

# COMMITMENT AND CONDITIONS

European Union Conditionality and Privatization Reforms in  
Slovakia, Romania and Turkey

By

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## **Abstract**

The dissertation aims to answer the following questions: what kind of influence the EU (vis-à-vis the International Financial Institutions) have had on economic reforms and the related institutional reforms in these countries and why there has been significant variation in these reforms given similar set of incentives and constraints. In the theoretical chapter (Chapter 2), the dissertation proposes that the ‘reinforcement by reward’ mechanism through conditionality and the credibility that external institutions lend to reformers make reforms happen. The dissertation also entertains alternative explanations which suggest that reforms are primarily domestically driven and the variation in the accession reforms is path dependent.

In the ensuing three chapters (Chapters 3, 4 and 5), the dissertation explores the utilization of EU conditionality tools with the help of comparative case studies of three accession countries: Slovakia, Romania and Turkey, all of which at some stage, were considered as accession ‘laggards.’ The case studies focus on privatization reforms and the regulatory institutions surrounding privatizations. In the comparative chapter (Chapter 6), the dissertation finds that the most influential factor for the effect of EU conditionality was ‘credibility’ in so far as the conditionality was able to make the external and domestic actors mutually commit. The comparative chapter also finds that the influence of EU and other external actors depended on their ability to mobilize strategically positioned domestic reformers in favor of a shared set of policy prescriptions. The dissertation concludes in Chapter 7, the EU has been influential on the success of privatization reforms, but mostly through the coalition it built with other transnational actors. The dissertation makes a contribution by highlighting an intervening variable that has been previously ignored by the existing Europeanization literature. The timing and sequencing of rewards (and punishments) vis-à-vis the compliance (measured in policy output) played also played a significant role in explaining why at times of no rewards, progress was made, and at other times with plenty of incentives, countries lagged in accession reforms.

Keywords: Privatization, Europeanization, Conditionality, EU.

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## ***Chapter 1: Introduction***

### **1.1 Opening Remarks**

Central and Eastern European countries (CEE) have witnessed enormous changes in the past two decades. The countries implemented extensive reforms to transform into market economies and democracies. Eight new countries from the region joined the EU in 2004, while two ‘laggard’ countries followed in 2007. European Union gave candidacy status to two more countries from the Western Balkans and to Turkey. There are two main puzzles that this dissertation aims to address. The first puzzle is to what extent could we see the EU as the key driver for change in the region? The second puzzle lies in the candidates continued implementation of EU policies despite the imposition of a transition period and despite high levels of uncertainty. Thanks to the burgeoning body of literature on enlargement and its dynamics, we can have a better understanding of how, when and why the EU shaped, and sometimes determined change. We still need to understand better how endogenous and exogenous pressures for change interact with one another, how the EU effect can be different from impact of other international institutions these countries were seeking to join or were receiving policy prescriptions. (Grabbe, 2006; Jacoby, 2004; Schimmelfennig and Sedelmeier, 2005) In addressing the second puzzle, we account for the missing part of the explanation of how and when policies of candidate countries changed by examining how a logic of adapting to the EU become embedded in the domestic policy making and institution making.

The dissertation examines EU’s influence on the Central and Eastern European candidates and Turkey focusing on what the EU has directly sought to change and the different mechanisms that facilitated (or hampered) national policies’ fit with the EU model(s).

Inarguably, the EU has had a significant impact on policy outcomes in CEE countries and Turkey between 1989 and 2006, where all governments past and present claimed that the membership to the EU was their first and foremost foreign policy objective. The EU also declared the success of its enlargement strategy, more specifically, that the conditions it held for membership claimed to have led the candidates along the ‘right’ path of market reforms and democratization. Aside from the attraction of membership, for some this attraction lasted for five decades, the EU has had specific routes in which it could influence political decisions for democratic reforms as well as economic reforms, in particular through gate keeping, benchmarking, models, assistance and advice. This dissertation argues that there are additional variables must be introduced to explain fully the behavior of applicant countries faced with the EU conditions for membership. Thus, the dissertation underlines the importance of domestic strategies of self-commitments vis-à-vis the timing and sequencing of EU conditions throughout the accession process, key to explaining the variance of policy change between candidate countries.

As we will read in our three cases in the following chapters, the EU does not exert the same influence in every target country. We trace the process of reforms in the

privatization and regulation of the financial sectors in these countries, and we observe that the EU’s influence interacts with other processes of change in the CEE states including the political salience of EU’s norms; frameworks and the agendas of the target government and the civil society organizations, and the institutional capacity of the country to respond to these demands.

## 1.2. Europeanization

Most of the literature explores this change through the lenses of Europeanisation, albeit with very different conceptualizations. Europeanisation as a force for change is defined by Christiansen et. al. ( 2001) as, ‘...polity formation through rules, and norms, the transformation of identities, the role of ideas, and the uses of language’. A more precise and useful definition of Europeanization for our purposes is the following by Radaelli and Featherstone (2003; 17):

*Europeanization consists of processes of construction, diffusion and institutionalization of formal and informal rules, procedures, policy paradigms ... and shared beliefs and norms which are first defined and consolidated in the EU policy process and then incorporated in the logic of domestic discourse, identities, political structures and public procedures.*

Albeit attempts to more precisely define the concept, Europeanization remains somewhat fuzzy. As included in the above definitions, it has been used by some scholars to mean the internalization of European values and policy paradigms at the domestic level, or by others, to name the process by which domestic policy areas increasingly become the subject of European policy making. (Olsen 2007) In other occasions, scholars have looked at the ‘goodness of fit’ between domestic policy and institutions with the European policy and institutions. (Börzel and Risse, 2003)

We aim to contribute to the existing literature by adopting Europeanization as an analytical framework to assess European Union conditionality worked as well as the conditions for its

success in effecting domestic policy change. In doing so, the dissertation constrains Europeanization effects to the effects of the formal accession process. The analytical framework and the working definition of ‘process of change in policy’, therefore locating ourselves in the policy analysis branch of Europeanization, is a useful way of distinguishing Europeanization effects from many other processes of change at work in the post communist political context.

Our focus is explaining the variance of European Union’s impact on transformation over time and across candidates. The temporal dimension meant that conditionality’s impact varied due to the change in incentives offered in different periods within the accession process (i.e. pre-accession, accession negotiations and decision phase). (Haughton, 2007) EU conditionality is theorized as negotiating and defining a fit within a complex framework of formal conditionality (direct); of informal conditionality (indirect) and domestic politics.

Formal accession is our dependent variable, in less strict terms, ‘the explanandum.’ Formal accession refers here to the overall process whereby aspirant countries start at the formal process of moving towards negotiations, and end in their final adaptation to integration from inside the EU. (Pridham, 2008)

We set forth two hypotheses driven from Europeanization literature. We argue that EU conditionality both coerced and persuaded candidates to political democratization and

economic restructuring.<sup>1</sup> We hypothesized that change happened in line with ‘reinforcement by reward’ mechanism as elaborated by Schimmelfennig et. al. (2006) Domestic actors agreed to reforms as a result of the rational calculations of the costs and benefits; change in policy happened where benefits of compliance outweighed the costs. The rewards and punishments were part of the direct conditionality of the EU. In addition to, but separate from direct form of conditionality, we explain EU’s influence with use of indirect conditionality. Namely, the attraction and credibility of membership of the EU (with self defined liberal and democratic institutions), gave legitimacy to actors’ policies while such commitment with high costs for defection, bound their hands. This was explained as a bottom up Europeanization approach as it involved the strategic use of European integration by domestic actors in order to achieve their preferred outcomes at the national level. The difference between the second type and first type of conditionality, was that in the first type: the domestic actors used the window of opportunity/ opportunity structures shaped by Europeanization to expand their policy discretion, while in the case of the ‘binding hands,’ (Elster, 2000 and Dyson, 2004) domestic actors used these opportunity structures to limit their own discretion.<sup>2</sup>

Alternative explanations in the Europeanization literature are also entertained in this dissertation. They could be summarized as the following. Active and passive leverage of the EU did not have a significant effect on the political and economic reforms in accession countries. The power struggle between the political elite about legitimacy at one hand and the fight for supremacy in clientelistic relations inherited from the old regime, between state

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<sup>1</sup> Dyson (2006) explains in the introduction of his book that that EU accession is a cognitive as well as a strategic process, one of argument, and persuasion rooted in ideas.

<sup>2</sup> **Europeanization** is described as a two level game in which national policy makers try to shape the fit between the EU and national level, acting on both levels. One of the ways, the fit can occur is for domestic actors to use pressures emanating from the EU level to change the configuration of national institutions. The institutional change can involve the attempt to enhance or reduce the policy makers discretion at the domestic level (Dyson 2006, 146-7). The main intellectual basis for such restriction, namely, the binding of hands come from Putnam’s two level games and pre-commitment mechanism as explained by Elster (2000).

owned enterprises, the government and the state owned banks and now transferred through inefficient privatization into exclusive private groups explained progress or lack of it. The political elites used EU conditionality to expand policy discretion, and pass legislation which are not prescribed or prioritized by the EU accession agenda. Those alternative explanations point to the path dependency in outcomes in privatization and reform in social welfare regimes in the latter part of 90's and 2000's. They hold the rather superficial adoption, and expansion of policy discretion to fit the domestic agenda, responsible for the lagging and reversal in reforms once past the post. They also point to variance, as some sectors were more susceptible to EU pressure than others- i.e. central banks and regionalization.

In the next three case study chapters, we assess the accession processes in the three countries through time and more specifically whether accession process has had an effect on financial sector privatizations, and in the penultimate chapter, I compare and contrast these findings.

The detailed case studies demonstrate a less than encouraging track record of EU conditionality, much need to be done to sharpen its tools and improve its efficiency. It is not the task for this dissertation to do some policy recommendations, but in the conclusion, there are some projections for its performance with respect to the future enlargement cases.

We are measuring in the dissertation the output of policy, rather than outcomes of those policies, in other words, not whether these policies resulted in similar economic or social conditions to those in the EU or with respect to one another, but rather that the rules that were produced resulting from EU pressure (Grabbe 2006, 61). Our aim is looking at interaction between exogenous and endogenous processes of change and trying to disentangle where the

EU has had a direct effect and how the candidates responded to incentives and constraints established by the accession process.

### **1.3. The structure of the dissertation:**

The project asks why some candidate countries of the Central and Eastern Europe to the European Union (EU) reform and fulfill the conditions of EU accession while others do not. There are domestic and external factors that bring reform. This project first seeks to flesh out and weigh these domestic influences against international and transnational influences. It will look at how EU conditionality (conditions that countries need to fulfill in order to acquire EU aid or actual membership to the organization) works. Then, it would assess its effectiveness by comparing three country cases that have either become members in 2004 or continue to be candidates. Within each country cases, the focus will be on privatization reform and the institutions that surround privatization such as property rights regimes and regulatory policies. The transfer of property from state hands to private hands was problematic in many of the Central and Eastern European countries but the question is how much and what kind of influence the external influence of the international financial institutions and the EU had on the success and failure of reformers in these countries.

The introductory chapter will map out the research question, why some countries reform and others do not. It will provide a bird eye view of the different reform trajectories these 10 Central and Eastern European countries that are candidates to the EU or have already become members. It will ask what explains the variation in these trajectories among these states and why there may be a convergence. Secondly, it will ask how the external factors, and most importantly, the EU conditionality explain this variation. Lastly, it will ask whether the



Central and Eastern European experience is exceptional in its economic and political reform experience.

The theoretical chapter will provide a roadmap of the argument and the possible domestic and external factors that explain this variation. The argument is that EU conditionality acts as an institutional anchor that provides continuity for reform of the state and economy, but once the country becomes an EU member the anchor function becomes less effective. Privatization is where economic and political reforms converge. Without the political and institutional back up, property rights reform cannot survive. Where it appears to be a relationship between the regime type and the rate of privatization, but what was the direction of the relationship? Did the countries that privatize rapidly that democratized as Aslund (1991, 17- 31) and others suggested or did the rate of democratization as anchored by the EU conditionality determine the success and continuity of privatization reforms? How did EU conditionality provide an anchor for political and institutional reforms? The project hypothesizes that EU conditionality functions as credible commitment device (ties the hand of domestic reformers and as well as strengthening the hand of reformers against reform opponents and the general public) to ongoing reforms while providing a road map- a blue print for reformers.

The research design contains detailed case studies. The project thus employs ‘the within case comparison’ in a complementary fashion, congruence, before and after comparison and process tracing (as explained by George and Bennett (2005)), as well as comparative cases, where the project agglomerates the findings from the within case comparisons.

The three chapters are case studies of three new member or current candidate countries, namely Slovakia, Romania and Turkey. Why these three countries? All three of our cases

went through in different periods, and as resulting from a combination of explanatory factors, tougher processes of democratic transformation and consolidation characterized by stop and go processes or fluctuation between significant progress and disheartening rehearsals.

Slovakian accession to the EU has been by no means smooth, in 1997, Slovakia was left out of the Central and Eastern European candidate states that were given the green light due to the worrying state of democratization and other political reforms in the country. In 1999, Slovakia is moved back in the game with seeming praise of the success of its domestic reformers.

Which factors explain this change? Romania has been noted since 2000 for its progress in economic reforms and but criticized for its lagging political reforms. What brought about this change in Romanian accession story? And lastly, Turkey has been left out like Slovakia and Romania from the candidates that were given the green light. In 1999, Helsinki summit of the EU gave Turkey a candidate status and more recently, in 2004, the EU finding the political and economic conditions satisfactory, decided to start accession negotiations. Turkey, different than all other CEE countries considered for membership, has had market institutions and democratic institutions though imperfect. Including Turkey in this comparative study, will shed a light on whether the central and eastern European experience is rooted in the economic and cultural institutions and political and policy choice unique to the post communist world. What are the similarities and differences with the post communist central and eastern European candidates and a developing country candidate such as Turkey?

Slovak case proved that a credible membership perspective was not sufficient condition for successful conditionality, where as the Romanian case demonstrates a lock- in effect of credible commitment device as well as transformational effect of EU's active leverage. On balance, in terms of the first hypothesis, incentives (direct conditionality) were more than a

range of normative tactics. The Turkish case seem to provide more evidence for the alternative hypotheses that the domestic power struggle and utility calculations of domestic reform coalition seemed to do much of the explaining of the variance in compliance across time.

We limited the time frame of our preceding case studies to 2006, which we argue is a good cut-off point. In terms of the longitudinal analysis in the case studies, the 2006 cut-off allows us to assess two years into the accession of Slovakia, when we can reflect on what happened in terms of the economic and political reforms in that country. 2006 is a year before the formal accession of Romania and a year after the opening up of negotiations with Turkey. In this concluding chapter, in contrast, we have the benefit of hindsight of three years (2006 to 2009), which we reflect briefly in the following sections. The benefit of hindsight is that the reform consensus seemed to be broken across the board in the former (now new members) and current candidate countries, where some of the economic reforms were stalled or reversed to some degree in Romania after 2006 and during the second tenure of AKP following the 2007 elections in Turkey.

By studying the policy process in the restructuring and privatization in the financial sector, this dissertation demonstrates the fluid nature of conditionality, the inconsistencies in its application by the Commission over time, and the weakness of a clear-cut causal relationship between conditionality and outcome in this policy area. The concluding chapter will evaluate the argument and the explanatory factors provided in the theoretical chapter. It will also provide thoughts for further research.

## ***Chapter 2: How does EU conditionality work?***

### **2.1 Introduction**

The project aims to explore how conditionality played a part in Europeanization of select countries' economic and political institutions and policies. In order to answer the question of how Europeanization occurred, we need to define Europeanization.

Institutional change in lieu of the accession reforms is the dependent variable of this research. It can be defined as the adoption of European economic and political governance in the formal sense and in the informal sense. In the formal sense, it means adoption of rules and regulations as sought by the *acquis*. In the informal sense, it means the absorption of norms and socialization of actors within economic and political institutions and societal acceptance of those rules and norms. From this angle, the formal and informal influence of Europeanization interacted to form a point of orientation to trigger controversial but necessary decisions for structural reforms (i.e. the sustaining and supporting the momentum for reform) as well as providing a formal set of rules which the EU checked the compliance and implementation of. Large number of issues which would normally be under the competence of national administrations has become the subject of scrutiny and public evaluation (Csaba 2005, p.335).

The New Institutionalism Economy (NIE) literature provides an important conceptual framework for evaluating varied paths of reform in these countries. The New Institutional Economic theory of institutional change is associated predominantly with the work of Douglass North. North (1994, p.360) defines institutions as 'humanly devised constraints that structure human interaction.' North distinguishes formal institutions such as constitution, laws

and rules and informal institutions such as norms of behavior and codes of conduct. North (1990) claims that informal and formal institutions shape the opportunity sets, on which agents optimize.

The link between organizations and institutions are that organizations are entities set up by the economic and political entrepreneurs to explore incentives created by the institutional framework. There is a close interaction between institutions and organizations. When institutions change, the incentives created by the new institutional matrix change as well. Changed incentives may change the perceived pay-offs of alternative entrepreneurial strategies, thus entrepreneurs may restructure their organizations to obtain the highest pay-offs available on the prevailing and expected opportunity set. However, as North (1990 and 1994), Eggertsson (1990 and 1996) and others point out, the institutional matrix creates a mixed bag of incentives – some are productive and some are perverse. Productive incentives are those, which, if pursued, create economic growth and development. Perverse are those, which merely redistribute or even destroy existing wealth.

The amended organizations provide a feedback, which influences prevailing institutions. If political entrepreneurs, who are responsible for introduction of formal institutions, think that another institutional arrangement could deliver higher pay-offs to their constituency and/or to themselves, they will initiate the change. These interactions are sources of the institutional change according to the NIE literature.

How do we explain the variance in the reform trajectories of these countries when they were faced with similar incentives and constraints? The dissertation asks how the individual reformer or a group of reformers in an organization that had the task to make policy decisions

to establish the economic, political and regulatory institutions from scratch or to recuperate the already existing ones, such as restructuring of state owned banks, or sale of assets of these banks and enterprises. How did the individual decision makers decide when faced with deteriorating conditions in the economic and political circumstances, declining output, increasing inflation and unemployment, non-performing assets in state owned enterprises and heavily insolvent state banks?

Albert Hirschman explains in his seminal book, *Exit, Voice and Loyalty* (1970) that when firms and organizations that provide services and products to consumers are subject to deterioration in performance, the consumer either chooses to exit, i.e. stop buying the firm's products or leave the organization that they are members of, or they choose to voice, or express their dissatisfaction to the management or to some higher authority. Hirschman assesses when and how one option prevails over the other option, and when both options come to play jointly as mechanisms for recuperation. In his analysis, he nevertheless leaves out an important explanatory factor that is capable of explaining the incentive and constraint matrix the individual decision maker or reform team find themselves in, namely the economic and political institutions.

Johann P. Olsen along with James March theorized the institutional effects on individual behavior in their decades-long research. According to March and Olsen's institutionalist perspective, as explained in their book *Democratic Governance*, governance involves the development of political identities, political accounts, political capabilities and political adaptiveness (1995). Institutionalization (i.e. Europeanization, as the adoption of European type of governance and accompanying institutions) involves development of identities of citizens and groups in the political environment. Secondly, it involves developing capabilities

for appropriate political action among citizens, groups and institutions. Acting appropriately and learning from experience requires not only will but also ability. Adoption of European rules and absorption of norms means the acquirement of such an ability to act in ways that are consistent with and sustain the European economic and political system. Thirdly, it involves developing accounts of political events. Accounts define the meaning of history, of experiences, the options available and the possibilities for action. As another component, institutionalization is developing an adaptive political system, one that copes with changing demands and changing environments. Political adaptiveness includes the manipulation of the level of risk taking, the balance between efficiency and exploration and lastly, the salience of diversity relative to unity. The extent of adaptation is not limited to adjustment of these countries to European practices of economic and political governance, but undertaking a new round of institutional and structural reforms in order to respond to global challenges such as financial vulnerability, breakdown of liberalization and the spread of electronic trade and IT revolution (Csaba 2005, p.136-7).

The countries of the CEE implementing reforms required by the accession process did not find themselves in an institutional vacuum. The countries have demonstrated considerable variance in their political and economic structures, courtesy of the previous regime and the 5-6 years of double- or triple parallel transition processes. More importantly the pre existing political, administrative and economic institutions imparted them with varying degrees of capabilities, adaptiveness, and accountability to adopt and adapt to the European rules of political, economic, legal, and administrative rules of governance. The focus of this analysis is the part the EU's external leverage played in explaining this variance in economic and political performance and more specifically the change (or lack thereof) in institutions surrounding property rights. If we ask as Hirschman does, which of the policy options was

available to consumers and policy makers when firms or organizations were deteriorating in economic outlook and quality of institutions, we need to consider to how the EU affected this choice of exit, voice or loyalty. If we somewhat simplify the four dimensional institutional explanation of Olsen and March (1995), i.e. capabilities, accountability, identity and adaptiveness, to reflect the capabilities and adjustability of a single decision maker or a team of reformers who are faced with an exit or a voice option a la Hirschman, the analytical question becomes to what extent does the external pressure or constraint (EU leverage) give voice and to what extent does it give exit to the pro and anti-reform groups. Greskovits in his comparative analysis of economic and political reforms in the CEE and Latin America suggests that in the absence of a voice option (lack of violent protest in CEE despite rapidly deteriorating life standards), other less considered exit options such as pilfering, asset stripping, hoarding and other activities in the informal sector became available to the actors (1998, 69-75).<sup>3</sup>

Political economy of policy reform literature establishes the nexus between institutions and policy. Various policies can be used to manipulate at least the formal institutions and influence to some limited extent the informal institutions, which in turn underline the quality

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<sup>3</sup> Bureaucrats' or state owned enterprise (SOE) managers' position could be analyzed as 'loyalists', those choosing not to exit despite deteriorating conditions, when the quality deteriorate. Exit is less of an option, since the exit would lower the quality more, the manager or bureaucrat think, so he or she decides to stay in but choose to get involved in other exit options. 'Opportunism can in this situation be rationalized as public-spirited or even better, can masquerade as secret martyrdom, 'Hirschman aptly suggests (1970, 116). Born from his analysis of the Nigerian railroads, Hirschman suggests that in order to make public firms (such as railroads) who are formerly insensitive to exit (loss of customers) more sensitive, measures of fiscal discipline and financial accountability need to be introduced. Fiscal discipline measures may be set up in the hopes that railroad managers will react to the fall of revenue like private enterprises threatened by bankruptcy. An alternative step is to increase the voice of customers or shareholders by decreasing the cost of voice or raising the barriers for exit (Ibid, 123). Aside from fiscal discipline, reform analysts suggested the role of the soft loans (soft budget constraints as explored in the analysis of Kornai (1992)) and the curtailing of them, which would put these companies in a fiscal crunch and thus induce exit by those firms that are now under hard budget constraints. The exit of public firms (by bankruptcy due to irremediable fall of revenues) could not be the only option when a large part of the population or the most vulnerable part of the population. Those for whom exit is not an option, such as the rural railroad customers or public schools attendants in the inner city neighborhoods or rural areas in countries of transition (and in other infrastructure areas), depends on the services of these after those with most voice power and who are most sensitive to quality have 'exited' and have taken up private alternatives.



of enforcement of formal institutions (Eggertsson 1996). It is recognized that, good policies create good institutions, which in turn help to sustain good policies ('virtuous circle'). On the contrary, bad policies create bad institutions, which support bad policies ('vicious circle'). This understanding the 'good' policies are those that change the formal institutions and their enforcement and induce gradual change of informal institutions so that all these three factors combined create a set of incentives compatible with long term sustainability of and wealth creation in the banking sector operations. On the contrary, 'bad' policies are those, which threaten long term sustainability and sooner or later will result into banking sector insolvency. Such insolvency inevitably destroys wealth and places huge financial burden on shareholders, depositors and/or taxpayers who, at the end of the day, will have to pay for the gap between the banking sector assets and liabilities.

Many of the studies of economic reform in developing countries and countries of transition provide a procedural approach to economic reforms (Williamson, 1994; Stiglitz, 2000). The individual sequencing of institutional change can be summed up as the following: 1) establishing an independent regulator; 2) introduction of the international standards (of regulation, accounting, banking, etc...); 3) dealing with vested interests and 4) achieving a long term sustainability of reforms. The sequential study of the reforms are evident in many of the case studies for property rights reforms in countries of transition and therefore provide a good analytical tool for tracing the process of reform in the case studies in this project. To reiterate the focus of this project, the role of external pressure, is discussed by many analysts, sometimes as a backdrop to the domestic reform processes, at other times, as an enabler, and at others as an active party. Berglöf and Roland in their 1997 paper argue that the EU can and has served as an 'outside anchor' to the reform processes, in many of these countries, as the

domestic battles become subordinated to the overriding goal of membership. They discuss that an outside anchor such as the EU, despite weak enforcement mechanisms, can relieve political constraints to economic reform.

Vachudova in her comparative analysis of EU conditionality argued that the active leverage of the EU, improved the quality of political competition in front runner countries such as Czech Republic, Hungary and Poland and had locked-in reform minded domestic groups as a guarantee of ongoing reform (2005, 161- 165). First it improved the information environment by undermining informational asymmetries, subsequently; it helped change the institutional environment by strengthening the political agenda of the opposition parties.

## **2.2. External pressure hypotheses**

Economists distinguish between two kinds of constraints for economic reform, ex-ante and ex-post political constraints (Berglöf and Roland, 1997). Reform needs ex-ante support to be implemented in the first place. Macroeconomic stabilization processes, for instance, were blocked in several countries due to the haggling between political parties and interest groups. After the initial support, a backlash may occur ex post to the reforms. Most countries experienced a voter reaction against reform processes. Outside anchors, according to Berglöf et. al., may relieve both kinds of political constraints (1997; 8). Aside from independent central banks providing a credible commitment device internally, international institutions such as the World Bank and IMF can impose policy conditionality when lending to countries with financial crisis. Politicians may choose to borrow from these institutions for the sole purpose of committing to certain policies. Ex ante, they come with loans to help buffer social consequences, ex-post, they make reversal of policy more costly since the breach of the

conditionality entails a stop in lending.

The European Union has the most effective of these conditions, making reversal by domestic policy makers costly, in other words, locking the candidate country in by making exit costly. In line with Hirschman's paradigm, the voice of the candidate country is very limited, the EU is often criticized for being insensitive to candidate country complaints for the inefficiencies and lapses in evaluation by the European Commission and the release of the awards. The emotional and cultural magnetism of 'return to Europe' to the contenders to political offices (the convergence of political debate on becoming a member to the EU, as will be demonstrated in the Slovak, Romanian and Turkish case studies to varying degrees), demonstrates the dynamics of loyalty.

EU conditionality is different from IMF conditionality in the sense that EU conditionality are a set of explicit requirements of the EU, as set out by the *acquis*, that only democracies and functioning market economies are eligible for membership in the Union, Whereas, IMF conditionality is used as a way to monitor that its loan as being used effectively in resolving the borrower's economic difficulties. Secondly, EU conditionality could be differentiated from democratic conditionality, as explained by Schimmelfennig et. al. as the main mechanism through which international organizations such as the EU, induce non-members to comply with their principles of democratic governance and human rights (2003, 495). EU conditionality is a step by step process, with the fulfillment of each step of political and economic criteria and the adoption of the *acquis*, the award is released by graduating the country to a higher stage of accession, and more access to the EU's partnerships and structural funds.

The institutions and the policy feed into one another. The vicious-virtuous cycle explanation presented by Eggleston (1996) above is very fitting as the theoretical framework of the Conditionality effect on reform progress. The EU *acquis* provides blue print for legislation. The EU has also sequenced accession reforms through putting into place several ‘checks’ , i.e. the effective use of opinions, demarches (as in the case of Slovakia), formal warnings and of progress reports, and ‘breaks’, i.e. safeguard clauses. The creation of formal institutions (regulatory institutions, laws and introduction of international standards) induces change in informal institutions, while strengthening the hand of pro-reform groups (via effecting actors’ utility calculations/opportunity sets). These key formal institutions interact with internal institutions of organizations (i.e. corporate governance, banks, commercial and bankruptcy courts, security market supervisors among others). All three interact to support or inhibit future policy improvements (hence providing continuity, which is also a built-in dynamic of the accession process). Policy is implemented, or law is translated into practice (as may be demonstrated the survey of the efficacy of property rights reforms (EBRD 2005)), depending on the strength of external incentives and the institutional anchor (external constraints); structural constraints, and the opportunity sets of reformers (as formulated by institutional constraints and enforcement characteristics).

The analyses of how the active leverage brings about Europeanization discuss several mechanisms (Vachudova 2001, 26- 27; 2005, 188-191; Schimmelfennig and Sedelmeier 2005, 1-29; Moravchik and Vachudova 2003; Schimmelfennig, Engert and Knobel, 2003; 496-498). For our analysis of the variance in Europeanization, we will adopt Schimmelfennig et. al.’s analytical framework, ‘reinforcement by reward,’ namely, the candidate countries comply with accession conditions in exchange for material and immaterial rewards extended by the EU. Vachudova’s distinction of active and passive leverage is also useful to

differentiate between two kinds of EU influence: between the attraction of EU membership where it does not use any deliberate policies to influence states in question and deliberate conditionality (2005; 63-63).

Property rights reform is discussed within the framework of institutional change undertaken during the accession processes. In this sense, there are two parallel narratives developed in this theoretical chapter and the ensuing comparative case studies: that of the policy output related to EU accession reforms, and that of property rights. The contribution of this set up is through process tracing, refine or in more quantitative terms tease out, ‘the external pressure effect.’ To reiterate the stages as construed by Stiglitz (2000) and here loosely adapted, preliminary stages are the establishment of independent regulation agencies and introduction of international standards, and the subsequent stages where ex post political constraints come to play are, dealing with vested interests and achieving long term sustainability prospects. For the property rights reform, we hypothesise that EU has been influential in all stages, but in varying degrees.

### **2.3. Europeanization as an External Pressure Mechanism**

Europeanization can be defined as the adoption of European economic and political governance in formal and informal sense. In the formal sense, it means adopting of rules and regulations that are sought by the EU acquis. In the informal sense, it means the absorption of norms and socialization of actors within the economic and political institutions and societal acceptance of those rules and norms. Europeanization, however, should be considered a process, not an outcome. Grabbe (2006) rightly points out that Europeanization is useful term but could be misleading because it implied both the process of joining the EU as well as the

much wider process of 'return to Europe' the wide range of institutional reforms and institution making, modernization and post communist transition. To reiterate, in this dissertation, our theoretical and analytical distinction is that, Europeanization is treated as an external influence mechanism, in its strictest terms, conditionality and the dependent variable is the output in policy, measured as the domestic response to this external mechanism, and not the outcome of the output of policy.

How do we know Europeanization when we see it? Europeanization is defined as the formal adoption of rules and regulations as well as societal acceptance of those rules and norms. The Europeanization literature on CEEs has lacked proper indicators about detecting Europeanization when it occurs (Schimmelfennig and Sedelmeier 2005, Epstein 2005 and Grabbe 2006). We believe that institutionalist literature may fill in the gap about defining and detecting the dependent variable under study. March and Olsen explain in their book *Democratic Governance*, that governance involves the development of political identities, political accounts, political capabilities and political adaptiveness (1995). Europeanization thus involves the development of identities of citizens and groups in the political environment and capabilities for appropriate political action among citizens, groups and institutions. Europeanization, adoption of European rules and absorption of norms, means the acquirement of such an ability to act in ways that are consistent with and sustain the European economic and political system. Europeanization also involves developing accountability of political events that define the meaning of history, of experiences, the options available and the possibilities for action and finally it can include the development of an adaptive political system, one that copes with changing demands and changing environments in which the extent of adaptation may not be limited to adjustment of these countries to European practices of economic and political governance, but undertaking a new round of institutional and

structural reforms in order to respond to global challenges such as financial vulnerability, breakdown of liberalization and the spread of electronic trade and IT revolution (Csaba 2005, 136-7).

To reiterate, conditionality is the main mechanism in which a regional organization such as the EU, induce aspirant countries in the CEE and Turkey to comply with their principles of economic and political governance. Conditionality is defined in this research as a process which requires specific conditions involving a promise of material aid and/or political support in exchange for compliance, passing of specific legislation, introduction of certain institutional and regulatory frameworks.

Some students of economic and political reform in CEE argue that European Union's conditionality mechanisms play a significant role in initiating progress in political and economic reforms in the candidate countries. Others attribute change or the progress in economic and political reform to domestic mechanisms primarily, which use conditionality as a 'pre- commitment device'.<sup>4</sup> They argue that conditionality only plays a secondary role, as it is the domestic struggle over power that brings about change. According to this explanation, the actors who cloak themselves in EU colors and use EU's conditions it to either convene a consensus on the necessity of reforms or to legitimize their reform agendas with the tried out

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<sup>4</sup> Self –commitment will be used interchangeably with pre-commitment from here on, as prescribed by Jon Elster, as he explains precommitment embodies a certain form of rationality over time (2000; p. 5). Reasons for precommitment are explained as overcoming preference change, overcome self interest and overcoming hyperbolic discounting and strategic time inconsistency while the devices vary from eliminating policy options, imposing costs to inducing ignorance, creating delays and setting up rewards (Ibid; 10-31). The term 'pre-commitment device' is adopted from Jon Elster's work on democratization reforms, whereby domestic actors utilise constitutions as devices to bind their own hands for present and future action (88-96). However, pre-commitment of individual and of society are discongruous and constitutions could work to bind others as well as pre-commit oneself. In addition to constitutions, there are also unwritten conventions that can be used as pre-commitment devices.

formulas and blue prints. The EU, they argue, may tip the balance of power towards the reformers, in the condition that the domestic costs of reform do not outweigh the benefits and incentives and there's significant support for EU accession in the first place.

The EU conditionality is as a form of material reinforcement strategy, along with NATO, OSCE and CE. NATO and the EU in relation to the CEE states opted for 'reinforcement by reward' (Schimmelfennig et.al., p. 7), the positive incentives consist in assistance, institutional ties, and ultimately membership, on the condition that the aspirant states adopt the constitutive norms of the community, if a state rejects or fails to adopt these rules, the international agency withholds the rewards. In contrast to the EU and NATO, the OSCE and CE did not promise material collective goods, and their 'strategies' were limited to persuasion, and social reinforcement. The distinction between the two kinds of conditionality is that the former is the deliberate- active leverage on countries wanting to join, where as the latter is the passive type of leverage where traction of membership is used to persuade actors to change policies to maintain a goodness of fit with the liberal democratic standards of the international organization.

The credibility of membership perspective may be sufficient condition in some cases. The sequencing and adaptable use of mechanisms may also explain partially what happened at key turning points. The lock in effect of credible membership perspective or the lessening effect of the lack of it or inconsistent use of the specific conditionality mechanisms can be evidenced in all three cases.



The sequential analysis of reform has a weaker position in explaining triggers and turning points that these individual reform stories would show. This will be demonstrated in more detail in the Slovakian case study, where one needs to analyze carefully what bring the tip over point for the overhaul of the illiberal regime pre-1998. We argue in the ensuing cases, that the EU leverage plays a key role in explaining both the turning point for reform and sequential continuity of reform in the countries of accession, but the sequencing of conditions and in what sequence the particular tools are used, could matter as much as the reinforcement mechanisms and rewards themselves.

We hypothesize the sequence of reforms as the following. In the first sequence of reform, i.e. setting up of international regulator and guaranteeing the independence of central bank by statute; the EU, along with the OECD, the IMF and the World Bank, provides technical support and know-how for the setting up of the independent regulator agencies such the central banks and the privatization agencies. The EU leverage is also influential in providing international economic and political governance standards along with the aforementioned international institutions. The EU plays a decisive role in dealing with vested interests in these candidate countries. This is perhaps the most discussed aspect of EU leverage from both rationalist and constructivists' research paradigms, respectively, the prospects of membership changing the cost-benefit calculations of the political and societal actors in candidate countries, and effecting the values, identities and feelings of belonging-ness attached to membership of a western political and economic institutions. This leverage was subject to change with the moving time frame. We agree with Berglöf et. al. (1997) that the prospects of joining rather than membership itself will relieve political constraints (p.3). Thus, a more dynamic approach is necessary to assess the ever changing calculus of interests and constant interactions between the domestic interests and external pressures along the moving time

frame and different phases of economic reform. In the last phase of reform, ensuring long term sustainability and good prospect of further reform (of the welfare state in former transition countries, as discussed by Kornai, Haggard and Kaufman (2001)), the EU leverage plays a less direct role of standardization, amidst the diversity of institutional and policy developments of new members is hypothesized by analysts (Csaba 2005, 176-180; Berglöf and Bolton 2003).

An alternative explanation in determining the extent of EU's influence may be the timing and sequencing of accession decisions as juxtaposed against the domestic reforms. As elaborated by Pierson in the concept of 'increasing returns' and contingency, when an event occurs may be crucial. In other words, Pierson explains that because earlier parts of a sequence matter much more than later parts, an event that happens 'too late' may have no effect, although it might have been of great consequence if the timing had been different. Secondly, with regard to contingency, relatively small events, if they occur at the right moment, can have large and enduring consequences (2000; 263). The EU's decision to enlarge at an earlier time or its demand of a set of reforms at an earlier time, could affect the response of domestic policy makers much more if this was taken at later time.

We adopt Vachudova's classification of active and passive leverages (2005), we regroup the mechanisms of conditionality. Direct type of conditionality can be divided into five different types as elaborated by Grabbe, the EU's gate keeping role, models, money, benchmarking, advice and twining (2006). The gate keeping function is the most direct one of all five, and has the strongest affect. We include softer tools such as demarches and as well as communiqués sent by the Commission. The indirect kind of conditionality is different from

direct conditionality, as it deals with an aspect of self commitment, i.e. the decision by actors to self- bind to prevent reversal due to change of preference over time or overcome time inconsistency problem. The actors could create additional costs, could create ‘audience costs’ by making strong public statements during a confrontation or institution, could give the ‘key’ over to an external actor or remove all possible options in order to avoid reversal of policy. For this to be effective, the international institution should be desirable and persuasive and have credibility in the eyes of the domestic reformers. The domestic reformers then should decide to commit themselves, or to bind their own hands to the course of reforms as prescribed in the direct set of conditions by the international institution to which they are seeking membership to.

Our theoretical innovation comes in understanding why and when reformers reform and Elster’s actor based but institutionally grounded explanation contributes to understanding of reformers and electorates’ choices. Elster in his seminal work, *Ulysses Unbound*, explains the action of self-binding and pre-commitment for individuals to restrict their own freedom of choice. The actors may want to protect themselves against preference change and time-inconsistency, they do so by removing certain options from the feasible set, by making them more costly or available only with delay, and by insulating themselves from knowledge about their existence. (Elster, 2000) For instance, the separation of powers could serve as a pre-commitment device in the monetary policy making. By entrusting monetary policy to an independent central bank<sup>5</sup>, and forbidding the government to instruct it, the constitution could solve the problem of time inconsistency. The reformers could change the constitution to bind

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<sup>5</sup> The standard argument is that central bank independence is a pre-commitment device to overcome time inconsistency problem caused by strategic interaction (Elster, 2000; 151). The central bank independence as pre-commitment device, could be measured either by formal criteria such as guaranteeing statute or by behavioral criteria such as the rate of turn over of bank governors.

their hands further by making the abolishment of the central bank's independence a matter of supermajority rather than simple majority.

We consider the pre-commitment mechanism as explained by Jon Elster, a valuable analytical tool to study the interface between external pressure mechanisms as explained above and the endogenous factors for reform. We hypothesize that pre-commitment describes accurately how the reformers acted and responded during a decade and half of continuous and changing matrix of conditions and rewards by the EU along with other international institutions such as the IMF and NATO, to whom the EU also *bound* its accession conditions.

## **2.4. Explanatory mechanisms and Hypotheses**

Our main explanation comes out the conditionality literature that looks at outcomes (as change in policy) as a result of the actors' rational cost benefits calculations in view of the rewards and punishments offered by the international institution. In this, we firmly ground ourselves in the conditionality literature. According to the 'reinforcement by reward' (Schimmelfennig et. al., 2003), the rewards offered by the organization upset the domestic equilibrium, given governmental and societal preferences and power balances. The domestic equilibrium is upset by increasing the marginal international benefits of compliance; the target government fulfills the organizations conditions to the degree that the domestic political costs of adaptation are outweighed by the benefits of the institutional rewards. In the second caveat of our explanation we look at the responses of the domestic actors and how their behavior is shaped. In this, the domestic reformers also use the conditions as credibility device against their domestic rivals while signaling guarantees for continuity to external stakeholders, but more importantly, they use these conditions to bind their own hands. The former constraint is

formed by the superimposed constraints, while the latter tries to understand how reformers could themselves constrain their actions. Lastly, the transnational coalition of external and internal stakeholders alter the benefit/costs calculations further, in which societal actors internalize the norms of the organization and change their identities and interests accordingly. The explanatory factors can be grouped as the following: incentives (direct conditionality), credibility (indirect conditionality) and resonance and identification (transformative conditionality).

The alternative explanation for variance in these three cases through time is the following. The reinforcement by reward process is turned on its head, namely, the external adoption occurs first, the domestic actor utilizes the credibility of the international organization, as a cloak, the domestic reformers comply with the minimum threshold of organization's conditions, often externally anchoring itself to the organization's popularity, thus trying tip the balance of power in her direction to come on top in the domestic power and ideological/ideational struggle.

Otherwise, the outcome can partially be explained by sequencing and timing of the interface between direct and indirect uses of conditionality tools, and the motivation of domestic pro reform coalition, (normally fragmented opposition join forces against the government).

The explanatory mechanisms this project uses to assess the use of conditionality and act of compliance across the cases are the following. Firstly, conditionality in the pre-accession process stipulates that the candidate government adopt certain laws and embark on certain

reforms of the state and the economy; secondly, the increasing monitoring and mutual involvement of the parts functions as a credible commitment device that makes any reversals costly and lastly, the impact of each stage of compliance changes the nature and the strength of domestic groups in the society, empowering those that will benefit from eventual membership to the EU. We accept the creed discussed by Elster (2000; 149) that commitments can be credible when power is divided.

It has been problematic to determine what Europeanization at the level of market and state reforms is, and the divergent and convergent trends within the region and between the CEE countries and EU members. Europeanization ‘at the level of market making’ is defined by Bruszt as the emergence and the strengthening of a state with strong capacities to preserve and to regulate markets while having at the same time increased administrative and transformed planning capabilities (2002; 121). The literature aiming to explain the divergent trends poses two main models of explanation: external incentives model and domestic institutional model.

The external incentives model is mostly used by the governance school of European integration studies. (Kohler-Koch 1999; Jachtenfuchs and Kohler-Koch 2004; Hooghe and Marks 2001; H  ritier et. al. 2001; Scharpf 1997) It is concerned with the impact of policy outcomes and institutions on the European level on domestic institutions and policy outcomes. The external incentives model is mostly a rationalist bargaining model (Schimmelfennig 2001, Schimmelfennig, Engert and Knobel 2003, Moravcsik and Vachudova 2003). According to this model, the EU sets the adoption of its rules as conditions that the CEECs have to fulfill in order to receive rewards from the EU. The EU offers two kinds of rewards,

to non-member countries: assistance and institutional ties. EU conditionality mainly follows a strategy of reactive reinforcement or ‘reinforcement by reward’ (Schimmelfennig, Engert and Knobel 2003). The most general proposition of the external incentives model under a strategy of reinforcement by reward, is that a government adopts EU rules if the benefits of EU exceed the domestic adoption costs.

The second, named as the domestic institutional model, contains elements of the historical institutionalist school, emphasizing the role of lesson drawing and social learning. The literature on policy transfer draws a key analytical distinction between voluntary and coercive forms of transfer. Lesson drawing is response to domestic dissatisfaction with the status quo. Policy makers review policies and rules in operation elsewhere and make a prospective evaluation of their transferability that is whether they could also operate effectively in the domestic context. According to this model, a government adopts EU rules if it expects these rules to solve domestic policy problems effectively. Conditionality compliance by the CEECs presents neither of the two forms of policy transfer, but an institutional anchor, a point of orientation for the economic and political policy reforms in the region (Csaba 2004). The EU accession with its multiple processes of European Agreements, law harmonization, *acquis* screening has resulted in ‘palpable and testable delivery, not a mere declaration of good intent’ (Ibid, 343).

Both models have their strengths. An institutionalist explanation that is adopted in this chapter combines both the external dynamics involved in rule adoption, while incorporating elements of capability building and social learning.

Privatization reforms in three countries are paid special attention, the mechanisms at play in EU conditionality impact privatization reforms, and restructuring of state owned enterprises but the impact of EU conditionality on *regulatory framework* that pace and surround ‘successful’ privatization is not studied. The regulatory framework either self-imposed by the reformers or similar legal framework for pre-commitment against short time reversals and change of preference can be counted as evidence for the hypothesis that purports that EU conditionality help governments credibly commit. Meanwhile the constraints that are externally imposed as part of EU conditionality in order to access rewards or avoid punishment (exclusion from membership) would be part of the evidence for ‘reinforcement by reward’ hypothesis. However, both suggest that conditionality constrains the choices and policy discretion of reformers, to steer the countries in the right path to candidacy and full membership. If evidence for the contrary could be found in our cases of regulatory and privatization reforms, then alternative explanations could be helpful. The institutional components of compliance with EU conditions will be explored across the Slovak, Romanian and Turkish cases between 1995 and 2006. The influence of EU is hypothesized in more detail below:

*A: EU conditionality provides a credible commitment device, where reformers bind their own hands, which is achieved through the indirect conditionality tools.*

- 1) The first phase is that international institutions use their social power to persuade an elite group of domestic reformers (often this elite group coalition would come into existence as a result of this pressure) of the desirability and credibility of particular policy measures.



- 2) The second phase is the tying of the hands of the domestic reformers, making reversal of policy costly, while helping the domestic reformer shift the blame/cost of reform to external actor(s) and signaling continuity of reforms internally and externally.

*B: The EU provides an outside anchor to institutional change, the reformers are bound and constrained externally by the prescriptions of direct conditionality<sup>6</sup>*

1) The unsustainability of the high and growing proportion of non-performing assets threaten a crisis. This crisis creates a window of opportunity where rival policy options are exhausted in the time of dire economic crisis or political deadlock.

2) Subsequently, the EU alongside the IMF and other international organizations apply direct pressure for the implementation of international regulatory standards. The governments act decidedly to fulfill these conditions.

The difference between the former (A) and the latter (B) conditionality, is that in the case of the ‘binding hands,’<sup>7</sup> domestic actors used these opportunity structures to limit their own discretion,<sup>8</sup> while in the second type, the domestic actors may use the window of opportunity/

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<sup>6</sup> Here legislative changes and later implementation on the ground need to be differentiated. Both the EU for later candidates and the IMF in its opinion papers and the EBRD in its annual transition reports and surveys have emphasized the latter issue of implementation in practice and efficacy of standards.

<sup>7</sup> Elster (2000); Dyson (1994).

<sup>8</sup> *Europeanization* is described as a two level game in which national policy makers try to shape the fit between the EU and national level, acting on both levels. One of the ways, the fit can occur is for domestic actors to use pressures emanating from the EU level to change the configuration of national institutions. The institutional change can involve the attempt to enhance or reduce the policy makers discretion at the domestic level (Dyson 2006, 146-7). The main intellectual basis for such restriction, namely, the binding of hands come from Putnam’s two level games and pre-commitment mechanism as explained by Elster (2000).

opportunity structures, to expand their policy discretion at the cost of domestic opposition ('binding the hands of others').

*C: EU conditionality is transformative by changing the nature of and the relative strengths of different interest groups in society, empowering those who will benefit from these changes.*

Whether international institutions prevail in seeing their preferred policies implemented at the domestic level depends on how well they create and exploit domestic cleavages in the service of building a winning coalition (Epstein 2005, 66-67). Here the theory of institutionalized influence suggests that the international institutions maximize their effect over domestic reform processes where they cultivate a transnational community bound by shared commitment to common values. Therefore the transformative effect comes in two stages.

- 1) International institutions cultivate a transnational coalition including both domestic and external actors who themselves are to implement the reforms, or who are in position to put pressure on positioned actors into implementing policies that are consistent with the institutions' requirements and ideology.
- 2) In the second stage, international institutions empower their domestic interlocutors to implement reform and overcome opposition through a range of mechanisms, by providing consistent messages and usable technical information, by conferring legitimacy on those favoring reform, and by granting rewards for compliance.

## 2.5 Methodology

The above hypotheses about the influence of external actors will be formulated and tested by the means of comparative case studies. The comparative case studies are formulated within the methodological framework as recommended in the George and Bennett eds. *Case Studies and Theory Development* (2005). The method is ‘structured’ in that the researcher writes general questions reflecting research objectives and asks these questions to each case in order to guide and standardize data collection, thereby making systematic comparison and accumulation of findings of the cases possible. The method is ‘focused’ in the sense that it only deals with certain aspects of the historical cases examined (p. Ibid, 67-68).

Aside from the ‘focused’ and ‘structured’ nature of the case studies, I employ a research strategy which could loosely be identified as most similar comparison. The comparative case study design employed here is typological case study, where the comparison focuses on cases in the same cell of the typology. The typology is one that is based on similar level of the manipulability independent variable (the EU conditionality). It can thus establish under what conditions that level of independent variable is associated with different outcomes. The process tracing will reveal different causal paths to that outcome and some of the left-out variables (Ibid, 80-82). Process tracing is a method used especially where there are multiple interaction effects, and where it is difficult to explain outcomes in terms of two or three independent variables (Ibid, p. 206). In this project, the intervening causal processes between what is explained (formal accession) and the explanatory factors, call for a careful tracing of the processes that may have led to the outcome. Generated are the numerous observations within the case, the lack of independence between these observations makes them a powerful tool for inference.

The research design contains detailed case studies. The project thus employs ‘the within case comparison’ in a complementary fashion, congruence, before and after comparison and process tracing (George and Bennett, 2005), as well as comparative cases, where the project agglomerates the findings from the within case comparisons. In congruence, the project ascertains the value of the independent variables and asks what expectation about the outcome of the dependent variable should follow from the hypothesis. Before and after comparison is the temporal extension of the congruence method. Process tracing has the potential to disentangle, or tease out, the causal effects of the concomitant conditional influences and changes, and to check the causal relation between the condition and outcome. The project does not do a full process tracing analysis which would have required a much more extensive research and would have taken a lot of space, but this method is used to identify the intervening causal process between the independent variables and the dependent variable.

