#H1#Overview of Regional Findings

#H2#East-Central and Southeast Europe

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An overview of development and transformation in Albania, Bosnia and Herzegovina (hereafter: Bosnia), Bulgaria, Croatia, the Czech Republic, Estonia, Kosovo, Macedonia, Hungary, Latvia, Lithuania, Montenegro, Poland, Romania, Serbia, Slovakia and Slovenia.

In the past two years, East-Central and Southeast Europe was characterized by stagnation in the consolidation of democracy and a slight decline in the quality of its market economies. The overall findings of the Transformation Index 2010 show that the East-Central European states attained better results than the Southeast European countries with respect to both democracy and market economy. There was a minor reduction in the gap between the two subregions regarding the quality of their market economy because the East-Central European countries—especially Latvia and Hungary—initially suffered more than southeast Europe from the financial and economic crisis. Most Southeast European countries were not exposed to the international financial markets to the same extent, and therefore they were still less affected when they were assessed in February 2009.

By contrast, the divide grew wider within the region with respect to the quality of democracy. Some progress could be seen in a few of the East-Central European countries, especially Poland, while some of the Southeast European countries experienced a decline in democratic standards. Similarly, the East-Central European countries and Poland in particular improved their performance in the Management Index, which rates the efficiency of political elites with regard to democratic and market economic reforms. The management scores for Southeast Europe show no appreciable improvement.

The October 2007 parliamentary elections led to a change of government in Poland, ending the confrontational and polarizing policies of Minister President Jaroslaw Kaczynski. The new government has sought to strengthen public confidence in it and has initiated important reforms. The severe economic crisis touched off a wave of protests and riots in Latvia, which forced Aigars Kalvitis' government to step down. All three Baltic states have cut public spending and government employees' salaries to avoid endangering their fixed exchange-rate systems and to prevent a balance of payments crisis. In March 2009, Hungary's Minister President Ferenc Gyurcsány likewise resigned in the wake of the economic crisis.

In Southeast Europe, the former Serbian province of Kosovo declared its independence on February 17, 2008. As of July 2009, around 60 countries had recognized Kosovo. Serbia, Russia, and five EU member states have refused diplomatic recognition of the new country. The creation of a sovereign and independent Kosovo is based on a plan of the UN special envoy for Kosovo, Martti Ahtisaari, from March 2007. This plan provided for Kosovo's independence, to be overseen by the international community and backed by a new UN Security Council resolution. This resolution was to supersede UN Security Council Resolution 1244, which forms the current legal framework for the international administration of Kosovo led by the United Nations Mission in Kosovo (UNMIK) and the multinational NATO peacekeeping force (KFOR).

Due to Russian opposition in the Security Council, however, Resolution 1244 remains in force. This has led to a complicated coexistence of three legal frameworks and centers of political authority in Kosovo: UNMIK; the International Civilian Office (ICO), the successor to UNMIK, founded on the basis of the Ahtisaari Plan and supported by expert advisers in the European Union Rule of Law Mission in Kosovo (EULEX); a democratically elected parliament, the Assembly of Kosovo; and the Kosovo government. The government claims to represent all citizens of Kosovo, but it is rejected by most ethnic Serbs who live in Kosovo.

Serbia's parliamentary elections of May 11, 2008, weakened the nationalists and allowed a coalition to form under the leadership by President Boris Tadic's Democratic Party. Tadic, who wants Serbia to join the European Union, had been reelected as president in February 2008. The newly elected Serbian government continued to oppose an independent Kosovo but did not want to block its chances of EU accession with its position on Kosovo. Elections in Croatia, Macedonia, and Montenegro returned pro-EU governments to office. However, Bosnia's political representatives have not been able to agree on the constitutional reforms that would be a prerequisite for EU membership.

Compared to other regions of the developing and post-communist world, East-Central and Southeast Europe still has the highest average scores for democracy, market economy and management. Overall, this can be regarded as a success. By no means, however, did the political transitions of the early 1990s open up a simple path to consolidated democracy and market economy. On the contrary, three socialist federal states collapsed, twelve new states arose from their ruins, and the disintegration of the former Yugoslavia was accompanied by war.

The high levels of consolidation can be partially explained by the prospect of EU accession, which provides an important external “anchor” and offers incentives for political and economic reforms. The region’s reformers have also profited from a number of additional factors: the population’s relatively high level of educational attainment, an initial lack of social disparities and class antagonisms, democratic orientation and civic mobilization, clever institutional decisions by the new democratic elites while drafting constitutions, and the complete delegitimizing of socialist and other authoritarian alternatives (Brusis and Thiery 2003).

