

Grzegorz W.

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“GLOBALIZATION” AND “EUROPEANIZATION”: A DOUBLE CHALLENGE FOR EMERGING EUROPE¹

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INTRODUCTION

Following the by and large successful completion of their transition from the Soviet model to the European type of market economy, the countries of Central Europe have been confronted with new challenges in the first years of the 21st century. On the one hand, the evolution of global processes and the growth of challenges that emerge on the world scale, from terrorism to the ITC revolution, call into question the foundations of all established societies. This is all the more demanding as these challenges pertain to the foundations of the European model of social market economy, emerging as an outcome of many years' efforts. On the other hand, the European Union – often mistakenly abbreviated as “Europe” – imposes immediate and concrete demands on the new members. This applies not only to the *acquis communautaire*, where living up to the commitments taken by the Copenhagen Council of December 2002 in such areas as environmental protection or rural development will take at least another decade. The *acquis* itself is an ever broadening set of rules and regulations whose precise meaning and interpretation evolves over time in the interplay between governmental and non-governmental actors (for further discussion see the reference book by Wallace and Wallace, eds, 2000). By the same token, it would be misleading to characterize the relevance of the EU in terms of the percentage of the member states' GDP – a maximum of 1.27 percent (in reality, just 1.13 percent in 2002–2006) – redistributed via the Community funds. Especially in such areas as environment, social policy, common foreign

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and security policy and legal rulings, the presence of EU policies and regulations has been constantly on the increase. Therefore, the enlargement of the EU in 2004 does not mean the conclusion of adjustment for the emerging economies. On the contrary, the more difficult part begins only now – a feature that could have been foreseen (Csaba 1998), and yet it has hardly motivated policy-makers, as is demonstrated by the stagnant institutional reforms.

In the following paper, we address four major issues. First, what “globalization” means for the emerging economies. Second, we try to deal with some of the peculiar stresses that follow from the speedy adjustment of the *acquis*, whereby the Amsterdam and Nice Treaties have foreclosed any further opt-outs, over and above the ones negotiated by the incumbents (such as Denmark, Great Britain or Sweden). Third, we attempt an overview of the salient features of a new round of institutional and structural reforms that are yet to come, if emerging economies wish to continue to emerge (from poverty and the heritage of the Soviet empire) rather than be a stagnant periphery. Given that the Constitution of the EU takes over the stipulations of the Treaty of Nice on enhanced co-operation, the prospect of second-rank membership is a very real one. But over and above this, the conditions of sustainable growth have not been created once and for all by the reforms of the early and mid-1990s, in the absence of similarly broad measures in the early 2000s. Thus it is primarily the self-interest in sustaining growth and avoiding the ramifications of being integrated into a non-dynamic part of the global economy² that may trigger further radical changes in Central Europe. Finally, we conclude with a normative subchapter on how to harmonize the need for more competitiveness with social equity – a major issue in the new political economy of development.

GLOBAL CHALLENGES – TRANSNATIONAL PROCESSES

The term “globalization” is one of the ideologically most loaded and academically meaningful ones. It is a product of the debates that have been going on since the East and Latin American financial crises and contagion, spurred primarily by social movements and academics sympathetic to these. It replaces the older terms, such as “imperialism” or “rule of financial capital” or “capitalism without a human face”, and is often portrayed by proponents as the ultimate source of all evils that plague humankind, from famine to environmental decay. Thus the majority view in the policy discourse is that it should be “tamed”, or at least “reshaped” (cf. most contributors in Krizsan and Zentai, eds, 2000). Under the Clinton Administration, high-level working groups were convened to elaborate what was then called the “new financial architecture”, an arrangement that was to replace, at least correct the major shortcomings in the workings of free capital markets.

It is worth noting how few constructive results these discourses have brought, both in intellectual and policy terms, let alone the institutional dimension. At one level, the outcome is that no conference or convention on the world economy may be convoked without triggering massive and violent protests on the streets, on a previously unknown scale, with great regularity. At another level, the talks on further liberalization of world trade

² Regular progress reports on the soul-searching Lisbon Strategy of the EU, adopted in 2000 with the aim of achieving growth and employment for all by the end of the decade, have not shown any major progress in areas criticized therein, such as the use of innovation as defined by patents, or other competitive gains against the United States.

...alled Doha or Millennium Round, were thwarted,³ first in Seattle in 1999, and then in ... in 2003, despite the fact that developing countries were to gain the most – and thus ... to lose the most – from the success or failure of these, respectively (Pangariya 2002). At ... level, in international finance, apart from cutting back the activities of the World Bank ... middle income countries and refocusing IMF activities on its original task of current ... amount adjustment (at the expense of more ambitious multi-year structural adjustment ... programs), not much has changed. Some initiatives, like the HIPC, took off, some calls for ... more transparency have been made, the Good Fiscal Practices Code was condoned, but the ... accounting scandals of 2000/2001 have swept away the more formal initiatives to change. ... Moreover, the Republican Administration has withdrawn support from the idea of the new ... architecture and become engaged in a series of unilateralist actions – from steel duties to ... withdrawal from the Kyoto protocol to refusal to submit to the jurisdiction of the International ... Criminal Court in the Hague. In sum, not much has happened, and the professions of ... accountants, lawyers and financial economists are equally divided internally over how to ... avoid the replication of similar mishaps. Therefore, not much progress in terms of ... constructive or positive initiatives has been achieved.

As regards the inclusion of environment and labor standards in international trade agreements, this requirement is known to be misplaced and harmful for developing countries (Bhagwati 1998). Moreover, the mandate of the WTO is such that it cannot be extended to cover these concerns, serious per se though they are. What we are confronted with at the moment is a situation when contracting parties, in their bulk, democratically elected, representative governments, back away from the forward looking commitments taken back in 1994 and are unwilling to subscribe even to those "concessions" that were agreed upon at that time. True, the implementation of the 1994 agreements has been inadequate, and market protection disproportionately hit the poor. However, this misbehavior does not invalidate the insight, proven in detail in the literature (Winters 2002; Greenaway et al 2002) that trade liberalization is welfare improving and in the long run is good for the poor. Therefore, if social groups call for the reform of the global order, they may have a point, but the WTO is the wrong door to knock at.

In fact, as can be proven (Whalley 2003: 188–92), it is primarily in the interest of poor countries to facilitate a success of the ambitious Millennium or Development Round. Tariffication of quantitative restrictions, for instance, is a major way of overcoming the protectionism of the advanced countries. The issue of special and differentiated treatment in a number of areas is also of major importance for the developing nations, and so is the issue of liberalization in the farming sector. Moreover the built-in agenda from the Uruguay Round is also to a large degree about compliance, implementation and dispute settlement, that is, the areas where complaints of the poor remain unaddressed. What may have been a useful tactical device in Cancún, is unlikely to be the last word on global trade talks.

