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In search of responsive government: State building and economic growth in the Balkans

Item Type	Working paper
Authors	Krasztev, Iván;Krizsán, Andrea
Publisher	Center for Policy Studies, Central European University
Download date	2024-10-12 00:04:08
Link to Item	http://hdl.handle.net/20.500.14018/7955

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A G E N D A F O R C I V I L S O C I E T Y
I N S O U T H E A S T E U R O P E

In Search of Responsive Government

*State Building and Economic Growth
in the Balkans*

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ISBN 963 85230 9 3
ISSN: 1785-4377

Printed in Hungary in 2003
Central European University
Copyediting • Alison Rose

Design and layout • Judit Kovács • Createch Ltd.
Printed by Createch Ltd.

About the Project

At the beginning of the twenty-first century, the real challenge of reconstructing Southeast Europe is reinventing Southeast Europe.

The “Agenda for Civil Society in Southeast Europe” was a three-year research project coordinated by the Center for Policy Studies at the Central European University, Budapest and involving the New Europe College in Bucharest, the Centre for Liberal Strategies in Sofia, the Wissenschaftskolleg in Berlin, and others. The project started with the assumption that the region’s invention requires the construction of a common regional vision and the emergence of a regional public debate. The project—surrealistically nicknamed Blue Bird—was an attempt to formulate such a vision and to assist the emergence of a civic regional debate. Until now, the region has been perceived in the terms of risks; the idea of the project was to reformulate the debate on the future in terms of opportunities.

The project’s primary ambition was to reflect on the reconstruction of Southeast Europe, both as an intellectual challenge and a policy challenge. The current debate has never addressed the production of knowledge and innovative ideas about the region as a distinctive problem. The international community fails to recognize the lack of local knowledge as a specific and powerful obstacle for the region’s development. This is one of the reasons why the academic community and the intellectual community in general remained marginal in the initial stages of debate about what to do in the Balkans. The urgency of the problems and the extremely limited time for debate on what should be done resulted in the recycling of the old ideas and approaches.

The present project started with the assumption that the reconstruction of the Balkans is an intellectual problem. In the last decade, Western and Southeast Europe have developed in completely different directions and have worked with completely different maps of the future. In the Western part of the continent, the integration process has reached a critical stage with the launching of the common European currency, the euro. This has led to fundamental reconsideration of such basic concepts as the nation-state, sovereignty, the national economy, national security, human rights, and so on. At the same time, the process of disintegration in the southeast part of the continent brought back some nineteenth-century ideas about the role of states and borders, the value of economic independence, and so on. There is an urgent need for a policy dialogue about the future of the Balkans that can help local and international players involved in the process to “see” the difference between their perceptions of the existing situation.

The existence of the European Union and the will of Southeast Europe to join it make the dialogue on the future more difficult, rather than easier. The temporal utopia of communism is replaced by the spatial utopia of the present EU. Consensus on joining the EU conceals the lack of debate on the future.

Understanding the intellectual challenge of development has persuaded us to avoid the accession type of questions in searching for new innovative ideas regarding Southeast Europe. The project’s ambition was to stimulate researchers to integrate their findings in the common product and not to focus on their own projects.

This policy document, “In Search of Responsive Government,” aims to serve as a vision paper for development of the region. The paper addresses both governments and publics and tries to offer coherent policy strategies. The paper is aimed to be a stimulus for opening the discussion to different sectors of society and for initiating regional policy debate.

“In Search of Responsive Government” is a collective product of the Blue Bird project edited by Ivan Krastev, the research coordinator of the project. Ivo Bicanic, Georgy Ganev, Venelin Ganev, Vladimir Gligorov, Ilian Mihov and Alina Mungiu-Pippidi made outstanding contributions to this paper.

The Blue Bird project was sponsored by a consortium of international donors, including:

- Central European University;
- The Volkswagen Foundation;
- The Bank of Sweden Tercentenary Foundation;
- The German Federal Ministry for Education and Research;
- Matra Project Program of the Dutch Ministry of Foreign Affairs;
- Stifterverband für die Deutsche Wissenschaft;
- Regional Bureau for Europe and the CIS of the United Nations Development Programme.

The Wissenschaftskolleg zu Berlin provided generous help in launching and running the project throughout its three years of activity.

In Search of Responsive Government

State Building and Economic Growth in the Balkans

Why is economic growth not generating support for market capitalism and why is state weakness reproduced in the Balkans? These two questions are at the center of our report, which challenges two assumptions at the heart of the present policy paradigm. It shows that economic growth is not sufficient to create a social base for a market society and that state building in the Balkans can not and should not be simply reduced to an EU-guided reform of public administrations. State building should be viewed primarily as a constituency building.

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1. GETTING INCENTIVES RIGHT, GETTING PERCEPTIONS RIGHT

The policy message coming from the latest academic literature on growth is that the paradigm should be changed from a focus on direct policy intervention to a focus on the economic environment. Instead of seeking growth-promoting policies, we view the task of lifting growth rates in the region as a question of establishing the right environment for growth. Policy intervention still has a place, but it is not an intervention to augment growth factors like capital and labor but rather to create the incentives for physical and human capital accumulation. How, in this context, should we understand the possibility of achieving sustainable economic growth in Southeast Europe?

1.1 The Current Situation in the Region

Improving the standard of living in Southeast Europe can be achieved by following growth-promoting reforms at three levels: national, intra-regional, and through integration with the EU. Regional cooperation is often viewed as a list of initiatives and policies that might help the economies in Southeast Europe lift their growth potential. To make some progress on the implementation of such policies, it is useful to group them in three categories:

- Trade integration. Tariff and nontariff barriers to trade must be removed and incentives created for trade cooperation.
- Infrastructure that facilitates trade and capital flows. There is a substantial role for international donors in reforming the physical infrastructure.
- Legal arrangements between countries that facilitate handling of private or public claims against parties in other countries.

With all this said, however, our research from the past three years illustrates that, while regional cooperation could be useful in promo-

ting growth, in most countries of the region, the key impediments to growth lie at the national level. In other words, before embarking on a concerted effort to increase the region’s growth rates, each country must work at improving the national conditions for growth, which is also a critical factor for the success of EU integration policies. In this report, our discussion focuses on the national institutional and policy reforms required to improve economic well-being in the region.

To understand why some policies work and others do not, we first examine regional growth in the past three years as well as the most recent data on GDP per capita.

Table 1
GDP Per Capita in 2001 and Growth of Real GDP Per Capita 2000–2002

	GDP per capita [in USD at PPP]	Growth 2000–2002 [% average annual]
Albania	4,040	6.77
Bosnia and Herzegovina	5,800	6.00
Bulgaria	6,840	4.73
Croatia	9,760	3.97
Greece	18,240	4.10
Macedonia	6,210	0.10
Romania	6,290	3.87
Serbia	6,380	5.17
Slovenia	17,690	3.57
Turkey	6,120	2.57
Area average	8,737	4.09
excluding Greece and Slovenia	6,430	4.15
EU average	24,900	2.03

Source: World Bank, World Development Indicators 2000–02 and other selected tables.

The question is not how to generate growth; it already exists in most countries (with the exception of Macedonia). The key question is whether the current growth rate is sustainable and, more importantly, whether the growth that does exist is sufficient to ensure political and social stability. The region's average growth rate for the past three years (4.15% p.a.) seems rather low. At this rate, after 50 years, the region will have reached only 75% of the EU average. Increasing the growth rate from 4.15 to 6%, which is feasible for most countries, will reduce the period by almost one half—to 27 years.

1.2 What Drives Growth?

Economic growth is a result of factor accumulation—human and physical capital—and of productivity improvements. The empirical and theoretical literature has identified many factors that promote growth—macroeconomic stability, legal environment, political and social stability, taxation, competition, trade, and so on. It is important, however, to keep in mind that most of these factors affect growth because they create the environment for higher investment (in physical or human capital). Even more fundamentally, these factors affect saving—the willingness of consumers to forgo current consumption for the sake of future consumption. In short, growth in poor countries is driven by investment, and investment is financed by saving. And, of course, saving might take the form of physical or human capital.

