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**Brainstorming Session on the Implementation of the
STABILITY PACT FOR SOUTH EASTERN EUROPE**

December 15, 2000

Union League Club, New York City

LIST OF PARTICIPANTS

Hon. Donald BLINKEN
Chancellor, Central European University
International Council
Former United States Ambassador to
Hungary

Dr. John BRADEMAS
President Emeritus, New York University
Chairman, National Endowment for
Democracy
Co-Chair of Brainstorming Session

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Open Society Institute



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**Brainstorming Session on the Implementation of the
STABILITY PACT FOR SOUTH EASTERN EUROPE**

***WRITTEN COMMENTS ON DISCUSSION PAPER
FROM INVITEES UNABLE TO ATTEND***

From Dr. Janusz Bugajski, Director, East European Studies at CSIS

- 1) The cause of "weak states" is not only institutional fragility (indeed some would see this as a consequence) but any analysis must take account of several other important elements, including the absence of democratic culture and tradition; persistence of the "spoils system"; bureaucratism and red tape; lack of stable and constituency-based political parties; corruption and control by special interest groups. If one can unravel the connections between these ingredients, one is half way toward finding applicable solutions.
- 2) Dr. Bugajski fully agrees that one key program focus in the region should be on creating a coherent and organized constituency for reform and law, through a combination of media activities, civic education, party development, youth work, local activism, parliamentary accountability, and so on. This is a costly and long-term effort that must be well coordinated with clearer measuring rods for its success.
- 3) Dr. Bugajski is convinced that the underlying fragility of the FRY is primarily due to the stilted disintegration of the old communist state and the illegitimacy of the third Yugoslavia in Montenegro and Kosovo. A focus on strengthening Belgrade and its institutions at the cost of Montenegrin and Kosovar independence could prove counter-productive and ultimately highly conflictive.

From the Hon. Lee Hamilton, Executive Director of the Woodrow Wilson International Center for Scholars

Mr. Hamilton supports the report's overall thrust which is to emphasize that institution building in the region is the most important priority for the Stability Pact and that the greatest obstacle to stability and development is the lack of such effective, sustainable and accountable state and private sector institutions. The Center's experience in Central and Eastern Europe over the past 10 years demonstrates that program assistance by itself, in the absence of viable private sector and state institutions, is simply not enough and not effective.

Mr. Hamilton expresses three related concerns, which are not directly touched upon in the report:

- 1) The US and the EU must properly coordinate their activities within the Pact, in order to avoid the common problem of duplication of effort and getting at cross-purposes with each other.
- 2) We must use the Pact as the primary coordinating mechanism for western assistance efforts in the region, as it was intended. Existing programs for the region, including the US program known as the Southeast Europe Cooperative Initiative (SECI), intended to develop new and better transportation and communication links throughout the region (a lot of time, effort and money spent with virtually no concrete results so far), still have not been folded into the Stability Pact. We need to urge our governments to do more to improve such coordination.
- 3) We must maintain our focus on the whole Balkan region and not get carried away with directing too much time and money to Yugoslavia, no matter how important that country has become now that Milosevic is gone from power. The focus on Yugoslavia is understandable and important, but we must not lose sight of the fact that the economic and political transformation in such countries as Croatia, Bosnia and Macedonia is still far from completed.



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FACSIMILE TRANSMITTAL SHEET

TO:	FROM:
Ambassador Donald Blinken	Amb. Dr. István Gyarmati, EWI Senior Vice President
	Dr. Brademas, President Emeritus, NYU
ORGANIZATION	DATE:
	11/29/2000
FAX NUMBER:	TOTAL PAGES:
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PHONE NUMBER:	SENDER'S FAX:
	+1-212-824 4149
RE:	SENDER'S TELEPHONE:
EWI Brainstorming Session on the Stability Pact for South Eastern Europe	+1-212-824 4100

NOTES/COMMENTS:

Dear Ambassador Blinken:

Please find enclosed a letter of invitation for the EWI Brainstorming Session on the Stability Pact, a preliminary list of participants and the briefing paper on "*Stability, Institutions and European Integration*".

If you have any further questions, please do not hesitate to contact me at evanhoye@iews.org or (212) 824 4100.