These deliberations might sound commonsensical, were it not for the widespread academic penchant for global regulation and global social rights (Deacon 2003), or opposition against the global market via social mobilization and inter-state regulation (Yeats 2003). Even the European Union sponsored a multi-year international project on how best to fight

³ Well informed sources in the business press tended to blame, on both occasion, poor preparations and domestic concerns in the EU and the USA, respectively, rather than the demonstrators for the cessation of world trade talks.

globalization as a strain on the welfare state (Manning and Palier 2003). In more mainstream sources, like the influential journal of Chatham House analysts (Underhill 2003: 779–80), ideas are being made for the explicit subordination of global markets to new forms of international control. This, as we have seen, proved impossible, if for no other reason than because of the decentralized nature of the market and financial innovation, relying on ITC, which has led to the dematerialization of major transactions. Thus such ideas as the age-old Tobin tax are simply impossible to implement.

In a way, it seems, if the talk is about globalization, it results, willy-nilly, in diverting attention from truly global issues, such as terrorism, the spread of infectious diseases, migration, child poverty, the tens of millions of displaced persons and the ever growing number of failed states. These are truly global issues, together with the environment, which relate to the fate of all humankind and require action on a global scale.

By contrast, as can be proved in detail, the new features of international economic intercourse, although they do transcend national borders, rarely take place on a global scale starting with the European Union and its regulatory framework. Global and local processes take place in parallel. These may, and often do transcend national borders, without necessarily assuming a worldwide nature. The regional belt that emerged around Frankfurt and spread all the way to Brussels, the newly formed Euro-regions and many other examples are case in point. What critics mean here, with a degree of justification, is the declining significance of the territorial state and thereby the diminishing legitimacy of actors, as long as the political process of control continues to be organized along national lines.

Therefore, it seems more appropriate to term these processes as *transnationalization* as long as both from the organizational and the regulatory perspective, the crux of the matter is the emergence of a variety of forms not relating to national legislation. If one thinks about international accounting standards, which are the rules of a profession that are being applied in the regime of self-enforcement, it is clear, that national authorities have clearly lost a part of their sovereignty, and that forever. Whatever a government may think appropriate in the field of accounting – and the principles as well as applications are subject to controversy within the accountancy profession and amongst regulators alike – it is unlikely to get along, if it follows its own ways. On the macro-level, the Code of Good Fiscal Practices, or the ESNA standard, enforced by the EU Directorate of Fiscal Affairs, on the micro-level the IAS standard, approved by the profession, rather than formally legislated, will take the lead.

It is hardly by chance that following the East Asian and Latin American financial crises and contagion, the issue of transparency has become a leading theme on the agenda of policymakers and regulators alike. This implies, on the one hand, the standardization of procedures and the international support for the diffusion mechanisms that enforce these against vested interests (Hanson, M., 2003: 63–4). In doing so, both the rules of the game and the enforcement mechanisms are increasingly originating from and located (or at least anchored) in institutions transcending national borders. In the case of accounting standards and anti-corruption drives, it would be hard to demonstrate the “heavy hand of the Americans” in other cases, such as the advocacy of general human rights as part of the expected civil

conduct to be followed by all nations, the move is clearly transnational, without ever being global.⁴

In sum, *financial vulnerability and embeddedness in global trade flows* have been shown to constitute major components of economic globalization. However, it is correct to recall (see, for example, Bell 2000; Bell 2003) that the extension of international economic relations to the entire world is by no means a product of the late 1990s. It has been a long historic process that has been typical of the spread of capitalism ever since the 16th century. As documented by the available sources, it was only in 1995 that financial globalization, measured against GDP, reached the levels attained in 1913; the same is the case with international commodity flows. Therefore, it does require some detailed scrutiny to find out what, if anything, is new in the processes that ensue from the geographical extension of trade and other exchanges.

What is new in this respect may thus boil down to *three major factors*: financial vulnerability, which has rendered the sustaining of national currencies a luxury, available to the largest players only; the breakdown of liberalization along the WTO disciplines at an early point, when free trade is more of a slogan (or a four-letter word) than reality in a number of markets; finally, the spread of electronic trade and ITC in general, whose regulation along the logic of WTO disciplines is less than perfect at the moment (more on that in Matteo and Schuchknecht 2002).

It would require separate monographs to elaborate these points, so let me restrict myself to a couple of observations. First, all these issues pertain to all players in the world economy, thus it is legitimate to call them *global*. This holds true even if they affect individual players in different and often asymmetric ways; they are more important to those who are more deeply involved in the transnational processes. Second, the spread of derivatives and dematerialized transactions has led to an ever growing volume of financial flows that are completely detached from what used to be called "fundamentals", thus the available set of regulations – national and international, especially at the level of elected governments – is becoming increasingly ineffectual. Third, in areas where states still retain some control rights, like the regulation of commodity flows or the transfer of intellectual property rights, the setting of some of the conditions for major cross-border investment flows, or, equally importantly, the regulation of services, especially those that relate to the flow of people, the threat of regressing into inter-war patterns of bilateralism, or even unilateralism, is perceptibly on the increase. In other words, regulators try to control what they are unable to regulate, while things they might be able to regulate in a co-operative fashion are being left unregulated, at least at the level of multilateral understandings. The latter are known to benefit the small and the less mighty, like the emerging European economies.

Let us just mention that the Internet – and, more generally, the ITC revolution – has created new opportunities and new threats. A lot has been written about the new opportunities, thus let me just mention the threats. On the one hand, terrorists and other groups hostile to the western type of democracy can already make good use of this new dimension in coordinating their activities. This applies not only to armed attacks, but also to money laundering and quite conventional criminal activities, like the trafficking of human beings or of drugs. Global co-ordination of police and security activities is obviously lagging behind; it is ad-hoc and at a rudimentary stage, mostly stuck in the narrow constraints defined

⁴ Amnesty International or the ICC do work globally, however, many governments do not condone their activities (starting with the US Republicans).

by 19th-century interpretation of national sovereignty. Furthermore, the ever more frequent attacks by global hackers, as most recently the "I love you" and SoBig viruses, have uncovered the extreme vulnerability of the global ITC network vis-à-vis non-political but non-cooperative minorities. Finally, cases of unauthorized access into such well protected servers as those of the Pentagon, NASA, or banks have also exposed the inadequate protection of sensitive information. But also in more general terms, as Geruschkat (2002) correctly underlines, ITC poses an insurmountable challenge to all sorts of traditional regulation, be that on product or factor markets, or in the realm of inter- or intra-state affairs.

Let me be clear: the state of affairs in what Kolodko (2002: 84–90) rightly terms global markets without global government is unlikely to change. As he also rightly suggests, the difficulties outlined above will not lead to more interventionism in general. However, there is a world of difference between petty meddling with the affairs of others (or micro management) on the one hand and the lack of regulatory institutions on the other. One possible option to overcome vulnerability, at least for small countries, is to join currency blocks – a suggestion well elaborated in the literature (Horvath, J., 2004). The hope for a more successful round of world trade talks is not to be given up yet, either, since global commercial talks normally last 8–12 years, and currently only four years have been wasted. Finally, self-regulation, which has been dominant in the financial sector and in the ITC community, is also known to be an efficient form of regulation, without necessarily calling for the creation of inter-state organizations and endowing these with the authority to police whatever they wish to.

