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# Keynote Address

# The Political and Economic Complexities of Transition

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## Introduction

This essay is an adaptation and extension of a June 2006 keynote address delivered at the Third International 'An Enterprise Odyssey: Integration and Disintegration' conference sponsored by the Faculty of Economics and Business at Zagreb University. It is an attempt to provide a general framework and insights into the process referred to as transition, that is, the transformation from authoritarian socialism to democracy and capitalism which began in 1989 in Eastern Europe and 1991 in the former Soviet Union (FSU). The framework is firstly a typology of variable that contributed to a more successful transition, yet it doing it was not possible to construct a conceptual 'fire wall' between factors contributing to success and my own views on most effective path through the transition process. References make note of the major works which influenced the author's positions on the transition process. Statistical references are not listed since this was not the focal point of the article, but they are based on data released by the World Bank, United Nations' European Economic Commission and the European Bank of Reconstruction and Development. Transition, or if you prefer, transformation, in this part of the world is a very complicated and revolutionary process that has involved a total of 28 countries; the former East Germany is not included but Montenegro is counted as a separate country. Of these 28 counties, 25 are in different stages of their transition to capitalism and democracy, but I would suggest that three of them (Belarus, Turkmenistan and Uzbekistan) have not yet begun their 'transition journey'.

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The essay posits three factors as the principal factors in determining the relative success of these 28 transitioning countries. The first factor is the impact of historical background and conditions which confronted each country at its transition starting point in either 1989 or 1991. The second variable involves the policies undertaken by the various governments in the 1990s. The third factor is the presence or absence of external and/or internal military conflicts.

## History, Culture and Starting Point

This variable is really a broad combination that includes historical background, culture, and the situation which confronted individual countries at the very start of their transition Odyssey. It is important to stress that historical backgrounds and initial situations, whether this involves the groups' collective memory, predominant cultural traits and values, geography, relative levels of wealth, or macroeconomic conditions, or economic structures, all varied considerably and strongly influenced the transition process. For example, when comparing the impact of economic structures, the Czech Republic's more nimble and relatively efficient medium sized industries, its boarder with the markets of the European Union (EU), and its powerful tourist attraction in Prague which brought money into the country and helped keep unemployment low, were all positive factors in prompting a forceful implementation of market oriented reforms in the early 1990s. The Czech Republic's neighbor, and until 1993 co-inhabitant of the same political entity, Slovakia, was much more dependent on large, non-consumer type industries (steel, armaments, chemicals) which could not successfully compete for sales to the EU market and were experiencing steep production slumps. Therefore, Slovakia was more concerned about high unemployment than market oriented reforms. While the Czech Republic pushed for price and trade liberalization, as well as voucher privatization, Slovakia delayed some of its price and trade liberalization policies until 1998 and abandoned voucher privatization in favor of slower privatization which favored those close to the ruling elite. Slovakia's early reforms did not promote independent market influences and this variant was sometimes referred to as 'crony capitalism'. Ironically, Czech policies, especially rapid privatization via the voucher system, under Finance Minister and later Prime Minister Vaclav Klaus, were qualitatively different from Slovakia, were not necessarily the ingredients for a successful transition. In some ways, it could be argued that the Czech Republic achieved solid economic growth by 2006 in spite of some of its early transition policies.

The transition process is complex. The component parts for success for failure are numerous, not at all limited to the economic sphere, not static but subject to change over the last seventeen years, and inter-related. In addition to differing economic structures, the saliency of the impact of relative wealth, which among other things contributes significantly to the strength of the domestic market, must also be considered. The difference, for example, between the relatively high GDP per capita of Slovenia as opposed to the relative poverty of Macedonia in 1989, is an important variable in the transition process. Furthermore, a common boarder with the larger and more lucrative markets of EU-15 is an advantage enjoyed by several Central and Eastern European (CEE) countries. This advantage stands in marked contrast to the extremely high transportation costs found in land locked Central Asian countries which are much farther removed form EU markets and where it is not uncommon to find political disagreements preventing the use of the most accessible and least expensive routes for exporting goods.