Sincerely,

Ermina Van Hoya



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November 29, 2000

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*on leave for government service

Ambassador Donald Blinken
466 Lexington Avenue, 10th Floor
New York, NY 10017

Dear Ambassador Blinken:

It is our great pleasure to invite you to participate in the first of three significant brainstorming sessions dealing with the implementation of the Stability Pact for South Eastern Europe.

As you may know, the Stability Pact for South Eastern Europe, initiated by the European Union and supported by the United States and other countries in Europe, was formally adopted in Cologne on June 10, 1999. Its main goal is to extend the area of stability, democracy and prosperity to all the peoples of South Eastern Europe. To meet this objective the Pact comprises of three "working tables" promoting: I) democratization and human rights; II) economic development; and III) security in the region.

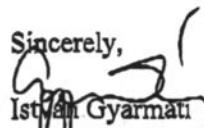
It has now been over a year since the Cologne and Sarajevo Summits and \$2.4 billion has been pledged by the participating governments. Yet work cannot go forward without an effective strategy for implementing the Pact. The EastWest Institute has therefore been invited by the Canadian Government, with the support of the Special Coordinator, to undertake a study on a political framework for working tables I and III of the Stability Pact.

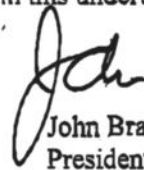
EWI is bringing together policy makers and non-governmental experts to help develop ideas to further enhance its work on democratization and security in South Eastern Europe during three sessions, and we are pleased to serve as co-chairs of the first meeting. We very much hope that you can be with us for this session, which will take place on Friday, December 15, from 2:00 p.m. to 5:00 p.m. at the Union League Club, 38 East 37th Street, in New York. A short briefing paper describing some of our preliminary thinking on the Stability Pact study will be sent to all participants.

To respond to this invitation, please confirm your participation with the EastWest Institute by sending a fax to (212) 824 4149 or email to evanhoye@iews.org no later than Monday, December 11. For any further inquiries, please contact Ms. Ermina Van Hoyer at (212) 824 4100.

Achieving stability in South Eastern Europe will depend not only on improvements in infrastructure and in the economic sector, but even more fundamentally on reform, reintegration and reconciliation. We believe that we can make an important contribution to these deliberations and we hope that you will join us in this undertaking.

Sincerely,


Istvan Gyarmati
Senior Vice President
EastWest Institute


John Brademas
President Emeritus
New York University

EWI BRAINSTORMING SESSION ON THE IMPLEMENTATION OF THE
STABILITY PACT
New York, December 15

Preliminary List of Participants

1. Ms. Doris Bradbury, Associate Director, Conflict Resolution Program, The Carter Center
2. Dr. John Brademas, President Emeritus, NYU
3. Mr. George Cunningham, Director of Press and Public Affairs, EU Mission to the UN
4. Ms. Rosemary DiCarlo, Special Coordinator for Stability Pact Implementation, US Department of State
5. Mr. Eran Fraenkel, Executive Director, Search for Common Ground
6. Amb. Dr. István Gyarmati, Senior Vice President, EastWest Institute
7. Mr. Andrew J. Loomis, Project Manager, Search for Common Ground
8. Mr. Paul McCarthy, Program Officer for Southeast Europe, National Endowment for Democracy
9. The Hon. John D. Scanlan
10. Mr. James Steinberg, Senior Advisor, Markle Foundation
11. Ms. Beka Vuco, Regional Director for National Foundations, Open Society Institute

Brussels Discussion Paper

Stability, Institutions and European Integration

31 October 2000

The EastWest Institute (EWI) and the European Stability Initiative (ESI) are working in partnership to prepare a study on a policy framework and strategic plan for implementing the Stability Pact for South Eastern Europe. Complementing the World Bank's study on the economic development aspects of the Stability Pact, this study focuses on Tables I (democratisation and human rights) and III (security issues).

This paper explores a number of concepts relevant to the study, in order to invite discussion and response. It was presented to a group of policy makers in Brussels on 31 October 2000 for discussion.¹

The problem of weak institutions

A new consensus is emerging among both regional and international actors that the greatest obstacle to stability and prosperity in South Eastern Europe (SEE) today is the lack of effective and accountable state institutions.