Actually, if global problems – i.e. the challenges pertaining to all humankind – are indicative of anything, it is the need to re-assess the traditional concepts of international law and economics, which tend toward an over-emphasis on both nation states and the regulatory activities of these. As Crocker (2003: 43–4) rightly emphasizes, tasks such as increasing involvement in the problems of what is termed "failed states", so as to foster their integration into the international community, spreading the universally accepted and sanctioned – codes of civilized behavior, including the disengagement of criminal networks from the polity, and in particular the opposition, the termination of civil wars, international switching off the sources of funding, or the already mentioned enhancing of international transparency⁵ – all require co-operation at the global level, and not primarily, let alone exclusively, among governmental actors. This is reflected in a recent World Bank initiative (Rischar 2003) intended to involve non-governmental actors in a flexible, issue-specific manner.

In sum, if we are to address the fourth global problem, terrorism, by more elaborate and in-depth means than the War on Terror (Byman 2003; Freedman, L., 2003), new forms of means of transnational co-operation and co-ordination are required. These should by no means be equated with the age-old attempts to create a global supra-government, whose legitimacy and thus efficacy would be questionable. When the combatant is not a nation state, the traditional concepts of military security are of little avail. Likewise, the greater reliance of terrorist groups on network principles of organization – the most modern and known to management science – the less efficient can the government and formal institutions

⁵ Here the classical problem is that everybody is interested and thus happy in enhancing the opportunity to peek at the cards of others, while reciprocity is seen as an offense. Transparency in banking and the disclosure of secrets as the most valuable commodity of a financial institution are an example of this.

is be in fighting these groups. Coping with failed states and with the terrorist groups in their territories would call for much more co-operation among security and police than is seen these days in the framework of Interpol and Europol, still much gained in their respective activities by the 19th century concepts of sovereignty. Early, the network organization follows a different logic than the still predominant national military doctrines that presuppose the existence of a well defined enemy – usually a hostile state – that follows a rationality of its own, which is easy to model in game theory. Therefore, we need to develop an understanding of a different logic and a different rationality which do not follow the wealth maximizing or the power maximizing principles but the constraints of customary financial and political rationality, if we are to devise effective preventive measures of various kinds. In these areas, the social sciences seem to have little to offer to policy-makers at the moment.

An important follow-up problem, also closely related to failed states, is the spread of infectious diseases and many other crippling repercussions of lasting poverty. A state can be considered failed when its basic functions remain unattended, such as securing public security and elementary public services, including health care. As the Human Development Indices, regularly published by the World Bank in its annual reports, testify, these services are not being regularly provided in a number of states, and may even show a tendency to deteriorate in the long run. This is a major problem insofar as it plays a main role in the vicious circle of poverty, where undernourishment leads to diminishing capabilities, the latter to the crowding out of labor markets, further marginalization, and exposition to crime. With massive migration that is unlikely to be controlled by police methods alone, the spread of diseases is a very real eventuality, as the proliferation of the HIV virus or the re-emergence of tuberculosis in advanced countries has shown. The SARS panic already foreshadowed that the modern interconnected world carries enhanced risks for each individual, thus facing these challenges is not the job of policy-makers only.

A sixth global problem is the crisis of the welfare state. It relates to migration in a fairly straightforward manner. If the crux of the matter is, as shown by numerous analyses, the gap between limited revenue raising capabilities of the state and unlimited demand for its services provided as entitlements, there is no solution for the crises of the pension systems within the framework of a closed national economy. A trivial solution, it might seem, is migration (Hewitt 2002), that is, allowing the young and enterprising people of underdeveloped countries to move according to economic criteria. Let us note that migrants should not be confused with refugees. While the latter are normally displaced persons who need to be assisted on humanitarian grounds by any civilized society, the former tend to be healthy, young and enterprising. Their taxes and social security contributions provide perhaps the only conceivable way to bridge the current implicit debt of the pension systems in the medium run. Let us also remember (Lipton and Ravaillon 1995) that migration used to be a major factor alleviating the demographic problems of the Old Continent: according to their calculation, no less than 45 percent of the population increment of the British Isles in 1863–1933 migrated outwards. Since labor remains a factor of production, it is hard to overlook its inherent capabilities for wealth creation, especially in societies where, allegedly, incentives are right.

But it is not migration that poses the major challenge to the welfare state. Over and above the fundamental problem (limited revenues – unlimited demand), the slowdown of the trend rate of growth and the ITC revolution exacerbate difficulties. In the 1950s and 1960s, 7–8 percent growth rates allowed for more lavish options than the current 1.5–2 percent.

Furthermore, when activity levels were high, and employment tended to be in the wage earning sector, the revenue raising capacity of the state could be taken as given. The latter has fundamentally changed due to major changes in industrial organization and employment, brought about by ITC (Kocsis 2000; Szabo 2000). These changes made what previously used to be called "non-traditional forms of employment" the norm. These include contract work, distant work, part-time employment, multifunctional, multi-task employees and many others. Their common effect is the loss of fixed jobs in large organizations, where the collection of social security contributions is secured by an elaborate bureaucracy. Irregular employment per se is an incentive to dodge public dues, and control costs are soaring. The less private provision of health and old age services occurs, the higher is the incentive to avoid self-care measures on a massive scale. The re-emergence of poverty among the elderly and among small business people in the West is an example of this.

The experience of the Western countries is mixed. On the one hand, political processes have clearly revealed a preference of the majority in European societies to preserve the salient features of the post-war welfare state. On the other hand, while some countries avoided any major changes and ended up with stagnation and a soaring public debt, as in Germany, Italy and France, others have made incremental reforms. Sweden and the Netherlands are perhaps the best examples of countries where the fundamentals of the welfare system remain, but their functioning has changed tremendously. True, most changes contribute to easing budgetary burdens, while other considerations of sustainability may not always be observed.

Last but not at all least, the problem of *localization* needs to be addressed. It means not only the ever growing share of the tertiary sector, which is often immobile and provides mostly non-tradables, but also a tendency of the political and information flows to focus on the funny at the cost of the important. Info-tainment dominates over analysis, and the survival of public broadcasting stations, as well as of major quality papers, has been called in question.⁶ This implies a serious challenge, insofar as the global problems are crowded out by local news, while the public opinion is in the hands of tabloids and popular show-biz. Thus a number of cases informed decisions are unlikely to be forthcoming.

The more convinced we are of the need to make public choices on reforming the welfare state, the more dangerous the process of super-localization of the media may seem. For it is unlikely that uninformed voters can make forward-looking decisions, especially if temporary welfare losses are also part of the longer-run solution. The more the Republican Administration in the US is involved in populist fiscal policies, the less one can think about the customary "do what I say, not what I do" in the context of welfare state reform and solution to the emerging problems.

