THE FUNDAMENTALS OF ECONOMIC STABILITY AND SECURITY IN CENTRAL AND EASTERN EUROPE

Todor Dimitrov

Head of the Centre for Strategic Development,
Institute for Advanced Studies, Vienna

The Link between Economic Stability and Security

While opinions differ when reviewing factors of economic stability and development, there is clearly a common endorsement of the belief that economic stability is linked to security. Therefore, addressing the issue of security in Albania and Ukraine, speakers actually focused on the search for solutions to the severe economic problems of these countries.

Indeed, "economic security is constructive - building a strong economy within" by opening of borders and "military security is defensive - keeping one's enemies out", as stated by David Snelbecker. This implies an eventual policy conflict - economic dependence from the "enemy" is undesirable, as it was during the cold war. Hence the importance of the ability to determine identity and threats in a post-Cold War globalise economy, where it is much more difficult to find out who is the "enemy". To this end, one should note the interdependence of economy and security, noted by Ambassador Comanescu, i.e. it is not only that a secure environment requires a healthy economy, but also that economic policy and development depend on how secure the environment is, both in real and "perception" terms. The perception, or definition of "friends" and "enemies", determine the political and economic orientation of a country while reality (such as regional instability) affects military spending and opportunity costs such as capital flight.

It is important to recognise the complexity and reflexivity of the issues of economic development and security as they could easily enter a self (re)inforcing relationship. The policy implication is that it is essential for the infant nominal democracies of Albania and Ukraine to achieve a sense of identity, supported by an integrated economic and security policy. Furthermore, it is important that such a sense of identity develops within an environment in which the role of borders diminishes, as the latter could offset the inconsistency of state attitudes in distressed countries.

Another need is to combine efforts to improve economic performance with efforts to establish social and international cohesion and co-operation, as the latter affect the flow of both financial and human capital. In other words, ensuring a stable economic environment needs domestic and international networking that would abolish barriers to trade, ideas and factor flows.

Economic Stability Endangered

Very volatile economic environments have become a serious source of concern and instability in a number of countries, Albania and Ukraine included. These environments are marked by severe overall macro-economic instability, a slow pace of reform, weak institutions, high domestic and international debt burdens, a dominant informal sector, and crime. Another common denominator is the absence of the rule of law, of checks and balances (civil society), of competition, and of a social safety net. The outcome is hence very discouraging: decapitalisation of assets and human resources, increasing poverty and marginalisation, declining life expectancy, and mounting social tension. In other words, all the necessary fertilisers for insecurity and a loss of will for further reforms.

All these features are generally recognised by most authors. What might need further clarification is how long and how much the erosion of quality of life could continue before it results in the sort of social unrest and anarchy that have occurred in several post-communist countries, including Albania. If one looks at current statistics, it is already difficult to explain why and how societies in countries like Albania and Ukraine continue to maintain relative peace and stability, despite the devastating costs of their reforms, or indeed the fact that there has been no reform. To many people's surprise, these countries, like Russia after the 1998 turmoil, have not collapsed entirely. It is important to understand why - otherwise forecasts and policy recommendations will fail.

One policy issue is though clear. It is necessary to fight against the factors that informalise the economy and not against the informal sector itself, because this performs an important economic and social role, especially when the absence of adequate governance and rule-of-law prevails. Another policy issue is to help the informal sector to become part of a modern and efficient registered economy when the institutional environment allows. This also implies a better estimate and understanding of the informal sector capacity, since this might be strong but not unlimited. In other words, it is essential to know when and why society is facing social unrest and collapse due to unbearable costs. Meanwhile, the free market in such countries will continue as it is: messy, opportunistic, secretive, and violent. This erodes the will to have a market in the first place.

Root Causes of Current Economic Problems

The state - good or bad

The state in many South-Eastern and FSU countries is both weak, when it comes to rule of law, transparency, accountability and public goods, and strong when it comes to monopoly, red tape, political lending and misallocation of resources. This dual nature of the state is probably the source of disagreement when its role is being addressed by speakers: opinions clearly differ from a straitforward neo-liberal approach of downsizing the state by rapid disengagement from economic and social life (David Snelbecker), to views that see strong state intervention as a key need for building/enforcing the institutional/regulatory environment that is essential for sustainable economic growth and social development (Prof. Genc Ruli and Dr. Vira Nanivska).

Both groups have strong arguments. On one hand, the poor performance of the state as a regulator and allocator of resources. On the other, the harmful effects of an unfettered market such as deregulation, an absent social safety net, rent-seeking, crime-oriented privatisation and the drain of assets.