In an open economy that allows for capital flows in and out of the country, local investment can be financed by foreign savings. This is the case, for example, with the much desired foreign direct investment. Many policy discussions have focused on how to attract foreign investors, with many observers arguing that, in poor countries, it is difficult to muster large savings pools that will finance investment. Historically, this argument is largely incorrect. Most fast growing economies have been growing by domestic savings, not foreign. Today, one of the fastest

growing economies in the world is China, which, over the past decade, averages a growth rate of about 10% per annum. In China, net foreign direct investment constitutes only about 15% of total investment. Domestic saving finances the other 85%. China is poorer than any of the economies in Southeast Europe (except Albania). It is certainly worth pointing out that China is not an isolated case. The same is true for Singapore or for a transition economy like Hungary. The lesson is that an economy must possess high rates of domestic savings to grow fast.

If saving is so important, how can the region's governments increase saving rates? There are two groups of policy and institutional reforms: (1) policies that are explicitly designed to raise the saving rate; (2) policies and institutions that create the environment for high savings. As an example of the first, one can point to various tax reliefs for saving. Such policies are implemented in many developed economies. In the US, savings for retirement under certain conditions are exempted from taxation; in most European countries, income from various savings accounts is not taxable. The key point is that there are policies that can be directly targeted at improving the economy's savings rate. But, of course, these policies are not the panacea. After all, the saved funds must bring the necessary return to justify the sacrifice of consumption. Environmental factors play a bigger role in this respect.

The environmental factors are subtler and potentially more important because they create a transparent and coherent structure of incentives to save and invest. A list of such factors is:

- *Macroeconomic stability.* When inflation is rather stable and low, consumers are more willing to commit their funds to savings because they know that unexpected inflation will not erode their savings.
- *Political and social stability.* Rapid political and social changes create an environment of uncertainty and sharp policy shifts. When consumers do not like risk, they will be less willing to save under precarious political conditions.

- *Legal environment.* It is a tautology to state that the observance of property rights is fundamental for saving. The fear of expropriation leads to low rates of saving.
- *Financial stability.* The banking sector plays a key role in channeling savings into productive uses. If the banking system is unstable, consumers will shy away from putting their money in banks, and there will be fewer funds to be lent. Investment will decrease and with it, rates of economic growth.

Increasing savings is among the critical indicators for success of reforms because the level of savings is not only an indicator of the environment but also an expression of the general trust in the political and economic system

It is important to point out that increasing savings is among the critical indicators for success of reforms because the level of savings is not only an indicator of the environment but also an expression of the general trust in the political and economic system.

1.3 What Does and Does Not Work in the Region?

Reports on the region tend to overlook the achievements in Southeast Europe. It is worth pointing out that many prerequisites for rapid growth are already present in most countries in the region. First, there has been significant progress in achieving political and social stability. Second, many countries have achieved single-digit inflation rates. There are, however, three countries with inflation above 10%—Turkey, Romania, and Serbia and Montenegro. Progress in the other two environmental factors is much more varying. Most judicial systems still require significant reform not only to ensure that property rights are observed but also that the system functions smoothly, and cases are tried promptly. Similarly, reform of the financial sector is at different stages. While Bulgaria has fully privatized its banking sector and isolated it completely from government intervention, in other countries, such as Turkey, the banking sector still requires significant reform.

But despite the recent progress in stabilizing the economic and political environment, saving is still very low in the region. While other countries in transition, like the Czech Republic and Hungary, have managed to sustain a saving rate of over 25%, countries in Southeast Europe have negative rates or rates below 15%. And again the saving rate depends on many behavioral characteristics, but it is not necessarily linked to the wealth of the nation. China is poorer than any of the Southeast European economies but has a savings rate three times higher than the regional average. Clearly, a large part of the discrepancy between savings in the fast growing Asian economies and the Southeast European countries can be explained by so-called cultural factors, but there is certainly room for policy intervention. Saving does respond to incentives and when the economic environment is right, savings will also increase in Southeast Europe.

Table 2

Domestic Savings as Percent of GDP

Domestic savings in 2000 [% of GDP]

	Domestic savings in 2000 [% of GDP]
Albania	-2.90
Bosnia and Herzegovina	-10.30
Bulgaria	10.97
Croatia	16.37
Greece	13.86
Macedonia	-0.41
Romania	13.63
Serbia	-4.46
Slovenia	24.24
Turkey	16.78
<i>Central European economies</i>	
Czech Republic	25.98
Hungary	26.49
Poland	19.58
<i>Some fast growing economies</i>	
China	39.94
Korea	31.44
Singapore	49.76

Source: World Bank, World Development Indicators 2000.

The low rate of saving is even more troubling in the context of the regional saving patterns from the last half a century. Why, in the former communist countries, did we see a change from the high saving regime prior to 1989 to a regime of negligible saving rates? Certainly the fact that, to a large degree, saving was forced before 1989 explains the difference. But, from a policy point of view, a more important reason is the macroeconomic and financial instability that followed 1989. High inflation rates and banking crises melted the public's savings. In such an environment of instability and uncertainty, saving seems undesirable. The governments' failure to create an environment enhancing high private domestic saving is the strategic challenge for sustainable development in the region. If sustainable growth is to be thinkable, savings rates must increase.

1.4 The Low Rates of Savings and the Lack of Public Support for Reform

Many reasons for the low rates of saving may be pointed out, but one merits special attention from a fundamental (paradigmatic) policy point of view—the lack of public support for market capitalism. If there are no major social groups supporting government policies, even when they are the correct ones with respect to achieving sustainable growth and development, these policies are bound to be unsustainable in the long run and ultimately will fail. This is because lack of public support for policies is associated with a low level of optimism about the future and low levels of confidence among major social actors that the country is going in the right direction. This means that the major potential domestic savers' subjective evaluation of the expected returns to their investments (the reward for saving rather than consuming) is relatively low compared with the corresponding negative effect on their propensity to save. The final result is that people do not have an incentive to forgo current consumption and invest in their personal future, as well as the future of their society. In other words, it is not

It is not enough to get incentives right; it is necessary to get public perceptions right to sustain economic growth.

enough to get incentives right; it is necessary to get public perceptions right to sustain economic growth. The rise of public optimism and the rise of public trust in institutions are key indicators for the success of the long-term economic growth.

When the members of a society do not see a reason to invest in the future, they generally do not do it because saving is costly, and they do not see any benefit from suffering for this cost. A lack of investment in the future means that the overwhelming majority of economic actors choose not to increase the stock of productive physical capital (buildings and machinery); not to improve their and their children's knowledge, skills, and abilities to engage in value-adding efforts; not to overcome the obstacles of developing and adopting new technologies; and not to cooperate with society for the sake of the future. All existing and conceivable models of economic growth predict that when all this is the case, the economy's productive capacity does not grow, and, short- to medium-term fluctuations notwithstanding, the society has virtually no long-term development prospects.¹

1.5 Growth Does Not Necessarily Lead to Public Support

A paradigm that has been around since the beginning of transition, but has not been tested empirically, is that once economic growth resumes after a period of restructuring, a healthy social base for capitalism and a functioning market economy will inevitably follow. In other words, the assumption has been that consistently following the correct policies will naturally lead to the emergence of significant supportive constituencies. These constituencies will become social owners of the reform process and will position their plans, energies, and optimism

¹ William Easterly and Ross Levine, "It's not Factor Accumulation: Stylized Facts and Growth Models," *The World Bank Economic Review* 15:2 (2001).

within the reform agenda, increasing their belief in the future, with all the potential positive effects on economic dynamics that this brings.

Two recent examples of this often quite implicit and hidden paradigm can be outlined briefly here, both coming from the World Bank, a leader in the analysis of both transition and Southeast Europe. The first example comes from the regional strategy paper “Road to Stability and Prosperity in Southeast Europe.” The report argues that reforms and intraregional integration must be combined with a clearly defined path for European integration because it “will anchor expectations and provide both an incentive for reform and intra-regional cooperation” (p. 9). The assumption is that clarifying the ultimate goal (prosperity—in other words, getting rich through growth and European integration) will create its own support.

The second example is also from a World Bank report. In “Transition: The First Ten Years,” the assumption is much more deeply hidden, reflecting the World Bank’s increasing knowledge about the reform process. The paper quite correctly states that it is not only market discipline (the traditional Washington consensus package) but also the encouragement of new firms and entrepreneurs that is important for development (p. xvii). It goes on to state, even more accurately, that encouragement is provided through incentives. The subtle difference is that “putting incentives in place” reflects the policymaker’s point of view, while “supporting reforms” reflects people’s perceptions about these incentives. In the report’s analytical framework, the two are equally important. The assumption, again, is that having the right policies and the right incentives in place will naturally lead people to actively use them. As Easterly demonstrates convincingly, you may have incentives in place, but because of externalities like “leaks, matches and traps,” it may be completely rational for individuals not to take advantage of them.²

The experience in Southeast Europe so far does not provide evidence that the “growth buys support” assumption is realistic.