Since the emerging economies of Central Europe are already confronted with the problems of graying population, negative birth rates, slowdown of growth and limited immigration while their welfare systems remain basically unreformed, the challenges, *ceteris paribus*, apply to them as well.

⁶ In 2002/2003 two leading papers in Germany, the left-centre *Süddeutsche Zeitung* and also the centre-right *Frankfurter Allgemeine* barely escaped bankruptcy. Even the business oriented *Financial Times* has become much slimmer than it used to be; and the *Neue Zürcher Zeitung* is also facing financial difficulties.

"EUROPEANIZATION" AS A SPECIAL CHALLENGE

Europeanization is a term that comes from the political science and European studies. It denotes a process of mutual adjustment of national and EU-wide systems in a number of planes, including the economy, regulation, legislation, political systems and institutions. There are several examples of this. For instance, if the EU takes a decision, by simple majority voting, to impose a strict environmental regulation, citizens of the non-compliant country can launch court cases to foster enforcement. The fact that the given country has not voted for it is no excuse. Likewise, the initiation of warnings and later punitive deficit procedures against non-compliant governments, such as Portugal, Ireland, Italy and most recently France, triggers adjustment processes in the respective countries. This follows in part from the feedback of markets, and in part from public debate/peer pressure.

There is understandably a reverse flow as well, with European institutions and policies affecting to a large degree the domestic policy outcomes of the member states. The conversion to monetary orthodoxy in the 1970s and 1980s, or the turning away from centrally planned big prestige projects to co-financed, regionally managed smaller ones are all clear examples of the feedback process.

It would be hard to overlook that in a number of areas, primarily in economic philosophy and also in fiscal approaches, there has been a fair degree of convergence between global and mainstream thinking and policies adopted at the European level (Lanyi 1997, 2001). However, it would be a mistake to identify the two processes; the European Union is to a large degree a closed economy, a unit of its own, with specific policies and institutions that require more and to some extent different things than the global markets in general do.

For the emerging European economies, to talk of the process of "Europeanization" is something of a misnomer. On the one hand, these economies have always been located in Europe, in economic, political, geographic and cultural terms. On the other hand, their accession to the EU has been up till now a process of unilateral adjustment, consisting in their controlled - taking over of the Community laws and regulations in the process of harmonization that preceded enlargement. Also the way the *acquis* was re-interpreted in the Amsterdam and Nice Treaties, and also by the Constitution, does not allow for opt-outs, like those enjoyed by some current incumbents. On the other hand, the sheer possibility of "enhanced co-operation" allows for the emergence of second-class membership. Finally, the attempts by the Polish and Hungarian governments to influence the wording of the Constitution have already triggered thinly veiled irritation among the incumbents already at the outset of the Rome inter-governmental conferences (IGC) of the EU.

Similarly to "globalization", the challenge of "Europeanization" also stems from circumstances that are different from what the name would imply. The real challenge comes from the clash between normative and actual processes. In normative terms, one of the few consensus points in the more academic and policy-oriented literature used to be the need for intra-EU reforms prior to enlargement. However, the inter-governmental conferences of Turin, Nice and Laeken fell short of producing an algorithm that would make allowance for the enhanced diversity and the ensuing divergence in preferences among member-states and even more among the citizens. In one of the big paradoxes of history, while in economic terms the enlargement adds only slightly more than 5 percent of GDP to the incumbent EU, in terms of population an additional one third of voters is added. Thus the more the EU moves

towards overcoming its democratic deficit and the more its institutions reflect the normative claim of being closer to the citizens, the higher the immediate repercussions of enhanced diversity are likely to be. This could, in theory, be a source of inspiration, but not for institutions where unanimity and informal decision-making used to be the name of the game.

As of the time of writing, no final text of the Constitution was available. However, it would be hard to overlook, on the basis of what we know, some features that will have an immediate bearing on the outcomes of the enlargement for an expanded European Union.

First, although the Constitution contains some federalist elements and principles of superiority of Community methods over inter-governmentalism, a feature already criticized by liberal observers (Bernholz 2003), no major change is taking place in favor of qualified majority voting on issues over and above procedural ones and those which used to be settled in this regime before, like e.g. fisheries. The size of the European Parliament will be over 730, which is reminiscent of the Congress of People's Deputies in the last years of the Soviet Union. This is highly problematic, if we subscribe to the insight (Longo 2003: 490) that constitution-building in Europe is about creating new forms of legitimacy and democracy, transcending the nationally constrained present forms, that should reflect the new realities of integrated Europe.

It would be misleading, however to overlook the difference between the two bodies mentioned in the previous paragraph: whereas the Congress was created as a countervailing power to the almighty Communist Party and played a useful taming role, the European Parliament is vested with elements of direct democratic legitimation. Though its role is mostly deliberative, the Amsterdam and Nice Treaties, as well as the Constitution, enhance its rights in terms of co-decision and approving funding and personnel. Knowing that a European Parliament represents 500,000 to 2.5 million European citizens (the latter figure would translate into a four-member strong parliament in Hungary) the legitimating power is not particularly high in this case. Furthermore, the size of the assembly, due to its different functions, may be counterproductive. The moment it acquires constructive rather than merely ceremonial or balancing functions, decision-making at the EU level may become unduly complex and burdensome. It may take much too long to come to decisions, thus the common foreign and security policy, as well as issues pertaining to the third pillar are unlikely to be settled in a flexible and operational manner. Given that small countries stick to "their" Commission and "their" languages, the workability of the Commission is severely impaired. Likewise, the four-minute constraint imposed by the Italian Presidency on Prime Ministers in Rome during the Constitution debate already foreshadows the type of difficulties unchanged arrangements may bring. And let us remember: in the examples quoted above, neither money, nor "war and peace" were at stake.

A second major challenge for the enlarged EU is the unreformed state of *redistribution policies*. Most of the EU literature that focuses on the technicalities of integration is devoted to various forms of solidarity, primarily expressed in the Common Agricultural Policy and various forms of regional spending via the structural funds. The fundamental problem here is twofold. On the one hand, the enlargement by ten, mostly poorer members has been done without *either* redefining the priorities of spending, *or* revising the ceiling on common spending set at 1.27 percent of GDP (in actual practice even less – a mere 1.13 percent). While such decisions are understandable on the grounds of vested-interest politics, this is a clear sign of lack of orientation. Either expenditure priorities need to be redefined (as proposed by the Commission but rejected by the member states in October 2003), or conversely, the

ness of net contributors needs to be re-assessed. If none of these happens – as is the case in the transitory period of 2004–2006 – the evolution of first- and second-rank membership is inevitable. The entire rationale, for instance, of direct income support 14 years after the MacSharry reforms can indeed be called into question, but only across the board. The principle elaborated in Copenhagen, that new members will be gradually phased in until 2014, is in obvious contradiction with the elementary principle of equal treatment among members.

