INSTITUTIONAL REIMAGINATION OF THE SOUTH EAST OF EUROPE*

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1. INTRODUCTION

Two decades after the fall of the Berlin wall the South East European countries remain a vulnerable area of Europe. The transition and accession of the countries in Central Europe offers us a good insight into the complex nature of these processes. Successes and missed opportunities of the Central European countries should be taken into account by both the South East European countries and by the European institutions before the accession process reaches its goal: enlargement to the South East of Europe. If the ultimate goal is to secure a more inclusive and more equitable development of the countries in the region, then broader policy space and maneuver room should be given to the countries themselves, when struggling to prepare for the full EU membership (Mayer 2008: 373 – 395). Broader and more inclusive development capabilities of the countries in the region are not only in the interest of the respective countries and their people, but also in the interest of the EU, if it wants not only to enhance but also expand its distinctive model of its inclusive, diverse and dynamic development.

The thesis of this paper is that there is no one single institutional setting of the modern market economy and representative democracy. Contracts and property rights,

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models of corporation and financial institutions can be organised in many different institutional settings. This insight should give the future generation of reformers in former transition countries additional room for more innovative and potentially more productive approaches toward the economic and social reforms.

The aim of this paper is to offer a critical assessment and analysis of the period of transition and integration of the countries in Central and Eastern Europe in light of the future accession of the South East European countries. The paper is not meant to be a list of tasks and steps to be pursued by the countries in South East Europe, but it is rather a reflection of the long and demanding process, trying to highlight the external constraints and also the missed opportunities at home in the endeavour to become a fully integrated part of the EU. As such it should serve as a starting point toward a more open, more innovative and more development oriented future for the countries throughout the region. At the same time, the paper tries to question certain overly dogmatic and orthodox approaches toward the reforms in the past. Sometimes the latecomers enjoy a unique opportunity to learn from and study the costly mistakes of others in their effort to use the transition and integration as a vehicle for the genuine transformative capabilities of their societies and their peoples.

Two decades after the fall of the Berlin wall the process of transition and integration of the Central European countries remains one of the most comprehensive and complex processes in modern history. The entry to the EU subsequently pushed aside the comprehensive socio-economic and legal assessment of the process of transition. Especially due to the rapid economic growth after the 2004 enlargement the impression was that most if not all of the Central European countries as new members of the EU are on the path of rapid economic and social convergence with the EU-15.

The recent financial crisis, which started with the collapse of the US housing market and which subsequently expanded to the financial and economic crisis almost all over the world, yet again exposed the underlying weaknesses of the Central and European countries, despite some of them being already fully fledged members of the euro zone. The crisis showed how vulnerable to the international volatilities the countries remain even after their membership in the EU and how dependent are their economies to the economic cycles of the European and global markets. Financial distress in the leading global economies greatly influenced the economic and social activities of the Central and East European countries. The countries that suffered most are the countries which have no locally owned banking system and those countries which have a banking system larger than the countries themselves can afford to rescue (Norris 2009).

However, this is not only a debate on the need for redefining the role of banks and other financial institutions in supporting national economies. It is a broader debate on the productive and development capabilities of the countries in Central and Eastern Europe which have not been fully developed during the period of transition and integration. Even after two decades the countries which have approached comprehensive socioeconomic, political and legal changes are unable to compete with the leading countries in the world. Does that mean that the fate of the countries in Central and Eastern Europe will remain dependant on prosperity and good will of their western neighbours? If so, what are the possible pathways toward real economic, social and political emancipation of these countries, and how to escape the rigid and narrow forms of division of labour which keeps most of the industries on the lower rungs of the ladder of industrialization characterized by low-wage and low-skill production? The findings and lessons should allow the future generation of genuine reformers in these countries a pathway toward a much more diverse, pro-active, 'knowledge based' economy and society compared to the societies which currently oscillate between high hopes and expectations at the beginning of radical reforms and apathy and despair after two decades of such reforms.

Instead of a sterile debate about whether radical reforms work better than the gradual reforms, and whether the 'shock therapy' works better than the piecemeal reforms, the genuine reform debate should focus on broader goals and more policy instruments, as succinctly put by Joseph Stiglitz when he summarized the critique of the Washington consensus policy and urged the transition countries to move beyond the orthodox repertoire of the Washington consensus (Stiglitz 1998). This does not mean that macroeconomic stability, for example, is not important. It means, however, that the original program was too narrow, the order of reform steps was often inherently contradictory and that it relied on oversimplified assumptions, such as that mass privatization would automatically lead to rapid development. As it turned it, it did not. One of the biggest surprises of the first generation of reformers under the auspices of international financial organization and mainstream western academia was that even after a decade of mass privatization the privatized firms did not secure more growth and development. It helped create, however, a class of new quasi-owners who were and still are more interested in securing their rents, in concentrating ownership and economic powers, than in investments and development of the firms. As such, they largely represent an obstacle rather than a solution to the newly privatized firms.

