - is not addressed in the plan. The trade shock resulting from an elimination of tariffs could be felt in a more dramatic way in the case of the Five. For Bulgaria and Romania the effect will be minor, since they have strictly defined time tables for their tariffs cuts, a qualitatively different trade relationships with Europe and many free-trade agreements already in place (EU, EFTA, CEFTA).
- 3.3.** The most ambitious proposal in the Plan concerns the EMA. When making a decision on it, two important regional factors need to be taken into account. First, the countries are very different, and their monetary systems even more so. The only case of an authentic currency board is in Bulgaria. In BiH the currency board is still a largely artificial system, which lacks the necessary coherent financial infrastructure. The other countries are operating more or less pegged exchange rate regimes. Second, the reading of the two-years experience of the Bulgarian currency board indicates that euro-ization is not expedient even for countries, which – like Bulgaria – are very close to the model proposed by the Plan. We can provide several arguments.
- 3.3.1.** All the advantages and developments (low interest rates, foreign banks, prudential regulation of financial intermediaries, etc.) which the plan lays at the door of euro-ization can be achieved within a currency board at a cost which is not higher.
- 3.3.2.** The Argentinian plan for dollarization is not relevant because the Argentinian authorities themselves do not support a unilateral dollarization, the Fed has strong reservations concerning the possibility to cover the lost seigniorage and to provide lender-of-last-resort facilities. As it seems, the ECB has not been asked about its views on the possible euro-ization of SEE countries.
- 3.3.3.** The deficiencies of an unilateral euro-ization are manifold. It establishes the most constraining monetary system by eliminating even the residual instruments of national monetary flexibility available to the CBA – a manipulation of minimum reserve requirements and some LOLR facilities. The adopted currency (the Euro) would be in fact a “surrogate” one – a currency without a central bank. Monetary restrictions would increase, but without the benefits of a full membership in the institutional infrastructure of the European monetary union. The residual central bank would have neither the voting power in the ECB, nor even the rights and the policy instruments of the national central banks of EU countries.
- 3.3.4.** The expected decrease in domestic interest rates and of the cost of rising money in the international capital markets is highly

- hypothetical as the country risk (and the risk of the national financial system) remains even under a euro-ized (dollarized) regime.
- 3.3.5.** A currency board provides a better means for macroeconomic monitoring than euro-ization. It has led to significant progress in the implementation of hard budget constraints for the fiscal and the banking sector. Many loopholes and soft budget constraints have, however, remained in the real sector. They are related to the lagging structural reforms. It is theoretically wrong and pragmatically unrealistic to expect that the needed changes in the real sector could be generated by a reform in the monetary regime. A stronger credibility for a currency board economy can be achieved only outside the monetary area.
- 3.3.6.** The Bulgarian (and to a less extent the Bosnian), currency boards are well functioning and established, so they can be a much easier example to accept and follow than the unknown and uncertain euro-ization. As such, the currency board seems to be a better institutional arrangement than the euro-ized regime. It preserves the central bank as an institution which can provide a better transition to the “desired” euro-ization, i.e. within the EU as a member. It is much more prudent to follow a gradual approach and the common sense rule “If it ain’t broken, don’t fix it”.
- 3.3.7.** The currency board provides an orderly exit strategy in the case of joining the EU. The natural way-out from a CBA pegged to the Euro is to join the EMU after accession to the EU. The mechanism designed for the “out”-countries to join EMU provides a clear framework for an exit strategy. The optimal path for countries like Bulgaria seems to be to maintain the CBA until the accession to the EU, to declare immediately the intention to enter EMU and to follow the established schedule. Probably some institutional amendments should be necessary at this stage.
- 3.4.** Aside from the major topics on trade and money, we have some additional remarks on some missing points.
- 3.4.1.** No official debt alleviation is foreseen for any of the countries (in the fashion in which Poland and Egypt were treated by the Paris club in relation to their involvement in the Persian Gulf crisis), even though some of the countries are experiencing a significant strain through no fault of their own;
- 3.4.2.** Nothing is planned for the free movement of labor between the region and the EU – a clear and honest attempt to introduce such an arrangement even in limited form will be a particularly strong signal for the commitment of the EU to the new processes;
- 3.4.3.** Given the fact that the war had increased risk perceptions in the region, the EU will need to devise a mechanism for taking some of the risk by guarantee schemes – this time, the sharp rise in risk perceptions about the region is due mostly to actions decided at least partly by the EU – it will be felt as just if it assumes some of the financial risks of reconstruction;
- 3.4.4.** The Plan does not identify the agents who stand to lose from the implementation of the proposed measures and the possible means to overcome their opposition;

- 3.4.5.** The reconstruction and development part of the plan relies on the support of the European Investment Bank, but no parameters and mechanisms for this cooperation are outlined. The proposed new Agency (SERA) is a good idea, but is not clear if it will work as a development bank (without the strict requirements for a commercial bank and able to assume the risk) or as another commercial bank with the relevant requirements. It is not clear who assumes the risk, promising to be very high, in all the projects. Assuming property rights in infrastructure may lead to losses, which are then transferred to the European taxpayers, and the European investment bank may not accept to have such a subsidiary. The part about the control over the projects is very important. The plan does not talk about a very important aspect of market reforms: the participation of private capital and the productive interaction between established Western firms and local private firms. The deliberate fostering of such interactions may turn out to be much more valuable for the region on its way towards a western-type economic prosperity than simply putting in place physical infrastructure.