Knowing the quite critical self-assessment of both regional and agricultural spending in the EU, which is a subject deserving a separate paper, one wonders why none of the cut options materialized prior to the enlargement. It would perhaps be in line with the philosophy of the SGP and the public mood in all net contributor countries to give up much of the solidarity principle, which does not seem to apply to the current conditions any longer. As the Constitution itself contains recurring references to solidarity, social rights and equality, it might be politically infeasible to get such reforms through. Given the current state of affairs, however, it is likely that the horse-trading that dominated the Copenhagen Council in December 2002 will intensify in the future. If this is the case, the elaboration of new financial guidelines for 2007–2013 may prove next to impossible. The laming of the community is a most probable scenario, that may well trigger a new wave of overdue reforms, but this is only one of possible options.

A third area where the European Union is seriously challenged is *regionalism*. In short, with the evolving decentralization of previously unitary states (Hrbek, ed., 2001), the idea of regional development based on central redistribution of resources and central policies in general has been questioned. This applies to member states, like Spain or even Great Britain in the Blair period, so it also applies a fortiori to the EU at large. To put it bluntly, the tendency of member states to get back "their money", as Baroness Thatcher once exclaimed, seems to have been dominant over other considerations. Thus it is not EU structural funds and related institutions that have been the driving forces of European regionalism, but, rather, the other way round. The emerging European regionalism has rendered EU-level structural spending largely irrelevant. And this is a major difference compared to the period of southern enlargement, when in certain years Portugal, Ireland or Greece received up to 4 percent of their GDP in terms of EU transfers, mostly in regional spending (which overlapped with CAP transfers as well).

This implies, among other things, that the relevance of structural funds and related EU policies is decreasing for both incumbents and new members; in a way this is the clearest example of why accession-driven transformation is over and a new, more innovative phase is to come in designing and implementing institutional and structural reforms in the new member states (more on that in Csaba 2004, chapter 4). The ongoing policies of re-tailoring territorial organization in the hope of official transfers that are either not forthcoming or may be negligible at the macro-economic level is a case in point.

The fourth major issue of "Europeanization", especially from the point of view of new EU members, is the future of the Stability and Growth Pact (SGP), as well as the stability of the single currency. For the time being several challenges are observable. On the one hand, due to the expansionary policies of the US and Japanese governments, the single currency has reached exchange rate parities similar to the levels at the time of its launching (and even above), which many exporting firms find too demanding. On the other hand, some of the biggest players in the EMU, notably France and Germany, and to a smaller extent Italy,

follow policies that openly question the rationale of the SGP. The new Franco-German growth initiative, followed immediately by the big ten-years investment project of the Commission, all point to a different dimension.

This is not the place to enter into the broad debate on the single currency and its relationship to the SGP. It has been shown by several analyses in the literature that the interrelationship, at least in theory, between the SGP and price stability is intermediate at best. On the other hand, knowing the dominant size of private capital flows and portfolio investments in particular, softening up the Pact would send a signal of lacking commitment to price stability, and thereby create a credibility problem. True, if we believe the more skeptical academic analysts, the final outcome may well depend on market sentiment. For instance, once the structural reforms initiated by the Schroeder government, with partial support of the conservative opposition, are assessed as credible, the exact size of German deficit in one particular year may not matter that much. Likewise, if public debt grows above the 60 percent line in France as a consequence of pension reforms which make the previously implicit deficit explicit, this may not be seen as a problem by the markets, at least not more so than the current large deficits in Italy or Belgium. Thus it may well be that breaching the Pact, if only temporarily and for good reasons, may not be a major problem.

On the other hand, if softening up the SGP is part and parcel of a populist turn in economic attitudes, condoning the non-reform policies out of political opportunism (i.e. just because it happened to the big guys), even relatively minor disturbances may trigger major reactions – even over-reactions – by the markets. The example of the US is telling, as much as the examples of East Asia. Neither of these cases involved seriously deteriorated macroeconomic fundamentals, and yet the devaluation of the respective currencies took place.⁷ Therefore, it seems hardly an innocent game to engage in activities that undermine the hard-won credibility of the single currency and the respective national policies.

The fate of the SGP has an immediate bearing on the new members, since this is part and parcel of the *acquis* they have signed up for, though with a derogation. Knowing the multiplication of fiscal difficulties in all Central European countries in the 2001–2004 period, they will keep a watchful eye on the debate. However, the fundamental economic insight that only non-inflationary growth is sustainable in the long run, is perhaps no longer questioned by any of the emerging European economies.

A fifth, maybe even more challenging factor is the slow progress – if any – of the Lisbon Strategy of the EU. It is known that in March 2000 the EU adopted a ten-year strategy to accelerate the use of ITC, enhance productivity and flexible organization of labor. One of the innovations has been the requirement to present progress reports to the Council every year on the implementation of its decisions. One of the few things that we do observe is progress in this area, most relevant for long-term growth in Europe, is limited at best. It means, among other things, that the new members cannot rely on a dynamically growing market in the EU that would, by and large automatically, produce spillovers and generate demand, thereby creating long-term growth potential for them. This finding is directly contradictory to the normative view (Langhammer and Woessmann 2002) that envisages the EU as a forum to elaborate a regulatory environment which is globally more competitive.

⁷ Some analysts claim that the US and other G8 governments "are talking down the dollar", but this is a very partial and short term explanation for a trend that has been with us for several years.

arrangements. Unsurprisingly, the authors cited above consider credibility to be a condition for this to materialize. But not least, mention should be made of what is usually referred to as the second pillar of the European Union, that is, Common Foreign and Security Policy (CFSP). It would be a pity to overlook how important this dimension should be, provided the EU does take its global aspirations, as reflected in the Lisbon Strategy, seriously. There are three areas where progress should be palpable: the policy on the West Balkans, the Barcelona process and proximity policies vis-à-vis the CIS countries.

As far as the West Balkans are concerned, the gradual disengagement of US-led NATO is taking place at a period when neither economic reconstruction seems to have gathered momentum, nor EU military capabilities seem to have been built up to a level needed to play the role of a judge who must, willy-nilly, be involved in peace creation, not only peacekeeping. The EU has fallen short of providing financial assistance on a grand scale. It has even more behind in providing a European perspective to the westward-looking, democratically committed leaders of the region. The assassination of Serbian Premier Zoran Djindjic in 2002 is just the tip of the iceberg. The inability to cope with the Macedonian conflict, to provide a perspective for Kosovo, or to overcome the ongoing rift among the three nationalities constituting the quasi-state of Bosnia-Herzegovina are further examples. It is equally difficult to see what the exclusion of Bulgaria and Romania from the Big Bang enlargement may imply for the future development of these countries. The promised deadline of 2008 does not seem terribly credible or convincing.

Regarding the CIS, the EU has yet to develop a policy that would go beyond the level of declarative diplomacy. On the one hand, the EU is the largest trading partner for Russia, and also a major player in Russian foreign policy. On the other hand, it found itself marginalized, first in the 1990s, behind the international financial organizations, and later in the 2000s, with the emergence of the War on Terror and the Coalition of the Willing. In a sense – and largely due to the open rift between Britain and Spain on the one hand, and the Franco-German axis on the other, which became manifest in the war against Iraq – the CFSP is in a state of clinical death. Rather than coming up with new initiatives, the second largest economic power of the globe is occupied with mending fences and trying to avoid further discord.

