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ARTICLES

OPINION AND REVIEWS

HUNGARIAN-TURKISH RELATIONS DURING THE COLD WAR (1945-1989)

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Abstract

In the first part of the last century, two World Wars devastated a large part of Europe. For decades afterwards, the East and the West challenged each other as enemies and were divided into two parts during the Cold War. Countries all over the world were forced to take a side politically by two superpowers. The external-internal political relations of countries have been shaped according to the Washington-Moscow line. The usually good Hungarian-Turkish relations were overshadowed by the bipolar structure of world politics and bilateral contacts were dependent upon the state of relations between the two superpowers.

Despite taking places in opposing camps during the Cold War, the two countries maintained their relations based on traditional friendship that was, in certain periods of time, disturbed by conflicts too. Though the two nations share many common elements of their past, they were in touch with ever their respective positions in Central Europe and Anatolia, we cannot forget that the Turks occupied much of present day Hungary after the battle of Mohács in 1526, until the Treaty of Karlóca in 1699. The mutual official visits continued between both countries during the Cold War. Hungarian-Turkish relations before, during and after the Cold War should be understood both in the context of Hungary's bilateral relationship to Turkey and within the framework of Hungary's Warsaw Pact membership and Turkey`s NATO membership. With the end of the WW II, Turkey turned its face toward NATO and Hungary turned its face toward the Warsaw Pact. In this study, the political relations between Hungary and Turkey during the Cold War will be examined with regard to the bipolar system in the world. In addition to these, the mutual official visits, which contributed to the development of Hungarian-Turkish relations, will be considered for the study by benefiting from written media sources as well. Besides that, this article tries to shed light on the state of Turkish-Hungarian political relations during the bipolar world order.

Keywords: Hungary-Turkey Relations, Cold War, Hungarian-Turkish Friendship, Budapest-Ankara line, Western-Eastern Blocks

1. Introduction

Turks and Hungarians are strongly interconnected throughout their history as they share many features in the past including their origins, cultural and linguistic characteristics and for 150 years the Ottoman empire ruled over most parts of Hungary. After the withdrawal of the Turks from Central Europe following the Treaty of Karlowitz (Karlóca in Hungarian, Karlofça in Turkish), the once belligerent nations could build very friendly relations with each other. Turkey gave shelter to several waves of Hungarian refugees including the hundreds of soldiers and political leaders reaching the Ottoman State after 1849 and in Hungary a real nostalgia for the Ottoman times can be seen. Turks and Hungarians were allies during World War I. and after the war, connections remained strong. Between the two wars good and bad times were shifting. Finally, Turkey preferred to establish a certain distance from Budapest as the Hungarians started to side with Italy and Germany whereas Turkey rather wanted to be neutral during World War II. As Turkey, indeed, could abstain from the great armed conflict (though declared war on Germany and Japan on 23rd February, 1945), threatened by Stalin's Soviet Union, it could not stay far from the vicissitudes of the Cold War in which the two countries found themselves in the opposite camps.

The aim of our present paper is -after drawing the picture of the Cold War and the respective foreign policies of Turkey and Hungary within its frame- to analyze how this once friendly relationship was partially destroyed by the Cold War and slowly reconstructed during the last long decade of this period. The Turkish-Hungarian ties are widely discussed in general. One can find plenty of academic studies on the subject if the goal is to learn more about the Ottoman times or even the first half of the 20th century, but when it comes to the years between 1945 and 1989, the sources are very limited. Scholarly studies are few and contain some discrepancies as we have noticed during the research phase of our work. There is even less information in English, so we are obliged to use texts in Hungarian and Turkish. Due to this shortage, besides the academia, we have based our research on the archives of two daily newspapers: the Turkish Milliyet and the Hungarian Nepszava.

The story of the Turkish-Hungarian relations during the Cold War is also a description of relative independence. Both Turkey and Hungary were framed and limited because of the bipolar world order. Nevertheless, they tried to change the situation by little steps and closer to each other.

2. International relations during the Cold War

The Cold War, the period between 1945 and 1989 was based on a global bipolar system which permitted the existence of a certain amount of armed conflicts around the Earth but let the two poles coexist in a relative stability. In other words "any possibility of maintaining a general peace required a willingness to fight small wars" (Waltz, 1964, p. 884). Both Hungary and Turkey during this period were fighting a number of small wars. Hungary was fighting for its independence and democratic transition in 1956 and participated in the invasion of Czechoslovakia in 1968, whereas Turkey got involved in the Korean War, the civil war on Cyprus and was hit by several conventional and post-modern military coups from 1960.

Turkey, a key periphery in the construction of the post-war West, was also the scene of one of the early chapters of the Soviet-American confrontations. After pronouncing territorial claims on Kars and Ardahan provinces of Northeastern Turkey in 1945, on the 7th August 1946, the Soviet Union announced its desire to revise the Montreux Agreement regulating the Turkish waterways connecting the Black Sea to the Mediterranean Sea. The Soviets garrisoned a high number of troops in the Balkans and a Soviet invasion of Turkey, was an easy Western target for the communist state, and was objectively feared (Mark, 2005, pp. 113-115).

The Soviet Union threatening Turkey, and also Iran at the same time on the issue of its oil fields, had an interesting impact on international relations at a global level. Originally, the United States of America did not consider the Middle East as vital to its national interest as it became later or as it is nowadays. The Americans were not that much in need of the Middles Eastern oil as the American economy of the 1940's did not require the same quantity as in the coming decades or today. It seems that the Soviet threat to Iran and Turkey was the key issue to raising awareness and to the value of the geopolitical importance of the Middle East (Mark, 2005, p. 116). It might sound paradoxical, but it was not the United States but the Soviet Union that gave Turkey a privileged position in the Western agenda. On the 19th August, 1946 the United States made some firm steps to show support for Turkey and calm down the Soviets, and later that year ceased their anti-Turkish activities in the region (Mark, 2005, p. 121).

Besides the wars fought on the peripheries, the economic growth of the centers also contributed to the maintenance of the equilibrium. As the expansion of the Soviet economy exceeded the rate predicted by the Americans, and as the major part of the income was used for armament, there were real agreements on disarmament, but at the same time an arms race was there that provided the bipolar world with a stability limited to its centers, namely the Soviet Union and the United States of America (Waltz, 1964, p. 883).

In the West, after World War II., the general public was almost unanimous about its superiority political, cultural, economic and military and believed that the Soviet Union and the Eastern bloc would not be able to be a competitor on the global level and would soon collapse. It was German born American Secretary of State, Henry Kissinger who realized that the United States had to change its approach, give up the position of being the unique source of universal principles and deal with other regions, especially the Soviet Union in a different manner. Indeed, there was a gap between the ideological and political ambitions and the reality that made the poles almost equal on the political and military levels (Lukin, 2016, pp. 94-96).

As the Soviet Union, which threatened Turkey in 1945 and 1946 and eventually invaded Hungary in 1956, caught up the military with the West, a decade long period of stability c characterized the central nations of the two poles. What we can now describe as a golden age of global security that lasted from the time of the Suez conflict and the intervention in Hungary until 1965 (Baldwin, 1995, p. 123). The decline of this golden age can be explained in two different ways and it clearly had a deep impact on the relative independence of the respective Turkish and Hungarian foreign policies after 1975 and especially in the 1980's. The first explanation can be proposed on the military level. The Cold War turn somewhat hot in Vietnam, where a clear Soviet-American opposition was there in the image of a cruel proxy war. The second one is on the economic level. The recession in the Soviet economy and the increasing signs of economic crisis on the communist periphery, like Hungary, made the Eastern bloc incredibly vulnerable (Baldwin, 1995, p. 124).

Deducing from the above time line, one can say that we can divide the Cold War into three main periods from the perspective of international relations. The first phase is the post-war emergence of the bipolar confrontation that lasted until shortly after the death of the Soviet dictator, Stalin, and the Soviet intervention in Budapest and the Suez crisis. The second phase is the golden age which sees crises like the one in Cuba, but major armed conflicts including the central nations are rare. This golden age is between 1956 and 1965. After 1965, we are assisted into a transitional period followed by the Vietnam war and the slow economic and military decline of the Soviet Union leading to relative autonomy of both Turkey and Hungary in their approach to international relations.

If we accept the above division of time, we can also apply it to Turkish-Hungarian relations during the Cold War. Though after World War II. Both Hungary and Turkey were exposed to Soviet "imperial" policies, they did not have the same opportunities as Turkey was defended by the United States of America during the 1946 crisis over the Montreux Agreement, and Hungary was increasingly controlled by local and international communists. At that time, it was not possible to continue the friendly relationship that had characterized Turkish-Hungarian ties in the past. This shift, the fact that the two countries were in different camps, meant a bigger division between the two countries than was observed in the 1930's when Hungary sided with Germany and Italy and Turkey tried to remain neutral. Having said so, of course, diplomatic ties existed between Turkey and Hungary. After the 1956 revolution in Hungary, some stricture was implemented by the Kadar government at that time, worried about its acceptance at the international level. So, the golden age of global security did not describe well Hungary prior 1962, meaning that Hunarian-Turkish relations could not evolve. It was rather during the period of the general relaxation of international politics after 1975 that permitted to the two sides to discover each other again, and to establish friendly relations again during the last long decade of the Cold War.

3. Hungarian foreign policy during the Cold War

According to Bekes we cannot speak of an independent Hungarian foreign policy after 1945 (Bekes, 2011, p. 65). This assessment might sound very harsh, but if the level of autonomy in Hungary is compared to Turkey described in the following chapter, one can see that in the bipolar world of the Cold War, the democratic nations belonging to the Western hemisphere had more opportunities to express dissident views or stress their own interests, though a certain degree of pressure was also put on countries like Turkey.

Initially, after World War II. a certain transition to democracy can be observed in East Central Europe. In Hungary, multi-party elections took place in 1945 and 1947. They were, by far, not fully free and fair, but at least, we can say that Stalin did not come with a direct communist takeover after the occupation of Poland, Czechoslovakia, Hungary, Romania and parts of Germany that became the GDR. The formation of this Eastern bloc can be understood as a reaction to the Truman Doctrine and the Marshall Plan to rebuild and unite Western Europe as an emerging ally of the United States of America. Stalin move to unite the East Central European nations and strip them of their independent foreign policies to pacify them as they were, in a sense, former archenemies (Bekes, 2011, p. 66).

After 1953, and the death of the Soviet dictator Stalin, a process of De-Stalinization commenced and also led to a partial re-thinking of the common foreign policies of the East Central European nations. The De-Stalinization process revealed a certain number of uncertainties and hidden internal conflicts between the countries of the Soviet bloc. The internal conflicts were already visible in how the new leaders tried to deal with the upcoming issues such as the 1953 Berlin and the later Poznan uprisings (Racz, 2007, pp. 9-10). Between 1953 and 1955 remarkable reforms were to be observed in the fields of domestic and economic policies, but relatively few steps were taken at the level of international relations. The first internationally noticeable act was the adhesion of Hungary to the United Nations in 1955 with the evident consent of the Soviet leadership because the Soviet government even encouraged the East Central European governments to implement more active foreign policies following the 1954 Four Power Conference held in Geneva, Switzerland (Bekes, 2011, pp. 74-75).

Probably the most important issue between the Soviet Union and Hungary was the 1956 Anti-Communist revolution. One of the main claims of the insurgents and the Imre Nagy government was a non-allied Hungary, independent both from the Warsaw Pact, the military alliance of the Eastern Bloc, and NATO. The fight for freedom started on the 23rd October and was crushed by Soviet tanks on the 4th November. It is worth noting that this event was not only the intention of Moscow, historians discovered that a special new power structure had started to influence the decision-making process in the East. It was basically the emerging impact of the Chinese leadership that pushed Khrushchev and the Soviet communists to "punish" Hungary and use extreme violence to put Hungary back on track (Bekes, 2011, p. 80).

After drowning in the blood of the 1956 revolution, Hungary once again became strictly controlled both internally and externally by the communists. During this period, "the Kadar era" (named after the powerful First Secretary of the Hungarian Socialist Workers' Party), Hungary continued to be a "loyal, dependable and predictable partner" of the USSR. Policy makers also referred to this attitude as constructive loyalty towards Moscow (Bekes, 2011, pp. 81-82). "In academic and journalistic writings and in school textbooks, it is often stated that the Kadar regime's growing independence in domestic policy was bought at the cost of subverting foreign policy to Moscow's demands" (Pritz, 2010, p. 105).

After the shocking events of 1956 in Hungary and 1968 in Czechoslovakia, the Soviet Union had to accept that the different Eastern European nations also had some initiatives with regards to their own foreign policy. The first step towards this relative independence was the Budapest declaration of the Warsaw Pact. This was in fact an open call for European countries to organize a continental summit to discuss the issue of security in Europe. Historical documents prove that certain Eastern bloc nations, especially the GDR and Poland were against such a move, but the Hungarians, the Soviets and the Romanians seemed to be more flexible, Janos Kadar and Frigyes Puja, then first deputy of the minister of foreign affairs made a compromise (Bekes, 2006).

The official preparation for the Helsinki Summit commenced in 1972, Hungary along neigboring Romania played a very active role in the process. The same can be also said about Turkey on the other side. The signing of the Helsinki Agreement in August 1975 acted as a catalyst for Hungarian foreign policy as the Hungarian government sent a proposal of strengthening the bilateral diplomatic and economic ties to 19 Western nations as early as 1976 and was followed by an important number of official visits in the West (Bekes, 2006). One of the key visits of that time finally normalized relations between Hungary and the Roman Catholic Church. On 7th and 8th June, 1977, Janos Kadar paid a visit to the Vatican where he was received by pope Paul VI (Sipos, 2011, p. 14). A similar procedure started with the Republic of Korea that produced its fruits a bit later when in 1989 when the Hungarian minister of foreign affairs, later prime minister, Gyula Horn signed the document of mutual recognition and the establishment of diplomatic ties with his colleague Chi Ho Joong (Torzsa, 2009, p. 212).

After the major armed conflicts of the Cold War, and especially during the 1970's and 1980's the different countries of the two blocs started to have more independent and critical foreign policies. In the case of Turkey -as we will see in the next chapter- the pretext to do so was the 1980 military coup, whereas the necessity to have an independent Hungarian foreign policy arose from economic needs (Bekes, 2011, p. 83). The Hungarian economy had a rather good period of development around the end of the 1960's and the first half of the 1970's, but this was followed by a time of recession and deepening crises after 1975 and even more in the 1980's. Hungary was in need of the economic and technological help of the West. This persuaded the Hungary to foster better relations with Western Europe and the United States of America. An important and symbolic gesture in this regard was the return of the Hungarian crown from America in 1978.

"Hungary's foreign policy since the late 1970s had been founded on relative independence, whereby in simplified terms what was not forbidden, was (perhaps) allowed" (Bekes, 2011, p. 86). This impression of Hungarian policy-makers was further strengthened by the changes in the Soviet Union implemented by the new leader Mikhail Gorbachev under the name of Glasnost and Perestroika, a shy democratization attempt by the Soviets. Real independence from Moscow was only attained when Secretary Kadar was ousted from power in 1988 (Bekes, 2011, p. 82).

4. Turkish foreign policy during the Cold War

Though the Ottoman Empire and the independent Republic of Turkey established in 1923 were keen on following an autonomous foreign policy, they were at many times obliged to take into consideration the international context and the relationship between other countries in a more and more globalized world. After World War I., the two newly created nations, Turkey and the Soviet Union -because of the very same logic- were forced to co-operate, especially against the interests of the West, the Triple Entente. Furthermore, the Soviet Union was helping militarily and materially the Turks between 1919 and 1923 when the latter were struggling for national independence against various armies invading Turkey. After the war, the Soviet Union was among the few nations to promote economic development in Turkey and the industrialization of Anatolia (Szigetvari, 2014, pp. 96-97).

A sudden shift could be observed right after World War II. as Turkey -a country abstaining from the horror of the armed conflict- found itself in the complete opposite camp. The divide between Turkey and the Soviet Union became day by day more visible during the lifetime of Stalin, because the soviet dictator could not forgive the Turkish leadership for trying to normalize ties with the West and introduced a multi-party democracy. With the death of Stalin, though Turkey joined NATO soon after its formation, there was much less tension between Turkey and the Soviet Union, but this did not mean that the relationship became friendly (Szigetvari, 2014, p. 97).

After World War II., Turkey found itself in a situation where the country was unable to continue its traditional foreign policy, best described by the famous quotation of its founder, Mustafa Kemal Ataturk: "Yurtta sulh, cihanda sulh", meaning "Peace at home, peace in the world." We might call the coldwar and its strictly bipolar environment an exceptional period in the history of Turkish foreign policy. As the USSR replaced Germany as the major threat to the Western world, an unusual diplomacy started instead of a rationally designed one (Okman, 2004, p. 15).

Turkey, a country that had successfully abstained from World War II., was suddenly surrounded by a great number of threats and challenges. As an early member of NATO, Turkey was a rather "distant outpost of NATO on the European periphery" than a nation secured by its chosen military alliance. The army command identified 13 out of the 16 major issues named by NATO as dangerous in the region of the Middle East and the Balkans. Turkish military leadership perceived the situation as being in the very epicenter of the conflicts. This perception was also responsible for the development of a specific Cold War mentality that only changed in the 1980's when Turkey started to implement less momentum-oriented and more relaxed foreign policies (Aydin, 2005, p. 2).

The involvement of Turkey in the Korean War was an important step in the Westernization of the country. A future American ambassador to Ankara, George C. McGee praised the Turkish military intervention and valued the quality of the Turks by saying that they feature "tremendous fighting qualities" and "demonstrated their willingness to participate in collective security" (Aliriza and Aras, 2012, p. 2).