It is also important to recognize that some CEE countries had made solid progress in establishing a functioning civil society in the 1980s, that is, before their transition. They did this despite the dominating presence of the state under communism. Poland lead the way in establishing individual groups separate from the state control (Ekiert and Kubic 1999). This sense of semi-independence from the authorities proved advantageous in fostering political attitudes and activities which became a driving force of their own and did not rely only on existing communist era political elites (as was the case in countries like Ukraine and Romania). Additionally, potential entrepreneurs were not inclined to first look to the state for approval before engaging in activities leading to economic growth. Hungary implemented reforms, however modest and non-fundamental in terms of eliminating their command economy, beginning with the New Economic Mechanism in1968 (Nagy 2003), and Hungarian firms were subcontracting from Western companies well before the collapse of communism. Hungary's experience with market mechanisms, however limited, as well as its interaction western markets, foreign firms, economist from a number of different countries, and international financial institutions can be contrasted to Romania's very limited external contacts or Albania which until 1989 was isolated and in a unique Stalinist time warp.

Existing macroeconomic conditions in 1989 played a critical role in the transition process. The high debt and hyper-inflation of Poland, the former Yugoslavia, and Russia (since it assumed all FSU debts) created challenges which were distinctly different from those existent in the Czech Republic, Estonia or Romania. Yet the differences at the starting point of transition go beyond macroeconomic conditions, the strength of the civil society, economic structures and per capita GDP. One must also mention cultural differences; regardless of how painful that devilishly difficult variable is to accurately measure and how strongly this interjection is resented by some political scientists and economists. By considering the impact of cultural differences does not at all mean that the presence of values which may not conform to the 'best practices of capitalism' as conceived in advanced economies are an unassailable burden to establishing capitalism. As with the case of South Korea and Taiwan in the 1980s, in the 1990s most of these 28 transition countries have demonstrated that policy decisions and reforms can modify their long standing traditions in order to fully implement a market economy. The development of capitalism in any country should not be a counter weight to cultural values, but should be an outgrowth of them. Nonetheless, it would be still be wise to recognize the advantages held by some societies whose

dominant values are more compatible with private ownership and open market economic activities, as opposed to those whose values are heavily influenced, for example, by powerful clan based loyalties, or where traditional informal practices conflict with legal structures developed in most capitalist societies. I want to stress that there is a definite limit to the impact of dominant social values. I am not certainly not suggesting that there exist certain 'national consciousnesses' which are better suited to capitalism (and the same reasoning, of course, applies to the suitability of democracy). However, with some trepidation, I am suggesting that it would be helpful to consider the impact of contrasting cultural situations. For example, Croatia's familiarity with market activities stemming from its historical traditions as part of the Habsburg Empire, and more recently the relatively open economy of the former Yugoslavia, should be viewed as an initial advantage over the dominant values found in Central Asian societies which have little or no experience with private ownership or capitalism.

Finally in regard to historical backgrounds and starting points, the depth of the roots of the pre-transition flawed command economy needs to be considered in an analysis of the relative success or failure of a country's transition. Simply put, the longer an economy (mal)functioned under the principals of a command economy, the more acute the handicaps in constructing capitalism. The fact that 11 of the 15 countries that were established after the implosion of the Soviet Union experienced 74 years of communism, as opposed to the 45 or so years experienced by countries of CEE and Southeastern Europe (SEE), is a distinct disadvantage for those 11 FSU countries.

### Impact of Policies and Conflicts

The second variable affecting the success or failure of the transition process is represented by the policies implemented in the transition process. Policy, like history, matters, or to paraphrase Anders Aslund, it matters very much if the transitioning state is led by concerned reformers who have the best interest of the public in mind, or if it is captured by rent seeking elites who buy political clout to prevent or delay market reforms (Aslund 2002).

Estonia, for example, was fortunate to be in a situation where reforming elites firmly and fully committed the country to a market economy in the early 1990s. Please note that in stressing active and complete commitment to the market economy is not the same as advocating the so-called 'shock treatment' approach (as was/is the case in Estonia) as opposed the 'gradualist' approach. Nor is a firm commitment to a functioning market economy the same as holding that all of the market oriented reforms of the early 1990s were optimally effective. In fact, as we have already noted, the voucher privatization program of the then Czechoslovakia, was generally counter productive to sustained economic growth. Czech voucher privatization resulted in enterprises which lacked capital to upgrade technology, and since almost seventy percent of these vouchers ended up in the hands of Investment Funds, of which seven of the largest ten were held by state owned banks, there was too little incentive to restructure these rapidly privatized firms. Credits were too easily obtained and this frequently dulled the urgency to restructure in order to enhance efficiency. At worse, many of the firms had their assets 'tunneled' into foreign bank accounts, or were left to the fate of having multiple owners, and thus complex and generally poor corporate governance (Orenstein 2001, Myant 2003).