Looking from today's perspective, CEU countries could and should have adopted a much more comprehensive and development oriented framework at the beginning of transition. Of course, a more development friendly framework from the side of the EU and other trading partners would have been beneficial. Not in the sense of the Marshall plan for Central, Eastern and South Europe, but in the sense of a more open policy space which would allow for different sequencing of reforms, introduction of broader goals and which would provide more instruments than allowed under the increasingly restrictive normative framework of the European *acquis*. Of course, to start from the beginning, the first generations of reformers in Central and Eastern Europe should blame themselves for their lack of knowledge and the lack of understanding concerning what are their economic opportunities and niches before acceding to the EU. As we have learned from the East German integration, even massive allocation of funds - in certain years comparable to the size of the entire EU budget - cannot secure shared growth and inclusive development. What went wrong during the transition?

In short, naïve beliefs that rapid liberalization, unconditional withdrawal of the government from running enterprises and mass privatization would bring about rapid economic growth and overall social development proved to be over optimistic. This is not to claim that the state bureaucrats – especially not the former socialist apparatchiks – can run enterprises and businesses more efficiently than the institutions of market economy, but it is to claim that the modern market economy assumes much more subtle mechanisms, more supportive institutions to the market economy than envisaged by the first generation of reformers. In such an environment, with multiple uncertainties and in the midst of the economic and social crisis, proper incentives to stimulate long-term investments, technological progress and good governance of both private and public sector can be more important than a simple search for those whom property rights of former state-owned enterprises are to be designated. For this, transparency of the public sector, fine tuning of legislation and its subsequent implementation and above all proper incentives for overall growth and development trump the simple search for macroeconomic stability and redesign of property rights. The latter model, created by mass privatization, can and in fact it did lead to a false mimicking of the market economy in which the wrong incentives for redistribution of economic power and wealth prevailed over the incentives for growth and long term investments. The struggle for concentration of ownership and redistribution of wealth resembled more a quasi-Darwinian struggle than a genuine attempt at restructuring enterprises and improving competitiveness of the transition economies. An interesting study by the European Bank for Reconstruction and Development about the people's attitudes to transition showed that "in many places there is a pervasive sense of dissatisfaction with some of the consequences of transition" (EBRD 2007: 48).

Leaving aside the turmoil with the macroeconomic stabilization problem in the early 1990s, and leaving aside the debate over whether the overall economic decline at that period was really necessary, the centrepiece of the transition was the idea of mass privatization. It was a unique historic situation and one of the truly innovative approaches toward reforms. Namely, the idea to freely distribute vouchers to the citizens and encourage them to participate in the privatization schemes was one of the most original idea of the transition. As it turned out, however, the whole exercise was implemented without a proper regulatory financial framework and as a result it facilitated massive frauds across the board. Insiders of the firms, usually politically closely connected, dominated the privatization process. As one OECD study on privatization has shown, 'innovative' managers in the Czech Republic created 15 different methods of tunneling out the assets of the formerly state-owned enterprises (Coffee 1999).

An interesting partial exception to the pattern was Poland. After the rapid decline in the first two years of privatization it started to grow again, and it was the first of all the transition countries which returned to its initial level of GDP. This was achieved in the absence of mass privatization which was delayed in Poland for many years due to the political conflicts over the method of privatization. As a result, Poland grew faster than any other countries in transition for several years, despite its large public sector and a large number of state-owned enterprises (Kolodko and Nuti: 1997).

This was just one of the surprises during the period of transition. It only confirms what is already well known in the Western-style of property rights and ownership regime in general. Namely, that there are many different forms of property rights and ownership regimes in the modern economies of the advanced societies. The consolidated and absolute property right which excludes everyone else is only one possible regime of property rights in the West, and it stems from the nineteenth century legal doctrines and practice. It is neither a precondition nor the only and absolutely necessary legal institution for the modern market economy. We can only remind ourselves about the ongoing global financial crisis in which the governments of the leading economies are forced to extend implicit and explicit guarantees to their financial sector under the 'too big to fail' banner. These guarantees, loans and massive subsidies to the financial sector create a new chapter in the debate over the relation between public and private sector, between the market economy, residual property rights and government involvement.

