East-Central and Southeast Europe

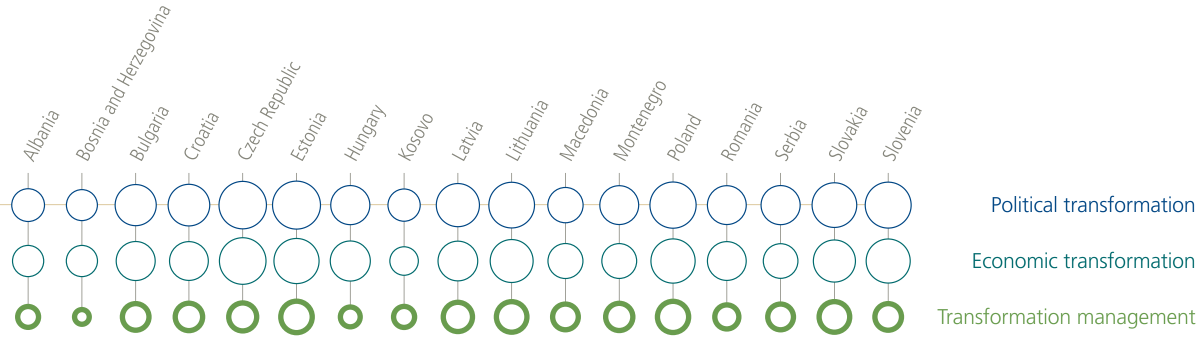
The EU crisis hits home

For the second consecutive time, the BTI's most developed region has deteriorated in all three dimensions as part of decline closely related to problems within the European Union. Frustration with lackluster governance is growing in many countries.

The good news is that none of the countries within the region of East-Central and Southeast Europe is in serious danger of regressing to autocracy and, in the BTI 2014, it remains the region with the largest number of advanced market economies. But, for the second time since the BTI 2012, political and economic transformation have been rolled back somewhat, with the quality of governance diminishing further in many countries.

This state of affairs is closely linked to the crisis within the EU that followed on from the global financial crisis. Membership in the EU has not led to across-the-board gains in prosperity, nor has it closed the economic gap between old and new EU member states as quickly as many had hoped. This has strengthened euroskeptic and outright anti-European political forces and generated widespread disappointment and dissatisfaction, which have found expression in protest movements, the mobilization of populist sentiments and power politics focused on dominance by parliamentary majority. These trends have contributed to significant declines in terms of political transformation in "newer" EU member states, such as Bulgaria and Romania. In the case of Hungary, these trends are also associated with a weakening of the institutions and principles underpinning the country's market economy. Hungary, along with Romania and Serbia, has been classified as a defective democracy in the BTI 2014. Deficits in these countries are manifest most visibly in the areas of political representation and autonomous civil society associations, as well as the rule of law and media independence.

However, these negative trends have not affected countries and societies in the region equally. Intraregional comparisons indicate, for example, that the Baltic states as well as the Czech Republic, Poland and Slovakia have each been particularly successful in maintaining their standards of democracy and market economies and, in some cases, have even shown improvement. Democratic institutions in the Baltic states have proved particularly resilient in the face of a deep economic crisis. This holds true

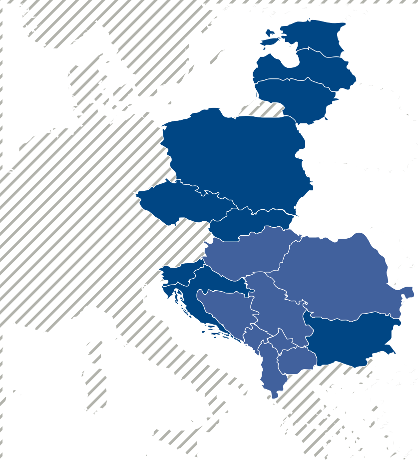


even in the case of Latvia, despite that country's referendum on Russian as an official language and the conflict between the president and parliament, both of which point to significant political instability and a deepening of the ethno-political divide between ethnic Latvians and Russian-speakers.