Process tracing is used first to how the presence or absence of our hypothesized conditions combine to produce an outcome. In particular, the project looks at the reactions of target governments to active and passive leverage strategies and instruments of the EU, and sees whether these reactions fit with or are justified by the structural domestic conditions and to disentangle which international strategies trigger which reactions. Secondly, the project uses process tracing to determine when multiple conditions point in the same direction, in order to determine which one was most likely to be the casually relevant one.

The project draws its descriptions and process analyses from a variety of sources. First it draws on the literature which assesses the domestic conditions for compliance for each country case, the costs of compliance, identification, and resonance of these to the key actors.

The core of the empirical data comes from the analysis of documents of the EU community organization, of daily news services, of international monitoring agencies, or arms of international financial institutions that monitor progress sectoral reforms. These sources allowed us to keep track of the reactions of the target governments as well as domestic actors to the demands, conditions and the feedback of governments to the progress reports of the community organizations. Limited number of background interviews was conducted with officials of the community organizations and government officials in the target countries to gain additional insights and back up or double check assessments.

The case studies also contain an overall view of macro-economic and sectoral conditions and a qualified comparison of the annual opinions and progress reports, pointing out the progress rate of adoption of the international standards, of the *acquis* and of implementation of reforms on the ground. These evaluations will then be contrasted with the EBRD annual transition reports indices for privatization reforms where the particular country case will be evaluated within its group of fellow EU candidates and in comparison to countries of transition that are not candidates to the EU. The bottlenecks and lapses in implementation of property rights reform will become clearer.

## **2.6 Empirical data**

The principle dependent variable in this research is the degree of adoption of EU rules.<sup>9</sup> For

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<sup>9</sup> In her assessment of the variation in the form and level of Europeanisation in post communist economic policy, Rachel Epstein tests social learning and external influence models to explain this variance. She finds that the crucial difference between the two sectors, central bank independence and agricultural reform, is the processes of rule transfer. In the case of the central bank, the efforts of international institutions at persuasion and coalition building around the idea of central banking in keeping with western models would prove essential. The lack of contestation in the central bank reform, is in stark contrast with the highly contested agricultural reform. The failure of EU to cultivate a similar reform minded coalition would explain EU's lack of influence (Epstein 2005, p. 178-198).

this purpose, I use country by country opinions of the European Commission until 1998 and annual progress reports. The country by country reform indicators of European Bank of Reconstruction (EBRD), Transition Reports are utilized for the macroeconomic indicators and the privatization reform indices in the case studies. As will be shown in the cases, the EBRD evaluations and rankings will correspond to those of the European Commission.

A second wealth of empirical data comes from two surveys on corporate governance by the EBRD (2004 and 2005), and *Law in Transition* (EBRD 2006). The privatization reforms are closely related to corporate governance issues, thus a view of the corporate governance evaluations would be a useful exercise. As various independent assessments of banking reform show, institutional framework (a set of formal institutions and their enforcement characteristics) should establish rights, responsibilities, and liabilities of parties in financial transactions and make these enforceable. Such institutional frameworks include contract laws, capable of defining contractual rights and responsibilities of all parties involved in loan transactions as well as in the purchase and sale of financial instruments; private property laws, and in particular provisions relating to the process of creating, registering, prioritizing and enforcing security rights; company laws that serve to protect investors, employees and other stakeholders from insider fraud and mismanagement; bankruptcy law, providing failing firms with an orderly means of exit or restructuring and protecting rights of creditors; tax laws, banking laws, clearly defining activities which can be performed exclusively by licensed banks and no other entities; accounting and auditing laws, which provide framework for expressing and evaluating the financial performance of banks; and banking regulation and supervision rules, which define prudential rules, credit limits, risk management and disclosure requirements, corporate governance structures. With the laws in place, the enforcement is then trusted apart from the judiciary institutions, to numerous government and associational

agencies depending on the organizational arrangements in a country, such as the Deposit Insurance Fund, Banking Regulator, Securities and Exchange Commission and Chamber of Auditors<sup>10</sup>. In 2003, following 2002 study, looking at corporate governance issues on European level by a high level group of company law experts, the European Commission issued an ‘Action Plan’ outlining new initiatives and policy objectives in the area of corporate governance. These objectives were, 1) to strengthen shareholder rights and third party protection, with a proper distinction between categories of companies, and 2) to foster efficiency and competitiveness of business, with special attention to some specific cross border issues. Various interventions by the Commission were deemed necessary with coming eastern enlargement, to achieve a modern European company law regulatory framework. The Report on Assessment results in 2002, noted previously that while the accession countries might be performing better in terms of economic transition, they do not always have better ‘laws on the books’ than other non-accession countries whose relevant legislation was also assessed by the project (EBRD 2004, p.6). 2003 was also an important year as being the last year of pre-accession to step up harmonization of legislation with the EU acquis, including laws and regulations having implications on corporate governance issues and practices marked by changes in the corporate governance legislation.

Corporate governance, is defined as the ‘system by which businesses and directed and controlled.’<sup>11</sup> According to the OECD, corporate governance involves ‘a set of relationships

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<sup>10</sup> The countries under study reflect a plethora of these agencies, with varying organizational structures and strengths. In the case of Turkey, BBDD, established with special decree from the Turkish Parliament, became in charge of the bank restructuring efforts, while in the latter stages of banking reform in Turkey, private auditing and accounting companies (subsidiaries of international auditing houses such as Ernst and Young, were entrusted with the sale of these banks to strategic private investors.

<sup>11</sup> Known as the Cadbury report commissioned by the London Stock Exchange in the late 1980’s, *The Financial Aspects of Corporate Governance* is the first code of corporate governance to advocate disclosure with a code of best practices. (EBRD Transition Report 2005, Annex, p. 31).

between a company's management, its board, its shareholders and other stakeholders.<sup>12</sup> In addition, it provides the structure through which objectives of the company are set and the means of obtaining these objectives and monitoring performances are determined. (Ibid, 23)

The corporate government indices can be used as a proxy for property rights institutionalization. The effectiveness and extensiveness of legal framework in which property rights laws form the core, can be measured by comparing corporate governance legislation with a the well known international benchmark issued by the OECD. The EBRD's 2004 report assesses the effectiveness of corporate governance related legal reforms and try to see how these laws work in practice are measured by the EBRD Legal Indicator Survey conducted in 2005, which focuses on the protection of minority shareholder rights in the context of related-party transactions. The check-list on which each country's corporate governance laws are gauged against, covers fives aspects: namely, rights of shareholders, equitable treatment of shareholders; role of stakeholders in corporate governance; disclosure and transparency and responsibilities of the board. The legal survey specifically looks at the extent of the use of existing laws by minority shareholders to obtain redress. Disclosure methods and options made available to the minority shareholders by law are also evaluated. The survey examined at a particular instance of related party transactions and assessed the institutional environment in transition countries. These assessments are very useful in pointing out the lapses and problems of application of law to property transactions in a more detailed fashion than the Commission's progress reports. A key problem stated is that related party transactions can be used by controlling shareholders, managers and insiders as a means for extracting private benefits for themselves at the expense of minority shareholders (Ibid, p. 27). The law and the enforcement of the law prevent insider opportunism, as one of the very symptoms of privatizations gone wrong in the countries of transition which are either new

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<sup>12</sup> Preamble of *The Principles of Corporate Governance*. (OECD 1999, revised in 2003).



members of the EU or candidates. Hence a careful evaluation of these surveys woven into the qualitative case studies will present a more comprehensive assessment of the sequencing of the property rights reform and influence of external actors.<sup>13</sup>

Process tracing is used to show whether the presence or absence of our hypothesized conditions combine to produce an outcome. In particular, the project looks at the reactions of target governments to active and passive leverage strategies and instruments of the EU, and sees whether these reactions fit with or are justified by the structural domestic conditions and to disentangle which international strategies trigger which reactions. Secondly, the project uses process tracing to determine when multiple conditions point in the same direction, in order to determine which one was most likely to be the casually relevant one.

The project draws its descriptions and process analyses from a variety of sources. First it draws on the literature which assesses the domestic conditions for compliance for each country case, the costs of compliance, identification, and resonance of these to the key actors. The core of the empirical data comes from the analysis of documents of the EU community organization, of daily news services, of international monitoring agencies, or arms of international financial institutions that monitor progress sectoral reforms. These sources allowed us to keep track of the reactions of the target governments as well as domestic actors to the demands, conditions and the feedback of governments to the progress reports of the community organizations. To a much lesser degree, background interviews were conducted

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<sup>13</sup> As the annex to the Transition Report by the EBRD (2005) states, effective corporate governance mechanisms protect the interests of investors and other stake holders in business ventures. The precondition to the development of capital markets is that outside investors can expect insiders not to divert corporate assets to themselves.

with officials of the community organizations and government officials in the target countries to gain additional insights and back up or double check assessments.

The empirical evidence from the above quantitative and qualitative assessments would be contrasted within cases longitudinally and between the cases of privatization reforms in the financial sectors of Slovakia, Romania and Turkey in the ensuing chapters. The within and between case comparison will test for our main hypothesis (reinforcement by reward, where we will try to discern EU's direct influence or whether alternative dynamics are in the forefront of change in policy, be it, internal politics of the EU deciding the end decision irrespective of the countries' own progress, or the domestic political agendas of the candidates that try to co-opt accession conditionality to their own ends and EU merely reinforcing the domestic agendas for reform.

## *Chapter 3: The Impact of EU conditionality on Slovak privatization reforms<sup>14</sup>*

### **3.1. Introduction**

Slovakian accession to the European Union (EU) is a case study of how EU conditionality impacts economic and political governance and institutions in candidate countries. This case study asks how conditionality played a part in Europeanization of Slovak economic and political institutions and policies from a period between 1995 and 2006. More specifically, the puzzle about the Slovak case, as both Gould (2003; 286- 288) and Vachudova (2005; 162- 165) asked, is: why and in what conditions the break through occurred at which the electorate sought to topple the illiberal and non-reforming government?

We argue in this chapter that the formal and informal influence of Europeanization interacted to form a point of orientation to trigger controversial but necessary decisions for structural reforms (i.e. the sustaining and supporting the momentum for reform) as well as providing a formal set of rules which the EU checked the compliance and implementation.

We defined Europeanization as the adoption of European economic and political governance in the formal sense and in the informal sense. In the formal sense, it means adoption of rules and regulations as sought by the *acquis*. In the informal sense, it means the absorption of norms and socialization of actors within economic and political institutions and societal acceptance of those rules and norms. How do we know Europeanization when we see it? We will detect Europeanization with the help of the four institutional components driven from March and Olsen's work on political and economic governance namely political identities,

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<sup>14</sup> I would like to thank László Csaba, Julius Horváth, Lucia Kurekova, Karen Henderson, Geoffery Pridham and Martin Bútora for their helpful comments and suggestions.

capabilities, accountability and adaptiveness. Through our exploration of these four components of institutionalization in the Slovak accession story, we hope to disentangle what the effect of the EU has been on the extensive political and economic transformation of Slovakia.

Conditionality is defined by Pridham as ‘a process which requires specifying conditions or pre-conditions for support, involving either a promise of material aid or political opportunities, and political monitoring of domestic developments in the countries under discussion.- concrete rewards, mechanism for monitoring and evaluations are the three constitutive elements’ (1999; 1222). We ask in this chapter whether and how conditionality fostered rule and norm adoption in Slovakia between in the period between its formal acceptance as a candidate and its final accession to the EU.

EU conditionality is different from IMF conditionality in the sense that EU conditionality are a set of explicit requirements of the EU, as set out by the *acquis*, that only democracies and functioning market economies are eligible for membership in the Union, Whereas, IMF conditionality is used as a way to monitor that its loan is being used effectively in resolving the borrower’s economic difficulties. Secondly, EU conditionality could be differentiated from democratic conditionality, as explained by Schimmelfennig et. al. is the main mechanism through which international organizations such as the EU, induce non-members to comply with their principles of democratic governance and human rights (2003; 495).

The dependent variable is the formal adoption of European Union rules and laws among post communist states and Turkey. The dependent variable is operationalized as the rule adoption- the transposition of EU law into domestic law, restructuring of domestic institutions according

to EU rule and/or change of domestic political practices according to EU standards- as monitored by the EU progress reports.

Vachudova in her analysis of EU conditionality differentiates between passive leverage from the active leverage of the EU after 1997 (2005, 161- 165). Active leverage, she shows in her cases, first improves the information environment by undermining informational asymmetries and then it helps change the institutional environment by strengthening the political agenda of the opposition parties, thus improving political competition.

The analyses of how the active leverage brings about Europeanization, and rule adoption discuss several mechanisms (Vachudova 2001, 26- 27; 2005, 188-191; Schimmelfennig and Sedelmeier 2005, 1-29 , Schimmelfennig, Engert and Knobel 2003; 496-498). For our analysis of the variance in Europeanization, we will adopt three causal mechanisms, namely, indirect conditionality which, through the transformation of identities and orientations of domestic actors and exhaustion of other possible orientations (other by an crisis or simply through deciding to take other ‘options of out the menu’), establishes the credible commitment of domestic actors in which they decide to tie their hands to the course of reforms, of direct conditionality, through which the imposition of formal adoption of rules and regulations occur; and the transformative mechanism of conditionality, defined as the formation of synergies between domestic elite, transnational capital and the EU, NATO, OECD and other international actors in an enabling international environment. The institution components of Europeanization will be explored as the interface between external and domestic factors for change.

The three causal mechanisms, the indirect, direct and transformative, will help explain the variance in Europeanization across different time periods in the Slovak case and both spatially and temporally in comparison with the Romanian and Turkish cases of accession. First, progress in the pre-accession process functions as a credible commitment device to the ongoing reform, making any reversal by either side costly. Secondly, conditionality of the negotiating phase stipulates that governments adopt certain laws and embark on certain reforms of the state and the economy. The impact on the polity and the political economy of moving towards EU membership changes the nature and the strength of certain domestic groups in the society generally empowering those that will benefit from EU membership.

Privatization will be given special attention within the EU accession related economic and political reforms. We argue that in the area of privatization, we see an intersection of change in the rules of the game as prescribed by external actors such as the IMF and OECD alongside the EU, and the behavior of the economic actors. We argue that the three mechanisms we described in EU conditionality impacted privatization and restructuring of SOEs in Slovakia, and try to show that by exhausting the policy options through pervasive economic malfunction, political deadlock and fiscal crisis, domestic reformers chose to tie their hands through a well-worn regulatory network of institutions-legislations-agencies, which then signaled the continuity of economic reforms to external actors, which in turn made them commit to the reform agenda, in shape of the inflow of foreign direct investments in Slovakia.

### **3.2. Slovakia at cross roads**

Between 1993 and 1998, Slovakia experienced a fiscal consolidation (IMF Country Report 1998, 50). The Slovak economy returned to growth in 1994 following a deep transition

recession (GDP contracted by 24% from 1990 to 1993, EIU 1997, p.21). A strong increase in exports underpinned growth of 4.9% in 1994 and 6.8% in 1995. Despite weak foreign demand and a more restrictive monetary policy, Slovakia recorded the highest growth amongst transition economies in 1996 (Ibid, p.22- 29). Despite the presence of high economic growth, there were still problems of both internal and external imbalances. With exceptionally strong domestic demand and replacing net exports as the driving force of growth, the current account balance deteriorated sharply and GDP growth had to be restrained. During the period of 1993 and 1996, economic policy gave preference to high growth rates and ignored to a certain extent institutional change requirements. (Marcincin and Beblavy 2000, 44) Economic growth had little impact on reducing unemployment (especially the regional disparities in unemployment levels), since reaching its peak of 14.8% in early 1994, it remained at 12-13% during this period, the fluctuations mostly being mostly due to seasonal fluctuations in employment in agriculture and construction (EIU 1997, 22). Meanwhile, rapid gains have been made in bringing inflation under control with steady reductions in the annual rate over the 1993-96 period, from 23.1% to 5.8%.

Monetary policy was kept tight throughout most of the post-independence period (1994 onwards), with the National Bank of Slovakia (NBS), following a strict anti-inflationary programme and restricting pressure from the government and the banking and industrial sectors for greater monetary expansion. The NBS loosened its reins on the money supply in late 1994, however faced with domestic economic overheating and a dramatic widening of current account deficit, the NBS retightened monetary policy. Widespread electoral support for Mečiar's populist party allowed vested interests with a strong base in his party to gain economic ascendancy. In 1995, a second wave of voucher privatization, which had been

prepared by the Moravcik government, was cancelled and was replaced by the government appointed National Property Fund (FNM).<sup>15</sup>

Slovakia's fiscal position weakened markedly from 1996 when the Mečiar government's spending on the highway construction program and other infrastructure projects led to a rapid deterioration of general government deficit rising to SKK34 billion in 1997 and SKK42.7 billion in 1998 (EIU 2000, 34).

A few days before the elections of 1998, the economic indicators pointed to a crisis which the electorate became more of (see Table 1 in Appendix 1). The previous government's Finance Minister dismissed it as a 'routine matter,' however the developments immediately after the election showed that the top government officials were either ignorant of the real state of the budget or misleading the public. In September the budget was to be rescued with loans at record-setting interest rates. The government was growing steadily indebted especially through current payments, which included wages for the state employees. According to the EIU, the downward pressure on the Slovak koruna, declining foreign confidence in the wake of the Russian ruble crisis, (had an important impact on the CEE economic transition), and the loss of Slovakia's investment grade credit rating increasing financing and repayment costs further (EIU 2000, 35-36). The government announced a reduction of 8% in expenditures which had the most severe impact on the health and education sectors. The international community of investors as well as international institutions was giving a strong message of disapproval. Rating agencies such as Moody's downgraded Slovakia's rating from an investment grade for Baa3 to a rating of Ba1 (IVO 1999, p. 208-9). The reason for the downgrade was the increasing deficit both in the government budget and in the current

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<sup>15</sup> The role of FNM will be discussed in more detail in the following sections of this chapter.



account. The 1998 elections (IVO 1999, Szomolányi 2000), was not a mere democratic procedure enabling citizens to decide on a new distribution of power but an event which determined the very nature of the political regime and the direction of the country's foreign policy. The election of 1998 was an attempt to establish a predictable environment for businesses and to establish the 'rules of the game' for both domestic and international entrepreneurs and companies.

The European Union 1998 progress report outlined the criticisms of economic developments. The emphasis was placed on the issue of rising unemployment (which was at odds with the apparently strong economic growth), the deficit in public finance and the difficulties financing that deficit. The report's primary criticism was directed at the government's expansionary fiscal policy and at the numerous measures and mechanisms which undermined the principles of a market economy.

At the conclusion of the report, European Commission (1999) stated that the ability to predict Slovakia's economic development was seriously impaired

([http://europa.eu.int/comm/enlargement/report\\_10\\_99/pdf/en/slovakia\\_en.pdf](http://europa.eu.int/comm/enlargement/report_10_99/pdf/en/slovakia_en.pdf)). The

International Monetary Fund regularly visited Slovakia, and released a report at the end of the trip which highlighted sluggish growth and export performance, increasing pressures on the financial position of the banks and enterprises (see Table 7 in Appendix 1), and the extremely large current account deficit. Slovakia meanwhile had no stand-by agreement with IMF.

Equally importantly, the IMF echoed the concerns of the EU about non-transparency and difficulty of predicting future developments (IMF Country Report August 5 1998, p.62). The report expressed doubts about the official statistics concerning GDP growth, which were at odds with rising unemployment, and the inflation rate which was in turn distorted by

procrastination in ending price regulations. The mission also described as inadequate foreign reserves of the central bank, and criticized the increase in the large foreign debt (\$12.2 billion, 60% of the GDP) with a large share of short-term liabilities. (see Table 2 and Table 6 in Appendix 1) On one hand, the mission was rather critical of the approved increase in the 1998 deficit and the provisional budget adopted for the first Quarter of 1999, on the other hand, the mission praised the government for its commitment to making privatization transparent and for abrogation of the controversial Revitalisation Act.<sup>16</sup> Support was expressed especially for speeding up the privatization of the telecom industry and other large state owned enterprises which would help improve the balance of payments. The report also pointed out the poor position the three banks partially owned by the state.

In the next section, we will discuss how much role EU's active leverage in bringing about the break-point in 1998 elections. We will first explain how the political identities was reoriented towards a return to Europe and how the opposition to Mečiar and the HDSZ party managed to organize itself and cooperate to win a parliamentary majority in the 1998 elections. As Vachudova points out, this cooperation turned out to be the beginning of Slovakia's dramatic turnaround that culminated in the implementation of sweeping reforms and in full EU membership by May 2004 as agreed in December 2002 (2005; 170). We will then explore how the direct conditionality tools of the EU helped develop political capabilities and political accountability. And finally, we will show how the transformative mechanisms of conditionality helped develop the adaptiveness of Slovakian political system through the cultivation of a transnational community bound by shared commitment to common values at one hand, and to prescriptions for restructuring the economy on the other.

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<sup>16</sup> Revitalization Act of 1999 included an increase in the lower rate of VAT, an import surcharge, price deregulation, as well as cuts in state administration personnel.

### **3.3. Indirect Conditionality- how and when nets of commitment and conditions are cast**

Europeanization effect can be explored in the use of the indirect conditionality in developing political identities. According to March and Olsen (1995; 51), institutions transform inconsistencies among identities and preferences into discourse which is pursuit of shared understanding, channeling disagreements into reasoned discussion and empathetic exploration of possible compromises and mutual interests.

Following the collapse of communism and given this historical background, for Slovakia the natural target appeared to be the integration with the Western system and realization of “return to Europe.” Not surprisingly, therefore, rapid and full integration into the economic, political and security structures of the Western world such as NATO and the EU has become a priority for Slovakia’s foreign policy. Returning to Europe served as the ‘focal point’ for cooperation among opposition parties and civic groups, helping to transform the institutional environment in the country. The party structure during the period leading to 1994 Parliamentary elections was characterized by a bipolar party configuration, and the 1994 elections and the creation of the new government reinforced this trend (Szomolányi and Gould 1997, 43). According to Kitschelt’s typology political parties, these two poles consisted of ‘standard’ and ‘non-standard’ parties. The ‘standard’ parties can be characterized as programmatic parties, with international party links and established ideological patterns and ‘non-standard’ parties, like the HZDS and ZRS on the other hand, fit into a category of charismatic and clientalist parties (Kitschelt 1995, 449). The support for HZDS was based on the charismatic popularity of Mečiar, but at the same time, HZDS had built significant clientalist relations to meet its financial expenses, and used its personal linkages of part of its leadership with organized economic interests to maintain party financing, such as industrial

associations, financial groups and particularly business lobbies (Szomolányi and Gould 1997, 44-45).

The new Party of Civic Understanding (SOP) emerged prior to 1998 elections, calling for communication and reconciliation between the opposition and the HZDS government. But what stopped the new party to break ranks with opposition and form a coalition government with HZDS? SOP leaders ruled this out because of the EU's uncompromising stance towards HZDS and Mečiar. The main difference between the 1994 election's outcome and 1998 election's outcome (see Tables 3 and 4 in Appendix 1 ) was that the realization of the possibility by the opposition that a SOP- HZDS government would be shunned by the EU and other western actors. According to Karen Henderson, lack of a similar realization by the electorate and the opposition did not come about in the very close elections of 1994 where the governing parties barely got a parliamentary majority for a coalition government (interview with author, November 22, 2005).

External pressure from the EU along with other international institutions arguably had an effect in strengthening the sense of unity in the coalition while also developing a sense of solidarity in the polity. According to Epstein, material incentives could not fully account for the influence of international actors on domestic politics. Material mechanisms, worked in tandem with social mechanisms not through coercion but appeal to western norms and values, adopted western values in seeking affirmation by the western actors and organizations (Epstein 2005;63-105). An SOP ad before the elections of 1998 suggested the gap between the commitments of government to EU and NATO membership and the reality, emphasizing the increasing isolation of Slovakia: 'none of the prominent world politicians visited Slovakia in the past years' (namely 1994-1998) 'and instead of the advanced Europe, we are moving closer to the unfathomable West,' marking on Mečiar's recent rhetorical approach to

Moscow. This rhetorical approach was not unfounded as in 1996 Mečiar visited Moscow where he proposed a continental security system which would include Russia. It may have created a response in Moscow, as the Russian ambassador in 1996 defended Slovakia's position with NATO, 'The West does not understand specific features of the young country, and does not take in to consideration either the history of the Slovak folk or the Slovak way of thinking, mentality....' (Szomolányi and Gould 1997; 221).

The involving of Hungarian parties into the coalition against Mečiar was also crucial effect of hypothesized mechanism of conditionality, i.e. the forging of a sense of solidarity. Hungarian parties were one of the most pro- EU forces in the opposition<sup>17</sup>. In addition, the discriminatory treatment of the Roma community was already becoming part of the discourse of the Slovak elites. The lack of resonance of Mečiar's inflammatory statements during the election campaign against the Hungarian coalition, was also an evidence of the logic of appropriateness at work. In Slovakia this was becoming more evident that scapegoating minorities and concentration of political power' was not European. (Ibid, p. 219).

The influence of NATO and OECD on the development of political identities could be discussed in tandem with the interaction with the EU influence. In terms of EU's enlargement policies, Fierke and Wiener noted that the *acquis* of the EU provided a normative basis for enlargement, while by contrast NATO lacking any formal equivalent of *acquis*, the purpose of

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<sup>17</sup> Previous to the 1998 elections, Mečiar passed a series of laws which aimed to centralize authority. The first of these laws was the Law of Foundations which was designed to complicate the setting of foundations. Another piece of legislation belonging to the same period was amendments to the Penal code allowing persecution of those that had the intention of 'destroying the constitutional order.' These amendments aimed at aimed at bringing to court bearer of statements in the printed press and by the civil society criticizing the coalition government under Mečiar. A new law on state language was also passed which played into the insecurities of the Hungarian minority, and prevented attempts to introduce bilingual education in Hungarian language schools.

the organization in the post-Cold War period, could be defined less in terms of defense, than of providing an anchor of stability (1999, 723). Explaining the influence of NATO enlargement prospects on domestic policies, Epstein argued that Slovakia's desire for membership to NATO, appeared to make impact (2005, 101-103). Pridham, agreeing with Epstein, argued that IO's such as NATO, and the OSCE had been advocates of particular aspects of substantive democracy (2002, 203-4), the Council of Europe over human rights; the OSCE over minority rights as well as fair and free elections; and NATO have remained committed to formal requirements such as civilian control over the military, and the existence of a constitutional state. However, he maintains that the EU has developed by far, the most extensive portfolio of conditionality demands. (Ibid; 203) The political conditionality of the EU in many ways overlapped with that of OSCE and NATO. In particular, the Progress reports in 1999 and 2000, often quoted findings of the OSCE mission in areas of election provisions, made mention of OSCE concerns and specific recommendations. (EU Regular Report 2000; 16, 17, 53, 54, 72 and 87)

### **3.4. EU Direct Conditionality**

#### *3.4.1. Developing of political capabilities*

Developing identities and acting in accordance with them require resources and capabilities. Europeanization of economic and political institutions in Slovakia could be evidenced in the extent of the development of political capabilities. Political capabilities are classified in four categories by March and Olsen (1995; 92-95): rights and authorities; political resources, political competencies and organizing capacity. This section aims to explore first the legal and regulatory frameworks that set the ground for furthering economic reforms, such as privatization. Secondly, the section will explore the political competencies and organizing

capacities that may have come about as a consequence of the reforms towards fulfillment of political conditionality. Political competencies could also be defined as state capacity, referring to the need to strengthen institutions of governance, both in their ability to deliver state services and in their capacity to enforce rules and regulations and public order (IMF 2005; Preface).

The relations between Slovakia and the EU started in 1992, with the dissolution of Czechoslovakia. The Europe Agreement, as the legal basis for the relations between Slovakia and the EU, was signed in October 1993 and was entered into force in February 1995. According to the EU's report on Slovakia's progress in 1998, Slovakian government established a coordinated institutional framework for dealing with European integration matters, and the implementation of the Europe Agreements. Established at ministerial level, was a Council for Integration into the EU, chaired by the Deputy PM. Each Slovak ministry had a department responsible for all EU related matters and was represented in the Council, depending on the issue under discussion. In 1996, a parliamentary committee on European Integration was established. From 1997, Slovakia started to be integrated in various educational and cultural programs of the EU (Socrates, Leonardo, Youth for Europe etc...).

The regular report on Slovak accession in 1999 noted that the Slovak government has made progress in clarifying many legal relationships (i.e. redefinition of the legal status of the FNM (state privatization agency). The government abolished the Act on Strategic Enterprises, which prevented the privatization of enterprises that were considered to be strategic. Besides the usual group of state enterprises, such as public utilities, post and railways, this group, also comprised enterprises in the armament and machinery sectors, the financial sector, telecommunications, pharmaceuticals, and agro-industry. With the approval of Law on the

Large Scale privatization, these could then be privatized, while up to 49% of the energy utilities could be sold. The 1999 report noted that no major privatizations have been finalized by the new government; however, it launched the privatization of the Slovak Telecom Company and of the state's share in GSM operators (EU Regular Report 1999, and IVO 2000). While these legal and regulatory developments sought to bring Slovakia's laws more into line with those of the European Union, and to give citizens greater access to information of public interest (the Law on Freedom of Access to Information), the finalization of the privatizations of the noted strategic enterprises would be delayed until 2004 (see table 1.9 in Appendix 1).

As a continuity of the constitutional majority acquired in 1998 elections, the period from 1999 to 2000 evidenced important institutional developments ' as can be evidenced from the EU progress reports of 1999 and 2000. Slovakia was deemed successful from the formal point of view of the EBRD and the EU Commission, to create fundamental formal prerequisites for state bodies to act in accordance with the law. The ruling coalition managed to remedy those laws which legitimized the unconstitutional behavior of state organs during the previous administration (i.e. the Municipal Elections Law).

The amendment to the constitution in 1999 for direct election of the president and limit of state head's power was also an outcome of the coalition formation discussions in 1998 and to prevent the failure to elect a president. The two constitutional amendments in 1999 and 2001 play a central role in the political changes for providing a framework for political competition. The effect of EU conditionality in creating support for these changes in the constitution is an indirect one. The effect conditionality may have been to strengthen the legal base for political



competition, but more importantly, the process maintained the norms and institutions that assured stability, while also providing a political arena in which rights and authorities were being negotiated and interpreted.

EU conditionality may enable politicians to implement long term policies, improving both the efficiency and the accountability of successive governments. As can be evidenced from Freedom House Democratization score, Slovakia has traveled the furthest among the Visegrád group, Bulgaria and Romania between the year 1997 and 2003 (See Fig. 1). Slovakian political system made most progress in terms of electoral process and democratization according to the Freedom House measures.

Figure 1.1: Freedom House Economic Democratic governance measures

	Year	Poland	Hungary	Czech R.	Slovakia	Bulgaria	Romania
Electoral process	1997	1.50	1.25	1.25	3.75	3.25	3.25
	2003	1.50	1.25	2.00	1.50	2.00	2.75
Civil society	1997	1.25	1.25	1.50	3.25	4.00	3.75
	2003	1.25	1.25	1.50	1.50	3.25	2.75
Independent media	1997	1.50	1.50	1.25	4.25	3.75	4.25
	2003	1.75	2.25	2.25	2.00	3.50	3.75
Governance	1997	1.75	1.75	2.00	3.75	4.25	4.25
	2003	2.00	2.50	2.25	2.25	3.75	3.75
Composite democrat.	1997	1.50	1.50	1.50	3.80	3.90	3.95
	2003	1.63	1.81	2.00	1.81	3.13	3.25

Note: The scale runs from the highest level of democratisation (=1) to the lowest (=7).

Source: Freedom House 2003.

Slovakia has a proportional representation (PR) and parliamentary system, but is faced with paradox: these two are good for reform but because of the divided government, there is little legislation for economic reform- very slow. The PR system also helped the HZDS for the popularity of the Mečiar name- especially with elderly people. Also people in the party cadres remained the same but party names and configurations changed. The active leverage of the EU in the period between 1994 and 1998 did not directly help develop the capabilities to overcome some of the systemic obstacles. The most noted of these systemic flaws was the Slovak Constitution, which was adopted in 1992 with the support of the MPs representing less than half of the country and without the participation of the electorate. Another obstacle in the full implementation of the rule of law was the task of elimination aspects of its Mečiar era heritage has sometimes led legislators to advocate questionable legal tactics. Two bills can be mentioned here, a constitutional amendment drawn up by the ruling coalition of Christian Democratic Movement to retroactively abolish the amnesties issued by Mečiar in March 1998 of those involved in the kidnapping of the former President's son and the thwarting of the referendum on NATO membership. Several other bills such as the one banning citizens from being members of more than one political party, and another that reversing an earlier bill that gave parties with seats in Parliament greater claims to the state budget funding, were also passed.

The IVO <sup>18</sup> report of 2000 claimed that in countries where the rule of law holds full sway, public officials follow models of accepted behavior and relations between various state bodies are clear, but in Slovakia, the politicians stay preoccupied with eliminating the consequences of the previous regime's wrongdoings, and the Constitutional Council meddles with decision making processes. President Schuster according to the report, used methods in conflict with

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<sup>18</sup> IVO stands for the Institute for Public Affairs, an influential research institute based in Bratislava.

the Constitution: as was demonstrated in his decision to evaluate a petition calling for a referendum on early elections (Ibid; 86). While pointing to the discrepancies between the governance standards of the EU and current state in Slovakia, it is also pointing to the change in premises of action and logic of appropriateness toward Europeanization in both the legislative and policy communities. It notes that Slovakia also failed to progress toward the rule of law and failed to build consensus on what justice means among the Roma ethnic minority, the majority society and the state officials. Although the law formally guaranteed equal protection and equal treatment, the Roma community in fact experienced legal and social discrimination.

#### *3.4.2. Organizational capacities*

Karen Henderson in her monograph mentioned that organizational capability which had developed as a result of the use of EU direct conditionality tools, but was insufficient in the first half of the 90s (2002, 111-114). She noted that the biggest problem was the lack of human capital and good diplomats in Slovakia, which she argued was due the Czech-slovakia legacy of concentration of state bureaucracy in Prague. This capability has developed extensively as Slovakian civil servants became more submerged in the workings of the EU institutions and the opportunities of participating directly in national and regional programmes of the EU in the later stages of accession. The institutional framework set up by accession process, i.e.: Association council and association committee, comprised of members appointed by Slovak government, and the members of EU Commission and Council of EU and prepared meetings technically. There was also an association parliamentary committee, whose role is formal and limited- members of EP and Slovak parliament, which played an important role in having opposition members criticize both government and EU conditions.

In the previous sections EU's influence can be seen in the development of legal and regulatory frameworks, and political competencies, however, without the organizational talent, experience and understanding of political parties and movements and various economic and social interest groups, other capabilities mentioned could be lost in problems of coordination, logistics, scheduling and mobilizing (March and Olsen 1995, 94-95). The organizational capabilities component as a by-product of EU direct conditionality is particularly important in the explanation of how the EU leverage over the elite groups worked and how the influence was channeled to the wider public.

Slovakia's Third Sector, the non-profit sector consisting of civic and volunteer organizations, did not only push opposition parties toward cooperation, but they also orchestrated a very successful civic pro-democracy campaign leading up to the 1998 elections that contributed to higher voter registration, higher voter turnout, especially among young people, and more pronounced support for the democratic forces in the 1998 elections.

The Third Sector, under the leadership of Pavol Demes, launched a 'Civic Campaign OK'98. The campaign made references to the events leading to the 'troubling developments' of the NATO referendum in 1997 (Human Rights Watch World Report 1998<http://www.hrw.org/worldreport/Helsinki-21.htm#TopOfPage>). In the beginning of the year 1997, several members of the parliamentary opposition organized a petition with a question: *Do you agree with a referendum about the direct elections of the President of the Republic?* More than 500,000 people signed this petition (350,000 signatures are needed). President Michal Kovac had to proclaim the referendum within 30 days. In the same time, the parliament accepted the project to the referendum about the entrance of the Slovak republic to NATO with three questions. So, the President of the Republic decided to combine all four

questions in one referendum: ‘1) Are you in favor of the deployment of Slovakia's membership in NATO?’; ‘2) Are you in favor of the deployment of nuclear weapons on Slovak soil?’; ‘3) Are you in favor of establishing military bases in Slovakia?’ and ‘4) Are you in favor of the direct elections of the President of the Republic?’. While the government wrangled over the legality of the referendum, Interior Minister Gustav Krajci declared his intention to print ballots with only the questions related to NATO. Despite the government's final decision to proceed with the referendum on presidential elections, many ballots containing only questions relating to NATO membership were distributed at polling stations. This provoked a boycott of the poll in which voter turnout was so low that the results of all of the referenda were ultimately invalidated. On June 8, 8,000 people demonstrated against the government's interference in the referendum, and opposition leaders demanded Krajci's dismissal.

Building on the widespread dismay of May 1997 referendum on NATO membership, the campaign led to unprecedented levels of civic mobilization and included unions, the independent media, the section of the Catholic Church (Butorova 1998). The most visible event was ‘Road to Slovakia,’ a 15 day march which about 300 civic activists passed more than 850 towns and villages and covered more than 3000 km. The Slovak NGOs would not have accomplished as much as they did without the Western support, no amount of western support however, could have engineered Slovakia's local and civic leadership and mobilization. This synergic action and the social dialogue between government, business and labor actors can arguably be triggered by the EU. More specifically, EU's indirect conditionality on one hand, as argued in the previous section, persuaded economic and political actors to constrain their policy discretion in line with EU conditions, thus binding

their own hands, EU's direct conditionality tools equipped key actors with the organizational capabilities to implement the accession reforms.

While in terms of democratization reforms, the political competencies seem to have developed somewhat uniformly, in terms of economic and regulatory reforms, the effect of the conditionality mechanisms have not been equally uniform across different policy sectors. EU Commission notes in its monitoring report in 2003 that with respect to the capacity of the new member states to manage and absorb the cohesion and structural funds, considerable efforts are required by the Slovak authorities to strengthen the country's capacity. (European Commission Report, July 16, 2003) Among the problems mentioned in the report, were the weaknesses in both the administrative capacity and in the monitoring system of the funds. In addition, problems in the coordination between the different levels of the administration were identified. The degree of project preparation was also marked as an area where Slovakia has been lagging behind, as its programme documents were still to be completed and revised. Thus, there was a risk that some of the funds which Slovakia was entitled to during the period of 2004-6 would not be made available in May of the following year due to strict conditionality for absorption and managerial capacity.

### **3.5. Transformative conditionality**

#### *3.5.1. Political Accountability*

As we hypothesized, direct conditionality along with imparting strategic tools for candidates to cope with the pressures and tasks for fulfilling conditions. Transformative type of conditionality in term provided the basis for accountability of domestic actors towards the electorate and their opposition. As elaborated by March and Olsen, the development of political accounts will be discussed briefly as a component of Europeanization (1995; 141).

The institutional aspects of providing bases for accountability are two folds: providing information and imposing sanctions. Vachudova (2005, 138-9) discusses how that EU's active leverage helped to change the information environment by bolstering the strength and shaping the political agenda of opposition political parties. We argue that in a synergy with domestic forces, EU's active leverage helped improve competition in the Slovak political system. However, we add in line with our hypothesized interface, that EU conditionality would be less effective without the enabling international environment and the overlapping requirements for membership and for aid from other international institutions Slovakia was aspiring.

The EU made extensive use of conditionality tools in the pre-accession process such as demarches and criticisms in the light of the Copenhagen criteria; regular reports and opinions; and accession partnerships giving candidate states a clear work plan. First demarche came in 1994 in response to the policies of the third Mečiar government, pointing to tendency of centralization of power, despite the resistance from the president. Demarches were starting to become everyday language in the period leading to the 1998 elections in Slovakia (Henderson 2002, 90). The first demarche had four conditions: efforts to consolidate democracy should be continued, stable market economy should be created; remove tensions with Hungarian minority and improve regional cooperation with Hungary. The second demarche came in 1995, and was worded more sharply. It pointed to the continued concentration of power in Mečiar's hands. The tools of conditionality became more institutionalized as the accession process continued. The accession partnerships and evaluations by regular reports identified poor performance in the conception and execution of the reforms to the state, in particular of the administrative capacity. The process of reform in the deficient areas as worded in the accession agreements was clear and transparent, if the host government would not make progress in a certain area of reform, the Commission would update and revise the priorities

and intermediate objectives identified in the Accession Partnership (Accession Partnership Nov 31, 2001).

An enabling international environment with respect to democratic conditionality also helped the effective of tools that EU used for criticism. The US government had played an important role in criticizing plainly and loudly the government before the EU-15 could agree to do so (Vachudova 2005, 127). Membership to NATO, the Council of Europe as well as OSCE also mattered not only of their good opinion, also because the political-democratic reforms as detailed in the political chapters of the Copenhagen criteria *overlapped* with the political conditions of joining all the three organizations.

The roles of other European international organizations with respect to democratic conditionality vary in focus and approach. However, certain overlaps made it possible for the candidate country to accomplish the tasks towards fulfilling EU's more focused conditions while preparing to join other IO's. In the case of NATO membership, democracy requirements have traditionally played a secondary role, its priority being matters of security. Since the end of the Cold War, its military dimensions have been downgraded, the relevant political conditions being civilian control over the armed forces, a constitutional state, a market economy and the resolution of outstanding ethnic disputes (Dimitrova and Pridham 2004; 100). The OSCE also defends human and minority rights. It places special emphasis on the monitoring during election time, as was the case in 2002 elections in Slovakia. It also continues to play a part in applying public pressure on different countries over the advancement of human and minority rights, such as language rights. The OSCE has a focused strategy and enjoys a certain prestige, it grants the stamp of international recognition to



countries that carry out fair and free elections and strictly observe other democratic processes (Ibid, 102).

The Council of Europe, notwithstanding its record in stressing human rights, was less rigorous in applying democratic criteria to aspirant members like Slovakia. The Council of Europe was considered in the transition period towards democracy, to be the first organization, the admission to which was indicative of a state's newly acquired democratic credentials. It enjoyed a certain prestige, especially in the first half of the 1990's. In 1993, it set out its membership criteria which until then have only been implicit. These criteria included free and fair elections, freedom of expression, especially of media, minority rights, and signing up to the European Convention on Human Rights (Zielonka and Pravda 2001, 41). The Council of Europe's approach was not based on strict conditionality and effective gate keeping but more on post-membership socialization into western democratic principles. (Dimitrova and Pridham, 2004, p.99).

Many point out that Slovakia made progress towards realizing the economic criteria of the EU, such as capital accounts liberalization, while preparing to join the exclusive economic club of OECD. The membership process to OECD started with the Council's decision to invite a country to engage in discussions with a view to joining the organization. Each country must have demonstrated its attachment to the basic values shared by all OECD members: an open market economy, democratic pluralism and respect for human rights. The applicant country must also state its position vis-à-vis the OECD 'legal instruments' (meaning the Decisions, Recommendations and Declarations adopted within the framework of the organization). The process is also designed to be flexible and to reflect the specific

characteristics of each country -- the intention was not to impose any particular social or macroeconomic policy, but to introduce certain objectivity into the procedure. Slovakia's accession to the OECD materialized in December 2000. During the accession process, as noted by the National Bank of Slovakia's directorate, the most significant accomplishment was of financial liberalization, the freedom of movement of goods and capital. The examinations were carried out by special committees, such as the Committee on International Investment and Multinational Enterprises, the Committee on Capital Movements and Invisible Transactions. The examination process also involved the assessment of tax and environment policies as well as the examination of Trade policies.

The overlaps between the priorities of the international institutions Slovakia reinforced EU conditionality however; an accurate description of the enabling environment should include an assessment of the regional conditions Slovakia found itself in. The European Commission delivered an important message recommending the start of negotiations with Slovakia's three neighbors, Poland, Hungary and the Czech Republic. An enabling international environment was evident with respect to the bilateral relations with the Czech Republic, The EU could not afford to leave Slovakia out and Czech Republic in and more importantly with Hungary, as Hungary favored the entry of Slovakia for rights of Hungarian minorities and for resolving the border issues. Slovakia duly signed a Basic Treaty with Hungary in 1995. This was considered an important motivational factor for the reform minded in Slovakia, as Slovakia had to catch with its three neighbors with whom Slovakia formed an historic co-operation, namely the Visegrád group. Timing of this declaration as well as the overlaps between the accessions to international institutions with overlapping entry standards created an enabling environment for the development of informal and formal accounting systems that made it

possible for political actors to learn from experience and to call citizens, officials and other powerful institutions and individuals to account in terms of democratic standards.

Besides inheriting a stronger economy and a better state administration, Slovakia had the strongest opposition, due to the vitality of the civic groups, known as the 'third sector' (Vachudova 2005, 171). The EU's conditionality worked in synergy with these groups and with Slovakia's opposition parties to break the democratic monopoly of the Mečiar government. The centralization of power was evidenced most clearly during the second Mečiar government of 94-98. The election law was appealed by the ruling coalition led by HZDS, to change threshold from 7% to 5% party level and that only name of the party leader to appear on the ballots which would make the best of Mečiar's personal popularity in the East of the country. Some of the centralizing tendencies were seen in the Broadcasting Law which was passed in 1998 which saw that stations who are anti-government would be given fines. Mečiar also made extensive use of state owned media- skewing elections his way. These series of events led to a declaration by the chancellors of 6 universities and the Catholic bishop against the infringement of civic liberties (Henderson 2002, 94-95). The act of the ruling coalition member parties after the elections also point the institutional development of political accountability following the 1998 elections.

The third sector's institutionalization of accountability had precedence. In 1996 already, the third sector, an umbrella organization for civic groups coordinated the "SOS Campaign", to protest the government's attempts to suppress the activities of independent foundations. This campaign, according to Demes and Butorova, 'contributed to the creation of a tradition of civic resistance, exactly the sort of tradition in which Slovakia displayed a deficit compared

with Poland and the Czech Republic.’ (1999, p.156) In the spring of 1998, the Third Sector organized a ‘Democratic Round-Table, consisting of representatives of Trade Unionists, towns and municipalities, youth groups, and the four major opposition parties including the Party of Hungarian Coalition (SMK). The IVO as well as other institutes and NGOs published an array of studies analyzing the bad performance of the Mečiar government over the past four years, especially its increasingly damaging economic policies.

EU conditionality also played an important part in changing the information environment in Slovakia as also explained previously, in particular perspective of political accountability. (Vachudova 2005, 174). Demarches and regular reports were important instruments in changing of the information environment. As the demarches became more specific, it became more difficult for Mečiar’s government to recast them as general approbation or reject them as condemnation of Slovakia. As the institutional capacity of Commission to follow domestic politics in applicant states increased, the detailed criticisms of government policies became more visible and strengthened the hand of the opposition. The EU demarches in 1995, 1996 and 1997 served as a signal to the electorates and to the economic elites that government policies were endangering Slovakia’s position for membership. The Campaign OK 98, capitalized on this visibility of condemnation of policies.

Another evidence for the changes in the information environment was a timely survey by the Institute for Public Affairs (IVO) showing the acceptance of the majority of Slovak public of the criticisms from the EU. The survey of October 1997 found that 55 percent of citizens blamed Slovakia’s failure to move toward integration with the EU and NATO, on ‘the ruling coalition, which was reluctant to conduct democratic politics’ while 33% blamed President

Kovac and the Slovak opposition (Gyarfasova and Meseznikov 2004,113). Particularly noteworthy were the changes in the actions of state security organs and other bodies showing they are bound by law. The use of police task force to bring former PM Vladimir Mečiar in for questioning in April 2000, the fact that the executive branch has respected the independence of law enforcement organs in deciding whether or not to keep suspects in custody and readiness of political leaders to observe standard judicial procedures in cases involving murky deals with state property under the previous administration (IVO 2000, 85).

Europeanization's effect through the creation of enabling information environment for domestic groups calling for reform of the state can be summarized as the following: pressure from Brussels was surrogate for pressure from domestic interest groups, then these reforms attracted the attention of civic groups, which the EU supported. EU created opportunities for entrepreneurs and producers that depended on the EU market, thus EU may have helped the formation of *stakeholders for reform*. In 2002, the Slovak electorate voted out two parties for coalition who stood in front of economic reform (the SOP and the Party of the Democratic Left) and picked 3 main partners of government who were ambitious reformers, SDKU (Christian union), SMK (Hungarian coalition) and the KDH (Christian Democratic Movement) and a minor partner, ANO.

### *3.5.2 Transformative Conditionality and political adaptiveness*

Another component of Europeanization, political adaptiveness, explores whether it is possible to build political institutions that civilise transformational political and institutional change and achieve intelligence through learning (March and Olsen, 1995). It puts emphasis of the processes of learning, namely learning taking place within a cycle of adaptation in which

individual beliefs lead to collective actions, which lead to outcomes, and which lead to revised beliefs. The learning aspect of political adaptiveness is connected with the political capabilities component of Europeanization as discussed above.<sup>19</sup> We will explore the extent of how political parties and civic groups adapt to changing environments, and how EU transformative conditionality improved the capabilities for experimentation of political actors and decision-makers in candidate countries and of how they formed inferences from their past experiences.