During the Cold War, Turkey developed into a Western style multi-party democracy and a free market economy, though its history was marked by frequent military coups. These intrusions to the evolution of democracy by the army totally contradicted the principles pronounced by the West and NATO. Even though the slogan of the 1980 putsch was to re-directTurkey to the path of real democracy, until 1987, the end of the democratic transition from strict military rule to real democracy, we cannot speak of democratic management of the country. So, Turkey was a integral part of the West, whereas in the country the values of the West could not fully prevail (Aydin, 2005, pp. 10-11).

As the Western nations were, even at the beginning of the military intervention very critical of the situation, they became even more hostile towards the coup as time passed, the strong and good relationship of Turkey with the West began to degrade. The European governments between 1980 (the coup) and 1983 (limited restoration of civilian democracy) opted for keeping Turkey inside the Western structures and put pressure on it through the traditional channels therein, not breaking the ties and totally severing the relationships to show their dissatisfaction. Though these reactions of the European nations might seem rather soft, Turkey tended to respond with very harsh criticism of the West. While Turkey was harshly criticizing the West, even in the worst moments of the confrontations, the Turkish leadership never wanted to quit the Western structures as the western element of the Turkish identity and the Turkish foreign policy was still very influential (Aydin, 2005, pp. 12-13).

Militarily speaking, there was another issue causing the deterioration of diplomatic relationships between Turkey and the West and especially between Turkey and the United States of America. Turkey, as a full member of NATO was happy to accept the basic military strategy of the alliance in 1954 when the first democratically elected government ruled the country. Turkey at that time was liberalizing its market and widely opening up to the West and its investors. This so called massive retaliation strategy fitted perfectly the situation of Turkey, as the country was surrounded by a growing number of threats like the USSR itself, the communist countries in the Balkans. There was also the case of the Turkish speaking minorities in the Balklans, the uncertain relationship with Greece and the Cypriot question, the apparition of new nations and conflicts in the Middle East. NATO adopted a so called flexible response strategy in 1967, after the end of a major diplomatic confrontation between the USA and the USSR, namely the Cuban missile crisis. The United States might have felt more secured at that time, but as the strategic and geographical environment of Turkey did not change, they formed a vocal opposition to the shift (Ozkan, 2015, p. 71).

Another issue that contributed to the deterioration of the Turkish-American relations in the 1960's right after the first military coup of Turkish history that removed from power the first democratically elected government and executed its head, the rather popular Adnan Menderes. The Cuban missile crisis had a detrimental effect on Turkish-American and Turkish-Soviet relations. Turkey was in fear of a Soviet attack because Moscow might have perceived the putsch as a sign of weakness, at the same time, the Turkish government fully disagreed with the American project of removing the defensive Jupiter missile from its territory. The two year long diplomatic tensions between Turkey and the United States of America ended in April 1963 with the withdrawal of the military technology and the Turkey was offered the Polaris submarines instead. It became public information, courtesy of a Soviet leak, that the USA and the USSR concluded an accord on the issue behind the back of the Turkish government (Ozkan, 2015, pp. 72-73).
After these two incidents, Turkish-American relations were normalized as Turkey was highly dependent on its ally. The United States between 1948 and 1975 provided Turkey with 4.5 billion USD in military aid and also included the country under its nuclear umbrella. (Aliriza and Aras, 2012, p. 3).

As we can see, the Republic of Turkey was an integral part of the Western alliance system, nevertheless there have been a number of Turkish-European and the Turkish-American diplomatic confrontations. Even in times of deep crises like the Cuban missile crisis, the Cypriot question or the subsequent military coups in Turkey, Turkey has maintained its privileged positions, and remained a Western nation for the West and for the internal public, though it is is also true that Ankara became more and more critical of the status quo just prior to the fall of the Berlin wall.

5. Hungarian-Turkish relations during the Cold War

Though Turkey strongly disagreed with Hungary's pro-German foreign policy before World War II. and during the German occupation of Hungary, it maintained its diplomatic representation -even during the war- in Budapest. The Turkish embassy only closed its doors on 1st April, 1945 as the Turkish government did not feel the situation secure enough to carry on the diplomatic duties in the Hungarian capital. Turkey recognized the necessity to re-open the embassy as soon as 1946 and a delegation was sent from Ankara to Budapest to meet with the newly nominated president of the newly proclaimed Hungarian Republic, Zoltan Tildy. The talks resulted in the re-opening of the embassy in 1947 with Agah Aksel at its head. After Aksel's arrival in Budapest a reception was organized by the Hungarian Turkish Chamber of Trade and many of the members of the Hungarian political elite joined the evening (Calik, 2015. p. 38).

After the normalization of diplomatic ties, the first official visit to be held between Hungary and Turkey was conducted by Sandor Ronai who from 1952 to 1963 acted as the head of the Hungarian Parliament. Ronai while in Ankara, invited the representatives of the Great Turkish National Assembly (TBMM) to Hungary (Calik, 2015, p. 39). It is worth noting that at that time Hungary was characterized by a single party dictatorship, Ronai himself was a member and MP of the Hungarian Workers' Party (MDP), whereas Turkey was just over the transition from a single party system to a multi-party democracy. Political parties were authorized in 1946 and the first free and fair elections were held in Turkey in 1950. The president of the TBMM in 1953 was Refik Koraltan, a member of the right wing ruling party, the Democratic Party (DP). We have to underline here that even though there was a huge difference between the political situation in the two countries and an ideological gap, the two parties could establish good contacts and relationships.

As in other parts of the world, the public in Turkey got very interested in the events of October and November 1956 in Hungary. The Turkish ambassador to the United Nations, Selim Sarper tried to raise awareness of the Hungarian cause and supported an initiative to discuss the case of the Hungarian revolution at the meeting of the Security Council. At the same time, across Turkey, aid campaigns were organized and preparations were made in order to better receive the Hungarian refugees coming to Turkey. The first group of 79 Hungarian asylum-seekers arrived on 12th February, 1957 and was offered genuine Hungarian food cooked by the Free Hungarian Association of Istanbul. In February 1957, a total of 507 Hungarian refugees reached Turkey (Calik, 2015, p. 40). On 17th February, Refik Koraltan, who was still the president of the TBMM at that time, visited the refugee camp where the

Hungarian refugees are housed and met a young Hungarian girl identified as Laura Tanko and offered her a place outside the camp as she had undergone too many tribulations in her country – the story was reported in the Milliyet newspaper. The events of the Hungarian revolution were widely covered by the Turkish media. On the 20th October, 1956 reports on the discontentment of Hungarian workers and students appear in the newspapers and some 155 articles were published during the following 41 days. Most of these articles of the main press organs like Hurriyet, Cumhuriyet, Ulus or Zafer emphasized the opposition between the Free World and the Eastern bloc and the possible diplomatic impacts of the events (Yagci Aksel, 2014, p. 92).

We have to add to the story of Hungarian refugees that Turkey has a long tradition of getting and helping Hungarians who were forced to run away from their home country. From among the Hungarian national heroes, in the 17th century Imre Thokoly and Ilona Zrinyi, in the 18th century Ferenc Rakoczi and in the 19th century Lajos Kossuth lived and most of them died on Ottoman Turkish soil.

With the arrival of the third phase of the Cold war, Turkish-Hungarian diplomatic relations also ameliorated. After 1967, full scale diplomatic relationship were followed by the mutual visits of the ministers of foreign affairs. Janos Peter, the Hungarian minister of foreign affairs spent almost a week in Turkey between 22nd and 27th July, 1968 (Calik, 2015, p. 41). Peter was known for his important sympathy towards the Turkish nation. The Milliyet newspaper published an interview with him almost two years after his visit to Ankara on the 1st March, 1970 where he was quoted as saying: "If there were no Turks, there would not be a Hungarian nation." Peter also participated in 1968 in the opening ceremony of the Rakoczi Museum in the Western city of Tekirdag (known as Rodosto to Hungarians) on the shore of the Marble Sea, the locality where the leader of the 1703-1711 Anti-Habsburg uprising lived and died. In fact, according to the website of the museum, the building receiving the memorial exhibition was used as the ceremonial dining hall of Prince Rakoczi.[1] Besides opening the Rakoczi Museum, Janos Peter urged his Turkish colleague, Ihsan Sabri Caglayangil to sign a long-term trade agreement with Hungary as Hungary was going through a period of emergance as far as the economy was concerned and was looking for partners outside the Comecon, among the Western nations – reported by the Milliyet newspaper on the 24th July, 1968.

[1] http://rodosto.hu/hu/rodosto.html

Ihsan Sabri Caglayangil -on Janos Peter's invitation- visited Hungary in November, 1970. The most important achievement of this official visit was -as reported by the Milliyet newspaper- that on the 23rd November, 1970 the first long term post-war trade agreement between the Republic of Turkey and the Hungarian Peoples' Republic was signed by Caglayangil and Peter.
The next ministerial visit was most probably the most important in the history of the two countries during the Cold war. In January 1977, Frigyes Puja, the Hungarian minister of foreign affairs went to Turkey for a five day long visit that included a stop in Istanbul, Izmir and -of course- Tekirdag. The latter place became a quasi obligatory visit for Hungarian politicians while in Turkey. Puja's delegation included two high ranking ministry officials: Mr. Petran responsible for international security and Mr. Vass.

The very importance of the visit was that the two parties signed the most complete international agreement on the 11th January, 1977 in Ankara. The full text signed by the president of the Republic of Turkey, Fahri Koruturk and all the cabinet ministers was published on 13th December, 1977 in the official journal of the Turkish government called T.C. Resmi Gazete.[2] The agreement named the following sectors of the economy to be developed on the basis of a mutual friendship:

- Processing and preparation for marketing of agricultural produce and food-stuffs
- Metallurgy industry
- Complete plants for various sectors of production
- Power industry /thermal power stations, hydraulic and steam turbines, etc.
- Electro-technical, chemical, petrochemical and pharmaceutical industries
- Extractive industry and its equipment - Production of domestic electric and electronic appliances
- Ready made clothing industry - Textile dying products
- Transport and communications
- Other fields of mutual economic interest.

Turkish-Hungarian economic relations were not very intense after World War II until the 1960's as both countries had to recover from the situation caused by the armed conflict. Hungary and the Hungarian production infrastructure was virtually destroyed and had to be reconstructed, the Turkish economy had come to a halt as its main partners were at war. Though an agreement between Turkey and Hungary was signed as early as 1949, the real exchange started only around the mid-1960's. A very sharp increase of

[2] Online version: http://updatetest.palmiyeyazilim.com/eskiregalar/1977/12130.pdf

around 50% in the foreign trade balance can be observed from 1965 to 1966 as it passed 20.2 million USD to 30.5 million USD. This made Hungary the second most important trade partner of Turkey in the Eastern bloc after the Soviet Union itself (Calik, 2015, p. 43).

This period of increase was followed by a time of deintensification as in 1974 the Turkish export was around 26 million USD and the imports were as low as 18 million USD. This visible decrease did not change the position of Hungary of being the second most important trade partner in the region but made those responsible think about modifying the level of exchange between the two countries. The agreement of 1977 was implemented in order to re-launch the foreign trade relationship between Turkey and Hungary. In 1980, we can already see a completely different landscape as Hungarian exports to Turkey culminate at 59 million USD. Three times as much as six years earlier. At the same time, we can see that Hungary bypassed Turkey as Turkish exports reach 41 million USD. This equated an increase of 57.7% in six years (Calik, 2015, pp. 44-45).

As Turkish-Hungarian relationships became friendlier again, various cabinet ministers visited in the other country. One of those official visits just preceded the Puja visit to Turkey. As the Milliyet reports on 12th December, 1976, the Turkish minister of national education, Ali Naili Erdem had the chance to pass a few days in the Hungarian capital. As the Hungarian politicians used to visit the Rakoczi Museum in Tekirdag, Erdem was driven to a famous remnant of the Ottoman past, the still standing minaret in the city of Erd on the Southwestern outskirts of the Hungarian capital. This tower had been restored six years before the ministers presence as the top of it had been hit and destroyed in a thunderstorm. Erdem's visit drew the attention to fate of Ottoman heritage in Hungary.

In the 1980's when international relations tended to be more relaxed despite the continuation of the Cold War, Hungarian and Turkish politicians kept visiting each other. An important step and an integral part of the more friendly Turkish-Hungarian relationship was the Ilter Turkmen's visit to Hungary in 1981 (Calik, 2015, p. 41). Turkmen was the minister of foreign affairs in the Bulend Ulusu administration that governed Turkey after the 1980 military coup. Though Turkmen has to be considered a classical diplomat, his involvement in the Ulusu cabinet discredited him in the eyes of everyday Turks, but he seemed a reliable partner for the socialist government of Hungary. Turkmen after resigning from his post served as ambassador in Paris and at the United Nations, but could not return to politics in 1995 when he presented himself as a candidate for the nationalists because of his stigma.

Turkmen was received by the same Frigyes Puja who was the guest of the Turkish government four years earlier.

Hungarian officialdom continued to have excellent ties with the military administration involved in the coup and accepted an invitation sent by Bulend Ulusu. The Hungarian prime minister (President of the Council of Ministers as this post was called by the Hungarian Communists), Gyorgy Lazar made his official visit to Turkey in November, 1982 (Calik, 2015, p. 41). According to the 23rd November, 1982 issue of the Hungarian daily Nepszava. Lazar was accompanied by Istvan Torok and Karoly Szarka, the Deputy Minister of foreign affairs, and was joined in Ankara by Ivan Foti who served there as the ambassador of the peoples republic. During his short visit Lazar insisted in visiting a number of cultural sights around Akara, therefor he was driven to the Museum of Ancient Civilization, one of the highlights of the city. Lazar was received in Ankara by Ulusu, the head of the government and Kenan Evren, the 7th president of Turkey – according to Nepszava two days later. Due to the fact that Lazar accepted to be welcomed by Evren, he also legitimized his rule. Evren took power in 1980 and the mastermind of the putsch remained until 1989, the end of the Cold War. Evren was later judged for his crimes against the Turkish democracy, for being responsible of the demolition of the rule of law in the country. He was sentenced to life imprisonment in 2014 and died in 2015.

The following year, in 1983, it was the turn of Bulend Ulusu to go to Hungary. Ulusu arrived to Budapest on the 29th June and was received by Gyorgy Lazar (Calik, 2015, p. 41). Ulusu after leaving Budapest again headed for Bucharest where he spent three more days – according to the 28th June issue of Milliyet. This combined visit to both Hungary and Romania shows the interest in and the importance accorded to the South East European region (often referred to as Balkans by the Turkish sources) by the government of the coup. According to the 30th June copy of the Milliyet the main subject of the political discussion between Ulusu and Lazar was disarmament, a favorite topic for the last decade of the Cold War. Ulusu, according to the reports published in the Nepszava at that time, also had a short conversation with Janos Kadar, the leader of the Hungarian communist party, MSZMP and the selected members of Parliament. He also had the chance to admire the city, including Heroes' Square.

The former Chief of General Staff of the Turkish Army, the 7th President Kenan Evren was also invited to Hungary. His visit took place in 1986 (Calik, 2015, pp. 41-42). As Ulusu had combined his visit to Hungary with another country, Evren arrived from Sophia, Bulgaria where he met with Todor Zhivkov, the head of Balkan country. Nepszava reports on the 25th June, 1986 that Evren was received by both Pal Losonczi, the President of the Presidential Council (this was a collective political body in Hungary after 1956 that can be described as a weak presidency) and his deputy, former engineer and minister of the construction industry, Rezso Trautmann. On the second day of his visit, Evren's hosts tried to change the topic from generalities to more practical issues, namely, economic cooperation between the two countries as the Hungarian economy was about collapsing and there was an urgent need to find partners in the Western World to which Turkey belonged to at that time. As we can read in the Nepszava daily on 26th June, Evren was brought to an important factory, BHG and was convinced that his country should buy the electronic equipment manufactured there. On the same day, Evren was also received by President of the Council of Budapest (the mayor in the communist system), Zoltan Szepvolgyi. One of the main messages of the 1986 Evren visit to Hungary emphasized by journalists reporting from the event was that Turkey was promoting a new foreign policy in the Mediterranean and Balkan regions. This multidimensional approach let Turkey to rebuild its ties to former friends like Hungary and increase its influence where its impact was evident during several centuries. This revision of Turkish politics and the increase of the attachment of the Turks to their past is was underlined by a symbolic act during Evren's visit. As the the 26th June, 1986 issue of the Milliyet reminds it readers, Evren paid homage to the Ottoman Turkish martyrs of World War I. buried in the New Public Cemetery (Uj Koztemeto) of Budapest.

The last important diplomatic visit between the two countries took place a few weeks before the fall of the Berlin wall. Bruno Straub, a renown scientist in biochemistry and the last President of the Presidential Council of Hungary traveled to Turkey in 1989 (Calik, 2015, p. 42). This visit was organized during a period of great turmoil in Turkey that largely influenced the whole program. Even the Hungarian daily Nepszava notes in its copy on the 1st June, 1989 that the hosts were highly concerned by an issue opposing East and West again. This conflict placed Turkey in opposition to Bulgaria over the fate of the ethnic Turkish minority in the country. After the killing several dozens Turkish speaking Bulgarians, Sophia forced its citizens of Turkish descent to change their names and become fully Bulgarian. In this situation hundreds of thousands of ethnic Turks opted to leave Bulgaria forever. In these days, Turkey was obliged to give shelter to these masses and this internal, especially because it has an impact on the East-West relationship, was one of the main topics of discussion between Straub and Evren. Hungary found itself in a very peculiar situation in which its own ally, Bulgaria, might have been accused of committing violations of human rights but it has to understand to arguments of both sides. The meeting also focused on bilateral questions. One of them, according to the 6th June, 1989 issue of the Hungarian daily Nepszava, was facilitation concerning trade and tariffs between the two nations. At the end of the day, a special agreement was signed on this subject.