The point is that the specific contents of these early reforms, while important, were not as important as the strength of the overall commitment to open market capitalism, and to combating the goals of rent seeking elites, as in Ukraine, or elected former communists officials who lacked a market agenda, as in Bulgaria and Romania before 1996. Delayed reforms were the key negative variable, not necessarily because delaying some aspects of the transition was inherently a bad idea, but because the delay gave strength to those who opposed serious market oriented reforms. Bulgaria and Romania waited until economic conditions deteriorated to the point where the populace forced political change which then initiated genuine reform processes beginning in 1997. One had hoped that the 2004 Orange Revolution in Kyiv would provide the stimulus for deep, on-going market oriented reforms and an opening of the Ukrainian economy. Yet at this time it is not possible to predict the political strength of reformers versus non-reformers in Ukraine. The political maneuverings of the summer of 2006 have demonstrated rather clearly that the label 'revolution' appears to have been prematurely and perhaps incorrectly applied to the events of November–December 2004 in Kyiv.

Other countries delayed reforms because of the complications caused by military conflicts. External as well as internal conflicts are the third variable in determining the relative success of the transition process. The fiscal policies necessary to finance military conflicts are often severely disadvantageous to macroeconomic stability and decisions made by the state under the duress of waging war understandably place political rationale above economic effectiveness. Conflicts impact trade as can be seen in Central Asia and the Caucuses where cross-border trade remains costly and hindered by past and on-going hostilties. Extensive war damages, human and material, caused by the fighting in Bosnia-Herzegovina, Croatia, and Serbia cannot be underestimated. Transportation networks were rendered ineffective, factories and housing stocks were lost, and the displaced refugees placed strains on societies even after the fighting had ceased. War also took its toll on Armenia, Azerbaijan, Georgia, Moldova, and Tajikistan.

## Attempt at a Score Card

To borrow a phrase from Ivo Druzic (2005), where are these 28 countries on their 'journeys trough transition time' ? The answer is, since they all began with different backgrounds and at different starting points, had varying levels of commitment to market reforms, and because some avoided external or internal conflicts while others did not, they are all at different stages of their transition journey. This might be accurate, but it is not especially helpful.

It is more useful to begin by dividing these 28 countries into three separate geographical regions, which in turn represent three different transition 'time zones'. These three regions are (1) the eight countries of Central and Eastern Europe (CEE), which includes the three Baltic countries and Slovenia, (2) the eight in Southeastern Europe (SEE), and (3) twelve countries that were formerly part of the Soviet Union (FSU). Moldova could be placed with the SEE countries, but it is here somewhat arbitrarily considered an FSU country.

The eight countries of CEE have surpassed their 1989 GDP levels, with the exceptions of Latvia and Lithuania who are very close to their 1989 levels, are functioning democracies, members of NATO and have thus obtained their much desired insurance policy for national security issues, and most importantly, since May 2004 they are all members of the European Union (EU). It may be brash to say, but I believe that the transition is over for these eight countries. Transition is a bridge between past and future. It does not imply that the past has become unimportant, nor that future developments and events will not be critically important to the journey. Instead the end of transition means that these countries have moved across the bridge from their former command economies to capitalism and now travel on more secure terra firma. The events of 1989 were indeed revolutionary, but all revolutions must end, for either good or ill. Naturally not everything is new and different and much of what existed before 1989 (values, geographical determinants and even economic conditions) will continue to exist and impact the future of these countries. Yet their revolutions, as all revolutions must do eventually, has entered into a period of normalcy. The feverish pace of radical political and economic change has cooled; developments are less extreme and more predictable. For the countries of CEE, their opportunities and challenges are no longer set by revolutionary or transition agendas, but by the EU. On the other hand, it is a great understatement to note that the transition in SEE or the FSU is far from over.