Gyarfasova and Meseznikov (2004, p.39-40) observe that party competition in Slovakia until 2002 was stable on a single dimension, i.e. the democratic/liberal and authoritarian dimension, which political parties sooner or later joined one of the competing blocs. Even though these blocs were internally heterogeneous, their constituent parties having different ideologies, these parties merged in terms of their attitudes towards either respect for liberal attributes of democracy and necessity for the centralisation of power. The authors fail to point out Europeanization as a dimension of change in the political party competition in Slovakia as evidenced by the change of party platforms, of strategies and self-representations. While the Third Sector provided a forum and arena for the different accounts of why economic and political reforms lagged, securing EU membership for Slovakia provided a substantive focal point for cooperation among the parties. The mechanism at work was two aspects of learning; namely the capability to act on the basis of knowledge and capability of actors and institutional actors involved to retain knowledge. More precisely, it was the transformative mechanism of EU conditionality. EU leverage worked in tandem with domestic political elites, the mechanisms of cooperation, adaptation and implementation,

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<sup>19</sup> March and Olsen explore four aspects of learning, namely, capability to experiment; capability to form inferences from experience and construction of political accounts; capability to act on the basis of knowledge and capability of actors and institutional actors involved to retain knowledge (1995, 206-211).

helped create a unified opposition around the goal of moving Slovakia away from illiberal policies and toward EU membership. The four parties, The Slovak Democratic Coalition (SDK), the Party of Hungarian Coalition (SMK), the Party of Civic Understanding (SOP) and the Party of the Democratic Left (SDL), came from very different backgrounds and had very different agendas, they were particularly far apart on their preferred strategies of economic reform. They however adjusted their platforms to fit better the pan-European party groupings that they had or hoped to join. And they could all agree in the imperative of defeating Mečiar, reasserting the democratic standards, reversing Slovakia's deteriorating relationship with the EU, and qualify as quickly as possible to start negotiations for EU membership. Since the exclusion from enlargement negotiations by EU and NATO in July 1997, the opposition has been quick to point to their opponents' deficient international credentials. The divide was between standard and non-standard parties, the standard parties those compatible with existing international party structures (Szomolányi and Meseznikov 1995, 104-105). We would see in terms of the extent of political adaptability, the non-standard political parties such as the SNS (Slovak National Party) would attempt to find itself an international partner(s), at one point inviting Le Pen to Bratislava and later perhaps as the pressure to prove international respectability increased, the SNS adapts and modifies its preferences and turns its attention to the Union of Europe of the Nations in the EP (Henderson 2005, 10). The SDK also made significant effort to identify itself with the western European parties and the EU institutional actors and diplomats. On the eve of the 2002 elections, Austrian Chancellor Wolfgang Schüssel appeared in person in Bratislava to support Prime Minister Dzurinda (SDK), while EU representative Günter Verheugen spoke to those gathered from Brussels (Election Observer , Freedom House <http://www.freedomhouse.sk/hirek/September%2018.doc>).

We need identify the links between the voting out of office of the political class that held important leverage over privatization of banks and state owned enterprises, as noted by Orenstein (200) and Gould (2003) in their analyses. According to Miklos in his While Mečiar's third government had by and large continued the macroeconomic transformation course, the significant shift of policy in the realm of privatization and sectoral industrial policy provided the space for a number of interest groups to benefit from close, mutually advantageous ties with the government (1997, p. 21). Contrary to expectation that opposition parties would seek support of the economic elites which benefited from partial reform and insider privatization, the opposition parties did not promise such economic nomenklatura any special protection but also did not seek to completely cast them out of the political processes. Especially the SDK took a more conciliatory tone against HZDS, permitted the opposition members to sit in parliamentary committees (Pridham 2002). This conciliatory tone amongst the others was evidence to an Europeanization impact on party systems in Slovakia, and a process where 'losers learn they can win and winners learn they can lose' (Bunce 1999, 770). In addition, parties did not generally exploit the economic hardships from economic conditionality. The linking of economic dissatisfaction with EU accession was low in the opinion polls conducted between 1998 and 2002. Support is high amongst business community but lower amongst farmers and enterprise managers.

The process of adapting their political agendas to the EU rules was also helped by interacting with Western actors, often in forums that were sponsored by Slovak NGOs. Adapting their political agendas to the EU rules was particularly important for members of the HZDS that defected to the opposition over time, many of these prominent politicians in the SDK and SOP had once been members of the HZDS party, and had had posts in the Mečiar led cabinets. The adapting was aided first by the conferences and workshops organized by



Western foundations, as well as their informal and formal contacts with Western officials and diplomats while in office. The evidence to such adaptation was that subsequent losses of one foreign minister after another by Mečiar as the impossibility of ‘selling Mečiar to the west combined with the weight of Western disapprobation was too much to bear.’ (Vachudova 2005,172)

As evidenced more clearly with the 2002 elections, the previous division of parties was giving way to a new pattern of party competition, as new issues emerged in the political struggle. Rybar would argue that the classic right-left issues were gaining relevance (2004; 40). He explains that the policies of the second Dzurinda government also played a part in this new formation of party competition. The government in this period prioritized cuts in public spending and the complete deregulation of prices. In return, Smer, as the largest opposition party, claimed itself to be the only left alternative to the government.

From the start of the 2002 elections campaign, there has been the clear emergence of a more defined debate about the EU (Haughton 2004; 9). Firstly, political parties such as the SDK did not base their presentations on the different economic standpoints, but rather tended to emphasize their respective administrative and managerial skills vis-à-vis their opponents in steering the state towards the EU. This was clear in the pre-election discussions of political parties and the ability of political parties to secure early accession. The two SDK vice-chairmans, Milan Hort and Ivan Miklos (later became finance minister) were introduced as the expert in public administration and economic respectively (SDK 2002 election campaign, [sduonline.sk](http://sduonline.sk)). A particular discussion during the 2002 election campaign emphasized the European Commission report criticizing Slovakia for its lack of administrative capacity to

absorb structural funds, and Slovakia's potential disqualification from the recipient group for the 2004-2006 period.

This section demonstrated how the impact of indirect, direct and transformative conditionality could be analyzed with the help of four institutional components of Europeanization, i.e. development of political identities, development of capabilities, development of political accounts and of political adaptiveness. As we see summarized in the below (see Fig.2), we can confirm that the largest impact of EU' direct conditionality was on the formation of political capabilities and political accounts. Without the EU's inducement of rule adoption, policy choices and more importantly capabilities to implement these choices in a timely manner in Slovakia would not have occurred. However, the rule adoption in Slovakia lay at the border of domestic choice and EU-induced rule adoption. EU indirect conditionality reduced the search for options by policy makers, so the rules were imported voluntarily, as result of a perceived utility. Finally, through the mechanism of transformative conditionality, i.e. a synergy between domestic and international actors, Slovakia got back in the course of complying with EU conditions which was rewarded with 2002 decision for the accession of Slovakia as a full member in 2004 along with 9 other countries.

Figure 1.2: Conditionality and institutional components of Europeanization

	Political identities	Political Capabilities	Political Accountability	Political Adaptiveness
Indirect Conditionality	Effective	-	-	-
Direct Conditionality	-	Effective		-
Transformative Conditionality	-	-	Effective	Effective

### 3.6. EU Conditionality and institutional development of property rights

The analysis in this section follows the historical development of institutions of property rights reform and analyses the extent of Europeanization. The analysis defines Europeanization of the institutions surrounding property rights in Slovakia as the formal adoption of rules and standards of good governance, as well as the informal absorption of norms. We can evidence the impact of EU conditionality in the break- up of the clientalist networks consisting of government, state owned enterprise (SOEs) heads and state owned bank directors the credible commitment mechanism of tying the hands of reforms with the establishment of independent and autonomous agencies that oversaw the privatizations of those SOEs and banks. Gould's analyses is adapt at looking at the relationship between the

method of privatization and the type of regime: arguing that the illiberal credentials of the Mečiar regime went hand in hand with the abandonment of voucher type of privatization and obstacles to foreign participation (2003).

The early years of the post communist period witnessed the start of small scale privatizations in 1991. Slovakia implemented a voucher system of privatization. At the same time, agricultural reform in the first years of transition was taking place in the form of restitution of agricultural land. Pre collectivization pattern in Slovakia consisted of very small land holdings which made the end of the large scale agricultural cooperatives problematic. Even after restitution, some farmers decided to stay in the co-ops. Second wave of privatizations was experienced in 1993 under the Moravcik government, but privatization schemes came to a stand still until 1997. In 1995, under Mečiar most of the second wave privatizations were cancelled.

Between 1993 and 1997, clientalism became the name of the game, as loyalty to the Mečiar government was rewarded with sweetheart deals. Clientalism, at the centre of the economic transformation in Slovakia in this period, could be described as an elite 'pact'. O'Donnell and Schmitter define it as a pact as 'an explicit, but not always publicly explicated or justified, agreement among a select set of actors which seeks to define (or better, to redefine) rules governing the exercise of power on the basis of mutual guarantees for the vital interests' of those entering into it' (1989, 37). Clientalism is defined as the misuse of political power to ensure economic advantages for select groups within society. To the extent that economic power and political power are mutually reinforcing, clientalism practiced over a period of

time risks development of plutocratic<sup>20</sup> structures of economic and political privilege. Under clientalism, political and economic powers are concentrated in the hands of narrow groups of political and economic elites who coordinate their actions to secure their continued privilege and influence over other actors in society.

Clientalism in this period was also described as a form of nomenklatura privatization, i.e. through the revolving doors between managers and party elite as new private owners of enterprises. The most substantial mark of privatization during Mečiar's third government has been the near total influence of the managerial lobby over the re-organization of the privatization process. The managerial lobby primarily consists of old management cadres from the socialist era. They opposed both the voucher method and most foreign participation in privatization. Their chief concern was that these privatization methods were jeopardizing their chances of gaining control of privatized companies. In the past, these cadres were directly connected with the severe and rigid rule of the communist regime where an inevitable condition for any high-level managerial position was membership in the Communist Party nomenklatura. These managers in the post-communist era became organized in the Association of Employer Unions and Alliances (AZZZ). In the meantime, most of the former managers of large industrial enterprises had also become enterprise owners. The AZZZ openly promoted most government privatization measures under Mečiar's third government, in particular, the abolition of voucher privatization and preference to domestic applicants.

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<sup>20</sup> Plutocracy can be defined as government by wealthy individuals. A common criticism of democracy, made around the turn of the 20<sup>th</sup> century by an Italian sociologist, Vilfredo Pareto, was that abuses of the system of financing elections meant that democracies were actually no more than plutocracies. By their ability to bribe politicians and to fund their campaigns, the wealthy retained a grip on power, despite 'one person, one vote'.

AZZZ was open about its success in shaping government privatization practice. In addition, all six ministers of economy have also held high positions in AZZZ.

Szomolányi and Gould focus on the clientalism of Mečiar's second government and characterize it as anti- intellectual and anti-foreign, with strict control of the state media and coercion from surveillance (1997). Gould explains the managerial class 'sought to use privatization as a vehicle to transfer positional assets they inherited from Communism to material assets, comparing the role of insiders to the role of Securitate officers in Romania with their specialist knowledge and foreign contacts (2003; 280). Mečiar's 'privatization triangle' was comprised of HZDS, the security services and crime syndicate. The National Property Fund (FNM) concealed the names and the identities of new enterprise owners. Political abuse of privatization and network of clientalism was attracting more attention of the Slovak media outlets. The absence of foreign investors, heavy borrowing and uncompetitive enterprises lead to the doubling of external debts during the third government of Mečiar (see Table 5 in Appendix 1). Anti foreign attitude of the Mečiar government was palpable. Mečiar's privatization strategy did not welcome FDI, as he likened Slovakia to Asian tigers.

Privatization continued to be sluggish and mired in controversy in 1998. Political accountability of the past and present policies regarding privatization became the centre of the attention. Opposition produced evidence of the pilfering of state assets by some politicians to relatives and political supporters. In June 1998, Ivan Miklos, the only non-governmental member of the supervisory board of FNM, gave a list of such officials together with the enterprises that they had privatized, to the media outlets and posted it on the internet. He revealed the suspiciously soft terms of privatization agreements and charged that these

agreements often included assistance from front companies and persons. Some of these deals were the privatization of the Nafta Gbely, (state gas storage firm), in 1996, FNM allegedly ignored offers from potential foreign investors and decided to sell 45.9% of its share to an unknown company, called Druha Obchodna. In comparison to the sale price of 500million Slovak Koruna (SKK), the market value of the package was 3.2 billion SKK. It became known in 1997, that Vladimir Poor, the chairman of the HZDS regional branch was one of the owners of the unknown Druha Obchodna. Another case was the regaining of a stake in the Slovenske Liecebne Kupele Piestany spa by FNM after asset-stripping operation its the majority owner, Vadium group. Vadium group purportedly transferred spa assets to other legal entities. Since 1997, a Bratislava based travel agency, CKSK (Cestivana Kancelaria Slovenskych Kupelov) had played an important role in stripping this famous spa of its assets. The travel agency processed all payments by the foreign customers of the spa and pocketed 15% commission. These transactions led to considerable deterioration in the performance of the spa and an indictment was brought against the chairman of the spa. By the time FNM regained a stake in the spa, FNM incurred losses of at least 602 million crowns. It was seen that these enterprises had been lucrative and their sale under preferential terms cost the treasury millions of crowns. Miklos's (non-governmental member of the supervisory board of FNM, later finance minister) resignation letter from the board of FNM, he stated that 'the FNM acted in many instances contrary to the law and protected the interests of powerful groups associated with the governing coalition headed by HZDS (IVO 2000).

1998 elections, voters were consulted about further privatization of SOE's in the energy sector. Between 1998 and 1999, privatization riches and sweetheart deals were starting to be investigated. 1999 and 2000 evidenced publicized disputes about the privatization of 'strategic industries.' By September 1999, cumulative inflows of FDI had reached SKK 79.4 billion, an

increase of just SKK 7.9 billion since the end of 1998 (EIU Slovakia Report 2000, 46). This was somewhat disappointing in view of the government's aim of increasing FDI four-folds by the end of 2001. Germany was the largest source of FDI with a share of 20.8%, followed by Austria (17.9%), the US (13.7%), the Netherlands (12.3%) and the UK (9.8%). By economic sector, 48.1% of FDI has been into industry, followed by banking and insurance (21%) and wholesale and retail trade (19.6%). (EIU 2000, 47) Inflow of FDI intensified in 2000 (see Table 5 in Appendix 1). The US Steel's purchase of VSZ, banking sector's privatization to strategic foreign investors and 99-00 purchase of utilities, i.e. the Deutsche Telekom's purchase of Slovak Telecom. In 2001, the European Commission reported Slovakia as a 'functioning market economy, medium term fiscal consolidation, fully implementing structural reform programme.' (EU Regular Report, 2001).

### **3.7. EU's active leverage and institutionalization of commitment**

One of the key institutions in the Slovak privatization process was the National Property Fund (FNM). It was founded in 1991 under the Act no. 253. The main role of the Fund has been the implementation of the privatization projects based on the privatization decisions in the legislature. In the event of direct sale of property or stocks, the Fund invites bids and organizes a public tender. The Fund drafts and executes purchase agreements with acquirers of private property. When state property is privatized through its transfer to a joint stock company, the Fund becomes both the founder and majority shareholder authorized to sell the company stock to individual bidders in accordance with the privatization decisions. The National Council supervises the Fund and approves of the Fund budget. The revenues and expenditures of the Fund are not part of the Slovak State Budget and can only be used in compliance with the Act.



According to Keren and Ofer, an intensive flow of FDI of commercial and financial services provides an knowledge capital, managerial services, information services, which then leads to the spread of efficient and modern production in supplying or using branches (2002, 37).

The weakness or backwardness of the banking sector, seen as the greatest hindrance to transformation in CEECs, was mostly the result of their previous role in a socialist economy, of a passive lender to loss-making enterprises, and a basic link in the softening of the budget constraint. Keren and Ofer argued that foreign banks possessed the know-how and were free from the transformation-inhibiting networks, and would therefore be an ideal catalyst for change. (Ibid, 31)

By December 31, 1998, approximately 85% of the entire banking sector's classified loans totaling 141.6 billion SKK were concentrated in the three of Slovakia's largest banks, SLSP, VUB and IRB. In addition, to the high proportion of classified loans in their respective portfolios, all three banks had insufficient capital adequacy ratios. The IRB was in the worst situation, as it had been under a central bank forced administration regime since December 1997. In accordance to Keren and Ofer's insights, the only way of rescuing the banking sector was to allow strong, financially sound foreign investors with sufficient capital and know-how to enter the banks. (2002) However, the situation was that in order to make the banks more attractive, they had to be restructured which meant that restructuring their credit portfolios and increasing their equity capital.

The Mečiar governments did not accomplish this task, so the task fell to the Dzurinda government. Between 1998 and 2001, but especially in 2000 and 2001, the Dzurinda

government achieved the great progress in bank restructuring, which was an indispensable precondition for bank privatization. The restructuring of these three banks began in 1999 when the Dzurinda government increased the banks' equity capital and removed significant proportion of classified loans. The state cut out 14.8 SKK billion of bad debt from VUB; 22.8 billion SKK from SLSP and 6.5 billion from RIB. (IVO 2000, 250-251) Besides solving the bad loans and inadequate capital ratio problems, the ministry of finance in 2000 decided to increase the equity capital by raising government controlled shares in each bank. These restructuring operations thus allowed the government to offer more lucrative stakes to foreign investors in subsequent privatizations.

The privatization of the SLSP (Slovenska Sporitelna Bank) in 2000 was deemed as the first positive signal for the recovery of the banking sector in Slovakia (IVO 2000, 247). A transparent international tender was carried out. The Austrian Erste Bank won the tender and signed a privatization contract with the Slovak government, and bought 87% shares for 18.3 billion. Similarly, the privatization of Vseobecna Uverova Banka (VUB) was finished in July of 2001, when government representatives signed a privatization contract with Italian corporation IntesaBCI. The cost of bank privatization to Slovak tax payers was SKK105 billion (approximately 1/10 of Slovakia's 2001 GDP) as the government perceived the privatization of the largest banking houses very sensitively, since these institutions administer more than half of the total deposits of the population.

Between 2002 and 2004, the sale of medium size banks were accomplished, such that of IRB to OTP Hungary and of Istrabanka to Austria's BAWAG. These sales nearly completed the transformation of the financial sector. Only the smaller banks, such as Postova Banka and

Banka Slovakia remained in state hands, and their privatization tenders were under way in 2005. As of 2005, the foreign capital controls nearly 100% of banking assets (EIU 2005). The 2005 report by the EIU and the 2005 EBRD Transition Report predicted that the privatization of the Slovak banking sector through strategic foreign investors would create a more competitive credit environment with most banks moving into retail banking. Although Slovak firms will have more difficult time to get loans because of their high credit risk, both report in so many words predict that the increased competition will force the banks to improve local risk management policies to prevent the exclusion of applicants with acceptable risk levels (EBRD 2005, 178-179 and EIU 2005, 42-44).

Besides the marked progress in bank privatization, the government also focused on the privatization of the Slovak Gas Industry (SPP) gas utility, the Transpetrol oil pipeline operator, energy sector corporations, and the Slovak Automotive Transportation (SAD) bus network. The institutions involved in these privatization efforts were various ministries, in cooperation with the FNM. According to the report of IVO concerning Institutions of Transition, the Fund and Privatization Ministry has been in a power struggle, in 2001 the Privatization Ministry was more on a side track. The privatization in utility sectors was especially important in terms of its impact on social equity and welfare as marked by the European Commission in 2001. Although the years of 2000 and 2001 have often been referred to as the years of privatization (as born out by the percentage for revenues produced to the GDP) the FNM has repeated problems with liquidity and a shortage of funds needed to redeem its bonds. Eventually due to the relatively successful privatization of financial institutions, the FNM managed to redeem all of its bonds by the end of the year 2001.

In 2002, the Fund took 54 new privatization projects containing 85 proposals for privatization outputs from the Ministry of Administration and Privatization of National Property (9 of them as foundation of joint stock companies, 50 of these proposals are related to direct sale of assets, 26 of them as gratuitous transfer of assets to municipalities and none of these are related to public tenders). The Fund made progress in the sales of natural monopolies, alongside the sales of healthcare facilities and Slovak Bus Transportation companies. Among the aforementioned natural monopolies, the most important privatization transaction was the sale of 49% of the Slovak Gas Utility. The consortium of Ruhrgas AG and Essen, Germany and G. D. F. International, France became the acquirer based on selection proceedings. The sale of 49% share of Transpetrol to Yukos Finance B. V. Netherlands was also carried out. The privatization process in the energy sector, included the sale of two companies, providing electrical power distribution, Zapadoslovenska energetika and Stredoslovenska energetika. As of December 2002, a total of 87 new purchases and sale agreements were concluded, involving 56 agreements relating to the sale of entire companies and 31 agreements relating to the sale of stocks, the total purchase price amounting to SKK163, 994.2 million. This represents an increase of 430% from the 2001 purchase price. By the end of the year, the Fund portfolio contained 126 joint stock companies, representing a total of SKK 109, 536, 036.

In the reports published in late 2002, both the European Commission and the IMF praised the completion of the privatization and restructuring process in the banking sector. In 1999 –2001 bad loans, worth 112 billion SKK (13 percent of GDP in 2001) were transferred to the Consolidation Agency. In September of the following year, the same agency put 40% of this portfolio out to tender. However, the cost of the banking sector restructuring remains significant, representing between 1 and 1.5 percent of GDP annually in 2002 and 2003. Foreign ownership accounted for 85% of the sector.

The activities of the Fund in 2003 included the completion of the privatization of 49% share in significant power producing companies such as the SPP- Slovak Gas Industry and other distribution companies. Secondly, the Fund was responsible for the gratuitous transfer of water-supply utility companies property shares to certain municipalities and the changes in the restitution claims of citizens, i.e. the revision of the manner of restitution claims settlements of entitled pursuant Act no. 87 and the transfer of the agenda related to the Fund bonds to the direct competency of the Capital Market and Bond Section. The most important sales in 2003 were the sales of investments in the banking sector; Banka Slovakia, VSZ (Kosice) and VERITEL (Bratislava). The ongoing projects in 2003 were the privatization of healthcare facilities and the sale of investments in 3 companies of the Slovak Bus Transportation Company (National Property Fund Report 2003).

In addition to the Fund's activities, the law preventing the state from lowering its stake in strategic enterprises to below 51 percent was amended in late 2003. This was done to allow for the full privatization of most of these firms. The exceptions were the postal services, the railway companies and the national forests. Only a few of the state-owned companies have yet to be fully privatized and are at the Fund's control. In the energy sector, the companies not yet fully privatized include the electricity generator Slovenske Elektrarne, for which a strategic investor would be decided upon by the Fund as of end of 2004, and the regional distribution companies. In the telecom sector, the government still held a 49% stake in Slovak Telekom, as of 2003. In the transport sector, regional bus companies, Slovak Airlines and the country's airports are still to be privatized.

In 2004 and first half of 2005, privatization of remaining large state owned companies resumed. In late 2004, the government announced its intention to complete the sales of the Slovak Telecom (majority owned by Deutsche Telekom) and the regional energy distribution companies in 2005-6. In January 2005 Austrian Airlines announced the injection of 2.8 million euros of fresh capital in Slovenske Aerolomie, increasing its share in the domestic airline by 62%. The sale of a 66 percent stake in the dominant electricity generator Slovenske Elektrarne to Italy's ENEL for 10 million euros was agreed in February 2005, and the deal could be utilized before the end of the year. The government also initiated the sale of majority stakes in several district heating plants and of 66 percent stakes in the country's two international airports in Bratislava and Kosice. In December 2004, the European Commission criticized the slow and inconsistent liberalization of the telecommunications sector which allowed Slovak Telekom to preserve its monopoly in the fixed-line market. Slovak Telekom was charged 22 million euros by the Anti- Monopoly Office for abusing its dominant position and restricting access to the local network by alternative operators. The government has set aside the revenues from the privatization of the 49 percent share in gas utility SPP (18 billion euros) to cover the cost of the pension reform.

As this section tried to establish, the most important factor in attracting FDI in a sustainable manner were the pro-FDI stance of the government; the integration of Slovakia to global structures and the credible commitment through somewhat autonomous institutions such as the FNM. Slovakia's integration into the OECD had an important economic dimension, reflected mainly in the area of foreign investment whose inflow to Slovakia lagged behind for most the nineties. The Dzurinda government adopted comprehensive supply side reforms such as the abolishment of the Act preventing the state to lower its stake in strategic enterprises. The current law form of the law permitted the complete privatization of most businesses and

allowed for 49 % foreign ownership and management control of the natural gas company, the electric power producer, electricity distributors, and an oil pipeline.

The Dzurinda government also passed an industrial park law, which helped municipalities develop special industrial zones through funding assistance from the government. The fund could fund up to 85% of the overall cost related to the purchase of land and development of infrastructure in an industrial park. This pro-FDI stance of the government and the supply side reforms were responded with a jump in FDI figures in 2002 (see Table 5 in Appendix 1). In addition, a major tax reform was implemented under Ivan Miklos, deputy prime minister responsible for the economy. Gift tax and inheritance tax was abolished, real estate transfer taxes has been lowered from 5% to 3%; and most importantly, a uniform 19% flat tax rate for corporate and personal income as well as the VAT was introduced, making Slovakia the largest EU economy to implement a flat tax system (Romania followed suit shortly).

Dzurinda's second administration (2005-2008) promised to continue its FD- friendly stance by promising to remove other impediments to industrial restructuring that were under-pinned by the insider oriented non-transparent character of privatization in the Mečiar -led governments.

In 2005, Slovakia was notable among transition countries for its steady improvement in governance and enterprise restructuring. Slovakia remains the lowest of the Visegrád countries for the development in securities market and non-bank financial institutions (see Table 4 in Appendix 1). Slovak Republic in 2005 is noted for its dynamic business environment and increased confidence in governance post EU accession, as evidenced through increased investment and portfolio flows. In comparison to the CEE countries (see Table 8 Appendix 1), in terms of governance Slovakia alongside Hungary and Poland is awarded an upgrade. This reflects the improvements in building effective corporate

governance institutions and progress in long-delayed restructuring and a positive market reaction to these developments (EBRD 2005). The CEECs, including Slovakia continue to align their more closely with European standards of good governance, according to the Report, which included general improvements to the business environment, strengthening the legal framework for corporate governance, reducing state intervention in the economy and cutting subsidies and other forms of state support.

### **3.8. Conclusions**

Which factors brought a turning point in the privatization reforms? Gould (2003) focuses on the institutional aspect of privatization reforms, and argues that the choice and success of the privatization reform framework is related to the political regime type. The reform in his explanation is not related to external incentives but to domestic political factors. According to Gould's empirical analysis, illiberal regimes chose insider dominated privatization, where as liberal democracies chose outsider dominated and foreign dominated privatization, as born out by the correlation between the freedom house scores, and the privatization methods (outsider vs. insider dominance. Causality in Gould's model runs in both directions, that conflict over privatization frameworks contribute to a weakening of democracy. Privatization in illiberal democracies generates high stakes political engagement to weaken democratic institutions and mismanagement to lead to economic crisis, insiders are likely to resolve the tension between incumbents' need to retain legitimacy and uncertain outcomes by employing identity politics and xenophobia- these two are used to justify the state take over of assets.

Kikeri and Nellis's assessment of the welfare effects of privatization showed a more nuanced picture. Quoting studies conducted in Latin America and Transition Countries, they argued



that privatization was not a main cause of the overall increases in unemployment and wage differentials, even where both have risen dramatically. Contrary to the causal links between democracy credentials and efficiency of privatization by the Gould study, Kikeri and Nellis showed that in infrastructure sectors in particular, privatization improved welfare when it is accompanied by proper regulatory and policy frameworks (2004; 87-118). They argued that promoting competition by removing entry and exit barriers and by linking privatization with financial sector reforms was crucial for the development of a dynamic and competitive private sector and thus for successful privatization (Ibid; 107).

Voucher privatization, deemed a failure in Czech Republic, was declared unsuitable by Mečiar. Alliance between Mečiar and industrial elites, (SOE managers) formed. The insiders (Mečiar party members and enterprise managers) opposed the investment privatization companies, (which exchanged fund shares for citizen voucher investment points). Some of these were independent while others were in state hands. Opposition supported voucher sale while Mečiar and company supported direct sales to outsiders. Mečiar consolidated further executive control by establishing FNM (national property fund) and delayed voucher privatization and also allowed political allies and insiders to buy shares with very low value. FNM made decisions entirely away from public scrutiny. The democratic decline continued, rule of law in management declined. Two of Mečiar's most important privatised companies gained control of the largest financial institutions, once in control of its creditors, these companies extended credits on soft terms to themselves. The banks' percentage of non performing loans grew drastically (see, Table 7 in Appendix 1). Like the financial sector and large enterprises, weak rule of law, poor contract enforcement and lax bankruptcy procedures led to persistent problems of non performing debt and deteriorating financial sector. [these are wider institutional collapse]. Non performing enterprise loans, draining industrial policy by

Mečiar ally owned defence and construction heavy industries, led to steady growth of fiscal deficit, government borrowing, crowding out of private investment not to mention detracting FDI and poor corporate performance. The economic crisis leading to 1998 elections as discussed in the previous sections led to strengthening and unity of opposition in an unprecedented way against Mečiar under the Democratic Coalition (SDK).

From this perspective, policy dissatisfaction developed in order for decision makers and institutions involved to search of policy options outside of the domestic framework. 1998 Dzurinda government came to power and implemented urgent economic reforms, in setting up an outsider-accessible privatization framework attracting FDI. Business associations and other economic actors cooperated under EU tutelage pressed for political openness, lobbied for political accountability. Meanwhile a tension was inherent in the dual demand of EU conditionality that is requiring from its prospective members not just democratization but also absorption of *acquis*. The political criteria allowed local leaders to settle institutional battles but it could have also hindered the consolidation of consensual institutional frameworks, where political actors' identities, interests would not settled adequately and stability of parties and party systems would remain fragile. The opening of the accession negotiations in 1998 was the catalyst for a 'virtuous cycle' where credible commitment from the EU empowered domestic groups to implement economic and regulatory reforms. The EU also strongly promoted the development of social dialogue among government, business and labour actors. The credible commitment locked in the decision makers for implementation of reforms such as banking restructuring and transparent procedures for enterprise privatisation. For domestic and international investors, progress in EU's preaccession reforms, served as a credible commitment to ongoing and predictable economic reforms. The raising of foreign and

domestic investor confidence reinforced the implementand reduction of transaction costs, rebuilding of market institutions help turn Slovak economy around.

The breaking point was brought forward by the EU's active leverage, on one hand, giving institutional and informational assistance to opposition who would cooperate, adapt and implement EU economic and political conditions. While on the other hand, the domestic input materialized through the development of political capabilities and political accountabilities in the institutions of reform. The EU's active leverage is translated into reforms through three main mechanisms; direct conditionality; indirect conditionality in the form of credible commitment from the EU which locked in domestic elite in continuing reforms in Slovakia, and transformative conditionality, in which state, economy and society are transformed as a result of taking part in the process that lasts over a decade. The Slovak case of privatization reforms in the light of EU conditions did not provide substantial support for the main alternative explanations as elaborated in the theoretical chapter. In the alternative explanations whose representatives are Gould (2003), Ekiert (1998 <sup>21</sup>) and Orenstein (2001 <sup>22</sup>) are that success of reform is path dependent<sup>23</sup>, as the existence or absence of political competition and rule of law as a legacy of the communist regime and regime immediate to transition. These explanations contrast with institutional explanation in this chapter and the wider project, where the former explains reform mainly as domestically driven, and the while our

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<sup>21</sup> Ekiert emphasized that the legacies of dissent, opposition and reform were prerequisite conditions for early progress towards market democracies (1998).

<sup>22</sup> Orenstein demonstrated that robust political competition in post-communist democracies contributed to economic reform in his analysis of Polish and Czech privatizations. In the case of the Czech voucher privatization, the government's refusal to engage in privatization associated capital market and financial sector regulation, brought many flaws to the process and had been continued by Klaus until his resignation. In the Polish case, he argued that political instability and policy alternation produced a better quality economic reforms than political and policy continuity in Czech Republic (2001, chapters 2 –4).

<sup>23</sup> Orenstein differs from Ekiert and Gould by arguing that liberal democracy did not affect outcomes but prior inheritances did shape the political resources to rival insider and outsider property claimants.

hypotheses purports that reform can be explained mostly as a reinforcement by reward and is driven by the synergy of the domestic conditions with external conditions. In the period between 1994 and 1998 the active leverage did not help reformers develop capabilities to overcome the systemic obstacles, the clientalistic relations barring efficient privatization was intact and pervasive.

Direct conditionality- named by reinforcement by reward- i.e. the material incentives- does not alone explain the tipping point of 1998 elections. We would agree with Epstein that material incentives could not fully account for the influence of international actors on domestic politics. Material mechanisms, worked in tandem with social mechanisms not through coercion but appeal to western norms and values, adopted western values in seeking affirmation by the western actors and organizations (Epstein 2005; 63-105). In terms of giving organizational capacities, EU indirect leverage was effective according to this analysis, as is evidenced in the formation of the third sector. The material incentives were not the main motivator for the turn around. As explained in the indirect conditionality hypothesis, the first phase is that international institutions use their social power to persuade an elite group of domestic reformers (often this elite group coalition would come into existence as a result of this pressure) of the desirability and credibility of particular policy measures. The second phase then came when the reformers chose to tie their hands and credibly commit to the course of reform- but the course was a combination of their own imposition and external institutions' such as the EU, NATO and IMF as well as the OSCE. A comparison of Slovakia with the privatization reforms in Romania and Turkey will better assess the extent of Europeanization and the influence of EU's active leverage through the mechanisms of EU conditionality.

## ***Chapter: 4 EU Conditionality and Romanian Accession and Privatization Reforms<sup>24</sup>***

### **4.1. Introduction**

In all of the 12 Central European new member states, the students of EU enlargement argued that Romania's domestic context offered arguably the poorest 'goodness of fit' with the rules and policies as well as norms of the EU and in its *acquis* (Börzel 1999).<sup>25</sup> This chapter is a case study of EU's influence on Romanian structural and institutional reforms. The EU's influence can both be explained as Europeanization ('the goodness of fit' between domestic and EU policies (Cowles, Caporaso and Risse; 2001); the adoption of Western European models,) or a more specific EU-ization (changes driven by desire to join the EU, (Wallace, 2000)). The research question that runs through the dissertation is why countries of Central and Eastern Europe, along with other accession candidates complied to reform their institutions and their compliance varied with respect to one another?

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<sup>24</sup> I thank Prof. Csaba, Prof. Fumagalli and Prof. Bokros for their comments and suggestions.

<sup>25</sup> We hypothesize in this case study that the EU accession process pushes the applicant countries towards greater convergence with particular policy models than had occurred within the EU-15, as documented by Cowles, Risse and Caporaso (2001), Heritier et. al. (2001) and Kochler Koch and Eisling (1999). Grabbe (2006) in her assessment of EU conditionality on CEE, brings forth some explanatory factors why there may be this convergence. The policy convergence is first brought forth by the speed of adjustment in the adapting CEE institutions and policies to the EU. The openness of CEE to EU's influence owing to the process of post communist transformation and that there had been few established public policies that commanded widespread support and their political leaders were seeking external legitimation for their policy choices, reinforces the convergence tendency. Thirdly, in CEE countries were going through radical re-regulation, and this process made them more receptive to regulatory paradigms than the EU-15, as CEE policy makers were seeking models to implement in many areas. This policy convergence should not however be overestimated; the patterns of divergence in CEE economies are aptly discussed by an emerging body of Varieties of Capitalism literature (Greskovits 2006; Böhle and Greskovits 2006).

The more specific puzzle for the Romanian story for accession that we aim to solve is that why Romania remained a ‘persistent laggard’ for most of the 90s and beginning of the 2000s despite the incentives offered by the membership to the EU? (Papadimitriou 2006, 215).

As a point of clarification, EU conditionality, is conceptualized as an instrument not as stable across time and cases, but as an evolving and a dynamic concept. While conditionality locks the applicants into the processes of Europeanization (Grabbe 2004 and 2006), it is also a moving target effecting and is effected by the continuous interaction of EU actions and institutions and their domestic counterparts. We will aim to show in this chapter longitudinally and across the cases further on, that Europeanization has a momentum and a logic that exists independently of negotiations. The CEE actors accumulate sunk costs and political capital invested in aligning with the EU policies. Secondly, top level actors in CEE become part of the EU political space, which gave them incentives to behave as willing partners to the existing member states and socialized them in the political discourse of the EU.

The specific nature of the EU- CEE relationship is that power is asymmetric between the EU and the candidates, and the level of uncertainty that different policy areas in which conditionality functioned is high. The attraction of the EU was that Romanian policy makers, as in Slovak and Turkish cases considered in this dissertation was that it served as blue prints in the absence of domestic models and templates in the shape of economic, political and regulatory institutions, as well as in terms of norms and ways of doing things, domestic actors adopted. Our case study shows that between the years of 1991 and 1997, the EU conditionality had much more of an indirect effect during when transformation reforms were planned and negotiated and implemented, the EU institutions served as model, bundling

prescriptions and best practices. In 1997 with the formalization of Agenda 2000, the EU conditionality had a more direct and active influence on Romania. Also, until to the Agenda 2000, the compliance with EU conditions for accession had a much more voluntary character, but Agenda 2000 introduced a clear pre-accession program for post communist candidate countries and formal monitoring for the reform process, where rewards and compliance to the conditions became tightly linked.

Why was there a large variance between compliance of different candidates which had fairly similar starting points and were given a similar set of incentives and constraints? We propose that the variance in the use of conditionality mechanisms did much of the explanation. We also acknowledge the myriad of alternative explanations. One alternative explanation in particular, which we would loosely phrase as ‘path dependent explanation<sup>26</sup>,’ proposed that it was the timing and the sequence of the introduction of reforms and the interference by the external institutions that explained the variance in the outcome. The common point between path dependent explanations and the explanatory factors we propose is that EU conditionality is taken within the continuity of Europeanization (defined in the theoretical chapter). In this continuity, sets of practices and postures also evolve, namely, how a particular country and EU Commission adopt certain practices, postures and action modes which are adapted to changing circumstances.

To see how EU conditionality influenced these outcomes, this chapter will focus on the structural and regulatory reforms surrounding property rights reform. Privatization is

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<sup>26</sup> Pierson explains that path dependent processes can be characterised by increasing returns in which there is a critical role for timing and sequencing. In increasing returns processes, when an event occurs may be crucial. Because earlier parts of a sequence matter much more than later parts, an event that happens too late may have no effect although it might have been of greater consequence if the timing had been different. (2000; 263).

considered a main pillar of transition reforms and a formal condition for the receipt of financial and technical assistance from International Financial Institutions such as the World Bank, EBRD and the IMF. Regulatory reforms exist between the economic and political realm and is the missing link for us to explain how the EU influences structural reforms. In terms of Romanian privatization, the picture looked pretty dismal until 2000 elections, but the PDRS managed to reinvent itself as a pro- European force and an ‘avid privatizer’ once it came to power. Our analysis will try to explain what brought about this change.

#### **4.2. Romanian political economy: A bird- eye view**

If we start the story from the end, Romania was characterized as ‘a functioning market economy’ with strong economic growth and functioning regulatory and democratic institutions in the year 2005 according to the EBRD report (Transition Report, 2005). The country acceded to the European Union in January 2007, with competitive business environment, improving infrastructure and noted progress in the financial sector and social reforms (Ibid). A quick look at the political, economic and social indicators for Romania between 1989 and 2006 (see Table 1 in Appendix 2) as well as the assessment of structural/enterprise, financial and market reforms (see Table 3 in the Appendix 2) show that Romania can be classified as a ‘success story’ by the middle of the first decade of 2000s.

As can be seen from Table 2 in Appendix 2, Romania is a middle sized country, in the CEE region, with the GDP per capita collapsing in the beginning to mid -90s, then recovering in the early 2000 and growing significantly between the year 2001 and 2006. Structurally, Romania has a large agricultural sector, even though the share of agriculture in the GDP has decreased significantly from 23.7 in 1990 to 19.1 in 1996 and to 8.9 in 2005. The structural



trend in terms of share of industry in GDP has also decreased from 49.9 in 1990 to 32.9 in 1996 then to 24.4 in 2005. It is indicated that the services grew from 24% in 1991 and now accounting for more than 50% of GDP. Current account deficit for the Romanian economy did not decrease as significantly, between 1990 and 2005 (from -9.6 to -8.8), even though it reached its lowest point in 2000. Foreign direct investment's (FDI) trend in Romania between the economic transformation years of 1989 and 2006 is most noteworthy, as it grew from -18 to 6,587. The change in the flow of FDI between 2003 and 2004 is remarkable; it is recorded to have grown from 2,156 to 6,368 million dollars within one year. This remarkable growth trend and the sudden hike in the years 2003 and 2004, reflect privatization deals and Greenfield investments, as well as the increasing amounts of EU pre-accession funds (EBRD 2005). In 2006, the foreign direct investment for Romania is projected to be roughly 9 US\$ million (8.652 US\$ million). The last figure is a good indicator of the success of transition of Romanian economy and the success of the structural and financial sector as well as intensified efforts on side of the Romanian reformers to improve governance and strengthen the weak business environment. In the year 2005, we see that the economy grew by 4.9 percent year on year (following the record of GDP growth of 8.3% in 2004, boosted by a bumper harvest (EBRD Transition Report 2005, 167). On the demand side the growth was driven by a 12% increase in private consumption (fuelling an import boom), seen as the driver for growth rather than the investment.

Another snapshot of indicators in the year 2005 comparing the economic indicators from the 5 CEE countries in the region show that Romania is only a 'moderate' success story (see Table 2 in Appendix 2). Romania seems to lag behind in comparison the 3 new members in terms of GDP per capita, as well as the consumer price inflation. Current account deficit is notably the highest in the region with a difference (-9.0), with the exception of Hungary (-8.7), and in

comparison to its fellow accession country Bulgaria (-3.9) In comparison to the three new members, Romania has the lowest volume of exports, but fared higher than Bulgaria for the size of its economy. Lastly, the debt service ratio, is the lowest in Romania, 17.0% paid in comparison to Hungary's 23.8 and Poland's 19.4. Romania's population is the one of the largest amongst the new member countries, however, she ranks the lowest in terms of GDP per head in purchasing power parity terms.

How could one explain this moderate success of Romania to reform and modernize its economy and comply with European standards and to compete with the EU-15 and EU-25?

We would argue in this chapter, the EU conditionality acted as an external anchor to Romania's market reforms. The extent of its effect can be measured not only by looking at the aggregate outcome of structural, financial and institutional reforms in improving the country's much criticized business environment (IMF, WB and EU reports seem to converge), but by looking at the level of output in public policy that complies with EU legislation. In order to qualify the EU influence, we therefore, consider not the outcome of these reforms, but the output in public policy; and we consider how policies resemble EU policies, instead of whether and how these policies resulted in similar economic and social conditions or the quality of formal and more importantly, informal institutions and legal development for regulatory institutions.<sup>27</sup>

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<sup>27</sup> Bevan, Estrin and Meyer (2004) explain that although legal framework has been changed radically to create a new set of formal institutions during the 90s, the process varied considerably across transition countries and the transformation of informal institutions lagged changes in the law. (p. 4)

In the area of property rights, several different regulatory models overlap. The efficiency of property rights reform is conditional on whether property rights are complemented by an institutional environment consisting of market regulating, stabilizing and legitimizing institutions (Rodrik and Subramanian 2003; Fabry and Zeghni 2006). Aside from the wide policy framework of the EU *acquis* to be adopted by CEE governments, the third accession condition includes the special functions of government on the ability to take on the obligations of membership. For instance in order to implement and enforce the *acquis*, the EU is concerned with the entire judicial system and the need to administer EU regional aid. It sometimes necessitates the creation of administrative (and political) units of sub-national government, depending on the administrative make-up of the accession country. Especially important, is the condition of the capacity to join an economic and monetary union which translates into the requirements for an independent central bank and new regulatory institutions to implement the single market rules.

This case study aims to test several mechanisms with which EU purportedly exerted influence on CEE states through the accession process. Vachudova (2001, 2005) and Grabbe studies (2004 and 2006) provide diverse sets of means of influence in their analysis of conditionality. However none of the above authors manage to provide a compact set of mechanisms to study the EU conditionality's influence that both directly or indirectly shape institutional reform and increase the organizational capacity of the economic reformers in the government vis-à-vis interest groups that block these reforms. We study three mechanisms in this case study namely; 1) the direct conditionality of the EU through specific policy tools; 2) EU's indirect accession process as a credible commitment device, and 3) the transformative aspect of EU's conditionality.

In terms of direct conditionality, we are referring primarily to political capacity building tool such as models, aid and technical assistance, advice and twinning and benchmarking and more importantly to the gate keeping tool. The EU provides legislative and institutional templates. Legal transposition of the *acquis* and harmonization with EU laws are essential to becoming a member. Legislative gaps and institutional weaknesses are identified by the screening process that took place with each applicant prior to negotiations of 31 chapters of the *acquis*. The previous chapter on Slovakia elaborated on a different kind of gate keeping function, i.e. the use of demarches and ultimatums, which were used only in rare occasions of very serious breach and proved to be a very effective tool. Schimmelfennig (2001) among other students of conditionality believes that gate keeping or possible threat of exclusion is a risky enterprise, in the case of non compliance by CEE countries, the EU's own credibility may suffer. He points out that this process of 'socializing' of CEE countries into international norms happens through reactive reinforcement rather than active conditionality.

Another mechanism of gate keeping is the cycle of Accession Partnerships and Regular Reports published by the EU Commission on how prepared each CEE applicant is in different fields. These documents set out as direct leverage on policy making in CEE by setting out a list of policy priorities that have to be implemented each year, or in the medium term. Often the goals are very general and vague, citing a need for 'increasing capacity' or 'improving training' rather than detailed institutional preferences (Grabbe 2004 and 2006).

Secondly, we hypothesize that EU conditionality worked as a credible commitment device, locking in the policies of countries, through sunk costs, procedural momentum and

socialization of actors, making non-compliance and exit costly, for domestic actors and EU. Credible commitment mechanisms insures against policy reversals, providing positive signals for foreign investors and domestic constituency who benefits from economic and political reforms. In the first phase is that international institutions use their social power to persuade an elite group of domestic reformers (often this elite group would come into existence as a result of this pressure) of the desirability and credibility of particular policy measures. The second phase is the tying the hands of the domestic reformers, making reversal of policy costly, while helping the domestic reformer shift the blame/cost of reform to external actor(s).

Our third hypothesis is that EU conditionality is transformative by empowering those who will benefit from these changes (through their coalition with international institutions) who will then expand their policy discretion. Whether international institutions prevail in seeing their preferred policies implemented at the domestic level depends on how well they create and exploit domestic cleavages in the service of building a winning coalition (Epstein 2005, 66-67). Here the theory of institutionalized influence suggests that the international institutions maximize their effect over domestic reform processes where they cultivate a transnational community bound by shared commitment to common values. We propose that transformative conditionality comes in two stages. International institutions cultivate a transnational coalition, consisting of external actors who are in position to put pressure on positioned domestic actors into implementing policies that are consistent with the institutions' requirements and ideology. In the second stage, international institutions empower their domestic interlocutors to implement reform and overcome opposition through providing consistent messages and usable technical information; by conferring legitimacy on those favoring reform, and by granting rewards for compliance. In the next section we will provide an overview of different phases of the accession process, and a case within a case of

Romanian privatization and regulatory reforms. We assess each of the three conditionality mechanisms. In the final section, we will evaluate which of these mechanisms may have been more effective to produce the variance in compliance through different phases.

#### **4.3. EU's direct influence mechanism**

The accession process from 1995 to 2006 could be divided into two main sections in which we assess the utilization of EU's conditionality tools: 1995 to 1997 and 1999 to 2006. In 1997, Romania was excluded from the accession countries in the Luxembourg Summit along with Slovakia and Turkey. 1999 Helsinki Summit was another turning point in EU-Romanian relations, when Romania is included as accession country.<sup>28</sup> In comparison to the Slovak accession, it should be noted that the conditionality tools grew in number and sophistication for the second and consecutive waves of enlargement, which confirms that conditionality is a dynamic and evolving concept.

##### *4.3.1. Early stages of Institutionalization: EU- Romanian relations, 1993-1997*

The association negotiations with Romania were started in May 1992, but the relations with EU bodies were not formalized until the signing of the Europe Agreement in February of 1993. The European Agreement in 1993, marking the first step of formalized relations, was a comprehensive trade agreement, with specific provisions establishing a 'political dialogue'; technical and financial assistance, and economic cooperation. (Sedelmeier and Wallace 2000) The first association council, Romania- EU took place in Bucharest in October 1995.

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<sup>28</sup> We systematically look at the regular reporting of the Commission of Romania's institutional and policy response and discovering the bottlenecks<sup>28</sup> of reforms in the Romanian case as pointed out by the reports and communications by the EU institutions as well as the reporting of other monitoring institutions.

On the EU side, between the Copenhagen European Council in 1993 and the Madrid European Council in 1995, EU enlargement changed from the question of ‘if’ to when with the design of the Copenhagen criteria. Romania was included among the recipient countries of PHARE assistance and submitted its application for membership in June 1995. On the Romanian side, we see a political consensus evolving among the political parties on the objective of integration and the practical needs for coordination as regards to EU assistance and answering the Commission’s detailed questionnaire about Romanian legislation and institutional arrangements regarding economic policy, regional and local administration and judiciary. The Romanian executive branch set up the Inter-ministerial Committee for European Integration (ICEI) and in 1995, the Department for European Integration (DEI). The DEI provided the forum for interaction between EU institutions and national administrative bodies dealing with European integration issue and together with the Ministry of Foreign Affairs, and Ministry of Foreign Trade formed the secretariat of ICEI.

#### *4.3.2. Transition from passive to active leverage: 1997-1999*

This transition from passive to active leverage occurred with the Agenda 2000 in 1997.

Agenda 2000 in 1997 recommended the start of the negotiations with six candidate countries excluding Romania while Bucharest was conceded to the status of candidate country. With spring of 1998, the Commission started to conduct a process of analytical examination of the acquis (screening at first on multilateral then on bilateral basis), and this increased the need for domestic coordination. The Accession Partnership was signed in the same period and the government of Romania submitted its first National Programme for the Adoption of the acquis.

The main institutional actors in this period between 1997 and 1999 were the *troika* of the Department for European Integration (DEI), the Ministry of Foreign affairs (MFA) and the ministry of Industry and Trade. The DEI within the Cabinet office, headed by a minister delegate, coordinated the policies on European integration and the distribution of the reimbursable assistance granted to Romania, working with a small staff and was given significant visibility on the cabinet meeting. The MFA also established an EU unit controlling the direct communication channel with the Permanent Mission in Brussels. The DEI and the MFA were under different political patronage in this period. Competition for control of the allocation of the incoming EU assistance and due to the high domestic salience of European integration increased frictions in the governing coalition, made the collaboration between the two bodies highly problematic. The DEI ended up monopolizing the secretarial tasks well as the screening process, while the relations with Brussels remained divided due to overlapping competences between DEI and MFA units.