Bosnia and Kosovo are exceptions to the usual assessment approach of the Transformation Index. Since the authority and accountability of local ruling elites are limited by the presence of international monitoring institutions, some of the Transformation Index questions are not very applicable. It was therefore decided to evaluate and score only the actions of the local elites, while international representatives and organizations are interpreted as the framework for domestic policy. In addition, Bosnia’s verbal and numerical evaluations apply to the state level and are not intended to rate Bosnia’s two substate units (entities).

#H3# Transformation status: democracy

According to the criteria of the Transformation Index, all of the East-Central and Southeast European states can be classified as democracies. However, they are characterized by deficits to different extents. Differences in the quality of democratic development and the normative BTI standards for constitutional democracies relate especially to weaknesses in civil society and in the representation of political interests, but also to political corruption and persistent constraints on judicial independence.

By contrast, the rules of democratic elections are observed to a very great extent in the region. Democratically elected representatives are not constrained by anti-democratic veto power or extra-constitutional enclaves, all significant political actors accept democracy as the valid rules of the game, and the citizens support democratic norms. In none of the region’s countries is the state monopoly on the use of force seriously contested—except for Kosovo, where the northern part of the country, which is dominated by ethnic Serbs, does not recognize the Assembly of Kosovo or the government in Pristina. All of the region’s states have basic administrative structures. They are also all secularized, and religious authorities do not enjoy any prerogatives in the legal system or in the exercise of political power.

Twelve of the 17 East-Central and Southeast European states can be ranked as functioning liberal democracies that are completely or nearly consolidated, with democracy scores between 8.0 and 9.8. Serbia has risen to this group mainly because extremist political groups are weakening, with concomitant growth in the social acceptance of democratic norms. The other five states, with scores between 6.5 and 7.95, can be considered defective democracies: Albania, Bosnia, Kosovo, Macedonia and Montenegro. These states differ significantly from East-Central Europe in regard to the rule of law. The most recent democratic elections in Albania and Macedonia were marred by violence, manipulation, and irregularities. Bosnia, Kosovo, and Macedonia are ethnically heterogeneous countries with a recent history of violent conflicts, which hinders the consolidation of democratic institutions.

Table 1: Transformation status: democracy; BTI 2010

Democracies		**Defective democracies**	
(10 to 9)	**(<9 to 8)**	**(<8 to 7)**	**(<7 to 6)**
Czech Republic	Latvia	Macedonia	Kosovo
Slovenia	Bulgaria	Montenegro	Bosnia and Herzegovina
Estonia	Croatia	Albania	
Slovakia	Romania		
Lithuania	Serbia ▲		
Hungary			
Poland ▲			
Note: The table corresponds with BTI data. Countries are listed in order of their democracy scores. Arrows indicate movement to a higher or lower category than in the BTI 2008.			

In Bosnia and Kosovo, the authority of the state is monitored by representatives of the international community and secured by multinational peacekeeping troops. The Bosnian state consists of two entities with extensive powers of self-governance: the Federation of Bosnia and Herzegovina (FBiH) and the Republika Srpska (RS). Bosniaks (Bosnian Muslims) and ethnic Croats are the dominant ethnic groups in the FBiH, while ethnic Serbs dominate in the RS. The FBiH is subdivided into ten cantons with extensive rights of self-governance.[1] These structures are overseen by a High Representative who answers to a Peace Implementation Council drawn from 55 countries and international organizations. The costs and problems in governing Bosnia have bolstered international efforts to restructure the state. However, Bosnia’s political representatives blocked an attempt at constitutional reform in 2006.

[1] In addition, the district of Brcko has a special administrative status within Bosnia.

After Kosovo declared independence, the RS parliament in February 2008 demanded the right to a referendum on independence. The Prime Minister of the RS, Milorad Dodik, threatened to hold a plebiscite on secession if constitutional reform called into question the status of the RS. Haris Silajdzic, the Bosniak representative in the state presidency, countered the demands and threats of the Bosnian Serbs with a call to abolish the RS because, he said, it came into being through genocide. These statements point to increasing political polarization, which goes hand in hand with the people's dwindling support for the joint state.

A representative survey from 2007 showed that 14.2 of those questioned did not identify themselves as citizens of Bosnia. Half of the Bosnian citizens rejected the constitution, and 12.8 percent admitted they contemplated the use of force to achieve political goals. One consequence was that the Peace Implementation Council once again extended the mandate of the High Representative and his office (OHR) on March 26, 2009. The Council conditioned closure of the OHR on the fulfillment of five goals, which included agreement on the allocation of state property, functional coordination of fiscal policy within Bosnia, prosecution of war crimes, and reform of the judicial system. In November 2008 and in early 2009, leading Bosnian politicians managed to agree on some of the reforms that are necessary for the withdrawal of the OHR.