As we can see, after an intermezzo following World War II. and the establishment of the Cold War, Turkish-Hungarian political and diplomatic relations were normalized, and the visits became more and more frequent. It is also clearly visible that historically good ties were restored after the relative relaxation of the Cold War took place. At the time of the regime change in Hungary, both Hungarians and Turks were expecting a further increase in trade and the amelioration of the political relationship. The post-Cold War era can be characterized by a more intense cooperation of the nations. The first sign of the advances was, we think, the high number of Hungarian tourists popping up in the Istanbul's Grand Bazaar around 1990.

Conclusion

After the fall of the Berlin wall in 1989, the diplomatic and economic relationship between Turkey and Hungary was normalized and intensified. Some important agreements were signed including the one regulating trade and traffic in 1992, the one excluding double taxation in 1993, the free trade agreement in 1997 and the agreement on economic cooperation in 2005. These documents permitted –among other developments- the establishment of over 100 Turkish companies investing more than 100 million USD in Hungary. The foreign trade balance was much more important after the regime change in Hungary than it was before, during the communist era. In 2000, it was 326 million USD, but after that a slight decrease can be noted (Bulut, 2017, p. 55-56). The diplomatic ties can be characterized by a long list of official visits. Nearly every 6 months, such an event occurs.

The bipolar world order in which neither of the two camps was able to overcome the other with traditional political or military means, separated friends and families, both specifically and figuratively. This rule also applies to the large family of the Uralo-Altaic nations. Tensions between Hungary and Turkey were evidently present since the 1930's as Turkey strongly disagreed the diplomatic choices made by Hungary at that time, but it had a strong message even in these conditions, Turkey maintained its diplomatic mission until the end of World War II., and the ambassador was called home only after the Soviets subjugated Hungary. It is also symbolic that soon after the closure of the embassy, the Republic of Turkey felt need to reopen it. As the embassy was back, the fading relations were also slowly restored.

Restoration was accelerated after the end of the Vietnam war when the countries of the two camps were able to run almost independent foreign policies. We are convinced that this halt in the relationship between Turkey and Hungary must serve as a lesson. Hungary and Turkey should never underestimate the importance of their ties and should never consider short term alliances more crucial than the long-term friendship of the two nations.

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CONVERGENCE AND CATCHING UP IN THE CASE OF HUNGARY AFTER THE EU ACCESSION – A QUANTITATIVE APPROACH

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Abstract

Hungary became a member state of the European Union in 2004, therefore the issue of convergence and catching up became a priority for the country. Convergence plays an important role primarily from the perspective of the euro introduction. Therefore, it is a necessary task to monitor and assess this process from time to time. The aim of this paper is to provide a general overview of the results and experiences of Hungary's catching up process after 2004. In the study I apply a quantitative approach and analyze some aspects of convergence by using different indicators. The main finding of the paper is that the Hungarian results – in spite of the EU transfers – are contradictory. The country has been able to get closer to the EU-28 average but it has had a bad performance within the Visegrad Group. It draws attention to the fact that Hungary will have to put great emphasis on the issue of catching up in the future.

Key words: convergence, catching up, Hungary, EU

Introduction

The first Eastern enlargement in 2004 was a significant milestone in the history of European integration when ten (eight Central and Eastern European and two Mediterranean) countries joined the EU. Since the economic development level of these new member states was far below the average level of the EU, it became a priority to decrease regional disparities between and within the countries and to boost the catching up process. It is a strategic goal for at least two reasons. Firstly, because economic homogeneity (among other factors) is an important precondition of a well-functioning regional integration, and secondly, because EMU-accession requires member states to meet the so-called Maastricht convergence criteria.

In this paper I analyze the convergence and catching up process in the case of Hungary by using different quantitative indicators and methods. The primary objective of the study is to reveal and present the main results and experiences of the convergence following the EU accession. The paper describes the current tendencies of Hungary and evaluates it from the aspects of the examined indicators. In this sense, this work is a short quantitative summary.

The study is divided into two main parts. The first section encapsulates the theory of convergence and provides a general overview on the EU's regional (cohesion) policy regarding its major goal. The basic purpose of this part is to describe the relationship between theory (economic homogeneity) and practice (cohesion policy). The second part analyzes the convergence process in Hungary in order to evaluate the country's performance and economic position in the integration. The analysis focuses on two basic areas. In the first subsection I examine the convergence within Hungary at NUTS-2 level. In the second subsection I analyze the catching up process of the country and set up a model which makes it possible to extrapolate potential catching up trajectories by estimating the time necessary to catch up with the EU average. At the end of the paper I summarize the results and draw some conclusions regarding the future challenges.

1. The concept and significance of convergence in the EU

1.1. Theoretical background of convergence

The phenomenon of convergence plays a key role in macroeconomics and economic policy. This importance comes from the fact that convergence is an essential precondition of catching up. Understandably, it is a priority for economically backward countries and regions to get closer to developed states. In order to achieve this objective, poor countries have to produce higher rates of economic growth than developed ones.

It is clear now that there is a strong relationship between economic growth and convergence, they are tightly intertwined. The neoclassical growth model which was elaborated by Robert Solow (1956) assumes that convergence between countries with different development levels is an automatism in the long run. The theory is based on a production function of two factors, capital (K) and labor (L) and assumes that decreasing returns to scale exists:

$$Y = F (K, L).$$

Furthermore, technological development is an exogenous variable which means that it is not explained by the model. This factor (A) – which is also called total factor productivity (TFP) or Solow-residuum – can be identified indirectly. In other words, Solow-residuum is the part of economic growth which cannot be explained by the contribution of capital and labor. Using a Cobb-Douglas production function, the extended relationship will be as follows:

$$Y = AK^{\alpha} L^{1-\alpha} \text{ (Solow, 1956, p. 66).}$$

By transforming and ordering the previous equation, we get to the TFP:

$$dA/A = dY/Y - \alpha\,(dK/K) - (1-\alpha)\,(dL/L).$$

The conclusion of the Solow-model is that countries with less capital stock grow faster until they attain their steady-state. If countries have equal savings rates and production functions, backward states will catch up with rich ones because of higher marginal product of capital (MPK). This is what we call absolute (or unconditional) convergence. In the case of different savings rates and technologies, each country will converge to its own steady-state. This is the phenomenon of conditional (or relative) convergence. After reaching the steady-state, economic growth will be determined by technological development, in other words, by the improvement of the production function (Mankiw, 2005, p. 150).

Unfortunately, the lack of convergence (or divergence) is also an existing phenomenon in the world economy which cannot be explained by the neoclassical approach. Thus, in the 1980s alternative growth theories emerged with the aim of providing better explanations of economic growth. These theories extended the neoclassical model by adding new explanatory variables. For instance, endogenous growth theory assumes that human capital, technology, knowledge and innovation are all endogenous variables (Kengyel, 2015, p. 20). Robert Lucas (1988) in his work distinguishes between physical and human capital. By human capital he means the general skill level of an individual. According to Lucas, this type of capital has two effects simultaneously. Internal effect is the improvement of an individual's productivity, while external effect refers to the phenomenon that human capital may have a positive impact on other production factors as well (Lucas, 1988, pp. 17-18).

Institutional theories also try to explain economic growth but from quite another point of view. They stress that the existence and quality of social, political and economic institutions determine growth rate to a great extent. Firstly, institutions can increase economic efficiency by reducing transaction costs. Secondly, they can foster or hamper technological development and the process of innovation. Finally, institutions may have an impact on socio-political processes which influence the response time of individuals. This factor is very important from the point of view of competitiveness (Kengyel, 2015, pp. 22-23).

In summary, these alternative theories suggest that development (regional) policy is needed because the neoclassical model is unable to explain divergence among and within countries and regions.

1.2. Regional (cohesion) policy in the EU

Reduction of regional disparities, convergence and catching up are common goals for member states of regional blocks as well. This is because economic homogeneity is a momentous precondition of successful integrations. Because of this, in the mid1980s, regional policy became a Community policy.[3] In the framework of the policy, backward member states access to additional financial sources from the budget of the EU. As a result, they can facilitate their convergence and catching up process within the integration. There is also a strong relationship between regional policy and Economic and Monetary Union (EMU). This correlation comes from the fact that a well-functioning EMU is based on an optimum currency area (OCA). As a result, catching up of new countries is an important objective of the EU as well.

Let us take a look at Table 1 which represent the total structural and cohesion funding allocated for 2004-2006 to the member states that joined the European integration in 2004. According to the table 21 709 million euros were transferred to the new countries in the first three years. As it can be seen, the Visegrad Group got the largest proportion of the transfers and 2 847 million euros were allocated to Hungary until the end of the programming period of 2000 and 2006.

[3] It is well-known that the Mediterranean enlargements of the Community in 1981 and 1986 significantly increased economic heterogeneity within the integration. As a result, it became evident that different measures had to be made to decrease inequalities.

Table 1: Structural and cohesion funding of the new member states (2004-2006) (million EUR at 1999 prices)

Country	Funding	Ranking
Cyprus	101	9
Czech Republic	2 328	3
Estonia	618	7
Hungary	2 847	2
Latvia	1 036	6
Lithuania	1 366	5
Malta	79	10
Poland	11 369	1
Slovakia	1 560	4
Slovenia	405	8
Total	21 709	

Source: own compilation and table based on Horváth (2011, p. 398)

These transfers increased in the following programming periods with the aim of promoting the convergence.

2. Results and experiences in the case of Hungary

Hungary joined the European Union with nine other countries in 2004. Since then, catching up with the 'old' member states has been a priority for Hungarian economic policy. Furthermore, the country has to aspire to meet the Maastricht convergence criteria in order to introduce the single currency. It is a great challenge for Hungary to increase real convergence and meet the criteria simultaneously. Before analyzing the convergence, let us take a look at the macroeconomic trends of the country.

2.1. The macroeconomic situation of Hungary

Table 2 shows the major macroeconomic indicators of Hungary between 2004 and 2016.

Table 2: The macroeconomic performance of Hungary (2004-2016)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
A	5.0	4.4	3.9	0.4	0.9	-6.6	0.7	1.7	-1.6	2.1	4.2	3.4	2.2
B	6.8	3.5	4.0	7.9	6.0	4.0	4.7	3.9	5.7	1.7	0.0	0.1	0.4
C	5.2	6.1	6.5	6.5	6.9	8.8	10.0	9.9	9.7	8.9	6.7	6.0	4.5
D	6.5	7.8	9.3	5.0	3.7	4.5	4.5	5.4	2.4	2.6	2.7	2.0	1.9
E	58.0	60.0	64.1	65.0	71.0	77.2	79.7	79.9	77.6	76.0	75.2	74.7	73.9

Source: own compilation and table based on Eurostat data (http://ec.europa.eu/eurostat/data/database)

Remarks:
A = annual real GDP growth rate (%)
B = annual inflation rate (HICP) (%)
C = unemployment rate: % of active population (age 25-74)
D = budget deficit: in % of GDP
E = public debt: in % of GDP

It can be seen that the country had relatively high real GDP growth rates in the first three years. From 2007 economic growth slowed down and remained low until 2014. In 2014, the growth rate was 4.2 percent but since then, we can see a downward tendency again. Relatively high inflation rates (HICP) could be experienced in the period of 2004-2012. From 2013, the annual price index has been below the official inflation target of the National Bank of Hungary. Unemployment was also a weak point of the Hungarian economy in the examined time period. The highest rate could be seen in 2010 and since then, the official rate has been decreasing. In 2016 it stood at 4.5 percent. Regarding the budgetary position, budget deficit/GDP ratio is below the Maastricht level of 3 percent. Public debt/GDP ratio has been declining since 2012 but it still exceeds the reference level of 60 percent by more than 10 percentage points.

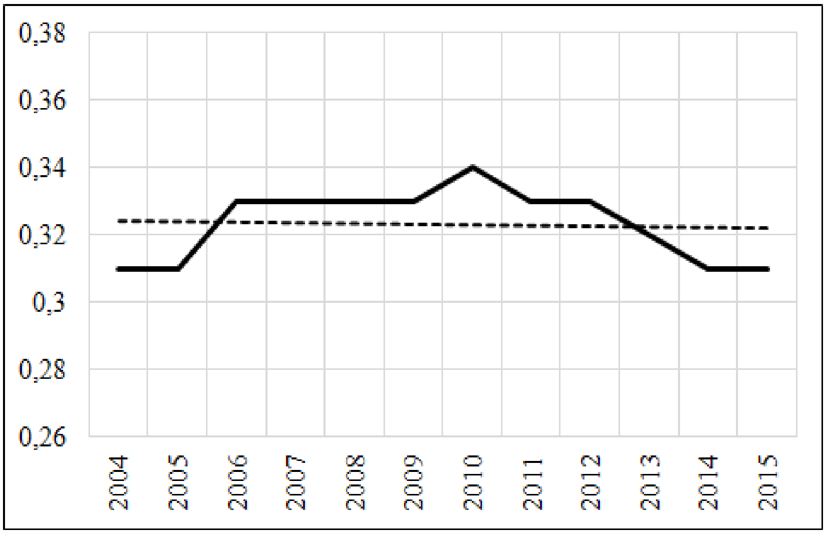
In summary, Hungary meets the convergence criteria with the exception of the ERM-II membership and the public debt/GDP ratio, but it can be accepted because of its decreasing trend. The major indicators tell us that the country is in a relatively good macroeconomic position which may provide a good basis for the catching up process. However, it has to be emphasized that convergence depends on other important factors as well such as foreign direct investments (especially in less developed regions) or the successful absorption of the EU's cohesion transfers.

2.2. Convergence within the country

There are numerous methods available to quantify the phenomenon of convergence. However, it is important to emphasize that there are two basic types of convergence. On the one hand, convergence can be interpreted as the decrease of disparities among different entities (e.g. regions or countries). On the other hand, it can refer to the process of catching up which means that backward entities are getting closer to a given point.

In this subsection I analyze economic disparities within Hungary. This type of analysis can be implemented by the so-called sigma (σ)-convergence computation which focuses on the dispersion of regional GDP data. More precisely, this indicator examines how the distribution of income evolves over time (Sala-i-Martin, 1996, p. 1328). In this paper I used the GDP/capita (PPS) as a reference indicator. Figure 1 represents the result of the examination.

Figure 1: Sigma (σ)-convergence and its trend in Hungary (NUTS-2 level)



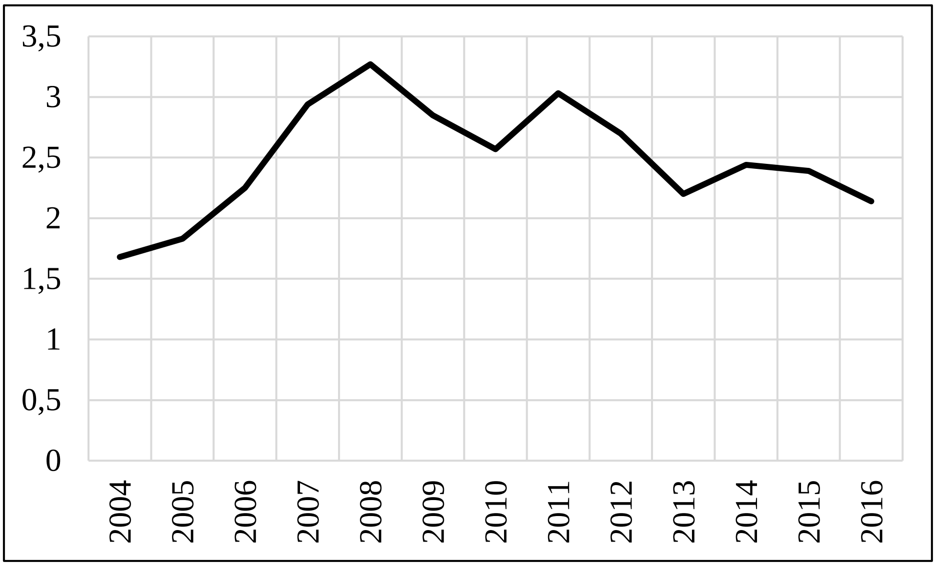
Source: own calculation and figure based on Eurostat data (http://ec.europa.eu/eurostat/data/database)

Remark: σ-convergence is the standard deviation of the logarithm of GDP/capita (PPS) data. The higher value of σ-convergence means greater regional disparities and divergence among the examined entities.

It can be seen that in the first two years after the EU accession regional disparities at NUTS-2 level started to grow. Between 2006 and 2009 σ-convergence remained at the level of 0.33. In 2010, inequalities grew further and reached the highest level in the examined time period. Between 2011 and 2014 the indicator decreased and in 2015 regional disparities in Hungary stood at the same level as in 2004 and 2005. If we take a look at the linear trend of the time series, we can see an almost horizontal trend line. In other words, data show that in spite of the cohesion transfers coming from the EU, Hungary has not been able to reduce its regional inequalities compared to the level of 2004.

Unemployment rate as an indicator of real convergence may also be an important factor in assessing regional disparities. Figure 2 represents the standard deviation of unemployment rates at NUTS-2 level. The chart indicates that standard deviation started to increase following the EU accession but since 2009 a downward tendency can be seen. However, it has to be noticed that the whole period reflects a slight positive trend. Put differently, regarding unemployment rates a divergence can be experienced in the examined time period.