² William Easterly, *The Elusive Quest for Growth: Economists’ Adventures and Misadventures in the Tropics* (Cambridge, Mass: MIT Press, 2002), pp. 145–170.

The experience in Southeast Europe so far does not provide evidence that the “growth buys support” assumption is realistic. From 1998–2002, most Southeast European countries implemented a rich package of reforms. Weaknesses of implementation notwithstanding, these were the right reforms in terms of being reasonable for growth and creating incentives to engage in saving and productive activity. Southeast European countries have experienced healthy economic growth, especially in per capita terms, but any social base supporting markets and capitalism is difficult to find. In fact, surveys of public opinion in 2002 indicate a coincident to the period of economic growth and very low levels of public trust in democratically elected institutions.³ The surveys also note a trend of collapsing expectations regarding the future. This is illustrated in Table 1.

Table 3
Actual Per Capita Income Growth vs. Perceptions of Moving in the Right Direction

Country	Cumulative percentage change in income per capita 1997–2002	Percent people feeling the country is going in the right direction in 2002
Albania	+35	N/A
Bosnia and Herzegovina	+33	23
Bulgaria	+29	18
Croatia	+15	28
Macedonia	+6	18
Romania	+7	34
Serbia and Montenegro	–6	49

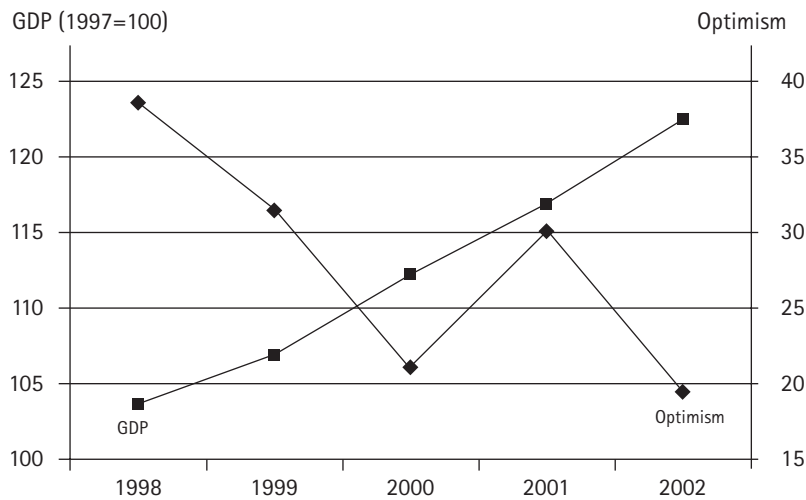
Source: For GDP and population—WIIW, WIIW Balkan Observatory, <http://www.wiiw.ac.at/balkan/data.html>;

For Perceptions—International IDEA, Complete Quantitative Survey Results, http://www.idea.int/balkans/survey_detailed.cfm

³ Data from Krastev, Ivan, *The Inflexibility Trap: Frustrated Societies, Weak States and Democracy. Report on the State of Democracy in the Balkans*. (Sofia: Centre for Liberal Strategies, 2003), pp. 5–6; and International IDEA: International Institute for Democracy and Electoral Assistance.

The fact that one of the countries furthest ahead in terms of economic and institutional reform (Bulgaria) also enjoys one of the lowest levels of trust in institutions, appreciation of public services, and optimism for the future (see Figure 1) is especially telling. It strongly questions the assumption that economic growth and accession to the EU naturally builds proreform constituencies. This evidence should be enough to examine the assumption and to contemplate what the implications of abandoning it may be.

Figure 1
GDP and Optimism in Bulgaria, 1998–2002



Source: For GDP—National Statistical Institute, Bulgaria;

For Optimism—BBSS Gallup International, Annual data averaging monthly data; percent positive responses to the question “Is Bulgaria heading in the right direction?”

Bulgaria is very interesting in illustrating this so-called experience gap, the discrepancy between objective and subjective realities in the Balkans. According to a set of objective indicators, 19.8% of respon-

dents in a double nationally representative sample qualify as winners of the reforms (the policies and the incentives have actually worked for them), but only 5.8% actually identify themselves as winners (in other words, perceive that policies and incentives have worked for them). In the current Bulgarian political reality, a social group representing 20% of the population is completely capable of dominating the agenda. A group of less than 6% is not. In Bulgaria, the correct policies and incentives have been in place for six years. What is missing is the perception that the policies and incentives are there.

1.6 Why Does Growth Not Generate Its Own Support?

Examining the assumption that economic growth, sustained over a medium-term, leads to public support for economic reforms should start by questioning the importance of this assumption in terms of policy decisions. This assumption has indeed been important in setting agendas and policies in the Balkans. It is in the very fundament of the external conditionality imposed on policy makers across the Balkan region as a necessary condition for sustainable development. The logic of external conditionality is that if economic development is to be consolidated and sustained, a period of growth leading to stabilization and rising incomes is needed. This period will inevitably create the social base supporting the deepening of structural and policy reforms, without which the ultimate goal of sustainable development seems unachievable. The idea was that growth not only creates wealth but votes as well.

Given the importance of the assumption that growth leads to social support for reforms, its failure to be empirically validated in the Balkans must be explained. Some possible reasons may be that the time period under examination is still too short, that growth is very unevenly distributed, gains accrue to a very small constituency, that optimism is not

solely dependent on material status and perspectives, and that many perceive growth as unfair.

For example, market reforms are by definition associated with a loss of security. This includes insecurity on a personal and property level but also insecurity in terms of social status and perspectives. Status uncertainty means that previously prestigious groups have lost status, while at the same time, the new elites are aware that they can lose their status easily, especially when political changes take place, with clientelist networks changing with them. And political changes have occurred after every election in the Balkans since the beginning of reforms.

In addition, market reforms are correlated with increased inequality, which is easy to be perceived as unfairly achieved and undesirable on moral grounds. People who perceive inequality as unfair, or unfairly achieved, tend to consider themselves losers from the reform process regardless of the dynamics of their personal consumption paths. This perception is magnified by the activities of two types of actors: populist politicians whose election strategies are based on winning a protest vote where the protest is against unfairness, and media with a heavy spin bias.

All of this is experienced as impoverishment, especially against the background of people's expectations, which are endemic and impervious to empirical studies, according to which the economy and economic welfare is a zero sum game, and the future is unimportant relative to the present. Because of this, when evaluating a politician or a policy, social actors give much weight to policies' short-term wealth redistribution effects, while giving absolutely no weight to their long-term wealth creation effects.

There are two corollaries to these mental models. First, they underlie the widespread belief that a better situation is not only possible but easily achievable, usually by means of redistributive political will rather than through capitalist market interaction. Second, not only is there a lack of appreciation for market reforms (their sole aim is to increase the economy's long-term wealth creation capacity, and, as such, they are practically irrelevant to the social actors), but there is an inability and

People who perceive inequality as unfair, or unfairly achieved, tend to consider themselves losers from the reform process regardless of the dynamics of their personal consumption paths

There is a lack of support for policies aiming to increase the economy's long-term capacity to create wealth even when these policies do have results and do lead to growth

lack of desire among social actors to learn the workings of the market economy and economic policies. The data from most transition countries indicate a certain “blindness for success,” namely, the majority of respondents attribute success to corruption and unethical behavior.

Thus, we see that there is a lack of support for policies aiming to increase the economy’s long-term capacity to create wealth even when these policies do have results and do lead to growth. This leads to the question about the relevance of relaxing the assumption that growth generates its own support for the appropriate policy mix. There is a need for a second policy track that targets perceptions, not incentives.

1.7 Getting Incentives Right

The success of this second policy track depends on the government’s ability to come up with the right incentives.

Macroeconomic and financial stability in some countries is still lacking. Although recent institutional reforms and policy changes stabilized economies, reform is still incomplete. From a policy perspective, macroeconomic stability has several dimensions, with the two most important being monetary and fiscal policy. Monetary stability is manifested in a low and stable inflation rate. Governments are often tempted to use monetary policy for short-term gains, such as the short-term reduction in unemployment. It is now widely realized that such policies are not only ineffective in the long run but, more importantly, lead to undesirable increases in macroeconomic instability. Given that it has been difficult to curb the desire to inflate, the best approach for the region has been institutional reform eliminating this discretion from policy making. Bosnia and Herzegovina and Bulgaria both have currency boards. Other countries, such as Slovenia, Croatia, and Macedonia, attempt to stabilize macroeconomic conditions by following some sort of fixed exchange rate policy. The reduction in policy volatility is important for at least two reasons: (1) as argued above, more

stability leads to higher savings (investment) rates; and (2) macroeconomic stability reduces inequality. Indeed on the second point, several studies attempting to determine which growth factors affect inequality have discovered that only one factor is significant—inflation (or the volatility of inflation).