Aside from Bosnia, only the legitimacy of the state of Kosovo remains in dispute. Most Kosovo Serbs boycotted Kosovo's parliamentary elections in November 2007. Their political representatives rejected the integration of Serbian settlements into the state of Kosovo. Instead, they upheld parallel governance structures and in May 2008 they held local elections together with Serbia's local elections—a violation of UNMIK rules.

Estonia and Latvia continue to enforce a doctrine of citizenship that classifies Russian-speaking minorities (which make up 35 to 40 percent of these states' populations) as migrants and thus excludes them from citizenship. However, a growing number of these residents have been naturalized and gained full civil rights since the two former Soviet Republics gained their independence. While 16 percent of the Latvian population remained de facto stateless in 2008, the corresponding figure for Estonia was around eight percent.

Macedonia has developed a model of power sharing between the ethnic Macedonian majority and the Albanian community in Macedonia (roughly 25 percent of the population). The internationally mediated Ohrid Framework Agreement of 2001 reaffirmed principles of consociational democracy—ethnic proportionality and group veto rights—and the practice of forming interethnic governing coalitions has endured through the July 2008 parliamentary elections. However, especially in the rural areas populated by ethnic Albanians, the democratic quality of elections has been undermined by attacks on polling sites, shootings, ballot stuffing, “family voting” (where one person, usually the man of the house, votes on behalf of all family members), voter intimidation, and the breaking of ballot boxes by armed intruders.

Albania and Romania modified their electoral systems in 2008. Albania replaced its mixed-member system by a proportional formula with twelve electoral districts and closed lists of candidates. The new system favors the larger parties and forces independent local politicians to secure support from a national party. Romania introduced a mixed-member system.

Among the 17 questions in the Transformation Index on the quality of democracy, the scores for freedom of the press have declined most precipitously since 2008, especially in Southeast Europe but also in Slovakia and Lithuania. The country reports document two particularly great threats to the independence and pluralism of the media. For one thing, dominant ruling parties are interfering with the institutional autonomy of public broadcasters in such countries as Bosnia, Croatia, Kosovo and Montenegro. For another, the weak finances of private media make them dependent on powerful and sometimes shady groups of companies. These groups use the electronic and print media that they control to achieve their own political goals.

Investigative journalists perceived as threatening these groups’ business interests put their lives at risk. Such was the case with two journalists at the Croatian weekly *Nacional* who were murdered in October 2008. A journalist at the Serbian weekly *Vreme* was nearly killed in 2007. The publisher of a Bulgarian Internet news site was beaten up in September 2008. Journalists at the dailies *Republika* and *Vijesti* in Montenegro were also assaulted during the period under review. In Bosnia’s Republika Srpska, Prime Minister Dodik insulted journalists from Alternative TV and the newspaper *Dnevni Avaz*.

Especially in the defective democracies of Southeast Europe, the ruling parties tend to undermine the independence of the legislative and judicial branches. In light of weak party organizations and the lack of stable constituencies, control of the government offers incentives for parties to use public offices and resources for patronage politics, in order to build clientelistic networks of loyal supporters. Because such patronage is decisive for their political survival, party elites try to monopolize state power. They therefore perceive autonomous parliaments, presidents, courts, and administrative structures not only as constitutional checks on their own power but also as a threat to their own resource base.

Several developments between 2007 and 2009 suggest that ruling elites are increasingly centralizing their power. In Bulgaria, Croatia, Macedonia, Montenegro, Romania and Serbia, directly elected presidents have democratic legitimation to limit the powers of the prime minister and the ruling parties. Presidents who belong to or sympathize with opposition parties use their position to constrain government policy—even in countries where the president is not constitutionally empowered to prevail over the parliamentary majority. Such “cohabitation” came to an end in Macedonia and Serbia in 2009 and 2008, however. In July 2007, Albania’s Prime Minister Sali Berisha got his deputy in the Democratic Party elected president. Romania’s Democratic Liberal Party, which supported President Traian Basescu, was returned to office in the November 2008 elections. The president of Montenegro elected in April 2009 is a close confident of Prime Minister Milo Djukanovic.

The parliaments of Southeast Europe still lack sufficient technocratic and political expertise to hold governments accountable and to help shape legislation. The executive dominates the legislative process, and opposition lawmakers tend to abuse the parliament as a platform for protest and confrontation instead of using it to influence legislative outcomes.

In Macedonia and Serbia, the inefficiency of parliamentary debates and procedures has led governments to use emergency sessions to pass laws, which further marginalizes the influence of parliament. A survey of parliamentary resolutions in Bulgaria found that over a period of three and a half years, more than half of the votes violated rules of procedure because there was not the necessary quorum of members present. Opposition representatives boycotted the parliaments in Albania, Macedonia, and Montenegro in protest of majority decisions that ignored their interests. In Bosnia’s federal parliament, Prime Minister Nikola Spiric and the RS delegates boycotted the work of the parliament and government for several months in protest of a decision by the High Representative to simplify voting procedures in these institutions.