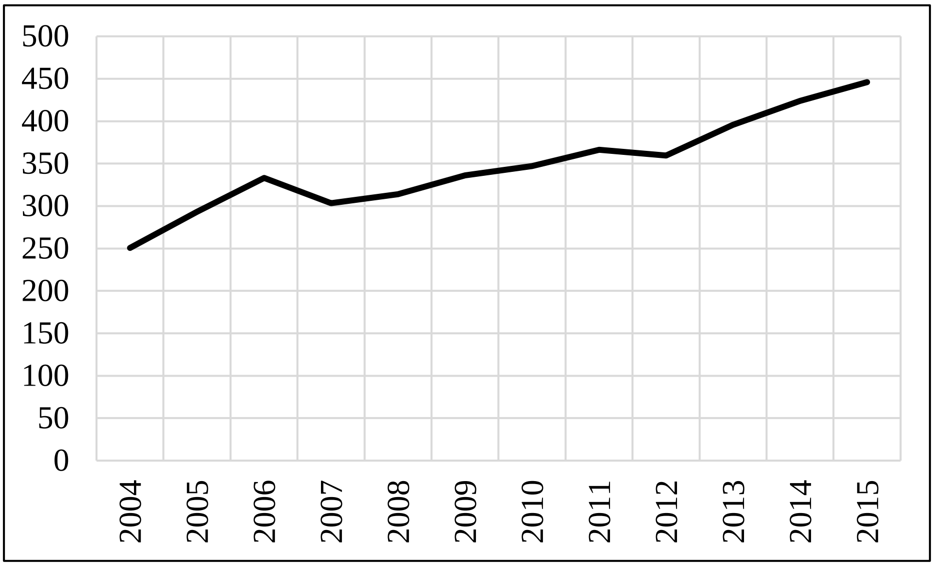
Figure 2: Unemployment rate (%, total, 15-74 years, NUTS-2 level)



Source: own calculation and figure based on Eurostat data (http://ec.europa.eu/eurostat/data/database)
Remark: the graph shows the standard deviation of unemployment rates

Finally, it is worth looking at the R&D expenditures at NUTS-2 level (Figure 3). The graph focuses in this case again on the standard deviation. Unfortunately, the increasing tendency suggests that the distribution of R&D expenditures among NUTS-2 regions is getting more and more unequal. This tendency is worrying because it can contribute to the growth of regional disparities in the long run.

Figure 3: Intramural R&D expenditures (million PPS at 2005 prices, NUTS-2 level)



Source: own calculation and figure based on Eurostat data (http://ec.europa.eu/eurostat/data/database)
Remark: the graph shows the standard deviation of R&D expenditures

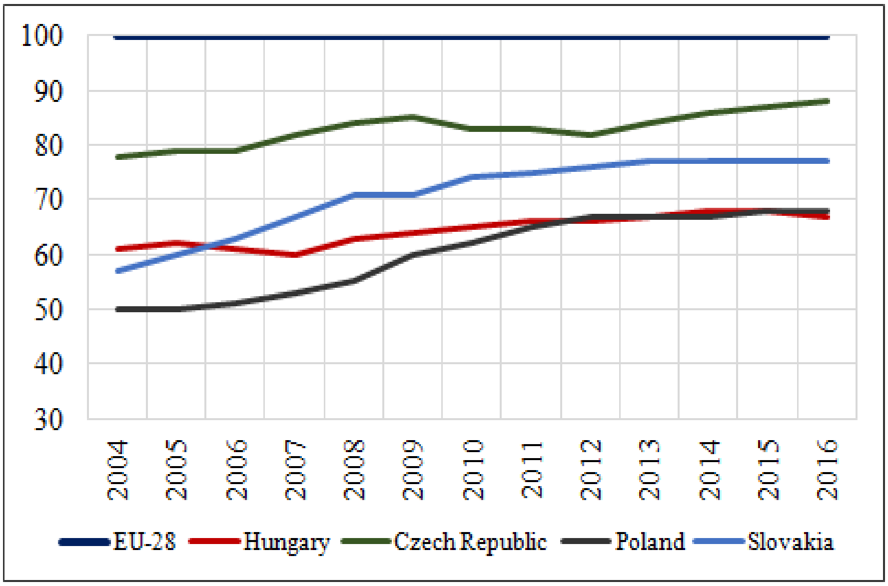
2.3. The catching up process of Hungary

As it was mentioned before, catching up is another type of convergence. In the case of Hungary, the reference point is the average development level of the European Union. In this part I focus on the GDP/capita of Hungary compared to the EU-average. In addition, it is useful to compare the performance of Hungary to the other Visegrad countries. By doing so, it is possible to draw some conclusions regarding our position in the CEE-region.

2.3.1. The development level of the EU-28 and the Visegrad Group

Figure 4 shows the GDP/capita (PPS) data of Hungary, the Czech Republic, Poland and Slovakia between 2004 and 2016.

Figure 4: Development level of the Visegrad countries
(GDP/capita, PPS) (EU28 = 100)



Source: own compilation and figure based on Eurostat data
(http://ec.europa.eu/eurostat/data/database)

In 2004, when Hungary joined the European integration, the country's GDP per capita was 62 percent of the EU-28 average. At that time the Czech Republic was the only Visegrad country which stood at higher level (79 percent). By 2007 Hungary's performance fell somewhat, the indicator was 60 percent. Following 2007 we can see a slight convergence until 2015 when the GDP/capita attained the level of 68 percent. In 2016 the indicator fell by 1 percentage point compared to 2015 but Poland and Slovakia stagnated as well. The Czech Republic could improve its development level by 1 percentage point. If we have a look at the whole time period, it becomes clear that Hungary was able to achieve a slight convergence (from 62 percent to 67 percent) since its EU accession. Unfortunately, this performance was the worst compared to the three other member states. In the analyzed period, the position of Poland and Slovakia improved by 18 and 20 percentage points respectively. The development level of the Czech Republic increased by 9 percentage points, but the country has the highest GDP per capita. Table 3 encapsulates the results of Hungary and the three other countries regarding their convergence.

Table 3: Results of catching up in the Visegrad countries

	GDP/capita (2004) (EU-28=100)	GDP/capita (2016) (EU-28=100)	Difference (percentage points)
Hungary	62 (2)	67 (4)	+ 5
Czech Republic	79 (1)	88 (1)	+ 9
Poland	50 (4)	68 (3)	+ 18
Slovakia	57 (3)	77 (2)	+ 20

Source: Own compilation and table based on Eurostat data (http://ec.europa.eu/eurostat/data/database)

Remark: the numbers in the brackets show the ranking of the countries.

While the Czech Republic was able to secure its first place since the EU accession, both Poland and Slovakia improved their positions. Hungary – which stood in second place in 2004 – was in fourth place by 2016 which was due to its weak convergence dynamics. In summary, Hungary has succeeded in getting closer to the EU but this slight catching up has proved to be insufficient compared to the regional competitors. In general, it is clear that convergence can be detected in case of all Visegrad-countries.

2.3.2. Potential catching up trajectories

How long will it take for Hungary to attain the average development level of the EU-28? It depends on different factors and thus, it is impossible to give a clear-cut answer. In spite of this, a useful model can help us to determine potential catching up intervals (Nemes Nagy, 1998, p. 178). These possible trajectories are computed from hypothetical economic growth combinations of Hungary and the EU-28. Table 4 represents different convergence scenarios in the case of Hungary.

Table 4: Potential catching up trajectories of Hungary

	H (1) = 2 %	H (2) = 3 %	H (3) = 4 %	H (4) = 5 %
EU-28 (1) = 1 %	t_{11} = 41	t_{12} = 20	t_{13} = 14	t_{14} = 10
EU-28 (2) = 2 %	**********	t_{22} = 41	t_{23} = 21	t_{24} = 14
EU-28 (3) = 3 %	DIV.	**********	t_{33} = 41	t_{34} = 21
EU-28 (4) = 4 %	DIV.	DIV.	**********	t_{44} = 42

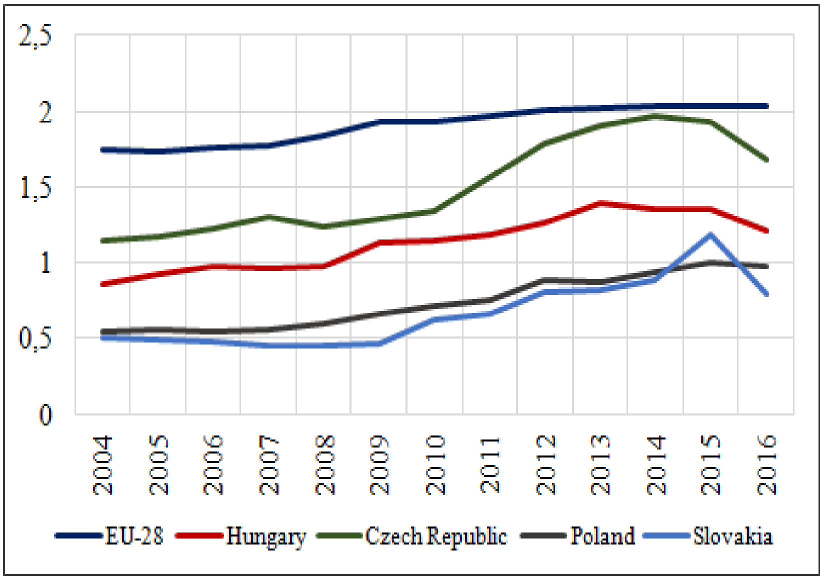
Source: own model estimation and table based on Nemes Nagy (1998)
Model estimation:
the following equation makes it possible to estimate the years to catch up with the EU-28 average.
By assuming different growth-rate combinations we get different catching up trajectories.
time = [log D (EU28) – log D (Hungary)] / [log r $^{(e)}$ (Hungary) – log r $^{(e)}$ (EU28)]
D (EU28) = development level (EU-28 = 100)
D (Hungary) = development level (Hungary = 67)
r $^{(e)}$ = expected GDP growth rates
* = no effect
DIV. = divergence
Remark: rounded values

The model clearly shows that catching up is a long-term process and depends on the economic growth rates. It is evident that Hungary has to grow faster than the EU in order to catch up. In the opposite case divergence can be experienced. Let us see the best-case scenario of the model. Assuming that Hungary is able to maintain a GDP-growth rate of 5 percent in the long-run (and the EU-28 has a rate of 1 percent), it will take 10 years for the country to catch up with the EU-average. According to the worst-case scenario, if the difference between the growth rates of the EU and Hungary is only 1 percentage point (in favor of Hungary), the country will have to wait about 41 years to attain the EU-28. Assuming a realist trajectory, the time of catching up is somewhere between 15 and 20 years. It is important to stress that the model is a static one because it assumes the same growth rates over the years. Apart from this fact, it provides a good tool to estimate the order of magnitude of the catching up process through different scenarios.

2.4. Research and development as a driving force of economic growth

Finally, I compare the research and development (R&D) expenditures of the Visegrad countries and the EU-28. According to the neoclassical model R&D and innovation contribute to economic growth in the long run. Therefore, countries must spend a lot of money on these activities. Figure 5 represents the GERD-indicators in the Visegrad Group and in the EU-28.

Figure 5: The GERD-indicator of the Visegrad countries (in % of GDP)

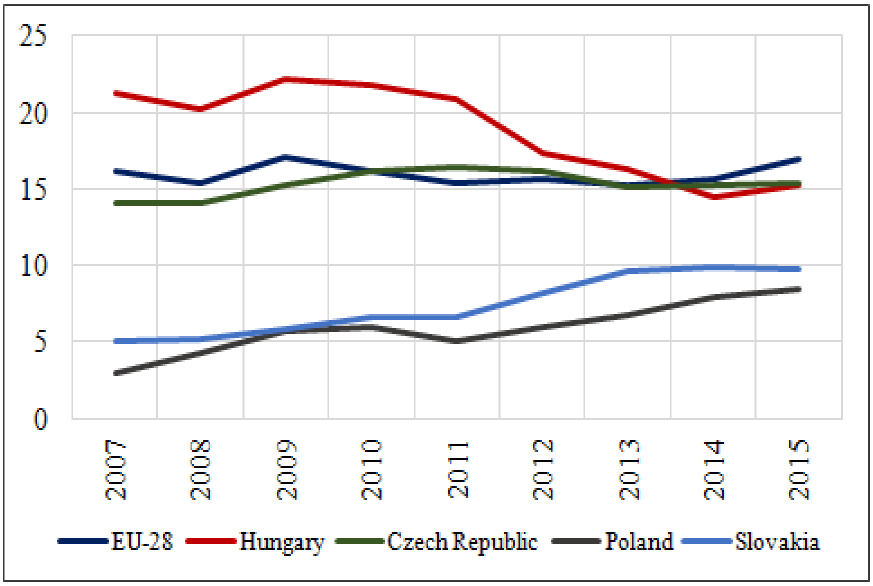


Source: own compilation and figure based on Eurostat data (http://ec.europa.eu/eurostat/data/database)

The average R&D expenditures of the EU-28 were between 1.7 and 2 percent over the examined years. From the perspective of the European integration it is worth mentioning that R&D expenditures have always been below the level of the United States and Japan. In the Visegrad Group the Czech Republic spent the most on R&D as a percentage of GDP. Hungary stood in second place with a continuously increasing tendency. The country's position is relatively good among the regional competitors, but Hungary should enhance these kinds of expenditures in the future as well. Poland and Slovakia had the lowest GERD-rates, both countries attained the level of 1 percent in 2015. It is common in case of all countries that the rate started to decline somewhat after 2015.

There is one more indicator which can be relevant and important from the perspective of R&D and technological development. This is the ratio of high-tech exports as a percentage of the total exports. The indicator is represented in Figure 6.

Figure 6: High-tech exports of the Visegrad countries (% of the total exports)



Source: own compilation and figure based on Eurostat data (http://ec.europa.eu/eurostat/data/database)

It is positive that Hungary had the highest high-tech export ratio until 2013 which was also above the level of the EU-28 average. Unfortunately, the trend of this rate declined steadily, in 2015 the high-tech products made up 15 percent of the total exports of Hungary. By that time the country's indicator was below the level of the EU-average and the Czech Republic. In addition, Poland and Slovakia showed a continuous rising tendency. To sum up, Hungary has an advantageous position in the area of R&D but compared to the processes of the other Visegrad countries this advantage may evaporate in a few years.

Concluding remarks

Convergence is a crucial point for backward countries and regions in the world economy and in the European Union as well. It became a priority for Hungary as well following its EU accession in 2004. In this paper I analyzed Hungary's convergence process by some models and indicators after the accession. Unfortunately, the situation of the country is contradictory. The basic macroeconomic indicators of Hungary are not bad, but it would be necessary to increase economic growth rate in order to boost catching up. With respect to the regional disparities it can be said that Hungary has not been able to decrease income inequalities at NUTS-2 level (σ-convergence cannot be detected). Regarding the catching up process the country has the worst performance among the Visegrad countries. Hungary got closer to the EU-average but due to the weak dynamics of convergence, the three other countries exceeded its development level by 2016. Hungary has a relatively good position in the area of research and development. The expenditures (in percent of the GDP) grew steadily after 2004 but from 2015 the GERD-indicator shows a slight downward tendency. The country is in an advantageous situation regarding the high-tech export ratio too, but a falling trend can be experienced in this indicator as well.

From the trends of the last decade we can draw the conclusion that in all probability Hungary will have to make significant efforts in order to improve its position in the region and to get closer to the EU-average.

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THE IMPACT OF FDI, FOREIGN AID AND REMITTANCES ON THE EAST AFRICAN COMMUNITY'S INTRA-REGIONAL TRADE: A GRAVITY OF MODEL ANALYSIS

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Abstract

Free trade agreements or regional integrations implying a deeper form of integration play an important role in trade promotion. Being part of an integration can improve bargaining power as compared to third countries; the elimination of internal tariffs and barriers to trade can boost trade within the integration, which can eventually contribute to a decrease in the external dependency of integration members. As far as Africa is concerned, initiatives of integration already appeared after the colonnial era; one example is the East African Community, which primarily aimed at increasing trade among members. The present study analyses the factors affecting the internal trade among members of the East African Community. External sources such as foreign direct investment, aid and remittances play an important role. The literature review and the statistical analysis based on the gravity model imply that the internal export and import of the members were affected by the size of the market, the common colonial partner and external sources; however, the direction of their impact is not identical.

Keywords: East African Community, gravity model, trade

1. Introduction

The growth of the Sub-Saharan region has slowed down in recent years. While the growth rate was registered at 3.1 percent in 2015, it only reached 1.5 percent in 2016, according to the estimates of the World Bank. However, a more dynamic growth is forecast for 2017. The slowdown in 2016 mostly affected the South African Republic, Nigeria – the two countries producing half of Africa's GDP – along with other oil exporting countries, because of the fall in the price of oil/barrel and other internal shocks. The slow recovery of Europe after the crisis and the change in structure in the Chinese economy relying mainly on internal consumption have also been factors that subdued the import-based external demand of the African region. This, in turn, underpins the importance of trade among African countries (World Bank, 2017).

International organisations and development programmes, among others, that of the United Nations Economic Committee for Africa and the New Partnership for Africa's Development – (NEPAD), emphasise that trade agreements can play an important role in the development of Africa and can contribute to the creation of regional integrations. Belonging to an integration can improve the bargaining power of members towards third parties; furthermore, the elimination of tariffs and trade barriers can promote trade within the integration and decrease the external dependence of members (UNCTAD, 2009). Analysing the impacts of free trade agreements, Hannan (2016) pointed out that the average annual export growth of parties reached 3.8 percent because of the agreement, and the positive effect was even more characteristic in the case of smaller and developing countries.

Plenty of regional integrations exist in Africa, whose operations go back long decades. The increase in internal trade as an objective is always treated as a priority; therefore, it is important to examine which factors influence the trade among members. The present paper focuses on the analysis of the East African Community (EAC). Compared with other African integrations, it is the East African Community parties where the highest proportion of export flows to another partner within the integration (UNCTADStat, 2016). In addition, a study by UNECA (2016) found that the level of integration and level of trade integration of the East African Community exceeds that of other African regional integrations.