As part of the *benchmarking and monitoring tool*, the 1998 Regular Report, the first published report of its kind, deals with the issues of decentralization, administrative capacity and judicial reform. The report also marked the frequency of the government's use of emergency ordinances as concerning. The reform of the penal code dealing with the Law against libel and offence of authorities had limited freedom of expression by media and the NGOs.

The *model and template tool* was used by increasing pressure for the adoption of European legislation on financial institutions and bankruptcy laws. On part of monetary policy the largest progress was made in terminating special credits extended by National Bank of Romania (NBR) to agriculture and enterprises, strengthening the independence of NBR



further. Three important laws were enacted with respect to the banking sector, the new statutes of NBR, the law on Bank Bankruptcy and Banking law greatly improved the legislative framework. In addition, the government passed WIPO conventions, but failed to implement them. Prudential regulations became fully operational in line with the EU acquis, and competition law became in line with the European Community legislation, but no progress was made on the alignment of Romanian legislation to the acquis on securities market, and serious gaps persisted in relation to insider regulations, as well as the lack of any legal framework on state aid.

As part of *the aid and technical assistance tool* the 1998 PHARE<sup>29</sup> program consisted of the national allocation of 117 million ECU based on the Accession Partnership priorities, which were support for child protection, customs regulations, regional policy and transportation as well as the participation in Community programs and Tempus. Additional funding was provided under the Catch up facility for projects in rehabilitation of mining areas and restructuring of financial institution under the 1998 allocation of PHARE.

#### *4.3.3. Intensification of pressure: 1999-2003*

On the basis of the Regular report of 1999, the Commission recommended that accession negotiations be opened also with Romania. 1999 Regular Report focused on the progress in issue of property rights, in particular the government ordinance regarding the restitution of properties belonging to minorities. Structural reforms had been stepped up, much due to the pressure from the EU and the support from World Bank Private Sector Adjustment Loan and

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<sup>29</sup> PHARE is accession driven, with 30% of PHARE allocation is used for institution building (helping countries to improve institutional capacity to implement the acquis and 70% is financing investments to regulatory infrastructure needed to comply with the acquis and to reinforce economic and social cohesion including the effects of restructuring in important industrial sectors (1999 Regular report, EC).

the IMF standby agreements. The EU Commission used its *aid and technical assistance tool* by adopting a significant program of economic restructuring and privatization to be financed by '99 Phare program. The Regular report noted that the government accelerated restructuring and privatization of large scale enterprises. Special attention was given to the recapitalization operation of the two largest public banks (BCR and BANCOREX<sup>30</sup>),

But, the main shortcomings noted by the Commission in its monitoring were with regards to the judicial process.<sup>31</sup> To remedy these, *advice and twining tool* was increasingly used in 1999 and 2000, as 16 projects were twinned under PHARE. There was a division of labor between EU-15 member states, which supervised twining and advice projects in different sectors that Romanian accession lagged behind due to the accession partnership agreement; namely, Greece and France (in agricultural reform and veterinary sector); two environment projects focus on water management and projects in the financial sector (on internal financial control, new taxation instruments) and the Netherlands is leading a project on the development of the school of public finance. French ministry of Justice worked with Romanian counterparts on approximation of legislation, management of prosecutors office and the office of secretary general and organization of courts. UK on the other hand, led two projects on fighting organized crime and corruption, and to develop control systems and administrative capacity to handle Structural Funds. The government responded by announcing an ambitious plan for closing down of the largest loss making enterprises, and with a program to reduce the arrears at three largest utility providers through the forced execution of bank accounts. Major shortcoming in the fiscal sector regulation was reportedly due to lack of

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<sup>30</sup> The NBR took control of this bank, replaced management and extended a large direct credit to avoid bankruptcy

<sup>31</sup> The headlines of criticisms were the back-logging of property rights cases and lack of technical skills in EU law, financial, fiscal and banking law and new fields of commercial law, and specific legislation on money laundering, drug trafficking, illegal immigration and computer crime. (EU Regular Report 1999)

implementation of reforms in controlling public expenditure in the medium term, including the overhaul of the health and social security sector. Meanwhile much progress was noted in the agricultural sector restructuring, in the context of the agricultural structural adjustment loans agreed with the World Bank, external tariffs were lowered and the privatization of largest grain trading and storage companies was accelerated. Nevertheless, privatization of state farms were blocked due to unsettled legal problems and agricultural lobby and local councils' pressure on the central government.<sup>32</sup>

Much emphasis in the 2000 Regular report were given to progress or (lack there of) structural reforms. New adjustments were made to Privatization Law in 1999 and 2000, and the progress reports, but the institutional density authorized to selling off public assets (overlapping of the competences of State Ownership Fund (SOF) and State Property Fund (SOP)), made the process more complicated and slow, coupled with the lack of enforcement of hard budget constraints, allowing the continuation of unprofitable and unviable companies to continue operations and avoid bankruptcies. 1999 and 2000 reports assessed Romania as 'not a fully functioning market economy' and as 'not able to cope with Union competitive pressures.' (EU Commission Regular Report 1999 and 2000) While the progress of adoption of state aid control and law on public procurement were noted as steps in the right direction, but it was qualified with lack of institutional development in regulatory and public administration agencies, financial supervisory and regulatory bodies and public procurement agencies.

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<sup>32</sup> The effects of privatization of ROMCEREAL, the lack of functioning land market and a reliable land cadastre and the lobbying efforts on local level are aptly explained by the extensive study of Verdery (2003) and Verdery and Humphrey (2004).

Immediately after the opening of accession negotiations, the focus of coordination shifted to the Ministry of Foreign Affairs, by the transformation of former DEI into the department of European Affairs (DEA), and the formation of a Core Negotiating Team. The Accession negotiations were opened formally in February 2000. As part of the *aid and technical assistance mechanism*, coming out from the negotiation phase, EU Commission paired PHARE assistance with other two pre-accession instruments, ISPA (dealing with structural policies) and SAPARD (Special Accession Program for Agriculture and Rural Development). Thus, coordination requirements soared. In response, the Ministry of European Integration was established by the new government of 2000, taking over the functions of the former DEA. With respect to the oft criticized lack of progress in public administration reform, it should be noted that the EU failed to provide any clear blue prints and benchmarks; evidenced in the Regular Report of 2001,

*‘ as in the member states, each administration has to decide how to allocate scarce human and financial resources, ... there is no ‘ideal’ level of staffing and numbers alone are no indication of the capacity to implement the acquis effectively’ (p. 61).*

In the general assessment of the acquis transposition in the Commission’ Regular report of 2002, the overall capacity of public administration to implement the acquis deemed only to be at the design stage with a notable gap in implementation.

The gate keeping despite these lags did not function as it did in other cases of accession with respect to Romania. Romanian accession went further, and deadlines for the conclusion of negotiations were already pronounced in the previous stage of accession. The Commission resorted to some extraordinary moves in both laggard countries’ cases. For instance the Commission imposed specific tasks for Bulgaria (on nuclear power) and Romania (on

economic reform and state orphanages), before they could start negotiations in 2000. The strategy paid off at least on paper: 13 chapters were provisionally closed by 2001.

2002 evidenced another turning point for the Romanian accession. At the Copenhagen Summit of December 2002, the accession negotiations were announced to be concluded with 10 accession countries of CEE and set a date of May 1<sup>st</sup> 2004 as the accession. Moreover, the Summit set 2007 as the target date for Romania (along with Bulgaria) to join the EU. In the words of the former Enlargement Commissioner, Gunter Verheugen, ‘the 2007 entry goal is a realistic scenario,... "Romania is in a decisive phase - it may be hard but it's possible...’<sup>33</sup>

*Gate keeping tool* (for more details, see figure 1 below) was utilized against the ticking clock, putting pressure on the Romanian government, realizing the strategic importance of making the deadline before the big bang expansion of 2004. The Brussels European Council in December 2003 marked the first EU official statement on an accession date for Romania (EC Enlargement website). Conditional upon the appropriate progress on the ground, the Council set the objective of concluding accession negotiations in January 2007. The Thessaloniki European Council declared Bulgaria and Romania as part of the 2004 Strategy Paper of the Commission (COM 2004c) and reiterated the objective to conclude negotiations by the end of 2004, and set the target for signing the Accession Treaty by the end of 2005. The adoption of the financial package for Romania for 2007- 2009 period (COM 2004 b) in early 2004, as well as the closure of the accession negotiation before the end of 2004, put additional pressure on the Romanian administration to implement reforms to increase, absorption capacity. Inherently, through the utilizations of both benchmarking and gate keeping tool, the ministry

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<sup>33</sup> The quotation was accessed at [www.euroactiv.ro](http://www.euroactiv.ro), on Feb. 23<sup>rd</sup> 2007.

of finance gained further importance and visibility, reflected in new institutional arrangements for policy coordination.

Figure 2.1 Gate keeping stages of the EU

1. Privileged trade access and additional aid
2. Signing and implementing an enhanced form of association agreement (European Agreements for the current candidates, Stabilisation and Association Agreements for SE Europe)
3. Opening of negotiations (explicitly dependent on meeting the democracy and human rights conditions after 1999)
4. Opening, negotiation and closing of 31 chapters
5. Signing of Accession Treaty
6. Ratification of accession treaty by national parliaments and the EP
7. Entry as a full member.

Source: Author's own compilation

The mechanism of provision of legislative and institutional templates, did not only consist of the imposition of EU's own norms, but reinforcement of other international legal norms by making them part of the accession conditionality. The league tables at the end of the progress reports of 2002 and 2003 and 2004 show, entitled 'Human Rights Conventions ratified by the candidate countries; show a listing of x's next to the various conventions and protocols such as EHCR protocols, European Convention on Torture, European Social Charter and International Convention on Civil and Political Rights and International Convention on Economic and Social Rights among others, and the 13 accession countries. (European Commission Regular Reports, 2002, 2003, 2004)

The aforementioned, bottleneck of administrative capacity was addressed by *the benchmarking and monitoring tool*, and specifically through the formation of league tables, analyzed in parallel to the administrative performance of other candidate countries.

Comparable league tables were by assessments of EU accession management conducted by

the World Bank and OECD. Policy transfer as required by *acquis* were reinforced by the *advice and twining tool*, the former minister delegate of EU affairs was seconded by French experts, for the French model of administration has been an inspiration for Romanian institution building, particularly informed the procedural level decisions by the government between 2000-2004 (Moia, 2005), also by the secondment of French government advisors in various high places. The creation of the Permanent secretariat for European Affairs, within the Prime Minister's office happened as the PM was closely advised by a French advisor borrowed from the Central French Administration. Other combinations of agents consisted of member states with consulting firms and government agencies. The MATRA project, a Dutch initiative aimed at assisting the Romanian government in improving the EU policy coordination system, was collaboration between experts, consulting firms and governmental agencies. On top of those, particular Romanian civil servants and politicians proved exceptional entrepreneurship in importing external models.

By the end of 2003, all 30 chapters of the *acquis* were opened, 20 of them were provisionally closed, but negotiations were to be continued in 10 chapters.<sup>34</sup> The European Commission's Regular report for 2004 concluded that Romania complied with the criterion of functioning economy. With vague and general terms, the report stated that privatization needed to be accomplished and post privatization disputes needed to be settled. (European Commission Regular Report 2004, 47) The Commission recommended the continuity of perseverance in restructuring in the key sectors had to go hand in hand with privatization. But the most important conclusion of the report was not about the economic criteria but on the third 'criterion' of administrative capacity. The report underlined in several different chapters that

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<sup>34</sup> Those chapters were the free movement of persons, freedom to provide services, competition policy, agriculture, transport policy, energy, regional policy and coordination of structural adjustments, environment, cooperation in the field of Justice and home affairs, financial and budgetary provisions.

substantial progress needed to be made in the functioning of the judiciary and public administration: ‘even and predictable application of law is required to create a business environment with a level playing field.’ The Commission’s regular report is preceded by the Brussels European Council’s (June 2004), underlining that particular attention should be paid by both Bulgaria and Romania for improving their judicial and administrative capacity provided by the previous year’s (2003) report. The Regular report of 2004 clarified in more detail which areas of the judiciary and administrative structures required for implementation to what aspects of the *acquis*. In this clarification, Commission not only underlines the lack of progress in the third criteria of accession, but the Commission ‘attempted’ to use its *gate keeping tool*, by tying compliance in this area to the reward of Accession Agreement. We would argue later that despite the attempts to use gate keeping and threat of exclusion, the hasty push through the door of Romania and Bulgaria may have upset some of the progress maintained by the application of other conditionality tools.

#### *4.3.4. Assessment of the direct influence mechanisms:*

In June 2004, Commission installed ‘safeguard’ clauses, with possibility of delaying the planned accession by one year if the accession targets were not met. Meanwhile, in May of 2004, Romania became a member of NATO. Following closely, the Brussels Council in December 2004 decided that the country ‘would be able to assume all the obligations of membership at the envisaged time of its accession.’ In February 2005, the Commission passed a positive judgment on the scheduled April 2005 signing of Romania’s accession treaty. The sequence and timing of this decision carried extreme importance in our opinion. In June 2005 and July 2005, France and the Netherlands carried out referendums on the Constitution of the EU, which produced results that put the deeper EU integration into jeopardy. The decision to sign the Accession Treaties with Romania and Bulgaria came



immediately before the two no's in the summer of 2005. There was a clear urgency on the part of the Commission to pass a positive judgment and not further delay the signing of the Accession treaties with the two enlargement countries. The Commission was perhaps acting strategically not to delay these enlargement decisions further than the referendum on further integration, concerned that the public opinion polls conducted by Eurobarometer were both showing signs of the enlargement fatigue on the parts of the EU-15 and core EU-6 (two of which were France and Netherlands) and superimposition of the doubts and negative opinions on deeper integration with further enlargement (Ray and Bingöl McDonald, 2005).

This urgency and 'sense of purpose' on the part of the Commission is replicated with the positions of the main group leaders in the EP. These positions in 2005 converged on two points; the first being the possibility of the loss of [political] momentum on both sides, especially on the part of the reforming partners and secondly that once Romania and Bulgaria are allowed in, the two accession countries would still have time to adapt and implement remaining acquis and legislation on the areas of concern. Romania was duly given the green light with October 2005 report, which stated Romania would be ready for accession by January 2007. At the same time, the Commission also showed the stick by remarking on the possibility of additional safeguards, emphasizing that it is the responsibility of the authorities of Romania (along with Bulgaria) 'to take all the necessary measures to address the outstanding issues identified in the 2005 report , so as to be able to carry out their obligations under the acquis upon accession.<sup>35</sup>

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<sup>35</sup> The Commission maintained that: '...The failure to do so would lead the Commission, as guardian of the Treaties, to take the necessary preventive or remedial action to safeguard the functioning of EU policies. This part sets out the safeguards and other measures which could be imposed in the event of certain shortcomings not having been adequately addressed upon accession. These are outlined in three broad areas: the internal market,

The final monitoring report by the Commission indicated tougher conditions on Romania's accession in 2007. The country would be closely monitored on the remaining areas of concern. These include further efforts in the justice system and the fight against corruption and the integrated administrative control system for agriculture (IACS), Paying Agencies, and the interconnectivity of tax systems.

#### **4.4. Indirect Conditionality and Credible Commitment Mechanism in the area of Romania's privatization reforms**

Privatization reforms did not effectively take hold until late 2000 and 2001 according to the World Bank. What were some of the explanatory factors explaining this 'delay' even though privatization was the part and parcel of all policy advice and conditional aid to Romanian economy? We argue that despite the conditionality from IFI's for progress in privatization, it was not until EU's active leverage became effective, we saw progress in this area. The lag in privatization reforms can be explained by institutional deficiencies identified by both 'old' institutional and 'new' institutionalists. Old institutionalists regard factors such as the influence of communist industrial legacies, the network between ministries, central bankers and managers of large state owned enterprises were reproducing itself, these social institutionalist ties, and continuation of soft budget constraints hamper effective progress in the structural reform. New institutionalists regard the lack of progress as a manifestation of lack of complementarity between private property institutions, regulatory and judicial institutions that need to replace the old institutions.

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the judiciary and fight against corruption, and the disbursement of EU funds...' (Accession Report, EC website, 2006).

We aim to converse between these schools, looking at the synergies that arise from appropriate combination of institutions such clearly defined property rights, full functioning financial institutions and regulatory institutions and ‘reregulation’ that is part and parcel of the EU accession reforms. The government’s policy stance between 1995 and 1999 had been subject to two opposing forces, namely the country’s external financing constraint and political fear of isolation from the EU and OECD and NATO. These pressures arguably pushed economic policy makers in the direction for reform and macroeconomic prudence. But also in this period, the reformists in Romania were balanced out by conservative vested interests, with a strong base in agricultural sector and in the managerial class of the SOEs, the ruling PSDR and CDR respectively, were led to reluctance and foot dragging in privatization large industrial firms and their affiliated banks.

#### *4.4.1. Credible commitment mechanism: how does it work?*

For domestic and foreign economic actors, especially investors, progress in the EU’s pre-accession progress served as a credible commitment device to ongoing and predictable economic reforms (and political reforms esp. pertaining to state regulation of the economy). As Hall and Taylor state, ‘institutions affect action by structuring expectations about what others will do’ (1996). For economic actors, the pre-accession process created expectations that comprehensive economic reforms will proceed apace. Jon Pevehouse provides a good formulation of the credible commitment mechanism in his 2003 assessment of regional organizations. According to Pevehouse, membership can be made conditional upon democratic institutions, which can instantiate a credible commitment on the part of the regime. First, conditionality is credible since regimes would incur significant political and economic costs by joining these organizations, then violation of these conditions would risk

total exclusion, so the reversals from democracy would be costly to winners. Secondly, memberships also provide a public and highly visible external validation to new regime which legitimizes it in the eyes of the citizens, making their support of anti- system actors less likely (2003; 37).<sup>36</sup>

In the 1997 Opinions, in the area of structural reforms, Romanian government was told 'to privatize two banks'; as opposed much more loose terms for Slovakia ('make progress in the structural reforms. '). EU Commission also brought the transformation of the *regie autonome*<sup>37</sup> into the commercial companies, again there is no indication in the 1997 Opinion on the progress of Romanian reforms, that there is any directions for the ownership and regulatory make up of the commercial companies that the *regie autonome* needed to be transformed into. Thirdly, Romania government was told to implement foreign investment regime. More importantly, Romanian government was told to restructure- slash- privatize a number of large and state owned industrial and agricultural companies. Lastly, the Commission advised Romanian government to implement agreements with international institutions, pointing to the mini crisis of stand-by agreement with the IMF.

The period between 1996 and 1999 was characterized by the second transformational recession by OECD (2001 Report). Following the elections of 1996, the new government led by the CDR was faced with strong pressures both from the domestic economic situation and IMF and WB (halting their financial support at the end of the calendar year of 1996), to catch

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<sup>36</sup> The external legitimation of a new set of actors would be especially critical with respect to the AKP reformers in the Turkish accession story.

<sup>37</sup> The *regie autonome*, included large 'strategic' enterprises, and public utilities, representing 20% of employment in the economy, have not been included in the privatization program of 1998 and remained largely unstructured until 2000-2001.

up with the implementation of structural reforms at a rapid pace. After res-establishing dialogue with the IMF and WB, the new government negotiated a package of financial assistance in early 1997, committing to a shock therapy program of both macroeconomic and institutional reform (OECD 1998 Report). A broad package of legislation were put forward to be adopted, where early priorities were given to liberalize prices under control of the state (energy, agricultural inputs and public services); allow exchange rate to be market driven, remove subsidies and phase out directed credits to agricultural sector. The major loss making state owned enterprises would be liquidated and privatized in early 1998. The government was also recommended by both IMF and OECD<sup>38</sup> (1998 report) to adopt a foreign Investment Law, which eliminated restrictions on repatriation of earnings, guarantees free transfers of foreign currency for the purchase and sale of assets, and foreign nationals were granted the right to buy land. The banking sector seemed to be dominated by 4 large state owned banks (BANCOREX and Banca Agricola in particular), were heavily burdened by non-performing loans, mainly a legacy of the pre-1997 policy of lending low interest credits to energy and agricultural sectors. By mid- 1997 over half of the banks credits were in the doubtful or loss categories, the banks were charging wide margins, demanding high collaterals and generally willing only to lend to large and well-established clients. The government announced large restructuring packages for the two most problematic banks noted above with the urgings of the IMF and the EU 1997 Opinions.

The coalition approach of the IMF, evidenced in the oft repeated creed: ‘helping countries to help themselves through coalition with reform oriented core groups,’ was adopted also by the EU. 1997 EU Opinions set a very pessimistic tone for the Romanian economy and political

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<sup>38</sup> Romania as of date is not a member of the OECD.

institutions.<sup>39</sup> Yet, no demarches were used in the case of Romania during this period. When compared the demarche functions in Slovakia and the comparable conditions falling behind the economic and political criteria, Romanian coalition government managed to avoid getting any demarches or critical warnings. The 1997-1998 period was presented by the EU as a good window of opportunity to put its house in order, and the incremental improvements were seen by the OECD and IMF as: ‘important opportunities to improve market discipline and competition in the sector and the supervisory regime of the National Bank of Romania.’ (OECD 1998, p. 10)

1998 took a bad turn: FDI inflow which recorded highest levels in 1997 fell to lowest since 1993. The National Bank of Romania was forced to finance the current account deficit by running down its foreign exchange reserves and increasing foreign borrowing. This came after the failure of the government to meet its targets for accelerating the privatization of large and medium sized state enterprises, the privatization of state owned banks and restructuring of loss making public utilities, the ‘regie autonome.’

The complicated reduction of the budget deficit resulted in renewed conflict with the IMF. The IMF stated that Romania made visible progress in structural reforms as a major condition for the agreement of a new stand-by agreement (1999). This promise and signal was essential for Romania to get the much needed access to World Bank credits, the EU’s balance of payment support and credits from private financial institutions. Romania’s limited progress with economic and structural reforms in particular, was highlighted in the report of the EU

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<sup>39</sup> 1997 Opinions included the violation of Hungarian and Roma minority rights violations as reported by Freedom House *Nations in Transit* report, and the weakness of judiciary and independent media as the most frequently criticized aspect of political reforms, and slow privatization and structural reforms.

Commission in November 1998. The report concluded that ‘Romania made little progress in the creation of market economy’ and ‘the capacity to cope with the competitive pressures and market forces had worsened.’

Vachudova assessing the EU conditionality on Romania’s political reforms (2001) stated that, with its re-rapprochement to NATO and EU, and continuing public relations campaigns at home and abroad, Constantinescu government had transformed Romania by establishing an open arena for political competition, bolstering the rule of law, by promoting ethnic tolerance and by anchoring Romania very firmly to a Western foreign policy. We would support this assessment of Romania’s ‘turn-around.’ We argued that through the further involving in the coalition, Romanian reformers ‘bound’ their own hands, as well as the hands of the consecutive governments, i.e. making the second Iliescu government space for maneuver smaller and preempting a stricter monitoring and gate keeping function from the EU Commission.

By 2000, Romania had already signed the Accession Partnership, and the government, formed under the leadership of Adrian Nastase had to continue with structural reforms and privatization programs. With the backing of the IMF and EBRD for the PDSR’s reformist wing and Nastase boosted the credible commitment of the government to continue with the privatization of state owned banks, shutting down inefficient enterprises and attracting FDI. By 2001, the economy was already turning to positive growth after the 1997-1999 period of recession.

‘What should the EU done differently between 1997 and 1999?,’ asks Vachudova (2005). Her answer is spending more aid money and technical assistance and training to civil society leaders. However, Romania was the largest recipient of advice and twinning program aid between 1998 and 2000 amongst all the candidate countries in public finance reform and the third biggest recipient in the area of Justice and Home Affairs (European Commission Strategy Paper, 8 November 2000). So the answer does not lay as much in increasing EU aid, but perhaps through reinforcing EU’s credible commitment by coupling it with commitment to other international or regional organizations.

In line with further integration into the international coalition, Romania followed an extremely active Atlanticist stance in this ensuing period. We can conjecture that the timing of the Kosovo War and the Iraq War of 2003 were critical for Romania to assert herself firmly in the Transatlantic camp and perhaps later reaping the benefits of such a position in negotiating with the EU towards getting an accession date ( author’s interview with the European Commission DG RELEX senior policy adviser)

Relations with neighboring Hungary also improved by signing a Romanian- Hungarian conciliation treaty in hopes of improving chances for NATO membership. Romania was rejected previously in the 1997 Madrid Summit, but was explicitly recognized as future member for its stabilizing influence in the Western Balkans, following a consolation visit by President Clinton. However, after fully supporting NATO’s actions in operations in Bosnia and Kosovo, opening over-flights to NATO and denying those to Russia during the Kosovo crisis. Despite lack of popularity of these decisions, NATO membership remained popular. Romania’s Euro- Atlantic relations (Light and Phinnemore 2001) improved drastically when



the Romania supported anti- Milosevic humanitarian intervention. Romania expected and received a bid to join in 2002 Prague summit. In the case of the Iraq war, conflicts between foreign policy interests emerged between the support for US and support for EU members. It is notably that although Copenhagen criteria expected full support of the Common Foreign and Security Policy, the EU did exert neither compliance pressure, nor conflicting security responsibilities on this capacity-poor country. According to Linden (2004, p. 48), the war in Iraq changed it all, as the overlap between NATO and EU's CSFP goals started to dissolve. Romania (and Bulgaria), in the EU queue, expected Washington to ask for logistical and troop support.<sup>40</sup> Shortly after, Romanian government agreed to send troops first to Afghanistan, then to Iraq. Although resisted by the EU, it can be argued that Romania's Atlanticist stance strengthened its chances with NATO and later on with the EU.

Despite the criticisms of the Commission (European Commission Regular Report, 2002), for Romanian foreign policy stance, the costs were relatively low for Romanian government for guiding an Atlanticist stance even domestically, as the parliamentary opposition was divided. Both NATO and EU membership entailed an anchoring of policies to the goal of (re)integration to Europe. A contrasting foreign policy dilemma would be observed vis-à-vis Turkey's relations with the EU and US on the eve of 1999 Helsinki Summit to include Turkey as official candidate and during the 2005 and 2006 negotiations to open accession negotiations.

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<sup>40</sup> This was epitomized by Romanian government signing on a special deal exempting US military personnel from prosecution (referring to the ASPA- American Service members Protection Act passed in the US Congress, prohibiting cooperation with the ICC).

The 2000 elections in Romania returned Iliescu to presidency and his party the PDSR a comfortable majority in the parliament. The ineffectiveness, gridlock and corruption scandals of the CDR-led government caused the success of Iliescu, as the Romanian voters according to public opinions polls were not exactly voting for PDSR, but against CDR government. Installed back into power, Iliescu and the PDSR have behaved quite differently than during their previous 7 years tenure. The tying of hands continued in the 2000- 2004 period with Iliescu and his PM Nastase. Enmeshed and anchored in the EU's accession process, they had to continue with the reforms of the state and the economy now more directly stipulated by the Romania's Accession Partnership and the Accession Negotiations were due to start in March 2000. The government formed by Adrian Nastase from the PDSR's reformist wing, was praised by the World Bank, the EBRD as well as the EU Commission for tackling stalled structural reforms and privatization. The government has made important progress in privatizing state owned banks, shutting down inefficient enterprises and attracting foreign investment. The upward turn can be evidenced in the EBRD's Transition indicators, and upward trend leading to 2000, while there is not much change in small privatization indicators, but significant gaining of ground in large scale privatizations in Romania (see Table 4 in Appendix 2) After 2000, the economy returned to positive growth after the long recession from 1997 to 1999 in part thanks to these policies. More strikingly, PDSR also abandoned its use of ethnic nationalism, and nationalist appeals in its 2000 campaign, had been cooperated with the UDMR (major Hungarian umbrella party) on legislation to improve the status of ethnic minorities (these are duly acknowledged as steps in the right direction by the European Commission Regular Reports, 2001 and 2002). By working with the Iliescu government and giving Romania target dates for opening negotiations at first place and a timetable for end of negotiations and signing of accession treaty, the EU conferred the legitimacy of the Iliescu government.

Until 2000, privatization was slow and inefficient. Failure to privatize large scale enterprises led to increasing of inequalities between economic sectors (while trade and services developed agriculture and industry remained behind) and social inequalities. Mistakes in legal design and concessions made to protect political interests or to avoid social violence have also contributed to failure of ambitious programs of reform advertised by short-lived governments. The period between 1997 and 2000 was also marked by a lack of experience in basic administrative and political structures. But most importantly, was the lack of coordination between privatization reform and other elements of reform such as competition policy, governance and enterprise restructuring and securities markets and non-bank financial institutions, as well as banking reform and interest rate liberalization.

Could political instability (fractious coalitions prior to 2004) explain partly the lack of continuity in privatization reforms and restructuring efforts in the previous phase of reform on one hand, and formal implementation of judicial and administrative reforms on the other? Short lived governments were unable to implement and continue long term effect economic reform programs. As OECD's reports pointed out (2001 and 2006), implantation of a comprehensive policy package (consisting of macroeconomic stabilization coupled with restructuring of the financial and enterprise sectors, creating an environment favoring the expansion of new private businesses) failed to take off because of lack of policy coordination units, leaving decision making fragmented.<sup>41</sup>

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<sup>41</sup> These factors could also be traced in the privatization story told by Verdery. The real interest rates (the bank interest rates) influenced by the IMF stabilization program forced new owners of land and directors of State Farms to fall behind in paying back their loans. The three digit inflation in this period make many farmers incur high losses to a point that they are not able to afford the seeds, the fertilizers and other production factors to cultivate the land, meanwhile the bank loans were more difficult to obtain. It was more expensive to cultivate

#### *4.4.2. Policy response to credible commitment coalition: privatization reforms between 1999 and 2002*

In 1999, delays in large scale privatization were due to over bureaucracy and political in-fighting of the Ciorbea government. By June 1998, only US\$700 million was raised against 2.1 US\$ billion planned by the State Ownership Fund (SOF) and ended with the resignation of privatization minister and the SOF chief. The new chief quickened the pace of privatization, as close to 1000 companies were privatized in the first four months of 1999. The Ciorbea government also started the privatization of ‘crown jewels, such as Romtel and the Postal service privatization. Renault bought majority stake in Dacia (promised to invest 220 million in to Dacia operations). A new privatization law was passed in 1999 which envisioned streamlining privatization; which enabled ministries to sell firms directly instead of going through the SOF. Another new legislation was adopted for international valuing of state owned enterprises. The government required to provide more information on the existing liabilities, furthermore the government was provided with ability to indemnify buyers against undisclosed liabilities. New methods for privatization were put into practice, such as liquidation, sale of properties and assets of SOEs and the ‘regie autonome.’ (for more details on methods of privatization, see Table 5 in Appendix 3) Another policy change was that the government changed legislation to allow restituted land to be sold in 1999 government approved sale of 480 state farms.

The IMF reported in its annual report that that plans for privatization of large scale and closing of loss making SOEs and state owned banks were behind schedule. The IMF and

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crops than to buy them on the market. Thus bigger proportions of new land owners had to live their lands uncultivated which devalued their land.

government jointly prepared 1999 budget, and passed it in record time. The finance ministry recognized 150 loss making SOEs', 49 of them, sold off; 47 of them liquidated, and the rest was scheduled to be restructured. 140 mines were closed off in 1999. In 1998 and 1999, dramatic improvement in bank privatization took place, 51% stake of Romania Development bank was sold to Societe Generale, in April and the 45% of stake in Banc Post was bought by GE international holdings and Banco Portugese de Investimento. Bancorex (being the soft lending champ) was scheduled to be liquidated in 1999, with reporting from the NBR that by end of 2000 half of banking sector will be foreign owned (Nations in Transition 1999).

The center right coalition of Democratic Convention tried with limited success to make progress in the bank privatization or to create a properly functioning and regulated financial system capable of channeling savings into productive investments and providing security for population's savings. Both the IMF and the European Commission produced damning reports on the progress of reform. The government formed following the elections of 2000 (2001-4) seems to be much more committed to macroeconomic stabilization, implementing tight macroeconomic policies and imposing financial discipline on enterprises. The government in 2001 signaled its commitment to stabilization and structural reform, by concluding an 18 month stand-by agreement with the IMF program, whose main points included a progressive reduction in the consolidated annual budget deficit, measures to address the poor financial situation of the state owned enterprises and utilities, eliminate losses in the energy sector and finally strengthening the regulatory framework and supervision in the financial sector. OECD reports also gave positive but largely cautionary signals to the more sober and coordinated efforts of restructuring by the new Iliescu government in the 2002 its report. It underlines that progress has been reached in financial sector reform through privatization, liquidation and

restructuring of large state owned banks, promise finalization of the privatization of the large bank *Banca Commerciela Romana* by early 2003.

2000 started with rumors of cash shortages in BCR and Bancorex , followed by the NBR stepping in to prevent their collapse. Pressure was set high for speeding up privatization; regulate taxation; control inflation and lower unemployment and which would add to strains on society. The Government and local governments increased efforts to limit shadow economy.<sup>42</sup> In 2001, international institutions and the EU increased efforts to push PSD (formerly PDSR through merger with the smaller Social Democratic Party of Romania) government to accelerate privatization. The EU initiated RICOP program for the preparedness of companies in view of privatization. The WB's private sector adjustment fund loaned the government money to restructure 62 large, 1500 medium and small firms and also to liquidate one large bank, BANCOREX. The PSALII agreement (includes 300 million euros to help the privatization efforts of close to 20 companies) remained under negotiations with the IMF, although a second line of IMF credit was postponed. Romania remained 'laggard in liberalization, privatization and restructuring' according to the IMF as 25% of industry is owned by investment funds and political clientalism ran rampant in management of these funds.

A much anticipated restitution law (Law 10/2001) passed in the parliament, even though the religious communities' and minority communities' properties and agricultural and forestry land could not be claimed under this law, the deadline for the agricultural claims had already

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<sup>42</sup> Basescu (the popular mayor of Bucharest, later to be elected as president of the country) was becoming famous for his aggressive stance for black market, i.e. removal of kiosks from centre of Bucharest; which led to violent clashed in the city centre between the police and the kiosk owners.

passed). The process of land restitution was deemed to be confused and hurried. (Verdery 2003) The restitution of church property, (i.e. the Greek Catholic Church remained in limbo, and when the minority community leaders (the Reform Church of Hungary and German minority church) reportedly appealed to the Commission for advice and help, but the Commission expressed that land rights were not in the competencies of the Commission, and recommended that they take their claims up with ECHR if they could prove that there is a violation of ethnic minority rights.

Decentralization policies throughout the accession process did not seem to work effectively, as the co habitation between the mayor and local county majority did not work, so local government operations could often become paralyzed. The practices by local councils (as in the case of Bucharest) of stripping the mayor who was politically elected and is political accountable, of his responsibilities such as the managing and privatization of local assets and contracting public services epitomized the aforementioned diagnosis. This was coupled by lack of measures to ensure the accountability of the prefects. Centralist tendencies and failed local government and decentralization reforms were witnessed and the influence of strengthening local governments and subsidiarity of the EU accession process did not work as effectively as expected. Rural communities which have been most in need, suffer from the erratic distribution of funds, and the most important skill of the rural mayors become the ability to negotiate with the county council to secure the highest possible allocation.

A new standby agreement was with IMF in October of 2001. The government's commitment to the IMF program overlapped with the recommendations from the Commission word by word, (i.e. continuation with privatization of BCR, elimination electricity subsidies, reduce

number of civil service and public administration, and lower ceiling on budget deficit). It was observed by the OECD (2002) that debts of public companies amounted to 50% of the GDP and was thus putting undue pressure to macroeconomic stabilization program. The constitutional ambiguity on property rights continued, in particular, restitution law was very problematic as the 'illicit' sales in 90's were legalized by the Romanian parliamentary efforts, compensation for claims were under the mercy of cash poor local administrations. Bucharest mayor and prefect fought one another on restitution of buildings repeatedly, and privatization of utilities were highly pronounced in EU accession negotiations during 2001, continuing in 2002.

In 2002, restitution remained an unresolved issue, and state engaged in selling property to existing tenants; as compensation state offers to former owners shares in bankrupt SOEs. Privatization accelerated in 2002, but APAPS, the main privatization agency's agenda remain unfinished especially in the energy sector. APAPS managed to get rid of 90% of the state owned enterprises in its portfolio, having sold 416 of them and held voluntary stakes in 355 companies under voluntary liquidation, judicial reorganization and bankruptcy procedures. In relation to actual transactions, the legal framework for a market economy continued to improve, but vis-à-vis the enforcement of property rights, government aimed to improve investor climate by further cutting red tape and by establishing Romanian Agency for Foreign Investment and ensuring greater stability of the tax code.

Arguably, the progress in Romania's privatization due to the increased foreign interest in the Romanian firms was underpinned by the prospect of accession to the EU, and by increasing integration to the EU markets. At the end of 2004, Romania provisionally closed 27 of the 31



acquis chapters. The Romanian government increased its credibility for the continuity of privatization and regulatory reforms with the positive signals from the Commission, the Council, the IMF and WB. The latter two remained more critical in 2003. The two IFI's in various reports pertaining to 2003, maintained that, while most small and medium sized enterprises has been privatized, the restructuring and privatization of several large state owned enterprises and utilities was running behind the schedule. The OECD in its investment report for Romania assessing the period of 2003 and 2004, remained optimistically cautious, stating that Romania still faces considerable challenges in completing its structural and institutional governance reforms. The report stated that one of the major obstacles against successful structural reform remain administrative barriers, inflexibility of the labor market, burdensome tax administration and a weak judiciary and widespread corruption. Privatization revenues saw another jump (first one being 1997 and 1998), in these two years, where the major sales in the regie autonome and the energy sector were started in 2003 and were completed in 2004.

The privatization of large state owned enterprises accelerated in the first half of 2004, with several important sales in the energy sector. The Authority for Privatization and Management of State Owned Enterprises sold about 190 companies between September 2003 and May 2004. During April it was merged with AVAB, the authority responsible for the recovery of banking assets and the new entity was called AVAS. In July 2004, Romanian authorities and Austria's OMV AG signed the country's single-largest privatization transaction to date, purchasing 33.3% stake in the national oil and gas company SNP Petrom SA.

#### *4.4.3. Credible commitment: a coalition approach*

There was a widespread perception for the students of transition in the CEE that the EU was not having much of an impact on fundamental parts of the transition process such as privatization and budgetary consolidation, in comparison with the IFIs, principally the WB and the IMF. The ‘coalition approach’ as described by Jacoby (2006) emphasizes how outsiders can help insider minorities by providing material and intellectual resources, or by simply lengthening time horizons such that they are willing to trade off short term benefits for long term benefits that may flow from better policies.<sup>43</sup> In the case of EU conditionality, the insider minority were a core executive of reformers within in economic agencies, esp. in the National Bank and privatization agencies. This tendency was supported by the technocratic nature of EU enlargement process as discussed by Grabbe (2006).

More specific and wide ranging agenda by the Accession Partnerships and closer conditionality of EU financing on these objectives changed the situation from 1998 onwards increased the EU’s influence on the process of institutional and policy reform in the CEE. IN contrast to the CEE applicants that started negotiations earlier in 1998, the IFI’s role were diminishing at the same time as the EU’s role was growing (Grabbe, 2004; 23). The EU strongly promoted the development of social dialogue among government, business and labor actors. Secondly, by insisting on reforms such as bank privatization, bankruptcy laws, restructuring of state aids and transparent procedures for enterprise privatization, EU requirements helped reduce (but certainly not eliminate) opportunities of economic rent seeking. The EU’s accession process served as a ‘commitment device’ for domestic and

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<sup>43</sup> The role of external actors in lengthening time horizons in favour of long term benefits, is line with Elster’s (2000) , Pierson’s (2003) and North and Weingast’s (1989) explanations of the self binding that political actors choose to practice. Pierson summarises that credible commitment approach, as the actors can often do better in the short run as well as the long run if they remove certain options from their future menu. The

foreign economic actors, especially to foreign investors, for the continuity and predictability of economic reforms. Once the candidate was on the way of joining the EU, the costs of losing ground and reversing the course became more prohibitive, thus the hands of reformers were sufficiently ‘bound.’

IFIs, however, had much more limited policy aims such as macroeconomic stabilization and development than the EU, and IFI policies generally restrained the redistributive functions of states (Fabry and Zenghi, 2006), but that were not so concerned with regulatory functions. By contrast, the EU had a clear prioritizing of the regulatory functions and the establishment of regulatory institutions. During the 1998-2002 negotiation periods, the Regular Reports from the EU clarified several points in how Romania was making little progress and its economy was getting worse. Romanian government was told specifically to reform its state childcare institutions and improve macroeconomic situation. The specificity of some observations and suggestions in contrast with others are noteworthy. Romania was making little progress but the Commission found it that the government was still promising. Moreover, Romanian opposition parties looked even worse in the eyes of the EU member states who chose not to isolate the incumbent government in Romania internally and externally with the strict use of the gate keeping (Grabbe 2006; 18-19). With Bulgaria between 2000-2002 the negotiations were repeatedly slowed down by holdups over the free movement of persons and the allocation of regional funds, but this was not so much the case for Romania.

The involvement of the OECD in monitoring and providing credibility and expertise to government programs was noteworthy. OECD was behind the ‘the Regulatory Governance Initiative’ (RGI) which was a framework agreement for international co-operation among 40

countries, organizations and regional groupings in order to develop a shared strategy for ensuring stability and growth in the countries of South East Europe (SEE). The Steering Group on regulatory governance which kicked off in Vienna in 2003 and agreed that on a ministerial Statement in which they recognized "the importance of achieving further significant progress in the areas of regulatory reform, public and private governance, and combating corruption more effectively' (OECD website).

More significantly, the EU required the establishing of sectoral regulators with its harmonization laws which were often a precondition for obtaining World Bank Structural Adjustment loans. The role of the IMF in complying with the economic and regulatory standards of the European Union was instrumental. The Romanian government negotiated a loan of 370US\$ million, which provided a close monitoring of key reform targets over the last two years until 2006. The agreement also included the acceleration of the privatization program in the energy sector, including the 51% of stake in the integrated state oil company of Petrom, and the sale of remaining state owned gas and electricity distributors. The government also consolidated budget deficit of 11% of GDP in 2004, and managed to shift the monetary policy away from the exchange rate targeting towards inflation targeting, largely contributing to meet the requirements of the EU accession in 2007.

In the early period of reform characterized by the SLIP agenda, Romania seemed to have lost precious time, due to excessive interference of political considerations in the economic realm. This political interference with the privatization process had often resulted in inconsistent reform programs being proposed and adopted, and in populist policies adopted to be later abandoned in the face of the pressure from IFIs. With respect to governance of privatization

reform, we observed that the state regulatory agencies' responsibilities were not clearly delineated. Even though the main agency, SOF, forbidden from making any payments to state and local budgets, aimed at more the independence of enterprises from founding ministries, the budget constrains the SOF operated under could not be classified as 'hard,' with the privatization law in its unrevised format stipulated that any remaining obligations of the SOF upon its liquidation are to be assumed by the state budget. Also with respect to the appointment or election of cadres of the SOF and POF council members, political considerations were abounding. Although they were supposed to be chosen among persons of commercial, industrial, legal and financial expertise,' the fund managers were appointed by the state, so there was high probability that the fund managers would behave like their predecessor bureaucratic rent-seekers rather than competitive profit maximizers. (Stan 1995, 431)

The credible commitment 'coalition' among the IFI's, OECD and the EU have limitations, as it is deemed only to succeed if the international institutions are credible and can find support in at least a core executive group of reformers who also have the support of the wider public and are accountable to them (Stone 2002). Johnson showed in her work on CEE central banks, EU accession process established the reform 'tunnels' in which expertise, templates and models were shared, and where a core group of actors internalized modes of behavior conducive to EU style institutional convergence (2002 and 2006). Csaba also explained that ensuring the independence of central banks, sustaining the independence of the competition agency have shown significant influence of European screening process (2004, p. 11), imparting political difficult institutional arrangement a credibility. Without the voluntary groups, the coalition approach would not bear fruit. However, without the credible commitment from the IFIs and more importantly from the EU, the Romanian agencies within

the ministerial apparatus and within the new autonomous agencies, would not have found the necessary anchor for continuing the momentum of privatization reforms and political will for passing complementary regulatory legislation.

Fluctuation in the trajectory of reforms was stronger than in the case of Slovakia. Vachudova in her coherent but less detailed analysis, is quick to classify Romania's reform for EU accession, 'as minimal reforms done to please the international community, with no basis for real and internalized agendas of Romanian political parties and interest groups.' (2005, p. 215). She adds that perhaps active leverage can only do so much in this case (Ibid, 216).

What her analysis misses out is the fluctuations on the credibility of conditionality. A comparison of the 1997 Luxembourg and 2002 Copenhagen decision could reveal much of the change in effectiveness of credible commitment device. The decisions of the Luxembourg Council divided applicant countries in two groups- frontrunners and laggards- and thus raised the stakes of 'being left out.' (Csaba, 2005) The individual treatment of the applicants and the intensive competition for EU membership appreciated EU's bargaining power vis-à-vis the applicants, and thus has triggered controversial but necessary decisions over structural reforms. However, in the case of Romanian accession, the decision of affirming an exact date on accession have lost EU dear credibility and changing the nature of commitment from bilateral to unilateral. In deciding against postponing accession until 2008 in order not to discourage reformers in Bucharest, the EU remained committed to accede Romania to the EU no matter what.

The EU's active leverage has helped to inspire reform of the judiciary, civil service and other arms of state administration where political inertia might otherwise block reform in accession

countries. Some reforms of the state turned out to be inconvenient for all political parties elected to political office, given the short time horizons of sitting government and due to the lack of clarity in political rewards. The future rewards were not enough to make incumbents give up existing perks of holding office. The Regular reports by the Commission created a metric for good performance, especially the procedure for closing of individual negotiating chapters were relatively simple and transparent. Conditionality mechanism had been watered down for bureaucratic efficiency, and holding parallel negotiations with other acceding states with the same time frame increased competition.

#### **4.5. EU's Transformative conditionality**

##### *4.5.1. How does it work?*

Romania (along with Bulgaria) made considerable efforts with strong acceleration in 2005 and 2006. There was across-the-board political consensus for EU accession, on the need to bring the politico-administrative system in line with the EU accession criteria (OECD 2006). How did the EU accession process transform the political and institutional environment? Such transformation would mean transfer of power to a new constituent group who would benefit from reforms against strong resistance from the old elite with new names clinging to authority.

The EU's accession conditionality was transformative, in changing the nature and the relative strengths of the different interest groups in society. This transformative component of the process empowered domestic groups in two stages. First, pressure from Brussels acted as a temporary surrogate for pressure from private groups promoting reforms that were in the interest of the public and the state, but rarely in the interest of the bureaucracy or governing

elites. These reforms however, and with time, attracted the interest of certain civic groups. The EU actively encouraged politically oriented pro-reform groups through financial and other assistance to take up the cause of democracy's watchdog in the candidate states at large and in Romania. Meanwhile, market access improved for the candidates, the EU created opportunities for producers and entrepreneurs to depend on the EU market and future membership. Vachudova establishes effectively such a causal link between market access and access of export oriented interest groups to policy circles pressuring for EU compatible reforms of the state administration (2005, 185-188).

At the second stage, external transparency demanded by the EU's accession process helped foster greater domestic transparency that facilitated the work of pro-reform groups. With so much information on government policies provided by the EU, the information environment has changed. This had a particular impact on reforms of state structures, the EU demanded for a modernized judiciary trained in European law and an independent, professional civil service inspired important public debates about 'European standards' in these areas, meanwhile the perspective of EU membership and possibility of working as part of career in Brussels managed to attract some qualified professionals to state administration, rather than the private sector.

The lagging in judicial, administrative and civil service reform, could be explained by the threat faced by the power base of the ruling party in Romania until 2002. The SPD in government had very strong central-local connections with the local councils and prefects which blocked reform. It repeatedly preferred to fill the state bureaucracy with its own supporters rather than crafting and supervising de-politicization. Most controversially for



Romania and other laggard cases was the reorganizing or creating from scratch, a regional level of government as required by the *acquis*, negotiating a fit for the existing system of distributing monies from the EU's regional funds.

#### *4.5.2. Transformative conditionality and political accountability:*

The vigor of the civic debate about the legacy of Romania's communist and post-communist institutional capacity; in particular about the inefficiencies in the functioning of courts in Romania and of corruption and political cronyism in judiciary and administrative functioning in the country was remarkable to put extensive pressure on the government. In their assessment of EU influence on administrative reform in Romania, Hintea et. al. explained that EU conditionality has been the only pressure pushing towards the creation of coherent strategic documents. (2004) In the view of this case study, this is somewhat a single dimensional assessment of the nature of the EU influence. It dismisses the affect of domestic reform groups in the outcome. This section would argue that the transformative aspect better capture the interface between domestic and external pressure for change.

The political salience of laggard performance in administrative reform within the framework of EU accession increased with time. From the elections of 1996 to 2000 and onward to 2004, the issues of European integration and attachment to European values increased their share in the political and civil debate. Any performance lag started to be reported in the local and international NGO publications, while reports from international institutions were increasingly followed and reported in the Romanian press.<sup>44</sup> As public support in Romania for

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<sup>44</sup> The EU monitoring program's country reports by the Open Society Institute and Freedom House's detailed annual reports are two among these.

EU integration remained highest in the region according to both the 2004 and 2005 Eurobarometers, the opposition groups continued to attack government policies for being just a ‘façade’, accusing the government of promoting different policies at home then from outside the country<sup>45</sup>. Administrative and judicial weaknesses and the accountability gap in particular remained according to 2004 MEP Baroness Nicholson’s report, which found a receptive audience in Romania, and quoted by several NGOs active in administrative and civil service accountability.