Lastly, we should mention the Barcelona process. It is vital for the EU, in particular because of its historic ties and geographical patterns of migration, to enjoy especially good relations with countries of the Mediterranean. The process, started in 1993, aims at closer cooperation in all the areas mentioned, including free trade or even association agreements. Turkey has been a candidate for full EU membership since 1999.

However, it would be hard to overlook the fact that – not least because of the violent nature of the conflict in the Middle East, with the Intifada going on for several years – the EU's inability to develop a defense arm and a similar unwillingness on its part to provide massive financial assistance to reconstruction have led to continued US dominance and European marginalization. Over and above conferences and declarative diplomacy, there remained precious little room for a peculiarly EU accent in managing these affairs.

It goes without saying that the very real challenges of migration, economic and social insecurity, or suppressed but widespread social tensions, as reflected in the ongoing civil war in Algeria, the Kurdish insurgency in Turkey or the violence in tourist places in Morocco and Egypt, are but a few of the manifestations of the problems. All in all, the EU has a strong interest in developing something more meaningful than its proximity policies used to be. In

doing so, the new members have a shared interest, and perhaps some additional regional competence to share with the incumbents.

NEW MEMBERS: THE CHALLENGE OF THE THIRD WAVE OF TRANSFORMATION

One of the pre-conditions for the post-communist countries to join the EU has been, according to the Copenhagen criteria of 1993, their successful completion of transition to market economy. By joining the OECD in 1995–7, the three frontrunners actually exceeded this target, insofar as the OECD, unlike the EU, did require commitment to capital account liberalization. Admission was preceded by intensive scrutiny, where the market economy characteristics of the respective countries underwent careful professional assessment.

Looking from this perspective, the entry into the EU in 2004 is rather delayed. On the other hand, one of the motives that prompted the EU to defer that moment for so long could have been the desire to provide additional incentives to structural reforms in a number of post-communist economies (more on that in Balazs, P., 2001, chapter 8). Considering the phases of the *acquis* screening process and the detailed discussions over the 31 chapters that paved the way to accession, this approach does not seem without merit.

In reality, the first phase of transition in the Central European countries, characterized by stabilization, liberalization, institutional reform and privatization (SLIP), was concluded by the mid-1990s. Following this stage, the so-called second generation reforms were initiated in several countries, such as re-tailoring the welfare system, the privatization of network industries, pension reforms to address the inter-generational implicit debt, as well as administrative reforms.

This is not the place to replicate the detailed assessment of institutional reforms, periodically regularly by the *Transition Report* of the EBRD, one of the first analysts to have emphasized institutional progress. Whatever we think about the merits and weaknesses of the institutions developed by the London-based analysts, they are clearly related to economic performance and observed changes in national policies. Besides, an appraisal by an international agency is more likely to be even-handed than national self-assessments are.

A glimpse at the EBRD data may be enough to see that structural reforms, especially second generation reforms, *have been suffering severe setbacks in 1997–2003 in emerging European economies*. Pension reforms, where initiated, have been slowed down and on occasion reversed. Utility privatization, though started, has not been completed in other network industries, as well as in the transport sector, privatization has been limited. Even in the more conventional tradable sectors new initiatives have been lacking. Slovakia, Estonia, the Czech Republic and Lithuania have been catching up with Hungary in the mid-1990s. In the latter country, the center-right government stopped the privatization process, and its center-left successor basically spent the first two years in office talking rather than acting.

It would be hard not to relate the secular slowdown in the economies of Central Europe to the stagnant institutional and structural reforms. In a way, the convergence among economic systems took place around the level reached by Hungary by 1997, and except for Slovakia and Estonia, no further progress is observable. In the first years of the 2000s, we observe old-fashioned Keynesian attempts, by both left- and right-wing governments.

growth by expanding domestic demand – an attempt that could only bring transient growth in small open economies. Therefore, it is hard to see in what ways these economies can be restored to growth, in degrees required by conditional convergence models, other than by instituting a new wave of reforms that aim at creating conditions of sustainable growth and its financing.

One of the reforms that have long been dodged in the post-communist countries – though only there – has been in the area of *public finance*. At the moment, some elementary conditions of fiscal sustainability are not being met. The transparency of government expenditure leaves much to be desired, from the point of view of both publicity and legislative control. Also in terms of the assignment of tasks, it is traditions and compromises of daily political matters, rather than more general considerations, that set expenditure priorities. In the area of revenue raising, such simple maxims as those of few and low taxes coupled with broad tax bases and effective enforcement have a long way to go. In the populist outbursts of 2000–2003, discretionary elements on both the tax and the expenditure sides have increased tremendously. The question is very rarely asked whether any given task is currently attended to and financed publicly serves a specific national interest and is justified on the grounds of public good, or whether there is an alternative possibility of outsourcing this task. One extreme example in Hungary is the assay office (a quality control, rather than a tax collecting authority) – a monopoly firm which operates at a loss, but is still publicly owned in Hungary, once a champion of privatization. Sustaining national carriers at a time of big international mergers in the airline industry is yet another example. And there is no end to cases like these.

It is relatively easy to see that broad coalitions, whether within a single broad-based party (*Volksparteien* in German terminology) or formally established by competing forces, are tempted to spend ever more, and that the tendency towards discretionary spending is on the increase. Likewise, if the economy slows down but social pressure to hand out more pork is mounting, it is certainly easier to give in and blame the "straitjacket of Maastricht" and "cold-hearted monetarists" than to rationalize expenditure and stick to old-age norms of solid housekeeping.

One of the major obstacles to fiscal reforms in Central European economies is the institutional integration of local municipalities within the system of general government finances. This implies that any conceivable cut is immediately politicized; the more individual constituencies weigh in the electoral policies (and they do), the higher is the probability that any attempt at fiscal cuts will be resisted and reverted in behind-the-scenes bargains. Until the limitations on public involvement in the economy become constitutionally regulated and clearly delineated politically, the tendency to overspend – once called Wagner's Law in classical economics – is hard to revert.

The size of the public sector is rarely considered in the context of discussions revolving around the concept of optimality or social cost, as postulated by the theory of optimal economic policy. Rather, it is ad-hoc coalitions, the "policy of grievances", and continuous improvisation in managing local crises that shape the outcomes. This leads, by necessity, to a growing state involvement, not necessarily through nationalization, but also through a set of regulations and other covert forms of intervention. An analysis of the Hungarian experience (Voszka 2004) is indicative that reference to *bad* EU practices can reinforce monopolistic, redistributory and anti-competitive practices.

A reform of public finance is thus hard to implement without *a reform of public administration*. In the view of Agh (2003: 68–9), the institutional transfer of the EU harmonization period may and should be followed by a phase of policy transfer. This, indeed, may be the easier part of the story, since – as we tried to show above – the EU lacks operational policies that would lead to radically improved performance in the new member countries.