2. Factors determining the trade of regional integrations

At present, the World Trade Organisation (WTO) registers 445 bilateral or plurilateral reciprocal Regional Trade Agreements (RTAs) in force (WTO, 2017). The classic grouping of regional integrations by Balassa also devotes significant attention to trade among partners; however, recently, there are other approaches regarding the grouping of integrations (Kang 2016). Furthermore, the Jacob Viner theory on customs unions (1950) also examined integrations from a trade perspective, making a difference between trade creation and trade diversion, the balance of which represents the profit arising from the integration (Kocziszky, 2000; MacPhee–Sattayanuwat, 2014).

Trade creation means that the trade flow increases between members of the integration, thanks to the dismantling of trade barriers. As far as trade diversion is concerned, members of the integration substitute the (more efficient) trade with external partners with more expensive internal products (MacPhee–Sattayanuwat, 2014). After the turn of the millennium, but especially after the crisis in 2008, the reappearance of protectionism and the slowdown of globalisation further strengthened the role of regional integrations, whose main objective continued to be trade promotion (Bernek, 2010). The positive correlation between trade openness and economic growth – also in the case of Africa – is widely recognised and empirically substantiated (Kim et al., 2016; Manwa–Wijeweera, 2016); therefore, it is worth analysing which factors influence the trade of integrations. At the same time, certain studies underscore that the correlation is not evident and the impact of trade on economic growth is decreasing in the long term (Hur–Park, 2012; Menyah et al., 2014).

In the international literature, several authors have already analysed the factors effecting the trade of regional integrations (for instance: Geda–Seid, (2015) or Udvari–Kis, (2014), but in the case of certain factors, the results are fairly heterogeneous.

The impact of the market size (expressed by the sum of the GDP) and the income level (expressed by the GDP per capita) on trade is generally considered similarly. In the above studies, the variables were either analysed separately or as multiplication, showing their positive effect on the trade of integrations (Head et al., 2010 Udvari–Kis, 2014). However, the analysis of Iwanow–Kirkpatrick (2009) did not find the impact of the market size significant.

The distance between trading partners also effects trade. This refers to the distance between the capitals or major trade centers of the two countries, which has a negative impact on the volume of trade (Quaresi–Tsangarides, 2013; Shepard–Wilson, 2009). Inversely, having a common border increased the trade in goods among trading partners (according to Iwanow–Kirkpatrick, 2009), or had no remarkable impact (Head et al., 2010; Shepard–Wilson, 2009). On the other hand, the geographical distance as the indicator expressing transport costs is likely to lose its importance, given that the geographic space in the classical sense has narrowed down with the dynamic development of information and communication technology and transport infrastructure (Csizmadia, 2016). However, the lack of transport infrastructure is still a major obstacle to trade (Erdősi, 2012b), and thus, a landlocked location may play a negative role as well (Quaresi–Tsangarides, 2013).

2.1. The impact of external financial assistance in Sub-Saharan Africa

The Sub-Saharan region is in need of substantial development in several areas, such as in agriculture, health, education and energy sectors (Kis, 2017¸World Bank, 2017). Due to the low capital concentration of the national and regional banking system, the financing needed for the African continent is still to be resolved (EIB, 2015). Given the lack of national resources, external sources play an important role in the economy of African countries (Erdősi, 2012a). The relevance of the latter is emphasised by several analyses (Hühne et al., 2014; Okodua–Olayiwola, 2013, Udvari–Kis, 2014). Among external sources, foreign direct investment (FDI), aid, remittances are often mentioned. The relation between these factors and trade is generally highlighted; therefore, the present paper will also review their impact on trade (Fuchs et al., 2014).

In the case of African countries, FDI is usually considered as the most efficient source. The incoming technological transfer can contribute to the improvement of productivity, while the presence of foreign companies can increase the competition, which in turn might lead to the improvement of domestic companies' productivity (Amighini–Sanfilippo, 2014; Szent-Iványi–Vigvári, 2012). In the past few decades the FDI directed to the Sub-Saharan region has grown dynamically until 2015, when a slowdown was registered in investment dynamics, which was further deepened by the unfavourable business conditions, serious structural problems, political and economic risks as well as the steep deterioration of the exchange rate (Okafor et al., 2015; World Bank, 2017).

In addition, the slowdown of investments can be attributed to external factors, since most FDI comes from China, the European Union and the United States. The present American administration is a severe element of uncertainty for the region, while China, the biggest investor is also facing structural problems. In addition, the distribution of FDI flowing into Africa is not uniform, given that Asian investment is generally directed towards countries that are rich in mineral resources. This is also emphasised by Asiedu (2006), who claims that large local markets, the available resources, suitable infrastructure, low inflation rate, predictable legal and investor environment all have a positive impact on the flow of FDI, while corruption and political instability have the opposite effect, thereby also influencing exports negatively (Moussa et al., 2016). The existence of regional integrations may impact the flow of FDI positively. Common rules can strengthen political stability, by encouraging the organisation of democratic elections (Asiedu, 2006). Regional integrations represent bigger markets and the inward FDI can extend the range of export products, especially in low-tech industries such as the processing of agricultural products and the textile industry, thereby contributing to the increase of internal trade (Amighini–Sanfilippo, 2014; Moussa et al., 2016). The bigger openness to trade and the inward FDI can boost economic growth (Tahir et al., 2015). On the other hand, according to the difference in the level of development, the impact can be bigger in certain member states, since the better qualified workforce and the more stable financial environment can attract more FDI, to the detriment of other member countries (Longo–Sekkat, 2004).

In addition to FDI, it is aid programmes that are used for the achievement of trade objectives as well, and this form of support accounts for the majority of external sources arriving in Africa. Official Development Aid (ODA), which are aids provided to low and medium income countries, represents a special type of aid programme. According to the ranking by the World Bank, low income countries have a per capita GNI of 0-1 025 USD; lower - medium income countries 1 026 – 4 035 USD, while upper-medium countries have a per capita GNI of 4 036 – 12 475 USD (World Bank, 2016). In addition, today the so-called emerging donors (China, India, Brasil, Saudi-Arabia, United Arab Emirates) also play an important role in the provision of aid (Udvari, 2014b; Udvari et al., 2017).

China plays a major role in aid programmes. African countries can even favour Chinese capital as opposed to Western capital, due to the basic principles of Chinese aid programmes such as the non-interference in internal affairs and the respect for sovereignty of the recipient countries (Vári, 2016). On the other hand, Swedlund (2017) underlines that the Chinese presence is merely regarded as an alternative by African countries and does not entail the reduction of the engagement of traditional DAC donors in Africa, since DAC donor countries in areas such as the development of health and education systems continue to play a particular role. Hailu (2011) analysed the impact of ODA on Sub-Saharan countries and found that ODA had a positive influence on imports and a negative on exports, which underscore the fact that aid serves the purpose of supply, not the development of production capacities

Within ODA, the details of Aid for Trade (AfT) programme had been specified by 2006 in the framework of the World Trade Organisation (WTO). The main objective of the programme is to support the export growth of least developed countries (LDCs) by integrating them in the multilateral trading system. In order to achieve the above-mentioned objectives, it supports the development of trading infrastructure and production capacities, also encouraging trade development and the efficient solving of disputes (Udvari, 2013). Examining the period between1995 and 2005, Vijil (2014) showed that the incoming AfT support has a favourable impact on the trade of regional integrations, whether they are developing-developing countries or developing-developed countries groupings. If we differentiate the support according to the specific objectives of the AfT, we can conclude that aid targeting the development of trading infrastructure had the biggest impact on trade, income and prosperity. Udvari–Kis (2014) analysed the impact of AfT on the internal trade of a specific integration. Their results show that the AfT flowing into ECOWAS further diminishes the trade among members of the integration; moreover, aid can set obligations for donor countries.

In addition to FDI and aid, remittances are often considered as a potential source of financing. (Erdősi, 2012a). Remittances add to the disposable income of households, which, via rising consumption, can contribute to economic growth. Furthermore, the increase in the demand of households based on imports can drive a recovery in foreign trade (Tahir et al., 2015). Globalisation and the aging society of developed countries creates a demand for immigrant labour force; therefore, home transfers play an increasing role in the economic development of the sending country. In comparison with FDI and aid, the distribution of remittances is more regular and stable. Their inflow is not sensitive either to political instability or the level of financial development and business environment, as opposed to FDI (Okodua–Olayiwola, 2013). For that reason, the Sub-Saharan region also considers remittances as an important source of income. This is reflected by the dynamic rise in home transfers directed towards the region: between 2000 and 2015, their number increased ninefold, almost approaching the value of aid (WDI, 2017).

Based on the review of literature, FDI can prove the most efficient source of trade facilitation, whereas the importance of remittances is justified by their relative stability. On the other hand, the impact of aid on trade is not clear cut, although they do represent a significant source for the Sub-Saharan region. Therefore, it is worth analysing the external sources flowing into the East-African Community.

3. Intra-trade of East African Community

African countries which became independent after the colonial era considered forming regional integrations as an integral part of their development policy. Consequently, several integrations are in force in Africa today, and all African countries are members of at least one integration. The importance of regionalism has already been highlighted by many international institutions as well as by the European Union's development policy, since integrations can have many positive effects (Kis, 2016). A larger market means better bargaining power over its external members, it can result in economies of scale and even attract more FDI. Landlocked countries can more effectively engage in trade, the resource allocation can improve, common interests can prevail better, and it can contribute to structural transition (Geda–Seid, 2015; Tarrósy, 2007; UNECA, 2016). However, several factors hinder the effective functioning of integrations in Africa, such as frequent military conflicts, infrastructure deficiencies, overlaps between integrations, insufficient financial resources or lack of political will (Erdősi, 2012a; Longo–Sekkat, 2004; Marsai, 2016; Szent-Iványi, 2010).

Nonetheless, regional integrations in Africa put an emphasis on encouraging internal trade and the East African Community (EAC) is one of the integrations where significant progress can be seen. The development of internal trade shows different images in each integration. Examining the internal exports of the integrations in the ratio of total exports, it is mainly the integrations in the south and east of the continent that show greater activity in internal trade. These integrations are the East African Community (EAC), the Southern African Development Community (SADC) and the Southern African Customs Union (SACU). In addition, it is the West African Economic and Monetary Union (UEMOA) where exports between member states exceeds 10% of the total export, to which the common currency also contributes (Udvari, 2014a; Udvari–Kis, 2014). In the meantime, the internal trade is negligible in the Central African relation, as shown by ECCAS data (Figure 1).

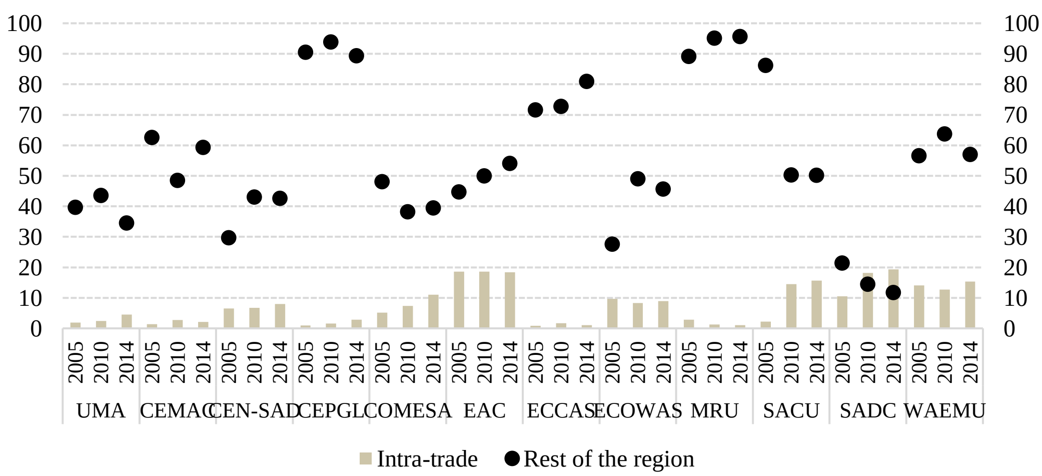


Figure 1. The export share of African regional integrations (percent), 2005, 2010, 2014

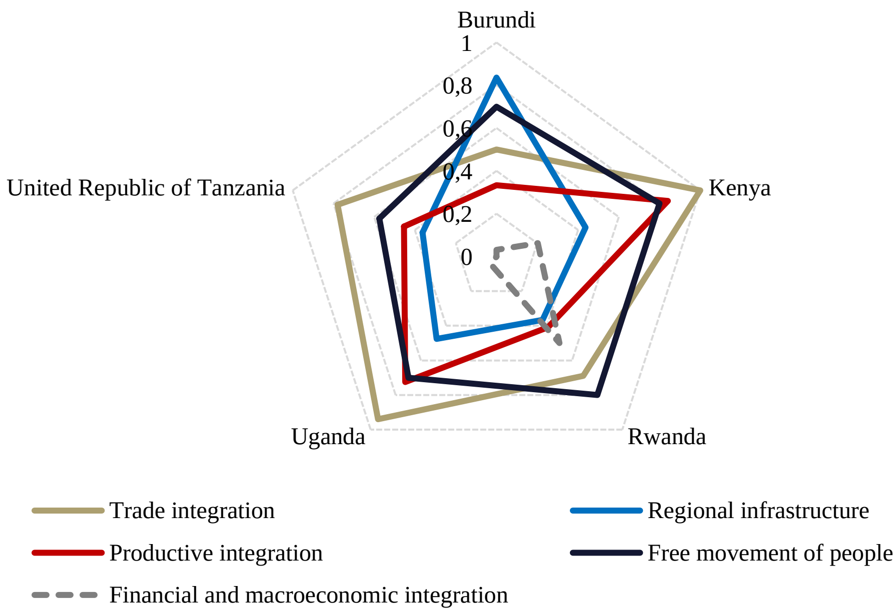
Note: Intra-trade: the trade between all members of the group; Rest of the region: the trade of the geographical region the group belongs to (Africa), minus the intra-trade of the group.

UMA – Arab Maghreb Union, CEN-SAD – Community of Sahel-Saharan States, MRU – Mano River Union, ECOWAS – Economic Community of West African States, WAEMU – West African Economic and Monetary Union, CEMAC – Economic and Monetary Community of Central Africa, CEPGL – Economic Community of the Great Lakes Countries, ECCAS – Economic Community of Central African States, COMESA – Common Market for Eastern and Southern Africa, EAC - East African Community, SADC – Southern African Development Community, SACU – Southern African Customs Union

Source: UNCTADStat (2016).

The treaty establishing the East African Community was signed on 30 November 1999 by the three founding states - Kenya, Tanzania and Uganda - and it entered into force on 7 July 2000. Two further member states - Rwanda and Burundi - are, as of 1 July 2007, full members of the group headquartered in Arusha, Tanzania. Finally, the Republic of South Sudan joined EAC in September 2016, becoming the sixth member of the Community. The East African Community was first established in 1967, but then it only operated for 10 years (EAC, 2017). Tarrósy (2007) identified the reasons for the decline as the different political ideologies, the unfair distribution policy, the lack of a common economic strategy, and the armed conflicts between the countries of the region in the 1970s. In September 2016, the East African Community (EAC) signed an accession treaty with Africa's youngest state, South Sudan and devised a special programme to assist South Sudan's integration process. Among the objectives of integration, special attention is paid to the promotion of internal trade and action against external members, which resulted in the integration reaching the level of customs union in 2005 and it has been operating as a common market ever since 2010 (Debrun et al., 2010, EAC, 2017). The EAC has already requested guidance from the European Central Bank in 2010 in relation to the institutional framework to be set up (East African Central Bank) and the convergence criteria required to create a monetary union being the next step forward (Debrun et al., 2010). Moreover, Tarrósy (2011) also raises the idea of building a federal political system. Analyzing the integration of the members of the East African Community, we can see that member states show the closest cooperation, which is also required by the common market. Cooperation is weaker in the areas of infrastructure and productive integration among the countries, the integration of the financial system is the weakest, which shows that successful monetary integration is still to come. Out of the member states, Kenya is the most cooperative, while Tanzania is the least integrated country (Figure 2).

Figure 2. Regional integration scores of East African Community, 2016



Note: The analysis was prepared before the accession of South Sudan to EAC, therefore it only includes the five former member states. Regional integration scores are calculated on scale of 0 (low) and 1 (high).

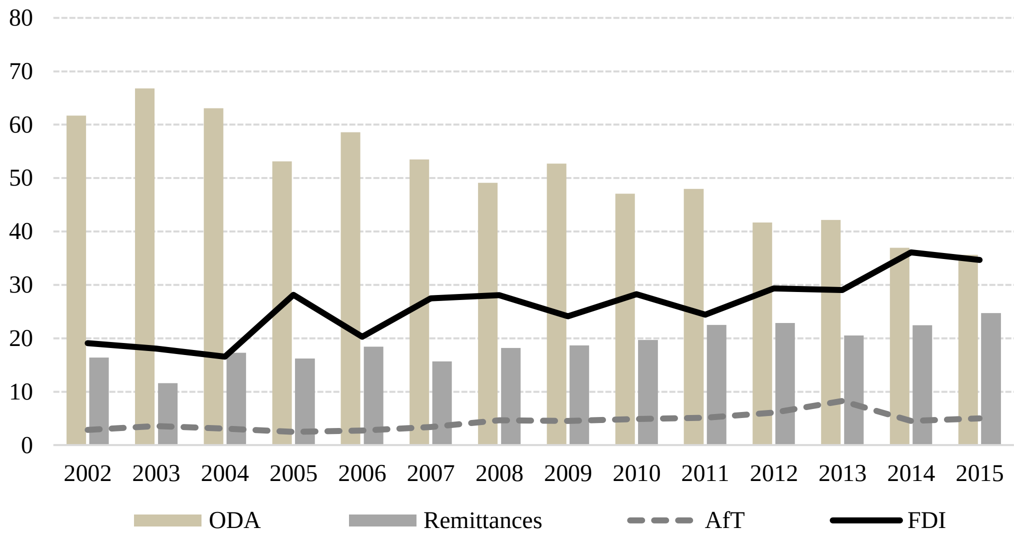
Source: UNECA (2016).