The Romanian Legislation on Free Access to Information, proved to be an important device for improving political accountability, according to the Freedom House report *Nations in Transit*<sup>46</sup>. Both NGOs and media resorted successfully to this legislation, to obtain important information in the public interest. However, most electronic media continued to be controlled by the vested interests, and the provincial print press captures by a small financial oligarchy. The public media remained biased in favor of the government. Also the advertising internal regulation signed by the secretary general of the government, revealed by a national daily, that all ministries and central administration authorities including the companies under the state authority, could sign advertising contracts only under the approval of the PM.

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<sup>45</sup> The Law of Status of the civil servant was adopted under significant and consistent pressure from the EU Commission, and brought forth positive development for the delineation of duties of political figures and professional career civil servants. The macro strategy as policy response by Romanian government became most pronounced in 2003; new measures such as Law 161/2003 concerning the declaring of personal property and assets of political leasers, law concerning the free access to public information and the Law 52/ 2003 concerning transparency in decision making processes in public administration were announced, but after they were voted, they failed to produce the intended outcome of reducing corruption. The new legislation introducing an action of administrative judicial review concerning power abuse of local authorities (allowing citizens to take action for the annulment of local council decisions) have produced less than positive results, due to the abuse of the politically appointed prefects’ administrative control function.

<sup>46</sup> More detail on the assessment of this report can be found in Table 5 of the Appendix 2.

Considering that Romania continued to have the largest state sector in all accession countries, public enterprise ads accounted for a significant share of advertising. In addition, the government continued to tolerate the accumulation of significant tax arrears by a number of large media corporations, as reported by the European Commission Regular Report 2004. So stations had to be on good terms with the government to get favorable terms in the settlement of these debts. However, in June of 2004, the legislation seemed to follow the lead taken by the civil society. The criminal code was amended to repeal the crime of ‘insult’ removing the possibility of a prison sentence for slander of political and public figures, and aligning with the requirements on the burden of proof with those of the European Court of Human Rights (*Nations in Transit* 2005).<sup>47</sup>

There was a paradoxical situation in the case of the judiciary reform under EU influence. Majority of cases overloading the courts were and still are due to the confusing property rights restitution. Verdery’s accounts of the numerous court cases that the newly propertied smallholders brought against their neighbors (2003) were confirmed in the Freedom House records of the overload of the judiciary. The Romanian Government lost significant cases in Strasbourg about restitution in 2004, the EHRC overturned ‘extraordinary appeals’ that the government had made against the owners. The acquis chapter about JHA duly was closed with several conditions relating to the judiciary, if left unfulfilled, it was deemed to delay formal accession. National anti-corruption strategy formulated in 2002, was not effectively implemented as the ruling SDP insisted on pursuing the politicization of the appointments to administrative and executive positions. While most of the administrative funds were in the

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<sup>47</sup> This ‘insult’ to state and civil servants legislation is an equivalent of the infamous article 301 of the Turkish constitution, which remains a major bottleneck in compliance of Turkey, as will be discussed in greater detail in the following chapter.

hands of one party in the service of the political clientele, the infrastructure funds went mostly to the counties of the transportation minister and the deputy minister.

According to the report of the *Nations in Transit Report* by the Freedom House (2004), the EU Commission remained the chief promoter of judiciary reform, as the political will from the government remained insufficient in 2004, however, the account in this chapter tried to show civil society followed very closely what the developments and increased their critical voices. One such case is especially important in confirming the above diagnosis. The government tried to improve the regulatory framework of anticorruption by passing the first code of conduct for civil servants clarifying the conflict of interests, it left the elected and appointed officials out of reach of this code. The SDP repeatedly made underhanded efforts to dissipate the image of SDP as the only corrupt party, by making deals with parliamentary opposition and newspaper editors about leaking corruption evidence of its own cabinet members in exchange for similar allegations about opposition MPs to be leaked. Romanian civil society in 2004, through increased coordination and organizational capacity, leaked transcripts of SDP dominated government meetings about a plan to counteract the NGO movement in Romania. The plan was drawn by SDP nomenklatura to create a counter civil society, with indications given to party faithful to set up parallel non-governmental organizations (NGOs) to copy and combat those with highest profiles. In this context, the Romanian NGOs played an important (and a fairly paradoxical) role in complying with the democratic criteria of the EU, however, and becoming a more prominent and respected public actor.

The NGOs in Romania during this period between 2000 and 2002 were instrumental in improving the information environment in Romania. The Freedom House assessed chronologically how the NGOs initiated anti corruption coalitions with the assistance and advice of international organizations and European organizations (Transparency International amongst others). The chronology of events from 1999 and 2004 (see Table 6 in the Appendix 2) specifies the increased involvement of the civil sector vis-à-vis progress (or lack there of) of Romania in rule of law and anti corruption reforms.

The positive developments on better governance and anti corruption were carried out by newly emerging transnational coalition of domestic civil society, government agencies and international civil society institutions. One of the preliminary conclusion of this section is that the EU accession process was able to initiate a change in the nature and relative strengths of interest and civil society groups, the former one being less developed or/and less pronounced in the case of Romania. The EU changed the informational environment, through its monitoring coalition with OECD and international and domestic non- governmental organizations.

#### **4.6. Conclusions**

The case study produced several preliminary conclusions for assessing EU's direct influence mechanisms. From the EU's direct conditionality, *benchmarking and monitoring tool* has been moderately successful in communicating areas of progress and stalemate to the Romanian reformers. At the same time, the EU utilized the resources of international NGOs such as the Freedom House and the Open Society Institute, and engaged in coordination of monitoring and reporting efforts with international organizations such as the IMF and OECD.

The goals set in the regular reports were often vague and general and the candidates were asked to prepare national strategies in a particular area, with no further details on what it should contain and what institutions should be involved. The diffuseness of punishment for non-compliance, and lack of concrete measures in assessing progress by the Commission were criticized by many students of conditionality to hamper the effect of EU on reforms. More detailed guidance came from a range of EU actors, i.e. the Council, the Parliament, the EU member states' institutions. The benchmarking tool was not perfected but the learning curve was steep. Learning happened both from the experiences of the (former) new member countries strategies and the expertise and involvement from the EU-15 by utilization of *the advice and twining tool* (OECD 2006).

The less useful tool in the area of privatization in particular was *provision of models and templates*. Often the Commission used vague parameters for recommendation for plans in restructuring and privatization. In the May of 2000, the Commission Working Document entitled, 'main administrative structures required for implementing the acquis,' was referenced by the National Bank of Romania, though not circulated widely in the policy circles in Romania. This document described the institutions required for implementing the acquis. *The aid and technical assistance tool* seemed to have more effect during the latter years of the accession process, but multifaceted problems in implementation of PHARE and SAPARD programs (deficiency in planning level and lack of administrative capacity) were often reported in the assessments of the EU and other independent assessments. Most of the *twining* projects took place in the area of public finance. The Romanian government audits and EU's own reporting agencies, as well as academic assessments of the frequency and efficiency of these exercises, suggest that this mechanism has been fairly effective in both the transfer of best practices and the diffusion of norms through the bureaucratic and civil service

circles. Finally, as we argued above, *the gate keeping tool* had a patchy record in case of Romania. The internal political agendas of the EU as well as the decisive Trans-Atlanticist stance of Romanian foreign policy won the day, defeated more cautious approach to Romanian accession (i.e. the possibility of a delay of the accession)

We conclude that the credible commitment device of the EU were used effectively but The policy transfer had a degree of locking in, but for the students of credible commitment, made it hard to differentiate whether the process was voluntary or coercive (as argued by the most rationalist explanations of external pressure). Would policy transfer from the EU to Romania have taken place without EU having imposed accession conditions? It is a preliminary conclusion this chapter that the policy transfer process had a more voluntary rather than coercive nature. Romanian policy makers (similarly but perhaps more desperately than their Slovak counterparts) were looking for models in a particular policy area and decided to adopt EU models in a particular policy goal of joining the EU. *Nevertheless, it is also difficult to assess where coercion ended and consent began.* We trust that the comparative assessment that follow will more effectively answer this question.

The transformative mechanism of the EU meant two things: first, diffusing norms and forms of behavior (through best practices or values of accountability and transparency perceived as European) and secondly, improving the information environment. This case study did not provided a view of the diverse constellation of actors, some of which were, national civil servants (twinning agents); parliamentarians (under joint committees); trade union officials and employers' organizations (sent by Economic and social committee); commission officials; national experts from the Council and politicians from individual member-states and

civil society activists, but did not identify them individually with the possible exception of Monica Mascovei. The revolving door between the governmental and civil society sectors were epitomized with the Minister of Justice Mascovei, who became the poster child of the Romanian reformer, with zero tolerance for corruption in the judiciary (EIU Country Profile, 2005). Testing the influence of EU in improving the information environment, this case study observed that by 2004, the gap between the Europeanized Romanian legislation and the practice of freedom of information, and press seemed to narrow (Nations in Transit, 2004 and 2005). Structural problems, such as the vested links between media owners and management and the governing party and old nomenklatura (through concentrated ownership and failed privatization deals to foreign media corporations, following scandal) remained to a large extent, but with the emergence of regulatory agencies and constant attention from the NGOs, the conditions were improving according to the consecutive reports of the Freedom House and the Commission.

One major theme emerged from the analysis of accession process was the strengthening of the core executive through continued use of emergency decrees. Government practice of legislating through emergency ordinances, frequently criticized by the EU, continued despite limitations set in the revised 2003 Constitution. A more recent assessment by the Commission (2006) seemed to find a decrease in the use of emergency ordinances. The speed of the adjustment process reinforces the trend of elite technocracy in the EU and the CEE as criticized by Grabbe in her analysis (2006), to produce a technocratic process of law making, which did not improve in transparency from the efforts of the reformers' and EU's interaction under direct conditionality. This case study concludes that the transformative mechanism of the EU accession, may have tried counteract but not lessen this 'unintended' effect.



Lastly, Romanian accession process showed the dynamic or moving target nature of EU conditionality in which emphasis on implementation increased. The consequences of rather formal implementation of judicial reforms, anti corruption legislation and stagnant decentralization efforts continued to raise doubts about the limited efficiency of EU conditionality mechanisms for accession countries, as described by Csaba, ‘scrapping past the finishing line’ (2005). The following chapter on Turkish accession will further put these three mechanisms to the test. Lastly, a comparative chapter will help illuminate how uses of these mechanisms create convergent and divergent policy responses by the three accession countries.

### **5.1. Introduction**

The chapter aims to explain the economic restructuring of Turkey and the surrounding political and regulatory reform in the light of conditionality from the International Financial Institutions (IFI's) and the European Union (EU). The time period under consideration is from 1995 to 2006 with some limited discussion of pre 1995. The rationale behind this time restriction is that in 1995, Turkey signed the Customs Union with the EU which marks the first serious use of EU conditionality. The year 2006 is selected in parallel with the timing of the previous two case studies. 2006 is also crucial for marking the first after the formal start of the accession negotiations, where the analytical examination of the *acquis* ('*acquis screening*') was completed but already in 2006 the EU was being critical of the slowing down of the political reforms in Turkey. The co- linearity of the accession process and restructuring of the Turkish economy leads us to the central question: 'how much did the EU impact reforms in Turkey?'

The economic restructuring in Turkey from early 1990s to 2006 will be divided into different phases for analytical clarity, running parallel with the critical turns in the accession process. To reiterate the main hypothesis of this dissertation: the more credible the EU conditionality tools and mechanisms as perceived by domestic policy makers, the more the domestic actors will comply with criteria, the more they will decide to commit to the continuity of reform and eventually, the further the country will graduate towards accession.

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<sup>48</sup> I thank Prof. Ziya Öniş and Prof. Caner Bakır for their comments and suggestions on the earlier versions of this chapter.

The central puzzle in this case is: how the Islamist oriented and anti- regime political party was turned into the most avid Europeanists and reformers? We will see how the AKP government utilized EU conditionality in order to defeat their opponents in the establishment composed of staunch laicists and clientalist networks handed down from nearly four decades of statist economy. The chapter also tries to solve a second puzzle: why despite the lacking credibility and a definite time frame for full membership, Turkey's policy actors continued to comply with the IMF enforced, EU labeled reform agenda. This utilization of the EU conditionality in our opinion is key to understanding the forces behind the success of restructuring and privatization reforms in the financial sector along with the sale of the 'family silver' of the Turkish economy.<sup>49</sup> Used by the economic actors within state bureaucracy and policy makers, as well as the key business associations in Turkey (Öniş, 2005) as a consensus point, the EU anchor after 1999 tilted the balance of power in favor for the pro-reform actors through the strings of stricter compliance with Copenhagen political and economic criteria. In both the period leading to 1999 and the period after the coming to power of AKP government (2002), the transformative mechanism along with credible commitment mechanism were aptly used by the pro-reform actors against the statist and Kemalist elite who remained opposed to the privatization reforms and political liberalization. Political reforms such as extending freedom of expression and of association were perceived as 'threats' against the Turkish unitary state by the opponents of these reforms. Thus, one may argue that Turkey's EU accession could be considered more as a 'means' rather than as an 'end.' The perceptions of the policy elite in Turkey towards EU, and the credibility of commitment of the EU to Turkey's membership are juxtaposed in the following sections.

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<sup>49</sup> Family silver is referring to the sale of the 55% of Turkish Telekom in 2005 and the privatization of Turkey's main oil refinery in 2006 to name the main ones of these family silvers. (Republic of Turkey, Prime Ministry, Privatization Administration web site (<http://www.oib.gov.tr/baskanlik/administration.htm>))

The role of conditionality will be explored in this chapter as in previous case studies with a special focus on property rights reform, and accompanying regulatory institutions from the new institutionalist perspective. This case study puts to the test what this dissertation hypothesizes: European accession process has brought critical policy consensus that has been needed for the shaping of relevant regulatory institutions and the conduct of policies that may run counter to vested interests such as trade liberalization, ensuring price stability via independent central banking<sup>50</sup>, and for the particular focus of this project, for large scale privatization of state owned banks and enterprises. Thus, Europeanization is considered both from its rationalist and its historical institutionalist conceptualizations. The main argument of this chapter could be rephrased as follows: the statist economic policies as part of the Kemalist regime are challenged by the more liberal rules of the European single market, as these rules also granted new -comers legitimacy and credibility to expand their policy discretion and to eventually defeat their domestic opponents.

Kelley (2004) asks why would political conditionality work so well in CEE, but economic conditionality has faced the most difficult of challenges and only met with partial success. In Turkey the reverse of this observation is more apt. Political conditionality remains the real challenge in comparison to compliance with economic conditionality, in comparison to the previous two case studies. The growing stability of the AKP single party government as perceived by domestic and international investors evidenced in the hike in FDI inflow and strong growth that was mainly externally induced, between 2002 and 2006 (following the

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<sup>50</sup> Similar policy consensus are aptly described as forming in the CEE transition by Csaba (2005).

consolidation of the failing banks by the state and reinforcing of regulatory framework in banking sector).

In contrast, resistance to political conditionality in areas of freedom of expression, minority rights remained strong. As the main actors of resistance to reforms, the roles of the state elite and the military are complicated. The military was prescribed the protectorate of the secular state with its authoritarian tendencies. The tension is further revealed between the democratization requirements of accession and the Turkish republic, with strong emphasis of territorial integrity and national security and economic paternalism, and central planning.

To reiterate the main hypothesis, the more pressure from EU is perceived to be credible, the more the domestic actors would comply with the accession criteria and adopt policy. How are EU conditionality tools utilized? The chapter looks at 1) the more precise use of direct conditionality tools (through the use of demarches, communiqués, progress reports, release or holding back of funds and other forms of assistance); 2) the use of credible commitment tool (signaling effect and tying of hands of domestic actors) and finally 3) the use of the transformative tool, which are explained in stages of, a ) transformation of the information environment and the change in the density of the political actors b) the change in the density of rules and guidelines as framed by the accession criteria and international standards and regulations as overseen by the twin organization of the IMF and WB.

## **5.2. The accession road map of Turkey**

The first major turning point in Turkish accession road map starts with 1987 application of Turkey for full EEC membership. The relationship is further institutionalized through the adoption of the Customs Union in 1995 and its 1996 enforcement. This is a unique outcome when compared to other cases of integration by candidate countries to the EU institutions. A major turning point came with the 1997 Luxembourg Summit, when the EU declined to grant Turkey, candidacy status. In 1999, the second turning point came when the Helsinki Council recognized Turkey as an official candidate. In 2001, the EU Council adopted EU- Turkey Accession Partnership, followed by 2002 decision to open accession negotiations. The year 2002 sees a parallel upsurge for passing of legislation in the parliament to comply with the EU's political criteria, especially in area of human rights . Could this surge in parliamentary activity and progress be explained entirely as the success of conditionality's gate keeping function (the previous exclusion and the rewarding re-inclusion)? Or could one argue instead that the domestic conditions were ripe more than ever, in terms of opportunity structures for passing difficult whole -sale legislation and setting up institutions that would open the way for compliance with these strict conditions?

In its 17 December 2004 decision, the European Council recognized Turkey's significant legislative progress in many areas but added that these need to be further consolidated and broadened. Furthermore, the 2004 progress report preceding the above decision took note of the improvements in the country's economic stability and predictability and the strengthening of the independence and efficiency of the judiciary. Regarding the respect for human rights and the exercise of fundamental freedoms, Turkey acceded to most relevant international and European conventions. (European Commission 2004 Regular Report) Following on these positive developments, in October of 2005, Ankara got a fixed date for starting membership negotiations from the Commission. The Turkish side had originally hoped for an earlier date

from the 2002 Copenhagen summit, which declared that the EU would open talks "without delay" once Turkey is deemed to have made sufficient progress in its reforms (for a more detailed time line, see Figure 1 in Appendix 3). Nevertheless, 2005 opening of negotiations with this slight delay would still be a very welcome development in the eyes of domestic and international economic actors.

### **5.3. EU's direct conditionality and the restructuring of Turkish economy:**

The restructuring of the Turkish economy was explained in three main phases by Öniş and Bakır (2007), each phase triggered by political and/or institutional crises. The first one of these phases could be called deregulation phase (1980- 1989), evidencing the opening of the capital accounts completely by the Özal administration during the overhauling of the inward oriented economic model for an export oriented economic model (Ibid). The IMF, WB and OECD were heavily involved in early 80s, but their influence somewhat diminished following the recovery process. The EU remained at the background, Turkey applied for full membership in 1987. The transition from authoritarian interlude following 1980 military coup and ISI economy took place under the leadership of Turgut Özal (two times prime minister and president of Turkey in early 1990's), through his strong executive and firm commitment to economic reform of his governments. Significant recovery and surge in exports took place in the early 80's but by the end of the decade the quality of performance deteriorates to growing financial instability and rising inflation.

FDI inflow into the Turkish economy in comparison with the other emerging/ developing economies remained low. The cumulative FDI inflow into Turkey has barely reached 11\$ billion from the early 80's (the first phase of trade liberalization and de-regulation); while

inward FDI stock accounted for an average 16 percent of GDP for the developing countries in 1997, this percentage was only 3.5% of the GDP in Turkey (YASED Fact sheet , 1999). Eder (2001), in her analysis of globalization and regionalization trends of the Turkish economy, rightly brings forth the following puzzle: ‘Why did the FDI performance of Turkey remain stagnant for most of the 80s and early 90’s, despite the significant liberalization of the FDI regime in Turkey?’ She points out to the creation of FDI department to streamline FDI applications in order to avoid bureaucratic delays and uncertainties to investors, the establishment of free trade zones in which Turkish labor laws would not apply for 10 years and foreign investors would be tax exempt, and the establishment of build, operate, transfer models to attract FDI were some of the institutional developments). The answer to this puzzle may come from what was missing in most of the 80’s and the 90’s up to 2002: the lack of signals for continuity and implementation problems in regulatory frameworks, and most importantly the lack of a strong anchor for reforms.<sup>51</sup>

### *5.3.1. 1990’s: the lost decade?*

Entering the 90’s, as Buğra (1994), Öniş (1999) and Waterbury (1992) argued, it proved more difficult for Turkey to undertake long term structural reforms such as privatization, and achieving the so called ‘retreat of the state.’ Accompanying Özal’s liberalization reforms were the expansion and concentration of state’s economic power, the public sector still dominating the economy, the problem of endemic fiscal deficit with inadequate tax revenues and rising internal/ external debt remained unresolved. Side payments to various interest groups such as subsidies for agricultural elites and industrial incentives to various textile and manufacturing

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<sup>51</sup> Eder in the same analysis argues that the coincidence of FDI liberalization in other emerging economies with Turkey has created immense competition, as the location advantages for FDI became the availability of a reliable labor supply, physical infrastructure, and easy access to international markets, in lieu of the internally integrated production and marketing system important for TNCs decisions to relocate, so Turkey had to offer much more than a liberal policy framework (Ibid;199).



groups, as well as the lowering of import tariffs on certain goods, were all crucial for building various electoral coalitions between 1995 and 1997 with centre right parties with the help of growing subsidies for farmers and cheap state bank loans for the new Anatolian business community and small to medium sized enterprises during True Path- Welfare Party- ANAP coalitions (Eder, 2001; 203). The consequences of the endemic meddling of the state in private sector banks and the dependence of Turkey's new export elite on export subsidies and export promotion schemes would be more evident in the second phase of economic restructuring in the 90s. The state patronage and distribution of side payments to these interest groups would bear fruit in building the base for the support of the Anatolian 'tigers' for the Welfare Party whose descendant was AKP in the following decade of 2000, resulting in the subsequent acquiescence of these business groups for AKP's reform agenda cloaked in EU colors.

The expected benefits of the liberalization (increased capital flows, FDI increase and greater exports), failed to materialize in the 90's, due to declining investors' confidence and it launched a well known phenomenon of 'vicious circle' of rising interest rates, soaring public debt leading to further loss of confidence, yet higher deficits and interest rates. Rent seeking activity coupled with inefficient state economic enterprises that led to high deficit spending meant serious misuse of public funds.

This second phase from 1989 to 2001 was marked with financial and institutional crises and weak macro economic performance. Two smaller macro economic crises in 1994 and 1997 mark this phase. The IMF was temporarily involved after the 1994 crisis, while the EU was weakly involved through the Customs Union signed in 1995. The first turning point comes

with the 1999 Helsinki summit where Turkey is granted official candidacy, but the impact of the EU anchor is less immediate on restructuring reforms. New bureaucratic agencies are introduced but they have not emerged as effective and autonomous players in the regulatory playing field. This period unlike the first phase is marked with weak coalition governments of centre right and center left, which were unable to impose fiscal discipline. The lack of commitment to reform of the subsequent governments were criticized by the IMF and the EU, but Turkish policy makers saw the signing of the Customs Union as a necessary step towards EU accession. Economic performance was generally weak, growth was largely conditional on short term capital inflows; economic growth was fragile and debt-led. Turkish economy was associated with three crises in less than a decade with devastating consequences for overall growth, income distribution and employment.

The problems with privatization also reflected the above paradox of liberalization reforms coupled with state based patronage. Despite some success in the 1980s, less than 10 percent of the privatization program's goals according to the 1996 privatization report of the WB, Turkey was ranked among the worst three privatizing countries, with the total privatization revenue not exceeding 3 \$billion USD between 1987 and 1997(WB 1996). A proof state meddling was the open intervention of PM Yılmaz in 1998 in the auctioning procedure of Türkbank. This intervention further exposed the ties between the government, politically favored business community, and the infamous mafia figures that played central role in the 1999 scandal, leading to the collapse of the minority government.<sup>52</sup> 'Deep state' relations

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<sup>52</sup> Korkmaz Yigit, the businessman who bought Turkbank for \$600m (£323m), was accused of getting a suspected mafia don to intimidate competitors during the tender process. Mr Yigit in turn pointed the finger at Mr Yilmaz, alleging that the politician was behind the purchase of Turkbank.

between the state rentier, the security elite and mafia are exposed, but continue to block restructuring reform through cooperation with the two centre right parties in the parliament.

### 5.3.2. *Crisis as opportunity?*

The ensuing phase is marked by the financial crisis of 2001. In this period following the 2001 crisis, re-regulation of the financial market became the name of the game, where both the IMF and the EU become powerful anchors. The World Bank was also important but secondary to the former two. The coalition's (consisting of a centre left and nationalist party) commitment to reform increases considerably with the inclusion of the reformer Minister of Economics, Kemal Derviş, given extensive extra-parliamentary powers. Following the election victory, AKP (Justice and Development Party) established a single party government in 2002 for first time in decades, and immediately declared its allegiance to the previous government's standby agreements with the IMF for post crisis bail-out. Significant improvement in economic performance followed in the next three and a half years. By 2006 (where this analysis ends), it would have been too early to say that sustainable growth is fully consolidated, for the elements of fragility given the continued importance of short term capital inflows and a large current account deficit, but main institutional deficiencies were corrected.

Major regulatory and legal changes in monetary and financial governance as required by the IMF standby agreement between Turkey and the IMF since 1999 were enacted, which were administered by the National Economic Convergence Program with the EU acquis, adopted following the Helsinki Summit in 1999. The latter was clearly embedded in the former. The

National Economic Convergence program clearly demonstrated the alignment of the EU and IMF conditionality and the government's response.<sup>53</sup>

The following question needs to be answered: 'What role can domestic policy entrepreneurs play under this pervasive economic conditionality?'

#### **5.4. Credible commitment in property rights and banking sector reforms**

In this section, we will evaluate to what extent the balance of power between the pro- and anti-reform groups were affected by the process of European Union conditionality. These interest groups consisted of the Turkish military, Islamic and secular business associations, and labor and trade unions of both persuasions, various ethnic communities (which looked to utilize the support of client states within the Union to further their interests). A 'window of opportunity' opened through the political conditionality of EU accession and privatization legislation for the pro-business lobby as well as for 'Islamist democrats,' as this period was stage to many unique coalitions between the Islamist civic and business organizations and their more secular counterparts as well as the the international financing groups who recalculated their credit ratings in line with reform assessments of international NGOs and their rapporteurs and to the organic links between those and the rapporteurs of the Commission and other international monitors<sup>54</sup>, and finally the crony capitalists with their patrons among the Turkish political parties

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<sup>53</sup> Available as full text in English at <http://ekutup.dpt.gov.tr/ab/kep/pep2001.pdf>

<sup>54</sup> For further elaboration, please refer to Timothy Sinclair's (2005, 2008) brilliant analysis of the much ignored role of the rating agencies.

#### *5.4.1. Supervisory implications of bank failures and 're-regulation'*

The crony capitalists of the late 80's and 1990's were embedded in the bank based financial system. Governance by state control, state intervention in banking as part of ISI Import Substitution Industrialization policy, included interest rate controls, direct involvement of state in allocation of credit mainly through state banks; barriers on foreign bank entry, and high liquidity and reserve requirements. Crony capitalism of late 80's and 90's can be defined as the network of a few wealthy individuals who dominated political campaign financing- active in acquiring state banks and/or establishing new private banks with the help of the politicians they financed to elect. The state banks throughout the 90's were instruments in channeling deposits into political rent distribution, through the provision of cheap loans to corporations and individual donors as well as special electoral constituencies such as farmers: "bad loans to good friends" as characterized by OECD ( Annual Report on Turkey, 2002; 2003, and 2004). The crony capitalists' activities arguably paved the way for what was about to come, namely the financial collapse of 2001.

The IMF provided close to 8 billion USD in December of 2000 following the failure of Turkey to meet its inflation targets despite full implementation of its monetary and fiscal policy targets. (IMF Letter of Intent, 2001) The tight monetary and fiscal policies implemented to comply with IMF conditionality, according to Öniş and Rubin, caused the recession and became a causal factor in 2001 crisis (2003; 413). The criticisms of the IMF stabilization program pointed to the design of the program which led to liquidity crisis of November 2000 and the mismanagement in crisis intervention paved the way to the full blown crisis of February 2001. There was apparently a twin crisis of implementation: the poor implementation of banking reforms and the Banking Acts of 1999 by the domestic community

and the lack of effective governance by the financial policy community, i.e. regulators and regulated firms. These poor twinned with crony capitalists marked the country's step away from integration with the European financial area all throughout the later 80's and 90's (Bakır 2006). Did the 2001 crisis open a policy space for reform at a hind-sight?

The benefit of the crises (Drazen and Grilli 1993) has been widely researched in literature of policy reform. Crises were also discussed to open a window of opportunity, owing to the cataclysm, when vested interests previously opposing any change may be overrun (Csaba 2005). Others argued that despite the unexpected outcomes, 2001 crisis' damage was irreparable (Öniş and Rubin 2003)<sup>55</sup>. The financial crisis of 2001 in Turkey exploded with the dispute between PM Ecevit and President Sezer criticizing the PM's coalition government for its failure to tackle corruption.<sup>56</sup> The crisis had major ramifications, marking the largest economic recession in Turkey's history and its real GDP contracting by 7.5 percent, whilst the consumer price index realized a 68.5 percent in 2001. The Turkish lira depreciated by 115.3 percent against the US dollar, and 111.3 percent against the Euro (Central Bank of Turkey, 2002, 6-10). Following the crisis, Turkey returned to floating exchange regime with the Central Bank controlling short term interest rates.

Collateral damage was high on all sides: the coalition parties and their leaders were much discredited; the IMF program was much criticized, and the IMF took a major reputational damage in the academia and policy circles in Turkey and abroad; unemployment in white

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<sup>55</sup> For a multi faceted discussion, please see the collected articles edited by Barry Rubin and Ziya Öniş, The Turkish Economy in Crisis (2003)

<sup>56</sup> More literally, the latter hauled off a volume of the Turkish constitution to the former's face during a National Security Council Meeting.

collar class rose to unprecedented heights, particularly in the financial sector. The SDIF (Saving Deposit Insurance Fund)<sup>57</sup> was handed the biggest portfolio of non- performing loans in Turkey. By December 2004, 21 banks were transferred to the SDIF. The cost of the financial restructuring in these two years to the tax payer, with the capital injection to banks, was estimated around 47 billion USD. The bail out of the failing banks and the agricultural support resulted in a budget deficit of 29.8 percent of GDP in 2004. Financial sector in Turkey could not recover until 2006. (See Table 1 below)

The crisis also marked a major turning point for the burgeoning ‘policy entrepreneurship,’ defined as those who introduce, translate, and help implement new ideas into public practice from outside the formal positions of government. The primary policy entrepreneur in this period was the Economics Minister, Kemal Derviş, the former Vice President of World Bank, and part of a global network of professionals (i.e. an ‘epistemic community’), who possessed the necessary policy expertise and competence, and an authoritative claim to the policy relevant knowledge. Such policy entrepreneurs, starting with Derviş, followed by the Economics Minister of the first AKP government Babacan -who later became the minister of foreign affairs and chief negotiator for Turkey’s accession to the EU- acted as mediators moving between the parties in the intergovernmental negotiations environment. One can argue that the coalition government needed Derviş badly in or to recover the lost credibility and also for playing the go between in the epistemic communities and in the international negotiations between the Turkish government and the IMF.

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<sup>57</sup> SDIF was formerly under the authority of the Central Bank of Turkey, started to operate under the authority of the newly established Banking Regulation and Supervision Agency (BRSA).

Table 3.1: Macroeconomic Indicators of Turkey

Indicator (%)	2000	2001	2002	2003	2004	2005	2006
GNP Growth	6.3	-9.5	7.9	5.9	9.9	5.5	6.0
Unemployment Rate	6.6	8.4	10.3	10.5	10.3	10.3	10.1
Inflation	39.0	68.5	29.7	18.4	9.3	7.7	9.65
Budget Deficit/GNP	-10.6	-16.2	-14.3	-11.2	-7.1	-2.0	-0.9
Primary Surplus/GNP	5.7	7.1	4.7	5.3	6.1	7.4	7.2
Total public debt stock/GNP	60	110	90	90	80	70	70
Current account deficit/GNP	-4.9	2.4	-1.0	-2.9	-5.2	-6.4	-6.6
Foreign exchange deposits/total bank deposits	55.3	55.3	55.3	55.3	40.8	63.8	70.1
Treasury interest rate	36.0	63.9	49.8	28.7	24.9	16.2	17.5
Privatization revenues (in million USD)	2674	84	367	289	1206	3032	9580
Credit/Total bank deposits	36.5	36.5	36.5	36.5	44.8	63.8	52.7

Source: Turkish State Planning Office



These policy entrepreneurs acted under what could be described as a ‘supranational interdependence’ and within its three pillars complementing one another in producing domestic change, namely, IMF, WB and EU (Bakır, 2005 and Bakır, 2006). The three pillars were 1) EU accession process which required Turkey to adopt and implement the complete EU legislation and standards (35 chapters of the *acquis*) 2) The IMF conditionality where IMF lending is conditional on the adoption of IMF policy prescriptions and 3) WB Programmatic Financial and Public Sector Adjustment Loans, which required implementation of the financial and public sector reform program in Turkey (and additional technical support to implement these programs). Unlike the other two pillars of supranational interdependence, it could be argued that EU conditionality provided the strongest signal of credibility to the domestic and external actors in this period. Öniş argued that the EU in this period became the longest institutional anchor (2007; 417). In contrast, the IMF’s conditionality was somewhat shadowed by lack of credibility due its poor intervention pre-2001 crisis, but, despite the lack of political will to implement the IMF conditions.<sup>58</sup>

The Turkish Industrialist and Businessmen Association (TUSIAD) was another policy entrepreneur in this period that full heartedly backed the Central Bank reforms, and pressured strongly for the implementation of the economic reform program. The crisis could be argued to open a ‘window of opportunity’ for the reformers to push through with particular policies, as the reform program devised between the IMF and some of these policy entrepreneurs, entailed both macro (tax reforms, financial restructuring, removal of extra budgetary funds...) and micro economic reform agenda (reform of the prudential and disclosure regulations and supervision, the restructuring and privatization of state owned banks) (Bakır 2006, p. 187).

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<sup>58</sup> The IMF continued to provide financial support which led to a debtor moral hazard problem according to Öniş and Türem (2001).

In comparison to the economies of EU and the new EU members in particular, the banking sector of Turkey was weak in contrast to CEE-4 (Poland, Hungary, Slovak and Czech Republics) in terms of its role in the economic development when the respective financial intermediation indicators are compared (the share of assets, loans and deposits of the GDP in 1999 and 2001 figures, in other words before and after the 2001 crisis in Turkey (see the Table 3.2 below).

Table 3.2: CEE and Turkish banking sectors in comparison

	Total assets/ GDP		Loans/GDP		Securities/GDP		Capital and Reserves/ GDP		Non-bank Deposits/GDP	
Year	1999	2001	1999	2001	1999	2001	1999	2001	1999	2001
<b>Czech Rep.</b>	124	119	46	40	24	32	10	7	59	69
<b>Hungary</b>	64.5	64	29	35	12	13	6	7	41	41
<b>Poland</b>	58	62	27	28	13	13	5	6	37	41
<b>Slovak Rep.</b>	91	92	43	27	13	27	12	8	60	66
<b>Turkey</b>	89	92	24	18	20	36	5	8	56	61

Source: OECD 2003.

Turkey had the lowest share of loans to the GDP and indeed the highest share of government securities in total banking assets (Banking Association of Turkey (BAT), 2001), although

both Turkey and CEE-4 have relatively underdeveloped financial services. By September 2003, after the major restructuring the sector went through, the deposit items still constituted the major source of funding, however loans constituted only 27 percent, the banking sector was still unable to channel funds to the ‘real sector’, therefore impact economic growth. The share of loans in total assets was only 28 percent in 2003, below the pre-2001 crisis level of 32 percent in 2000 (BAT 2004).

#### *5.4.2. Policy response to credible commitment: the new regulatory framework:*

Banking sector reform legislation as part of the policy output in response to the external anchor of the EU and IMF, can be surmised from the mandate of the Banking Regulation Supervisory Agency (BRSA): ‘...incorporating market risk into capital adequacy requirements; clarifying definitions for reporting and accounting purposes; including repurchase agreements on the balance sheet; improving monitoring the supervision of the banking system and adopting international accounting standards.’ (2003). Other important legislations can be summarized as the following (following listed are not exhaustive, but only for the financial sector): 1) Central Bank Law 2001; 2) the institutionalization of the banking supervision system which involved BRSA and SDIF (Savings Deposit Insurance Fund); 3) Law on the public sector banks between 2000 and 2001 4) Private Banking Restructuring Program in 2001 5) *Istanbul approach* <sup>59</sup> (for corporate loan restructuring in 2001) 6) Public Financing and Debt Management Law in 2002. 7) Ministry of Justice drafted new bankruptcy and foreclosure laws in consultation with the World Bank.

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<sup>59</sup> ‘Istanbul Approach’ in June of 2001 gathered real sector representatives, financial sector representatives and regulators in order to discuss how to reach a consensus on incentives tailored for the specific needs of the Turkish restructuring programme.

Anchored but also empowered by (through credible commitment) the World Bank sponsored laws, SDIF effectively seized control of companies and personal property of insolvent bank owners, who failed to propose a plan to pay the debts due to the collapse of their banks in the tax payer's money, and ended the 'light approach' of the previous administration. Bakır argued that the partial financial regulatory and supervisory consolidation and increased central bank independence in Turkey were the domestic responses to IMF pressure. (2006, pp.198-200) In this sense, we agree with Öniş's diagnosis that Turkey had benefitted from the 'double anchor' from the EU and the IMF at this critical time (Öniş 2009; 412). The conditionality from these two institutions became interlocked so that the incentives provided by the EU- as explained by the reinforcement by reward mechanism- rendered the task of implementing the IMF conditions easier. But is this entirely a result of external pressure? Would this tough policy agenda, under the heading of the Economic Programme of 2001 (see *Figure 3* in Appendix 3, for a more detailed item list), signed between the Turkish government and IMF, be followed through religiously by the consecutive governments, if it was not for the internal credibility of the AKP and its external credibility to foreign direct investors, improved by the rapprochement to the European regulatory frameworks?

The regulatory framework was boosted further by property legislation changes in Turkey post 2001, where important pieces of real estate in Istanbul and in the coastal areas of the Aegean and Mediterranean were opened to construction whereas before, they were under the protection of the state property and forestry law and not open to new construction and re-development. Soon global buyers of real estate and investors interested in building large hotel complexes and malls flocked to this enabling environment, and would bid for the new property for sale.

This regulatory framework was also part and parcel of the accession national program with the EU. One could observe both a rhetorical overlap and policy consensus amongst the international triumvirate (EU, IMF and WB) and the domestic policy entrepreneurs, be it state or civil society. Instead of direct conditionality, one could more securely contend that, the EU provided feedback through its regular progress reports, but it also provided the much needed rhetorical backing to Derviş and his team, ( i.e. the laudatory references for the Turkish ‘dream team’ are plentiful in the speeches of EU term president and his successor).

The IMF released another 8 billions USD in May of 2001. The IMF declared that Turkey maintained the strong implementation of its economic program. As a result, in February 2002, the IMF approved a new standby agreement of 12.8 billion USD which would expire on February 2005. Derviş resigned in the August of 2002 due to the internal squabbles of the weak willed coalition. Following the elections of November 3<sup>rd</sup>, 2002, the first single party government in one and a half decades came to power with 34% of the vote and 66% of the seats in the Grand National Assembly. AKP with its Prime Minister Erdoğan, made strong promises to fight corruption (couched in conservative compassion and social justice rhetoric), to implement structural economic reforms sponsored by IMF and the WB and to continue reforms in order to meet the Copenhagen criteria for EU membership.

AKP was widely untested, even though its main cadres were well known from the 80’s and early 90’s. PM Erdoğan, who was twice successful mayor of Istanbul, a metropolis of 15 million, before becoming the founder of AKP along with President Abdullah Gül (who was first elected to parliament from the Anatolian entrepreneur town of Kayseri through the

Islamist Welfare Party (the predecessor Islamic part shut down in the late 90's by the Constitutional Court);<sup>60</sup> had served as foreign affairs minister and head representative of the Turkish parliament in the European Parliament. In the new government, Gül would first become the prime minister first until Erdoğan's parliamentary membership is realized through a bi-election (after the political ban of Erdoğan for inciting against the infamous article of 301, expired). After the election of Erdoğan to parliament and becoming the PM, Gül was once again assigned as foreign minister. He would go on to open membership negotiations with EU foreign ministers in October 2005, although only 2 of the 35 chapters would be opened during his foreign ministry. His presidency bid of late 2006, received large support from all three party groups within the European Parliament.<sup>61</sup>

#### *5.4.3. Privatization reforms between 2002-2006: 'Open for business'*

The privatization of state owned enterprises (SOE's) enjoyed support for many of the leading politicians since the later 80's, but the sale of SOEs had proved difficult mainly due to the legal challenges designed by nationalist politicians and trade unions. By late 90s, the government started to tackle more seriously, the issues of regulation of markets; opening up utilities and infrastructure to competition; the overhauling of social security and agricultural support systems; the transparency of public finances and regulation and strengthening the banking system.

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<sup>60</sup>For more on this please refer to the ESI report (2005) on the specialness of the Kayserian business class for the growth sectors of the Turkish economy post 2001 crisis, entitled: *Islamic Calvinists: Change and Conservatism in Central Anatolia*

<sup>61</sup> The EPP-ED stated that 'Gül will play a constructive role in Turkey's reform process,' and ALD added that, as 'Gül is the right man for the job' and the Commission President, Manuel Barroso confirmed that Gül, '....was a fresh, immediate and positive impetus..' and to to that '... is a modern reformer.'  
([http://www.alde.eu/index.php?id=42&tx\\_ttnews%5Btt\\_news%5D=8867&no\\_cache=1](http://www.alde.eu/index.php?id=42&tx_ttnews%5Btt_news%5D=8867&no_cache=1))

The institutional development of privatization was started to take root in the earlier phase of restructuring. The first major privatization law was enacted on 27 November 1994; (Law No. 4046). This new Law contained the provisions aiming institutionalization of privatization reforms through the establishment of a Privatization High Council; Privatization Administration, a Privatization Fund, legal arrangements on the personal and social rights of public employees, and their compensations (for a more detailed list of the privatization law provisions, see *Figure 2* in Appendix 3).

Privatization got a special boost in 2005. Halkbank (the second largest state bank), the tender for the re-development of the historical Galata neighborhood of Istanbul across the Imperial Palace, the state monopoly producer of alcohol and tobacco (TEKEL); electricity distribution and production companies owned by the state, 25 sugar factories and highways and bridges were only some of the items for sale in the privatization portfolio of 2005. The above discussed macro and micro economic reforms were backed by extensive legal reforms including new commercial and central banking laws and the introduction of good governance principles.

But does the main break through come for the partial removal of bureaucratic and political impediments in the post-1999 Helsinki inclusion or does it follow from the cataclysmic events of the 2001 crisis?<sup>62</sup> Firstly, the IMF backed programs since 1999, made release of funds conditional on progress in these areas. Secondly, the accession economic conditionality paid

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<sup>62</sup> In other words, had the crisis not discredited most of the political and economic actors and exhausted policy options: could the AKP manage to defeat the opposition and pass difficult legislation?

much attention to privatization legislation and regulatory agencies in the utilities and energy sector (through the eventual establishment of the Telecom and Energy watchdogs in 2002 and 2003). The AKP government instead of using their parliamentary majority and electoral support did not act to realize their agenda of more socially conservative domestic and anti-western foreign policies, but instead it chose a pre-commitment strategy<sup>63</sup> against their own electorate and interest groups, by binding themselves closely with the previous economic administration's Transition Plan and the IMF structural adjustment goals. AKP was far more pro-active on the issue of Turkey's EU membership than any other political party in the recent history of Turkish politics, and did not treat EU membership as a vague ideal in itself (Öniş 2005). The 'rhetorical trapping' (Schimmelfennig et. al. 2003) and pre-commitment (Elster 2000), can be evidenced throughout the parliamentary statements of AKP leadership, and the government action plans in 2003 and 2004. In the economic front, large primary surpluses, robust economic growth, lower real interest rates and debt amortization as a result of privatization helped to keep the gross government debt/GDP ratio on a downward path, from almost 100% of GDP in 2001 to just over 60% in 2006.

## **5.5 Credible commitment and political conditionality**

While the credibility of the EU full membership promise increased with the Helsinki decision, the positive signals given out by the commitment to continuity of IMF favored economic reforms. Political reforms in compliance with EU political conditionality were also been perceived positively by the international and in particular, the EU business interests.

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<sup>63</sup> Self binding and pre commitment concepts are borrowed from Jon Elster's discussion of constraint theory (2000)



Following the 2001 economic crisis, both the big business in Turkey, and the EU and international investors placed even greater emphasis than before on the need for the permanent EU anchor as opposed to simply relying on the temporary IMF discipline for establishing durable economic growth and avoiding future financial crisis in the enormity of 2001<sup>64</sup>. To state more succinctly, the behavior of the market participants increasingly depended on the country's ability to undertake the EU related reforms, both on the economic and political fronts. The emphasis on the political developments by international business, can increasingly be evidenced in the reports of the major international banks and financial investing firms. They borrow in large excerpts from the progress reports by the Commission, focusing on developments on the freedom of expression, minority rights and other implementation of the political component of the Copenhagen criteria, in order to interpret the current state of the Turkish economy and conveying information to potential investors.<sup>65</sup> The most notable domestic equivalent was the TUSIAD report, outlining a blue-print for democratic reforms notably with respect to the extension of minority rights in 1997 which generated considerable controversy and generated critical reaction from key sections of the state establishment (Tanör 1997).<sup>66</sup>

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<sup>64</sup> The speech of the Volvo group's CEO, Johansson in the TUSIAD annual meeting explaining Volvo's decision to establish its regional hub in Turkey was especially timely; 'For us Turkey is already a member of the European Union. We do not pay very much attention to the discussion on whether Turkey should be in or not. I believe that Turkey will surely enter the club. What is important is the country's performance.'

<sup>65</sup> The reports by large investment and consultancy firms (Gide Noyrette Novel report on Real property rights and foreign investment, 2004), financial institutions such as the Deutsche Bank, (Turkish Banks report, 23 March 2004), Morgan Stanley and Raymond James reports focusing extensively on the 2002-2003 changes of legislation in the area of freedom of association.

<sup>66</sup> Other major business associations such as MUSIAD, representative of 'Islamic Business' in Turkey followed TÜSIAD's lead towards the end of the decade.

Needless to say, not all business actors were for EU reforms although the pro-reform coalition despite its heterogeneity and comprehensive. Especially the Union of the Chambers of Commerce and various labor and trade unions in Turkey remained staunch EU skeptics. The opposition from these groups wavered if not became marginalized given the extraordinary politics of 2001 crisis. Due to time and space restrictions we cannot really do justice to the evolution of the Euro-scepticism in Turkey, instead, we choose to focus on some key policy entrepreneurs and explore how they made use of the EU context to advance their reform agendas.

The overlap of political liberalizations with that of ‘Copenhagen criteria’ can be seen in the oft discussed title, civic- military relations and the role of the National Security Council (NSC) in making foreign policy. The 1982 constitution granted (Article 105) wide range of duties and powers to maintain law and order after the 80 coup, to have a supervisory role in state economic planning, defense spending, and foreign policy making. The EU constantly criticized Turkey for not willing to curb NSC’s role in policy making (Article 118 of the Constitution giving it a function of chief decision making body). The general Chief of Staff made extensive public statements about government policies, formulating the political agenda in terms of protection and preservation of the secular principles in the public space during this time leading up to the 28 February (Post-modern) Coup in 1997.<sup>67</sup>

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<sup>67</sup> The accompanying red booklet document outlined the threats to national security, and provided detailed guidelines for foreign and security policies for government and institutions to take precedence before parliamentary debate and government decrees. It continued to line out the guidance of the Kemalist military establishment with respect to the relations of Turkey with its neighbors in the Middle East, this guidance continued during two AKP periods, as Israel remained a strong ally of Turkey in much of the 1990s up to 2002, much due to the driving force status of the Turkish Armed Force.

The civic- military relations was also affected by the ‘unintended consequence’ of the War in Iraq. Previously the military-security establishment in Turkey relied heavily on the US- Israel- Turkey triangle as an alternative axis to the EU. However the deterioration of relations with the US following the 2002 Parliamentary decision not endorsing the passage of US troops across to the Turkish border to Northern Iraq and the following decision not to open Turkish air bases to US allied incursions to Iraq, helped weaken the long standing strategic alliance linking Turkey closely to the US. As an ‘unintended’ repercussion of this land mark decision, the stance by the AKP majority parliament may have arguably brought Turkey closer to Europe and notably to the position held by the Franco- German alliance. By clearly abstaining from US war effort, Turkish government may have strengthened the pro- Turkey coalition in these core EU countries on the elite level.

The important link of this international development to the domestic politics was the following: this abstention and the following changes centering on the status of the military in Turkish politics, involving limitations over the powers of the National Security Council and controls over the defense expenditure and extra-budgetary funds extended to military’s Southern operations against the PKK, shifted the balance of power in Turkish politics in favor of the civilian element. As a result of this, the Turkish military also started to shed off its hard-liner posture and adopting a somewhat more favorable stance towards EU conditionality as evidenced in the public speeches and statements of the Chief of Staff, Büyükanıt. This was a novel development noted by the Commission in its 2005 Progress report. (EU Commission, 2005) It was also evidenced in the relatively neutral approach the military elites adopted with respect to the proposals involving the resolution of the Cyprus dispute along the lines of the ‘Annan Plan,’ in a marked contrast to the heavily nationalistic attitude of the 90’s and early 2000’s.

Furthermore, developments concerning the Kurdish and Cyprus issues continued to be approached with caution and reservations by the military elite. In light of the unintended consequences of the Iraq War and the changes involving the National Security Council in the parliament and the constitution as demanded by the political conditionality post-1999 (as earmarked in each consecutive progress report by the Commission), it would be fair to say that the military has swapped from the Euro skeptic camp to the pro- reform camp.