Across the diverse sectors of international assistance, institution building is emerging as the key priority, as relevant to human rights and social inclusion as it is to economic development and democratisation. Without reforming and reinventing the state in SEE, neither closer integration with Europe nor integration within the region itself will yield significant benefits. Without a solid institutional framework for the exercise of public power, free and fair elections will not lead to representative or accountable government. Without strong institutions to implement the rule of law, there is little prospect that states will provide effective protection of human and minority rights, whatever international conventions they may accede to. Without stable economic regulatory structures to establish a climate favourable to business enterprise, neither privatisation nor trade liberalisation will generate sustainable economic growth.

In its landmark study of the prospects of economic development in the Stability Pact region, the World Bank concluded:

"Much of economic development, social inclusion and regional stability in South Eastern Europe will depend on strengthening of institutions, governance and a lowering of the level of corruption. Gradual integration with European and global structures will also require significantly more mature institutional structures... Cross-country evidence shows that South Eastern Europe has very weak institutions and governance."

The same conclusion underlies other objectives in Tables I and III of the Stability Pact. A team of leading experts from the region engaged by the United Nations Development Program to analyse threats to human security in the region noted that:

"At present SEE faces a proliferation of protectorates and 'weak states' - states that are unable or unwilling to create and enforce rules in a democratic context. In particular they are unable to

¹

Policy makers present at the Brussels discussion included Javier Solana, Martti Ahtisaari, Chris Patten, Bodo Hombach, Klaus-Peter Klaiber, Elmar Brok, Doris Pack, Fabrizio Saccomanni, Alain le Roy, Björn Lyrvall, Stefan Lehne; from the EWI Istvan Gyrmati and Minna Jarvenpaa; and from ESI Gerald Knaus.

maintain the rule of law. In at least three cases, Kosovo, Albania and Bosnia and Herzegovina, the major security provider is not the national state but the international community... Weak states are the major source of political, economic, social and cultural insecurity."

There is considerable variation within the region. In Bosnia and Herzegovina and Kosovo, the post-conflict missions are still working at the level of basic state architecture, trying to stabilise the constitutional order. In these places, the international community itself has assumed legislative functions, and provides the external subsidies which sustain a core of governmental services. This provides opportunities for intensive, and often intrusive, international approaches to institution-building, but also poses the particular challenge of making imposed or newly-built institutions legitimate in the eyes of the local population. In Bulgaria and Romania, by contrast, the state is stable and effective enough to enter into accession negotiations with the European Union, although there is a widespread sense that membership is still a distant prospect for both countries. These are weak states only in the narrower sense that it is the low capacity of public institutions which is the primary obstacle to be overcome before they can integrate effectively with Europe.

Other countries in the Stability Pact region lie somewhere between these poles: states such as Albania, Macedonia and the Federal Republic of Yugoslavia deal with the international community as sovereign states, but are fragile in nature and need to first develop the institutional capacity to embark upon the Europeanisation process.

For all the variations, there is enough of a common thread to the weak state problem for the World Bank to call for a "quantum leap in institutional development" right across SEE. The costs of poor governance are high. In the economic sphere, weak states are unable to formulate or implement consistent macroeconomic policy, or to enforce the rules necessary to create a competitive market place. Where the legal and policy framework is weak, profit-maximising firms will have short time horizons and little fixed capital, favouring trade or the black market over productive investment. As Douglass North noted, such conditions

"overwhelmingly favour activities that promote redistributive rather than productive activity, that create monopolies rather than competitive conditions, and that restrict opportunities rather than expand them. They seldom induce investment in education that increases productivity. The organisations that develop in this institutional framework will become more efficient – but more efficient at making the society even more unproductive and the basic institutional structure even less conducive to productive activity."

A weak state traps the economy in low-productivity forms of exchange. There is "nothing automatic about the evolution of co-operation from simple forms of contracting and exchange to the complex forms that have characterised the successful economies of modern times... One cannot have the productivity of a modern high income society with political anarchy." This dynamic is readily observable across South Eastern Europe. In Albania, for example, 79 percent of all enterprises have just one employee, and only 10 percent are in industrial activities. Contemporary Kosovo and Bosnia also approach the economic and social conditions described by North.

Despite the growing awareness of the importance of effective states to SEE, institution-building is the least developed segment of international aid. Programs which address the weak state problem directly continue to be marginal to international efforts. Among various reasons for this, the most important is that international aid providers and domestic elites generally prefer activities such as reconstruction or humanitarian aid for which the delivery instruments are more advanced, and the results both more predictable and easier to identify.