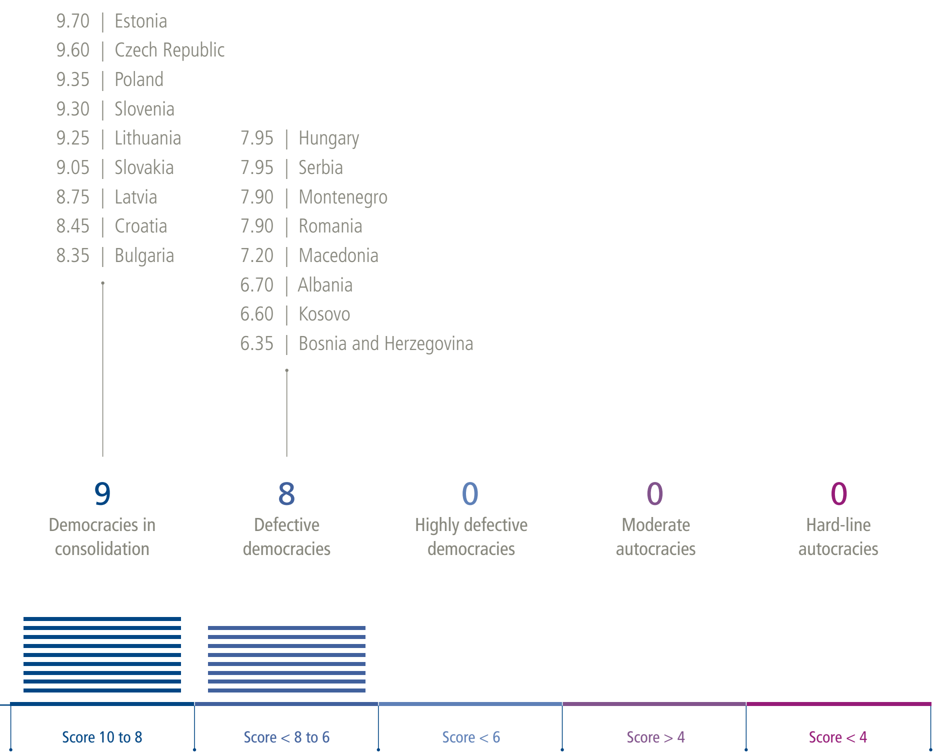
In Southeast Europe, Montenegro managed minor gains in each of the three BTI dimensions, all of which are related to its preparations for accession to the EU. But here, too, the results were varied. While the EU accession process and accession prospects held out to Croatia and Serbia may have helped in the fight against corruption, they weren't enough to give serious impetus to democratic and economic reforms.

Ethno-political conflicts make political and economic transformation processes in Bosnia and Kosovo more difficult. However, since the change of government in Serbia, Belgrade and Pristina have commenced political dialogue, which in April 2013 resulted in an agreement on the integration of Kosovo Serb structures within Kosovan institutions. While Macedonia persisted with its model of a joint ethnic-Albanian and -Macedonian government, which emerged during its transformation toward democracy, government policies of polarization and monopolization of power have eroded the quality of democracy there, as was also the case in Albania.

On average, Southeast European countries deteriorated to a greater extent than the East-Central European countries in terms of political transformation and transformation management, thereby widening the divide between the two subregions, which amounted to 0.93 points for transformation management, 1.63 points for political transformation and as much as 1.67 points for economic transformation.



Political transformation



Abuse of power

Democracy has suffered in 12 of the region's 17 countries. Two long-standing trends in particular are responsible: majority governments disregarding the rule of law and growing mistrust in democracy.

A model of dominance-oriented power politics according to which ruling parties utilize their legislative majorities to weaken the "checks and balances" stipulated by the constitution in order to consolidate their own power in the state and society was particularly prevalent during the review period in Albania, Hungary, Macedonia and Romania. In Romania, the social-democrat/national-liberal coalition government led by Prime Minister Victor Ponta disempowered the parliament and Constitutional Court in its fight against President Traian Băsescu, who has campaigned for judicial reform and effective anti-corruption measures. This transgression and manipulation of the constitution brought EU-member Romania the greatest decline in the region (–0.65 points).

Further retrogression was observed in Hungary as well (–0.40 points). Here, the conservative government coalition led by Prime Minister Viktor Orbán used its two-thirds majority to fast-track a new constitution in April 2011 against resistance from the opposition and without proper debate within society or consultation with parliament. The "Fundamental Law," as it was dubbed by the government, introduces "cardinal acts" for more than 50 policy areas that can only be amended with the support of a two-thirds majority in parliament. By June 2013, parliament had already passed 49 such acts – a sign that the two-thirds majority was being exploited to cement the government's political will in ensuing legislative periods.

In Albania (–0.55 points), followers of Prime Minister Sali Berisha's ruling Democratic Party occupied key public positions, including those of the president, head of secret police and attorney general. After a controversial tally, they also managed to get their candidate elected mayor of Tirana in May 2011.