Another surprise of the transition process was an empirical analysis of the post-privatization behaviour of the enterprises. When comparing enterprises which were privatized and enterprises which remained in the hands of the state – as well as the firms with insider owners and outside owners (individual shareholders, newly created institutional funds and others) – it turned out that there is no significant distinction in terms of their efficiency, quality of governance and long-term development strategy. The partial exception of Poland - despite its delay and slow process of privatization – shows us that other relevant factors, such as a more competitive economic environment, emergence of new small and medium size enterprises, good governance of state-owned enterprises, transparent and well regulated capital markets, as a solution to the issue of external financing of enterprises may play an equal or more important role than the mechanical belief that mass privatization will solve the problems of governance, incentives, technological advancement, active restructuring, innovations and overall development (Estrin 1998: 92; for a recent debate see also Estrin, Hanousek, Kocenda and Svejnar 2009).

This is not to say that privatization and macroeconomic stabilization are not important elements of the comprehensive economic, social and institutional reforms in Central and Eastern Europe. Instead, the claim is that privatization and macroeconomic stabilization are far from sufficient to achieve more vibrant, more inclusive and more successful economies and societies than we witness at present. The impression remains that the countries in Central Europe even after two decades remain on the of a path dependency trajectory with only vague and distant hopes to ever fully emancipate themselves in the presence of the EU membership. The fate of the Latin American countries which unsuccessfully followed the path dependency trajectory seems to be closer than the real emancipation and progress of the most successful countries which rescued themselves from the economic and social periphery, such as the East Asian tigers in the past, or Ireland and Finland as examples of successful integration into the EU.

For such a successful emancipation of the countries and their economies, broader goals, more policy instruments as well as a more sophisticated approach by the next generation of reformers is necessary. The future approach should be a combination of more imaginative and more accountable reformers and more initiative and better organized civil society. The top down approach of reforms as practiced in the last two decades led mainly to a loss of initiative, weak entrepreneurship, loss of public support of reforms as well as to weak accountability and poor transparency of implementation of reforms. It comes as no surprise therefore, that such a pattern of reforms worked well for the economic and political elites, much less so for the broad parts of the population throughout the region. The reform process throughout the transition and integration led to the disillusionment of the public. Instead of undertaking economic and social reconstruction, the countries in Central and Eastern Europe – with a small degree of differences among them – entered a path dependency trajectory which widened and solidified the gap between economic and political elites on the one hand and the excluded majority of people on the other (Csaba 2007: 263 – 277).

Southeast European countries enjoy a certain advantage and privilege to be able to learn from the experience of the countries in Central and Eastern Europe when they themselves proceed with the reforms in an effort to join the EU. Some of the key lessons are presented below more in detail. When analyzing lessons from CEU countries two important caveats should be taken into account: - any imitation should also be an innovation in order to creatively and successfully introduce certain reforms to the specific economic and social context of each country; - the rapid process of globalization and

Europeanization constantly changes the rules of the game, raises the competitive pressure on emerging economies and societies and poses new challenges to the reformers in South East Europe.

Finally, the lessons of transition and integration should be taken seriously not only by the newly emerging countries themselves, but also by the EU countries and EU institutions. More policy space for restructuring and development should be given to the countries in the region. The rules, requirements and standards created for some of the most advanced and most competitive countries in the world cannot be directly and immediately applicable for the countries in South East Europe. The rules and regulatory constraints, such as the state aid rules – it should be noted, however, that these rules are abundantly violated by the leading countries themselves when they are coping with the present financial and economic crisis by providing huge stimulus to their various sectors of industry and particular important firms –the rules on competition, the intellectual property rules and many others should be reasonably accommodated to serve the needs of the nascent industries for the countries in the region. The diffusion of new technologies via multinational companies to be shared by the companies in the region should be supported and aided by the European institutions. On the other hand, requirements for transparency of policy-making and policy-implementing, requirements of labour standards, environment standards, protection of small shareholders, small investors and entrepreneurs, and small property holders should be strictly required by both the European and domestic institutions. More imaginative reforms at home and improvement – if not reversal – of some of the European policies toward the region should significantly improve the possibilities of the countries in the region and their people to embark on a much more proactive path of development.