Fiscal policy is the other determinant of macroeconomic stability. Here, constraining policy makers to behave within a framework guaranteeing stability is much more complicated. Quantitative restrictions, such as the 3 percent cap on deficits in the Stability and Growth Pact, have their strong advocates, but they are also bitterly criticized because they restrict policy too much at the wrong time or because violations of such rules are difficult to punish. We suggest an alternative solution. Fiscal policy should be constrained by checks and balances rather than by quantitative targets. A lack of checks and balances create an environment allowing fiscal policy to be used for opportunistic reasons. The extensive use of fiscal policy creates macroeconomic volatility and overall instability. In short, the scheme is the following:

More political constraints → lower variability of fiscal policy →
lower macroeconomic instability → more saving → higher growth

Which political constraints should be imposed? The goal is to reduce the executive branch's ability to use spending and taxation in an opportunistic manner, such as to improve an incumbent's chances for reelection. Empirical evidence clearly illustrates that countries with more vetoes on the executive's decision-making power have more stable fiscal policies. There are various ways of increasing checks and balances in a country, such as an independent judiciary that can challenge government decisions or a budgetary process that will allow the legislature to curb executive power. Of course, the latter is meaningful only if the executive and the legislature have different sources of legitimacy. If governments are simply appointed by the parliament, it is difficult to argue that legislature will veto the executive's decisions.

Fiscal policy should be constrained by checks and balances rather than by quantitative targets.

A measure of veto points was constructed by Witold Henisz and is reported in the table below.⁴

Table 4
Political Constraints on the Executive

Country	Political Constraints
Average	0.38
Albania	0.52
Bulgaria	0.74
Greece	0.70
Romania	0.56
Turkey	0.62
Serbia and Montenegro	0.46
Bosnia and Herzegovina	0.00
Croatia	—
Macedonia	0.41
Slovenia	0.73

Source: Witold J. Henisz, “The Institutional Environment for Economic Growth,” *Economics and Politics* 12: 1 (2000).

The index ranges from 0 (no constraints) to 1 (all possible constraints, meaning an independently elected executive with a bicameral parliament, independent judiciary, and federal structure). The index also adjusts for the political alignment across branches (in other words, if the executive and the parliament are from the same party, then the likelihood of vetoing a decision can be expected to be lower). For Southeast Europe, there is much to be desired. Only Bulgaria, Greece, and Slovenia have scores close to the more developed economies (where the index is usually between 0.75 and 0.85). Institutional reform that will

⁴ Witold J. Henisz, “The Institutional Environment for Economic Growth,” *Economics and Politics* 12:1 (2000).

strengthen the separation of power should be high on the agenda for several of the countries. Of course, checks and balances have many other desirable implications that reinforce the need for institutional reform. The problem is that in their focus on imposing the correct policies instead of creating the correct structure of the policy process, the international community is not very interested in promoting institutional solutions that will increase the veto possibilities in the decision-making process.

Overall, macroeconomic stability can be the outcome of policy conducted in a discretionary way or a result of an institutional arrangement that restricts policy makers in certain ways. In our view, the institutional solution—by separation of powers in the case of fiscal policy or by having an explicit monetary target in the case of monetary policy—seems to provide a better environment for long-term strategic planning by consumers and firms.

Continuing the policy and institutional reforms leading to macroeconomic and social stability is well understood by most policy makers. The sections above point out three critical dimensions in this respect—the importance of promoting high saving, the importance of checks and balances, and the importance of monetary stability. One other important point must be mentioned. It is not new, but its importance is often forgotten. Demographics is a challenge that is often neglected. The first and rather obvious dimension is the aging of the population. With more people going into retirement, the burden on the working population will increase since most pension outlays are on a pay-as-you-go basis. The second and probably more important dimension of population dynamics is brain drain. There is a continuous emigration of young people with high potential. Improving growth will reverse this flow, but the question is whether one needs a more active policy to change the direction of flows. In our view, there is a clear need to be proactive in this respect because human outflows can generate self-fulfilling growth disasters. The country sets aside revenue to improve education opportunities, but this investment provides no return if people leave the country. Taxes are high, investment in human capital

There is a continuous emigration of young people with high potential. Thus there is a clear need to be proactive in this respect because human outflows can generate self-fulfilling growth disasters.

is high, but the return is nonexistent. This leads to low growth and a higher desire to emigrate, which of course exacerbates the problem. At present, the demographic challenge is largely neglected, and emigration is perceived as an instrument for reducing unemployment.

1.8 Getting Perceptions Right

Since growth policies, even if successful in the medium term, do not seem to create their own social support in the Balkans, it is obvious that the policy mix should include a set of policies aimed at fostering such support.

Since growth policies, even if successful in the medium term, do not seem to create their own social support in the Balkans, it is obvious that the policy mix should include a set of policies aimed at fostering such support. This reformulation means that while the full set of reform policies will still be in place, it will be complemented by a set of support-enhancing policies, which will need their share of political and administrative time and resources. Promoting economic growth should not be conceived of as a sufficient constituency-building policy. In this context, social optimism and the will for saving should be analyzed both as an economic and noneconomic phenomenon.

The support-enhancing set of policies must have two focal points—the first is to increase support for reform among the social groups who are most likely to provide it; the second is to decrease resistance to reform from the social groups who are most likely to resort to it.

From this point of view, it is important to have a model, however generalized, of the main social groups as they are situated along the (potential support for) reform axis. This analytical framework includes the political economy model based on Perotti and Hellman’s identification of types of social actors—losers, winners, and partial winners.⁵ The social actors with diverse interests and relative strength constantly interact in the political space, and the result of their interactions are shifting coalitions with specific and varying attitudes toward reform policies.

⁵ See Perotti, Roberto, “Income Distribution, Fiscal Policy, and Delays in Stabilization,” *Journal of Policy Reform*, 1: 4 (1996) pp. 335-55 and World Bank, *Transition: the First Ten Years* (Washington D.C.: The World Bank, 2002).

If this model is taken as a starting point, policies aiming at increasing support for reform focus on the long-term winners from reforms. On the other hand, the focus of the policies aiming at decreasing resistance to reform is naturally the group of reform losers. The pivotal point here is that the suggested policies are at the expense of the third group—the winners from partial reforms who oppose their completion.

This third group, the predatory elites, exists in all transition countries but seems especially strong in Southeast Europe. Their predatory projects slash the effectiveness of social support programs (aiming at the losers of reforms) by channeling these programs' resources away from the target groups. These predatory projects also hamper the competitiveness and profitability of authentic market agents (and thus their relative social strength) by preventing competition through the creation and protection of monopolized niches and by threatening to damage the interests and rights of legitimate businesses through nonmarket means. Ultimately, the predatory projects in Southeast Europe have been able to drain the savings of both households and firms, causing macroeconomic catastrophes. This social group's presence and strength is one of the region's particular features, and economic policies must recognize this. This is why anticrime policies are a major component of building proreform constituencies.

Of course, the composition, background, motivation, and incentives of all three groups are very specific for each separate country in the region, so the details of the policies suggested here must be tailored to these specifics. However, four general policy lines can be outlined as seemingly relevant and important within the context of the region.

The first two suggested policies target the winners of reforms—the competitive entrepreneurs who fare best in the type of economic and business environment space toward which the Southeast European economies are striving. The first policy recommendation concerns the definition and enforcement of property rights. One reason why competitive entrepreneurs are unsuccessful relative to predatory elites in the Balkans is the fact that property rights are poorly defined and

barely enforced. This helps predatory elites establish strong positions through nonmarket means, carve out monopolistic niches, engage successfully in unfair competitive practices, and limit the profit margins of authentic market agents, which prevents the growth of their relative social importance. On the other hand, clarity and improved enforcement of property rights is the natural habitat of modern functioning competitive markets and their agents. More specifically, Southeast European governments should devote resources to creating rules fostering competition and financial discipline, establish transparent procedures in dealing with the private sector, and build a system of property and contract enforcement balanced in terms of competencies and responsibilities that efficiently serves economic activities.