At the same time, if we compare the East African Community with other regional integrations in Africa, the EAC emerges from the integrations in terms of trade integration and the average of the dimensions as well (UNECA, 2016). This is also underpinned by the development of intra-community trade as its internal trade is growing and the dynamics of growth has been further strengthened with the introduction of the customs union since 2005 (UNCTADStat, 2016). The establishment of integration has had a positive effect on internal trade, which is also underpinned by the analysis of MacPhee-Sattayanuwat (2014). In their study they analyzed the impact of the existence of regional integrations on the internal trade of integrations and on exports and imports with third countries between 1981 and 2008, using a statistical model. On the basis of their results, the 226% increase in trade between the members of the East African Community is due to the establishment of integration.

The East African Community has also recognized that internal resources are not sufficient to accomplish the necessary investments and has already signed partnership agreements with several organisations outside Africa such as the World Bank, the European Union, the European Central Bank, the Swedish International Development Cooperation Agency and the Norwegian Agency for Development Cooperation. Indeed, several countries have developed a specific development program for the development of the African region, such as the Tokyo International Conference of Africa's Development or the China – Africa Cooperation Forum (EAC, 2017, Kis, 2016; Tarrósy, 2011; Tarrósy, 2016; Tarrósy, 2017).

The European Union considers the East African Community as a separate region in the framework of the Economic Partnership Agreements (EPA), and in the negotiations completed in 2014, members of the Community have been granted tariff and quota free access to the EU market, which enters into force after the ratification. The European Union also attaches great importance to the promotion of regional integrations, which is emphasized by the EPA's rule system. Hence external resources can also serve this purpose, as European countries have a prominent place among DAC donors (Kis, 2016). After the turn of the millennium, the external resources flowing into the East African Community nearly quadrupled, showing continuous growth. The official development aids and Aid for Trade subsidies have declined in terms of their volume and in terms of their proportion to external sources, while the share of direct capital investments has been growing steadily (Figure 3).

Figure 3. The share of external financial assistance inflows of East African Community (in percentage), 2002-2015



Source: OECD-CRS (2016), UNCTADStat (2016) and WDI (2017)

East Africa embodies a major investment target in regard to the incoming FDI. The East African economies are among the most prosperous countries in the continent, and the recently discovered crude oil and natural gas stocks have further improved their prospects. In Tanzania, investment in the former infrastructure and service sector further strengthened economic growth (EY, 2017). In Kenya, which is regarded as the key economy of the East African region, a record of $ 1.4 billion FDI flowed in during the course of the year 2015. The investments were motivated by the increased internal demand and the increased investor confidence driven by the improving business environment (UNCTAD, 2016). Nevertheless, in 2016 both the number and volume of FDI investments decreased compared to the previous year, as the uncertainties surrounding the announcement of Brexit had a strong impact on them. At the same time, Kenya's investment prospects remain favorable and it has the second best outlook in the field of investments in Africa (EY, 2017). The growth dynamics of remittances similarly did not decline after the turn of the millennium, which could support the analysis of Okodua-Olayiwola (2013) in the East African Community, which emphasize the lower volatility of remittances.

3.1. Data and methodology

With the help of the statistics, we examine which factors may affect the intra-community trade of the East African Community and how the inflow of external resources impact trade among member states. In the analysis, trade of the member states is broken down and factors affecting exports and imports are analyzed separately to determine whether the factors significantly influence exports or imports. Examination of trade between the member states of the East African Community is accomplished by the help of the gravity model, based on linear regression calculation. The gravity model is the most commonly used method for modeling foreign trade, as it is suited to estimate potential trade between two countries, incorporating trade facilitation and barriers to trade into the model (Székelyhidi, 2017). Factors affecting trade have already been approached from several aspects, and are also widely used in the analysis of trade in regional integrations. Table 1 provides a more detailed overview of the relevant literature.

Table 1. Literature review of determining factors of trade based on gravity model

Author(s)	Empirical findings
Amighini – Sanfilippo (2014)	The inflows of foreign direct investments positively impact the ability of African economies to upgrade their export baskets. FDI from developing countries enhance diversification in key low-tech industries and raise the quality of manufacturing exports.
Erdey – Pöstényi (2017)	One-percent increase in the distance from a trading partner decreases the trade of Hungary by 1.4-1.5 percent. The increase in the national income of Hungary, sharing a common border and trade agreements with the trading partner have a positive effect on trade.
Geldi (2012) Martínez–Zarzoso et al. (2009)	The impact of regional integration agreements on trade is not unambiguous. The EU has a positive effect on intra-union trade. On the other hand, the agreements that involve only less developed or developing members follow a slow pace on trade liberalization and they are still depended on external countries.

Glick – Rose (2016)	The use of a common currency in the framework of the European Monetary Union has boosted intra-regional trade by around 50 percent.
Hühne et al. (2014)	Aid for Trade granted by DAC donors increase South-South exports, strengthening the trade relations between developing countries.
Longo – Sekkat (2004)	Insufficient infrastructures, ineffective economic policy and internal political tensions have a significant eroding impact on intra-African trade. On the other hand, these obstacles do not affect African trade with developed countries except for internal conflicts.
Narayan – Nguyen (2016)	Vietnam's trade with rich nations is more sensitive to distance, economic size, openness of trading partners and exchange rate than trade with low income nations. During an economic shock, Vietnam experiences lower trade decline against lower income countries (African and low income Asian nations) than high income countries.
Udvari (2014a)	Aid for Trade provided by the United States and European Union does not show significant impact on intra-trade of ECOWAS, which may imply a trade diversion effect.
Viorica (2015)	Trade partnerships of European Union countries are more efficient for partners with common borders and that are not landlocked. GDP and distance between EU member countries are also significant variables in bilateral trade flows.
Yu (2010)	Democratization in the exporting country can improve product quality and reduce trade costs, enhancing bilateral trade. At the same time, democratization in the importing country may increase trade barriers and thus reduce imports.

Source: the authors' own analysis

The basic gravity model includes the logarithm of import, export, or total trade as a dependent variable. Among the independent variables, the market size is illustrated by the logarithm of the GDP value, the countries' income position is approximated with the logarithm of GDP per capita, while the proxy of transport costs includes the logarithm of the distance of countries (Dusek, 2003; Pöstényi, 2017). In addition to the basic indicators, several other factors can be added to the statistical model (Dusek, 2016). In the course of our analysis, we also incorporate factors influencing the trade disclosed in the literature review into the model. During the study, we take the distance between the capitals of the countries into consideration, so the common border dummy variable is no longer used in the model. To capture the impact of common past on trade, we use the common colonizer dummy. In the absence of historical data with multiple indicators, the analysis was carried out on data between 1995 and 2015, while the model including AfT was used to analyze the period between 2002 and 2015 as AfT data has been available since 2002. The study includes five members of the East African Community (Burundi, Rwanda, Uganda, Kenya and Tanzania), while South Sudan, which joined in 2016, is not yet included, as it was not a member in the analysis period.

The equation (1), (2) of the models used for the examination of bilateral trade and the content of the indicators used in the model is the following:

$$\ln EX_{ij} = \beta_0 + \beta_1 \ln (Y_i{*}Y_j) + \beta_2 \ln (Yc_i{*}Yc_j) + \beta_3 \ln Dist_{ij} + \beta_4 \ln FDI_i + \beta_5 \ln ODA_i + \beta_6 \ln Remit_i + \beta_7 \ln AfT + \beta_8\, comcol + \varepsilon,$$

(1)

$$\ln IM_{ij} = \beta_0 + \beta_1 \ln (Y_i{*}Y_j) + \beta_2 \ln (Yc_i{*}Yc_j) + \beta_3 \ln Dist_{ij} + \beta_4 \ln FDI_i + \beta_5 \ln ODA_i + \beta_6 \ln Remit_i + \beta_7 \ln AfT_i + \beta_8\, comcol_{ij} + \varepsilon,$$

(2)

where

- EX_{ij} is the export from i to j country (intra-export);
- IM_{ij} is the import from i to j country (intra-import);
- $Y_i{*}Y_j$ is the multiple of GDP of i and j country, as a proxy of market size;

- Yc_i*Yc_j is the multiple of GDP per capita of i and j country, as the proxy of income level
- $Dist_{ij}$ is the distance of the capital of i and j country, as a proxy of transport costs;
- FDI_i shows the amount of Foreign Direct Investment inflows of i country;
- ODA_i shows the amount of Official Development Assistance of i country;
- AfT_i shows the amount of Aid for Trade of i country;
- $Remit_i$ shows the amount of Remittances of i country;
- $Comcol_{ij}$ the value 1 of the dummy shows that the two countries have common colonial history, otherwise its value is 0;
- ε is error term.

GDP, GDP per capita, export and import, and foreign direct investment data included in the analysis in current prices come from UNCTADStat (2016), while official development assistance and Aid for Trade data come from the OECD-CRS (2016) database. The value of remittances can be found in the World Development Indicators (WDI) (2017) database. The common colonizer and the distance can be found in the datasheets of CEPII (2017). With regard to the data used, the constant price has come up, but the OECD and World Development Indicators and UNCTAD databases only provide data at current prices for variables and AfT data is only available in the OECD database.

As expected, the variables included in the regression model were tested for the stationarity of the variables with the augmented Dicky-Fuller (ADF) test. The test showed stationary processes. Furthermore, according to the recommendations by Kovács (2008) we have checked that multicollinearity does not exist between the variables and the results of the White test show homoscedasticity time series. In the model, we had to take into account the problem of endogenity, when there could be an opposite relationship between the dependent and independent variables (Gács, 2007). Looking at the current empirical study, it is unclear whether incoming external sources have an impact on the volume of trade or that improving trading performance encourages inflow of external resources. To eliminate endogenicity, lagged data is often used, but there is no consensus on the extent of the lag.

This results in the lag of some explanatory variables, similarly to the analysis of Gábor et al. (2012), we have estimated it using an optimization process, which resulted in a lower Schwarz criterion (SIC) value, i.e. a better model fitting, having improved the explanatory power of the model. Indeed, with delays, the autocorrelation of error terms was also managed.

3.2. Empirical analysis and results

Before presenting the results of the regression model, it is worth examining the correlation to be found between the two dependent variables (export and import) and the independent variables in the model (Table 2). Based on the results, we found significant co-movement with all eight explanatory variables. In line with the literature review, we can see that distance and trade move in the opposite directions, while with the other indicators the co-movement with trade is positive. However, it should be noted that in the case of exports, closer co-movement with independent variables can be observed.

Table 2. Correlation between the dependent and independent variables (and p-values)

Indicators	Export	Import
Market size	0.66*** (0,00)	0.53*** (0,00)
GDP/capita	0.61*** (0,00)	0.54*** (0,00)
Distance	-0.14** (0,02)	-0.13** (0,03)
Common colonizer	0.42*** (0,00)	0.34*** (0,00)
Foreign Direct Investment	0.23*** (0,00)	0.23*** (0,00)
Official Development Assistance	0.46*** (0,00)	0.16*** (0,00)
Aid for Trade	0.46*** (0,00)	0.24*** (0,00)
Remittances	0.65*** (0,00)	0.26*** (0,00)

Note: *** significant at 1%, ** significant at 5%

Source: own calculation

The results of the regression models are shown in Tables 3 and 4. Thanks to the use of lagged variables, all eight explanatory variables showed significant correlation with exports and imports. The number of the lag of independent variables differs. It is because of the optimization process where only the same period appears, while there are places where the model analyses the effects of four-year-old values; in other words, the model shows the best fit.

Table 3. Results of the gravity models on the intra-export

	Model 1. (1995-2015)		Model 2. (2002-2015)	
	Coefficie	p-valu	Coefficie	p-value
Market size	0.62***	0.00	1.45***	0.00
Market size (-1)	-0.37***	0.00	-1.32***	0.00
Market size (-2)	-0.25***	0.00	-	-
Market size (-3)	0.29***	0.00	-	-
Market size (-4)	-0.23***	0.00	-	-
GDP/capita	-0.03	0.82	-1.21***	0.00
GDP/capita (-1)	-	-	1.03**	0.01
Distance	-0.86***	0,00	-2.60***	0.00
Distance (-1)	-0.14***	0.00	-	-
Common colonizer	-0,03	0,82	-0,84***	0,00
Foreign Direct Investment	-0,01	0,76	0,12***	0,00
Foreign Direct Investment	0,09**	0,02	0,17***	0,00
Foreign Direct Investment	0,10**	0,01	0,19***	0,00
Foreign Direct Investment	0,06*	0,05	0,08**	0,05
Foreign Direct Investment	-	-	0,08**	0,01
Remittances	0,01	0,11	-0,01	0,91
Remittances (-1)	-0,02*	0,09	-0,03*	0,06
Remittances (-2)	0,03***	0,00	-	-
Official Development Assistance	0,52***	0,00	0,05	0,77
Official Development Assistance (-1)	0,13	0,42	-	-

Official Development Assistance (-2)	-0,44***	0,00	-	-
Aid for Trade	-	-	0,27***	0,00
Constant	-0,18	0,84	0,42	0,52
R^2	0,92		0,93	
Adj. R^2	0,92		0,92	
SIC	2,36		2,21	
Durbin–Watson	2,02		2,09	

Note: *** significant at 1%, ** significant at 5%, * significant at 10%

Source: own calculation

The explanatory power (R^2) of the models is high, 0.92 and 0.93 in case of the exports, 0.88 and 0.90 in case of the imports, and the values close to two of Durbin-Watson indicate the autocorrelation of the error terms. Analyzing the results, we obtained a result in line with the literature concerning the distance, as it reduced both exports and imports. The common colonial past encouraged trade relations from the import side, while on exports it had a negative impact or no significant impact. The level of development and income of the countries did not affect the import and the impact on internal export is also unclear as the impact of market size can not be identified in a consistent manner.

Table 4. Results of the gravity models on the intra-import

	Model 1. (1995-2015)		**Model 2. (2002-2015)**	
	Coefficient	**p-value**	**Coefficient**	**p-value**
Market size	1.13***	0.00	1.49***	0.00
Market size (-1)	-0.67***	0.00	-1.12***	0.00
Market size (-2)	0.16	0.18	-0.09	0.47
Market size (-3)	0.07	0.53	0.28**	0.02
Market size (-4)	-0.50***	0.00	-0.48***	0.00
GDP/capita	-0.20	0.28	-0.21	0.16

Distance	-0.25	0.15	-0.90**	0.01
Common colonizer	1.29***	0.00	0.82***	0.00
Foreign Direct Investment	-0.12***	0.00	-0.14***	0.00
Foreign Direct Investment (-1)	-0.14**	0.01	-0.08*	0.06
Foreign Direct Investment (-2)	-0.12**	0.01	-	-
Foreign Direct Investment (-3)	-0.09**	0.02	-	-
Remittances	-0.00	0.97	-0.04	0.06
Remittances (-1)	0.03**	0.02	0.03	0.11
Remittances (-2)	0.03*	0.06	-	-
Official Development Assistance	-0.07	0.73	-0.75***	0.00
Official Development Assistance (-1)	-0.11	0.59	-0.30	0.12
Official Development Assistance (-2)	-0.64***	0.00	-0.32*	0.09
Official Development Assistance (-3)	-0.30	0.10	-0.37**	0.04
Aid for Trade	-	-	-0.13*	0.05
Constant	1,75	0,11	1,71**	0,02
R^2	0,88		0,90	
Adj. R^2	0,87		0,89	
SIC	2,78		2,50	
Durbin–Watson	2,10		2,02	

Note: *** significant at 1%, ** significant at 5%, * significant at 10%

Source: own calculation

Concerning external resources, a more consistent result can be observed. FDI and Aid for Trade subsidies also have a positive effect on internal exports, while in the case of imports, an opposite result can be seen. On the one hand, it can be assumed that trading capacities are also increased from FDI and AfT sources, which also has an impact on internal export. On the other hand, it may have a negative impact on internal import that the country imports from the donor country providing external sources. In addition, member states are also developing the industrial sector that generates an ever higher added value from external sources, which is one of the key objectives of FDI, and this enables domestic production of previously imported products. Official development aids are also reducing the value of internal exports and imports, although this predicts the serving of interests of donor countries allocating the aid. However, remittances also have a positive effect on internal export and import, but their effect only can be seen after one or two years.

Overall, the present study gave the same results as the literature, taken into consideration that FDI, remittances, and Aid for Trade in the East African Community also stimulated internal exports, while official development assistance often follow the interests of donor countries. The distance has a negative effect on internal trade as well, whereas the size of the market, the income situation and the direction of the impact of the common colonial past cannot be clearly identified.

4. Conclusion

The main motivation of writing the present article and preparing the statistical analysis was to examine the impact of external resources flowing into the member countries of the East African Community on the internal trade of the integration, separately analyzing the factors affecting internal export and internal import. The actuality of the analysis is that regional integrations play an increasingly important role in the world economy. The protectionist economic policies following the crisis in 2008, the slowdown of world trade and the uncertainties affecting the main trading partners of African countries outside the continent (China, European Union) could turn the attention of African country leaders to intra-continental trade. Encouraging internal trade on the level of an integration can be enforced more easily because of common regulation. Internal trade of the East African Community shows steady growth, which was further helped by the introduction of the customs union. However, in the absence of domestic capital, external resources play a prominent role in promoting trade.