The Albanian parliament ratified constitutional amendments on April 21, 2008, that introduce a constructive vote of no confidence and empower the prime minister to dissolve parliament when a no-confidence vote is defeated. Opposition parties that want to force the resignation of a prime minister must now agree on a new candidate, and the prime minister can discipline his critics within the ruling parties by threatening to dissolve parliament. Albania’s new lustration law of December 2008 enables the government to use the oversight commission created by the law to remove their opponents from public administration. The Berisha government also threatened to remove Albania’s prosecutor general and tried to bring the office under its control.

While an independent judiciary is guaranteed constitutionally and institutionally in every country of the region, there were repeated challenges to its independence from the executive and parliament, especially in Southeast Europe. Problems include corruption, the courts’ inadequate financial autonomy, political patronage in appointing judges, abuse of judicial immunity, and criticism of court decisions by politicians.

In February 2008, Montenegro passed a law creating a judicial self-governance council, but the political independence of this new institution is questionable. The new Albanian law of March 2008 on reorganizing the judiciary allows the minister of justice to fill key positions in the administration of justice. In the opinion of the national association of judges, this could erode the independence of courts and enable the government to intimidate judges. Croatia's justice minister appoints the presidents of most courts (except for the Supreme Court and the Constitutional Court), which allows the executive to influence the court's work. RS Prime Minister Dodik attacked judicial independence by accusing Bosnia's High Judicial and Prosecutorial Council of being corrupt and partisan. His government refused to cooperate with the public prosecutor and the state news and security agencies. Poland's Kaczynski government tried to interfere with judicial autonomy. Minister of Justice and Public Prosecutor General Zbigniew Ziobro publicly presented the names of suspects as if they had already been found guilty.

Non-partisan public prosecutors and courts play an important role in effectively prosecuting corrupt public officials and limiting patronage politics. The BTI country reports for East-Central and Southeast Europe document numerous cases of high-level corruption that indicate the scope of abuse of public office by political elites to benefit their own interests and those of their party. For example, the Bulgarian Minister of Economy and Energy and the Minister of Internal Affairs resigned in 2007 and 2008 due to corruption scandals.

Because the judicial systems of Bulgaria and Romania continued to be affected by corruption and deficiencies even after their accession to the European Union in 2007, the EU member states introduced a cooperation and verification mechanism to monitor judicial reform and the prosecution of corruption. In July 2008, the EU Commission suspended the payment of 500 million euros to Bulgaria due to financial irregularities and conflicts of interest.

The party systems in East-Central and Southeast Europe are weakly rooted in society. Most parties lack a consolidated organization or a broad-based active membership. The last elections significantly reduced the effective number of parties in Croatia, Macedonia, Poland, Romania, and Slovakia. The Hungarian party system continues to be the most bipolar in the region. This is partly due to its electoral system, which is based on a mixture of the majority and the proportionality principles, and which provides an institutional explanation for the high degree of polarization in Hungarian politics.

The low degree of fragmentation in the party systems of Macedonia and Montenegro points to the clear absolute majorities that the center-right party VMRO-DPMNE and the center-left party DPS enjoy with their electoral coalitions. Early elections have placed these parties in dominant positions and reduced the largest opposition parties' parliamentary seats to 23 and 20 percent, respectively. However, the VMRO-DPMNE, the DPS, and also the Serbian center-left party DS lead party coalitions consisting of various individual parties whose leadership could terminate their cooperation.

The party systems in Albania and Bulgaria are still characterized by comparatively high electoral volatility, while this has diminished in Poland and Lithuania. Even so, the cultural ties between certain voting blocs and party leaders with certain ideological values are substantially more stable than suggested by the high volatility rates, which are more indicative of the parties' organizational instability. The Czech Republic, Estonia, Hungary and Slovenia continue to have the most highly developed party systems, consisting of a limited number of relatively stable parties. The 2008 parliamentary elections in Serbia and Romania indicate gradual consolidation of both party systems. Clientelistic parties with weak programmatic identities exist mainly in the Baltic and Southeast European countries.

Populist and extremist parties belong to the governing coalition in Slovakia; however, populist styles of argumentation and simplified interpretations are widespread in the region's other countries, too, and represented in their party systems. Examples of parties with populist rhetoric include the Alliance of Young Democrats (Fidesz) in Hungary, Res Publica in Estonia, and the Labor Party in Lithuania. Fidesz managed to stop healthcare reform initiated by the government with a referendum against the introduction of copays.