4. Utopian and Wishful Thinking

- 4.1.** The enthusiastic mood of the authors of the project, as well as their strong motivation to provide a novel approach for the SEE problems has produced – in some points – a bias towards unrealistic assessments. The missing knowledge on the cultural realities of the region generates, as a rule, an excess of optimism, which is not shared by the local observers. In the following comments we are drawing the attention to some of those points.
- 4.1.1.** The Plan incorporates a fairly romantic view of the ability of the region (institutional, market, mental attitudes, etc.), and especially of “the five” to absorb and adapt to the “shock” of the virtual integration.
- 4.1.2.** There is an almost endemic instability (political, economical, social) in four of the Five countries. Due to an awareness of that fact, the current political elites of these countries would, with pleasure, accept the NAM status. But it is far from clear if the elites are able to realize and to execute the - relatively very high – requests and standards, required by the NAM status. Although even the prospect to obtain a NAM status has a stabilizing effect, it is probably not enough for them to do it.
- 4.1.3.** There has to be a distinction in applauding the initiative (which boils down to an unconditional appreciation of the fact that European Union acknowledged the fact that it had to “assume its responsibilities”), and giving a more balanced account of the premises and practical arrangements included in the project.
- 4.1.4.** The underlying premise of the project is that the prospect of full integration into the EU would bring about prosperity and democracy in the five countries taken into account. This premise should be questioned. While it is clear that offering these countries a clear perspective of joining the EU and a more or less clear time table would strengthen the democratic and pro-European trends and developments in the region, devising a detailed mechanism of

including them into a kind of European Economic Area starting with 1.1.2000 is a more debatable matter. The optimism is based on the fact that the European construction itself and the establishment of the original European Economic Area have been put into practice with impressive results. But a model which worked in the case of Iceland or Switzerland will almost certainly not work in the case of Albania or Bosnia and Herzegovina.

- 4.1.5.** Other premises are even more unrealistic. The willingness of the governments (which is taken for granted) to accept the outright liberalism proposed by this project (a “zero-tariff free trade should be implemented very fast, preferably in a “big bang” on 1.1.2000”) in order to “make a clean break from the present use of customs posts as instruments of state corruption and the protection of crony capitalism” is not a realistic assumption, to say the least, from various reasons which will not be developed at this moment.
- 4.1.6.** There are statements of outright “wishful thinking” which should not, as a norm, be taken - as here - as a basis for elaborate projects. It is true, the project admits, the current government of Croatia, for example, “does not move decisively towards implementing international norms...”, but “it is entirely possible that there will be a change of attitude in the very near future” (p. 21). Bosnia, it is reminded, “has so far wasted the chance to make a lasting economic recovery”. The answer lies - the project quotes a European Representative - “in a more enlightened government”. The case of Serbia is even more problematic: the authors of the study suggest that “the only good solution to the war is one in which Serbia becomes truly democratic, converging on modern European norms” (p. 27). Whereas “good solutions” of “enlightened governments” seem a remote prospect, nowadays NATO leaders accept in principle that a post-war Serbia does not mean necessarily a post-Milosevic Serbia and are now willing to make peace with the Serbia’s strong man. But even after the Milosevic downfall, there is no certitude that we will have a fully democratic Serbia.
- 4.1.7.** The understanding of the roots of corruption, criminality and cronyism is simplistic. It is directly related to superficial effects like customs, monetary policy, etc. Abolishing the customs will not eradicate corruption. The criminal and corruption channels (many of them including Western counterparts) are a fact, and are already well established throughout the region. To be able to avoid the real dangers, a much more elaborate plan, including the involvement of established international organizations and a set of monitoring rules in real time, is needed. The money “wasted” on monitoring will be very well spent. The roots of those problems lie in deep historical traditions and institutional deficiencies.
- 4.1.8.** The Plan has no chance of being accepted whole-heartedly by everyone in SEE. Some very well defined and concentrated interests will have a strong incentive to oppose it, because they are winning from the *status quo*. Also, there will be other groups, interested in ruining or distorting the whole idea. Finally, the overall public opinion cannot be assumed to be well informed about the Plan, and about the real meaning of reform and of European integration. The very success of the Plan depends on the degree to which it is able to

accurately pre-determine the winners and the losers of its implementation, and to provide a set of adequate means and actions to enlist the full support of the former and to overcome the opposition of the latter. A full-fledged campaign aimed at winning and educating the public opinion in both the SEE countries **and** the EU is a *sine-qua-non*. It will cost a large portion of money, and will take at least 3 to 5 years of consistent efforts carefully coordinated with all the other steps of the Plan.