2. SOURCES OF INSPIRATION

What then are the sources of such alternative, potentially much more promising path of development for the countries in the region? There are European regions and countries that belong to the most developed and most advanced parts of the world. Regions in northern Italy, Catalonia, southwest Germany or some of the advanced small countries in Europe, such as Denmark, are examples of the most successful economies within the industrial democracies. They serve as an example and a source of inspiration for many other countries and regions not only in Europe, but also across the globe. They represent a successful example of a regime, called cooperative competition. Small and medium-sized companies or decentralized divisions of large firms, compete and cooperate at the same time, pooling financial, commercial and technological resources (Unger and Cui 1994: 80). In addition they have confirmed in practice that there is no necessary trade-off between competitiveness and social cohesion. On the contrary, they have clearly showed that only the countries and regions with well organized social and inclusive polices, with creative supportive institutions can really and successfully compete in the present day of open economies and societies. Public institutions play a vital role, lending the hand of active and productive partnership to the private sector while creating many intermediary institutions to secure the flow of knowledge, skills, information, finance and initiatives in both ways.

The problem at the national and supranational level is how to expand and broaden such successful examples. For the time being successful regions and countries are exceptions to the pervasive pattern across Europe. The EU did not develop a comprehensive new set of policies and did not create an institutional framework which would support a comprehensive transformation from the fordist-type of mass production into a flexible type of production. This would require many of the alternative policies in the area of monetary and fiscal policy, in the area of competition policy, labour and industrial relations, in the area of higher education and research and in the domain of social policies. It has resorted to the policies of the common market accompanied by competition rules, but it has not developed instruments which would support the establishment of new business and new enterprises the way as practiced by some other leading countries around the world.

It remains beyond the scope of our discussion to what extent the protracting constitutional debate in Europe is or is not conducive to alternative socioeconomic futures in Europe. The main theme of the present discussion is whether the countries in the region can embark on a different path of development, based primarily on endogenous growth and development instead of being almost completely dependent on vicissitudes of the main European and global markets. Accepting such a dependence would mean accepting the stark international division of labour and primarily specializing in the areas of comparative advantages, which almost all lie in the sectors of low-skilled low-wage industries. Instead of climbing a ladder of industrial advancement, the countries would get stuck at lower rungs, whereby competing with other low- wage and low-skilled economies from around the globe.

In this context it is worth to take a short look at how some of the small advanced European countries are copying with the current financial crisis. Finland, which is one of the most export-oriented EU countries, especially in high-tech industries, was expected to suffer most. Indeed, Finland did suffer a lot in terms of output decline and rise of unemployment, but its economy also showed a lot of resilience. Learning from by far worst decline in the early 1990s, both the country's macroeconomic policies and industries were better prepared for such an international financial crisis as we currently witness. Fiscal surpluses at the beginning of the crisis allowed the government a much more proactive approach than in many other EU countries which did not enjoy such a domestic advantage. Despite the decline in production and export and despite the fact that export-oriented enterprises suffered from the euro's strength, Finland still manages to retain unemployment rates below the EU average, whereas its economy shows unexpected resilience in this difficult economic period. It has also retained one of the most competitive positions in the world. This means that a country with many strong institutions, such as one of the most competitive education systems in the world, one of the most developed and hi-tech industries in the world, can defy and partly restructure even in the midst of the global financial crisis. Other important institutional elements, such as transparent government and public administration, the ability of collective learning from the past failures and the ability to orchestrate economy and society along the knowledge based premises can present an important source of inspiration and encouragement also for the countries in South East Europe (Atkins 2009).

The next important debate relates to the issues of social welfare. The countries in South East Europe shaped before transition a strong tradition of developed social policies. During the transition it was often mentioned that such a 'generous' welfare is not sustainable anymore if these countries want to become competitive and if they want to enter on a path of rapid economic development and if they want to integrate with the international community. Premature welfare states have, according to the prevailing doctrine of leading international financial institutions and mainstream academics, a negative impact on the development prospects of the poor countries in the region – and they are unaffordable. It was often repeated to them that the processes of globalization and europeanization do not allow for a comprehensive and generous social welfare framework, if these countries truly want to become internationally competitive. In other words, there is a necessary trade-off between social welfare and international competitiveness.

However, more in-depth studies show that the relation between the welfare and economic development is much more complex and subtle than is usually presented (De Grauwe and Polan 2005: 105 – 123). First of all, some of the most competitive countries in the world, most notably from Scandinavia, also have the highest levels of social spending. This fact goes against the conventional wisdom that globalization necessarily leads to the reduction of social spending and that the countries with high levels of social spending cannot remain globally competitive. In addition to this argument, there is another, probably even more important finding, namely the argument of causality. To the argument of successful combination of competitiveness and developed social welfare it is often added that only the most advanced and the most competitive countries in the world can finally afford to start developing an advanced system of social welfare. This is another argument which does not have empirical support. The empirical findings on the relation and causality show that the countries which are able to organize a well-functioning social system, in the sense of building and improving skills of the people, supporting and enhancing human capital, organizing and maintaining the life-learning educational system, are the countries that can successfully compete internationally. Domestic cohesion, the ability to include broad parts of the population into productive capabilities of the countries are the essential ingredients of successful national development policies (De Grauwe and Polan 2005, see also Hemerijck 2009: 71 - 98).