The Stability Pact aims to promote regional co-operation and to chart a path for the region to become integrated with European institutions. Neither has much prospects of success unless it is accompanied by improvements in the effectiveness of state structures. The key challenge for the Stability Pact is therefore to determine how

institutional development in SEE can be supported from the outside. As a study of regional experts recently concluded: "If the Stability Pact is to succeed, it must help each of these societies refashion their state and reinvent their democracy." The Stability Pact must become an institution-building Pact.

The challenge of institutional reform

While institution-building is now recognised as a critical component of international aid, it is becoming increasingly apparent how difficult it is to accomplish lasting and effective reform of domestic institutions through program aid. Among evaluations of international programs across a range of sectors, a common theme is the disappointing results of institution-building. There is ample evidence to suggest that most current modes of international assistance are not targeting the problem effectively.

From an economic-development perspective, the World Bank has identified the poor state of domestic institutions as the most fundamental obstacle to economic growth in the Stability Pact region. The Bank stresses that strengthening public institutions – both central and local administrations – is essential to creating the conditions to encourage private sector investment. It notes that:

"Building large infrastructure without sound policies and institutions for private sector development and social cohesion and inclusion means wasting large amounts of resources without achieving the objective of sustainable economic growth and prosperity for the region".

The World Bank is frank as to the difficulty of accomplishing this. It uses the term 'tractable institutional arrangements' to distinguish technical institutional questions, which are more readily changed, from the basic state architecture. Tractable institutions include public expenditure management arrangements and budgetary processes, inter-governmental relations and fiscal transfers, civil service management, and legal and judicial arrangements. A clear lesson of governance reform around the globe is that even tractable institutions are hard to reform. First, reform initiatives at this level are technically complex and prone to failure in any number of ways. Second, all institutional and governance reforms upset prevailing interests among political or bureaucratic elites, and therefore meet with resistance. This creates a 'daunting collective action problem'. Institutional reforms impose direct and immediate costs on a relatively small but influential group, which can be expected to act in defence of their interests. The benefits of reform are less apparent, and accrue to a dispersed and unorganised population. There is therefore no natural or necessary constituency for reform. Where the necessary political will is not present, the impact of program aid may be limited.

There is a similar cautionary tone in most analysis of current international approaches in the field of democratisation and rule of law programs. Democratisation, as practised by most aid providers in SEE, consists of building institutions in three sectors: (a) the electoral arena (elections administration; political parties; independent monitoring); governance (parliaments; judiciary; public administration); and civil society (advocacy-oriented NGOs; independent media; trade unions). Democratisation strategy works by identifying deficiencies in existing institutional arrangements, and offering international expertise – usually in the form of training programs and technical assistance – to bring them closer to Western models. Democracy assistance therefore consists of a wide range of discrete, small-scale programs, each addressed to a particular institution.

It does not appear that programming of this type has much scope for overcoming resistance from entrenched power structures and vested interests and building the capacity at the level of the state to carry out difficult reforms in the face of both resource constraints and vested interests. In his studies of democracy aid around the world, Thomas Carothers describes the typical approach as 'artificially technical': "training courses often fail to change underlying configurations of interests, transfers of equipment and technical expertise frequently are put to no use by entrenched elites with other plans, and planned modifications of institutions end up producing little change in their actual functioning". International programs offer excessively standardised solutions, without

proper assessments of the needs of the target institution, and with no reference to political and financial constraints. Donors prefer programs with modest goals and relatively short time scales, which can be carried out in isolation of the wider context. Such a piecemeal approach does not generate the critical mass required to overcome major structural problems. A detailed assessment of US government democracy aid to Romania in the first half of the 1990s offers an excellent illustration of the problem. Carothers notes that in the first five years of the transition process, aid amounted to only 60 cents per Romanian, and concludes that the results were "little more than tinkering around the edges of the complex challenges that the country faced".

A third, and potentially much stronger, approach to institution building is the European Union accession process. In the work of the European Commission institution-building is focused on building the administrative capacity in candidate states to implement the *acquis communautaire* and partake of the benefits of EU membership. This has been recognised by the European Council since 1997 as the major priority in the accession process. In its Agenda 2000, the Commission defined the institution-building task as "designing management systems and training and equipping a wide range of civil servants, public officials, professionals and relevant private sector actors; from judges and financial controllers to environmental inspectors and statisticians". As it developed, the accession process offers a more integrated and intensive approach to institution-building by combining three different elements: (a) institutional models or output targets based on the specific needs of EU membership across the 31 areas of the *acquis*; (b) a clear incentive for reform and a political process which provides continuing pressure and guidance; and (c) specific institution-building programs carried out by the European Commission, chiefly through Phare.