Protest voting and swing voters reflect the low trust in society that is substantiated by representative surveys. The Baltic states and Slovakia are characterized by relatively high scores for interpersonal trust, but only the Estonian and Slovakian citizens also manifest substantial trust in their governments. By contrast, social trust in Bosnia and Macedonia seems to be far lower. Both of these societies are marked by significant ethnic heterogeneity and a legacy of violent ethnopolitical conflicts.

#H3#Transformation status: market economy

The Transformation Index assesses the quality of a market economy by analyzing the economic system's institutional framework and socioeconomic performance. Social policy and sustainability are also evaluated. In the East-Central and Southeast European countries, the average scores for market economy are weaker than for democratic development. Measured against the best possible BTI scores, the region's countries show their greatest deficiencies in educational and research policy, socioeconomic development, and economic performance. The Southeast European countries score lower than the East-Central European countries across all questions and criteria. The discrepancy is especially great for the question on market competition.

Nearly all of the region's countries have completely liberalized their foreign trade and pursue a consistent inflation policy as well as an appropriate monetary policy backed by independent central banks. The decline in the average scores for market economy is primarily attributable to growing socioeconomic inequalities, weakened macroeconomic stability and trade balance, and continual cutbacks in spending on education and research.

Three groups of countries may be distinguished on the basis of the Transformation Index criteria. The first group consists of EU member states with developed market economies and well-functioning institutional frameworks characterized by clearly defined, secure property rights, more inclusive social systems, and less discrimination and inequality. Croatia also belongs to this group thanks to its overall scores and its performance profile. Scores fell most steeply for Hungary and Latvia, mostly due to their vulnerability to the economic and financial crisis.

The second group consists of Bulgaria, Macedonia, and Romania, which show notable deficiencies in access to their social systems and in equality of opportunity. Furthermore, their bank systems, financial markets, and educational policies are less developed. The third group includes countries that have significant defects in their economy's institutional framework and/or that trail the region's other states due to both their economic performance and their socioeconomic inequalities: Albania, Bosnia, Kosovo, Montenegro, and Serbia. Serbia has most clearly improved its overall score, thanks to continual institutional reforms and more even-keeled economic performance.

Table 2: Transformation status: market economy; BTI 2010

Developed market economy:		Viable or functioning market economy	Market economy with functional flaws
(10 to 9)	**(<9 to 8)**	**(<8 to 7)**	**(<7 to 5)**
Czech Republic Slovenia Estonia	Slovakia ▼ Lithuania Hungary ▼ Poland Latvia Croatia	Bulgaria ▼ Romania ▼ Macedonia	Montenegro Albania Serbia Bosnia and Herzegovina Kosovo
Note: The table corresponds with BTI data. Countries are listed in order of their scores for the status of market economy. Arrows indicate movement to a higher or lower category than in the BTI 2008.			

The global financial crisis struck East-Central and Southeast Europe especially hard because the region's countries depend heavily on foreign capital for modernizing their economies. Since the end of state socialism, all of the region's countries have sought to attract foreign investment. In order to strengthen the confidence of foreign investors, all of the states have liberalized their financial markets and restructured or privatized their banks. As a consequence, the majority of bank assets are held today by West European banks. The governments demonstrated their commitment to monetary stability by securing the independence of central banks and pledging themselves to the principle of fiscal discipline. Many countries pegged their national currency to the euro or limited exchange rate fluctuations between the national currency and the euro. All of the governments demonstrated their determination to join the European Union and to fulfill the convergence criteria of the economic and monetary union.

These policies aimed to convince foreign investors that their profits in the region's countries would not be threatened by inflation, currency devaluation, or capital export restrictions. Pegging their currencies to a fixed exchange rate was also a rational political decision in view of the small size of most East-Central and Southeast European national economies, in which foreign trade made up a large share of gross domestic product, and which had close trade relationships with the eurozone. The commitment to monetary stability was effective insofar as it generated large inflows of foreign investment. These capital inflows allowed countries to finance their trade deficits, which stemmed from growing domestic demand for consumer and financial goods. Inflows of foreign capital further strengthened the national currencies and thus reduced inflation.

Credit for the private sector drove dynamic economic growth in the region, and it grew rapidly—in Romania, for example, at an average annual rate of 47 percent (IMF 2009). The

East European subsidiaries of the West European banks supported this growth in credit, since they not only profited from the interest on credit, they could also refinance credit relatively cheaply in the international capital markets. As a consequence, the banks' foreign debt exceeded their reserves in nearly every East-Central country. The prospects of appreciation and membership in the eurozone, along with stability-oriented monetary policy, encouraged local households and companies to take out loans in foreign currencies, which offered lower interest rates. In Estonia and Latvia, foreign currency loans accounted for 85 to 89 percent of the total volume of credit (IMF 2009).