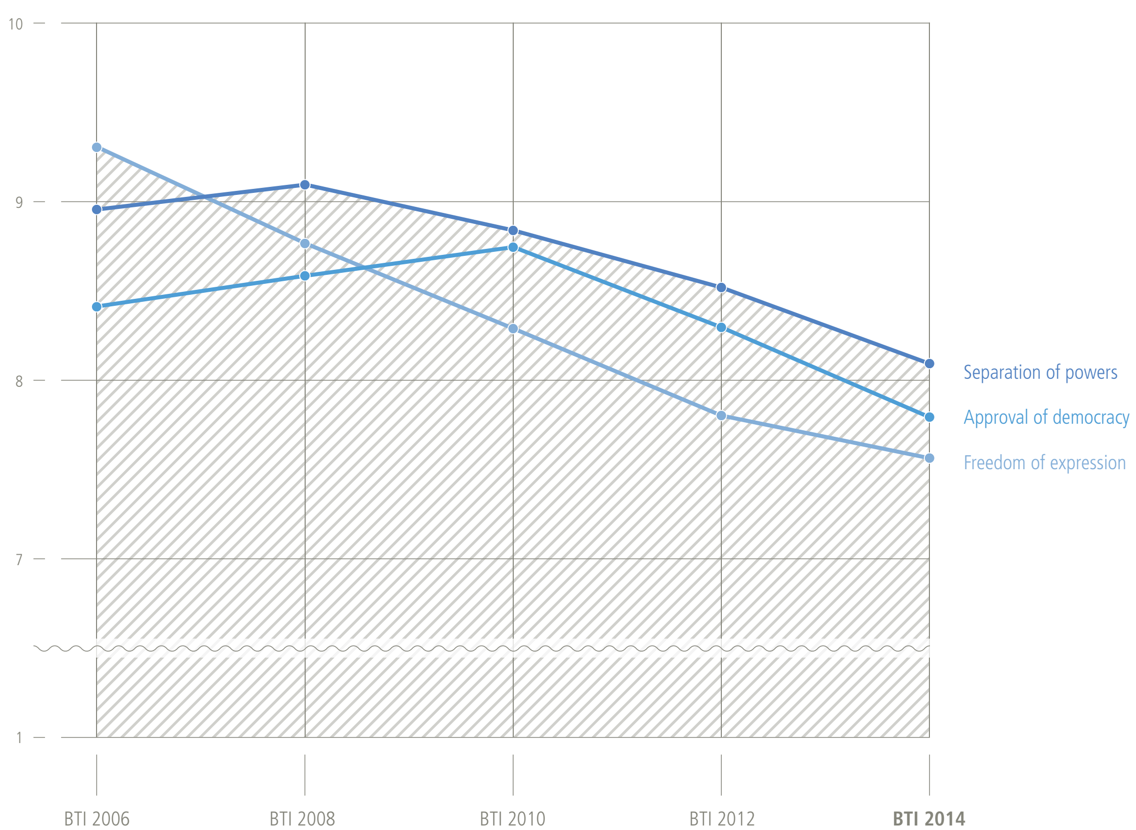
Finally, in Macedonia (–0.40 points), the conservative government coalition has increased the number of state employees by more than 50 percent since 2006, offering extensive potential for party-political patronage – especially in the face of a 30 percent unemployment rate. In addition to building up clientelistic dependencies, the government extended its control over the public broadcaster and put opposition-aligned media under pressure, using such tactics as withdrawal of newspaper licenses because of ostensibly unpaid taxes – just one of many regional examples of the increasing pressure on the Fourth Estate.

However, an eroding separation of powers isn't an entirely new phenomenon: Since the BTI 2008, the regional average for this indicator has deteriorated by 0.94 points. Confidence in democracy has been further shaken by the scandalously corrupt practices of political elites, the ongoing economic crisis and the dwindling appeal of an EU seen to have failed in managing the crisis. The regional average for the approval of democracy indicator fell significantly, with Estonia being the only country in which confidence in democracy remains as strong as ever.

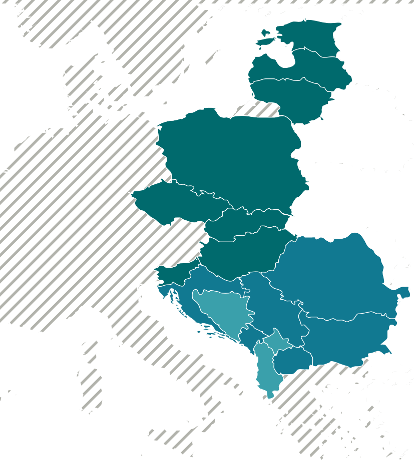
The prospect of EU accession put pressure on the countries of Southeast Europe to reform their judicial systems. One key problem for reformers was ensuring that the judiciary remains shielded from political and other external influences while also instituting mechanisms for censuring judges who violate professional standards of conduct. In Serbia, for example, the Constitutional Court decreed in July 2012 that all judges who had been dismissed by the government in the course of judicial reforms and subjected to an assessment of their professional competencies should be reinstated.