## Aspects of the Transition

As opposed to discussing the conditions which contribute to success or failure, it is necessary to comment on some of the constituent parts of the transitions. What follows does not pretend to be either systematic or comprehensive, rather it is meant to explore several aspects of this complex process in order to provide useful insights. In discussing aspects of various transitions my own preferences will surface and at times the narrative will contain elements both of a survey of developments and a suggested prescriptions. It is hoped that this approach will not prove to be unnecessarily confusing.

First, I believe that Joseph Stiglitz (2002) and many other scholars of transition are correct in stressing the importance of sequencing particular sets of reforms leading to the establishment of capitalism. Yet some basics are needed up front, as it were, and generally reforms attempting to establish these basics ought to be implemented as quickly as possible. In order to ‘build capitalism’ (Aslund’s apt phrase), prices have to be liberalized in order to establish a functioning market. Macroeconomic stability is also required, as is open domestic and foreign trade. Into this mix one also needs to add private property, openness to Foreign Direct Investment (FDI), some form of currency convertibility, and institutions supportive of the market such as an effective legal infrastructure. The trick is in what order, and how fast to implement which reforms. It is not surprising that given the absence of theoretical guideposts to lead reformers out of a command economy into capitalism mistakes were made. Seventeen years after the start of this revolutionary process many analysts have strongly criticized international financial institutions, especially the International Monetary Fund (IMF), for their dogged emphasis on anti-inflationary measures through tight budgetary constraints. The claim is that the so-called ‘Washington Consensus’ approach was not appropriate for many countries in this region of the world (Nagy 2003, Papava 2005, Kolodko 2000, Stiglitz 2002). There is merit in this claim, although it is difficult to image positive economic change without at least taming inflation. Yet the key variables in progressing through one’s own ‘transition time’ were not external factors such as international financial institutions like the IMF, the World Bank, the EU or more recently the World Trade Organization. While these external actors are important, the bulk of the praise and blame lies with the level of seriousness and persistence of the initial reformers to an open market system. As previously stated, the critical dimension was not so much the specific contents of the reforms themselves, nor whether they were labeled 'shock treatment' or 'gradual', but rather the level of commitment and the tenacity of the reformers.

The debate between the 'shock treatment' approach and the 'gradualist' is not an especially relevant debate (Orenstein, 2001). It is neither necessary not productive; perhaps explaining why it has persisted so long in academic circles. Much, but not all, of this debate centers on privatization and, as is the case with freed prices and macroeconomic stability, it should be recognized privatization is a necessary but not sufficient condition for 'building capitalism'. The mixture of these three conditions, plus others including the free and open trade, convertible currency, and the rule of law, should be seen as a cocktail of pre-requites, but a cocktail whose exact proportions vary according to the needs of individual countries. The low inflation rate found in Hungary (Nagy 2003) and the Czech Republic (Myant, 2003) in 1989 requires a different mixture of ingredients than the high inflation raging in Poland or Russia at that time. Furthermore, it is not even possible to accurately or clearly define a 'shock treatment' country as opposed to a 'gradualist' one. For example, Poland is considered to have pursued a radical 'shock treatment' approach, yet it delayed the privatization of over 500 of its largest enterprises until 1997 (Kozarewski 2006).

It bears repeating that the transition to a capitalist economy requires freed prices, an open economy in terms of trade, currency exchange, FDI, market supportive institutions such as a legal system which protects property rights, processes bankruptcies, assists the formation of new businesses, etc., and certainly private ownership. The emphasis placed on each component for a specific country will necessarily vary according the needs and strengthens of that country. Nonetheless, I believe the evidence points to the fact it was an economic advantage for countries to work for a more rapid, as opposed to slower, establishment of those component parts.