However, one should not overstate this shift. The rift between the military elite and AKP (backed by a hybrid group of pro business and Islamic conservatives; much likened to Christian democratic coalitions in Europe by analysts of Turkish party politics) continue onto this day. But a transition from a hardliner to soft liner stance by the Turkish military establishment was tangible: how the military communicated its hard liner stance as protectors of the Turkish secularism in the early 1990s against the its predecessor the Welfare Party in government contrasted with its reaction to AKP. The military showed its opposition by taking the streets with its tanks and other heavy artillery positioned on the outer skirts of Ankara , where in contrast, the military limited itself to ‘e-muhtıra’, electronic declaration released from its web site ([www.tsk.mil.tr](http://www.tsk.mil.tr)) in order to express its reserve about AKP’s political reforms in religious freedoms and expression of minority rights and use of languages (27 April, 2007). The declaration targeted the nationalist party, and the republican, centre left party opposition parties the parliament and answered their criticism of the military actions in the southeastern Turkey. This stance broke off the traditional alliance between the Turkish military with the staunch anti reform, pro military Kemalists within the Turkish Republican party (Ataturk’s CHP) and with the pro military and anti minority rights, Nationalist Action

Party (MHP). The increasing credibility of the EU conditionality following the Helsinki decision, to the opening up of the negotiating chapters in 2003, arguably helped democratize the Turkish military, making it less menacing to democracy and more transparent, and duly diminishing the power and resilience of the EU skeptic elements.

The cross-class coalition of the AKP electoral base, including small to medium sized enterprises as significant beneficiaries of globalization and Turkey's external orientation, and the Turkish big business in increasing partnership and subsidiary agreements with European based TNCs, resembled the rhetoric of the 'third way' style of European social democrats, with its rhetorical commitments to the principles and values of multi-culturalism, social justice and a properly regulated market economy. AKP aimed at extending the boundaries of religious freedom and encourage religious diversity as opposed to challenging the notion of secularism itself, unlike its predecessor Islamist parties who challenged the status of state-religious affairs in Turkey. The pro-poor and redistributionist stance of AKP was however was balanced once it came to power in 2002, having bound itself to the disciplines imposed through the IMF program.

Before the landmark victory of AKP in 2002 general elections, Nationalist Party (MHP) parliamentarians were the major coalition partner of the anti reform-hard liners in CHP and the Kemalist statist elite. The overlaps between the state owned enterprise managers and the nationalist leaning politicians became more evident during the privatization 'debacle' of Turkish Telekom, where the MHP (Nationalist Action Party) member energy and infrastructure ministry became main opposition within the coalition government. Meanwhile, the MHP parliamentarians seriously objected to ending the death penalty and the recognition

of Kurdish minority rights, as perceived attempts to undermine the unitary character of the Turkish state (Müftüler-Bac 2005)

Although strongly rooted in the social base of the Islamist movement (with its two banned predecessors, Welfare and Felicity Parties), AKP represented a novelty. AKP tapped on the socially conservative values of its core electorate, but increasingly abandoned Islamism as a political programme. The party stood for modernization and democratization in its rhetoric at least, and looked to the EU as a natural way to achieve these values (Narbone and Tocci 2005; 6). Its leader Tayyip Erdoğan declared that ‘...meeting the Copenhagen political criteria is an important step forward for the modernization of the country...<sup>68</sup>’. Indeed, the first AKP government frequently dubbed the accession criteria as the ‘Ankara criteria’ Thus, a very curious alignment occurred between AKP interests and ideology and EU political and economic conditionality.

The EU conditionality served the AKP’s interests in a number of ways. On the one hand, embracing EU-inspired reforms provided a ready made political and economic roadmap and on the other hand, it would consolidate the AKP’s legitimacy and credibility both domestically and internationally. Delivering on reforms would also eliminate doubts and suspicions, particularly amongst the civil and military establishment, about the ‘real’ political intentions of the party and would strengthen its pro-western credentials and its legitimacy internally and externally. The party leadership believed that full endorsement of democratic and human rights reforms could bring about a lasting transformation of the country which would give the AKP a lasting guarantee to *survive* as a key actor in Turkey’s political life.

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<sup>68</sup> Quoted in Dağı (2005,p. 30).

### *5.5.1. Political conditionality balance sheet:*

By the end of 2001, the coalition government led by Bülent Ecevit, and the Turkish Grand National assembly passed 34 constitutional amendments and with the consecutive AKP government between 2001 and 2003, seven harmonization packages followed. The first two packages concentrated on the freedoms of expression and association. The third harmonization package abolished the death penalty and lifted the ban on broadcasting and education in languages other than Turkish. The fourth and fifth packages amended the Law on Political Parties, increased penalties for torture crimes, expanded the freedom of the press and freedom of association and allowed for retrials of cases contrary to ECHR judgments. The two packages passed in July 2003 extended freedom of speech and association, increased the civilianization of the (previously military-dominated) National Security Council (NGC) and extended cultural, religious and linguistic rights. A further set of constitutional amendments (amending ten articles) was passed in May 2004. The amendments further enshrined the abolition of capital punishment, strengthened gender equality, provided for the civilianization of the Higher Education Board (YOK) and abolished the infamous State Security Courts. This was followed by the eighth harmonization package in June 2004, which implemented the second set of constitutional amendments. There has also been a new Law on Associations (July 2004), a legislative package Reforming Public Administration (July 2004), a Law on Compensation of Losses Resulting from Terrorist Acts (July 2004) and a new Penal Code which, amongst other matters, strengthened women's rights (September 2004).

The amendment on the Law of Associations in particular deserves special attention because for several decades, civil society associations prepared the ground work and lobbied for this

change, yet their arguments have not gained resonance until 2004. The density of rules (through Accession Partnership Agreement and close monitoring of the Commission) and the density of actors intensified between 2001 and 2003; and the EU accession arguably strengthened the momentum of the diverse motley of civil society actors (including leftist intellectuals and religious inspired group).

On the political conditionality front by 2005, there remained two main thorns on Turkey's side, as repeated in the negative side of the balance sheet of progress reports: the first one being the stand still on Cyprus and the Greek veto and the second one, the freedom of expression and the deadlock in the revision of the infamous Article 301 of the current constitution. Under the Council's decision, a framework for Turkey's EU membership negotiations was established by the Commission. According to the document released on 29 June 2004, the negotiating framework had been described by Enlargement Commissioner Olli Rehn as 'rigorous.' It rested on the following elements (see Figure 4 in Appendix 3). The negotiation framework needs some attention as it is markedly different from the accession and negotiation frameworks of the other accession cases. The differences are prominent in the following: the negotiations could be open-ended with no definite deadline for accession; it could be suspended in case of a breach of the principles of democracy.

By 1999 following the twin earthquakes in Greece and Turkey, the relations between the two countries improved, leading to a new entente and Turkey's inclusion in Helsinki. In 2002, Greece and Turkey reached an agreement on building a trans-border gas pipeline. Following the election of Karamanlis in 2004 in Greece, the relations between the two countries again cooled off. Before the accession of Cyprus (the southern half of the island) to the EU, there



was a notable window of opportunity for resolving the Cyprus obstacle for Turkish accession, but that window was missed mainly due to a ‘no’ vote from the Southern Cyprus in the referendum for the Annan Plan. In July 2005, Turkey signed an additional protocol extending customs union agreement to the new EU member states, including Cyprus. But since October 2005, progress slowed. By the end of 2006, the Turkish Grand Assembly was still refusing to ratify the additional protocol which would have required Turkey to open its ports and airports to Southern Cypriot registered ships and planes, unless the EU and Cyprus agreed to open direct trade between the Northern Cyprus and EU. As a result, European Council, on recommendation from the Commission, decided to suspend 8 of the 35 negotiating chapters of the *acquis*.

With regards to the condition for expanding freedom of speech, much attention was drawn to Article 301 of the Turkish constitution by the Commission, raising public consciousness through the author trials in the early 2000’s among which was the first Turkish Nobel laureate Orhan Pamuk.<sup>69</sup> Commissioner Rehn reiterated that the EU wanted to see an amendment of Article 301 to facilitate freedom of expression in Turkey. He added that the law cases or jurisprudence have gone into a direction which is restrictive to the freedom of expression. The EU urged Ankara to speed up political and judicial reforms to ensure freedom of speech (Article 301 of Turkish penal code), and to show flexibility over the sensitive issue of Cyprus, warning that otherwise the fate of its EU membership might be at risk.

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<sup>69</sup> A stronger resurrection of the article 301 issue comes with the dramatic assassination of the Turkish Armenian journalist Hrant Dink who was standing for trial for its violation, by a young ultra-nationalist with alleged connections to the ‘deep state’ and the state security organizations.

5.5.2. *Rhetorical use of EU accession conditionality: the case of minority property restitution*

Turkish parliament was expected to fulfill another condition for EU membership which was to return the property confiscated by the state to Christian and Jewish minority foundations.<sup>70</sup> Greece and Cyprus continued to veto Turkish accession, inciting the lack of progress in restituting prime real estate on the Princes' islands of Heybeli (Halki in Greek), in central Istanbul and the Aegean Islands of Imroz and Bozcaada to its former proprietors from the Turkish Greek community now living outside of the state's borders.

The Orthodox patriarch Bartholomew, a key actor in terms of Turkey's minority contention, uncharacteristically made a strong statement on the eve of the Orthodox feast in 2005 expressing his community's feelings of victimhood and the opportunities EU accession process could create to ameliorate the situation.<sup>71</sup>

Moreover, during the same period, Turkey's Supreme Court rejected the patriarchate's claim to property rights over an orphanage one of the Princes' Isles, having vetoed two months earlier the restitution, also to the patriarchate, of the theological seminary of Halki, confiscated and closed more than thirty years ago. Restitution was promised by the spring of 2005, by PM Erdoğan, The timing of the fulfillment of these political conditions was critical. Turkish prime minister knew that during the second half of 2004, when voting will be held on

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<sup>70</sup> Turkish lawmakers complied finally on 20 February 2008 by signing a law in this direction.

<sup>71</sup> The exact quote is the following: '... But today we find ourselves the victims, not only of the terrorists, but also of the authorities of this country, through unjustifiable delays in granting the license necessary for the reconstruction of our church. We have not asked for reparations or favoritism. We have simply asked for what belongs to every citizen of the EU by law, and we are fully within our rights to demand it as peaceable citizens of this country, a country that wants to be accepted within the EU.'

entrance into Europe, the Netherlands will hold the EU presidency. In the law regulating construction of religious buildings in Turkey, it was recommended that the phrase "place of worship" would be substituted for "mosque," theoretically placing all the religions on the same footing. ( International Religious Freedom Report-Turkey, 2004)

Under a compromise formula agreed at the December 2004 EU Council, before October 2005 agreement with Turkey on a protocol that will adapt the 1963 Ankara Treaty to the ten new member states of the EU, including the Greek Cypriot government. For all practical purposes, this would amount to an implicit recognition of this government for the first time since the island's division in 1974. 'The adoption of this protocol is in no way recognition, and I've put this on the record...' PM Erdoğan emphasized. The deal did not include a commitment from Ankara that the protocol would be ratified by the Turkish parliament before October 2005. As for the other key condition: on 1 June 2005 Turkish parliament enacted the revised penal code.

Next critical point with respect to minority property rights came in 2006. The Turkish Parliament on November 9, 2006, adopted an EU-required law aimed at improving the property rights of the country's non-Muslim religious minorities. The 'religious foundations law,' which needed to be approved by President Ahmet Necdet Sezer to enter into force, would allow the mainly Greek, Armenian and Jewish foundations to regain properties confiscated by the state in 1974. The legislation, which set an 18-month period for property claims, also envisioned the creation of a special committee tasked with determining which properties are to be returned. However, the bill reportedly failed to address all types of confiscated properties. For example, it did not stipulate compensation for properties that have already been sold to third parties. The Agence France-Presse (2006) reported that some of those affected have warned they could sue Turkey at the European Court of Human Rights. Under the legislation, foundations were allowed to operate abroad and receive foreign funds,

provided that international activities fall within the scope of activities listed in their statutes. Some had criticized the inclusion of such a restriction, saying it would effectively leave out non-Muslim institutions. The bill was passed about two months after it was put on the parliament's agenda and a day after the release of the European Commission's (EC) regular report on Turkey in late October of 2006. The report criticized Ankara for making little or no progress in the implementation of reforms in a number of areas, including freedom of expression, religious freedom, women's and trade union rights. While freedom of worship was 'generally respected' in Turkey, 'non-Muslim religious communities have no access to legal personality and continue to face restricted property rights,' the Commission report said. It added that minority religious communities continued to encounter problems in the management of their foundations and in recovering property by judicial means (EU Commission 2006).

The report, furthermore, urged Turkey to remove any restrictions barring the full operation of all religious communities by adopting framework legislation in line with the European Court of Human Rights case law. In September of 2006, Turkish lawmakers voted in favor of a motion extending the administrative rights to minority schools, but removed a provision that would have allowed them to enroll foreign students. According to reports, they were trying to avoid paving the way for the reopening of a Greek Orthodox seminary, something for which the Commission and Greece in particular, had also been pushing.<sup>72</sup>

The legislative developments beyond 2007 showed that some important obstacles remained with respect to the acquisition of property rights of foreigners and minority groups in Turkey.

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<sup>72</sup> Under a 1971 law that put religious and military training under state control, the century-old Halki Theological School on Heybeliada Island off Istanbul stopped admitting new students, depriving the Eastern Orthodox Church of a key facility for the training of clergy. The seminary's last five students graduated in 1985, when the seminary closed its doors.

A law allowing the sale of real estate in Turkey to foreign companies was annulled by Turkey's Constitutional Court in late 2007. In an attempt to gain entry to the EU, Turkey's centre-right government had previously approved the law allowing the sale of Turkish property to foreign individuals and businesses. This however changed in late 2007 when the ruling of Turkey's Constitutional Court favored the nationalist-leaning Republican People's Party. This decision by the court would ultimately affect companies specifically set up to acquire property in Turkey by foreign investors through joint ventures. Prior to this recent development, foreign investors set up joint venture Turkish firms to acquire real estate restricted to only Turkish citizens. The restrictions to foreign buyers buying property in Turkey included a limit of 30 hectares on a single land purchase, banning off of military zones and rural lands. There has already been some notable opposition in the Turkish Government. Kemal Unakıtan<sup>73</sup>, Turkey's Finance Minister who would also remain in charge of the lucrative privatization agency for the next 6 years, said, after the ruling, '...this does not help our efforts to attract foreign investors into Turkey....' There is quite a lot of uncertainty as to how this ruling will affect the numerous IPO's planned in the Turkish property sector this coming year. One thing that is certain is that foreign property developers in Turkey seeking to purchase land for projects would be the hardest hit by this law.

## **5.6. Transformative conditionality and policy entrepreneurs**

The window of opportunity opened post 2001 crisis for the governing AKP and its cross class coalition. The moderate Islamists realized the utility of the EU conditions as means of consolidating and solidifying their own position against possible threats from the 'hyper-

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<sup>73</sup> Another key actor in the re-regulation phase of Turkish reforms, Kemal Unakıtan, was in charge of Privatisation for the 58-59<sup>th</sup> Turkish governments came from the State Enterprise Sector in the 70s and early 80s and with the textile export boom in late 80s, he comes to own his own textile corporation and gets on the board of one of Turkey's Islamic Banking Group, Albaraka Turk until 2001.

secularism of the established elite' (Öniş 2006; 11) while EU political conditions helped to a certain extent the key sections of Turkish civil society with their demands to expand the boundaries of freedom of association, of equal rights of women and freedom of speech. Thus, it would not be overestimating the instrumental role of political conditionality, in transforming the balance of power between pro and anti reformers in Turkey in this period. On the other hand, in a rather unexpected fashion, conditionality became a mechanism for Turkey's new found moderate Islamic for making it more compatible with a secular, democratic and pluralistic political order. The implementation of the political reforms were bound to a tighter instrumental anchor, while the benefits of these reforms were more directly felt by the electoral base of AKP (increasing its electoral majority to 41% in the ensuing elections of 2007), the chances for reversal of the political opening up becomes less, as credibly committing the policy elite by its electorate on the domestic front and signaling continuity of reforms to by international investors and pro Turkey forces on the external front.

A parallel window of opportunity appeared for technocratic policy entrepreneurs for passing difficulty banking regulation, supervision and property rights legislation regarding the privatization of state owned utilities. A small nucleus of officials within the core executive acted in relative isolation from the electoral pressures and parliamentary oversight. At the start, the policy style was essentially reactive but it displayed clarity, coherence, and consistency in the positions adopted. Paradoxically, what is characterized as a 'weak' state displayed strong policy coordination.

The 'window' emerged during period leading to the 2001 crisis with strong backing from the Commission, with the establishment of BRSA, and the strengthening of Central Bank

independence with special legislation. And in period after 2001, the opportunity was utilized for further institutionalization of bank supervision and regulation of financial sector. The authority of the BRSA was strengthened on- site and off -site supervisory powers; it also incorporated the Sworn Bank Auditors. The SDIF has become both the deposit insurance fund and agency responsible for the liquidation of the insolvent banks and was also incorporated into BRSA. Furthermore, the regulation and supervision of non –bank financial institutions have been transferred from the Treasury to the BRSA in 2005. Yet the BRSA did not have independence from the government, as the president and the senior executives were appointed by the Council of Ministers which also had the final authority in the cancellation of the banking and deposit taking licenses.

Two such failures of the Banking Authority in early 2000 and 2001 are especially telling in terms of the stark contrast with the decisive implementation in 2004 and 2006 by the BRSA. Pamukbank, being the sixth largest bank of Turkey, owned by Çukurova group was given a sweet heart deal (due to the conglomerate's good relations with the top echelons of the coalition parties, and with the major foreign investors who could pressure the government through the transnational channels of IMF and WB). The deal between Pamukbank and the government was that its 6 billion USD debt was postponed for 15 years with no payment required for the first 3 years. In the Imar Bank case, which belonged to the Uzan conglomerate, associated with a range of underhanded activities in the black economy of 90's, the case for regulatory and supervisory failure was more acute. The bank managed to hide the actual amount of deposits, sold non-existing treasury bonds and channeled funds into off-shore accounts. The BRSA failed to detect the misreporting of Imarbank and failed to conduct on-site inspections effectively. The Uzan conglomerate reportedly had good relations with the previous government, and through these good connections, managed to fall through the cracks

of supervision. The Central Bank cancelled Imarbank's license to participate in government debt market in 1996, but the bank through massive public ads, continued to sell non existent treasury bills to the public until 2002, and the supervisory agencies had not inspected the bank carefully(!) enough.

The centralization of the supervision authorities of the banking sector in Turkey which was previously very fragmented, in which the separate authorities did neither coordinate nor cooperate. The fragmented state apparatus also had conflict of interest problems and lack of adequate cooperation with the Treasury. Treasury had no incentive to push for tight financial regulation and supervision of banks which were essentially funding government deficits and beef up the capital of state banks which would worsen the fiscal deficit. The restructuring of the Banking sector proved to be fairly successful by 2004 in which the role of supervisory and regulatory agencies was central. Along with strong economic growth, it generated improvements in the asset and profitability growth and improved asset quality and capital adequacy. The total bank assets increased from 130 billion USD in December of 2002 to 184.9 billion in June of 2004, while the net profits increased from 1.8 billion USD in 2002 to 4 billion USD in December 2003. The head of BRSA commented: '... the regulatory activities of the agency continued in accordance with European Union regulations...and the Draft Banks Act prepared in order to strengthen the regulatory framework and in achieving compliance with the EU legislation...' <sup>74</sup> We can confirm that the EU's regulatory framework provided the Turkish policy entrepreneurs and agencies useful blue prints as was the case in Romanian banking sector reform.

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<sup>74</sup> Monetary governance is about price stability and central bank independence as one of the conditions for entry to the EMU as Dyson explains in his article (2000).



### **5.7. Perceptions of credibility and the evergreen ‘identity’ question:**

Turkey’s effort to be included in the various projects for European integration was not so much an innovation as it could be perceived as an integral continuation of the Western patterned modernization and realization of the objective of becoming ‘European’ (Öniş and Keyman 2007; Rubin and Kirişçi, 2001; p. 2).<sup>75</sup>

There lay an interesting paradox in the continuity of the perceptions and self-identification of the political and economic elites in Turkey as ‘European and western’ despite the lack of financial and short term political awards for fulfilling accession requirements. AKP with a clearly Islamist look and infrastructure, and once came to power following the December 2002 elections, continued the accession reforms while large privatizations revenues filled the coffers, regulatory institutions in the banking sector strengthened .

The continuity between Derviş and Erdoğan- Babacan duo in policy orientation and entrepreneurship towards EU accession is notable. Consecutive governments with very different ideological orientations and compositions, stuck with the conditionality agreements with the IMF and WB without much alteration. AKP managed to gain international credibility and experience fairly quickly, and managed to translate parliamentary stability to economic and political stability. Indeed the Economic Transition Program- prepared between Minister Derviş and the IMF and the WB- was fully adopted by AKP government and was successfully

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<sup>75</sup> Thus, in the Kemalist modernization project, westernization and modernization were largely synonymous terms. Developing close relations with Europe was a natural counterpart of the broader project of Westernisation and modernization.

implemented (albeit some revisions in early 2002 towards the period of 2002-2004). Erdoğan has been an important domestic actor who could also be considered a policy entrepreneur but did not belong to a transnational ‘epistemic community’ like Derviş and Özal. The policy entrepreneurs’ impact as discussed throughout Turkish story evolved into the ‘discursive construction’ of the EU accession process which as Bakır suggested, was about ‘how state elites from their identities, define the interests, and legitimate both the European integration process in general and specific policies by framing them in convincing ways.’ (2006). The Pre-Accession Economic Program (PEP) submitted to the Commission on December, 2004 was a road map for macro economic targets and structural reform agenda, as well as for meeting the Maastricht criteria. Continuity in the use of IMF and WB anchoring went hand in hand with the economic and political conditionality of the EU. The 2001 standby agreement with IMF served as basis for new standby agreement with IMF signed by Minister Babacan in February of 2005. High privatization revenues played a large role in reducing public debt and getting marginally closer to the Maastricht target of 60% of GDP (EIU 2007). The Commission’s report in 2004 stated that: ‘...Turkey’s institutions and regulatory set up underwent substantial modernization, while the Central Bank of Turkey gained independence...’ Once more, the strong overlap between IMF standby agreement’s three conditions with the ‘PEP’ promises are observed; in particular with respect to the harmonization of the Banking Law with the EU in bank ownership and in management and licensing and connected lending.

Hence, robust public support for AKP for being the right track with EU accession roadmap continued until late 2006. Nevertheless, given the domestic stability the fact of conditionality's existence hardly predetermines the mechanisms’ effectiveness in producing intended outcomes ((Tocci 2005; Öniş and Keyman 2007; Hughes et.al. 2004). Treating

conditionality as a uniform variable is highly problematic in most instances and most particularly in the case of the EU, which uses conditionality on a highly inconsistent basis as we evidenced in case of Romania, and to a much lesser extent with Slovakia. The cost of compliance should not exceed the benefits.<sup>76</sup> In this case, when conditions conflict with the ‘existential’ organizing principles of Turkish state, such as national identity and sovereignty, one would expect that change cannot be explained as solely driven by external pressure.

One would expect compliance where there are ample rewards and relatively lower costs, but the variation across in the cases of Slovakia, Romania and Turkey show a much more complicated picture for the rational explanations consisting of actors’ cost and benefit calculations. We see compliance (in case of Turkey) where the cost of compliance is hefty, the risks involved are high, and there are hardly any definite rewards or finalité. The AKP government faced very high political and electoral risks for complying with the European Union criteria. First time in majority government, AKP risked the support from their base of moderate to conservative Islamists by fully backing Europeanization and formulating success in compliance with the conditions. It reaped the benefits of risk taking with some eventual rewards in 2004 and 2005: the European Council followed the Commission’s recommendation and approved the opening of accession negotiations with Turkey which commenced in 3 October 2005. But save for the pressure from IMF stand-by agreements; the straight jacket of EU accession criteria came as a ‘blessing in disguise.’ AKP pushed through its agenda of liberalization, privatization and structural reform on one hand, and liberalization of the political regime on the other, through the instrumental use of direct conditionality and

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<sup>76</sup> With 2001 adoption of Accession Partnership, the rewards in shape of financial and technical assistance for the first time became a reality. Commission presented a single financial framework regulating financial assistance to Turkey, including pre-accession credit facilities, MEDA, customs union assistance as well as European Investment Loans. Accession aid increased with Copenhagen Summit of 2002.

through the use of the ‘cloak’ of credibility on its agenda in terms of its ideological orientation to the Western European model against domestic Eurosceptics and international critics, and maintained stability and accountability.

### **5.8. Remaining questions: What is beyond 2007?**

A stagnation of economic reforms is expected to occur, especially with respect to property rights due to political instability after the squabble about the election of the new president between the AKP government and the Kemalist establishment in the military,, political parties and civil society. In the meantime, some further challenges may arise with respect to the implementation of EU’s social and environmental norms and engineering a major restructuring of the agricultural sector which is currently characterized by a massive labor surplus. Turkey’s ability to graduate towards full membership will depend on its ability to sustain the high rates of (inflation-free) economic growth on a sustainable basis, as aptly reviewed in the Working Paper, co-authored by Derviş, et. al. It argues that Turkey as a society, realized in 2001, that the rent seeking political economic system had to change and that something fundamentally different was required for the country to continue to progress. (Ibid, p. 23). <sup>77</sup>

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<sup>77</sup> It further predicts that the decision to start negotiations will have an immediate positive effect on expectations leading to a reduction in real interest rates. This would consolidate the positive debt dynamics experienced over the last three years and may well lead to a virtuous cycle with lower interest rates, more investment, more rapid growth, lower debt ratios, further declines in real interest rates. In the second or third years of this process, a steep increase in direct foreign investment could be witnessed, adding another powerful factor to the positive growth and debt dynamics (Ibid, 27-8).

## 5.9. Conclusions

How did the policy makers between 2001 and 2006 achieve consensus on structural and regulatory reform in Turkey? We can argue in this case, Turkey reaped the benefits of long term orientation of the Turkish politico-economic elite towards European Union Model.<sup>78</sup> The chapter argued that AKP government in particular pre-committed itself to reform, while the extraordinary crisis situation provided a fertile ground for such pre-commitment. Reform choice and commitment theories are interrelated when one considers constitutions and other international standards as forms of pre-commitment. As Elster states, ‘men are sometimes free to choose their constraints.’ (2000, p. 34) Rationality becomes a ‘maximizing by a sacrificing’ concept. By binding oneself (taking some options off the menu), in strategic interactions, one can manipulate an opponent or prevent him from manipulating him/herself as was the case with AKP. One can lay one’s reputation on the line in case of a reversal, thus preventing the weakness of the will of the future selves by the present selves.<sup>79</sup>

A case could be made for the alternative explanation entertained throughout the project, that timing and sequencing could explain EU’s decision to open negotiations with Turkey in exchange with Turkey’s compliance with the Copenhagen criteria. When August 2002

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<sup>78</sup> Z. Kudrna’s research affirms that the case for convergence of banking regulatory regimes in emerging countries seems very strong (2003-4 MA Thesis, CEU). This is only reinforced for the EU10 cases by the role of the EU conditionality in harmonizing regulatory regimes of candidate countries with *acquis communautaire*. This included the Financial Sector Action Plan, which subsumes the international banking standards advocated by the Financial Stability Forum (European Commission 1999, Strategic objective 3). However, there are also powerful arguments against convergence hypothesis.

<sup>79</sup> This is aptly explained by Elster, with the example of Ulysses binding himself to the mast not to be tempted by the voice of the sirens and putting wax in his rowers’ ears so that they would not go off course and shipwreck). In this chapter’s opinion, AKP policy elite practiced a similar self binding to that of Ulysses.

constitutional package aimed to fulfill the political conditionality, it became clear that CEECs were about to conclude their accession negotiations and begin talking with the EU about the timing of their accession treaties, it became evident that Turkey would be out of the first wave and the second wave, awkwardly placed somewhere in the third wave. Nevertheless, this case study attempted to show that the credible commitments made by the EU post 1999 have rendered the adoption of the Copenhagen criteria a powerful mechanism for transforming the Turkish economy as well as Turkish democracy and foreign policy behavior.

Turkish- EU relations remain in flux, yet keeping the membership option credible and open for Turkey, impact the capacity of EU to become genuinely inclusive and multicultural on one hand, and would test the extent of the EU to become a genuine global actor, through its enlargement policy vis-à-vis the Western Balkans and its larger 'Neighbourhood' and its relations with Russia as predicted also by Inotai his recent comprehensive foreign policy analysis (2007). Thus, de-linking membership of Turkey from its fellow candidates in the Western Balkans such as Croatia as suggested by Inotai (as a panacea for enlargement fatigue and accompanying capacity overextension) and treating Turkey as a separate and special case may be counter productive for the medium and long term foreign policy goals of the EU. Of course, much will depend Turkey's own performance in terms of enlarging the existing coalition supporting its membership, but the more credible Turkey's own reform trajectory becomes, the increasingly more difficult it would be for the EU to resist Turkey's full membership claims in the post September 11<sup>th</sup> environment.<sup>80</sup>

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<sup>80</sup> For further discussion of this dimension see Öniş (2006).

## ***Chapter: 6   Whither Enlargement? The cases of Slovakia, Romania and Turkey***

### **6.1.   Introduction**

To disentangle the EU effect is tricky, in this chapter we employ a diachronic comparison.<sup>81</sup> Some studied European enlargement as an intervening variable in domestic institutional development, rather than a driving force (Goetz, 2005, p. 217). The routes of EU's influence are manifold. In focusing on the use of conditionality, we are trying to narrow down the influence of the EU so that it can be studied across cases with more consistency. To further operationalize the EU effect, we divided the influence of the EU in its direct, indirect and transformative varieties. In its direct variety, the EU required that applicant country would take on the same kind of policies that its members have agreed to. The indirect variety of influence consisted of the transfer of ideas, norms and attitudes by the applicant country from the EU. The third variety is not independent of the former two, but the transformative tried to capture the dimension and synergies born from the interface between domestic and external factors.

Constraints to EU's influence are also manifold, and could come from both the EU's and the candidate countries' sides. In comparing, we test the hypotheses whether conditionality was the main driver of change, or alternately, EU's influence was one of the numerous factors leading to political and economic change. As some suggests, EU was mostly acting as a reference point to frame and legitimize demands by alternative domestic actors (Rumelili,

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<sup>81</sup> Diachronic comparison as we understand it here, means, the comparison of instances over time, as opposed to synchronic, at one point in time.

2004). The alternative explanations propose that the change happens as a result of a domestic power struggle where EU can signal direction or act as a backdrop for the power struggle.

In order to analyze EU's influence, our conceptual framework consists of four concepts to test the impact of EU conditionality, namely *principles, institutional structure, policy environments, and implementation*. These concepts come out of EU's own assessment of progress, namely its annual reports about the accession related reforms and institutional and regulatory changes as well as the candidates' reactions. When we try to locate EU's influence within these concepts, we find that the conditionality has been most effective in altering the policy environment in the candidates, while in providing principles and structures and implementation concepts, conditionality's impact lessens. In terms of the varieties of EU influence, EU's direct conditionality was not as effective as had been initially thought. Working against the clock without designing the agencies, and putting them to work without adequate human and financial resources may have been counter-productive. These findings are significant, but they indicate that conditionality in its use has been imperfect; and that the learning has been slow on both sides. The comparison across country cases, and in policy areas such as banking privatization where reforms depended on a strong regulatory blue print, demonstrates that conditionality has had the most significant impact in imparting tools for reformers to self-commit. Yet, with regards to implementation, conditionality did not use the carrots and sticks effectively, the checks and monitoring structure were lacking in even the most optimistic scenarios where the consensus across veto players for reform had been robust, but has often been at the cost of a more democratic forms of decision making as often witnessed in over-use of executive power.



## **6.2. Comparative framework**

The theoretical lay-out for the comparison comprised of the re-consideration of the EU conditionality's dynamics and specific tools. We found Vachudova's (2001, 2005) categorization of passive and active leverage useful, but there was a well founded need to adjust these theoretical lenses to reflect that the complexity of the interaction between external and domestic levels. We added a third type, called 'transformative conditionality'. We also considered the possibility of a return to an indirect influence either once the country formally accedes to the EU.

The below comparison of EU's influence in three different candidates is compartmentalized into four concepts: the principles, the policy environment, the institutional structures and the implementation. These are not chronological divisions, but are there to reflect the many aspects of the accession process. By principles, we mean the blue prints that are formulated by the Commission, the Copenhagen criteria plus the *acquis*. By institutional structures, we would like analyze pre-existing structures and institutions as well as those that were added on or created unilaterally by the candidate state and were not recommended by the Commission. The policy environment consisted of the domestic veto players, considering the domestic configuration of preferences, and the various interest group alliances. The last category, implementation, includes, developments further than legislative adjustments or amendments to the constitution, but their reflection on the economic arrangements; in arrangement of national and local administrations, judicial system, minority rights and relations, namely those that are put into practice not as direct consequence of *acquis*, but perhaps as consequence of the coping strategy of the adapting countries' institutions. Regardless of how often from 1997 (Agenda 2000 screening) onwards the Commission underlined the importance of

implementation, and that the laws should not remain on paper, it would be useful to look at how these reforming states fared in trying to increase the rate of implementation, and to what extent they managed setting up regulatory structures.

As the cut off year, 2006 is chosen on purpose as it is the last year before Romania acceded to the EU, and also the year that the negotiations eight chapters in the acquis with Turkey was suspended, with the European Council's decision that year to review annually progress until 2009. The year 2006 could not however be considered a milestone for Slovakia. But some analysts pointed out that Slovakia in 2006-7 would be a case of a former applicant country that had demonstrated resorting back to illiberal tendencies once inside the Union. There has been growing interest in the follow-up to the accessions, some body of work looked at the post accession compliance over conditionality, admitting that once the formal/direct pressure of conditionality is removed, sometimes by a definite promise of an accession date no matter what. Such was the exceptional cases of Romania and Bulgaria, whose accessions in January 2007 raised doubts about their state of preparedness especially in the light of Romania's persistent (!) reputation for being a integration laggard (Pridham 2008b)<sup>82</sup>. When we add the signs of backtracking in reform once past accession post, to the persistent impact of legacies and the evident strains on the rule of law (Economist, 31.05.2008), then it may be a worthwhile to include a grace period after accession for the longitudinal analysis (Slovakia between 2004 and 2006).

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<sup>82</sup> For more detailed analysis, it would be worthwhile to consult the Commission report entitled, 'Monitoring report' on the state of preparedness for the integration of Bulgaria and Romania to the EU.

### 6.3. Findings of the case studies

We classified three types of the instrumental use of conditionality, the first being the direct use of conditionality, the second one being the indirect use, which can either come before the direct use or could come at a later stage once the country accedes in the EU. The third kind of conditionality was the transformative kind, where conditionality created a change in the power distributions (similar to the direct use), but in addition, it created a change in the strategic adoption of norms by the key actors in the domestic calculus.<sup>83</sup>

Indirect tools of non-coercive nature, such as: bilateral EU-candidate country meetings, expressing concerns, resolutions, diplomatic notes, demarches, and other opinions, were widely used in the case of Slovakia between 1994 and 1998. Direct tools, such as the European Council's strategic decisions (either demoting or promoting countries to the next stage), or threat or practice of suspending the association agreements, suspension of *acquis* chapters are among some. Such decisions are based on the Commission's annual reports on the candidates. Luxembourg and Helsinki summits divided countries into fast track and slow track groups, but then it changed into proceeding with integration to the EU at their own pace.

#### 6.3.1. *Principles and Initial Conditions*

The set of principles which the EU applied, i.e. both the formal conditions and as well as the soft power tools, have been dynamic. Not only has the number of entrants and candidates

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<sup>83</sup> The transformative kind was most effectively demonstrated by Grabbe (20026), she explained that the changes involved in the logic of behavior of domestic actors and institutions that were driven by the absorption of EU norms.

have been rising, but also the pre-accession requirements continue to mount because of the regular increase in European legislation, the *acquis* and directives, as well as the tightening of conditionality procedures and expectations with respect to the Western Balkan candidates, the lessons learned with the 2007 entrants and Turkey.

However, in terms of providing blue prints, the EU had not been very resourceful in exactly the same issue areas that are classified as bottlenecks for Romanian and Turkish accession reforms respectively. Whilst the necessity for the modernization of the applicants' administrations has been emphasized on numerous occasions, the EU has fallen short of pointing out a best examples in this field, designing a blue print being out of its competence (Dimitrova 2002; Olsen, 2003). As a result, despite the EU's insistence on the speedy and full implementation of the *acquis* by the new member states, the choice of administrative tools through which this is to be achieved, remains very much in the hands of the applicant countries themselves. In the absence of a single 'European' model of public administration – itself a reflection of the strength and resilience of national administrative traditions across existing Member States – the role of the twinning exercise, as an instrument of policing the EU's conditionality, is a peculiar one. At one level, the dispatch of civil servants from the existing Member States to lead initiatives of administrative reform in the candidate countries can be seen as a relatively advanced form of policing conditionality 'on the ground.' Yet, the record on Romania and Bulgaria, the two implementation laggards, had been sub-optimal in the former's case (Phinnemore and Papadimitriou 2004); it led to interesting institutional anomalies in the latter's case (Vincelette 2004). This experience of national color, has been repeated in the practice of employing EU consultants to fill in for the lack of expertise in policy coordination in Romania, as was described in the case study, each consultant recommending his/her own country's national model as we will see explained below.

### 6.3.2. *Institutional Infrastructure:*

Our analysis of Slovakian democratic reforms focuses on changes to the rules of the democratic game after 1998 elections, followed by the critical amendments to the Constitution in 2001. These formal changes were not enough, unless there was a corresponding set of political actors, political cooperation between non nationalist political parties, and shaped the nature of party competition. EU conditionality played a catalyst role in uniting political opposition; increasing political awareness and mobilizing the public (Rybar and Malova 2008). The Commission *avis* published in 1997 coincided with the NATO decision not to invite Slovakia for the failure to meet political criteria. This came immediately before Mečiar government tried to call a referendum on NATO membership which in its 4 question format had biased the voters for a no vote, thus preempting the NATO's unfavorable opinion. Two external events, EU's rebuff and NATO's refusal, underscored Slovakia's international isolation, in this case *tipped the balance* towards the domestic opposition. After the elections of 1998, the Dzurinda government fulfilled most if not all political conditions, and the constitutional amendments of 1999 and 2001 were to provide a more effective framework for political competition.

EU conditionality provided the short term priorities (as published in 1998 Accession Partnership) for Slovakia to meet, which were free and fair elections, greater involvement of political opposition in decision making and control procedures, and enactment of legislation on the minority languages. The institutional infrastructure for instrumentalizing a speedy change to the right course was also put in place with the signing of the Europe Agreement in 1993 with Slovakia. It consisted formally of the Association council, at ministerial level, and at parliamentary level, and a similar council met under the framework of association

parliamentary committee. Association council met annually at ministerial level and supervised the implementation of the Europe Agreement and it comprised of members of the Commission, the Council and members appointed by Slovak government while the Parliamentary council consisted of MEPs and members of Slovak parliament, which met twice a year once in Bratislava, once in Brussels and could only inform the decision of and make recommendations to the Association council.

If we traced the process of Slovakia's gradual EU orientation, the following events could be named. After 1994 elections over a very short period, the parliamentary majority constituted absolute majority rule, with very few checks on executive and constitutional constraints on the cabinet, including voting down opposition candidates for vice chair of parliament and denying opposition MP's from sitting in parliamentary committees. The opposition parliamentarians also lost their seats in supervisory bodies overseeing the public mass media and intelligence service, as well as removal from Supreme Auditing Office, and National Property Fund and attorney general was replaced. The checks and balances were thus fully compromised at the institutional level.

These developments were noted by the Commission, which culminated in the historic 'demarche' (the first in EU conditionality's history) in late 1994 issuing the concern of the EU troika about anti democratic developments in Slovakia. It was followed by confrontation between the cabinet and the Constitutional Court which overturned the controversial laws. Afterwards, came the second round of diplomatic demarches in 1995, Mečiar government bemoaned of different standards applied to Slovakia and unfair attitude. Then a resolution by EU parliament in mid-1995 followed, calling for respect for democratic procedures and

warned that if Slovakia did not reconsider its policies, the EU may reconsider its programs of assistance and cooperation under EA could be suspended. The EU thus far, was consistently increasing the doze of the warnings and threats, and was arguably fairly responsive to what was going on through the creative use of tools that was available.

The Ministry of Culture of Slovakia made an announcement in 1995, about its preparation of a new Law on State Language that would regulate the use of Slovak language in all aspects of public life. The parliamentary majority adopted the law and cancelled the 1990 law allowing ethnic minorities to use their own language in official communications, and went as far as outlawing the publishing of all non-Slovak periodicals and in 1996. Added to this was the passing of the Law regulating the use of state language in all parliamentary debates, thus sanctioning the use of minority language in all debates and communication in the Slovak House of Parliament.<sup>84</sup>

This was followed by the adoption of ‘alternative education’ as a policy in education, overseeing the teaching of some subjects in Slovak in Hungarian language schools. The dismissal of school directors that protested against this new arrangement led to strikes by teachers, and parents. Another less substantial issue in this area, was termination of the issuance of bilingual certificates. The commission report made special mention of the minority language rules and expressed dissatisfaction in minority affairs.<sup>85</sup>

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<sup>84</sup> The Law of State Language was revived in 2009 by Fico government and has been a source of dispute between the Hungarian and Slovak governments.

<sup>85</sup> The parallel with the Turkish case is an interesting one. The state ban of all minority languages in parliamentary debates and all national and local administrative communication was strongly by the Commission. One of the landmarks of compliance with political conditionality, was the passing of the Law that permitted

Political instability was the course of most of 1996 and 1997, when the struggle between Mr. Mečiar <sup>86</sup> and President Kovac exasperated and when Kovac passed away unexpectedly, Slovakia was left without president because of lack of a parliamentary majority) to elect one, until the amendment to the constitution, to allow direct election of the president. Last chance resolutions were still being debated in the parliament before elections just before avis publication, calling Slovak government for compliance, in the joint parliamentary committee meeting, by November 1997, a month before the Luxemburg decision blocking Slovakia's accession.

Five opposition party alliance was established before 1998 elections, motivated by the need to break away from Slovakia's international isolation. In the elections, EU factor played a big part. The SDK (Social Democratic Party) went into a coalition with Hungarian ethnic parties and also talks were conducted amongst political parties, trade union representatives, international and national NGO's, and local government associations, duly named the Slovak 'democratic roundtable talks.'

Negotiations in Romania started officially in 2000 and by 2002, 27 chapters were opened and 13 had been provisionally closed. Although the weaknesses of administration were identified by the Commission in 1998 report, the Romanian government recognized the bottleneck real late in the game, despite inclusion in the National Plan every year. The tipping point was the

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primary and secondary education in minority languages and the Law that permitted the opening of language courses in Kurdish, Laz and Circassian.

<sup>86</sup> Meciar's granting of amnesties to abduction suspects and referendum meddlers was the last straw before the elections, which made him less popular even with his traditional base.



‘SAPARD fiasco’ - the two year delay in running the program because of a lack of administrative structure and resulting in delays in agricultural reform. This was a significant set-back in terms of citizens’ expectations and perceptions of the performance of the government at one hand and the lack of political will on the other, in implementing administrative reforms. According to Hintea et. al. (2008), the EU conditionality was the only real pressure, guaranteeing the continuity of reforms in this area. The lack of trust by EU on Romanian public officials to manage, and use funds impeded the implementation of SAPARD and ISPA. Romania still needed to adopt international measures to fight corruption such as the Council of Europe Convention on Money Laundering, Search, Seizure and Confiscation of Proceeds from Crime as well as Council of Europe Criminal and Civil Law Conventions and OECD conventions on combating bribery.

### *6.3.3. Policy environments*

The policy environment during the Dzurinda I and II governments seemed enabling for reforms. The direct conditionality tools, the careful negotiations and monitoring by Progress reports, bore fruit, in sense of enabling the political leadership to press ahead. The two successive Justice Ministers from 1998 to 2006 faced various constraints. The former reportedly were constrained because of the fragile coalition, and reservations especially on the part of the left wing partner SDL. However under the watch of the later minister between 2002 and 2006, reform sped up. Both ministers benefited from the determination and campaign promises of their party, the Christian Democrats to fight against corruption, and especially dealing with the cases of clientalism in the sale of state owned enterprises in the Mečiar period and in the period that followed it for two years.<sup>87</sup> What was decisive about

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<sup>87</sup> These developments are aptly explained in the Nations in Transit Report of 2001-2002.

positive course of reforms the was the transformative nature of EU's influence, thus empowering of the domestic actors through the external aid, in the case of judicial reforms coming from donors such as the OSI and American Bar Association and also from bi lateral cooperation with EU member states. Judicial independence was instituted through a constitutional amendment in 2001, with a new Judicial council, a special court was created to try major corruption in the deals in the sale of state owned enterprises (more detail in the Slovak case study), and in organized crime cases. A new system in the administration of justice and criminal law was re-codified while judges' assets were published on the internet. In addition, new judges were appointed in haste, to reduce the proportion of communist era judges.

Slovakia along with other accession countries received ratings from Transparency International and Freedom House, which identified Slovakia as one of the three most corrupt countries, along with Romania in the first place and with Turkey as a close second. The case study dealing with Turkish accession noted the intricate behavioral problems in the judiciary which the EU conditionality could not really instigate real change and also the lack of political will and the corrupting linkage between the political class and business interests. Similar to the Turkish case, the Slovak chapter argued that the transformative aspect of conditionality arguably led to a more widespread public awareness and disapproval of corruption with effective campaigning by INGO's and local civic groups. Pridham and Dimitrova (2004) argued that the EU external pressure was there, in Slovakia's case, it was far from being the only pressure, for other International Organizations like the OECD, the WB and the Transparency International closely monitored and imposed anti-corruption conventions. The EU conditionality's role was initiating new policies and setting up of new agencies, but its importance was underplayed by some practitioners in Bratislava in interviews

conducted by this author (as can be read in the Slovak case study). A series of direct measures in the Dzurinda's second government (2002-2006) government to fight corruption and indirect but effective measures such as the reform of public finances, (leading to a decline in corruption in the banking system), and of the judiciary and of the health care system, which according to some analysts the current Fico government is still consuming the fruits of these interlocked reform measures (Györffy 2008, 18-20).

In the area of minority rights, which was one of the political conditionality hurdles common in all three of our country cases, Slovak measures to address the criticisms in the progress reports presents a stark contrast between the treatment of its largest minority, the Hungarians and the dire state of its Roma community. One could argue that the steady improvement of ethnic minority rights of Hungarians could be due to the king maker role of the SMK, the ethnic Hungarian party. The passing of legislation favoring Hungarian language in schools, and such, were a solid achievement of EU's direct conditionality and would not have taken place in its absence. The EU arguably provided a 'benign' pressure although at times the tensions in the parliament between the SMK and its coalition partners became very intense with respect to the regional reform and the Hungarian status law. These bound the hands of the next government as any hostile policy moves would provoke adverse publicity in Brussels and Budapest. In terms of the Roma rights, the EU arguably had less of an influence, given the less of a public concern it caused, and the Roma themselves were very poorly organized in the time period toward 2004 accession. The WB's and Brussels' pressure and influence were instrumental in the setting up of the Roma Plenipotentiary's Office in 2001, and this office had some say over the regular reports of the Commission on Roma issues. During the second Dzurinda government, the Roma office became more operational, with five regional branches, networking transnationally with the EP, and the arrival of Structural funds after EU accession

for roads, schools and training in labor market promotion. The monitoring by fund givers such as the World Bank and OSI continued post-2004.

The accession negotiations were proceeding slowly but steadily at a technical level in Turkey during this period. Turkey was newest to the game in the sense of starting accession negotiations, but compared to the Romania and Slovakia, it is the oldest applicant since 1959. The Transatlantic integration of Turkey is even older, and it has been a staunch ally of the US, who intervened in the EU intergovernmental summits and conferences leading to 1999 Helsinki decision, has intervened on Turkey's behalf, consistently arguing that integration of Turkey would strengthen the global power and EU's security and foreign policy hand, due to its the geostrategic importance where EU needs to play a more decisive role such as energy policy, relations with Russia and in the Middle East.

Since October 2005 when the EU and Turkey have begun accession negotiations, eight chapters have been opened, and one (on science) has been provisionally closed. If we consider the accession as our dependent variable, and try to evaluate it according to the number of the chapters opened and closed, then Turkish accession could be argued to come to a grinding halt by 2006. EU officials said two more chapters (on free movement of capital and on media) might be opened before the end of the French presidency in December 2008, and possibly on energy and preparations started in taxation but no negotiations had been started to date. The process is running of steam unless it is invigorated on the political level. EU officials lamented that the reform process has slowed dramatically, since 2002-4, period when Turkey pushed through several large reform packages. Turkish policy makers, rejected the allegation, stressing that in 2006-7, Turkey has passed 29 laws, that were relevant for EU accession,

including a new law on political foundations and amendments to article 301, of the penal code, we discussed as being of the more fundamental bottlenecks in the Turkish ‘goodness of fit’ to European level processes and institutions.<sup>88</sup> The European Council in 2006 suspended eight chapters in the accession negotiations because Turkey was not implementing the Ankara protocol, and it added that it would review the situation every year until 2009.

#### *6.3.4. Implementation*

2002 proved to be a milestone year for Romania as it was invited to join NATO and it received news that it was slated for EU membership in 2007. Several key piece of legislation such as the Law on the Freedom of Information was passed with the active involvement of civil society and various interest groups. Among the most important efforts was the joint initiative of Chamber of Deputies and coalition of NGOs whose main goal was to consult citizens on proposed constitutional reforms and the campaign by Pro Democracy association to urge revisions to the electoral code, and passing of the aforementioned law of freedom of information. In March 2002, the Committee of Ministers in Council of Europe concluded that Romania which is a signatory of the convention for the protection of national minorities, made commendable efforts in supporting national minorities and cultures, i.e. the publications of textbooks in minority languages. The INGO’s such as the Open Society Institute and donors such as the EU and UN, decidedly urged local NGO’s to take more initiative in raising their own funding and thus scaling back their own contributions. In 2001 and 2002, the publication of several stories about the mismanagement of grants and subsidies by local NGO’s by the media shook the confidence of public in civil society. Romania’s progress on freedom of expression and media which is enshrined in EU’s political conditionality was also

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<sup>88</sup> Börzel and Risse (2003) discuss goodness of fit as a concept to measure domestic impact of Europeanization.

criticized especially after a key development in 2002, which was the passing of Law of the Right of Reply which furthered the threats against press freedom by politically well connected individuals. Around this time, Romanian parliament also approved the Law on State Secrets and Classified Information, which the media and human rights organizations criticized strongly for provisions that they believe allow governments administrations, state owned enterprises, the military and other public institutions to avoid public oversight and scrutiny (Freedom House, 2003; p. 10). This continued to be the soft belly of Romanian political reforms, and much similar to Turkey's infamous Article 301, which promoted in the progress reports from 1999 to 2007 as the main hurdle for freedom of expression, the law allowed to imprison journalists up to five years allegedly for insults, defamations or libels against civil servants or for any 'offence against authority' according to the law.