Active participation in setting the reform agenda will make authentic economic agents feel a sense of ownership over the policy package.

The second recommended policy targets the policy formulation procedures themselves. This means that resources should be devoted to establish, maintain, and enhance the policy dialogue within each country. Such a course of action will provide three important benefits to the winners of reform. First, active participation in setting the reform agenda will make authentic economic agents feel a sense of ownership over the policy package. These people will have confidence in the reform process and reward it with greater optimism and the propensity to save. Second, establishing a policy dialogue will lead to greater effort by dialogue participants to assess the impact of the proposed policies before they actually happen. This will lead to a higher level of knowledge about the economy and better preparedness of all parties involved in the policies' actual impact, ultimately decreasing the social cost of their introduction. Third, an enhanced policy dialogue will decrease the propensity of policy makers to change policies just for the sake of change, increasing the stability of the rules of the game. This will decrease the risks associated with developing long-term business strategies with various benefits for profits and savings. In addition to these three benefits for the winners of reform, an enhanced policy dialogue will benefit the reform agenda itself and society as a whole by legitimizing success, validating the winners' point of view, and thus possibly increasing the

winners' self esteem and individual perceptions about their present and future status.

The last two suggested policies target the losers of reforms with the goal of alleviating their losses and decreasing their resistance against further reforms. The first recommendation is to adopt a strategy of targeting relatively small groups of socially disadvantaged people rather than retaining the socialist-inherited tendency to disburse aid to the entire population. This change of focus should be coupled with significant attention to the administration's ability to implement the policies efficiently (as a result of bureaucracy building). When this happens, the personal incomes and consumption of the most disadvantaged groups will be significantly enhanced at a relatively low level of burden for the rest of society.

The second recommendation concerns not only policy makers but also the international community as a whole. It is related to improving the process of social learning about both democracy and the market economy. The gap between people's initial expectations in Southeast Europe and the reality after more than a decade of reform leaves a vast space for alternative explanations. In such an environment, many actors have incentives to significantly distort the truth or simply to resort to false theorizing, which often becomes embedded in the minds of many people, shaping their choices and causing a vicious circle of uninformed choices leading to disastrous results. This serves as a basis for false theories and uninformed choices. A concerted effort is needed to break this vicious circle of social learning. Local civil-society organizations seem to be the best group to generate reliable and rigorous knowledge about democracy and market economy. They have not yet been branded as adverse elites by the losers of reforms and also have the credibility to acquire knowledge and formulate messages that may inform and improve the decisions made by individuals.

2. BRINGING THE STATE IN

Postcommunist countries were faced with the task of downsizing government involvement while improving bureaucratic capacity. This worked in Central Europe but failed in the Balkans, where transition took the form of state building in the literal sense of the word.

The policy message coming from academic literature on transition is that development requires an effective state; one that plays “a catalytic, facilitating role, encouraging and complementing activities of private business and individuals,” a state where “ambitions are matched with capabilities.”⁶ Postcommunist countries were faced with the task of downsizing government involvement while improving bureaucratic capacity. This worked in Central Europe but failed in the Balkans, where transition took the form of state building in the literal sense of the word. The challenge is how to build a trustworthy state that is also legitimate for its citizens. At present, public trust in institutions is generally low.⁷ The Balkans are seen as corrupt and inefficient, a region where governments only nominally control sizable parts of their territories, and where organized crime is an indicator of state weakness and also a factor for weakening the state. The region presents a strange mixture of weak states, former failed states, and present protectorates.

Perhaps the following classification of political regimes in the Balkans could be useful:

- Countries approaching an advanced stage of democratization:⁸ Romania and Bulgaria;
- Countries in an apparently sustainable process of democratization: Croatia;
- Countries in the (postcrisis) process of democratization: Albania;
- Countries starting the democratization process: Serbia and Montenegro;

⁶ World Bank, *The State in the Changing World* (Washington, D.C.: The World Bank, 1997).

⁷ Data from International IDEA: International Institute for Democracy and Electoral Assistance. <http://www.idea.int>.

⁸ Democratization means the process of building democracy. It is taken to include at least two or three more or less free and fair elections and at least one orderly change of the parties in government.

- Countries recovering from a severe political crisis (the break-down of democratization): Macedonia;
- Countries with a significant international security and political presence (quasiprotectorates): Bosnia and Herzegovina;
- Territories beginning the democratization process: Montenegro;
- Territories that are de facto international protectorates: Kosovo;
- Political entities within quasiprotectorates: the Federation of Bosnia and Herzegovina and the Republic Srpska.
- Divided cities, cities that are out of control of their central government, and villages or cities under special international care: a number of them are in Kosovo (for example, Kosovska Mitrovica), Bosnia and Herzegovina (for example, Brcko), and Macedonia (for example, Sipkovic).

Proximity to the European Union is what separates the Balkans from most other postconflict regions in the world.

Clearly, the types of failed or weak states emerging from this classification span most of what can be found in the rest of the world. The difference is perhaps in the level and extent of international involvement, although the same can be said for a number of other regions. Proximity to the European Union is what separates the Balkans from most other postconflict regions in the world.

2.1 Defining Notions of Weak State and Failed State

The notions of “weak state,” “failed state,” “collapsed state,” and the even more playful notions of “hard states” and “soft states” became critical elements in the current discourse on the state. But, in most cases, they are used as metaphors and less often as analytical terms. In theoretical terms, a failed state represents a return to what Hobbes called the state of nature. Kaplan prefers to describe this condition as “criminal anarchy.”⁹ It represents the disappearance of the legitimate monopoly

⁹ Robert Kaplan, *The Coming Anarchy: Shattering the Dreams of the Post Cold War* (New York: Random House, 2000).

of violence over a certain territory that formally has been recognized as a state. Security and justice as public goods are either not provided or provided by illegitimate private agents. Albania in the spring of 1997 represents a classic case of state failure. The structures that should have guaranteed the rule of law failed completely. In the words of Badie and Birnbaum, “As the decision-making center of government, the state is paralyzed and inoperative: laws are not made, order is not preserved, and societal cohesion is not enhanced.”¹⁰ There was no judicial system. To the extent that police were found on the streets, they were agents of private violence. A substantial amount of weapons were seized by the population; the state of insecurity was total. The state was neither taxing nor spending.

A weak state can be defined as a state that fails to protect citizens’ rights and property rights. A weak state is not necessarily a state that does not dispose of significant resources. In the Balkans, some states are weak in that sense as well. Thus, Albania and Kosovo are weak in the key sense of the rule of law being weak, but they are also weak in the sense that they do not really influence economic development. This can be seen from the level and structure of their public finances. Tax revenues hover around 10–15% of GDP, while public expenditures exceed this figure by about 10% of GDP; this is effectively the fiscal deficit. Most public investments are part of the international reconstruction effort or are financed from international aid or with soft loans. These conditions could be taken as the prototype of a weak state.

Other states in the region collect significant resources in public revenue and have even larger public expenditures. Thus, a number of states or territories spend more than 50% of their GDP via the budget. These states also collect substantial revenue. In that sense, a number of Balkan states cannot be called weak. However, as in other developing countries, the sources of revenue and structure of expenditures show significant weaknesses or inefficiencies. There is no need to go into

A weak state can be defined as a state that fails to protect citizens’ rights and property rights

¹⁰ Bertrand Badie and Pierre Birnbaum, *Sociology of the State* (Chicago: University of Chicago Press, 1983).

details, but some general characteristics should be given. On the revenue side, the common problem is that the tax base is rather narrow. There is a large and growing informal economy, and taxes are mostly collected from state owned companies and consumers. Revenues from tariffs are also essential in a number of cases. On the expenditure side, a substantial amount of money is spent on wages and salaries, the military, and transfers and subsidies, with a relatively small amount on public investment. Public expenditures are “selectively paternalistic,” a euphemism for what is otherwise called a captured state.¹¹

2.2 Modes of State Weakness

In his influential work *Strong States, Weak Societies*, Joel Migdal defined the strong state as one with high capabilities to achieve its goals, including the “capacities to penetrate society, regulate social relationships, extract resources, and appropriate or use resources in determined ways.”¹²

In this respect, we can define state weakness either as the weakness of the state’s autonomous role or as the weakness of its organization capacities. The weak state is either a captured state or a state with an inefficient bureaucracy. However, in *Bringing the State Back In*, Evans, Rueschmeyer, and Skocpol demonstrated that the general judgments about a state’s strength can be misleading. They have demonstrated that there is not necessarily a positive relationship among different kinds of state capacities. A state can be efficient as a tax collector but a bad public manager. It can succeed in implementing certain policies and fail at implementing others. One of the new phenomena that can be observed is the emergence of the “cunning state,” a state that is

Balancing between pressure from the international community and pressure from the public, political actors manage to be weak in areas that are unimportant for the regime's survival while being sufficiently strong enough when it comes to the governing elite's interests

¹¹ For more, see Vladimir Gligorov, “The Role of the State in the Balkans,” in *Balkan Reconstruction: Economic Aspects*, ed. Vladimir Gligorov (Vienna: WIIW, 2000).