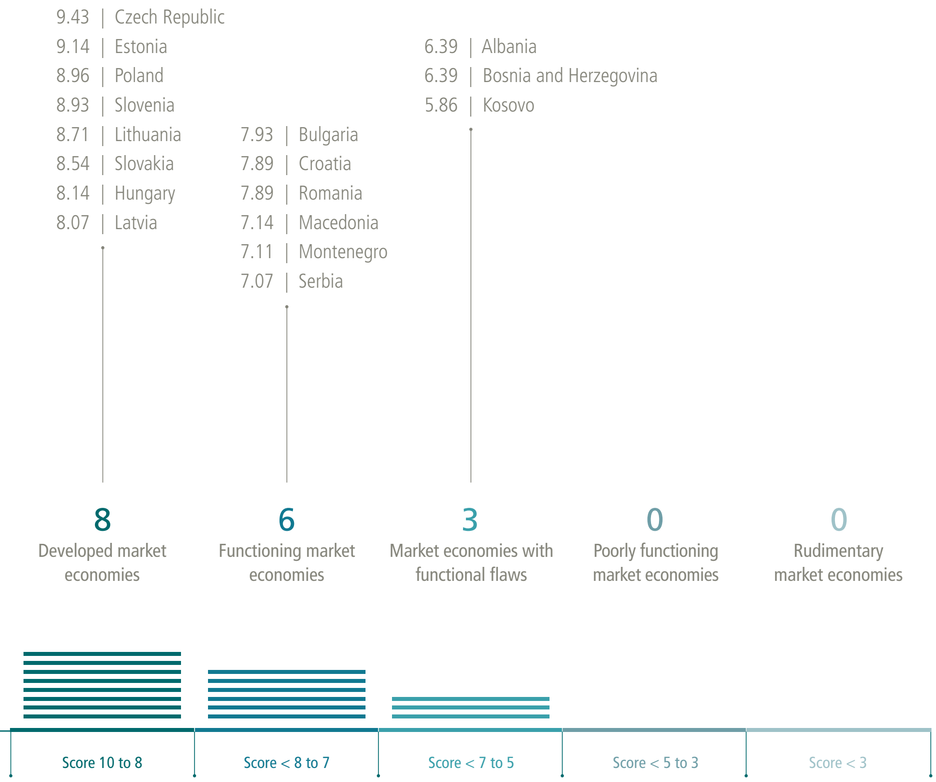
In the case of Bulgaria and Romania, the mere fact of EU membership has not yet resulted in the full consolidation of their democratic systems. Instead, the European Commission has identified persistent deficiencies, especially in the implementation and utilization of statutory provisions for preserving the independence of the judiciary. In Bulgaria, there were renewed tensions between the executive and the judiciary associated with these implementation deficiencies, with the Supreme Judicial Council dismissing judge Miroslava Todorova after she criticized the interior minister for breaching the independence of the judiciary. While the council justified the dismissal by claiming that Todorova had delayed criminal proceedings, numerous judges and civil society organizations protested against the decision, which they viewed as an attack on judicial independence.

Confidence in democracy has been shaken



Regional averages in three selected indicators, BTI 2006 – BTI 2014





Losing ground

Economic troubles within the euro zone and reduced access to credit have presented problems for the entire region. However, not all countries were affected to the same extent. While the Baltic states and Poland have managed to recover quickly, the pressure to save and consolidate led to ongoing crises elsewhere.

East-Central and Southeast Europe remains dependent on the euro zone and the EU. This dependency results from intensive trade integration with the EU and Western European countries as well as the extent of foreign direct investment (FDI), the dominance of foreign banks and the harmonization of domestic and EU monetary policies. The EU is the dominant export and import partner for every country in the region. According to figures from the UN Conference on Trade and Development, the accumulated stock of FDI in 2012 in East-Central and Southeast European countries was an average equal to 61 percent of GDP, a rate significantly higher than that found in many Western European EU member states. Furthermore, foreign banks dominate capital markets in the region; according to IMF figures, they control more than 90 percent of market share in many countries, and in almost all countries, they control assets worth more than 50 percent of GDP.

These structural factors explain why the entire region was affected so strongly by sluggish growth in the euro zone and its limited access to credit. Indeed, the crisis placed considerable pressure on economic performance in many of the region's countries. Seven, in fact, recorded poorer results in this criterion, with the average regional value being 0.47 points below that of the BTI 2010. But the economic crisis didn't affect every country to the same extent. EU member states Estonia and Poland managed to overcome the crisis relatively quickly. On the one hand, these countries' membership in the EU and close economic links with other member states made them more vulnerable to external shocks. On the other hand, as members of the euro zone, they enjoyed the effective external support and assistance provided by EU mechanisms for financial stability as well as access to extensive EU aid measures, such as structural and cohesion funds.

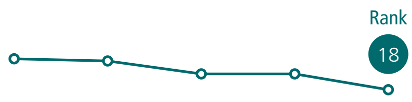
Furthermore, massive fiscal adjustment programs in the Baltic states were so effective that, since 2011, all three countries have returned to high growth rates. In Poland, the government of Prime Minister Donald Tusk reduced the budget deficit and undertook reforms for mid-term fiscal consolidation by raising the retirement age to 67 and extending the constitutional provision for debt limitation to subnational governments. In contrast, Croatia, the Czech Republic, Hungary, Serbia and Slovenia all faced recession. Albania, Kosovo, Romania and Serbia were particularly affected by reduced remittances from compatriots working in Western Europe.

The potential danger of foreign financial domination, exchange rate risk and macroeconomic instability determined the foreign trade policies of numerous countries. This led to smaller national economies joining the euro zone (Slovenia, Slovakia, Estonia and – beginning in 2014 – Latvia), unilaterally adopting the euro as a means of payment (Kosovo, Montenegro), anchoring their currency in currency boards (Bosnia, Bulgaria, Lithuania) or pursuing stabilized exchange rate regimes (Croatia, Macedonia).