In recent years the Commission has mobilised significant resources to help accession countries meet the requirements of membership. The principal vehicle is 'twinning' of institutions, which receives approximately 30 percent of Phare funds (468 million Euro) per year. Twinning involves long-term secondments of officials from institutions within EU member states to the equivalent bodies in accession countries. At least one pre-accession adviser is made available for at least 12 months to offer management advice, technical support and on-location training. At the moment, twinning is offered in agriculture, environment, justice and home affairs, and finance, concentrating on discrete target institutions which can offer 'specific and guaranteed results'.

Twinning is potentially a more sophisticated institution-building methodology, providing a means of transferring knowledge and expertise from EU member states to accession countries in a much more direct way than the traditional PHARE consultancies. However, although it is a relatively new and untested program, it already encounters a number of constraints which will need to be addressed to develop it further. First, there are doubts as to the absorption capacity of the recipient states for institutional reform, and whether they will retain the benefits of twinning once the project is concluded. Twinning works best where it complements an existing, government-initiated reform programs. Second, the focus on niche institutions has come at the expense of horizontal aspects of public administration, such as political interference in the civil service, low salaries, poor working conditions, job insecurity, and an unwillingness to delegate authority downwards. This means that "twinning currently risks building some elaborate structures on very shaky foundations". From the perspective of expanding and building on the program, the most important question is whether EU member states are willing to provide sufficient high-quality human resources to support the needs of the accession states. A group of experts assessing result to date noted:

"While there is support at the highest political levels for twinning there is a lacuna at the top management level within member state administrations where twinning is often seen as an irrelevant diversion from more important domestic work. Our conclusion is that twinning needs to be marketed more vigorously in the member states."

For the time being, the twinning program is available only to two states in the Stability Pact region: Bulgaria and Romania. While twinning suggests how a more intensive approach to institution building might be carried out, it is important to note that the constraints already observed in the accession states are likely to be apply even

more strongly to SEE, with its higher levels of political and economic instability. Here examples from Bosnia, Kosovo and Albania, where more focused and resource-intensive international institution-building projects have been carried out in discrete sectors (such as the European Union assistance program to Bosnian customs and tax authorities, CAFAO) need to be looked at closer.

This analysis suggests that there is widespread recognition that institution-building is critical across the entire spectrum of international aid. It shows that experience in three areas – development programs; democratisation; and the EU accession process – are all encountering similar problems and that existing modalities of institution-building do not address the challenge effectively. It also shows that there has been an important evolution in thinking and methodology that has taken place within the European Commission about the need for institution-building to progress beyond traditional technical assistance.

Physical reconstruction and institutional reform: the case of Bosnia

Because institution-building is difficult to accomplish in an unstable political and economic environment, international donors have a preference for reconstruction projects, where the implementing agency exercises a high degree of control and visible results are guaranteed. This donor preference is reflected in the high priority given to physical infrastructure within the Stability Pact: nearly 1 billion euros in Quick Start projects alone, in contrast to only 30 million in pledges for local government and public administration, and 1.5 million for judiciary and police projects.² While the destruction of war and a decade of neglect in SEE needs to be addressed, reconstruction alone cannot drive stability and prosperity.

In fact, the lessons of the enormous international reconstruction program in Bosnia and Herzegovina show that reconstruction aid without attention to institution-building not only limits the value of reconstruction, but can also undermine broader political objectives. Together with Kosovo, post-Dayton Bosnia represents one extreme of the spectrum of challenges facing the Stability Pact. With its basic state architecture still a matter of conflict among the nationalist elites, it has almost no governance capacity at central level, while the entity and local governments, established to control a war-time economy, have limited institutional resources. In order to deliver humanitarian assistance and 'kick-start' economic development in the shortest possible time, international reconstruction agencies pledged generous reconstruction assistance, and made speed of disbursement their priority. Jointly co-ordinated by the World Bank and the European Commission, the multi-year priority reconstruction program has been one of the most visible successes of the peace process. In the first three years, US\$2.8 billion in aid was disbursed, and by 1999, most urban infrastructure had been restored to pre-war levels, from telephone lines to electric power generation, from water services to primary schools.