¹² Joel Migdal, *Strong Societies and Weak States: State-Society Relations and State Capabilities in the Third World* (Princeton, NJ: Princeton University Press, 1988).

selectively weak but makes use of its perceived weakness.¹³ The fact that most weak states are democracies creates conditions for the strategy of selective weakness. Balancing between pressure from the international community and pressure from the public, political actors manage to be weak in areas that are unimportant for the regime’s survival while being sufficiently strong enough when it comes to the governing elite’s interests.

2.3 The Sources of State Weakness in the Balkans

Historians are tempted to view the current crisis of the state in the Balkans as a result of the delayed and unfinished process of state building, which is a distinctive feature of political development in the Balkans in the late nineteenth and early twentieth centuries. In their view, state weakness is historically specific for the region. But such an explanation is a dead end for understanding the dynamics of the reproduction of state weakness in the Balkans. Three other domestic sources of state weakness are of greater importance. These are the impact of political opening, the impact of the constitutional choices, and the impact of the dominant project of postcommunist elites.

Political Opening

It is perhaps warranted to argue that the malfunctioning of postcommunist states in the Balkans reflects a peculiar “paradox of political opening.” As the political and ideological conditions necessary to advance democracy transpired, the institutional tools of governance available to these societies—bureaucratic structures and administrative

¹³ On the “cunning state,” see Shalini Randeria and Ivan Krastev, in *Unraveling Ties*, eds. Yehuda Elkana, Ivan Krastev, Elisio Macamo, Shalini Randeria (Frankfurt, New York: Campus Verlag, 2002).

agencies—were adversely affected by the swift and unpredictable changes. The very implosion of the communist edifice of power that marked the end of dictatorships also aggravated institutional fragmentation and accelerated administrative decay. Hardly surprisingly, the changes of 1989 had a profoundly demoralizing effect on the communist-created civil service. To some extent, this effect might be attributed to ideological causes. After all, bureaucratic cadres, especially those who occupied important positions, were selected according to ideological criteria, and the spectacular breakdown of their ideological project must have had an unsettling effect on many of them. But it is not necessary to picture low- and mid-level administrators in communist countries as angst-ridden individuals who have experienced an existential loss of meaning to understand how political change may precipitate the evaporation of intangibles that keep personnel morale high. The collapse of communist regimes also gave rise to more mundane questions that determine the flows of motivational energies of bureaucrats in all times and places. The stability of hitherto institutionalized career patterns was shattered, privileges that were taken for granted melted in the air, and “ubiquitous routines” that created a sense of security were disrupted. In sum, no matter how one interprets the events of 1989—as a high drama featuring the fall of ideologies and climactic conflicts of worldviews or a more prosaic story of how civil servant cope with confusion, anxiety, and resentment—it is imperative to include the civil service’s demoralization among the immediate effects of the collapse of state socialism.

Furthermore, the robustness of state structures was adversely affected by the complex, multifaceted process of separation of party and state. While most obviously a sine qua non for democratization, this development also aggravated the dysfunctionality of state apparatuses. Simply put, nomenklatura cadres who were “leaving” the state en masse to begin a new life as agents of civil society also took the wherewithal indispensable for governance: material assets (means of transportation, means of communication, money) as well as intangible resources (information, knowledge, the logistical capacity to organize things and

No matter how one interprets the events of 1989, it is imperative to include the civil service’s demoralization among the immediate effects of the collapse of state socialism.

people). In the aftermath of this messy separation, state institutions frequently resembled empty shells bereft of infrastructural potential.

Constitutional Choices

More than the difficulty of transiting from an economy based on plan to market, the challenge of building democracy in multiethnic postcommunist Europe remains formidable.

In order to estimate the impact of constitutional choices on the reproduction of state weakness in the Balkans, we must take a comparative perspective. On the eve of the 1989 revolutions, the territory comprising the nine communist countries in Europe contained 69 major nationalities. Over the next six years, more than three-quarters of these nationalities (a total of 54) were engaged in ethnoconstitutional crises with at least one government over issues of civil rights, greater participation in the central government’s decision-making process, communal autonomy, or independence. A full 98% of these crises entailed claims to some form of statehood—either territorial autonomy within an existing state or complete independence. A fifth of these nationalities engaged in violence against at least one of the governments. By the end of the decade, this violence had developed into severe armed conflict for seven nationalities—the Abkhazians in Georgia, the Albanians in Serbia, the Armenians in Azerbaijan, the Bosniacs in Bosnia, the Chechens in Russia, the Croats in Bosnia, and the Serbs in both Bosnia and Croatia.¹⁴ More than the difficulty of transiting from an economy based on plan to market, the challenge of building democracy in multiethnic postcommunist Europe remains formidable.

But one thread is visible in the postcommunist puzzle of success and failure: only nation-states have succeeded in the European integration project. And their cultural minorities succeeded with them. These are the countries that have grown increasingly democratic and

¹⁴ From Philip Roeder, “National Self-Determination and Postcommunist Popular Sovereignty,” in *Nationalism after Communism. Lessons Learned*, eds. Alina Pippidi and Ivan Krastev (Budapest: Central European University Press, 2004).

civic while ethnic federations broke up, and disputed states ultimately became weak states or even failed states. This can be seen as merely stating the obvious—countries with fewer constraints did better, and ethnic heterogeneity was always seen as a traditional constraint on democracy. But it is indeed more complicated than that. The Baltic republics, Slovakia, Bulgaria, and Romania have also faced problems related to ethnic heterogeneity during their transition. A share of the region's ubiquitous ethnic conflict belonged to the successful part of postcommunist Europe. In all fairness, this part was also better equipped to deal with this challenge. Local institutions were more fit or better chosen, national politicians and the international community made less mistakes, and external destabilizing factors were better controlled. The European integration of these countries was well served by and prepared for during a previous phase of nation building and state consolidation, necessary after decades of Soviet domination.

While initial conditions of transformations, especially at the level of state building, vary greatly, some clear lessons do emerge out of a comparison between successful and unsuccessful state building projects in postcommunist Europe. It seems, therefore, that the successful management of multiethnicity in Eastern Europe cannot succeed without strong and unitary states. Achieving those may need, as in the Baltic republics, a period of intermediate or transitory institutions that have the clear goal of producing such states. At the other end of the continuum, a misunderstanding of this fact produced nearly failed states in countries such as Moldova. These are states that cannot protect majorities or minorities, are incapable of mobilizing their citizens around a project on the scale of European integration, and which are reduced to the passive role of producing large-scale emigration to the more successful regions of Europe. While considerable repatriation has occurred in the Baltic states, in Albania, Moldova, and Ukraine, there is a mass desertion by citizens fleeing their failed states. This is not the usual exodus of the poor toward rich countries, but the tacit desertion of failed national projects. Europe's eastern border can barely stop an

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invasion that translates into huge fractions of the total workforce of these countries seeking labor elsewhere. Interpreting this quiet disaster simply as a lack of economic success would be a mistake. When a country's entire active workforce would leave if given the chance, we are dealing with state failure, including the failure to produce national identity and mobilization around a common national project. Failed states create hopeless societies, who become sponsors of state failure.

In each country, political elites are responsible for managing state building, but we have also witnessed considerable international assistance and intervention in constitutional matters, and its role has been important in some countries, for better and for worse. To sum it up, the question is how to assist state consolidation and the enforcement of rights as equally legitimate processes, not how to reorganize the state for ethnic groups to share power as the main strategy of ensuring rights. Power-sharing without rights enforcement is not helpful.¹⁵ Even worse, it creates nonfunctional states—when what are needed are states with strong implementation capacity—or ethnic clienteles, who sabotage common national projects. This is the main reason why countries with more than one ethnic group have weak economies. A country must be a common project, not a playground of ethnic clienteles, to experience successful development.¹⁶

The successful part of postcommunist Europe is the one where constitutional arrangements were classic. Nations defined as civic nations consisting of individuals, not communities, where rights and state support for cultural difference is clearly stated, including nondiscriminative employment, education in different languages, and the use of minority languages in local governments and courts where minorities constitute more than 15–20% of the local population.