As a result of the ongoing economic crisis, the proportion of non-performing loans, and associated risks for banking systems, increased in Hungary, Slovenia and numerous Southeast European countries. The Slovenian government endeavored to forestall the threat of state insolvency through tax increases, public-sector pay cuts and privatization of public companies, but it was unable to prevent a downgrading of the country's creditworthiness to junk status in late April 2013. Slovenia consequently ceded 0.32 points in economic transformation in comparison with the BTI 2012, but Hungary fell even further (– 0.46 points). While reduction of the budget deficit there in May 2012 led to the lifting of EU financial sanctions, government crisis measures were accompanied by populist rhetoric (including a special levy on foreign banks and the "renationalization" of pension fund assets of Hungarian citizens), undermining the trust of many foreign investors and nurturing doubts about the country's ongoing financial stability.

Finally, Bulgaria's and Romania's failure to advance socioeconomic development has been just as sobering as their performance in the field of political transformation. While income disparity between the richest and poorest quintiles of the population remained largely unchanged or decreased in most new EU member states between 2003 and 2011, for Bulgaria, Hungary and Romania, it has significantly increased. The at-risk-of-poverty rate also climbed sharply in these states during this period, while it decreased in Poland. In almost every country in the region, and particularly in the poorer Southeast European countries, reduced employment rates represent a growing social problem.

Population: 4.3 mn
Life expectancy: 76.9 years
GDP p.c. PPP: $20,532

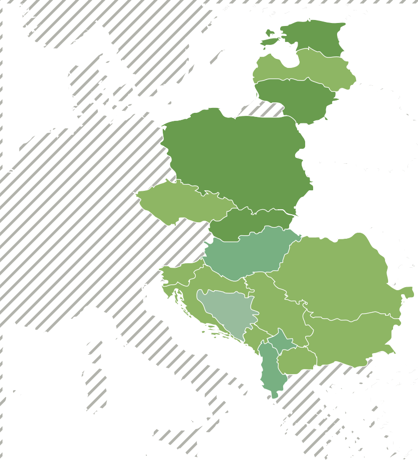


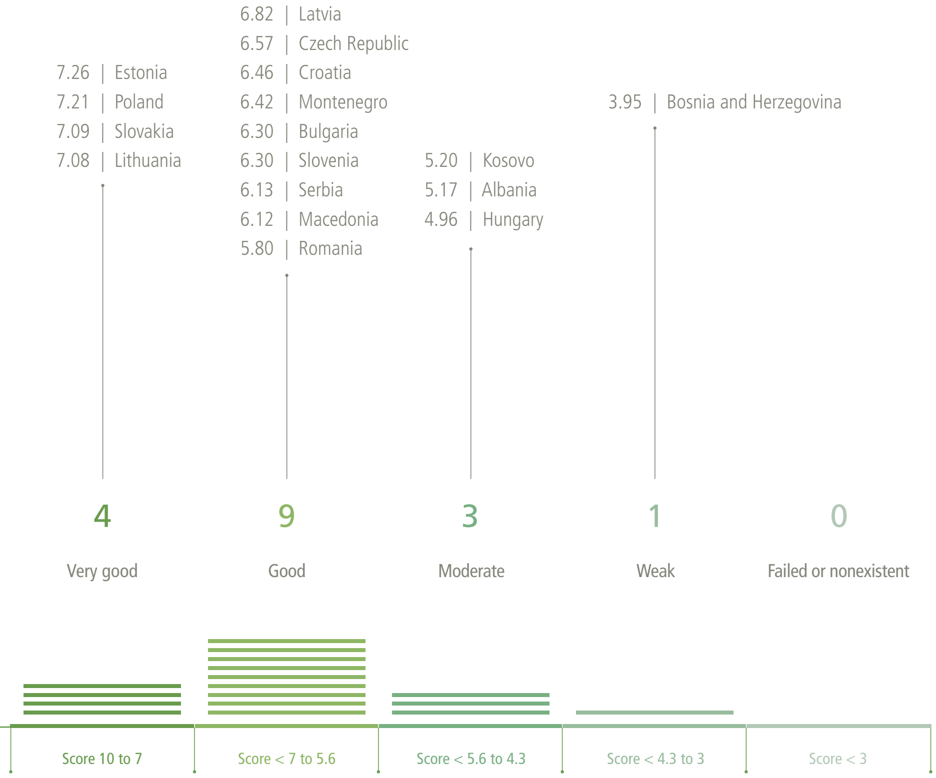
Economic transformation BTI 2006 – BTI 2014

Is Croatia ready for the EU?

The EU is hardly in a mood to celebrate these days. The rejoicing over its 28th member state was quite muted, too. Indeed, the absence of euphoria over Croatia's accession to the EU on July 1, 2013 was perhaps most notable in Croatia itself. Persistent economic problems account for this sad state of affairs. Since 2009, the country's economic output has contracted, a trend identified early on by BTI experts. They have continually downgraded Croatia for its performance in economic transformation – an indication that successive governments have not tackled its structural problems decisively enough. Apart from tourism, not a single economic sector is flourishing. State-owned enterprises, especially the shipyards, operate inefficiently. To make matters worse, Croatia is suffering from high public debt due to pension entitlements. This is reflected in losses of two points each for macrostability and economic output since 2006.