The collapse of global financial markets in fall 2008 led to foreign banks and investors withdrawing their capital from the region, partly because they had become more risk averse, and partly due to the increased costs and problems of refinancing. According to estimates of the International Monetary Fund, the outflow of bank capital could amount to five percent of GDP in many East European countries (IMF 2009: 9). The region's capital drain caused stock markets to collapse; it also made servicing foreign debt more costly, devalued free-floating national currencies, and endangered fixed currency exchange systems. The Polish zloty, for example, lost 30 percent of its value against the euro between September 2008 and February 2009.

Besides Poland, Croatia, Romania, Serbia, the Czech Republic, and Hungary have flexible exchange-rate policies. Following Slovenia, Slovakia joined the eurozone on January 1, 2008. The Baltic states have pegged their national currencies to the euro and participate in the European Exchange Rate Mechanism II in preparation for membership in the economic and monetary union. In Southeast Europe, Kosovo and Montenegro are already using the euro as their official currency, and Bulgaria, Bosnia, and Macedonia have pegged their exchange rate to the euro. In countries with a fixed exchange rate, the central bank had to intervene and buy up the national currency in order to protect the pegged rate.

In addition, the worldwide credit crunch set off a global recession, which led to a major decline in exports from East-Central and Southeast Europe. As of May 2009, the European Bank for Reconstruction and Development anticipated a five percent decline in GDP for the region. The Baltic states were hit hardest by the recession since they were especially dependent on foreign trade and had profited from portfolio investments. Latvia's exports and imports, for example, collapsed by 40 percent, leading to a 20 percent decrease in GDP. The economic crisis further exacerbated the financial crisis by increasing the number of defaulted loans and intensifying investment risks, which in turn worsened the banks' capital ratios and capacity to make loans.

Hungary, Latvia, Romania and Serbia were hit hardest by the financial crisis. These countries were especially vulnerable due accumulated economic and financial problems, combined with economic policy decisions that increased risk. For years, all of these countries had posted large trade deficits and budget deficits caused by state spending that greatly outstripped revenue. Large national debts, high inflation, booming housing and real estate markets, and a high percentage of mortgages tied to foreign currencies further contributed to their vulnerability. The International Monetary Fund made emergency loans to Hungary (November 6, 2008, 11.7 billion euros), Latvia (December 23, 2008, 1.7 billion euros), Serbia (January 16 and May 16, 2009, 3 billion euros) and Romania (May 4, 2009, 13 billion euros) to prevent national insolvency. All four of these countries were forced to reduce public spending and accept austerity packages in order to fulfill the eligibility requirements for the IMF loans.

The other East-Central and Southeast European countries were less harshly affected by the financial crisis as of June 2009. They profited from greater macroeconomic stability (Czech Republic), membership in the eurozone (Slovakia, Slovenia), and less international exposure in their bank sectors and financial markets (as in most of the Southeast European countries). Poland managed to avoid a price bubble in its real estate market and the expansion of mortgages linked to foreign currencies. Nevertheless, in April 2009 the Polish government requested a flexible preventive loan from the IMF (14.7 billion euros) that was not tied to fiscal or monetary conditions.

In 2008, the Southeast European countries were still achieving high growth rates, accompanied by increasingly unbalanced trade, growing inflation, and mounting budget deficits. Official unemployment rates remain high in countries such as Bosnia, Macedonia, and Serbia. Most of the jobless are employed in the informal economy. Older and unskilled workers are hit harder by unemployment because they have great difficulty reentering the labor market.

#H3#Transformation management

The average quality of transformation management in East-Central and Southeast Europe has barely changed from the Transformation Index 2008, and the average scores for the four management criteria are very close together. This indicates that overall management performance is relatively balanced. Scores were slightly lower for the internal dimension of state capacity—the efficient use of resources.

While anti-corruption measures were rated the lowest, the region’s countries received relatively high scores for all aspects of international cooperation. For all criteria and questions, scores for the Southeast European countries trailed East-Central Europe; the difference was most striking for the question on efficient use of economic and human resources. Nonetheless, the region’s countries are top rated in global comparison. Four countries rank among the ten best, and eleven are among the top 25 in the Management Index. The region can be divided into three groups. The leading group consists of two countries, Estonia and Slovakia, which performed well on all four management criteria: steering capability, resource efficiency, consensus-building and international cooperation.

Table 3: Quality of transformation management, BTI 2010

Successful management	**Successful management with weaknesses**		**Management with moderate success**
(10 to 7)	**(<7 to 5.6)**		**(<5.6 to 4.3)**
Estonia	Czech Republic	Macedonia	Kosovo
Slovakia	Lithuania	Romania	Bosnia and Herzegovina
	Latvia	Montenegro	
	Bulgaria	Serbia ▲	
	Croatia	Albania	
	Slovenia		
	Poland ▲		
	Hungary		
Note: The table corresponds with BTI data. Countries are listed in order of their Management Index scores. Arrows indicate movement to a higher or lower category for the BTI 2010.			