¹⁵ From Florian Bieber, "Power Sharing as Ethnic Representation in Postconflict Societies," in *Nationalism after Communism. Lessons Learned*, eds. Alina Pippidi and Ivan Krastev (Budapest: Central European University Press, 2004).

¹⁶ See William Easterly and Ross Levine, "Africa's Growth Tragedy: Policies and Ethnic Divisions," *Quarterly Journal of Economics* 112 (1997), pp. 1203–50.

Representation of minorities through proportional electoral systems and reserved seats for smaller groups in national parliaments have also been a good recipe. In Romania, Bulgaria, and Slovakia, the main parties of ethnic minorities have become constant participants in government coalitions. Ethnofederalism, to the contrary, emerged with a poor record for conflict prevention or containment from the postcommunist transition. It fostered ethnic polarization, multiplied institutional weapons, and increased the likelihood of both ethnoconstitutional conflict and violence.¹⁷

Ethnofederalism is sometimes unavoidable as a cease-fire strategy, but the Bosnian experiment shows that even this is not encouraging. The idea of ethnofederalism as an institution providing justice for all and diminishing conflict in the long run should be revisited. What worked in postcommunist Europe were formulas to make unitary states more inclusive and more accountable, through the adoption of international law on minorities, (strong) external conditionality so these policies were implemented successfully, and national cooperative politics. This is the package that has produced successful states and fair political societies. This does not rule out the case for federalism based on grounds other than ethnic concentration, but the fact remains that none of the postcommunist countries that had a successful democratic transition was a federal state. Institutional innovation should be discouraged when unnecessary, especially in a region where state consolidation should not be taken for granted.

Theorists and human rights activists alike agree that it is difficult for unitary states to be ethnically neutral. Ethnic neutrality should, however, be viewed in concrete, not absolute, terms. States have an interest to preserve the majority language as the main language of communication. But this should not be viewed as ethnicism if the use of minority languages is also ensured. Constitutions are modified daily

The idea of ethnofederalism as an institution providing justice for all and diminishing conflict in the long run should be revisited.

¹⁷ From Roeder and Valerie Bunce, “Is Ethnofederalism the Solution or the Problem,” in *Nationalism after Communism. Lessons Learned*, eds. Alina Pippidi and Ivan Krastev (Budapest: Central European University Press, 2004).

to make languages official, leading to intense battles around symbols of supremacy. It is more important that international legislation is adopted and implemented, that it is given a solid logistical basis, allowing people speaking a minority language to have equal opportunities with those who speak the majority one. The focus should be on practice, not symbols. Consolidated states are not possible if their structure is continuously challenged. It is not modifications of structure but rather of operation that are necessary to ensure minorities' rights. The conclusion of our research was that international involvement in conflict resolution tends to favor the ethnofederalist type of constitutional arrangements. But such arrangements are among factors for state failure in the Balkans.

The Dominant Project of the Elites

The dominant predatory elite project in postcommunism is extraction from the state.

During the transitions, the state's organizational supremacy was challenged. In some postcommunist countries in the Balkans, this challenge was launched by ethnic elites in pursuit of an alternative state project. Most frequently, and in the former Yugoslavia, the logistical outflanking of the state was fomented by newfangled collective actors who strove to gain control over the currency for which social organizations compete—namely, social control. The nature of this specific form of logistical conflict can only become clear if the historically unique context in which the collapse of state socialism occurred is properly understood. After decades of extracting from society, communist regimes created and maintained an enormous public domain that served as a depository of all productive societal resources. It was precisely this domain that the state's competitors targeted after 1989. The dominant predatory elite project in postcommunism is extraction from the state. The postcommunist regimes resembled oil regimes, where oil was the public property to be privatized. Hence state building can be meaningfully construed as the protracted process of offsetting and overcoming the organizational, institutional, and social consequences of this elite project.

A crucial institutional corollary of extraction from the state is the privatization of decision-making mechanisms or the exercise of governmental prerogatives on behalf of predatory interests. From a state-building perspective, this privatization is much more damaging than the theft of material assets or the distribution of state-held assets among elites. At times, the privatization of decision-making mechanisms results in the adoption of rules favoring monopolists and rent-seekers (in other words, state capture). More frequently, however, it is a prelude to local capture or the de facto exploitation of resource-rich public zones (the capture of state fragments). While state capture may be depicted as a form of governance, the series of local captures that swept through the Balkans in the 1990s are most adequately described as the neutralization (perhaps even sabotage) of governance.

As a result of the privatization of decision-making mechanisms, multiple normative orders begin to emerge. Different sets of rules are applied to different groups of actors, and sometimes the role of rules is thoroughly eclipsed by the persistent imposition of ad hoc decisions. In and of itself, this so-called heterogeneity of orders is probably not lamentable. It may attest to the flexibility of state institutions that react adequately to constituencies with diverse needs. As a manifestation of insider entrepreneurship, however, it may be destructive. The sustainability of governance orders depends on the reactions of apparatuses or what Weber called “specialized staff.” But when decision-making procedures are privatized, the staff acts when it should not, fails to act when it should, and reacts in a different manner in response to similar signals. State weakness, then, manifests itself as the radical unpredictability of the reactions of rule-enforcers. Consequently, bureaucracy building involves reestablishing control over captured locales, rechanneling flows of information toward decision makers, and streamlining the spontaneously emerging heterogeneity of normative orders

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2.4 International Sources for the Reproduction of Weak States

External constraints aim at arresting the elites' extraction project, but, at the same time, predatory elites use external pressure to excuse their lack of social responsibility.

The paradox of transition is that successful reforms require a stable and durable policy consensus based on long-term development goals (economic growth and EU integration). At the same time, the very process of transformation polarizes society, producing winners and losers. Governments do not have a lot of room for maneuver. In order to stay in power, they should follow the reform agenda prescribed by the EU or the IMF. External constraints are institutionalized as currency boards and other hard instruments. The decision of international organizations to limit governments' flexibility resulted from the permanent failure of governments in the Balkans to keep their promises. External constraints ensure policy predictability in the region. It is easy to understand and justify the West's desire for policies that bind elites' hands. External constraints aim at arresting the elites' extraction project, but, at the same time, predatory elites use external pressure to excuse their lack of social responsibility. In this sense, external conditionalities have a negative effect on relations between politicians and the public. Governments are elected after a love affair with the electorate, but they are married to the international donors.

Viewed from below, the Balkan democracies are political regimes where the voters are free to change governments but are very much constrained in changing policies. Any pressure from below is immediately labeled "populism." The international factor does not see anything wrong with parties winning elections on a populist ticket and governing on the IMF ticket. This process is conceptualized as a success of reform. But if this development can be seen as positive in the short run, it is destructive in the long run. The recurring failure of voters to vote for a policy change can lead to three undesirable developments: 1) it can bring a political party to power that is antisystem in character (for example, Tudor in Romania and Seselj in Serbia); 2) it divorces election campaigning from the actual practice of governance and makes it

impossible to hold politicians accountable; 3) it makes political learning ineffective.

2.5 Overcoming State Weakness

Construed as an instrument of democratic governance, a strong state is both an institutional and a social phenomenon. It is characterized by the particular qualities of institutional apparatuses and by recurring relationship patterns between social (large and small) constituencies and state agents. It would perhaps make sense, then, to delineate two distinct analytical rubrics that may help us sort out the policy response to state weakness: bureaucracy building and constituency building.

State Building as Bureaucracy Building

A cohesive corps of well-motivated civil servants is, by definition, a commodity perennially in short supply in the Balkans as well as elsewhere. The maintenance of efficient bureaucratic institutions does, of course, crucially depend on the allocation of material and financial resources for institution-building projects. But it is equally clear that such projects may succeed to the extent that they nurture what Peter Evans and Dietrich Rueschemeyer have felicitously called “the non-instrumental sources of cohesion of the bureaucratic apparatus,” in other words intangibles like loyalty, commitment, and discipline.¹⁸ As a general proposition, it is easy imagine how these sources will dry up during times of turbulent social change and political volatility. The point, of course, is not to deny the importance of civil-service reform

¹⁸ See Peter Evans and Dietrich Rueschemeyer, “The State and Economic Transformation: Toward an Analysis of the Conditions Underlying Effective Intervention,” in *Bringing the State Back In*, eds. Peter Evans, Dietrich Rueschemeyer and Theda Skocpol (Cambridge: Cambridge University Press, 1985), p. 59.

but to emphasize its long-term nature. The fruits of such reforms can be reaped, if at all, only after a long gestation period.