While it is clear that the state has to remove itself as an owner of assets and administrator of industries, its performance as policy-maker, regulator, social peace-keeper (safety net), institutions and law builder, investor in human capital and as the instigator of financial system safeguards is badly needed. The often-stated fact that the state has limited skills and capacity to cover the above needs is no justification for its abolishment or marginalisation. It justifies the acute need for public administration reforms, bottom-up pressure for change, training, and international hands-on support.

The old Washington consensus for economic development based on simplistic measures such as "liberalise everything, privatise everything and then pull back" might have achieved figure-based stability in Chile, but obviously do not work in C&EE. Here, governments cannot pull back as this only enlarges the vacuum within which monopolies and organised crime thrive, thus adding to social tension and unrest.

It is a role of the state, backed by civil pressure, assistance and public support, to ensure that markets deliver efficiency and stability. This requires more than low inflation, it requires sound financial regulation and its enforcement, competition policy, and policies to facilitate investment in technology and human capital. It also requires that resources match policy objectives, otherwise the key objective of improving the quality of life (by comprehensive, sustainable socially fair and democratic development) becomes divorced from the means to achieve it, such as GDP growth. GDP growth, monetary stability and functioning markets become meaningless if not geared to the ultimate objective of a better, safer, value-adding life.

It must be understood that state policy and its enforcement, with the hands-on support of the international community, have to keep the economic and social costs of transformation under control as these can be devastating. When lives and families are disrupted, money replaces intrinsic values as the only means for survival, poverty spreads, crime increases, and overall living standards decline. When this leads to social and political turmoil, security is gone.

Economic performance, security and global integration

David Snelbecker explains that "oligarchic socialism" did not appear in Central European Countries because market-oriented enterprises (mostly SMEs) became widespread and strong at the early stages of reform and the economies were open to international trade and contact with the rest of the world. While this is true - a result of civil society and market features that were present in Central Europe even decades ago - the issue is how to overcome the weaker starting conditions and policy capacity in countries like Albania and Ukraine that suffer from both geographical and cultural isolation from the rest of the world, the EU in particular. It should be mentioned that even in Poland and Hungary, transition costs are still high, ups and downs continue and decisive bail-outs were essential, e.g. about 50% debt forgiveness for Poland, despite its relative economic strengths compared to most other states in C&EE.

As to the capacity to design and implement sound economic policies, it has to be stressed that a number of factors that actually widen the existing gap, rather than close it, deserve more attention in the context of international co-operation:

- For achieving an impact, a critical mass of reforms, hence resources, is needed. This means that while reforms have to be enforced, bearable social consequences/costs have to be maintained. Furthermore, a widely supported "carrot" such as EU membership and hands-on international support geared to strategic goals such as EU integration will be essential.
- One should note that EU-associated states in C&EE have benefited from both domestic mobilisation towards a comprehensive objective (geared to results rather than means, i.e. a better standard of living, realistic or not) and a more streamlined international support geared to EU-matching institution building, as argued by Vira Nanivska in her paper.
- Easier mobility of both people and goods in many countries proved to be an engine for positive change, facilitating earlier adoption of new standards, ideas, and business practices. Therefore, a more imaginative approach to EU enlargement has to prevail if security of Europe is indeed the ultimate goal.
- As emerging markets are very vulnerable towards shifts in international financial flows over which they have no control, there is a clear need to address issues of risk management in an international context, as the step from financial to security crisis might only be a short one (remember Indonesia in 1999).

A key implication is clear: concerted action against contagion effects and systemic risks is needed to arrest both the domestic and international spread of social devastation. In this regard, market forces are insufficient, regulation and governance are needed as well as bail-outs that do not spread moral hazard. Easy to say, difficult to ensure. However, when such measures are not enforced, it is essential to maintain formal and informal social buffers, such as a targeted fight against poverty and support or at least acceptance of the shadow/barter economy respectively. It is not barter trade that causes weak financial and fiscal systems, but the other way around.

International aid - dust in the wind?

Often, to cover all the requirements for reform to be successful, international aid has a key role to play. This role appears to be highly debated and controversial - opinions vary from describing aid as marginal or as essential. It is also accused of spreading moral hazard and dependence. The EU assistance to Ukraine is seen as sizeable and effective in the paper of Mr. de Laroussilhe. He believes that the EU, as a large donor, has substantially contributed to a better policy direction after the 1991-1994 strategic policy mistakes of the Ukrainian government, though admitting that aid should be restructured in order to achieve focus on fields where more progress is observed. He also states that objectives should become more realistic as otherwise false expectations erode credibility. On the other hand, there are many critics of the EU and other donors' assistance, stating that aid programmes have been inefficient, inappropriate, and have had little or no impact. This position is expressed by Vira Nanivska in her paper.