The Commission's October 2005 report outlined the stages of preparation for 2007 entry and it showed that much needed to be done in implementation. It was far more critical of the progress of structural reforms and outlined a number of areas in which Romania might be considered deficient in meeting the economic criteria for accession. The report argued that vigorous implementation of economic reforms would be required for the economy to cope with competitive pressures. In addition, the Commission warned Romania about the need to reduce the public sector deficit by tightening financial discipline in state-owned enterprises and adjusting energy prices to cost-recovery levels. In addition, the rapid appreciation of the *leu*, partly resulting from the shift of monetary policy towards inflation-targeting, and partly from the asset boom in construction (with productivity rate of 0.1%) was having a negative impact on the trade balance, and was another area of concern mentioned in the report. In its general evaluation of economic criteria, the report urged the government to give priority to establishing a prudent fiscal policy by strengthening the revenue base and controlling public-

sector wages; accelerating privatization and dismantling non-viable enterprises; improving financial discipline in state owned enterprises; and making greater progress in reforms of the judicial system and the public administration to create a positive business environment.

The privatization process in Romania, despite significant external pressure from the IMF in the form of stand by agreements signed in 2001 and the 2003 and the critical approach of the Commission and the lobbying of the EU business lobby, continued to proceed slowly. After more than a decade of transition, state-owned enterprises continued to account for a significant share of economic activity. The private sector accounted for 70% of GDP in 2004, compared with 80% in Hungary, according to data from the European Bank for Reconstruction and Development (EBRD). After accelerating towards the end of 2004, the pace of privatization again slowed in 2005. Bankruptcy procedures had been cumbersome and had prevented the liquidation of large-scale tax debtors. Large parts of the energy and mining industries incurred losses and rely on direct subsidies and debt cancellation. In addition to the slowing down of large scale privatization of the SOE's, no privatization of state-owned farms took place in 2005 and many farms are teetering on the verge of bankruptcy. Progress in agricultural reform has been hampered by legal disputes, bureaucratic delays and local corruption in the distribution of land titles. This has hindered the creation of the properly functioning land market that is needed to permit the development of large farms. As a result, most processes remain under- capitalized and labor-intensive (EIU 2006).

The analyses from the progress reports and from the detailed sectoral analyses by the Freedom House reports (1999-2006), showed that Romania under the pressure of the EU accession, has made significant *legal advances* by 2004, but implementation lagged owing to

a lack of political will. The coalition conditions after the 2004 elections made the critical 2005 year, a time of promises but stagnation in the work of the parliament and of the special agencies continued. While Romania is considered to have been in compliance since 2000 (Progress report 2001 and 2002), with the Copenhagen Political Criteria, new concerns about the media freedoms and the independence of the judiciary arose in 2004.

The Copenhagen European Council (December 2002) resolved that if the European Council in December 2004, on the recommendation from the Commission decided that Turkey fulfilled the Copenhagen political criteria, the EU would open accession negotiations with Turkey. The period between 2001-2002 in terms of implementation and the instrumentality of EU conditionality was a test period. In March 2001, the EU Council of Ministers adopted Turkey- EU Accession partnership which was followed closely with the adoption of the National Program of Turkey for adoption of EU laws. The new economic program launched in the spring of 2001 embarked a set of structural reforms and a macroeconomic policy with the objectives of both stabilizing and strengthening the growth process in Turkey, as well as realizing an acceleration in the long term growth rate and protecting the country from a recurring crisis. The crisis of 2001 was a combination of banking crisis which forced the State to recognize its contingent liabilities in the banking sector with a risky attempt to dis-inflate by using a nominal anchor exchange rate policy. The Turkish state had to re-capitalize the de facto bankrupt state banks and important segments of the private banking system that were nationalized because they lost their capital, leading to surge of the public debt ratio to more than 90% GDP at the end of 2001. As fulfilling the objectives of the economic program, a new law on foreign direct investment was enacted in 2003. It aimed at improving the investment climate by creating a more transparent marketplace fully integrated with global markets, and was supported by a more rationally structured and more effective state. In that



direction, the concepts of foreign direct investment and foreign investors have been redefined within international standards and the rights of investors have been enhanced via making amendments to legislation dealing with national treatment, guarantee of transfers; access to real estate; international arbitration, and employment of expatriates. The government also has established the Coordination Committee for the Improvement of the Investment Climate (YOIKK). This body, composed of high-level representatives of relevant ministries, the private sector and NGOs, was formed to identify and remove regulatory and administrative barriers faced by foreign investors. Backed by the amendments for simplification and streamlining of company registration, Turkey purportedly had one of the shortest and simplest procedure to set up a business according to OECD's 2002 report.<sup>89</sup> A plethora of reforms passed as part of the economic program showed an impressive legislative and significant implementation performance of the 2001-2004 AKP government at strengthening the regulatory capacity of the state institutions and quality of the social safety net.

Thus, Turkish economic reforms were full anchored to the EU criteria by late 2003. What was happening on the front of political conditions? Between 1999 (the declaration of Turkey's official candidacy) and 2006, Turkey aimed to adopt close to eleven different democratization packages in total, in order to the political conditions for membership. An important element in this process of political reform was the pressure coming from various civil society groups in Turkey that wanted to begin accession negotiations with the EU. Thus, the prospect of membership increased the visibility of pro-democracy and pro-European groups in Turkey as well.

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<sup>89</sup> OECD 2002, 'Regulatory Reform in Turkey: Crucial Support for Economic Recovery'.

The most important reservations the EU brought forth in its progress reports between 1999 and 2004 can be summarized under the headings: the role of the military in politics through the judiciary; the State Security Courts; and through the National Security Council, the Turkish Penal Code and its articles on freedom of expression and association; the death penalty; the transparency of the public sector and the violations of human rights. From the end of 2002 to 2005, the Turkish government adopted seven further major packages of political reform. The first two constitutional reform packages by the new government were adopted immediately after they came to power in December 2002. The fourth adjustment package was adopted on 3 December and became operational in January 2003. The fifth adjustment package was adopted on 4 December and became operational in February 2003. First, these two packages operationalized most of the amendments, most significantly the retrial of all the cases in Turkey decided in State Security Courts, adopted by the previous government in the August 2002 package. Particularly important here is the retrial of the Democracy Part, DEP, its parliamentarians who had been in jail since 1994 for supporting terrorism and Kurdish separatism in Turkey.

The use of emergency ordinances in this period were also wide and could be compared to Romania in the same period, thus raising doubts about the democratic legitimacy of the reform process (top-down as opposed to bottom up). One should also note that the Europeanization process in Turkey has mostly been interpreted as democratization, that is, political Europeanization. However, an important aspect of Europeanization is improving efficiency in policy and decision making and Turkey continued to face the challenge of implementing and enforcing the political reforms adopted, especially with regards to the

freedom of expression clauses in the time of writing of this chapter. Civil servants in the lower ranks lag behind their governments in the implementation of the vast reforms adopted. The policy harmonization and the intensified adoption of the EU *acquis* once accession negotiations began with the EU became the other important areas of Europeanization in Turkey. The EU's twinning mechanism through which civil servants in EU member states are seconded to candidate countries could prove to be especially important for the enforcement of the legal changes. Turkey participated in twinning projects for the first time in 2002 with 13 projects mostly on justice and home affairs and financial sectors. The twinning projects arguably have contributed and will continue to contribute to Turkey's Europeanization process in the future, not least because they might instigate a larger socialization process.

The civil society's involvement, as the Turkish chapter emphasizes the involvement of groups not with the links to the political forces but rather with links to the private sector were critical from the period leading up to AKP's coming to power with a strong EU agenda. Associations such as TUSIAD (Turkish Businessmen Association), TESEV (Turkish Economic and Social Studies Foundation) and IKV (the Economic and Development Foundation), in particular, strongly benefited from their familiarity with the EU institution that provided them with additional resources to exercise pressure on the government's policy agenda. This is not to say that those groups lost relevance with AKP's government but one could perhaps arrive to a conclusion that AKP's reformist cadres and bias on the executive power may have hijacked the agenda of existing pro-EU coalitions prior to 2002 elections. Especially due to the exhaustion of the political parties in power before the 2001 crisis, AKP went mostly unchallenged in the first four years in power by their opposition party in the parliament. But more importantly, AKP and PM Erdoğan managed to portray themselves as the real champions of Europeanization reforms, pointing to political and economic stability at one

hand, and boasting about their backing from the two main external anchors institutions for reforms, the IMF and the EU.

In Romania, after elections in 2004, the government of the Truth and Justice Alliance was held by a thin and tenuous majority, threatened by each individual absence during the parliamentary sessions. The government despite serious concern by the Commission's monitoring reports in 2004 and 2005, continued to prefer emergency ordinances as the default option for much of the legislation proposed. As the urgency of the accession deadline increased (in particular, during the period leading to the signing of the accession treaty in April 2005), 114 such emergency ordinances were, down from 142 in 2004. The parliament, Freedom House reported (2005), remained idle for weeks, as each political group debated their own stipulations and regulations regarding the issue of early elections. Pointed as a weak spot for Romanian governance, policy coordination saw little improvement, especially assisted by the decrease of in the number of inter-ministerial committees. Problems arose from the lack of a policy planning centre to generate strategies across ministries, despite the existence of such 'competitive and professional' units in the government. The quality of legislation was poor due to the incompetence of professional civil servants, thus the outside help was often brought in from consulting firms, i.e. Deloitte Touche and Ernst&Young, that cross coordinated between Romania and Turkey<sup>90</sup> in order compensate for this lack. A plethora of EU advisers- each promoting the legal tradition of his or her country rather than a common European mode- made coherence even harder to attain. According to Freedom House Report (2006), proposed legislation continued to be sent to the Parliament often working against the clock, without a serious impact study of affordability and implementation capacity. Despite new legislative improvements, there were no notable developments in the

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<sup>90</sup> Based on the author's interview with Southeastern Europe management head consultant in E&Y.

implementation of civil service reform, as required by the safe guard clauses that were put into place in 2005 by the Commission. Civilian control, also one of the main hurdles in assessment of Commission of Turkish democracy, remained a problem in Romania. There was high suspicion amongst civil society activists and media, that former agents of the Securitate, were infiltrating the Parliament, the diplomatic body, and even the media. The agency in charge of screening the Securitate files remained weak, as was the agency, which was supposed to review files of MP candidates, failed to send them before the elections, to the Presidential review.

Despite these less optimistic assessments, the civil society continued a positive trend in monitoring democratization, arguably transformed by the incentive EU accession time line gave them. Romanian NGOs continued to act cohesively as advocates for various policy reforms and scored number of successes, giving one of their rising stars to the government to head the anti corruption legislation as a minister. In the transparency field, where NGO's made decisive input into the new legislations that would regulate procurement and state advertising in media which supposedly continued the dependency of media outlets on government money. One should add that these positive developments in the work of civic society was assisted by the cooperative approach of the new government, whose leader, Mr. Tariceanu, who continued the power struggle with the newly elected president, Mr. Basescu. Unlike the previous government, which made deliberate efforts, according to the Freedom House reports from 2001 through to 2004, in undermining independent civil society actors, the Tariceanu government improved the legislative environment governing the functioning of civil society <sup>91</sup>, in particular, by allowing of donations from income tax. The government also

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<sup>91</sup> The amendments to law governing financing of NGO's, renounced the category of public utility NGO's which had been a means of gaining privileged access to public funds. The government also passed new legislation on

started to use more NGO experts for policy matters. We should quickly add here that such consultations remained rather formal in most cases due to the short notice NGOs received from the government. Legislation and policy decisions were usually made under such time pressures, so the coordination of civil society with Ministry of Foreign Affairs were often not extensive. The transformative influence of EU political conditionality arguably imparted Romanian NGOs', autonomy and authority in monitoring quality of governance. The success of such initiatives were supported by the media which look forward to reports of different independent watchdog agencies, and often used NGO figures as pundits.

On the level of local governance compared to the previous two years, Romania also did not make much progress between 2005 and 2006, despite many months spent on revising the Law on Local Public Administration. The Freedom House's *Freedom in the World* reports (2003, 2004, 2005, 2006 and 2007), the OECD report (SIGMA 2006) and other analysts of Europeanization of Romanian public administration (Phinnemore and Papadimitriou 2004), concur on a likely explanation of this lack of progress. Stagnation was born out of conflict between a theoretical issue, how to endow local governments with autonomy and accountability, and a practical problem, how to dismantle the local networks of SDP oligarchs that still controlled the majority of county councils despite the ousting of SDP in 2004 elections from office. Romania passed overarching fiscal decentralization legislation in 1999, but SDP modified in 2001 passing most of the financial decisions to councils and council presidents, thus leading to the creation of local barons, heads of local networks of privilege and influence. Those county councils were elected on basis of party lists, but the presidents

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the sponsorship of NGOs that allows individuals to donate 1-2% of their income tax to NGOs. However, these positive legal developments may not significantly improve the financial situation of NGOs as Romania introduced 16% flat income tax in 2005, which an average monthly salary of 200\$, and fewer than 5 million working population, would not make significant contribution to the NGO coffers.

continue to be elected by council members on the basis of ad hoc regional alliances which did not always mirror the national system of political alliances and political migrations, and local defections became the name of the game. A vivid example of this incongruence was on the regions and regionalism, with the demands of the Hungarian alliance (DAHR). The Truth and Justice coalition accepted the request of their Hungarian allies to revise the projected regional structure of Romania which had been previously agreed with the Commission, and change to a make up that would secure a Hungarian dominated region. The current structure, based on the EU statistical criteria (EU-NUTS II), positions the three more populous Hungarian counties in the central region alongside the Romanian counties, leading to a balanced ethnic composition. DAHR, however, conditioned its support for the government, on the adoption of Law on Minorities Status which opened the door for self government for the Hungarian community. The problematic approach to administrative reorganization was opposed by the EU Commission because it would lead to a reorganization of the regions, as they are the main tools for distributing European structural funds, and Romania was still considered to be lagging behind in its preparedness to attract such funds. The serious warning by the EU, in the shape of introducing of a safeguard clause regarding EU accession at the December 2004 European Council may have provided serious impetus at one hand, as reform of the judiciary as a top priority, and failure to achieve these standards seriously risked accession to be delayed from 2007 and 2008.

## 6.4. Explanations

The focus in this chapter has been about the impact of conditionality on formal institutions.<sup>92</sup>

Dimitrova refers to this infrastructure of institutions as enlargement governance. Governance extended to enlargement, has an ‘executive bias’ and involves a relatively small number of societal actors (2004, p.18-21); an enlargement task force and the Commission on EU side, and the use of enlargement instruments, and the negotiating teams and the executives on the side of the candidates. The impetus on executive power has been discussed as one of the democratic shortcoming of this framework. But perhaps, one could come to terms with the observed processes that few actors have the possibility of becoming veto players, and as institutionalized veto points matter less in candidate countries. The variance amongst candidates can be demonstrated as follows. In some candidates states, the EU driven process has dominated over the domestically driven reform agendas and the domestic reform consensus is replaced by EU conditionality (as noted the Romanian case study, in the area of administrative reforms), while in others the interaction between the domestic institutional arrangements and the anticipation of EU requirements is much more complicated as in Slovakia’s privatization and financial sector reforms and Turkey’s financial sector reforms as explained in the preceding case studies.

In both Slovak and Romanian governments’ attempts for political reform to respond to the EU deadlines, the main problem can be summed up as lack of political will and the weight of political inertia. In the case of administrative reform in Romania, we observed that the direct conditionality was the *only* pressure to keep Romanian governments on track with putting institutions and legislative arrangements in place, even if only on paper. In the Slovak case,

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<sup>92</sup> The definition of institutions can be made as following: rules of the game in a society, or more formally, the humanly devised constraints that shape human interactions (North 1990).



the EU direct and indirect pressure came at a critical time, this pressure has arguably helped tip the balance towards the domestic opposition leading to the elections, and to reverse the amendments that were anti-minority rights and illiberal constitutional arrangements that affected the involvement of the opposition adversely. We could argue that in terms of changes in the institutional structure, in Slovakia, the EU's direct leverage was more effective than in the Romanian case of administrative reforms.

Comparing the policy environments in initializing and implementing reform agendas across these three cases, we observed a dynamic approach in the use of indirect and indirect conditionality tools by the EU. The Barroso Commission in particular adopted a stricter approach about meeting 'the letter' rather than just the substance of required political standards. As a long time observer of conditionality, Pridham (2008b; 365-387) marks this change in his retrospective view of Slovakia and Latvia accessions. This stricter insistence on satisfying the political conditions by the Commission was particularly visible when the Commission built in formal procedures for suspending negotiations at each stage if conditionality is not progressively been satisfied, in the negotiating frameworks for Croatia and Turkey (also see the association agreement for Slovakia on, [www.europa.eu/enlargement](http://www.europa.eu/enlargement)). The change in focus shifted to implementation as evidenced in the words of the Commissioner for Enlargement, Olli Rehn, 'we need not set schedules that cannot be realistically carried out.' (Die Welt, 10<sup>th</sup> December 2004).

Have the lessons learnt by the Commission been reflected in the gradual change in use of its tools on the three candidates in question across the time? How has the incentive structure leading to different stages of accession changed, and how have these changes been perceived

by the policy environment in these respective countries? We can answer these questions by reviewing the cases of democratic reforms since 1998 in Slovakia and in how Romanian domestic policy makers responded to the Commission's criticisms about lagging behind in public administration and civil service reforms, and in case of Turkey's efforts to overcome the opposition to minority rights and freedom of speech reforms.

On the economic conditionality front, all three candidates were facing a stalling in privatization reform due to the lack of regulatory institutions. In Slovakia's case it was the challenge of dismantling the clientelist structures of the Mečiar years; in Romania's case, it was with the restructuring hurdles of the banks, and in Turkey's case with the regulatory vacuum leading up to and immediately after the 2001 financial crisis. While one could argue in all three cases, crisis and the domestic factors could have served as a satisfactory explanation, the analyses in the three country cases have shown that the incentive structure have changed due to the use of EU conditionality direct and indirect tools leading up to post of accession. In Turkey's case, the time line was limited to the opening of formal negotiations in 2005. The direct and transformative aspects of conditionality empowered the hands of the domestic reformers through the induction of working norms that tend to favor European standards, meanwhile, the rules that were adopted became sticky after accession, according to some constructivist accounts of conditionality (Sedelmeier 2005, 227-8). But the comparison of accession processes in this chapter also purports that once the strict conditions were removed, stalling or reversals could be inevitable, because the tool box was simply not designed to reach beyond the formal accession, and in Romania's case especially beyond the acquisition of the accession date.

There has been skepticism in the field about the scope of EU driven institutional change during accession being ‘immediate’ rather than ‘lasting.’ (Goetz 2005; pp. 261- 2; Pridham 2008a) We would agree with the assertion that one need not wait to test this question of immediate or lasting until the candidate country has formally become a new member, thus can act then within the EU institutional structures. The comparison of policy environments may test an alternative claim that the incentive structure that is formed as a result of direct conditionality (the delivery of rewards in exchange for compliance), could stall the process or even reverse it even before the country reaches the finish line. This would also put into question constructivist arguments about the lock-in effect argued by the likes of Grabbe (2006); the status quo bias, as shown by Schimmelfennig and Sedelmeier (2005) and the attraction of the availability of new resources such as funds, expertise, ideas and legitimacy, as shown by Börzel (2005),

The rationalist accounts of conditionality mechanisms (Schimmelfennig et. al. 2006 and Hughes et. al. 2004) remain more cautious. The students of enlargement in this group converge on the opinion that the 2004 enlargement was one of ‘incomplete implementation,’ evidenced in the lack of consolidation of such legislation for eradicating corruption and lack of changes in behavior involving respect for law as basis for implementing the conditions. Just before the accession of Slovakia, the Progress report of 2002 concluded that, ‘some progress has been made in fight against corruption and combating discrimination’ (especially against the Roma citizens), but there remained a serious concern in the implementation of relevant action plans and drawing codes of ethics for the public sector (EU Commission Regular Report, 2002). The incompleteness of the judicial sector reform that would relieve the Slovak courts from backlogging of cases, and would impose impartiality, has also been an area of concern and reasonable doubt on the eve of accession (Ibid; p. 35).

In contrast to Slovakia, when it came to Romania and Bulgaria's turn, the progress reports detailing implementation was put in use. In the three areas of EU political conditions, judicial reform, fighting corruption and furthering minority rights, Romania fared even worse when the last half a decade of imposing of political conditions are taken into consideration. The EU also specified the strengthening of state capacity, the independence of judiciaries, and the pursuit of anti-corruption measures and when it was Turkey's turn, in addition to all above, was the elaboration of a series of various human rights and minority rights conditions, such as the trafficking of women and children, the prison conditions and gender equality and social rights of the Roma to name a few (Pridham 2008c; EU Commission, *Regular Report of Turkey*, 2007).

From the Slovak case, we can learn from the above discussion of EU conditionality and domestic interaction, that the most important tool was the creation of new structures and agencies as well as enlarged statute book. The real progress started only in the last two years of EU accession, for sometimes domestic factors slowed progress considerably.

In the Romanian case, carrots were used up and consumed and in the Slovak case, sticks and carrots seem to be in balance, and there has been a locking in effect. In the Turkish case the carrots were not used enough in comparison to sticks involved.

Implementation has been the primary hurdle against Romanian and Turkish accessions as emphasized in many times and as many formats in the Progress reports from 1999 (the time that the Commission invited Romania to join the EU, while giving Turkey a candidacy status)

to 2005 (the signing of the Treaty of Accession with Romania, with a target date for membership as 2007 and opening of accession negotiations with Turkey), including the semi annual monitoring reports published in 2006 following the announcement of the safeguard clause for Romania allowing a once year delay to the accession date if certain conditions are not met by January 2007.

We took up a detailed discussion of these two puzzles within the Turkish case study, but we could contribute from comparative perspective that the direct pressure from the EU coming in the form of advancement to the next phase in light of close monitoring timeframe. Pushing through wide ranging reform packages in the parliament in order to fit the time restrictions of the accession process rather than designing agencies and putting them into practice with human resources and financial resources, may have sometimes worked against real implementation due to the attraction of the quick fixes for politicians as well. ‘Working against the clock’ before the next step of accession may have exactly worked against more complete implementation.

In comparison to 2002 year, 2005 was expected to be another milestone year for Romania and Turkey. Both Romania’s (along with Bulgaria’s) accession progress in light of the safeguard clauses would be monitored very closely, as well Turkey’s compliance with the political conditionality before the opening up of negotiations as proposed in the previous European Summit of March 2004, deciding to end the monitoring of Turkey. But 2005- 2006 proved to be the opposite of a milestone, the 2005- 2006 period for both Turkey and Romania could be characterized by lack of progress in areas of governance, judicial framework, fight against

corruption and improving the implementation of legislation to improve the working of public administration.

## **6.5. Conclusions**

Some pertinent research questions that were addressed in the preceding chapters on Slovak, Romanian and Turkish accessions were; ‘how could the application of conditionality in Turkey, Slovakia and Romania lead to adoption of the European norms of human rights, and of the democratic norms such as the primacy of civic over military, and independence of judiciary?’ and ‘How were social and political cleavages in Turkey in comparison to Romania and Slovakia changed through the conditionality process? We hypothesized that diffusion of norms from the EU would create a transformative effect on collective identity in Turkey, Romania, and Slovakia respectively. Taken in consideration of the findings of the case study of Turkish political and economic reforms between mid 90’s to 2006, we argue that the EU’s transformative power was significant in bringing about socio-political change in acceding countries.

‘The Slovak reversal’ in shape of increase of share of votes for illiberal parties may be a consequence of the tolls of compliance with Maastricht criteria on the lower middle and middle classes; permissive external environment has given way to stricter EU enforcement of the criteria, and labor movements and other veto players were marginalized, and the social costs are born by the middle class, followed by a big drop in voter turnout, culminating in a temporary period of political destabilization post-accession in Czech Republic and Poland along with Slovakia (the former did not have a government for the better half of the previous year and the latter was ruled by a populist coalition). Zero-sum solutions to distributional

problems and middle class frustration with the economic and political aspects of unfinished transformation- the pressures to balance marketisation, macro economic stability with social protection made the most effected voters impatient with centrist approaches, and give radical alternatives a chance. There are few indirect pressures the EU could apply to reverse this trend. The over-stretching of conditionality tool box and incentives is evident, but also these countries have changed from position of decision-takers to decision-givers, as Poland has shown in the wake of deliberations on the failed European constitution.

Comparison was made with Greece for the Romanian phases of reform, in the sense that Greece would have failed some of the political conditionality extended to CEE states (i.e. fighting corruption and ethnic minorities) while the condition of the country's public administration were reprimanded by Brussels. But in the year leading up to its admission, the situation was deemed very critical for the domestic liberal opposition, so delaying entry would be lethal for the relative organizational capacity and power of the liberal forces, would deprive them of external guarantees (and EC development assistance to rural sections of the Greek society that according to Pevehouse (2002) had tendency towards authoritarianism). It was considered a negative model of implementation, and that any repetition of that experience would have been disastrous.<sup>93</sup> Romania is the most likely approximation to the Greek case, as one public administrator in Bucharest at the time of accession, said that 'Romania was likely to face a crisis as a member state to a degree comparable with Greece in the first ten years of

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<sup>93</sup> However, we also saw (despite the financial crisis Greece finds itself at the time of writing) that Greek case may be deemed an economic success, in particular between 1996 and 2006. Its admission to the euro currency zone comes as a result of macroeconomic stabilization reached over the 1990s, and economic growth in the 2000s that exceeded the EU average (3.3%)

EU membership.’<sup>94</sup> The sequencing and the delivery of rewards before meeting the conditions may have damaged the effectiveness and credibility of the conditionality tool.

Through an empirical analysis of the political reforms between 2002- 2006, we can conclude that there is a correlation between Turkish accession negotiations and the Turkish political liberalization. Turkey may be in the early stages of instrumental adaptation, in terms of minority rights issues, especially with regards to Kurds and dealing with the Armenian claims. Turkish government seem to be engaged in a rhetoric (Shimmelfennig 1997), according to the model of norm diffusion, the more the Turkish government justify their interests, however the more others will start to challenge their arguments, and the validity claims inherent in those arguments. First steps are taken with respect to the legislative changes that are induced by EU political conditionality, secondary steps seem to be taken by the civil society and human rights organizations and academia in Turkey in shape of a campaign, ‘for apologizing for historical errors that may have been committed against the Armenian community that were living within borders of Ottoman empire, some of which is today’s Turkey. As the model of norm diffusion suggests, the further advancement would be that the state institutions and the government become more entangled or rhetorically trapped, and they would need to respond by providing further arguments. (Schimmelfennig et. al. 2006) We expect argumentative rationality, dialogue, and processes of persuasion to prevail in later stages of socialization- and norm adoption.

Another important finding is that the EU conditionality acted as pre-commitment device to bring out the underlying reformist tendencies, particularly in the case of Romania accession reforms, which is most comparable to Turkish case. In both cases, the reformers were

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<sup>94</sup> Interview with Marius Profiriou, School of Public Administration, Bucharest, 05), for transcribed text, please contact this author.



enabled with a bargaining chip to encounter opposition to reform coming from different circles. In Turkey, as Müftüler-Bac and Gürsoy argued (2005), through norm diffusion and the adaptation process to the EU norms on legislative terms and institutional revisions (such as the reorganization of the National Security Council entirely from civilians), Turkish collective identity was redefined in particular regarding civil-military relations and secularism (Ibid). This is not to overplay the impact of the external player. The political elite between 2002 and 2005 was enabling and willing, despite the view in some European circles that the ruling political elite were resistant to reform. This is contrary to the findings that are stated Turkey's ability to incorporate European norms, is greatly restricted by the reluctance of the political elite to adopt necessary reforms.' The elite has been eager, and these reforms helped strengthen the pillar of liberal democracy in Turkey and arguably one of the core values of European states, closing the gap between the European respect to democratic principles and Turkish authoritarian tendencies.

Table 4.1: SK-RO-TR comparison

	<b>Principles</b>	<b>Institutional Structure</b>	<b>Policy environment</b>	<b>Implementation</b>
<b>Indirect Conditionality</b>	Effective in all three cases	Effective in Slovak case	Effective in Slovak case	Ineffective
<b>Direct Conditionality</b>	Effective in Slovak case	Effective in Slovak case	Effective except for Romania	Effective in TR case
<b>Transformative Conditionality</b>	Ineffective	Ineffective	Effective in all three cases	Effective in all three cases

We tried to reflect on the accession processes that we traced in the three case studies, and took up four concepts to compare and contrast the EU influence in each case. The principles and institutional structures did not vary in these three narratives as much as the policy environment and more importantly as the implementation. As we have shown that the creative use of indirect, direct, transformative varied across cases, as the Commission started to *learn* from past experiences. The Commission either admitted the irrelevance of some tools, or have identified the successes or failures of others (the latter is more rare) and reused or discarded them. What we have not managed to show systematically is the internalization process by domestic practices, as our stories still remain somewhat poor of individuals and perhaps of interactions between them. But we can hope to make up for this weakness by a more systemic comparison of outcomes (in policy) of how agents and structures interacted, in the European conditionality framework. The findings may not be trivial in terms of showing the dynamics of the use of instrumental adoption by domestic players and the strategic bargaining that took place through the use or misuse of sticks and carrots. Such use came in issues areas that were singled out by our preceding analyses of cases as bottlenecks. In these ‘trouble areas,’ progress still lacked despite the delivery of award due to political contingencies of the day, and due to the calculus of interests within EU institutions, not forget the by products of intergovernmental bargains in the EU.

In the ensuing chapter of this dissertation, we will view the findings of this diachronic comparison in the light of what lies in store regarding future enlargement. We believe most of the issues faced in these cases are becoming more relevant in the accession processes of current candidates in Western Balkans (including the continuing candidacy of Turkey). This would thus be a useful juxtaposition for demonstrating the dynamic aspect of conditionality

and its mechanisms. It would be also be beneficial in making some further policy analysis and recommendations for policy makers in the Commission and the Western Balkans, and Turkey.

## ***Chapter 7: Conclusion***

### **7.1. EU conditionality as a test case for external pressure mechanisms**

EU conditionality has been a test case for the impact of external pressure to induce domestic reforms in countries of democratic and economic transition. Within the 15 years spanning this unique experience, ten new central and eastern European states became full members and 3 states (as of 2009) gained candidacy status. Ongoing controversies in the EU enlargement debate contain when and where conditionality elicit its intended effects from candidate countries, the respective weights of the domestic and other external factors, and what kind of approaches best explain the processes and outcomes we have witnessed. Numerous scholars persuasively argued that EU conditionality has both persuaded as well as coerced aspiring members to political democratization and economic restructuring that they would not on their own would have accomplished. EU conditionality also forced candidates to restructure their legal codes to comply with the EU *acquis communautaire*.

The results have been varying success, spatially and temporally. Alternatively, the students of reforms have argued that without the active and passive leverage of the EU, much of the restructuring would have happened, and they effectively showed that the reforms lagged at times and reversed at other times, once the carrots of compliance were devoured or the stick no longer worked once the ‘cat’ (accession promise) was out of the bag. In other words, domestic conditions mediated the power of conditionality. While some sectors were more readily susceptible to external influences than others no matter what the historical legacies of the individual countries differed.

In the following section, we contrast our findings from our cases with previous analyses and draw conclusions in broader terms. We highlight the potential contributions of our research to the New Political Economy and Europeanisation literatures. We conclude by discussing the issue areas that were left unattended and the directions for future research.

## **7.2. State of the Union? Theoretical framework and mechanisms**

It has been argued in the final issue of *Journal of Democracy*<sup>95</sup> of 2007, that the reform consensus has been nearing a break down in most new members of the EU. There has been back-lash against political and economic reforms, defined as a twin development of a de-politicization of the marginal part of the society, and the centrist parties disillusioning the middle classes who have been most affected by the neo-liberal policies of the last decade and by the Maastricht criteria of low inflation, low fiscal deficit and moderate state indebtedness (cuts in tax and welfare spending) and the ‘unfinished transition.’ Some of the disillusioned moved to the far right in order to try out the radical options on offer, coming in nationalist, populist, xenophobic or/ and anti-EU colors. (Greskovits, 2007) In a way, populism that is evidenced in the later part of transition could be considered the ugly off-spring of the transition elite-consensus on policy. In the comparative chapter that precede, we showed that the EU conditionality has been effective in preparing these countries for formal accession but once the historical formality of accession to the EU is completed, there were few means to induce further reforms. We further argued that conditionality’s real success depended on achieving cognitive and behavioral change (i.e. in democratic norms) rather than the formal adoption of institutions and norms. Worries about receding back to authoritarianism could at

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<sup>95</sup> *Journal of Democracy* (2007: Vol. 18(4))

least not be evidenced in the reports of the Freedom House on the political rights, (including electoral process, pluralism, participation in the electoral process) and of civil liberties (incl. freedom of expression, associational and organizational rights, freedom of beliefs and expressions, personal autonomy and individual rights) in CEE countries.

In the successful transition cases during the last one and a half decades, we had the EU anchor. On the other side, we also had for the most part an elite led consensus on the liberal paradigm in the last decade of ‘triple transitions.’ (Offe 1997) The elite led consensus consisted of two parts: the primacy of constitutional order and the need of economic liberalization. The first part of the consensus entailed the ‘separation of powers,’ the maintenance of the political neutrality of the institutions such as constitutional court, the central bank, the board supervising public media, while the second part implied a need for large scale privatization, and integration into the world (and European) markets. (Rupnik, 2007 and Johnson, 2006) The absence of powerful social actors as well as the weakness of political participation was not seen as a large problem of democracy by assessors from international institutions, but often perceived as a blessing in disguise for passing the urgent reform packages in the national parliaments (the students of transition has widely accepted the paradox of economic and political transition, i.e. transition to market economy at the expense of political participation).<sup>96</sup>

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<sup>96</sup> It was best evidenced in Hungarian PM Gyurcsány’s speech in 2006 admitting that they faked governing, and lied to the electorate day and night, and also there was no choice in regards to economic policy. Such statements may have inflamed the ‘conspiracy theorists’ in the Hungarian political extreme (Hungarian Jobbik coalition) and the Polish populists (i.e. the Kaczyński twins) to name a few, who exclaimed that key institutions of parliamentary democracy and market economy were secretly sold out to the ex-communists and their fellow travelers in the former oppositionists. These populists have also markedly grasped the anti-corruption and de-communisation (e.g. Polish Lustration Law and Institute of National Remembrance in Poland and the Czech Republic) rhetoric to de-legitimize the existing political and economic elite and have divided the populace (Poland, Slovakia, Romania) some of which managed to avoid in the past decade (Radio Free Europe article, <http://www.rferl.org/content/article/1075471.html>) .

### **7.3. Implications for the study of Conditionality**

Our analytical lenses in the case studies focused on the reforms related to the restructuring of the economies, in lieu of the evolution of the regulative agencies which were considered as the missing link by many contributing to the New Political Economy literature. (Bakır, 2007 Dyson, 2006 and Csaba, 2009) In our separate case studies, we looked at how much the EU could guide these countries which are faced with triple task of transition, with imperfect market and democratic institutions and mired with political instability since its formal application to the EU. IMF conditionality and the EU conditionality were present in all three of our case studies at the same time, though at varying degrees. The main difference between the IMF conditionality and the EU conditionality were that in the beginning, IMF conditionality was mostly about fiscal and monetary policies, with a restrictive emphasis on the correction of external payments imbalances and strong deflationary impact, and it excluded any reference to political conditionality such as democratic institutions, rule of law, treatment of foreign investors, anti-corruption legislation and minority rights. The EU conditionality was much more diverse in focus and reach. IMF conditionality went through critical changes in the last decade or so, as it integrated more detailed recipes for the nature and structure for the countries' economic, regulatory and political institutions. We can argue that in the case of Romania and Turkey, IMF and EU conditionality became much more complementary to one another. Both governments of Romania and Turkey between 1999 and 2003 (who asked for extensive bail-outs from the IMF), were made to realize by the IMF and the EU, that macroeconomic stabilization and sustained economic growth would not be possible without the deeper structural reforms. Falling behind in schedule in the privatization of loss making utility, energy enterprises as well as restructuring of two banks respectively in Romania and Turkey were constantly criticized before 1999 both by the IMF and EU. We can see from our detailed analyses that the complementary pressures from these external actors in

both Romania's and Turkey's cases, resulted in the acceleration of privatization between 2003 and 2005, for the two of the biggest privatization in the countries' histories took place, i.e. the sale of majority share of PETROM to OMV in Romania and the sale of PETKIM, Turkey's biggest refinery.

Our analysis of Slovak economic and political reforms had two stages, first from the Meciar government formed after 1994 elections to 1998 and from 1998 to 2004 accession of Slovakia punctuated with the 2002 re-election of Dzurinda. It tries to first solve the puzzle of why and under what conditions the break through occurred in 1998 elections, where the electorate sought to topple the illiberal and non reforming government. The case study compares the international demands and conditions, with regards to membership to NATO, OSCE in different periods that accompanied the Europeanisation effect, through the use of EU's passive and then active leverage mechanisms. EU's active leverage will be discussed, with regards to what extents it hampers or facilitates the development of political identities, capabilities, accounts and adaptiveness, the four institutional components of Europeanisation (Olsen, 2007). The findings of the case study are as follows: the 'ping pong game' the first stage of accession reforms between the community organizations and domestic interest coalitions did not exhibit non sufficiency of the credible commitment of EU accession. In the second stage, the party competition flourished, the civic groups, i.e. the 'third sector' showed the political adaptiveness to point at the oppositions deficient international and domestic credentials in the areas of economic restructuring, minority rights protection and democratic and rule of law reforms. But given the very favourable international and domestic conditions, the compliance was over-determined. The size and credibility of the rewards and active leverage only qualify as a necessary but not sufficient condition. The alternative hypothesis, compliance as a result of domestic struggle cannot be falsified. The high domestic costs in



Meciar explaining non compliance, is confirmed by the Dzurinda period, where the Prime Minister Dzurinda would count on EU and NATO demands to stabilize his coalition. The main findings are that the economic restructuring was impacted by the EU conditionality, in that business association and other economic actors cooperated under EU tutelage for transparency and accountability. On the other hand, the political criteria allowed domestic actors to settle institutional battles but it could have also hindered the consolidation of the consensual institutional frameworks where political interests and identities of actors would not adequately, the party systems will remain fragile.

The Romanian case paralleled nicely with the Slovak case in many respects, but the internal conditions for compliance changed twice between 1995 and 2007 which places the two hypotheses about the impact of conditionality mechanisms under vigorous test. The same ruling elite under PDRS and President Iliescu, first between 1992 and 1996 and second term, from 2000-2005, behaved differently in altered external conditions and the changing application of active leverage of the EU. The most important finding of the Romanian case, is that after the 2001, low point in both privatization reforms and the damning review of progress by the Commission in political and administrative reforms, 2003 showed a hike in pro-activeness of the government to pass necessary legislation for restructuring of the financial sector and 2004 evidenced the change of structure of the government to increase reform efficiency to meet the 2005 promise of accession deadline (decision taken at the 2003 Summit) at all costs. The sequencing of rewards and punishments until 2003 paid off, underlining the pivotal role of credible commitment mechanisms, and credible external incentives. This was evidenced in political adaptiveness, political identification, (resonance)

in the civic actors as well as technocratic cadres and the plethora of creative institutional set ups. It seems that compliance mainly depended on calculations of domestic costs, credible commitment and sufficient high material rewards. Once the 2005 deadline was reached, Romania showed a major lag in the momentum of reforms, thus the credibility of membership perspective played an adverse effect, even though the rhetoric and lip service to EU's demands remained stable. EU's remaining conditions and safe guards seemed ineffective and insufficient in inducing further compliance, in the latter phase of EU accession between 2003 and 2007, while back tracking by the community organizations was close to impossible.

The Turkish case between 1996 and 1999 and 2001 to 2006 demonstrate a dramatic arch in the common accession stories which the previous two cases lacked even though Romanian case comes closest in complexity of state props and mechanics to create the 'illusion' of compliance to EU's criteria. Turkish case presents a paradox, as argued by some students of Turkish compliance with EU's political and economic governance rules. The paradox is that while the parts of the domestic actors who were identified most closely with modernization reforms historically have been the strongest critiques and opponents of EU criteria and necessary legal reforms and institutional restructuring, where as the conservative Islamist elite became the most ardent enthusiasts for EU induced reforms in the period between 2001 and 2006 when it peaked.

A major intervening factor in explaining compliance was the 2001 financial crisis and the deep financial restructuring that came as condition to IMF agreements. The domestic cost benefit calculations were starting to topple as a result of the structural reforms and breaking down of the state elite and un-rooting of its ideological foundations. The case of instrumental

use of EU conditionality in expanding the pro reform coalitions is Janus faced. While the ‘conservative globalists’ that came to power in AKP after 2002 elections, followed to the recommendations of the previous IMF accompanied technocratic government (led by former vice president of World Bank) to the ‘t’ . The new group successfully used the EU political criteria, in particular to win points in the power struggle between themselves and the Kemalist nationalist- statist elite that opposed them. The de-centralization of state capacity, the restructuring of civic- military relations and the legal steps taken towards ethnic pluralism in a former unitary state all strengthened the hand of the reformers; the more they were rewarded and approved by the community organizations, the more popular they came with the electorate, the higher the stakes became in the power struggle. The Turkish case thus, provides strong evidence for the alternative hypothesis.

The comparative chapter followed through the common threads in three stories of accession. In our comparative chapter, we chose to focus more closely on the *bottlenecks*, the issue areas noted by the consecutive progress reports by the Commission. These issue areas continued to form the biggest challenges for compliance two of our three cases, on the pre-accession and negotiation phases and for one country at least, they continue to cause concern post accession. By this rather limited focus, we were able to single out how conditionality worked once the active leverage, or direct conditionality were removed and the reformers are left on their own for the first time.

The comparison provided the real value added of this enterprise; the instrumental or strategic adaptation comes in front and on top of any other reaction of the domestic government. In terms of the explanatory mechanisms, the direct conditionality (the reinforcement by reward)

was the more effective across all three cases, in contrast to the indirect conditionality and the transformative conditionality. Three mechanisms were most effective in providing blue prints, and guiding principles and transforming policy environment, but became significantly less effective in impacting institutional reforms and much less in implementation of reforms.

There were several findings that came out of the comparative chapter. Firstly, we found that the processes of reform were more ‘top-down’ rather than ‘bottom up’. The relationship between EU institutions and the applicant country was of asymmetric interdependence<sup>97</sup> with the EU dictating the terms. Oft, the applicant countries’ elites and public assumed that the power relations would be symmetric, but later realized the true nature of the relationship, and adjusted or mal-adjusted (Grabbe, 2001 and Grabbe, 2006) Our three countries, Slovakia, Romania and Turkey have all been laggards at a certain point of their accession processes. All three were reprimanded and sometimes left out of their respective group of fellow candidates. However, one would argue that the dynamics of the conditionality that were utilized to put these countries back in the reform track, were comparable. The principles, the institutional infrastructure, the policy environment have all been impacted differently, yet the starting conditions were comparable and the pressure mechanisms came from the same tool box. Thus, our comparison shed light on what worked and what did not. With regards to the power asymmetry as explanation for country’s compliance, our case study of Turkey had shown contrary to the explanation of Grabbe (2006) and Schimmelfennig et. al. (2006) and Kubicek (2004). The main difference between my conclusion and for instance, Heather Grabbe’s conclusion is that the power relations between Turkey and the EU were not perceived by the Turkish political elite, as asymmetrical. The explanation that ,the more asymmetrical were the power relations (not here taking into account how it was perceived), the more coercive

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<sup>97</sup> To use the term elaborated by Keohane and Nye ( 2001)

influence the EU had over them,' does not hold for the Turkish case, where the political elite have been arguing that the five decade relationship with the EU has been long enough to put Turkey on an equal playing field with the EU and that Ankara chooses to go down the path of reform not because EU dictates, because these reforms are required to perfect market economy and institutions of democracy and to elevate the living conditions of Turks to the European level. These perceptions were for instance evidenced in Prime Minister Ecevit's and his successor Erdoğan's speeches and the re-naming of the Copenhagen criteria as the *Ankara criteria* in the declaration accompanying the National Plan of 2005.

What we are not considering was not whether these processes have prepared these countries for better integration to the existent institutions to the EU. This is the subject of an emerging area of research which we welcome, i.e. looking at the cross national diversity among the new member states as among old members or where some of these new members form regional or bilateral policy alliances. Such research for the long term and continuing effects of implementing the *acquis* on the CEE countries could perhaps be best pursued by means of sectoral work on different policies and the impact of enlargement on domestic institutions, policies and processes. (Cowles, Caporaso and Risse, 2001; Böhle and Greskovits, 2007) Our task here was limited to looking at the impact of conditionality on inducing formal rule adoption, in other words compliance with the framework of entry rules on one hand, and the 'strategic socialization' on the other hand. Such a process directed at or potentially leading to strategic rule adoption by target states to move up the ladder towards full membership, while these norms would be institutionalized in the domestic law, but the theory expected that these states would end up internalizing the rules and norms in behavior, identities and interests, the latter part of which we do not have data to analyze.

One should add another dimension of the analyses, which is defined by the *time* both the candidates and the EU spend accommodating one another. The conditionality from the EU side from 1989 to 2006 did not remain static. After the entry of Slovakia to the European Union, alongside nine other states, the Enlargement Commissioner Olli Rehn made the following remark, ‘... there is no further enlargement with a large group of countries at the same time in view... future enlargements will go at the pace dictated by each country’s performance in meeting the rigorous standards, to ensure the smooth absorption of new members...’ (Financial Times, Jan. 2005) In a separate strategy paper, the DG for Enlargement added that: ‘...the EU has taken the concerns on the pace of enlargement seriously... to avoid an overstretch of commitments, the EU honours existing commitments towards countries already in the process, but is cautious about assuming any new commitments.’ (EU Commission, 2006) These communications meant two things: the EU has learned from its big bang enlargement lessons and cannot afford to enlarge (to expectant Western Balkans in particular) without caution due to its current and continuous institutional and existential crises. The Commission did not heed its own words, as it gave a definite date for Romania and Bulgaria entry very soon after this statement was made. This also meant that if it were to enlarge (duly promised to Turkey, Croatia, and Macedonia as candidates to join at some indefinite horizon), these countries would be subjected to, much tougher standards, than previous enlargement cases.

The real challenge was explaining the delivery of reforms in countries lacking credible membership perspective and given hardly any material awards in order to counter the domestic costs of compliance with tough criteria (as we saw in the case of Turkey). Meanwhile, we needed to also explore the reasons for the lack of compliance in the case of Romania where the awards were given out prior to compliance and in the case of Slovakia, for

its over-performance in compliance with the Maastricht criteria and being the second new EU member country to enter the euro zone after Slovenia. Therefore, in times when rationalist approaches fail to explain the variance, could one find an alternative explanation in constructivist approaches? Some constructivist approaches would say that compliance came as a result of a quest for acceptance to the club of liberal state, reputational and discursive practices of European-ness or social learning and norm internalization through peering through the doors of Brussels. We do not endorse a specifically constructivist approach even though our hypothesis tries to capture the orientative capacity of EU norms and resonance of membership for domestic actors.

So, for both CEE countries and Turkey the puzzle lied in why the countries continued to implement EU policies despite the imposition of a transition period and despite high levels of uncertainty. (Grabbe, 2006) Some analysts focused on how the logic of adaptation to the EU became embedded in the domestic policy making in CEE and Turkey. They emphasized that applicants became locked into a process of Europeanization which had a momentum that existed independently. When they traced the process of domestic adaption, they saw that policy makers became committed to the process because they had already had considerable sunk costs and often invested personal political capital which makes the reversal of policy difficult. This did not only make the reversal less possible, but had also made domestic policy makers part of the EU political space, which socialized them into even more ‘willing’ partners. (Ibid)

Charged with such an explanation, we subjected our cases to a more rigorous test. When we set the mechanisms of conditionality across four dimensions that we operationalized to

capture conditionality's alleged rewards and benefits, we found that conditionality has been most effective in altering the policy environment in the candidates. The comparison across country cases, and in a policy area such as banking privatization where reforms depended on a strong regulatory blue print, demonstrated that conditionality has had the most significant impact in imparting tools for reformers to self-commit. It was the sunk costs and political capital that conditionality demanded domestic reformers to deposit upfront, that were most effective across cases to make reversals less possible, even if the rewards stopped coming, and penalties were not handed out effectively.

In principles and structures and implementation dimensions, conditionality's impact lessened. In terms of these three varieties of conditionality, we found that only indirect variety of conditionality has been effective in creating change, while the direct variety did not do as well. The resonance and identification with the EU's norms and values, we tried to capture, as a third kind of influence, which we borrowed from Grabbe (2006) and Vachudova (2005), as transformative. Transformative conditionality did better than direct kind of conditionality but did not do as well as the indirect kind of conditionality. Thus, the EU's direct conditionality mechanisms, the set of incentives and constraints were not as effective as had been thought and analyzed; working against the clock without designing the agencies, and putting them to work without adequate human and financial resources may have been counter-productive. These findings were surprising indeed, but they point out that conditionality in its use has been imperfect; and that learning has been slow. Thus, with regards to implementation, conditionality did not use the carrots and sticks effectively, the checks and monitoring structure were lacking in even the most optimistic scenarios where the consensus across veto players for reform had been stern often at the cost of a more democratic forms of decision making as often witnessed in the over-use of executive power.