Thirteen states demonstrated successful management performance overall with some weaknesses. Scores for Poland and Serbia were significantly higher than in the BTI 2008, while Slovenia, Croatia and Romania achieved somewhat worse results. In Poland, the center-right party PO and the agrarian party PSL formed a government in November 2007 under the leadership of Donald Tusk. This government initiated some important economic and political reforms and started a campaign to build confidence, aiming to reduce the social polarization that had been incited by the preceding right-wing populist government. The new government's priorities included health and pension system reform, introduction of a flat-rate income tax, prevention of corruption, decentralization of public administration, and establishment of a prosecutor general separate from the ministry of justice. In addition, the Tusk government reestablished Poland as a reliable and credible partner in the European Union.

The new Serbian government led by Prime Minister Mirko Cvetkovic pursued a more cooperative policy on Kosovo, arrested a number of Serbs accused of war crimes and transferred them to the International Criminal Tribunal for the Former Yugoslavia in the Hague, intensified the fight against corruption, and privatized the Serbian automaker Zastava. In addition, the government implemented reforms to prepare the country for EU membership and to cope with the financial and economic crisis.

The third group of states includes Bosnia and Kosovo, whose political elites were evaluated for the first time. Bosnia's management performance has further declined from 2008 due to increased political polarization and the ongoing blockage of important political reforms by local political elites.

East-Central and Southeast Europe continues to be governed by coalitions of two or more parties. Ruling cabinets—understood as teams consisting of a prime minister and a certain group of parties—are short-lived in most countries (see Table 4). However, the average time in office for cabinets increased in many of the region's countries during the period under review, indicating a trend toward more stable governments. Frequent changes of government can allow better policies to be substituted for failed ones, and can weaken the position of officeholders who try to block reforms (Orenstein 2001). However, instability also offers incentives for politicians to strive to stay in office as opposed to solving political problems.

Hungary still has stable governments, on balance, but its latest cabinets, headed by Gyurcsány and Bajnai, have had only a minority of seats in parliament. A new right-leaning party has formed, and for the second time in Hungary's history as a democracy, a prime minister resigned before the end of his term. The governments in Albania, Bulgaria, and Slovakia survived the period from 2007 to 2008 without changes in their composition. Poland achieved a stable government after the frequent crises and cabinet shuffles during the term of the Law and Justice Party.

The governments in Albania, Bulgaria, Croatia, Estonia, Kosovo, Macedonia, Montenegro, and Romania enjoy comfortable parliamentary majorities, enabling them to pass laws even in the face of opposition from dissenters within the ruling parties. Nine of the 17 countries elected new parliaments in 2007/2008. In Estonia, Croatia, Macedonia and Montenegro, elections returned the major ruling parties to office, thus strengthening the governments' political authority.

Table 4: Composition and length of existence of ruling cabinets

	Duration of cabinet	**Number of ruling parties**	**Parliamentary support**	**End of cabinet**	**Stability**
Albania	07/05–06/09	6	oversized coalition	elections	14
Bulgaria	08/05–07/09 07/09–	3 1	oversized coalition minority coalition	elections	22
Croatia	03/06–11/07 01/08-07/09 07/09–	3 4 4	minority coalition minimal winning coalition minimal winning coalition	elections resignation of prime minister	19
Estonia	04/05–03/07 04/07–	3 3	minimal winning coalition minimal winning coalition	elections	18
Hungary	06/06–04/08 04/08–04/09 04/09–	2 1 1	minimal winning coalition minority coalition minority coalition	withdrawal from coalition resignation of prime minister	25
Kosovo	03/06-01/08 01/08–	4 4	oversized coalition oversized coalition	elections	17
Latvia	11/06–12/07 12/07–02/09 02/09-	4 4 5	oversized coalition minimal winning coalition oversized coalition	resignation of prime minister withdrawal from coalition	12