Belonging to integrations implies a bigger potential market, which can promote trade against external members, while the statistical analysis of the study has shown, that it is not a clear incentive for internal trade. Internal trade is encouraged by earlier colonial relations, while distance has a negative effect. The impact of external resources flowing into the countries of the East African Community is also unclear. Official Development Assistance may have a binding effect on donor countries due to their impact, which is reducing domestic trade. Remittances, Aid for Trade subsidies, but mainly FDI have a positive impact on internal exports, so special attention needs to be paid to the development of the business environment in the East African region as well. Finally, reducing corruption, increasing political stability and improving the regulatory environment can further increase FDI inflows, helping the region's economic growth as well.

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THE MASTER OF SOFT POWER: RUSSIA'S ROLE IN SERBIA, BOSNIA-HERZEGOVINA, MONTENEGRO, MACEDONIA AND KOSOVO

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Abstract

Russia does not have a grand strategy in the Western Balkans because it cannot offer an alternative to the EU enlargement, but their approach might change in the near future. Nevertheless, as a result of the EU's enlargement fatigue, Moscow makes use of the emerging dissatisfaction with Brussels in the region. The Kremlin attempts to tie the economies of the Western Balkans to Russian energy companies, which gives Moscow leverage to engage the political class of the respective countries. To help the expansion there is a closed circle of Russian businessmen and Nikolai Patrushev the Secretary of the Security Council of Russia. To influence public opinion, Russia related media structures built out a network in the Serbian speaking territories of the Balkans so that the narratives produced in Moscow can be spread. As sign of their success, the local tabloid and daily newspapers are referring to Sputnik and RT often as reliable sources. Furthermore, the Orthodox Christian Church is also used rather as a tool than a reason to win the support of the public to Russia. The relatively weakest element of Russian influence in the region is the military because their cooperation focuses exclusively on Serbia.

Keywords: Soft power, media, economy, military, Russian influence

1. Introduction: the means of Russian influence in the Western Balkans

Russia currently does not have a grand strategy in the Western Balkans[4] but it aims to make use of the relatively weakening Western influence in the region, and uses it to undermine the relevance of the Western model (Bugajski, 2017). Definitely, the Western Balkans will not be the region which Russia invades next time but exerting influence there is used to undermine Western

[4] The Western Balkans as a politial region currently consist of Serbia, Montenegro, Bosnia and Herzegovina, Macedonia, Kosovo and Albania. Since Albania is not discussd in this paper, when we refer to the Western Balkans we only mean the five remaining countries.

efforts to stabilize the EU's neighborhood (Bechev, 2017 p.17). The model has two goals: firstly, to back movements and narratives which undermine the status quo: the current borders, the Dayton agreement and the independence of Kosovo. Secondly, Moscow wants to stop NATO enlargement and harden EU integration in the Western Balkans (Balkan Insight, 2017a), which it does by heating up regional conflicts and preventing them from carrying out reforms required by the EU (Wisniewski, 2017).

However, Russia's attempts to do so are not always successful as the Montenegrin and Macedonian examples show. Montenegro joined NATO in 2017 and with Macedonia's new government Skopje's euroatlantic integration may get a new impetus (Radio FE, 2017). Thus, it is probable that reacting to these failed attempts to interfere in the Western Balkans Russia will design a "grand strategy" that would be a more comprehensive approach to influence the region's political and economic structures (Galeotti, 2018 p. 5-6).

When it comes to Serbia, Russia does not impede its EU integration in the hopes of pushing a Trojan horse into the EU that might divide the community from inside (ibid, p. 10). Serbia's President Aleksandar Vucic plays a balancing game between Russia and the EU but his last moves show negative signs when it comes to Belgrade's relations to Moscow: he side-lined Tomislav Nikolic, the former president and his co-party member, and appointed a pro-EU prime minister, Ana Brabic (Bloomberg, 2017). However, Russia has been successful in assisting the sustainment of regional conflicts at least on a level, which prevents the EU integration process of Kosovo and Bosnia and Herzegovina (B92, 2017b). To achieve this, Russia uses its means of influence in four main fields: military, media, soft power and economic links.

2. Economy

In general, Russian economic presence in Serbia, Montenegro and Republika Srpska (RS) is weaker than at its heyday at the beginning of the 2000s (Samurokov, 2017). However, there is a currently increased presence that is explained by the competition between the EU, Russia, Turkey and China in the region and also by the EU's enlargement fatigue (Makocki, 2017). However, the depth of economic embeddedness of Russia still cannot be compared with that of the EU (Samurokov, 2017).

When it comes to the concentration of economic activity, Montenegro is the most influenced by Russian money due to tourism and the real estate sector, but it might change with the course-shift of Montenegrin politics (Bechev, 2017 p.68-69). In Bosnia Herzegovina and Serbia, Russia is mainly active in the energy sector, but the expected intensification of trade did not happen after the EU sanctions were imposed (ibid, p.67). This failure can slightly be attributed to the falling rouble because importing from the Western Balkans became expensive for Russia.

Since the mid-2000s Russian energy policy looks at the Balkans as a way to bypass Ukraine but Moscow's potential for success is doubtable for three reasons: (ibid, p.220)

- Firstly, although most of the countries are 80-100% dependent on Russian gas, it only accounts for a small fraction of Serbia's, Macedonia's and Bosnia Herzegovina's energy consumption, while Montenegro and Kosovo use no gas at all (ibid, p.218).
- Secondly, since the annexation of Crimea, the EU takes competition rules more seriously; therefore, the business environment is bumpier for Russian gas companies in the EU candidate countries (European Commission, 2015).
- Thirdly, the demand for Russian gas has decreased from Europe and the appearance of LNG contributed to a price decrement in the gas market (Platts, 2016)

Russia might lose market share as a consequence of the aforementioned reasons, but as long as the energy companies profit the ones in power in the countries under analysis, there will be opportunities to sustain Russian dominance (Bechev, 2017, p.223).

3. Military

Although Russia is not a competitor of the West in designing the security architecture of the Western Balkans, it will strengthen its cooperation with Serbia and exploit all possible weaknesses of NATO to balance the Western influence in the region (Bechev, 2017 p.196). A military intervention by Russia is not a realistic expectation in the region because of the presence of EU and NATO troops in Kosovo and Bosnia Herzegovina, but Moscow is trying to have good relationships with all the security sectors of the countries in the region. The reasons why military aspects are still key to understanding Russia's role in the Western Balkans are the following:

- Serbia has an intense defense cooperation with Russia that is backed by a military agreement signed in 2013 (ibid, p.187). The Russian and Serbian military did 17 military exercises together in 2016 (Balkan Insight, 2016c), and Moscow is active in modernizing Serbian weaponry (Bieri, 2017 p.24).
- Russia runs a Russian-Serbian Humanitarian Emergency Situations' Center in Niš. The Center's proclaimed mission is to respond to natural disasters but Western experts and the

surrounding countries, Kosovo, Bulgaria and Bosnia-Herzegovina doubt Serbian sincerity on this issue. Allegedly, there is active espionage activity coordinated from the Center and the Russian party demanded diplomatic immunity for the employees of the facility, which Serbia has denied so far (Kallaba, 2017 p.21).

- Russia is a member of the Steering Board of the Peace Implementation Council in Bosnia Herzegovina, which body oversees the implementation of the Dayton accords (Bechev, 2017 p.71). Although there are no Russian peacekeeping troops in the country, the special police of RS cooperates with Russia in anti-terror operations (Balkan Insight, 2016b). To support anti-NATO voices, the Russian ambassador publicly supported RS' attempts to resist the decision of Bosnia's Constitutional Court, which considers all military installations in the entity as Bosnian state property. The possession of all the weaponry by the federal government of Bosnia Herzegovina is a precondition of NATO accession (Balkan Insight, 2017b).

4. Soft power: the Russian Orthodox Church, Russian foundations and public opinion

Russia is not as influential in the economy and military sectors of the region as the West, but Moscow's might is unquestionably the strongest in one aspect: influencing the public sphere (Bechev, 2017 p.225). One way of doing so is done via media, which is discussed in another section (chapter 1.4) but the role of the Eastern Orthodox Church and pro-Russian cultural organizations is also important. As Dimitar Bechev (ibid, p.228) rightly concludes, Russian soft power is enough to convince the majority of populations in the analyzed countries, but it was not successful in each case to shift the political leadership to the East (see Macedonia and Montenegro). The means and results of Russia's attempts of shaping public discourse are the following:

- The Russian Orthodox Church has a strong relationship with its Serbian counterpart and with Serb politicians as well (ibid, p.230). They support Serbia financially to renovate the Orthodox churches in Kosovo (Bieri, 2017 p.17), and Russia cooperates with Belgrade in UNESCO to portray Pristina as unable to protect Serbian heritage in Kosovo (Kallaba, 2017 p.12-13).

- The Russian Orthodox Church did not recognize the breakaway churches in Montenegro and Macedonia, which is a gesture to the Serbian Orthodox Church (Bechev, 2017 p.230);

however, the Russian Orthodox Church maintains connections with its Macedonian counterpart (Radio FE, 2015).

- Official and semi-official Russian and pro-Russian organizations are working in Serbia and Kosovo with the main aim to stir up regional conflicts and prevent the euroatlantic integration of these countries. CEAS mapped 51 Russia friendly organizations in Serbia, which are all Eurosceptic, glamorize and victimize the Serb nation. They are active in street protests and on social media. In Serbia, they incite the population against NATO and the EU, while in Kosovo they stir up ethnic tensions between Albanians and Serbs (CEAS, 2016 p.83).

- In Montenegro and Macedonia, the presence of Russian-friendly organizations and media outlets is given though, the political class decided to side with the West. However, the soft power Russia exerts has repercussions not only on public opinion, but also in the policymaking in RS and Serbia.

- In Serbia, the youth supports Russian foreign policy, but when it comes to life choices, they would prefer living in the West (Bechev, 2017 p.241). Serbians support Russian foreign policy and they wrongly believe that Moscow is the greatest aid donor of the country (ibid, p.66). The pro-Kremlin people in general do not have factual information about how real life in Russia is but they base their opinion on the biased information they gather in the public media (Nedeljnik, 2016).

5. Media

Among all channels, Russia is mostly embedded in the media structures of the analyzed countries, especially in the Serbian populated territories. The ultimate goal of pro-Russian media outlets is to present Russia as a friendly ally, while delegitimizing the West, mostly the US, by blaming them for the migration crisis, terrorism and “Albanian irredentism” (RT, 2015). The Russian influence is the most severe in Serbia and Serbian tabloid newspapers are also spread in Kosovo, Montenegro, Macedonia and Bosnia Herzegovina (Capello, 2017).

RT and Sputnik are popular websites shaping public opinion, but “Russia Beyond the Headlines” is also distributed in the region (ibid). In Serbia, there are 16 Kremlin oriented and six Russian media outlets (CEAS, 2016 p.7). Other local magazines often cite RT’s and Sputnik’s coverages because they view them as reliable and factual (ibid, p.58).

Apart from Serbia, pro-Russian media exerts massive influence in Northern Kosovo. RT and Sputnik spread the narrative that the Kosovar government is a threat to the Serbs existence and Kosovo is a failed state that is unable to function. So far, the government of Kosovo has been unable to establish Serbian media, which could counter the negative narrative coming from Belgrade; therefore, the local population can only rely on the Serbia centered, pro-Russian coverage (Kallaba, 2017, p.26).

6. The executors of Russia in the Western Balkans: Nikolai Patrushev and business circles

Putin's main point man in the Western Balkans is Nikolai Patrushev, a former intelligence officer who met Putin in the 1990s. His appearance in foreign policy decision making in Russia is not a new phenomenon but an episode of a process, which gives more leverage to security services. He is the head of Russia's Security Council and well known for his nationalist, conspiratorial world view. Patrushev anticipates a second Cold War and accuses the West for elaborating plots against Moscow. According to Mark Galeotti, Patrushev thinks Russia is in an existential struggle for its survival (Politico, 2017).

After the allegedly Russian backed 2016 Montenegrin coup, Patrushev travelled to Serbia and talked with top government and security officials about the extradition of Russian citizens. According to the Guardian, Patrushev apologized for the rogue operation that did not have the Kremlin's approval, but the Security Council in Moscow denied that the apology happened (Guardian, 2016). A few days later Serbian media reported as unsourced information that two Russian citizens had been extradited to Russia as a result of Patrushev's visit (Grozev, 2017). In May 2017 Patrushev met the Serbian Interior Minister Nebojsa Stefanovic and held talks on issues from organized crime to the internet. According to Galeotti, Putin gave Patrushev the Balkans who appointed Leonid Reshetnikov, a Balkan expert to the Security Council. In 2016 October in times of the Montenegrin coup attempt Reshetnikov said, it was time for Russia to return to the Balkans (Politico, 2017).

Apart from Patrushev, Russia's businessmen have a great role in building up local connections in the Balkans. According to Bulgarian sources, the general idea of the Montenegrin coup came from Konstantin Malofeev, a since 2014 very active businessmen in the Balkans but as the task was too challenging for him, Patrushev took over. Apart from Malofeev, who has tight personal connections to Milorad Dodik in Rebuplika Srpska, Aleksandr Dugin and Leonid Reshetnikov are also key persons who from time to time act as if their operations were approved by the Kremlin (Bechev, 2017 p.232).

6.1. Serbia

Among all former Yugoslavian republics, Serbia has the tightest ties to today's Russia. This marriage is not necessarily romantic, however. Apart from the historical and cultural bounds that make the two nations sympathize with each other Russia has clear aims:

- diluting the pro-European views in Serbia but not blocking its EU integration
- strengthening nationalist feelings, especially the memories of the Kosovo war so that Serbia's relations with the EU are becoming compromised

6.2. Economy

The economic influence of Russia in Serbia is focused on the energy sector. Moscow accounts for 80% of Serbia's gas demands but to nuance the picture it has to be noted that gas only accounts for 18% of the entire energy consumption in Serbia; therefore, Russia's leverage is limited compared to the Central-European countries (Bechev, 2017 p.218). As the Ukrainian gas route in 2006 became unreliable for Russia, Serbia signed an agreement with Moscow about energy cooperation in 2008. According to the agreement Russian firms will become more and more active in infrastructure and utilities projects and they made an informal promise that Serbia would be included in South Stream. Despite the strategic deal of 2008 and its potential consequences, there were no significant Russian investments in the Serbian economy (ibid, p.64-67).

Putin called off South Stream in 2014 but Russian companies Gazprom Neft and Lukoil had begun to take over the Serbian energy sector. Under the framework of energy cooperation, Gazprom Neft purchased 51% of the largest Serbian oil and gas company Naftna Industrija Srbije (NIS) in 2008 (Bechev, 2017 p.64). As the second biggest deal, the Russian Lukoil purchased the Serbian oil distributor, Beopetrol for $134 million and Russia invested $800 million in form of a loan into the railway system of Serbia. According to the privatization agreement Lukoil is obliged to invest €93 million into the infrastructure of Beopetrol. However, instead of this investment Lukoil used Beopetrol's funds to transfer itself €105 million as a loan, which is around 90% of its acquisition price (Conley et. al. 2016 p.59). These transfers are all symptoms of state capture in Serbia, where the market share of gas is low though, the interconnectedness of Serbian political elite and the Russian hydrocarbon industry sustain Moscow's dominance. As previously stated, Russia's leverage in the energy sector is not to be overestimated, but their influence on the ownership structures anticipates an impact on policy-making.

Serbia did not impose the EU sanctions on Russia, but it must be noticed that originally there was more to it than purely political sympathy and loyalty towards Moscow. Serbia and Russia have an old free trade agreement, but the economic opportunities Moscow can offer cannot be compared with those of the EU; therefore, the expected increment in trade activity did not occur. The free trade agreement dates back to 2000 - yet it excludes cars and certain agricultural products (ibid). The agreement was extended in 2009 and 2011, but its intensity remained at a modest level. Russia in 2016 was Serbia's fourth biggest import source with $1,5 billion and fifth biggest export market with $795 million. Still, Russia was responsible for only 4,5% of the FDI flows to Serbia in 2015. To compare, Switzerland's number was 4,5%, while the EU's was 72,4% (Bieri, 2017 p.12). As a consequence of the EU sanctions on Russia and their countermeasures from Moscow, Serbia's exports only slightly increased to Russia; however, the trade balance still holds a huge deficit because of the import of Russian oil and gas (Bechev, 2017 p.67).

6.3. Military influence

The security cooperation between Moscow and Belgrade is cemented by a military agreement of 15 years of defense cooperation signed in November 2013. Under the agreement the parties cooperate in training, personal-exchange, arms procurement and intelligence information sharing. To proceed, in October 2016, Nikolai Patrushev, the head of the Security Council of Russia recommended a closer partnership between the intelligence services of Russia and Serbia and suggested to sign a Memorandum of Understanding in 2017 (Balkan Insight, 2016a).

The defense cooperation between Serbia and Moscow is more than rhetorical tactics: the depth of the collaboration is well illustrated by the military exercises done together. Serbia declared military neutrality in 2007 and plays a balancing game between NATO and Russia by having military exercises with both parties. In 2016 there were 206 military exercises with NATO and only 17 with Russia, which shows the transatlantic alliance's prevalence (Balkan Insight, 2016c). In SREM-2014, 207 Russian paratroopers participated in an anti-terrorist operation exercise in Serbia. The following year, in 2015 September Belorussian and Serbian paratroopers joined the Russian forces in the framework of the "Slavic Brotherhood" in Novorossiisk. In 2016 the "Slavic Brotherhood" took place in Serbia and in the same year NATO carried out "Montenegro 2016" just across the border. The striking fact is that Serbia participated in both of the military exercises (Bechev, 2017 p.188). In 2017 the third "Slavic Brotherhood" military exercise took place in Belarus, ten kilometers away from the Polish border (Medium, 2017).