## 7.4. Conclusions

### 7.4.1. *Revisiting the accession stories of Slovakia, Romania and Turkey*

To reiterate, Europeanization was defined in the theoretical chapter of this dissertation as a set of processes whereby rules and procedures were constructed and defined at the EU level, and then incorporated into the domestic discourse, identities, political structures and then into public policies at the national level. In the case of the applicant countries, there was an additional dimension to Europeanization because the conditionality for membership gave the EU, leverage in transferring norms, principles as well the shaping of its institutional and administrative structures. In this project, we restricted our explanandum to whether the EU has given the green light in each of the accession stages the candidates were to go through. We arrived at the following conclusions.

- 1- From our detailed case studies, we found out that in the Romanian case, carrots were used up and consumed before delivery of reforms, and in the Slovak case, sticks and carrots seem to be in balance, and there has been a locking in effect. In the Turkish case the carrots were not used enough in comparison to sticks involved.

Grabbe found that the diffuseness and uncertainty in the norms and models that EU is transferring, explains some of the variance. (Grabbe 2006) In contrast to her conclusion, we find that it was an uncertainty with a different face: while it was the uncertainty about the hierarchy of tasks, more importantly it was also about the distance and time. The time difference between accession decisions, ie. the ultimate reward, and the adaptation costs was too big. Added to this timing problem was the inconsistency of the Commission and Council in handing out rewards and punishments due to political contingencies, and internal agendas

and not due to actual progress. As the cases demonstrate, direct conditionality, is a blunt instrument at best, while indirect influence was too nebulous to quantify and hard to apply across cases with desired certainty. Hence, *much of the explanation could be done with sequencing and timing of the incentives and constraints (sticks and carrots) not in the actual mechanisms of rule transfer.*

- 2- The EU has had most effect on policy areas where it has already had a clear set of rules or an institutional model. In other areas, the empirical evidence suggested that on balance, international actors and vaguely defined EU norms *framed* the debates and perceptions and affected the timing and nature of a specific piece of legislation, while domestic constellation of actors and pressures ultimately had a more significant impact on the institutional and policy outcomes.
- 3- Domestic power struggles mattered as much if not more than the EU's transformative power in empowering the modernizers. The priority setting at the domestic level through strategic choices for defeating opposition overcame even the worst constraints or the best incentives EU had to offer. The political reforms in the case of Turkey between 2002 and 2006 and the lack of progress in Romanian banking reforms between 2002 and 2006 are two examples for such perverse incentives.<sup>98</sup>

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<sup>98</sup> For a more detailed analyses of perverse incentives, please see Györffy, D. *Democracy and Deficits* published by Akadémiai Kiadó, Budapest-2009.

- 4- The incentives and constraints created by the accession process supported the emergence of a core national executive at the expense of other branches and levels of government, and often at the cost of regional actors and national legislatures.

This is not to overlook the transformative effect of EU conditionality (i.e. transnational coalitions of pro- EU civil society actors) or the norm adoption (Sedelmeier, 2005): namely the way that some EU policies and norms becoming embedded in national policy frameworks, policy making structures and discourse. As Grabbe points out, this is when people stop referring to ‘EU policies’ that they have become truly Europeanised. (Grabbe, 2006; 215)

However, our findings contrast with such internalization and norm adoption explanations of why compliance occurred. One such study which also concurs with ours is Grzymala-Busse’s analysis of Europeanisation where she found that the reforms were mostly a *formal adoption* of EU rules and regulations with what followed as a limited internalization of the substance of these regulations. (2005; 230-239)

- 5- Credible commitment was the most influential intervening factor in determining the effectiveness of conditions. In so far as the EU’s imprecise and uncertain award, reformers in some cases outperformed the expectations. This could only be explained by the self -binding that the reformers chose to constrain themselves with, i.e. self imposed deadlines, constitutional constraints and unwritten principles and promises to electorate, abdicating autonomy to independent regulatory institutions. *The cases showed that there was a difference between the conventions the actors created themselves and those they found in existence.*

6- EU conditionality effect was constrained further by the uncertainty in the delivery of awards and punishments and EU's changing internal political agenda. The timing of the green light in the EU's decision for the candidate to accede into the next stage for accession was widely shaped by external political considerations (deepening agenda of the EU vis-à-vis widening): namely the enlargement decisions that came out the negotiations amongst the various EU institutions and the International Financial Institutions (IFI's), and the tug of war between the various client member states of the aspirant countries.

#### *7.4.2. Implications for the study of Europeanization*

As for the dissertation's specific contributions to the Europeanization literature, I find that neither the logics of appropriateness and consequentialism (March and Olsen, 1989) could fully explain what happened in the Slovakia, Romania and Turkey cases.<sup>99</sup> We find that the sequencing and timing of reforms versus rewards (or punishments) were just as significant in explaining the outcome (the policy fit between the EU desired and the domestic output). The finding about the banking reforms in Romania and Turkey show the importance of sequencing and timing in the accession strategies by countries' elite. Our findings agree with the

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<sup>99</sup> March and Olsen's (1989) seminal study of institutionalization explains two logics : one of appropriateness in which institutions that affect behavior through actors' internalization of the institution's norms and one of consequentialism, in which institutions affect the opportunities and constraints of actors or the distribution of power amongst them. The studies of Europeanisation that look at why and how EU enlarged can be divided into two: those who focus on the material cost-benefit calculations and the strategic alliances and instrumental strategies (rationalist approach) vs. those who argue non material factors such as rhetoric entrapment, the use of identity related arguments, internal discussions and normative criticisms (constructivist approach).

diagnoses in several case studies <sup>100</sup> explaining how frontrunner countries fall into laggards in euro adaption. (Dyson, 2006; 178-96) In the Romanian case particularly, we observed that the main driver for change in economic and monetary reforms were the timing and sequencing, which did not always work for compliance with EU conditions. The findings in this case study in particular, concurred with that of Papadimitriou's characterization of Romania as the 'persistent laggard.' (2006; 178-96) The timing and content of the EU's 'gate-keeping' strategy and opportunistic behavior of the domestic elites rather than a genuine commitment to economic reforms explained how reforms were lagging and reversed once the promise of formal accession came late 2003 after Prime Minister Nastase's government's relative political stability and improved economic performance.

Romania and Slovakia, in Schimmelfennig et. al. analysis, were classified as 'mixed-constellation countries,' in which political conditionality has had a significant impact: namely the joint transformative power of the EU, NATO, Council of Europe and OECD helped consolidate the liberal forces.<sup>101</sup> Change is explained through the interaction with domestic power balances with political conditionality in motivating often fragmented democratic opposition to join forces for the elections and after victory, to preserve coalition discipline, as seen in Vachudova's characterization of illiberal states' significant turn-around. (2005)

Schimmelfennig et al. identified key bottle necks (similar to our approach for within case analysis) for compliance such as minority rights, liberal democratic norms, and the role of

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<sup>100</sup> Greskovits explains that Hungary's euro entry strategy was caught up in between a divisive process of 'bottom-up' Europeanization in which different domestic actors used euro accession to open up new opportunities in electoral and party competition, and the result was the politics of Euro-populism, deadlock and drift. (Dyson 2006: 185)

<sup>101</sup> As revealed by the comparative case studies, the EU and NATO have opted for a material reinforcement strategy known as conditionality (tangible incentives such as assistance, institutional ties and membership) in addition to 'social reinforcement' whereas the OSCE and CE rely exclusively on social incentives like influence, persuasion and argumentation . (Ibid)

military in a number of cases including Slovakia, Romania and Turkey. In the Turkish case, these authors argued that the domestic costs of compliance were low, therefore reforms continued as planned. Our case study of Turkish accession refutes their account, and shows that the costs were not low, but the window of opportunity opened for the domestic reformer cadres. In the case of Romania, the same authors argued that the previous stage of compliance developed an identification with western norms and thus despite the return of a non-liberal government to power, Romania continued to comply with the EU. The assessment of the Romanian case in this dissertation showed that compliance was not as strong in the first stage as argued by Schimmelfennig et.al. (2006) and the pressure from the EU varied drastically between the period of 1996 to 2001 and post-2002. Romania had a definite promise of entry by late 2002, despite its growing shortcomings in public administration reform, judicial reform and anti corruption legislation and implementation (as noted in the consecutive progress reports drafted by the Commission). It would be fair to argue that Romania did not face the same compliance pressure in comparison to Turkey or Slovakia. This was again a result of faulty sequencing and timing as aptly argued by L. Csaba, that setting a definite date of accession would be 'shooting one-self' in the foot by the EU in contrast to the desired effect by the Commission. (2004)

The Slovakian accession could be considered as a case where a credible membership perspective was a necessary, but not a sufficient condition for successful political conditionality. It is the very exclusion of Slovakia from the rest of the Viségrad states in 1997, which have put the promise into serious doubt for Slovak reformers. We agree with this explanation, and argue that the opposite dynamic could explain variance in the stages of the application of EU conditionality on Romanian accession. In contrast to the Romanian case, whose progress could not be technically separated by the Commission from that of Bulgaria,

Romania's fellow entrant, Slovakia was kept aside from the rest of its Viségrad group, which arguably gave Slovak reformers extra incentive to catch up. Turkey in that regard forms a separate category to its self, where credible membership perspective was never extended by the Commission on purpose. So why did the Turkish government continued to comply with tough political conditions especially when the prospects looked most dim between 2002 and 2006? The case of Turkish 'adoption' miracle between 2002 and 2006 could perhaps be better explained in the *two level game* domestic reformers were playing. (Putnam, 1988) The skillful political elite and the transnational policy entrepreneurs in government were playing a two level political game, at one level to secure a successful outcome to negotiations, both inwardly and outwardly. At another level, while they expected their commitment strategy to provide legitimacy to their policies, in other words, to provide an EU 'mantle' against the criticisms of their domestic opposition and domestic veto players. But, it ended up tying their hands. This explains the paradox of how the most seemingly anti-European groups could choose to cloak themselves in EU credibility to push through with politically unpopular legislation and austerity measures and could at the same time defeat their opposition through their success in casting them as the new 'nationalist Europhobes.'

The dynamic interplay between the domestic veto players and the external pressure were analyzed in other studies regarding conditionality. One such recent study comparing Slovakian and Croatian accession processes shows that external pressures are constrained by the domestic balance of power even in small countries, with seemingly small bargaining leverage and where the power asymmetry between the EU and the aspirant would be most marked. (Sigér, 2009)

The stallings and reversals in reforms, explained above and in the respective case studies puts into question constructivist arguments about the lock-in effect argued by the likes of Grabbe (2006); the status quo bias as shown by Schimmelfennig and Sedelmeier (2005) and the attraction of the availability of new resources from the EU such as funds, expertise, ideas and legitimacy, as shown by Börzel (2005). One such assessment of Europeanization by Csaba, characterizes the stallings and reversals as ‘premature enlargement.’ It explains that the lack of progress in the third generation of reforms in the new members comes of the two mutually reinforcing stagnation trends; namely, the lack of punishment mechanisms for non-compliers and the lack of support behind further integration in the Union (external stagnation) is reinforced by the myopic policies and short electoral cycles regarding long term developmental considerations in the new member countries (internal stagnation). (Csaba 2009)

We also managed to refine the Europeanization mechanism further, referred to, in this dissertation as, credible commitment. This particular influence is explored in a study which shows how EU oriented constitution building has been a forceful commitment device signaling the commitment of the reformers to sound policies while increasing the accountability to and support from the public to large scale market oriented reforms. (Desai and Olofsgaard, 2006) Our comparative case studies evidenced domestic actors in terms of economic and regulatory policies chose to ‘bind’ their hands and limited their own policy discretion in two of the three cases we looked at (namely Romania and Slovakia). Whereas, in the Turkish case, domestic actors used the window of opportunity born out of a majoritarian government and the temporary temperance of interest groups due to deep fiscal crisis who would otherwise oppose such deep political and economic reforms, hence they



managed to expand their policy discretion well and beyond the EU prescriptions in the progress reports.

We also entertained an alternative explanation that argued that a crisis would be necessary to jumpstart the compliance and later implementation of the accession related reforms. If we are to track the process and reformulate the reform narratives in three countries from the explanatory lens of crisis as cathartic, it would be the following. The first stage involved a crisis, either a full blown financial crisis, or a crisis of credibility or international isolation and rejection.<sup>102</sup> This would usher the near collapse of all policy alternatives, which may lead to a general consensus on urgency for change, but would then need an extra step to overcome the political stalemate. The following stage then requires a tipping point where the policy consensus is regained and the reformist elite starts to re-build credibility. Then comes the third stage, in which fast tracking of political reforms occur (i.e. where large-scale amendments to the constitution and passing of laws upholding good governance in the parliaments without deliberation and opposition) and economic reforms (especially evidenced in financial re-regulation and large scale privatization) start to be implemented. The final stage depends on the external pressure and domestic factors. The removal of external pressure could make the countries lag and/or back-track in reforms, but the persistence of domestic policy consensus could prevent this reversal or sometimes the critical tipping point (as was explained in the case of Slovakia). Inversely, the external pressure may remain, but would be perceived to be less credible by the domestic elite, despite the existence of consensus on reforms, the pace could still lag. The crisis as cathartic explanation could help refine at what point EU direct conditionality has become essential in bringing about the critical tipping

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<sup>102</sup> Please refer to the use of crisis for more elaboration, in her comparison of Slovak and Hungarian economic institutions (Györffy 2009). The opportunity that economic crises brings comes from a most cited piece by Drazen and Grilli (1992), Allesina and Drazen (1991) and Bruno, M. (1993).

points between first and second stages and between second and final stages and also help explain what role IMF and EU conditionality could play in pulling countries out of political deadlocks and breaking the vicious circles.

## **7.5. Further Research**

We explored in the external influence and conditionality literature what could better explain the variance across countries and policy areas. Putnam's two-level game was useful in explaining what comes out of the negotiating process between the EU and the candidate governments, while the conditionality and Europeanization literatures explained that compliance with international rules depended on the actors' cost benefit calculations or socialization effects respectively. Our assessment of how target governments reacted to the specific conditions, testified that the theoretical frameworks in the literature could not adequately explain why: when the awards were present, the compliance (measured as change in policy outcomes in the dissertation) did not materialize, and when there were no awards in sight, some governments continued to comply with conditions. In other words, our analyses showed us that there was a significant incongruence between awards and compliance, and punishments and lack of compliance. The existing literature did not have a good explanation except to argue that the answer partially lay in the interface of external and domestic incentives.

We found a more useful model in John Elster's theoretical framework of commitment mechanisms. (2000) His actor based explanations gave clues as to what extent domestic reformers pre- commit to often (self-made) constraints and to what extent external institutions

could make them commit. We supplemented and revised the existing incentive based explanations.

Within our case studies, we picked a hard case, where we expected that there would be more compliance, where the rules of the game were more definite; the route of EU's influence was less controversial which was privatizations, in particular in the financial sector. Financial sector was where radical re-regulations were taking place, so we expected that the target governments would be most receptive to the regulatory paradigms from the EU, which were buttressed by the ongoing policy advice and additional conditionality from the IMF and WB.

To reiterate, our specific theoretical contributions were could be summarized under three headings: 1- further reconciliation of the divide between rationalist and constructivist approaches to Europeanization (Jupille, Caporaso and Checkel, 2003); 2- shedding light on the missing causal links between incentives and change in behavior and that and policy outcomes in the EU Conditionality literature 3- fleshing out the mechanisms in the sequencing of reforms in post-communist and developing countries. We have managed to accomplish the least under the third heading. Our contribution was restricted due to a lack of a rigorous method to disentangle to what extent reformers prioritized one set of reforms over the other.

Our methodological shortcomings came from the difficulty of qualitatively disentangling the EU effect. Further research needs to be conducted in order to see in a future time period (within the first decade of EU accession) how much of the EU related reforms are reversed or to what extent the groups of countries who have acceded have accomplished *acquis* related

tasks. In other words, once the rewards are dispersed and there is no longer a threat of punishment (in form of being placed at the back of the line), would governments continue to legislate and implement the regulations and rules that are not part of conditionality but part and parcel of complete membership? Some of these emergent research agendas and questions are addressed in the 2008 December issue of the *European Journal of Public Policy*. (Epstein and Sedelmeier, 2008; 795-805)

Such questions are pertinent both for perfecting theoretical explanations for external pressure mechanisms (be it in area of IFI's or bilateral assistance for democracy) and policy implications for the future of EU's enlargement in the Western Balkans and Turkey; and the external relations with non-member neighboring countries. The European Union- domestic government interaction is characterised as a 'two-level game on two moving targets.' (Orenstein, Bloom and Lindstrom, 2008) In the empirical analyses of Western Balkan accession cases, we can evidence that there has been changes as to how conditions have been applied in the current candidates with increased emphasis on implementation. Such changes preceded the current candidates, when in the 2007 round of enlargement to Romania and Bulgaria, the Commission added on a third type of conditionality namely, whether the countries possess the administrative capacity to manage the spending of EU Structural Funds given to members. In the case of the Western Balkans, the Commission added further steps to its previous 'gate keeping' function, namely the Stabilisation and Association Agreements (SAA's). They replaced the European Agreements that the EU signed with the past candidates in Central and Eastern Europe in early 90s. In the framework of the SAA's, the Commission is to conduct a (1) a feasibility study for opening negotiations on the association agreement; (2) the negotiation stage of the SAA with the future and (3) the signing of the SAA. These new institutional solutions come as a response to the apparent need for the EU to improve on

its past formulas for the next round of enlargement. Still there remains the question of whether the EU should do anything differently with regards to the lingering Turkish accession. What works and does not work in terms of eliciting compliance from unwilling government coalitions elected with EU skeptic ticket at best? Some of the insights from the Central European and Turkish cases are applicable to the future state of enlargement, while other applications are constrained by the changing dynamics within the EU, specific to the time of writing when enlargement decisions are strictly confined to existing promises to a handful of countries in the Western Balkans, and while EU's influence is restricted further by the increasing uncertainty about the entire Integration project.

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## APPENDIX : I

Table 1.1: Slovakia's economic crisis

<b>Slovak economy 1993-98</b>	1993	1994	1995	1996	1997	1998
<b>GDP</b> in millions of koruna	390,600	466,200	546,00	606,100	686,100	750,800
GDP per capita (in USD)	2,384	2,721	3,423	3,679	3,802	3,970
Private consumption (percentage change in real terms)	-1.5	1.0	3.0	8.2	5.6	5.3
Public consumption (percentage change in real terms)	-2.2	-11.4	2.1	21.0	4.0	4.0
Gross fixed investments (percentage change in real terms)	-5.4	-5.0	5.3	32.0	12.0	11.1
Consumer prices (annual average, percentage change)	23.2	13.4	9.9	5.8	6.1	6.7
Current Account (in millions of USD)	-601	665	391	-2,098	-1,952	-2,059
Trade balance (in millions of USD)	-932	59	-228	-2,293	-2,081	-2,293
General governmental debt (% GDP)	31.5	28.0	24.6	24.5	23.7	26.0
Foreign Direct investment (in millions of USD)	107	236	194	199	84	374
External Debt stock (in millions of USD)	3,380	4,660	5,678	7,670	9,896	11,902
Exchange rate (koruna per USD)- annual average	30.8	32.0	29.7	30.7	33.6	35.2

Source: EBRD Transition Report 2001

Table 1.2: Macroeconomic Indicators

Slovak Republic	1996	1997	1998	1999	2000	2001
GDP 1000 mil. euros	15,6	18,0	19,0	18,5	21,3	22,8
Real GDP growth rate %	6.2	6.2	4.1	1.9	1.7 (Jan- June)	3.3
Inflation rate %	5.8	6.1	6.7	10.6	13.6 Sept	--
Annual average	5.4	6.3	5.7	14.1	8.7 Sept.	7.0
Dec- on Dec						
Unemployment rate-end year- ILO definition	11.3	11.8	12.5	16.2	18.9 (April- June)	19.4
Current account balance						
% of GDP						
million Euro	-10.6	-9.6	-10.0	-5.9	-1.6 Jan-June	
	-1,655	-1,725	-	-1,088	-162 Jan-June	-2,059
Foreign debt						
debt export ratio %	38.8	53.6	57.4	60.4 E	-	44.7
Gross foreign debt- million euros	3,338	5,595	6,673	6,683 E	-	
Foreign direct investment in flow- balance of payment data- % GDP						
	1.8	0.9	2.7	1.7	1.3 Jan- June	--
Million euros	279	154	504	310	136 Jan- June	1763

Source: EU Regular Reports 1999, 2000 and 2001

Table 1.3:1994 Parliamentary election results

Party	Votes	% votes	Seats in <i>Národná Rada</i>	% of seats
HZDS-RSS – Movement for a Democratic Slovakia and Peasants' Party of Slovakia	1,005,488	34.97	34.97	61
SV - Common Choice	299,496	10.42	18	12.00
MK – Hungarian Coalition	292,936	10.19	17	11.33
KDH – Christian Democratic Movement	289,987	10.08	17	11.33
DÚ – Democratic Union of Slovakia	246,444	8.57	15	10
ZRS – Assoc. of Workers of Slovakia	211,321	7.35	13	8.67
SNS – Slovak Nat. Party	155,359	5.40	9	6
<i>DS – Democratic Party</i>	98,555	3.43	0	0
<i>KSS – Communist Party of Slovakia</i>	78,419	2.72	0	0
<i>KSÚ – Christian Soc. Union of Slovakia</i>	59,217	2.06	0	0
<i>NS – New Slovakia</i>	38,369	1.33	0	0
<i>SPK – The Party against Corruption, for Order, Labor and Money for all Decent Citizens</i>	37,929	1.32	0	0
HZPCS – Movement for a Prosperous Czechia and Slovakia	30,292	1.05	0	0
ROISR – Romany Civil Initiative in the Slovak Rep.	19,542	0.68	0	0
SD – Social Democracy	7,121	0.25	0	0
RSDSS - Real Social Dem. Party of Slovaks	3,573	0.12	0	0
ZPR-REP – Assoc. for the Republic	1,410	0.05	0	0
Total	2,875,458	100	150	100

Source: 'Political Transformation and the Electoral Process in Post-Communist Europe' University of Essex- ESRC Study, <http://www.essex.ac.uk/elections>

Table 1.4: 1998 Parliamentary Election Results

Party	Votes	% votes	Seats in <i>Národná Rada</i>	% of seats
Movement for Democratic Slovakia (HZDS)	907,103	27.00	43	28.67
Slovak Democratic Coalition (SDK)	884,497	26.33	42	28
Party of the Democratic Left (SDL)	492,507	14.66	23	15.33
Party of the Hungarian Coalition (SMK)	306,623	9.12	15	10
Slovak National Party (SNS)	304,839	9.07	14	9.33
Party of Civic Understanding (SOP)	269,343	8.01	13	8.67
KSS – Communist Party of Slovakia	94015	2.8	0	0
ZRS – Assoc. of Workers of Slovakia	43809	1.3	0	0
NS - Our Slovakia	16192	0.48	0	0
SLS – Slovak People's Party	9227	0.27	0	0
MLHZP – Hungarian Movement for Reconciliation and Prosperity	6587	0.2	0	0
NEI – Independent Initiative of the Slovak Republic	6232	0.19	0	0
SNJ – Slovak National Unity	4688	0.14	0	0
B - B – the Revolutionary Workers' Party	4391	0.13	0	0
JSPS - United Party of Workers of Slovakia	3574	0.11	0	0
NAS – National Alternative of Slovakia	3034	0.09	0	0
HTC - The Third Way Movement	2515	0.07	0	0
TOTAL	3359176	100	150	100

Source: Source: 'Political Transformation and the Electoral Process in Post-Communist Europe'

University of Essex- ESRC Study, <http://www.essex.ac.uk/elections>

Table 1.5: Foreign Direct Investment in Slovakia

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
FDI in USD millions	236	351	174	562	354	2,052	1,475	4,104	559	1,107

Source: EIU Slovakia Report 2005

Table 1.6: Unemployment

Year	1999	2000	2001	2002	2003	2004
Unemployment % of labor force	19.2	17.9	18.6	17.4	15.6	13.4

Source: EIU Slovakia Report 2005

Table 1.7: Financial sector performance of Slovakia

Year	1999	2000	2001	2002	2003	2004	2005
Number of banks (foreign owned)	25 (10)	23 (13)	21 (12)	20 (15)	21 (16)	21 (16)	Na
Asset share of state-owned banks (%)	50.7	49.1	4.9	1.9	1.5	1.3	Na
Asset share of foreign owned banks (%)	24.1	42.7	78.9	84.1	96.3	96.7	Na
Non-performing loans (% of total loans)	32.9	26.2	24.3	11.2	9.1	7.2	Na
Domestic credit to private sector (% of GDP)	39.1	33.6	28.2	24.6	24.9	25.8	Na
Domestic credit to households (% of GDP)	4.3	4.4	5.5	5.6	7.1	8.8	Na
Stock market capitalisation (% of GDP)	3.8	3.9	3.3	7.0	7.6	9.5	Na
Stock trading volume (% of market capitalisation)	60.0	130.0	141.0	179.0	29.0	20.0	Na
Eurobond issuance (% of GDP)	5.0	5.6	1.2	0.0	3.6	2.9	Na
EBRD index of banking sector reform	2.7	3.0	3.3	3.3	3.3	3.7	3.7
EBRD index of reform of non- bank financial institutions	2.3	2.3	2.3	2.3	2.7	2.7	2.7

Source: EBRD Transition Report 2005



Table1.8: The EU member CEE countries and EU candidates transition indicators, 2005

Country	Popl.	Priv. share of GDP	Large scale priv.	Small scale priv.	Gov. & enterp. restruct.	Price lib.	Trade and for-ex system	Competition policy	Banking reform and interest rate lib.	Sec. market and non-bank fin. inst.	Infra-structure reform
Czech Rep.	10.3	80	4	4+	3+	4+	4+	3	4 ↑*	4- ↑	3+
Estonia	1.4	80	4	4+	4- ↑	4+	4+	3-	4	3+	3+
Hungary	10.0	80	4	4+	4- ↑	4+	4+	3	4	4 ↑	4-
Latvia	2.3	70	4-	4+	3	4+	4+	3-	4-	3	3
Lithuania	3.4	75	4 ↑	4+	3	4+	4+	3	4- ↑	3	3-
Poland	38.2	75	3+	4+	4- ↑	4+	4+	3	4- ↑	4-	3+
Slovak Rep.	5.4	80	4	4+	4- ↑	4=	4+	3	4-	3-	3-
Slovenia	2.0	65	3	4+	3	4	4+	3-	3+	3-	3
Romania	21.7	70	4-	4-	2+ ↑	4+	4+	2+	3	2	3+
Bulgaria	7.8	75	4	4-	3-	4+	4+	3- ↑	4-	2+	3

\* the indication range from 4+ to 1, 1 being the little or no change from a rigid centrally planned economy, 4+ representing standards of an industrialized economy. The arrow up means change from the previous year in the sectoral transition indicator.

Table 1.9: Slovak enterprise and banking privatization in numbers

	1999	2000	2001	2002	2003	2004	2005
Enterprises							
Priv. rev. (% of GDP)	11.4	15.4	19.3	34.0	35.0	Na	Na
Priv. sector share in GDP (in %)	75.0	80.0	80.0	80.0	80.0	80.0	80.0
Priv. sector share in employment (in %)	70.0	75.0	75.0	Na	Na	Na	Na
Budgetary subsidies and current transfers (in % of GDP)	2.7	2.4	2.3	1.6	1.7	1.6	Na
Share of industry in total employment (in %)	24.4	25.3	29.4	29.8	29.2	29.2	Na
Change in labour productivity in industry (in %)	3.9	-3.1	5.8	4.3	4.3	4.3	4.3
FDI (mil USD)	701	2,058	1,460	4,007	549	1,259	1,800
Investment/GDP	27.6	26.1	30.0	29.3	25.1	27.0	Na
EBRD index for small scale priv.	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index for large scale priv.	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EBRD index for enterprise reform	3.0	3.0	3.0	3.3	3.3	3.3	3.7

Source: EBRD Transition Report 2005

## APPENDIX: 2

Table 2.1: Romania's Macroeconomic Indicators

Romania																		
(% change in real terms)	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Population (end-year, million)	23.2	23.2	23.2	22.8	22.8	22.7	22.7	22.6	22.5	22.5	22.5	22.4	22.4	21.8	21.7	21.7	21.7	n.a
GDP (in billions of lei) <sup>4</sup>	0.00001	0.1	0.2	0.6	2.0	5.0	7.2	10.9	25.3	37.4	54.6	80	117	151	198	246	287	326
GDP per capita (in US dollar)	na	1,648	1,244	859	1,158	1,323	1,564	1,563	1,565	1,872	1,585	1,652	1,793	2,103	2,738	3,483	4,535	Na
Share of industry in GDP (in per cent)	na	49.9	49.4	38.3	33.8	36.2	32.9	34.2	35.6	26.3	24.8	27.3	28.2	28.4	25.0	25.2	24.4	Na
Share of agriculture in per cent)	na	23.7	23.6	19.0	21.0	19.9	19.8	19.1	18.8	14.4	13.3	11.1	13.3	11.3	11.6	12.8	8.9	Na
Current account/GDP (in per cent)	na	-9.6	-3.5	-8.0	-4.5	-1.4	-5.0	-7.3	-6.1	-6.9	-3.6	-3.6	-5.8	-3.4	-5.8	-8.4	-8.8	-10.1
External debt - reserves (in US\$ million)	na	na	na	na	4,209	5,027	6,204	7,797	7,443	8,539	7,653	8,176	8,439	9,877	12,571	11,694	11,515	Na
External debt/GDP (in per cent)	na	na	na	16.5	16.1	18.5	18.3	23.6	27.3	23.5	25.8	28.8	30.9	35.0	34.7	35.1	33.0	Na
External debt/exports of goods and services (in per cent)	na	na	na	64.9	74.7	77.3	68.9	86.7	96.8	104.1	93.0	88.1	93.0	98.9	99.9	97.7	98.2	Na
Foreign direct investment, net	na	-18	37	73	87	341	417	415	1,267	2,079	1,025	1,051	1,154	1,080	2,156	6,368	6,587	8,652

Table 2.2: CEE in perspective

	Romania	Hungary	Poland	Bulgaria	Czech Republic
GDP (US\$bn)	92.5	110.3	302.8	26.0	123.8
GDP per head (US\$)	4, 279	11,026	7, 937	3,388	12,097
GDP per head (US\$ at PPP)	8,487	16,277	12,677	8,923	18,016
Consumer price inflation (av.%)	9.0	3.6	2.2	5.0	1.9
Current account balance (US\$ bn)	-9.0	-8.7	-4.3	-3.9	-3.5
Current account balance (% of GDP)	-9.7	-7.9	-1.4	-15.0	-2.8
Export of goods fob (US\$ bn)	27.6	61.2	96.7	11.5	77.1
Imports of goods fob (US\$ bn)	-37.3	-63.8	-99.3	-16.5	-75.5
External debt (US\$bn)	34.5	66.5	105.3	16.4	45.8
Debt service- ratio (paid %)	17.0	23.8	19.4	22.8	8.9

Source: EIU, *Country Profile Romania*, 2006.

Table 2.3: Enterprise and financial sector reform in Romania

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Privatization revenues (cumulative, in per cent of GDP)	0.0	0.0	0.0	0.0	0.1	0.4	1.2	2.2	4.6	6.4	7.6	7.8	8.3	8.7	8.9	9.2	9.5
Private sector share in GDP (in per cent)	15.0	15.0	25.0	25.0	35.0	40.0	45.0	55.0	60.0	60.0	60.0	60.0	65.0	65.0	65.0	70.0	70.0
Private sector share in employment (in per cent)	Na	na	34.0	41.0	44.0	49.0	51.0	52.0	58.0	62.0	72.0	45.0	49.1	52.5	56.5	58.0	na
Number of banks (foreign-owned)	Na	na	na	na	14 (1)	20 (5)	24 (8)	31 (10)	33 (13)	36 (16)	34 (19)	33 (21)	33 (24)	31 (24)	30 (21)	32 (23)	33 (24)
Asset share of state-owned banks (in per cent)	Na	na	na	na	na	80.4	84.3	80.9	80.0	75.3	50.3	50.0	45.4	43.6	40.6	7.5	6.5
Asset share of foreign-owned banks (in per cent)	Na	na	na	na	na	na	na	Na	11.5	15.1	43.6	46.7	51.4	52.9	54.8	58.5	59.2
Non-performing loans (in per cent of total loans) <sup>2</sup>	Na	na	na	na	na	18.5	37.9	48.0	56.5	58.5	35.4	6.4	4.1	2.7	5.7	6.8	6.1
Share of administered prices in CPI (in per cent)	100.0	85.0	47.0	29.0	20.0	18.0	18.0	18.0	8.9	8.9	11.1	13.9	17.6	20.3	21.5	22.4	21.9
Number of goods with administered prices in EBRD-15 basket	15.0	14.0	15.0	13.0	7.0	6.0	6.0	4.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Share of trade with non-transition countries (in per cent)	Na	63.0	65.8	74.8	84.4	86.2	88.8	88.9	86.5	88.0	89.5	87.5	83.2	84.0	83.9	80.5	77.3
Share of trade in GDP (in per cent)	Na	39.2	33.4	51.8	41.4	42.3	49.0	52.7	53.4	45.7	50.8	60.5	64.1	66.2	66.7	71.1	67.1

Source: EBRD 2006 Transition Report

Table 2.4: Indicators for property rights reform, regulatory and institutional reform

Romania	Large scale privatisation	Small scale privatisation	Enterprise restructuring	Price liberalisation	Trade & Forex system	Competition Policy	Banking reform & interest rate liberalisation	Securities markets & non-bank financial institutions	Overall infrastructure reform
1993	2.00	2.00	2.00	3.67	3.00	1.00	1.00	1.00	1.00
1994	2.00	2.33	2.00	4.00	4.00	1.00	2.00	2.00	1.00
1995	2.00	2.67	2.00	4.00	4.00	1.00	3.00	2.00	1.00
1996	2.67	3.00	2.00	4.00	3.00	1.00	3.00	2.00	1.00
1997	2.67	3.33	2.00	4.00	4.00	2.33	2.67	2.00	1.67
1998	2.67	3.33	2.00	4.33	4.33	2.33	2.33	2.00	2.67
1999	2.67	3.67	2.00	4.33	4.33	2.33	2.67	2.00	2.67
2000	3.00	3.67	2.00	4.33	4.33	2.33	2.67	2.00	3.00
2001	3.33	3.67	2.00	4.33	4.33	2.33	2.67	2.00	3.00
2002	3.33	3.67	2.00	4.33	4.33	2.33	2.67	2.00	3.00
2003	3.33	3.67	2.00	4.33	4.33	2.33	2.67	2.00	3.00
2004	3.67	3.67	2.00	4.33	4.33	2.33	3.00	2.00	3.33
2005	3.67	3.67	2.33	4.33	4.33	2.33	3.00	2.00	3.33
2006	3.67	3.67	2.67	4.33	4.33	2.67	3.00	2.00	3.33

Source: Transition Report 2006, EBRD

Table 2. 5: The methods regarding privatization according to Romanian legislation:

(i) The sale of shares including the specific privatization method of selling shares for a token price of one Euro; (ii) the increase of the share capital by private contributions, which can be exclusively cash contributions or in kind contributions consisting of modern equipment; (iii) the free transfer or sale of corporate assets or (iv) any combination of the methods above. Additionally, private investments in the utilities sector can also be attracted through private-public partnerships. Companies with a majority state-owned capital can (i) freely transfer corporate assets to local public administrative authorities or to public institutions or alternatively (ii) sell the corporate assets to any other interested individual or company. Special measures can be taken by AVAS during the privatization process, such as: (1) appointment of a director with an extended mandate for taking the necessary measures to accelerate the privatization process and (2) implementation of a restructuring procedure for the companies subject to privatization. In order to ensure a fair competitive environment, Emergency Government Ordinance no. 26/2005 has repealed the provisions on the incentives that could previously be granted by the State in relation to budgetary debts. The employees of State owned companies dismissed under collective redundancies benefit from the social protection measures provided under Emergency Government Ordinance no. 8/2003 stimulating the restructuring, reorganization and privatization process of national companies and State owned companies, as amended, based on restructuring and reorganization plans approved by the public institution involved in the privatization process.

Table 2. 6: Chronology of rule of law and anti corruption measures

**-1999-**

Public remains to have little access to government information and departmental secrecy. Bribery to receive public services is rampant. The legislation prohibiting ministers from holding offices in private sector seems to counter conflicts of interest. Legislation for financial disclosure does not exist. Article 139 established a court of audit. According to the transparency international survey conducted in 1999, marginal improvement in contrast to early post communist years, as local government officials are more likely to prosecuted than high level. 1997-2000 governance program to advance Romania for EU accession underlines anti corruption measures. Ministry of interior establishes an anti organized crime and corruption brigade. The Ministry of Industry and State secretary are to testify in the Sun-oil case. Also public awareness campaign on corruption is initiated by Institutional Capacity Development Program signed by Justice Minister and UNDP.

**-2000-**

May 2000, new law enacted to punish corrupt practices (penalizes private sector behavior infringing on competition and awarding of contracts, permits charges brought against politicians, trade unionist and NGOs and international employees. A new organized crime and corruption unit was established under general prosecutor office. National office to fight money laundering is set up in 99. Adrian Costea case erupted and found wide resonance in Romanian media (Franco-Rom biz man, in exchange for business favors, he bankrolled PDSR in 1996 elections, Illiescu called the media exposure a political game. Another case was eruption of the scandal of FNI - National Investment Fund (high interest trust company, executives embezzled funds, investors lost their savings. 381 public officials charged with corruption in 2000. As member of Balkan Stability Pact and EU candidate, Romania is expected to tighten border and custom controls. Corruption grew despite attempts by government (rise from 61 to 63 to 68 in the corruption index).

**-2001-**

3 issues are raised by PNL, the NGO forum for electoral reform: 1) election of the president by popular vote 2)2 chambers reorganized in order to avoid delays and duplicates 3) safeguards for min. not just protection by Constitution. Illiescu's respond to the framing of minority groups' property rights claims as human rights as 'whim.' 2001 emergency ordinance to improve Roma situation on EU demands/ re-opening of trials for 2 generals of '89 political interference to overturn their case. Minister of transportation exposed for having contractual relations with construction company, pointing to wide spread issue of preferential treatment for MPs' firms. EU's report converges with OECD governance assessment: 'legal framework is there but enforcement is lacking'. Auditing does not yet comply with international standards despite positive steps. Anti corruption investigations remain at low level bureaucracy. Complexity can be blamed for bribery despite simplifications of the processes in the EU related legislation, especially evident for SMEs ('a typical firm needs to get 23-29 approvals, licenses etc...). In 2001, emergency ordinance was used to reduce it single bureau for business licenses.

**- 2002-**

The weakest showings for corruption by Transparency International (72sd). The constitutional court declared the law of state secrets unconstitutional, but parliament passed it anyway and President Illiescu promulgated it. Romanian government signed up to World Organisation of Intellectual Property Rights (WIPO). An emergency ordinance passed by PM office to punish all forms of discrimination. The law on status of policemen as civil servants was revised in accordance with EU's pressure to address human rights and discrimination in civil service. 115 open corruption cases erupted, including one involving the PM Nastase who famously concluded, 'corruption exists, but cases have yet to be proven.' Council of Europe's Civil Law convention on corruption was ratified in Romanian parliament in April 2002. The convention on money laundering, search, seizure and confiscation of proceeds from crime was promulgated in August of this year followed by criminal law

convention on corruption in June 2002). The law on public procurement and transfer to electronic site for procurement is put in practice, but lacks necessary supervision from independent bodies. Perception of corruption (under current government) has increased, according to the 2002 OSI report.

#### **- 2003-**

Coalition for Transparency by main NGOs is founded aiming to pass transparency legislation and oversee implementation. Also monitoring child protection, public policy and media freedoms through cooperation of NGOs and the Department of European integration is noteworthy. The resignation of 3 ministers in 2003 for corruption charges is a first in its kind. The creation of National Authority for Control for anti corruption noted for non partisan stand for tax evasion and fight against corruption.

#### **-2004-**

Most corrupt EU accession country due to Transparency index, comprehensive anti corruption law passed in April 2004, due government's inability to deliver fair and timely public service, administrative corruption persists (both underdevelopment of services esp. in rural administration and communist legacy)<sup>103</sup>. Scrutiny and accountability mechanisms to be multiplied by enforcement remain the real challenge as seen by the Nations in Transit report (2004).

#### **-2005-**

New anti corruption legislation is passed in the parliament, accompanied by a new body, National Anticorruption Prosecutor in addition to anticorruption department. Romanian Helsinki committee leader Monica Macovei became Minister of Justice, testifying to a greater link between NGOs and governance Openness is advocated by Basescu to disclose media owners. TV network assets frozen for non payment of social security debt, as media outlets seem to be taking advantage of weak bankruptcy laws. Amendment to law on public procurement aims to make media outlets more accountable. Actions of government in this line are praised by EU Commission. EU Council acknowledges Freedom House audit of anti corrupt strategy. Big political fight over 2004 judicial package starts up between SPD (defending the head of the National Anti-Corruption Prosecutor (NAP)<sup>104</sup>) and government led by the Tariceanu who uses influence on the superior courts to block it. The NAP turned into NAD. Nastase investigation continues along with 744 court cases with defendant MPs, Magistrates, lawyers. The anti corruption and conflict of interest investigations are also politicized in the case of the president- PM struggle in late 2005. Tariceanu helps business associate Patriciu who was charged for money laundering. President Basescu gets on the case, based on the accusations by former secret service associated with largest gas supply network sale.

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<sup>103</sup> Reviews of SAPARD program, studying the impact on agriculture and rural development in EU accession countries are published for 2004 and 2005 by Open Society Institute.

<sup>104</sup> NAP is a special agency created to fight corruption on a large scale, and the main interlocutor of Romania's anti corruption strategy and related action plans.



## APPENDIX: 3

Figure 3.1: Timeline of Turkish Accession

- **February 1952:** Turkey becomes a full member of NATO
- **September 1959:** Ankara applies for associate membership of the European Economic Community
- **September 1963:** The Ankara Agreement (an association agreement) is signed to take Turkey to Customs Union and finally to full EEC membership. The first financial protocol is also signed.
- **November 1970:** The Additional Protocol and the second financial protocol signed in Brussels.
- **January 1973:** The Additional Protocol enters into force. It sets out comprehensively how the Customs Union would be established
- **July 1974:** Turkey invades Cyprus.
- During the **first half of the 1980s**, relations between Turkey and the Community come to a virtual freeze following the military coup d'etat on 12 September 1980.
- **June 1980:** The Association Council decides to decrease customs duties on almost all agricultural products to "zero" by 1987.
- **September 1986:** The Turkey-EEC Association Council meeting revives the association process.
- **14 April 1987:** Turkey applies for full EEC membership.
- **December 1989:** The Commission endorses Turkey's eligibility for membership but defers the assessment of its application.
- **March 1995:** Turkey-EU Association Council finalises the agreement on the Customs Union (CU) which enters into force on 1 January 1996.
- **December 1997:** At the Luxembourg Summit, EU leaders decline to grant candidate status to Turkey.
- **December 1999:** EU Helsinki Council decides on the candidate status of Turkey
- **March 2001:** The EU Council of Ministers adopts EU- Turkey Accession Partnership.
- **March 2001:** The Turkish government adopts the National Programme of Turkey for the adoption of EU laws.
- **September 2001:** Turkish parliament adopts over 30 amendments to the constitution in order to meet the Copenhagen political criteria for EU membership.
- **August 2002:** The Turkish Parliament passes sweeping reforms to meet the EU's human rights criteria.
- **13 December 2002:** The Copenhagen European Council resolves that if the European Council in December 2004, on the basis of a report and a recommendation from the Commission, decides that Turkey fulfils the Copenhagen political criteria, the EU would open accession negotiations with Turkey. In the meantime, EU leaders have agreed to extend and deepen co-operation on the EC-Turkey Customs Union and to provide Turkey with increased pre-accession financial assistance.
- **May 2003:** The EU Council of Ministers decides on the principles, priorities, intermediate objectives and conditions of the Accession Partnership with Turkey.
- **January 2004:** Turkey signs protocol banning death penalty in all circumstances, a move welcomed by the EU.
- **March 2004:** Council of Europe recommends ending the monitoring of Turkey.
- **October 2004:** Commission issues progress report on Turkey.
- **17 December 2004:** European Council decided to open accession negotiations with Turkey on 3 October 2005 - with strings attached.
- **23 May 2005:** Turkey names Economy Minister Ali Babacan as the country's chief accession negotiator.
- **1 June 2005:** Turkey's revised penal code, first adopted in September 2004, enters into force.
- **17 June 2005:** The Council reiterates the EU's determination to proceed with the enlargement process.
- **29 June 2005:** The Commission presents its 'rigorous negotiating framework to Ankara.
- **29 July 2005:** Turkey signs protocol to Ankara agreement, extending EU-15 customs union to the ten new member states including Cyprus. Ankara also issues a declaration on the non-recognition of Cyprus.
- **21 September 2005:** The EU approves its counter-declaration on Turkey's 29 July declaration.
- **3 October 2005:** Accession talks symbolically opened with Turkey.
- **23 January 2006:** The Council decides on the principles, priorities and conditions contained in the Accession Partnership with Turkey.
- **16 March:** The European Parliament adopts a resolution based on a report by Elmar Brok on the Commission's enlargement strategy paper.
- **12 April 2006:** The Selection Panel for the European Capital of Culture 2010 recommends Istanbul.

- **12 June 2006:** The EU starts concrete accession negotiations with Turkey. The negotiating framework specifies 35 chapters. Each chapter needs to be unanimously opened and closed by the Council. The Council agrees on opening and closure of the chapter on science and research.
- **12/27 July 2006:** The court ruling on “Turkishness” in the case of Hrant Dink sends an ambivalent signal to the EU and raises concerns over freedom of expression in Turkey.
- **31 July 2006:** Hardliner General Yasar Büyükanit is appointed chief of the Turkish military.
- **4 September 2006:** European Parliament votes a report concerning Turkey’s progress on preparing for membership. The report says that Turkey had made insufficient progress in the areas of freedom of expression, minority rights, corruption and violence against women.
- **8 November 2006:** Commission publishes a critical report on Turkey’s accession progress.

Source: Author’s own compilation.

Figure 3.2: Privatization Law Provisions in closer view

- The establishment of the "**PHC (Privatization High Council)**" and the "**PA (Privatization Administration)**" and the determination of their duties, responsibilities, and rights,
- The establishment of the "**Privatization Fund**" and the determination of the resources and utilization fields of such fund,
- The supply of financial and social rights to the personnel contracted at organizations included under the scope of privatization who might become unemployed as a result of privatization,
- The personal and social rights of the public employees working for the organizations included within the scope of privatization,
- Paying "Redundancy Compensation" in addition to other indemnities foreseen in the collective bargaining agreements and/or in the existing laws in relation with potential employment reductions that may occur,
- Not using the proceeds of privatization for general budget expenditures and/or investments,
- Preventing the negative effects resulting from a monopolistic structure that may occur,
- Procuring of a shareholders' group capable of undertaking the responsibility and authority of management, as well as the expansion of the ownership,
- Creating privileged State shares for strategic fields,
- Not allowing for transfers to public institutions, organizations and to the local administrations during privatization, unless the necessitated by the sake of national security and/or the best interest of the public.

Source: Republic of Turkey, Prime Ministry, Privatization Administration web -site.

Figure 3.3: Reforms adopted as part of the Pre-Accession Economic Programme of 2001

- Independence of the Central Bank
- Creation of a truly independent agency to regulate the banking system
- A new debt management and public finance law providing a comparative framework for risk management and limiting discretion of the executive branch of government in exceeding debt limits set in the annual budget law passed by Parliament
- Closure of the multiplicity of extra-budgetary funds which had rendered transparent fiscal policy impossible
- A new public procurement law based on UNICITRAL and establishing a new independent public procurement authority
- A new public financial management and control law
- Some simplification of the task system
- New banking laws aiming at much greater transparency and better risk management
- A thorough re-organization of the public banks and an end to their non-transparent quasi-fiscal law
- A new law regulating the telecommunications sector and opening it up to competition
- A far-reaching reform of the agricultural policies moving them from price support driven by political pressures of higher income farmers lobbies to direct income support attempting to target the poorer farmers
- A new electricity market law aiming at establishing a competitive energy market regulated by the state but open to the private sector
- A new law regulating the natural gas sector
- A new law for the sugar sector
- A new law for the tobacco sector
- A new law simplifying procedures relating to private foreign investment, putting it on a completely equal footing with domestic investment.

Source: *PEP of Turkey*, <http://ekutup.dpt.gov.tr/ab/kep/pep2001.pdf>.

Figure 3.4: TR- EU Negotiating Framework

- 1) The underlying and shared objective of the talks will be Turkey's accession. However, the negotiations will be "**open-ended**", which means that their outcome cannot be guaranteed beforehand.
- 2) At the end of the talks, should Turkey fail to qualify in full for all obligations of EU membership as specified in the Copenhagen criteria, EU member states will still ensure that Ankara is "**fully anchored** in the European structures through the strongest possible bond".
- 3) The accession negotiations will be conducted in the framework of an Intergovernmental Conference with the participation of Turkey and all EU member states. The policy issues will be broken down into **35 policy areas (chapters)** - more than ever before - and the decisions would require **unanimity**.
- 4) The EU may consider the inclusion of **long transition periods**, derogations, specific arrangements or permanent safeguard clauses in its proposals for each framework.
- 5) Membership talks with candidates "whose accession can have substantial financial consequences" (such as Turkey) **could only be concluded after 2014**, the scheduled date for the establishment of the EU's new financial framework.
- 6) Accession **negotiations could be suspended** in case of a "serious and persistent breach [...] of the principles of democracy, respect for human rights and fundamental freedoms and the rule of law on which the Union is founded". Suspension will require a Commission initiative or a request to that effect by one third of the member states. The final decision would be made by the Council by qualified majority, and the European Parliament would be informed.

Source: European Commission, Enlargement website: [http://ec.europa.eu/enlargement/candidate-countries/turkey/key\\_documents\\_en.htm](http://ec.europa.eu/enlargement/candidate-countries/turkey/key_documents_en.htm)