In addition to what reforms, and how fast or how slow should they be implemented, an important relevant question often raised is the size and relative strength of the state in transition economies. Of course, the extension of the state's powers had to be severely curtailed from what existed in a command economy. However, a weak state or a nearly failed sate as in Tajikistan, or one captured by oligarchic rent seekers as in Ukraine (Wilson 2005b), faces the realistic risk of being led by elites who will work hard to divert, delay and perhaps defeat the construction of a functioning market economy (Aslund 2002). In sum, a weak and ineffective state, as well as a state with an over powering presence, or put another way, one with either too little or too much control over the economy, are both negative factors. The weak Albanian state was not able to terminate or even contain a pyramid scheme in 1997 before losing almost one-third of its GDP. Conversely, in Ukraine oligarchic clans diverted money into their own pockets and became extremely wealthy by exercising rights granted to them by the all-intrusive state to buy energy at low subsidized prices and sell a portion abroad at much higher world market prices. Yet stronger states, Poland or Estonia for example, were able to effectively govern and implement policies even though it was clear to all that these policies would create deprivations in the short term.

Many scholars of transition failed to place due emphasis on the importance of good governance, the rule of law and an effective legal infrastructure. We all would have benefited from a closer reading of Hernando de Sota (2000) who fully appreciated the fundamentally importance relationship between laws, property rights and economic growth.

An effective state and the rule of law are two sides of the same coin; they exist only in tandem. I think all could agree that the state must be involved in the economy to some degree, even if only at the minimum level of establishing and enforcing the rules of the market place. However, most would also agree that the state must be able to collect taxes so that it can finance such important public functions as health care, education, defense, and environmental protection. Others (and I would add, correctly) want taxes to also assist with income redistributing policies which aid the weakest or most vulnerable in our societies. Assistance to those in need via income redistribution is especially important in transition societies which have had to replace their previous social safety nets, yet still provide for unemployment insurance, welfare benefits, numerous pensioners, etc. These countries need to be cognizant of the potential negative ramifications of the rising number of poor people, and the sometimes acute inequalities found in their societies. The Gini indexes of these countries have increased, and some like Russia's have increased sharply. Acute inequalities also exist in some transition countries in terms of the difference in wealth between the majority nationality and minorities. A particularly challenging situation exists with the Roma in several CEE and SEE countries.

An additional and important aspect of the transition process is the need to open domestic and foreign trade, as well as to attract FDI, both of which perform the vital function of connecting transition economies to the global economy. The World Bank (2005) and others (Allan 2000, Winiecki, 2002) have published excellent works on the subject of foreign trade in transition countries. I will thus only touch upon the multi-dimensional importance of FDI. The investment in production and services by foreign companies, unlike highly mobile portfolio investments, is capable of expanding the activities of domestic suppliers selling to or servicing the foreign investor, improving management skills in a variety of sectors but especially in financial services, and injecting new technology into the host country. Nonetheless, this is a generalization and recently many economists have rightfully stressed that not all forms of FDI are long term engines of growth. 'Greenfield' FDI adds to production, employment, technology, etc. , while a Merger and Acquisition involving a multinational firm may simply result in a change of ownership. The presence of Free Enterprise Zones in transition countries has a mixed record in terms of FDI increasing exports and expanding ('spillover') the technology base. FDI that flows into a transition country solely because of the presence of low wages or does not advance the existing technologies should be questioned before huge tax benefits are awarded to the potential foreign investors. This complaint is heard in Slovakia, in spite of substantial FDI in the auto industry, (Soltes 2004) and in Croatia where some have noted that there is far too little new 'greenfield' investments (Vuksic 2006) and that the country's technological base is not being advanced by the type of FDI presently flowing into Croatia. While these disclaimers concerning FDI are accurate and reasonable, the generally positive effects of FDI on foreign trade and economic growth cannot be ignored, in both transition countries as well as all economies (Sachs 2005). While FDI by itself will not guarantee increased economic growth, with the proper facilitating conditions existent in the host country it will introduce and cause the spread of new management skills and technologies, provide a expanded market for domestic suppliers, and assist in increasing exports by making other domestic firms more efficient or by being plugged into sales to a parent company. The role of FDI as a leading factor in increasing exports can be observed in Hungary, Lithuania and elsewhere. Increased exposure to foreign markets is undeniably important element of growth in the export-led economies of transitional countries. Almost two-thirds of the Czech economy, for example, is based on exports. FDI, like so many aspects of the transition, is an important component for success, but it is not a cure-all and progress along one's 'transition time' will largely be determined by the quality of host country's infrastructure, work force and leadership, as well as its ability to improve its economic situation on a number of different fronts. Yet the fact that Estonia, Hungary and the Czech Republic have roughly about \$4,500 FDI per capita, while Tajikistan and Uzbekistan have less than \$40, is a difference that does impact export capacity and economic growth in favor of the former.