Despite some reform efforts, the four-party coalition under Social Democratic Prime Minister Zoran Milanović that has governed since early 2012 has not yet managed to lay a solid foundation for economic growth. This would require the courage not only to undertake unpopular measures, such as downsizing the public administration, but also to increase the efficiency of the judiciary and, last but not least, to improve the long-neglected education system. Such actions are all the more necessary because, according to the prognoses, Croatia can anticipate only minimal growth in 2013 and 2014. Still, domestic analysts expect the economy to revive in subsequent years thanks to the EU.





Transformation management

Protest parties on the rise

The consequences of the crisis in Europe have without doubt made transformation management more difficult. But the main problem is homegrown: profound, persistent corruption. Numerous scandals and affairs have triggered widespread protests and, in some countries, they have even revamped putatively stable party systems.

Poland and Slovakia are the regional climbers in transformation management. Governance in these countries was defined as "very good" by the BTI 2014. Both countries experienced above-average improvement in the field of international cooperation: Poland, which gained 0.42 points overall in the Management Index, advanced by a whole point here, while Slovakia (+0.29 points in the Management Index) improved by 0.7 points. But these are the exceptions in the region. In 11 countries, particularly Hungary (–1.3 points), there have been reductions in the effective use of external support, international credibility and the willingness to cooperate on a regional as well as international level. There are various reasons for this: In numerous countries, corruption scandals, government crises, constitutional violations and polarizing conflicts adversely affected the international credibility of governments. The increasing populist and nationalist rhetoric in some countries has led to tension in relations with neighboring countries and the EU.

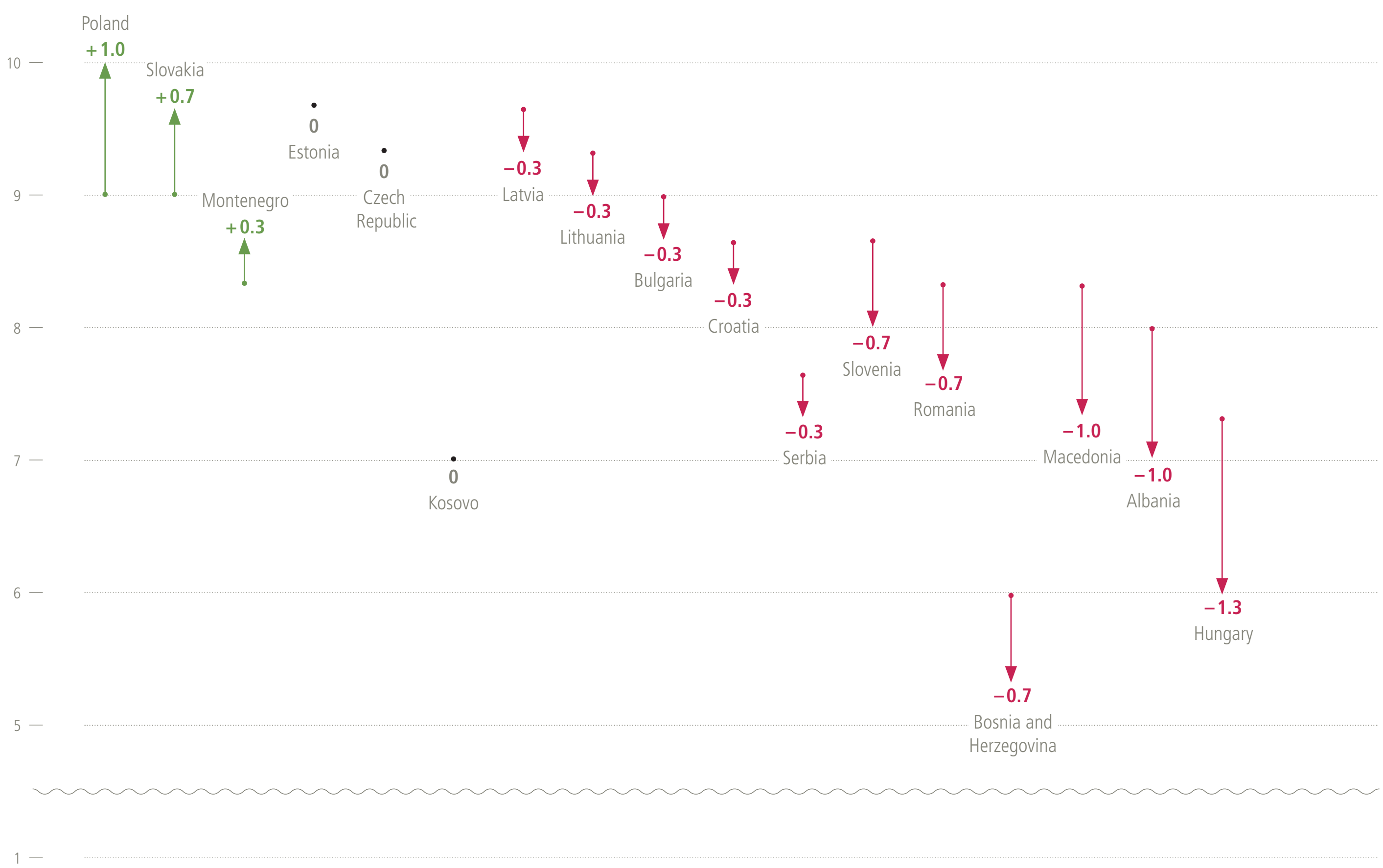
The main problem here lies in domestic political credibility: The revelation of numerous cases of corruption has not only triggered widespread public protests, but also led to governments collapsing or losing at the ballot box. The bribery scandal involving Croatian Prime Minister Ivo Sanader, who is currently serving a 10-year prison sentence, was one of the main causes for the electoral defeat of his former party, HDZ. In Slovakia, Iveta Radičová's governing coalition lost a parliamentary election after the publication of evidently genuine wiretap transcripts from the Slovakian intelligence service indicating that the influential Penta group had paid commissions to numerous politicians during its privatization process in 2005 and 2006. And, in the Czech Republic, the mayor of Prague and deputy chairman of the governing party, as well as the opposition president of the Central Bohemian Region, resigned on suspicion of corruption. Likewise, Czech Prime Minister Petr Nečas was forced to resign in June 2013 after an espionage and bribery scandal centered on his office manager.