The above described type of social policy is not a classical type of social welfare as developed in the tradition of Bismarck or Beveridge. This type of social welfare was built in the circumstances of the fordist type of mass production and under the premises of tax-and-transfer fiscal policies. Such a traditional economic and social model does not exist anymore. The post-fordist type of production and on the 'knowledge based' economy require a significantly different type of social policies, anchored primarily in the support of education throughout the life of individuals. As the economic paradigm changes, the social policies require changes, improvements and innovations, too. Here are some of the examples: subsidies to the low-wage low-skilled workers, educational support and vocational training for the workers on the job or between jobs, and profit-sharing for the workers who are employed in the most successful parts of the economy. This approach to the modern welfare, no matter how relatively distant from what we experience today in the leading economies in the world, is still a relatively modest approach toward the truly modern social welfare. The government can and should interfere in the economy, not in old interventionist style of choosing and picking the winners, but in a more advanced style of expanding and promoting the high-tech industries outside and beyond the advanced parts of the economy. The government should be actively engaged in expanding and promoting business opportunities and allowing access to the venture capital for new businesses and new entrepreneurs. In order to avoid the risk of clientelism and favouritism by the government, transparent mechanisms with clear accountability should be put in place. Vibrant and organized civil society goes hand in hand with such a development oriented and active government dynamics.

The question of financing such alternative pro-active and productive enhancing social activities is another part of this equation. It is necessary to secure substantial tax revenues to ensure public investments in developing human capital. While pursuing this task, the tax revenues should not distort economic activities and should not be overly regressive. From comparative studies of taxation we can learn that there can be a comprehensive flat-rate value added tax. Such a tax can be combined with a Kaldor-style consumption tax, taxing a difference between income and savings-investments, with a large exemption for a basic level of consumption and a steeply progressive scale. It is equally important to have an organized civil society engaged in the allocation and monitoring of public spending. Transparency of public finance is the strongest antidote against mismanagement and outright corruption. Conversely, low domestic saving rates would lead to dependency on foreign money (Unger 2001).

Raising public revenues and improving the quality of public sector management through close scrutiny of the civil society is an important, but only first step toward the much more organized, more effective and more overall development oriented society. The next step is to strengthen and tighten the links between improved savings, public and private, and the ability to channel these savings into long-term productive investments. Only improved links between savings and investments can improve productive capabilities either through traditional channels, such as banks or capital markets. In addition, the traditional links can be further supplemented with new routes of finance by establishing public venture funds, run by independent teams of experts or by decentralized, competitive provident funds. The goals of such an improved relation between financial institutions and investments are multiple. One of them is to broaden and expand access to capital by entrepreneurs, by firms and to support innovation and the establishment of new businesses. Others are to spur market initiatives and developments from the bottom (Unger 1998: 150 – 162).

When rearranging the market economy as an active and strategic partnership between public and private sector with the decentralized public financial and technological intermediaries, the twin evil between public favouritism and bureaucratic dogmatism must be avoided. The best guarantee to avoid such a twin evil, often seen in the developing countries which are trying to rescue themselves from the vicious circle of underdevelopment and poverty, is the active participation of independent group of experts, teams of workers and other parts of civil society. The top down approach run by the government bureaucrats - sometimes seen in the development efforts in other parts of the world - can quickly lead to government failures and misuses of available resources. Instead, the strategic partnership must be established through independent, decentralized and competitive partnerships, which are democratically accountable to the local population as well as to democratically elected representatives. In so doing, we can expand access to capital, expertise and best practices. By enhancing access to capital, expertise and by encouraging innovation and entrepreneurship we can have both at the same time: more public accountability and more private initiative. This represents a significant redirection from the neoliberal model which tends to widen the gap between the advanced and backward sectors of the economy, between the class of owners with privileged access to capital and support and the excluded large parts of population as well as between the economic and political elites on one hand and the excluded majority on the other hand.

The hierarchical distribution of production according to which rich and developed countries produce high-tech products, whereas the poorer and less developed countries have to specialize in low-skill low-wage export-oriented products for a long time before being ready to climb the ladder of industrial development, can and should be avoided. The countries can reorganize both the public sector and the market economy to make it more plural, more inclusive and more experimental, opened to institutional and practical innovation. As described at the beginning of this section, some of the most advanced regions and countries in the EU can serve as a source of inspiration and encouragement for the countries in the region when they are working through their protracted and delayed pathway toward full and active membership in the EU.