Finally we come to what is the cornerstone or key building block of capitalism (and I would add democracy as well), that is, private property. As previously noted, privatization is absolutely necessary, but not sufficient, for a successful transition. Some of the errors of the early transition period were the result of a failure to fully comprehend the limitations of both the market and privatization. There was often an over emphasis of what private ownership (or more generally, the market) by itself could accomplish. It was falsely assumed that if a country opened its economy and privatized, all the malfunctions of the flawed communist ancient regime would disappear and matters would set right. One can hold that this was an extremely nad've expectation without being in the least bit opposed to an open economy or private property.

I do not agree with the former leader of China, Deng Xiao-ping, who reportedly had said that he did not care if a cat was socialist or capitalist, as long as it caught mice. No, not me, I much prefer the efficiency of a capitalist cat since I like the chances of an independent or privately owned cat operating within the context of an open market economy catching more mice on a sustainable, long term basis. Yet it must be stated that while there is the need to privatize, it need not be done all at once, nor is there some model which dictates how much must be privatized, even though most, including myself, believe a large majority of the economy should be privatized at the end of transition's road. There is no blue print that stipulates that everything, including airlines, public transportation or even the production and distribution of raw materials and energy must be privately owned. The later discussion is a particularly contentious issue considering the recent events in Bolivia and Venezuela, or Russia's policies under President Putin which have also increased the role of the state in oil and gas industries and maintained control in the energy transport sector. Nor is there a set formula whereby all transition countries must privatize everything, or nearly everything, in three, five or whatever number of years. The point is that there is not one specific model of capitalism (the same is true about democracy). The basics components of capitalism must exist and dominant, but the precise shapes that these basic elements assume should be determined by the prevalent cultural values, relative strength of civil society, existing economic structures, level of economic development, and security needs of each individual state/society.

## The Future

It must be stresses that the countries of SEE and the FSU countries (excluding the Baltic countries) must recognize that their transition is not over, much remains to be done, and that the political will to continue and advance this revolutionary process must be strong and forceful. If this fundamental position is not accepted they face the very real risk of having the transition ambushed by elites wishing to distort, delay or even halt a market dominated transition. These elites could be either corrupted rent seekers or populists, but in either case, the results could be a stunted, deformed and possibly even mortally wounded transition.

The future of the FSU countries is, and will be, very strongly impacted by developments in Russia. The foreign trade patterns of the FSU countries are becoming more 'Russia-centric', as opposed to CEE and SEE countries whose foreign trade is becoming 'Euro-centric' (World Bank 2005). The export patterns of the FSU countries is also becoming dangerously lopsided and dependant on commodities (especially oil, natural gas, ores), as well as metals and agricultural products, while value added manufactured goods and service exports are either scarce or extremely limited. Furthermore, FSU countries (especially Central Asian countries) are not becoming increasingly integrated into global economy and this has troubling ramifications. Russia is the dominant trade partner of the Central Asian countries (up to 70 percent), and its sheer size causes a very unbalanced relationship to exist. Russia's ability, and apparent willingness, to use its abundant energy resources (and possession and control of much of the existing pipeline infrastructure) to enforce its economic hegemony over countries like Moldova, Georgia, Ukraine and those of Central Asia is a powerful determining factor in shaping the transition paths undertaken by these countries. Dependency is never the preferred option, but in truth these countries have limited options. They can decide to fully coordinate their policies with Russia and minimize their independence like Belarus, or attempt to strengthen their independence by diversifying their energy sources, using their energy much more effectively, and developing alternative sources like nuclear power. While they should diversify, conserve and develop alternative sources, their foreign policy must also attempt to develop a mutually beneficial politically and economically relationship with Russia. In the final analysis, they need what Russia has, energy and a market for their goods. Geography also matters.