In some countries, outrage has even given rise to new protest parties. Slovenia, for example, witnessed unprecedented violence in November 2012 amid the largest demonstrations since independence after the mayor of Maribor refused to resign in the wake of corruption allegations. In January 2013, an investigating committee established that Prime Minister Janez Janša and the mayor of Ljubljana had failed to fully disclose their financial circumstances. The prime minister refused to face the consequences, and his governing coalition collapsed in January 2013. The new government formed in February 2013 was led by the Positive Slovenia party, which had been established shortly before the November 2011 election. Bulgarian government party GERB has been the most successful of these anti-corruption parties to date, winning a parliamentary election and once again emerging as the strongest party in May 2013. In recent years, protest parties have arisen in Lithuania (Drąsos Kelias), Slovakia (OL'aNO), the Czech Republic (Věci veřejné) and Hungary (LMP), with each of them regarding the battle against corruption and the governing style of the established political elite as their primary objective. It is too early to say if these newly formed parties will manage to increase integrity in politics and effectively battle the corruption underpinning the mechanisms by which politicians attain power.

Along with corruption, general economic hardship triggered protests and demonstrations in numerous countries. This led to changes in government in Slovenia as well as Bulgaria, Lithuania and Serbia. In other countries, extremist parties with radical nationalistic or anti-democratic agendas have provided support to those segments of the population hardest hit by poverty. This applies not just to Hungary, but also Latvia, where the economic crisis has led to the political mobilization of the Russian-speaking community, which represents around one-third of Latvia's overall population. An electoral alliance that sees itself as the advocate for this group emerged from the 2011 parliamentary elections as the strongest party.

However, there was some progress toward resolution of the conflict between Kosovo and Serbia. While Serbia, Russia and five EU member states continue to withhold recognition of Kosovo as an independent country, 103 UN member states had recognized the Kosovan state by June 2013, including most of the EU as well as the United States. The EU High Representative successfully mediated in the conflict over border controls and, in April 2013, also negotiated the integration of Serbian municipalities and enclaves in Kosovo into an association of local authorities with wide-ranging autonomy and representation rights within the Kosovan institutional framework.

Scandals, crises and political polarization undermine international cooperation



Score changes in the international cooperation criterion, BTI 2012 – BTI 2014

The challenge of populism and polarization

The euro-zone crisis has shown the adjustment pressure faced by less competitive countries in East-Central and Southeast Europe as well as the social and political convulsions that enforced internal devaluation can unleash. Conflicts within the currency union and the ongoing recession in Southern European countries prove that accession to the EU and the euro zone is no guarantor of economic stability and development, nor does it suffice as a compass for internal reform. The crisis has also deepened lines of division between economic and social models and their underlying political economies in Northwest and Southern Europe.

The reduced appeal and orientation capacity of European integration also encourages developments in East-Central and Southeastern Europe that threaten democracy. First, it weakens those political elites who promote Europeanization through their identification with European values, as opposed to those who merely support EU membership for self-serving, strategic reasons. This last group doesn't interpret EU democratic norms and rule of law as integral elements of national economic, political and legal order, but rather as conditions imposed by external forces and only fulfilled to secure material advantage or avoid sanctions.

Secondly, it boosts populist parties and politicians who promise a disappointed populace spurious alternatives to economic integration, orchestrate demonstrations of the nation-state's strength and campaign against those allegedly responsible for economic hardship, be it the patronage network of excommunists, international financial capital or foreign powers. In contrast to several established Western European democracies, populist parties here are not confined to the margins of the party spectrum. Rather, the weaker bonds between voters and parties in the region's new democracies mean that the societal and party system mainstream is more susceptible to populist politicians.