This does not mean, however, that the region cannot still embark on a path of economic and social reconstruction, rather that such a pathway is necessarily much more demanding and more difficult to achieve. One of the rare advantages the region possesses lies in the experience, lessons, difficulties and mistakes made by other Central and Eastern European countries in transition. These countries, while enjoying the strong support of European institutions, are even after EU accession hardly an indisputable example of successful transition and integration within the EU – one has only to point to the transition period for the free movement of labour. It will take the Central European countries that did manage to join the EU in May of 2004 at least a decade or more to reach the EU-25 average level of economic development. Such a relatively slow path of development was not anticipated by most, if not all, experts and analysts at the beginning of transition in the early 1990s.

Other advantages that the Western Balkan countries have are a relatively high level of education of the people, a tradition of industrial development in many sectors of the economy, such as energy, and a fairly developed public sector in terms of social policies and infrastructure. All the stated advantages as legacies from the past, however, require massive new investment in order to modernize and overcome a decade of destruction and years of stagnation. In short, a comprehensive program of economic and social reconstruction for the region clearly requires the strong presence and support of the international community, the EU in particular, but it also requires strong democratic and accountable governments in the region.

Unlike many other observers, I do not believe that the mere process of accession to the EU will automatically trigger rapid economic development. Even more comprehensive economic and social support to the region – which is desired and welcome, to be sure – cannot replace the domestic development of political, economic, legal and social institutions. A domestic environment conducive to endogenous development is vital; foreign and international support cannot replace the supportive institutions necessary to secure real economic and social development of the countries in the region. Only when this is understood by international decision makers can a more coherent plan to fully integrate the countries of the region become more tangible. Of course, the realistic perspective of joining the EU will remain the driving force behind many of the reforms and efforts of the domestic governments. The presence of the international community in the region will secure at least the beginning of the process of long-term reconciliation. But the key to long-term sustainable development is to start building high-quality public and private institutions, to start strengthening the civil society and to start creating a transparent environment for partnership between the public and private sectors.

3. LESSONS FROM THE TRANSITION

As mentioned in the introduction, the countries in transition had high initial expectations and little experience in managing large-scale institutional reform. In fact, there was no ready-made blueprint for such a unique historical, economic and social transformation. It is also true that most of the countries in the region being considered here approached a similar reform to that of the Central European countries in the last years. The impression remains, however, that the lessons of the transition of the Central European countries are not taken sufficiently seriously by the regional governments themselves, nor by international organizations. As is usually the case, a lack of time and various forms of domestic and external factors remain key aspects in not paying enough attention to the main lessons of transition.

What, then, are these lessons? One key lesson was that for most of the time the goals and instruments of reform were confused. In the early stages of transition, there was a belief in the automatic positive outcome of certain reforms, for example that rapid and mass privatization would necessarily and automatically lead to higher levels of productivity and efficiency of newly privatized firms. As we know today, privatization brought many unpleasant surprises for many years. Many of the privatized firms did not perform significantly better than those firms that were yet to be privatized. Furthermore, in the absence of a coherent regulatory framework, mass privatization resembled more a struggle for redistribution of economic and political power than a long-term strategic goal of enhancing the productivity and efficiency of businesses and economies. This is not to say that privatization was a step in the wrong direction, but instead to underline that for successful privatization a broader institutional framework must be secured. Of the required institutions one need only point to an efficient judiciary to protect new shareholders from various forms of asset stripping by various levels of old and new managers. In addition, various classes of creditors and investors, suppliers and consumers must be sufficiently protected to engage in a long-term productive relationship with such newly privatized firms. Complex rules of securing fair competition in the emerging market economy, allowing fair competition between old, predominantly state-owned enterprises and new, privately established concerns must be in place prior to any large-scale attempt at privatization.

It took almost a decade of reform to come sufficiently to grips with the intricacies of successful management of reform. This recognition came with the insight of Joseph Stiglitz, who became Vice-President of the World Bank in the mid-nineties. In his well-known paper "More Instruments and Broader Goals: Moving Toward the Post-Washington Consensus" he criticized the policy of the Washington consensus that would require more instruments, a more precise sequence of steps toward reform, careful calibration of partial reforms and a clear perspective of strategic goals (Stiglitz 1998).