The World Bank operated in Bosnia on the basis of its Operational Policy 8.5, a post-natural-disaster model, which explicitly excludes explicit political objectives. As a result, Bosnia was able to take the benefits of enormous international assistance with no obligation or incentive to undertake consistent institutional reform. On the contrary, the reconstruction proved to be an external subsidy propping up unsustainable economic and political local structures. It has only been recently that the reform of the state institutions themselves has moved to the centre of the political agenda.

Over the first four years of the peace process, nationalist power structures co-operated readily with the international community for the purpose of securing the benefit of international aid. By May 1999, 1,300 kilometres of roads were repaired, 22 bridges were reconstructed, the rail track was almost completely repaired, and electricity generation had reached 78 percent of pre-war capacity. However, the limitations of this approach soon became apparent. As there was no central road administration responsible for maintenance roads which were not damaged during the war have begun to degrade, and those fixed with international funds already

²

Requirements and Commitments to Stability Pact Quick Start Projects, 20 September 2000

require further repairs. Rail traffic remains low, due "not to technical deficiencies and low standards but to lack of willingness to co-operate." In the energy sector, where Bosnia's hydro-electric capacity offers potential for growth and export, electric power exchange between the three segregated power companies remains limited, and there are no high-voltage links between the entities. Power stations in Republika Srpska are still controlled from Belgrade, and the ownership of major facilities such as the hydro-electric power stations in the Federation remains unresolved. Revenues from public utilities are being siphoned off to fund political parties and intelligence services.

The non-political, humanitarian approach to reconstruction in Bosnia achieved impressive results in purely physical terms – a major managerial achievement in itself. However, it has clearly failed to create an environment conducive to private-sector-led economic growth. Bosnia remains more dependent on foreign aid than any other country in Europe. With domestic savings so low that local banks derive most of their income from transfer fees, almost all investment comes from international donors. Consumption, which in 1998 amounted to 99 percent of Bosnia's gross domestic product, is fuelled by an unsustainable trade deficit of some US\$2.2 billion. In late 1999, public enterprises still accounted for two-thirds of registered employees. Most employment growth has taken place in public administration, which depends on revenue from customs and sales taxes. As these are linked to the unnaturally high levels of imports and consumption, which result from the foreign presence, the entire public budget is unsustainable, as evidenced by growing arrears in pensions and public sector salaries. While most families depend on some form of public benefit for a significant portion of their income, the present level of government spending is sustained only through foreign credits.

The clear lesson of Bosnia is that reconstruction alone cannot deliver economic growth or alleviate poverty in the general populace. Its contribution to regional stability is therefore dependent on the political and institutional reforms which accompany it. To anchor both the peace process and the achieved social and economic stability, the international mission in Bosnia is now forced to increasingly confront issues of inadequate governance at all levels.

Constraints on reform: the case of Bulgaria

Among the Stability Pact countries, Bulgaria lies today at the opposite extreme from Bosnia. Its government was elected in 1996 on a platform of institutional and policy reform with a clear 'reform-oriented majority' in the parliament, against a background of a deepening economic and political crisis. The political environment is healthy, with all the major political forces acting within the democratic process. Macroeconomic policy was stabilised by the new government, and remains steady. Bulgaria has been admitted as a candidate for membership of the European Union, and the negotiations offer a strong incentive to meet the admission criteria. As a candidate, it benefits from twinning and other Phare programs. To meet the approximation of laws requirements, its parliament has conducted a legislative reform program over the past two years that would make most Western European parliaments appear idle in comparison. Bulgaria has also made considerable efforts to reach out to its neighbours, and develop regional co-operation mechanisms. In the European Commission's assessment, during the Kosovo war "Bulgaria projected an image of a stable country which respects the principles of democracy, the rule of law, market economy, was firmly supportive of all EU actions and aligned itself to all EU and NATO positions".