It would be hard to find a cookbook to go by, insofar the pattern of public administration in all societies of the globe is also shaped by cultural and historical factors. In the new member states the problems differ substantially, with Malta being a small island and Poland a medium-sized power. For the majority of new members a relatively high degree of public services is a revealed preference of the electorate, as it has been parties offering more, rather than less, redistribution that have tended to be elected over the past decade or so.

The basic questions to be addressed in this respect are the following: to what extent does the provision of public services require public ownership and delivery, and to what extent could it be outsourced to a variety of non-profit organizations that may be private, cooperative or otherwise? The bad experiences in Britain have somewhat diminished the previous enthusiasm for public-private partnerships, although this may be a misreading of the outcomes of a clear regulatory failure.

The reform of *territorial administration* overlaps only in part with the government reform. It is a matter of deliberation and debate what pattern is best for decentralized and democratic territorial development, providing equal opportunities also for people living long distances from the capital cities and other major cultural centers. For the time being, the restructuring seems to follow the logic of how best to receive potential EU inflows, which is of course a clearly exogenous consideration (even if funds comparable to those following the southern enlargement were forthcoming). A major challenge in this respect derives from the fact that political structures, including electoral districts, are drawn along territorial lines. Unless a single-round party-list voting system, as adopted most recently in Italy, becomes the rule, local power is most likely to sabotage any major change. This, however, does not necessarily have to be a drawback, if top-down reforms follow non-realistic or non-priorities. Regionalism within the EU, as shown above, does not come from Community policies – rather, the causal link works the other way around.

A fourth component of reforms to be implemented is the restructuring of public service provision. In this respect not much can be added to the overall considerations unfolded in the context of West European economies. The new members are strikingly similar to the incumbents with respect to both their social structure and the public provision of a variety of services through state-owned units. The exigencies explained in this connection apply in the same way to the accession countries.

Some structural problems will be hard to overcome here. On the one hand, medical services in post-communist societies tend to be relatively cheap at the macro-economic level while provision is general. This is a fortunate mix, and many observers, both at the macro and the micro-levels, agree that it is an accomplishment. On the other hand, the cost explosion in medical technology and the lengthening of human lives, with the concomitant increase in requirements, clearly call for introducing economic incentives. These include not only the customary cost dampening measures, like co-financing, but also more investment in prevention, promoting healthier lifestyles, as well as incentives to stimulate private provision for medical purposes.

different problem crops up in connection with pension reforms. Here the credibility of financial institutions involved has been limited over the past decades. Due to wars and exchange rates, as well as the recurring inflationary periods in all countries except the Czech Republic and Slovakia, the time horizon of citizens has been shortened well below the levels. Experiences in the West, especially in Britain and the US, have been indicative of widespread myopia of the median citizen, which makes the fully funded mode of pension provision highly likely (on the grounds of a market failure). This situation has been exacerbated by regulatory mistakes, allowing for enormous profitability among private funds (basically allowed to invest in government bonds only). Furthermore, political controversies, like the one initiated by the center-right government of Hungary in 1998–2002, have further eroded trust in these, by definition very long-term investments. With a poorly-developed market of long-term securities (the longest government bonds run to 10 years only, against 30 years in the US), the idea of long-term investments in other forms of property than housing or similar fixed assets is not very widely accepted. Since trust cannot be decreed or imported from abroad, the market for funds and insurance will take long to develop. Until then, the typical shortcomings of a basically publicly run pay-as-you-go system, with the relegation of most pensions into subsistence allowances, unrelated to performance, is likely to prevail. That will further constrain the openness for long-term savings.

If this paper were solely on the EU, the *rural reform* should have been discussed under the heading "Agriculture". True, in a way, the ongoing reform of the CAP will create incentives and orientation for the new member states to modernize their rural structures. In so doing, the gradual move away from agriculture as a major source of revenue towards a variety of alternatives, from tourism to environmental protection, will be the major line of change. However, this will require substantial changes in the course rural development – as distinct from sectoral interest and sectoral policies represented by the farming lobby and the Department of Agriculture – will have to take. The role of "green ministries" needs to be strengthened – a process that is likely to gather momentum after accession to the EU. The development of the transport infrastructure, a major cost-intensive item, will perhaps remain in the focus of public controversies, political and economic alike.

Environmental protection is yet another area where lots of good intentions have been declared with quite limited practical implementation. The surveillance mechanisms of the EU may play a pivotal role in securing an appreciation of this area among the competing policy areas in the new member states. The implementation of a number of innovations, including greater reliance on private financing and private provision in such areas as waste management, water supply, and reforestation may open up completely new perspectives for the new member countries. This is an area where the EU has *explicit policies and requirements, though no common funds*, a feature that is likely to figure prominently in the future of EU integration.

Last but not least, the importance of *enhancing social cohesion* needs to be stressed. In the traditional theories of economics and in some political science approaches this is treated as given. What we have experienced during the transition and accession years is a warning sign that societies find it hard to put up with growing inequalities in wealth, income, lifestyles, potentials and perspectives. The rise of populism, both within and outside the established parliamentary parties, is a clear sign of the stress that is reflected in these processes. The low turnout in elections may undermine the legitimacy of governments.

Without shared values, the institutions of democracy can hardly function effectively. Without providing a minimum of equity, in whatever way the majority defines this term, the European-type of consensual democracies and societies are unable to function.

Therefore, additional efforts are needed to strengthen everything that traditionally used to be called *social intangibles*. These partly come from the system of education, partly from the media and from the norms represented and spread by the elite through their practices. If robbers and other outcasts provide role models for the youth, as could be observed in some countries and some periods, it does not bode well for the type of society we visualize when talking of common European values.

It would be hard to overlook the fact that what is called the Bologna Process in the EU will contribute to further deterioration of the adjustment of higher education to the labor market needs. This is a problem, since the world of labor is known to be the strongest integrating component in any society. All the more so since other integrating factors, such as religion, national consciousness, family values, commitment to locality and altruism in general are losing rather than gaining momentum, for a number of reasons that fall outside the scope of this paper. What remains is a clearly normative recommendation to spend more, and in more efficient ways, on education in the broad sense, so that an ever growing number of citizens could profit from the processes of transnationalization and the enlargement of the European Union, despite its paradoxical features.

ON SOCIAL STRESS: NO PAIN, NO GAIN?

When discussing the chances that those far-reaching changes that we advocated in the preceding sections will succeed, we can avail ourselves of the rich international literature on policy reform. This literature, which mostly draws on the experience of developing countries and more recently also transition economies, allows for more optimistic conclusions than the mechanistic extension of the rational choice model, currently dominating political science would allow. At the bottom line, rational choice extrapolates the dominance of short-term and immediate economic interest onto macro-economic and macro-social decisions, which often constitutes a legitimate approach. It follows, however, at the level of definition, that these reforms which aim to change the salient features of the status quo can never materialize. And yet in reality "out there" we do see successful reforms, not least in the countries joining the EU in 2004. Therefore, we must venture into a field where the customary arguments of the rational choice school are not taken at face value, although this approach can indeed explain the policy derailments of the past few years.