Lithuania	07/06–02/08 02/08–10/08 11/08–	3 5 4	minority coalition oversized coalition oversized coalition	withdrawal from coalition elections	12
Macedonia	08/06–05/07 05/07–03/08 07/08–	7 8 2	oversized coalition oversized coalition oversized coalition	cooptation of an opposition party withdrawal from coalition, early elections	14
Montenegro	11/06–02/08 02/08–03/09 04/09–	5 5 5	minimal winning coalition minimal winning coalition oversized coalition	resignation of prime minister elections	
Poland	10/06–09/07 11/07–	3 2	minimal winning coalition minimal winning coalition	withdrawal from coalition, early elections	13
Romania	12/06–04/07 04/07–11/08 12/08–	3 2 2	minority coalition minority coalition minimal winning coalition	withdrawal from coalition elections	16
Serbia	10/06–01/07 05/07–03/08 07/08–	3 4 2	minority coalition minimal winning coalition minimal winning coalition	elections withdrawal from coalition, early elections	14
Slovakia	07/06–	3	minimal winning coalition		19
Slovenia	12/04–09/08 11/08–	4 4	oversized coalition minimal winning coalition	elections	18
Czech Republic	01/07–03/09 04/09–	3 3	tie vote oversized coalition	lack of parliamentary support	22

Source: Authors' compilation based on country reports. Status as of July 2009. Oversized coalition: not all governing parties are necessary for a parliamentary majority. Stability: average duration of cabinets in months, since 1989 for Poland, Slovakia, Czech Republic (Czechoslovakia), since 1992 for Estonia, since 1993 for Latvia, since 1991 for Albania, Macedonia, Lithuania, since 1990 for all other countries (see also Müller-Rommel, Fettelschoss and Harfst 2004).

#H3#Conclusions

Twenty years after the end of state socialism, democracy and market economy can be characterized as relatively well developed in East-Central and Southeast Europe. In contrast to other regions of the world, the East-Central and Southeast European countries have not suffered relapses into authoritarian forms of government. Even so, the region did not achieve improvements in the quality of democracy during the economic upsurge until mid-2008. The economic and financial crisis is not only challenging the region's economic development model, it is also testing the resiliency of its still young democratic institutions. A number of factors appear to increase the probability of serious political crises.

First, the supply of foreign capital will become tighter and more expensive as banks and investors behave in more risk-averse ways and come under tighter regulation. These countries lack capital sources of their own that could help them make up for the decreased supply of foreign capital. One consequence of this is that economic recovery will take longer and will generate gains in prosperity only later and for a smaller group of citizens.

Second, the economic crisis has struck the region at a time when previous economic reforms have increased socioeconomic inequality and redistributed opportunities for social advancement. While the initial reforms to introduce a market economy in the early 1990s were facilitated by relatively great social equality and widespread opportunities for advancement, impoverished groups are now easily identifiable. The long-term unemployed, poorly-trained and older workers, small businessmen, retirees, peasants, and the residents of rural, peripheral, and declining industrial regions will likely suffer most in this recession and already have political advocates in right-leaning and populist parties and movements.

Third, although the Southeast European countries were less exposed to the financial crisis, they are being hurt by the economic crisis because they depend on trade with the European Union and transfers of funds home from migrant workers in the European Union. Both income sources will drop sharply and worsen the social situation of much of the population. This effect is especially worrisome because the Southeast European countries are not only poorer than their East-Central European counterparts, they are also characterized by greater socioeconomic disparities, lower social trust, and more obvious patronage politics, which erodes the legitimacy of the political class.

Fourth, the EU member states are now much less inclined to establish a realistic timetable and roadmap for further enlargement to the southeast. The general enlargement fatigue has been reinforced by the blockage of the Lisbon Treaty, problems following the accession of Bulgaria and Romania, fears and resentment of Turkey’s possible EU membership, and the strengthening of Euroskeptical and xenophobic political forces within the European Union. The remoteness and uncertainty of EU accession reduces Southeast Europe’s attractiveness to foreign investors and weakens liberal, pro-European political actors in Southeast European countries.

Fifth, the lack of strong EU-wide momentum for enlargement has already made preparations for accession more susceptible to blockage. Croatia’s accession negotiations were blocked by its quarrel with Slovenia over the maritime border between the two countries. Serbia signed a Stabilization and Association Agreement (SAA) with the European Union in May 2008; it has not gone into effect, however, because the Netherlands insisted on Serbia arresting and expediting Ratko Mladic, the former commander of the Bosnian Serbian army who is charged with war crimes. Macedonia has applied for EU membership, but the opening of accession negotiations will probably depend on overcoming Greek resistance to the name “Macedonia.”

Bosnia represents the biggest problem in Southeast Europe. The emotional rhetoric of wartime has reinfected public debate. Politicians from the three ethnic groups have taken extreme and rigid positions that limit the scope for negotiations on constitutional reform, which is a prerequisite to EU access. Bosnia did sign an SAA with the European Union in June 2008 and the key Bosnian political actors seem ready to cooperate at the minimal level required for abolishing the High Representative. However, the advanced state of ethnicization and political polarization make additional government reforms highly unlikely. Bosnia’s situation has further deteriorated in comparison to its neighboring states. The poor condition of its democracy and market economy, together with the management failures of its political elites, give little hope for a positive transformation dynamic in the future.