Thirdly, the crisis in the euro zone and beyond has in several countries empowered political elites who use state resources to marginalize the opposition and employ polarizing rhetoric to mobilize their own supporters. To consolidate their positions of power, these forces put as many of their own party members in public offices and key positions as possible and dismantle constitutional checks and balances.

Finally, protests and social movements oriented against austerity programs of the government and the political establishment in general have emerged in many East-Central and Southeast European countries. This open expression of dissatisfaction suggests rather disappointment in the foreign-let modernization propagated by political elites than it does a maturing of civil society and more politically active citizenry. In several countries, violent riots near protest demonstrations and staged counter-protests have contributed to political polarization and increased the risk that extremist politicians could exploit protests for their own anti-system objectives.

In Southeast Europe, the EU managed to support reform processes and a normalization of Kosovan-Serbian relations by holding out the prospect of accession. Croatia joined the EU on July 1, 2013, and in June 2012, the EU commenced negotiations with Serbia and association negotiations with Kosovo. However, the broader outlook for Kosovo remains uncertain, as it does for Albania and the stalled rapprochement processes in Bosnia and Macedonia. Moreover, events in Hungary and Romania illustrate that membership in the EU is no guarantee against deconsolidation of democracy, and that indeed in some cases it can loosen the constraints political elites had accepted for their power struggles in the interest of accession.

This summary is based on the East-Central and Southeast Europe regional report by Martin Brusis, available at
www.bti-project.org/ecse

Full reports for each country in the region available at
www.bti-project.org/countryreports/ecse

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Interview

"The citizens must stand together"

Bosnia and Herzegovina is not governable – but there is a desire for substantial change, says Naida Mehmedbegović Dreilich

Following the October 2010 elections, representatives of the three ethnic groups – Bosniaks, Croats and Serbs – took no less than 15 months to form a government. Is the country governable in its current state?

The problem is that the country has not been governable since the end of the war in 1995 and will remain in gridlock as long as there is no political will among political elites to cooperate. It was the constitution set up through the Dayton Peace Agreement that produced such an ungovernable structure in the first place. Another problem is that only members of the three constituent peoples are allowed to run for any office, which prevents many capable people from joining in high positions. Apart from that, there are just too many individualized wishes and goals among political representatives. These are always put beyond the will and needs of people in Bosnia and Herzegovina.

According to the BTI, state identity remains weak, and both conflict management and reconciliation efforts lag behind the regional standard. What is the actual driving force behind this apparent lack of integration? Would it be segregation, with an apathetic population ignoring the power struggles of the political elites, or confrontation, including the latent danger of conflict escalation?

Both segregation and confrontation play a role. For instance, the school system in some areas still runs through the so-called two-schools-under-one-roof system, where children of two different nationalities, mostly Bosniak and Croat, are physically separated from each other and learn different views on history. There is also almost no interaction among pupils from different parts of the country, which was common in the former Yugoslavia. And confrontation happens all the time on the political scene – the political elite, especially some representatives from the Republika Srpska, constantly seek opportunities to confront and question everything related to state identity, undermining any possibility for reconciliation.

In terms of political transformation and governance performance, we record since 2006 a continuous negative trend underway in Bosnia and Herzegovina. What fuels your optimism in the face of all this?

It's really disturbing to see no upward trend in my country. As the results of the 2010 national elections show, people wanted a substantial change. The relative winner, the multi-ethnic Social Democratic Party (SDP), was given a chance to substantially change things. They failed mainly due to the fact that they could not break out of the power system established in the '90s, as many people responsible for the continuance of this power system also run the SDP. What nonetheless keeps me optimistic are the people of Bosnia and Herzegovina – when a baby was denied a social identity number and could not be sent abroad to a hospital, people demonstrated to persuade the government to adopt a state-level law that will regulate the issuing of social identity numbers for all babies in Bosnia and Herzegovina. Demonstrations addressing other problems have since taken place. If Bosnian citizens manage to stand together against the government, they might be able to change things for the better. The people have the power to change things; they must just be self-confident enough to demand greater accountability.

The BTI country report concludes that the international community still holds the key to Bosnia and Herzegovina's development. It calls for a "more creative approach" by the EU and its member states to promote national integration. Would you agree, and what might constitute a promising step forward? Are there more successful role models for your country?

I think that the international community made mistakes when drafting the Dayton Peace Agreement. I also think it might have been better if Bosnia and Herzegovina had been made a protectorate and not a "semi-protectorate." It seems that the international community never really knew what to do with Bosnia and Herzegovina – there have been so much miscalculation and misunderstanding; I can't imagine a new approach able to turn things around. Even the carrot of EU membership doesn't help, as people have other problems. I think things can be changed by the citizens of Bosnia and Herzegovina alone, of course with some backing from the international community. I don't see how the EU and its member states could promote national integration when member states such as France or Spain are struggling with their own national integration issues.