One of the many paradoxes of democracy is its reliance on a strong "core state", as well as on trial and error. While democracy does have a tendency to be myopic, it also has been able to overcome these features whenever major challenges were faced, be that totalitarianism or terrorism. Therefore, it is only right if we do not deny the new democracies the possibility of "rule by persuasion".

It would be hard to overestimate the importance of a "first things first" approach. What is needed in order to move towards such advantages that show up in the longer run, like free trade, solid public finances, or improved environmental management, is perspective combined with actions *on the home front*. In other words, these changes should ideally be implemented immediately, without waiting for the EU, for the improvement of the international climate.

...culous revitalization of economic activity. Policies aiming at improvements in the ...d Bank under the Wolfensohn Presidency. As demonstrated, most recently in ...stan and Iraq, and previously in Bosnia, Rwanda and Somalia, attempts to construct ...y, market economy and multiculturalism from abroad are bound to fail. ...grave danger of the present moment is that it may be easier to emulate the dubious ...of large EU countries than to launch a vigorous policy aiming at economic vibrancy ...ustainable growth in the long run. Instead, at least in normative terms, ...eanization" should become *the window of opportunity* to launch a series of reforms ...implementation will take decades. The EU, in most of the new member states, may ...e the *rallying point* of modernization, along which *social consensus could be built* at ...n a number of issues of principle, such as long-term goals. These may pave the way to ...prospective policies also in real life.

...the new EU members have to tackle a broad development agenda, that of *participatory ...*. For the time being, they face a next to insurmountable dilemma. In periods when the ...ations were being laid for sustained growth, economic strains were transformed into ...l strains and growing inequalities. By contrast, in those periods when social strains were ...t to be addressed, governments relapsed into old fashioned populist policies that are ...ously harmful to growth already in the short-to-medium run. The normative way out, ...owing the development agenda, would be participatory growth, i.e. a platform where ...blic sector reforms and institutional change bring about transparency and welfare gains at ...same time.

Let us be clear: hardly a trivial option though it is, participatory growth is feasible in the ...ew EU members, to the extent they have already mastered the elementary agenda of creating ...market institutions and disinflation, while retaining and strengthening the democratic setup. ...y allowing for a broader-based growth, which requires the support of SMEs rather than big ...public work projects, by sustaining disinflation rather than extending services as entitlements, ...irrespective of costs, and by fostering sincere public discourse instead of the infantile ...manipulation of the public opinion that has emerged over the past few years, the state would ...by no means be relegated to the role of a night watchman, but would be actively shaping ...outcomes, primarily in its capacity as a regulator and supervisor. Deepening the capital ...markets, for instance, definitely requires more active public policy involvement than before.

What has been said about developing countries applies to emerging economies as well, in ...terms of the Millennium or Development Round of the WTO negotiations. It is not in the ...interest of these small open economies that bilateralism and unilateralism, the practice of ..."might is right", should overwhelm the existing dispute settlement mechanisms, which are by ...no means perfect, but do provide some backing to the weaker and the poor. It would be an ...important contribution to the evolving EU if these countries could play a constructive part in ...shaping a more co-operative European negotiating stance, rather than joining the "coalition of ...the nasty" trying to sabotage any reform that would diminish redistribution inside the EU. ...However, the latter scenario may be more realistic in the medium run, despite its obvious ...moral and economic drawbacks.

Finally, it would be hard to eschew *the fundamental question of non-inflationary and ...sustainable growth*, which is in the self-interest of the emerging markets. Quite irrespective of ...whether EU funds will or will not be available, and irrespective of what happens to the SGP, ...it is no longer disputed in economics that only non-inflationary growth is sustainable. And

while the output of the economies in question still lags behind at 40–65 percent of the EU average, transnationalization has permeated most of them to an internationally unprecedented degree and their citizens have already acquired the four freedoms of the EU.

It is important to face the tough realities: convergence of less developed countries, also the context of a market-led integration, can only be conditional. In other words, *there is potential, but no certainty*: growth rates that would exceed the trend rates of the EU countries are conceivable, though by no means given. While the new EU members, unlike the CEE countries, are not suffering from too low levels of savings, the efficiency of their financial intermediation systems – and thus their macro-economic allocational efficiency – still leave much room for improvement. Deepening and broadening of capital markets is a condition for innovation to turn into embodied technological change. Without more extensive financial services, the SME sector is unlikely to grow. Unless the state ceases to crowd out private investment, that is, unless general government turns into equilibrium in normal years of growth, there is no scope for funding new establishments.

In order to master these tasks, the well known guidelines offered by the new developmental agenda, stressing the necessity of investment in human capital, the importance of supporting SMEs, the need to create productive jobs (including self-employment), spreading computer literacy at early ages, or finance the integration of marginalized minority groups, need to be heeded.

What has been said in normative terms echoes broadly accepted insights in the global literature on policy reform. However, it certainly would require a sea change in the way policy is formulated, communicated and generally conducted in the new EU member states. The need to differentiate between what looks and what really *is* socially sensible, what is affordable and what is not financeable, what does and what does not require public intervention, runs counter to the practice of media-led policy-making.

It would be hard to overlook the fact that in the need to switch styles and substances, the new EU members have already converged to the incumbents. Most of the issues on the new agenda, the need to overcome short-termism, or the need to better co-ordinate welfare needs and financing possibilities, are largely overlapping. Similarly the need to face the challenges of global nature and of transnationalization, discussed in the first sub-section of this paper, is common, indeed.

One of the gravest dangers the new EU members face is the negative spillover scenario. A decade ago it was customary to maintain that the EU is likely to gain from enlargement, for no other reason, than because of the vibrancy and vitality the new members might add. However, an ossifying Western structure (Daianu 1996). However, by now the situation may well have reversed. Less-than-enlightened practices of incumbent EU members are easy to emulate. Reference to EU standards, real rather than normative, may undermine efforts to introduce policies with a longer time horizon, or policies that take advantage of the global availability of private financing, irrespective of EU funding. Likewise, the normative statements, like the ten-year plan of the EU Commission promulgated at the start of the Rome IGC, may divert attention from real issues. The word “reform” may have been overused and become a fashionable letter word in political discourse.

As long as the future options are open, it is hard not to conclude on an optimistic note. Once we are able to call a spade a spade, it should be possible to orchestrate the consensus needed for the successful completion of the third round of transformation in the new EU member countries. If the EU is able to provide, at least in part, the credible regulatory

ment, promote the evolution of independent regulatory agencies, and of course, monetary stability via the single currency (with or without the SGP), it has already contributed to its historic mission of re-unification of Europe in the name of democracy and economy, welfare and social consensus, co-operation and peace. This could, indeed be the greatest service rendered – by providing example – to the less successful countries of the communist transition.

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