The situation in SEE and CEE is different. For them the EU is the dominant factor in any forward looking political and economic analysis. The eight countries of CEE are already members of the EU, and Romania and Bulgaria will be soon, and hopefully they will be followed by Croatia, later Turkey and the Western Balkans. Beginning with the very start of the transition process, there was a dramatic shift of the foreign trade of these eight CEE countries from eastern to western markets (Smith 2000, Winiecki 2002). For example, in 1988 Bulgaria exported about 80 percent of its goods to Council of Mutual Economic Aid (CMEA) countries, but today about 55% of its foreign trade is with the EU-15, that is, the pre-May 2004 members. Furthermore, the existing trade of these countries with Russia is heavily unbalanced and dominated by the import of oil and gas.

The pattern for Croatia is different. Before 1989 it was part of the former Yugoslavia and therefore trade with Slovenia was not 'foreign', and Croatia's foreign trade was rather evenly divided between Italy, Germany and Russia. Today about two-thirds of its foreign trade is with the EU-15. While this pattern is to be expected and not unwise, the fact that only 20 percent of its exports and a mere 4 percent of its imports are from other SEE countries does seem to represent a missed opportunity. In this case, SEE does not include Slovenia, but does include Turkey, Cyprus and Greece (Papazoglou 2005), which, unlike the smaller Western Balkan countries are wealthier and/or significantly larger markets. While SEE countries have traditionally not traded with each other for a variety of political and economic reasons (Donnorummo 2002), there are now a few positive signs indicating increased intra-regional trade and energy/power sharing as agreed at the 2002 Athens Conference. Nonetheless, the existing low level of intra-SEE economic interaction, that is, interaction with immediate neighbors, would appear to be somewhat counterproductive and not in the best interest of long term development. The inhibiting legacy of past conflicts as a reason for the relative absence of intra-SEE foreign trade seems to a weakening determinant and one that belongs to the past (yet, unfortunately, this only slightly diminishes its importance). Effective leadership requires a more visionary look into the future. Among Croatia's top ten foreign trading partners, only Bosnia-Herzegovina is listed, and then only for exports, not imports. I am not suggesting that Croatia's foreign trade patterns should lessen its focus on western markets and the EU, but at the same time there are potentially significant positive economic outcomes and national security benefits to be realized from increased economic interaction (trade and energy sharing) with other SEE countries.

The above statement should not be interpreted as an Euro-skeptic position. Foreign trade is not a 'zero-sum' game whereby their must be either a EU or SEE focus. In fact, increased trade amongst SEE countries might be conceived as a prelude to a SEE free trade association, which in turn would be a stepping stone to joining the EU in the future. I fully understand and agree with the high percentage of CEE voters (and presumably future SEE voters) that supported for their country's entry into the EU with approvals ranging between 67 and 92 percent in pre-accession referenda. EU membership collaborates and confirms their 'Europeaness', and means greater access to a large and wealthy market. When this is combined with NATO membership, it also represents greater national security and stability, which in turn enhances the likelihood of increased FDI.

Yet the EU is not a magical silver bullet that will solve all problems. It is a step in the right direction, but the keys to growing these economies remain in the possession of the individual nation states. The IMF, World Bank, European Bank of Reconstruction and Development, EU, NATO, and WTO are important external agents, but success will be determined even more so by actions taken in Warsaw or Zagreb, not Washington or Brussels. Ireland has shown the most effective path to growing one's economy by wisely using its membership in the EU to its fullest advantage in terms of trade opportunities and infrastructure improvements via structural assistance, but also by implementing domestic policies which opened up the economy, lowered taxes and established other market friendly reforms that have brought it from about 60 percent of the average EU of GDP per capita to over 125 percent in less than 35 years.

One hopes that the EU-15 can learn from the experiences of its new and pending members. Progress and growth have come from a reduction of the role of the state in the economy, by opening and not over regulating the market. However, at the same time the state has remained active in the more successful economies of CEE and has not abrogated its responsibilities to that somewhat amorphous 'market'. In sum, the

West has much to learn from the East. The substantially higher growth rates of the CEE counties as compared to those of the EU-15 should serve as a motivating example for some of the overly regulated and presently low growth economies in the western half of the continent.

As a non-European, I much admire the post-1945 achievement of Western Europe, the post-1989 achievements of eastern Europe, and to a lesser extent, developments in the FSU since 1991. I want and welcome a strong Europe (and Eurasia), both economically and militarily. Together with United States, and other developed countries, we can be effective partners in defeating, or at least containing, such global treats like poverty, terrorism, AIDS, energy needs and environmental problems.

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