Table 1: Selected reform initiatives in Bulgaria, 1998-9

Law on the judiciary amended	New telecommunications law
Notary system reformed	Value added tax introduced
Criminal procedure code amended	Amendment to law on statistics

Regulator for broadcast media established	National strategy against organised crime
Extra-budgetary funds reduced from over 100 to 28	International anti-corruption agreements ratified
New national health insurance fund established	New customs code and procedures adopted
Self-financing deposit insurance system established	Reorganisation of state structure, including law on regional development and law on administrative-territorial divisions
New law on securities	Agreement on the position of Roma
New public procurement law	
New law on identification documents	
New law on national standards	

However, despite a political leadership committed to change, Bulgaria continues to experience a difficult transition, evidenced by a growing 'implementation gap' between reform of legislation in the parliament, and the institutional changes required to implement it. While considerable progress has been made in a short period of time in establishing the legal framework for new institutions, implementation programs are meeting significant resource constraints, and are in danger of stalling. The more reform initiatives are announced by the government, the more the resource problems become apparent.

While acknowledging the important progress in the transposition of European law, the European Commission's regular assessment process reported that "implementation and enforcement capacities need to be strengthened. Given limited administrative and financial resources, this remains a major challenge and it is too early to assess if the newly transposed legislation will be effectively applied." Bulgaria continues to share with its South East European neighbours major problems in the staffing of its public institutions. New civil service laws provide a better legal framework for an independent and professionalised administration. However, the laws "fail to address a number of key issues indispensable for a modern and efficient administration, such as creating working conditions and career opportunities, ensuring that public servants with appropriate knowledge and skills are recruited, developed and retrained; the generally low level of salaries; assuring open competition for entering the civil service..." The Commission found that "insufficiently coherent and effective policy, including lack of financial resources, for the recruitment, remuneration, training and development of staff of the state administration remains a significant constraint for Bulgaria's reform and accession process," amounting to a failure to meet accession conditions.

A similar story is apparent in the judiciary. The Commission found that while legislative reform is well advanced, implementing structures are not well prepared, and that trained officials exist in a limited number of areas. Career structures and training of judges are not up to European standards. Only a few judges have been trained in European law, and the overall number of judges, approximately 1,400, may not be sufficient to apply the *acquis* effectively. This has additional effects on other areas of the accession process, such as creating an adequate business climate. For example, the development of a private banking sector is constrained by the lack of effective judicial enforcement of property mortgages and bankruptcy laws.

Some new institutions are struggling to become fully operational. Both the Competition Commission and the Nuclear Safety Agency are reported to be lacking both in numbers and quality of staff. On transport, reform has accelerated, but the Commission called for an implementation strategy to build administrative capacity, as well as further study of the resources and technical assistance, which will be required. Energy utility privatisation has barely started, and the regulatory authority does not yet have the means to function effectively and implement the European Union Gas and Electricity Directives.

In the social field, Bulgaria is still confronted with widespread poverty, and the health sector requires more resources. A political commitment to improve the situation of the Roma population has been incorporated into a Framework Agreement, after extensive consultations between the government and civil society representatives. However, the Commission noted that "the necessary budgetary means for the implementation of this program also need to be allocated".

Taken in turn, each of these challenges would appear surmountable. Collectively, they add up to a significant shortage of resources. Importantly, the Bulgarian government's commitment to reform has not yet translated into significant economic growth to even make up for the losses of the past years of non-reform. There was a cumulative economic contraction of 17 percent in 1996-97. A recovery with 3.4 percent growth in 1998 was marred by a sharp decline in industrial production. The current account deficit widened during 1999. Productivity growth has been prevented by low levels of investment, with fixed capital formation only 12 percent of GDP in 1998. There has been no significant increase in foreign direct investment since 1997. European Union membership still seems a distant prospect. The Commission concluded: "Bulgaria is not yet in a position to cope with the competitive pressure and market forces within the Union in the medium term".

The Bulgarian experience is instructive of the problems, which are likely to be faced by countries of the region which attempt comprehensive reform programs. It is commonly observed that institutional reform is not feasible without a political commitment. Equally important, however, is that even with the requisite political will, the weak institutional environment itself makes reform very difficult to accomplish. Large-scale reform programs require strong public institutions to implement them successfully. When those public institutions themselves are the target of reform, the state suffers from an **agency problem**, lacking the human or budgetary resources to undertake the task successfully. It is thus an illustration of the argument advanced also by the World Bank: "an approach focused on country-by-country reform and intra-regional integration, while necessary, is not sufficient to achieve peace, stability and prosperity in South Eastern Europe."