More concretely, he assessed a few years ago that Serbia had certain potential advantages as a laggard in transition (Stiglitz 2001). This, of course, could materialize only if a new generation of reformers were fully cognizant of the difficulties of reform in other countries, such as the Czech Republic, Hungary or Russia. In his analysis he pointed to three main lessons of transition, namely: "insisting on speed, on rapid privatization, is disastrous – countries that lagged behind at first, like Hungary, Poland and Slovenia, are now the leaders; incentives matter – if the wrong incentives are in place, Russian and Czech-style asset stripping will follow; privatization works only if it is part of a broader transition strategy that emphasizes job creation and creates the legal and other institutions needed to underpin a market economy (id.)." In short, he pointed to the empirical fact that there are no easy, simple reform steps in the process of transition to improve the economic and social environment. Some of the goals are inherently conflicting and involve large-scale trade-offs, while others ought to lead to win-win situations. Only careful and transparent management of reform and building broad partnerships and coalitions can lead to positive outcomes in transition countries.

One of the insufficiently discussed issues in transition is the problem of financing future growth and development. In the situation where economies and firms suffer multiple external and internal shocks, one of the unresolved questions remains what model should be used to secure the long-term financing of the restructuring of firms. Closely related to this is also the question of what criteria should be used to determine which companies are potentially viable and which companies should be allowed to go bankrupt. In the absence of established market criteria and market mechanisms of coordination, this poses a difficult dilemma to the first generation of reformers in any of the transition countries. What is the right financial model of financing economic and social development in the transition countries? In the past, some reformers have relied mainly on emerging financial markets; others have been hoping for foreign direct investment. Certain prominent authors, such as Jane Corbett and Colin Mayer, warned East European reformers in the early stages of reform not to simply identify capitalism with capital markets. In their belief, it would be more important to define the role of banks in the transition; however, liquidity issues, credit constraints and the role of banks were set aside in favour of mass privatization, the creation of capital markets and the struggle against inflation (Corbett and Mayer 1991). From comparative experience it is possible to conclude that countries in the early stages of development rely primarily on banks; then, after the economy matures, capital markets become more important (id.). For an enhanced role, banks need sufficient mechanisms to monitor companies and sufficient information to participate effectively in project selection. This is true for the short-term as well as long-term financing of firms. The division of risk between firms and banks can be effective only as long as the banks, and their skilful personnel, have access to firms' investment projects and other important information. Conversely, insufficient monitoring and poor information can cause widespread bank failures, especially if banking regulation and supervision requirements are not met (id.).

All of the countries in the Southeast European region have approached many if not all of these reforms in recent years. This is why it would not be correct to treat them as complete reform laggards, especially considering that most reforms are irreversible and irrevocable. However, this does not mean that greater insight into the complex matter of reform and institution-building cannot serve as useful information about obstacles, risks and opportunities. The role of government, its accountability and transparency, does matter. In order to reach advanced levels of market economy, competitiveness and entrepreneurship, public institutions and prudent regulation are of key importance. The space for launching restructuring and developmental policies must be broad enough to secure the rapid economic and social recovery of the countries in the region. There is no doubt that the maneuvering room for successful reform is very narrow due to macroeconomic constraints; nevertheless, even in very limited circumstances committed, creative and well informed reformers, in close cooperation with business circles, trade unions and civil society, can find niches for rapid growth and development. Unfortunately, if such niches cannot be found, the region may then resemble more the destitute countries of Latin America that have followed a path of dependency for decades with slim hopes of ever escaping the vicious circle of low growth rates and high rates of poverty.

4. EUROPEANIZATION AND GLOBALIZATION

The already very demanding process of transition does not occur outside the actual processes of Europeanization and globalization. In fact, the pressure of the twin processes, Europeanization and globalization, is such that even the leading EU countries must deal with them on a daily basis. For the reformers in the region under consideration, this only means that the space for endogenous development is even smaller and the hopes for overall development are even slimmer.

On the most general level, the process of globalization forces nations, governments and businesses into an ever-more convergent set of policy choices and institution building. On the more concrete level, the process of Europeanization presents a distinctive set of policies aimed at higher levels of regional integration. This process is often described as negative integration, according to which national governments are required to further liberalize and open up their markets. This negative integration inevitably leads to a further loss of domestic autonomy and control in areas such as industrial policy, legislation and coordination. In part, the goal of such negative integration is to re-regulate on the supranational level in order to maintain some of the distinctive elements of the European pathway toward modern capitalism and in order to retain some control over the process of globalization (Schmidt, 2002: 13 – 58).