To achieve a realistic assessment of the role of aid one should consider that commitments to aid often play a steering role by ensuring direction and support that are seen as an incentive by both policy makers and the public. This is clearly the case when the donors' commitment is tangible, e.g. the commitment to enlarge EU membership as mentioned above. In other words, prognosis and expectations geared to improved standards of living bring enthusiasm and support for reforms. However, lengthy reforms (whether real or virtual) and declining living standards do not match the often unrealistic expectations and result in evaporating support for reforms, as well as the rise of protectionism, nationalism and authoritarianism. Therefore, the role of aid is often negative if clearly defined objectives do not exist or were not reached, because what remains is mixed feelings, a sense of dependency, incapacity and even humiliation.

This does not mean that aid could succeed without the proactive role of recipient governments. It does, however, mean that aid has to anticipate and ensure this role. There is no doubt that ownership of reforms should be national. However, if support is international, the responsibility for failing measures has to be shared. If the governments of Ukraine and Albania have to take the drivers seat in the collapsing reform vehicle and aid has to guide them from the next seat, it is not efficient or fair if the driver knows that only one airbag is installed - to protect the donor.

As argued by Dr. Nanivska, it is time for reconsidering and restructuring aid if any impact is to be expected. A key need is a more comprehensive gearing of aid towards impact and goals. Public administration reforms, SME support, third pillar support and policy advice are among the key goals, but to achieve them it is necessary to build sound national capacities, both institutional and human, as well as ensuring the higher mobility of people and ideas outside the limited frame of aid.

Another essential task is to ensure more transparency and streamlining by not mixing demand-driven (official) with supply-pushed (de-facto) approaches. Focus, vision, responsibility and better accountability are needed within a new global context of values that should not be dual (e.g. supply should be geared to impact rather to promoting the implementing agents).

Aid should be seen as an investment in the future for common safety and prosperity, rather than remain piece-meal, lobby-pushed and cosmetic. It has to create the critical mass of resources that would ensure transformation, otherwise it will be wasted. It has to demonstrate cases of excellence and disseminate best practices. In order to ensure this, it has to have a critical mass of resources as well. While it is difficult to determine, current aid budgets of 0.1%-0.2% of annual GDP clearly cannot have an impact on distressed economies as empirical evidence suggests that budget deficits of such magnitude do not make a difference.

Policy Conclusions

As capitalism needs more than private ownership and money values, it is essential to ensure a widespread acceptance and performance of rules and safeguards that result in competition, a social safety net, security and predictability. This requires a new role of the state and international aid, as well as the development of domestic human and institutional capacity. It also means that privatisation and liberalisation should be accompanied by regulation and enforcement - otherwise results will remain discouraging.

All policy measures have to be geared to bearable social costs and their impact on the quality of life, not on means per se, such as inflation and growth. To this end, the fight against poverty and social exclusion should go hand in hand with the fight for competitiveness and efficiency. Sound international networking and integration will be essential to achieve this.

In a situation of distress, simple policy instruments should prevail. This implies the abolishment of multiple licenses, taxes and confusing regulation that fuel corruption and force businesses into the shadow sector. An SME-friendly environment is at the core of economic and social success. Hence the need for adequate investment in human capital, networking and mobility of people, ideas and capital. This also requires a diminishing role for state borders.

A certain level of economic development has to be achieved and international support is a critical starting point. Only then will policies and democratic governance become feasible vehicles for growth and stability. Hence the need to abolish unfeasible aid conditionalities in pre/post crises situations. To this end, international aid could play an essential role if a new, realistic mode of content and delivery takes place. In critical situations, this might require aid agents to assume more responsibility and risk, in proportion to that faced by the recipients.

Stability can easily be eroded by systemic risks, such as financial systems default. Therefore a focus on preventing domestic and international contagious effects is essential. This requires due diligence, early warning, supervision and regulation because markets do not protect themselves. Markets need frameworks and institutional back-up, as well as an evolution in concepts and instruments in an ever-changing environment.

No miracles, no perfection. Keep on trying with the support of research, debate and openness of approaches. Do not wait until the situation becomes hopeless and desperate, when the competition of arms replaces the competition of markets.

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