This assigns a crucial role to outsiders. Where a government in SEE has taken ownership of reforms, but finds itself beset by the problems of institutional weakness, significant outside support beyond what is presently offered must help steady the course. Reform governments may bear considerable political costs, without being able to deliver economic benefits quickly enough for the electoral cycle. As a result, there is a risk that the states of the region will remain caught in a cycle of stop-go reforms. Even where the democratic process results in the emergence of reformist governments, as in Bulgaria, Romania, Croatia or possibly in Serbia, there is a risk that reform initiatives will falter unless the international community finds a way to support them directly. Having credibly established their commitment to reform, such governments deserve more help.

Points for discussion

The role of the Stability Pact

The aim of this research project is to develop a strategy by which the Stability Pact can enhance the effectiveness of institution-building efforts in SEE. Because institution building should be integral to Stability Pact objectives across all three working tables, it should not be constrained within the table structure. Instead, the Stability Pact should be undertaking general measures to help mould diverse forms of international assistance into a coherent approach to strengthen institutions.

Institution-building and democratisation efforts, contrary to a widespread perception, are generally not cheap. As the Commission has found, one of the most important inputs are experienced civil servants from western countries willing to spend time in the region to help transfer the managerial and practical know-how essential to reform efforts. As an expert team noted in the context of twinning, such effort generally need to be marketed much more vigorously, both among European Union administrations and among the sectoral DGs in the European Commission, to sustain support.

There also is a strong argument for more resources devoted to key areas of institutional reform. When one steps back and considers the enormity of the task of democratisation in the countries of SEE – drastically altering the relationship of the state to society, transforming a fundamentally undemocratic state apparatus and often building completely novel institutions – most present democracy assistance programs may appear as dots on a large screen. The Stability Pact can play a significant role to lobby both for higher-intensity efforts and for an increase in targeted resources for the required efforts.

Promoting learning in this field is vital, as the evolution of Phare assistance since the beginning has shown. As one expert evaluation noted, establishing a link between changes in institutional performance and specific Phare programs "usually requires more information and analysis than is available" in existing internal evaluation reports of projects. The World Bank report also stressed the importance of benchmarking: "Tracking good government at any level below the broad-brushed generalities that predominate in this area requires that we assert that specific institutions, legal, political, bureaucratic, are associated with good governance outcomes".

An important issue is the involvement of civil society in the countries of the region and in the generation of information that makes reform efforts transparent, helps identify options and helps build a broader consensus. There have been a number of success-stories in the region in this respect which are presently being studied within this project to suggest how to increase the effectiveness of present civil society support.

The EWI-ESI project will thus undertake detailed research of the following areas:

- a) the record of international institution-building programs in the region, using a case-study method to identify successful program models;
- b) the state of reform efforts of domestic institutions across the region in core areas (judiciary, police, civil service);
- c) the progress of reform amongst progressive governments in the states of SEE, the obstacles they have encountered, and the domestic institutions which have successfully acted as agents of change
- d) the link between outside support for civil society and successful institution-building

This research material will be analysed to see where there are opportunities for effective action by the Stability Pact. Possibilities may include:

- a) **Supporting institutional reform in SEE states**
 - Promoting awareness of institution-building needs among governments of the region

- Promote the development of elite reform units within SEE states
 - Arrange for regular candidate evaluations and needs assessments of institutional reform in each SEE country, along the lines of the reviews of candidate countries presently carried out by the Commission, with a view to providing consistent pressure and support for reform
 - Finding opportunities and mechanisms for increased exchange of expertise within the region
 - Building a political process which minimises the domestic political costs of difficult reforms
 - Identifying opportunities and providing political support for institutional integration of network industries as a complement to regional infrastructure investments in the region
- b) **Improving institution-building methodology among aid providers**
- Encouraging aid providers to devote more resources towards high-intensity institution building
 - Developing a standard methodology of assessing the impact of institution-building programs, to help build expertise in this field
 - Find ways to integrate infrastructure programs with institution-building priorities, so as increase the financial leverage available to support reform
- c) **Increase support for high-intensity institution-building in donor country's administrations**
- Work with EU member states on increasing the supply of sectoral expertise for use in long-term institution-building projects
 - Developing the twinning mechanisms into a tool that could be applied across SEE

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