Globalization and Europeanization, as mentioned above, do strongly pressure European economies to adjust. This pressure can be seen as twofold: on one level there is pressure on the traditional labour-intensive sectors of the economy, where EU countries cannot compete any longer because competitors from developing countries can produce with a much cheaper workforce. On another level, the drive toward cutting edge industries in the area of the "new economy" requires massive investment in research, development and education.

Yet, for all the pressures and dynamic processes, European governments overall have not shifted their development trajectories from their past successful directions. Despite the pressures and increasing loss of autonomy and control, this does not mean that the European governments are completely ill-equipped for future development of new technologies, innovation and an overall increase in competitiveness. It only means that the instruments of economic policy have become more sophisticated, in line with international and European rules and general trends of development. This requires that the next generations of reformers be familiar not only with the experiences of the former transition countries, but also with the efforts and good practices of those in advanced economies who are competing under various forms of global pressure. To be more specific, reformers should also pay close attention to the Lisbon Agenda, their instruments and goals, as well as to the open method of coordination, one of the most advanced, practical and sophisticated methods of cooperation and competition among European countries. It should be recognized by European leaders that the earliest possible inclusion of the Western Balkans in the Lisbon Agenda can bring positive results to the region, as well as to the process of EU enlargement. In so doing, however, European leaders and European institutions should not require from the region that which they themselves are not prepared to do at home – for example, radical and immediate liberalization without transition periods and the possibility to adjust. Despite various forms of pressure, despite rapid processes of Europeanization and globalization, accompanied by increasing loss of autonomy and control, "no single European model has supplanted distinct national practice (Schmidt 2005: 383)."

Finally, policy makers in the region should not aim toward the race to the bottom of the social policies in order to attract foreign direct investment. As the most advanced European countries show, it is possible to manage high levels of competitiveness, innovation and added value on the one hand and a high level of social security on the other. This does not mean that it is not possible to adjust, modernize and improve welfare policies and to focus more on a productivist rather than a redistributive paradigm. The examples of the leading countries, in Scandinavia and elsewhere, suggest that only through maintaining and managing all economic and social aspects is it possible to secure real growth and development in the society. It would make little sense to push the region down the path of dismantling welfare policies before joining the EU and then criticize the region for attracting low-wage and low-skill foreign direct investment from EU countries. The alternative path toward economic and social reconstruction would be much more in line with current and anticipated trends in the EU and would dissipate scepticism before the regions join the EU.

The policy recommendations on how to best approach the region and secure its development apply both to the regional governments and to the EU authorities. More often than not, they are interlinked and interdependent. This means that sensitivity on both sides and a constant search for the best policy options must be carefully weighed against each other. The lessons from the previous round of enlargement are useful not only to the governments in the region, but also to the EU authorities, unless we believe that the previous rounds of enlargement were entirely ideally carried out, which would probably be somewhat presumptuous and misleading. Regional development and the level of social policy and welfare protection are only some of the unresolved issues of the last round of enlargement, reminding us that even European authorities do not have ready-made and definitive answers to many of the important developmental issues and dilemmas.

5. CONCLUSION

The policy recommendations on how to best approach the region and secure its development apply both to the regional governments and to the EU authorities. More often than not, they are interlinked and interdependent. This means that sensitivity on both sides and a constant search for the best policy options must be carefully weighed against each other. The lessons from the previous round of enlargement are useful not only to the governments in the region, but also to the EU authorities, unless we believe that the previous rounds of enlargement were entirely ideally carried out, which would probably be somewhat presumptuous and misleading. Regional development and the level of social policy and welfare protection are only some of the unresolved issues of the last round of enlargement, reminding us that even European authorities do not have ready-made and definitive answers to many of the important developmental issues and dilemmas. Despite the obvious requirements for adjustment according to the *acquis* and other international legal rules, a broad space for autonomous development must be retained in the hands of national and regional governments.

Only if this sort of ambitious, comprehensive and realistic approach to the region is taken, recognizing the initial conditions and comparative advantages of the region, a tragic decade of war and destruction, obstacles and opportunities, will the region perhaps for the first time in its history have a chance to catch up and integrate with the advanced countries of the EU. Alternatively, if advantage is not going to be taken of this opportunity, for a number of internal and external reasons, the region will almost certainly remain on a path of dependency without hope of ever escaping the vicious circles of nationalism, ethnic tension, disaster and despair. It is primarily up to the next generation of reformers, better organized and development oriented civil society to mobilize the existing resources and productive capabilities of the countries in the region. The best thing the EU authorities can provide is to secure an open policy space aiming for a more inclusive, more diverse and more institutionally innovative trajectory in the future.

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