Can the West be instrumental in constructing short-cuts to bureaucratic cohesiveness? The experience of countries like Bulgaria, Romania, and Croatia seems to suggest that flows of Western resources and—equally, if not more importantly—Western recognition might, in fact, enhance bureaucratic performance in specific ways. More concretely, it seems that local bureaucrats engaged in the process of European integration have a much greater incentive to be efficient and persistent because the rewards they are likely to receive if their job is well done are financially significant and culturally meaningful. Such teams, therefore, may form the nuclei around which efficient practices begin to gel. Lest one misinterpret the potential impact of the phenomenon, however, it is important to bear in mind three specific features of this short-cut to bureaucratic normalcy. First, the process of bureaucratic regeneration will most likely take the form of the bureaucracy's bifurcation, in other words, only some agencies will be Weberianized while the privatization of decision-making mechanisms will persist in others. Reform-friendly political elites will have to carefully map the bureaucratic terrain to comprehend the opportunities and constraints that the emergence of a bifurcated bureaucracy will create. Second, efficient bureaucracies will not be in touch with large local constituencies. They will accord priority to their relationship with fellow Eurocrats in Brussels. Conversely, bureaucracies whose primary function is addressing the needs of large local constituencies will face much less potent incentives to reform. However—and that is the third point—some spill-over effects from the improved performance of some segments of bureaucracies may trickle down to these local constituencies. Put differently, the process of bureaucracy building will be mediated in a particular fashion. Ambitious technocrats who covet Brussels's recognition may become the principals who have an incentive to discipline unruly agents. It is crucial, therefore, that such spill-over

effects be properly identified, managed, and magnified (for example, through fostering proefficiency coalitions within the civil service).

State Building as Constituency Building

Constituency building is the second broad issue that may help to overcome state weakness in the Balkans. As a social phenomenon, a so-called strong state is a multifaceted and yet fairly coherent collective actor that may resist the intrusive entreaties of rent-seekers, enjoy the trust of the citizenry, and generate positive synergy in its relations with productive societal groups. These are precisely the social projects that weak states in the Balkans are ill-equipped to carry out.

To begin with, postcommunist states find it very difficult to dislodge entrenched predators. Network connections that sustain rent-seeking are remarkably resilient and will reemerge, Hydra-like, every time damage is inflicted on them. It is important to emphasize, however, that state extraction is a project with dim long-term prospects. In countries that do not possess natural resources—as is the case in all Balkan countries—predators will eventually discover that they have little to prey on once state-owned enterprises are stripped of their assets, depositors' money is siphoned off from banks, and IMF loans are “misappropriated.” That is why, as time passes, the other two facets of state incapacity—the absence of trust and failure to engage productive groups—should become the focal point of analysis, both because they have enduring significance and because they hold the key to understanding the peculiar ways in which state weakness is reproduced in postcommunist contexts.

Balkan states are rarely, if ever, trusted by their citizens. Historical legacies and political traditions shed only limited light on this phenomenon. More plausibly, it may be explained in terms of the aftereffects of state extraction. Specifically, the gap between states and citizenry widened as a result of what might be called the embezzlement of the state's social capital. Social capital might be defined as relations of

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trust which entitles the agent to credit in the various sense of the word. Just as any other actor, individual or corporate, the state possesses social capital, and its social capital (which is quite distinct from its capacity to exert coercion) is measured by the willingness of citizens to give it credit or to enter medium- and long-term collaborative relations with the state's representatives. And just like any other form of capital, this social capital may be extracted from the state or embezzled when it is employed in violation of the socially acceptable conventions regulating its usage. The empirical scenarios that might be conjured up in this context may feature state officials who urge private depositors to put their money in a particular bank, at which point the bank is stripped of its assets by the collaborators of the state officials; bureaucrats who request business information that is later passed on to competitors for a price; organized interests that are advised by administrative agents to collaborate with particular private institutions, at which point the former are deceived by the latter while the administrative agents receive their cut from the hijacked resources. In a sense, the primary target of this form of predatory elite behavior is not, strictly speaking, state-controlled assets. What predators appropriate are resources held by nonstate agents (depositors, private companies, and organized societal groups). However, these schemes can only work if at critical junctures of the collaborative effort the predators convince the partners they are about to deceive that the state is involved in the deal as a guarantor and backer. It is because societal actors are prepared to extend credit to the state that they enter the partnerships that ultimately facilitate conversions of power. Therefore, societal actors' willingness to extend this credit in the future will suffer when the criminal intent behind the putative partnerships is finally revealed.

These concrete experiences are magnified as a result of a more general phenomenon, namely the experience of a spectacular exclusion of what might be described as productive social constituencies: entrepreneurs, young managers, and professionals. The redistribution of state-owned resources was a readily observable spectacle the consequences of which

everyone could experience. And yet, only a very few insiders partook in it. Arguably the most important aftereffect of state extraction, then, is the erection of a cultural wall delimiting the domains of exclusion and inclusion. Even social groups that objectively benefited from the changes in the post-1989 era will subjectively consider themselves losers as long as they perceive that participation in the redistribution of state assets is the only meaningful act of inclusion. Economic achievements are habitually measured against political experiences—and the bitter taste left by the latter overshadows the positive aspects of the former.

Under such circumstances, a tendency transpires that seriously hampers good democratic governance: the rise of the protest vote. This is a triply troublesome phenomenon: 1) it creates a disincentive for incumbents; 2) it afflicts the opposition with moral hazard; and 3) it blocks the process of learning where publics form more or less adequate notions about causality, responsibility, and the institutional dynamic of governance. Without such rudimentary learning, democratic governance may be well nigh impossible. The slide into a so-called protest-vote democracy is accelerated by the perilous impact of the media, which tends to perpetuate ignorance and superficiality rather than learning. In short, not all democratic configurations are equally conducive to state building. The protest vote, while arguably not inimical to democracy per se, is certainly not conducive to better governance.

It is the distance, whether real or imagined, between the state and key social constituencies that renders possible the reproduction of the weak state model. The connections between rent-seekers and corrupt state agents may eventually dissipate as the reservoir of public resources dries up; however, the disconnectedness that marks the institutional position of a weak state endures. This reproductive cycle is relatively unaffected by the increased affluence of an increased number of citizens. Socioeconomic data from Bulgaria and Romania suggests that individuals routinely link their success not to certain aspects of governance (for instance, more efficient enforcement of

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property rights, the maintenance of stable local currencies, more effective regulation of the financial sector, or the sheer reduction in the number of meddlesome state officials, a primary sign of improved bureaucratic performance) but to the noninterference of state agents in their immediate business pursuits. How to define personal success as the intersection of (privately driven) economy and (publicly managed) politics—this is the main challenge faced by those who believe that collaboration between state agencies and social actors is indispensable to good governance.

Ultimately, then, it is important to distinguish, chronologically and analytically, between two distinct manifestations of state weakness. During the early stages of postcommunist restructuring, states failed to perform their preventive function. They were unable (or unwilling) to prevent the looting of the public domain. Later, another, though not unrelated, form of malfunctioning became increasingly relevant—the failure to perform the positive task of creating, nurturing, and supporting social groups that constitute the natural constituencies of the rule of law and market-based economic activities. The state’s agenda-setting capability is strategically very important, and perhaps it should be restored not on the level of societal programs, but with a view to stimulating particular activities of social groups whose economic breakthroughs would benefit the entire society.

2.6 In Search of Responsive Government

Contrary to the current intellectual consensus, our report defines the growing gap between the state and the key social constituencies as the major risk for reforming the Balkans. Reforming the public administration and positive changes in the economy are not sufficient to bridge this gap. What is needed is a new generation of democratization policies that focus on the quality of political representation. What we see as a priority is a shift from the normative approach to demo-

cratization that focuses on democratic institutions (elections, courts, and media) and which is most often expressed with the idea of “accountable government” or “good government” to the idea of “responsive government” that underlines not the state’s autonomy from civil society but the influence of major social constituencies over state decisions. Reforming political parties should be at the center of such a search for responsive government. The building of representative parties comes close to our view of state building as constituency building.

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