Nevertheless, it remains a question, how much of a security threat to the transatlantic community does a country intending to join the EU and participating in the Partnership for Peace programme of NATO, and at the same time holding military exercises with Russia pose? The Serbian public is prone to Russian influence, which is underpinned by a survey that says, only 12% of the asked people would support a NATO accession (Ninamedia, 2016 p.22). Exacerbating the suspicion of Serbia's Russian bias, Serbia bought two Mi-17V-5 helicopters from Russia in 2016 (B92, 2016) and received six MiG-29 fighter jets for free in 2017. However, the overhaul of the jets will cost $236 million for Serbia (Defense News, 2017).

In addition, since April 2012 there is an often disputed Russian-Serbian Humanitarian Emergency Situations' Centre in Niš. Western experts accuse the Centre of conducting espionage activity in Serbia and in the neighboring countries because Niš is close to the border with Kosovo and Bulgaria and its Russian co-funding institution. The Russian Ministry for Civil Defense, Emergency Situations and the Elimination of Consequences of Natural Disasters have a semi-militarized structure. Moreover, Moscow demanded Serbia to grant diplomatic immunity to the employees of the Center, similarly to those of the NATO in the country. Thus, Russia tries to lift the Center's prestige and functions to the same status as NATO has, and also to counterbalance KFOR's presence in Kosovo (Bechev 2017 p.187-188). The Russian friendly Serbian Radical Party (SRS) in the Assembly of Vojvodina plans to initiate the opening of a Serb-Russian center in the Serbian province, similarly to the one existing in Nis (B92, 2017a).

7. Soft power: the Russian Orthodox Church, Russian foundations and public opinion

Russia's soft power in the Western Balkans is the most powerful if we compare it with other means of influence, such as military or economy. Although culture is not the most decisive when it comes to impact political decisions, but it plays an important role in shaping the public opinion of Serbia, Macedonia, Montenegro, Northern Kosovo and RS. Russian soft power in Serbia can be split in three categories:

- cultural ties based on religious cooperation
- establishment of pro-Kremlin institutions
- media (chapter 3.4)

7.1. Russian Orthodox Church

As an important and trusted tool among citizens in Serbia, Russia puts an emphasis on supporting the Serbian Orthodox Church. Patriarch Kirill awarded the then President Nikolic in 2016 March for his lifelong support to Orthodoxy and Russian friendly relations. He is a frequent visitor in Belgrade and importantly, the Russian Orthodox Church has refused to recognize the separated churches of Montenegro and Macedonia, which is of symbolic significance to the Serbs (Bechev, 2017 p.230).

In the Western Balkans first and foremost the Serbs are the target audience because 84% of the Serbian population belongs to the Orthodox Church. To grasp this connection, we have to be aware that in Serbia national origin and religion are considered to be identical: they measure belonging to a religion with ethnical characteristics, they are melted together and constitute defining elements of identities. This feature is embodied in politics: although the president and the prime minister of Serbia represent all citizens irrespectively of religious belonging, they often give privileges to the Serbian Orthodox Church. While relying on state support, the Serbian Orthodox Church supports organizations which work for tightening ties with Russia and with Russian organizations in Serbia (CEAS, 2016 p.71). What is more, the Russian Orthodox Church plays a pivotal role in the maintenance of Serbian claims for Kosovo, which are mainly based on the narrative that the center of the Serbian Orthodox Church used to have its seat there (Bieri, 2017 p.17). The support for the Kosovo case is not in line with the EU's aims in the region, because Brussels set the normalization of relations between Pristina and Belgrade as a condition for EU accession. There have been steps made in a positive direction by both sides but Russia incites irredentist and eurosceptic Serbian politicians to oppose the consolidation. Kosovo is also used by Russia as a precedent in the discourse to justify its recent actions in Georgia and Ukraine (Conley et. al. 2016, p.16).

7.2. Russian related foundations and public opinion

Coming to the second point, Russian foundations are also widely present in Serbia and a lot of them are located in the northern part of Kosovo. The International Humanitarian Co-operation (Rossotrudnichestvo) is present in Serbia and the Russian World (Russki Mir) has an office at the Belgrade University. To shape discourse in the expert community, the Russian Institute of Strategic Studies has an office in Belgrade and their director is an often-cited commentator in the Serbian media (Bechev, 2017 p.229).

A report by the pro-European CEAS mapped 51 Russia friendly associations of citizens, student organizations and political movements which all try to influence Serbian public opinion. Most of them are eurosceptic and glamorize the Serbian nation, neglecting the 21 ethnic minorities of Serbia. These organizations' communication builds on emotions and turn to slogans such as "*our country is occupied*", "*the statehood is challenged*", "*the value system of Serbian people is destroyed*" and "*the preservation of Kosovo and Metohija*". Almost all have a number of profiles on social media (CEAS, 2016 p.83) and the most influential among all is the SNP Naši, which was founded in 2006 and on their website promotes the Eurasian Union. It was named after the Russian youth movement Naši

("Ours"), which backed Vladimir Putin and protested against the color revolutions and triggered certain violent protests in Northern Kosovo (ibid, p.8). Apart from them, there are a lot of Russian friendly organizations but all of them have one thing in common: the refusal of the European integration process and the opposition of the spread of European values (Bieri, 2017 p.18-19).

A number of opinion polls underpin Russia's tactics when it comes to influencing the public opinion of Serbia. A survey asked the youth about their opinion of Russia and the EU and its results pointed out that 64% support Russian foreign policy, 57% support Russian military bases in Serbia but at the same time, when it comes to emigration the majority prefers the EU (CEAS, 2016 p.116). The Serbs sympathy towards Russia is well illustrated by the data of another survey as well, according to which 49% of the asked people think the Russian society is more suitable for Russians over the EU, 34% voted for the EU and 17% did not know (Ninamedia, 2016 p.18). According to another poll done in 2014, Russia is the most generous development aid donor country to Serbia, but in reality the EU, USA and Japan stand before them (Bechev, 2017 p.66).

7.3. Media

Moscow views Western media and NGOs as an extended arm of the US, which is considered a threat to national security. Therefore, to counter their influence RT's and Sputnik's activity in former Yugoslavia is looked at as a contest in a competitive environment (Bechev, 2017 p.228). Russia is present in the Serbian media aiming to portray Russia as a positive and friendly ally, while delegitimizing Western powers and blaming the US for the hardships the Balkans - according to the pro-Kremlin media outlets - is facing today: the migration crisis, terrorism and "Albanian irredentism" (RT, 2015).

To support the narrative of victimization, in Serbia there are 16 Kremlin oriented and six Russian media outlets present (CEAS, 2016 p.7). The Serb media outlets are also spread in Kosovo, Montenegro, Macedonia and Bosnia. There is a concern over press-freedom in the region which is accompanied by a decreased quality in journalism. All of this became acute after Russia invested into the WB's media industry and built up the supply of pro-Russian media. In 2015 February, Sputnik founded a Serbian speaking subsidiary, and Sputnik is used as a reliable source by several media outlets in the region. Unlike Western European countries, the Serbian leadership welcomed the arrival of the Russian media outlet (ibid, p.58). Sputnik news runs an internet portal, a radio program, a website and a mobile application with 100.000 users (ibid, p.62). The reason for the Russian media's popularity is their cheapness: unlike Western outlets, they offer free of charge services. Apart from Sputnik, Fakti is used as the most common source for broadcasting about Ukraine and

Russia which results in one-sided reporting. Sputnik critiques the Serbian government but only their approach to euroatlantic integration. Besides, Montenegro's NATO accession is also under harsh critique (Bieri, 2017 p.15).

These channels and printed press (i.e. Russia Beyond the Headlines) (Bechev, 2017 p.231) produce narratives playing on regional stereotypes, ethnic tensions and fragile conflicts. The prevailing narrative is to present Russia as a trustable partner on whom Belgrade can always rely due to the ethnic, cultural and religious boundaries (Wisniewski, 2017). As a new element, they recently question the pacifism of Albanians in the region and accuse them of insisting on a Greater Albania (Sputnik, 2017). Nonetheless, Sputnik is looked upon as a credible source among local journalist because it is still more sober than the Serbian tabloid media, which "hero-worships" Vladimir Putin (FT, 2017). Apart from Sputnik's original readers, it reaches out to more because leading media outlets in Serbia, such as *Večernje Novosti*, *Politika*, *Pink*, *Studio B*, *Informer*, *Pečat*, *NSPM*, *Standard*, *Novi Standard*, and *Pravda* follow the discourse created by them (CEAS, 2016 p.62).

8. Bosnia Herzegovina

When it comes to Bosnia Herzegovina, the Russian influence mainly concerns supporting irredentism in the country. The main activities are the following:

- supporting irredentism in RS and the Croatian part of the Federation
- blocking EU integration of Bosnia through RS
- blocking Bosnia's accession to NATO by demanding a referendum on it (Bechev, 2017 p.75).

8.1. Economy

Dodik's alliance with Russia has an economic dimension, and similarly to their activity in Serbia, Russia is the most active in the energy sector. However, the share of gas in the Bosnian energy consumption accounts for merely 2,2%; therefore, the Russian influence is limited in the gas market. Nevertheless, in February 2007 the Russian Zarubezhneft purchased Bosnia's oil refinery and filling stations' operator Petrol for €121.1 million without an open tender, which in itself assumes good Russian connections in the Bosnian administration. A few years later, in September 2012 Russia made a declaration to include RS into South Stream that would have meant investment for the Republic. However, Russia cancelled the pipeline and Dodik blamed the EU for depriving RS of €2 billion in investment. To compensate, Russia provided €72 million in direct budgetary support to RS (Bechev, 2017 p.74).

The statistics have to be dealt carefully when it comes to Russia's economic influence in Bosnia Herzegovina. Russia is the fourth largest investor in Bosnia Herzegovina, but the number is not more than €0,5 billion. Bosnia hoped to become more attractive to Russian investments with the Ukrainian crisis, but Moscow's promises were not kept. Symbolizing the relative insignificance of Bosnian-Russian economic relations, Moscow banned the import of Bosnian fruits and vegetables in 2016 August (Samorukov, 2016).

In the past three years Dodik attempted to handle the critical economic situation in the country by lobbying for Russian financial support. Thus, he became a frequent guest in Moscow and before the elections in 2014 - without Russian confirmation – declared that the Russian government approved a loan of 500-700 million euros to RS (Reuters, 2014). In 2017 Russia officially agreed to pay off $125,2 million an outstanding debt of the Soviet Union to Bosnia Herzegovina, which meant a lifeline to the country (Reuters, 2017).

8.2. Supporting irredentism

Russia is a member of the Steering Board of the Peace Implementation Council (PIC) that oversees the 1995 Dayton Accords setting the framework of BIH's constitutional and political landscape. Thus, Russia is present in the peacebuilding process in Bosnia since the beginnings, but the economic and political relations only intensified since Milorad Dodik came into power in RS in 2006. For Dodik and the RS Russia in PIC is a tool to resist EU intentions to centralize authority and decision-making in Bosnia (Bechev, 2017 p.71).

Until 2007 the Russian-Western relations regarding Bosnia were balanced but since then Moscow has been criticizing EU efforts to break the institutional deadlock in the country. This time coincides with Russia's return to the region as a possible energy transit route replacing Ukraine. Since then, Russia is a spoiler behind Dodik's attempts to gain more autonomy in Bosnia Herzegovina. In November 2014 Russia abstained in the UNSC vote about prolonging the mandate of EUFOR Althea and on July 8 2015 Russia vetoed a resolution which used the word "genocide" to describe the anniversary of Srebrenica (ibid, p.72). Dodik is the primary ally of Russia in the region because he is the one most loudly championing Russian interests: opposition to NATO, the EU and the US influence in the Balkans (Mujanovic, 2017).

Dodik wanted to make January 9 a public holiday, which day is of symbolic significance to Serbs for historical reasons. BIH's Constitutional Court opposed the referendum just like the international community and Serbia did. However, Russia endorsed the suggestion to strengthen Dodik's power and the political tensions in BIH (Zakem et. al. 2017 p.14). Before the plebiscite Dodik went to Moscow to see Putin, where he found no opposition. This move helped him win the local elections on 2 October 2016, side-lining the allegations of widespread corruption (Bechev, 2017 p.73).

Another aspect of Russian influence concerns the Croatian part of Bosnia Herzegovina because there is an emerging link between Dragan Coviv and Moscow. Covic is the head of the Croatian Democratic Union of Bosnia and Herzegovina (HDZ BiH) and tightly linked to the Croatian Democratic Union (HDZ) in Croatia. Croatia's governing HDZ continuously supports irredentist claims in Bosnia, because according to the Dayton agreement only the Serbs have their own entity, whereas the Croats have to share the other one with the Bosnians. On August 24 2017 the Russian Ambassador to Bosnia Petar Ivancov said that Bosnia's Croat question cannot be ignored and a solution has to be found (Mujanovic, 2017).

In BIH, the military is looked upon as the unifying body of the country's ethnicities. Thus, although RS sympathizes with Russia, the other entity has no interest in cooperating with them. However, the special police is organized on the level of entities so RS cooperates with Russia in anti-terror operations (Balkan Insight, 2016b) and purchases weapons from Russia (Balkan Insight, 2018). To break the federal unity, the Russian ambassador to Bosnia Ivancov publicly announced to support RS' attempts to resist the decision of Bosnia's Constitutional Court, which considers all military installations in the entity as Bosnian state property (Balkan Insight, 2017b). This move is key to Bosnia's NATO integration, because the alliance expects the country to have authority over all of the military facilities on its territory before accession (Mujanovic, 2017).

9. Montenegro

The links between Montenegro and Russia became intensified since Milo Đukanović, - either as president or a prime minister – appeared on the political scene between 1999 and 2016. The main arenas of Russian influence are the following:

- Russia is active in Montenegro's economy, but their focus is not energy but the real estate sector
- Russia is active in destabilizing Montenegrin domestic politics and also in shaping the public opinion against NATO and EU integration

9.1. Economy

Among the countries of former Yugoslavia, Russia is mostly embedded in Montenegro economically. However, unlike in Bosnia and Serbia, the investments are not concentrated in the energy sector, rather in tourism and real estate. Hence, their nature is less government oriented than in other parts of the region. The Adriatic seaside became a popular holiday spot for Russian tourists and after 2008 the share of visitors from Russia was 20-30% of the total (Bechev, 2017 p.68-69). Currently, Tourism accounts for 22% of Montenegrin GDP but predictions show that it might increase to 40% by 2024 (RWR, 2016). Roughly one third of Montenegrin companies are in Russian hands and in 2015, 7000 Russian citizens had permanent residency in the country. The numbers are vague but there have been huge investments from Russia in the Montenegrin real estate and industrial sector as well (Bechev, 2017 p.68-69).

In 2005 the Russian Oleg Deripaska purchased a majority in the Kombinat Aluminijuma Podgorica (KAP), an aluminum smelter. The millionaire negotiated directly with Đukanović, the then PM of Montenegro. KAP accounted for 20% of Montenegro's GDP and 80% of its exports. However, even with KAP Russia was just the seventh biggest investor in the Montenegrin economy. The 2008 economic crisis reduced aluminum prices and KAP became dependent on government funding, and the company went bankrupt in 2013 (Reuters, 2013). Despite the bankruptcy, Deripaska, the Putin close oligarch remains involved in the Porto Montenegro yacht marina project as an investor, which is a superyacht marina and resort built as a rival to Cannes (Guardian, 2017a). In 2015, Montenegro was invited to join NATO and Đukanović decided in favour of the West. As a reflection of the paradigm change in Montenegro, in 2015 they changed the legislation to make it more difficult for foreign real estate buyers to acquire permanent residency in Montenegro (Bechev, 2017 p.70).

9.2. Political relations

Since the 2006 declaration of independence, unlike the economic, the political relations worsened between Podgorica and Moscow. There are three reasons for the conflict of interest: Firstly, Russia supports the Serbs in Montenegro, who voted against the independence of Montenegro in 2006, and refused NATO and EU integration. Secondly, Montenegro joined the Western sanctions imposed on Russia after the annexation of Crimea (Bechev, 2018 p.7). Thirdly, in 2015 Montenegro was invited to join NATO that was followed by violent protests supported by pro-Russian stakeholders. According to Đukanović, Russia friendly groups were behind the protests and opposition party leader, Andrija Mandić from the New Serb Democratic Party was on Moscow's payroll. In June 2016, Mandić signed a cooperation agreement with Putin's United Russia party, and after that he insisted on a referendum on Montenegro's NATO accession, echoing the opinion of the Russian Ministry of Foreign Affairs (Bechev, 2017 p.70). Thus, the upcoming 2016 elections were deemed as a quasi-referendum, about the NATO accession where the governing party won 42 seats out of 81 (Bieri, 2017 p.19-20).

On election day in 2016, the police arrested 20 Serbs who allegedly planned to commit a terrorist attack against Milo Đukanović (Bechev, 2017 p.195). Later, Montenegrin authorities accused Russia of being behind the coup-attempt. Đukanović resigned as prime minister explaining his decision as pressure from Russia. According to journalists, the sponsor of Ukrainian separatists Konstantin Malofeev was behind the incident (ibid, p.71). Although no one has confirmed the accusations about Russia's interference, it is certain that Russian actors became a significant player in Montenegrin domestic politics irrespective of their official or unofficial status (Marusic, 2016).

As a further aspect, there are suspicions that Russian intelligence infiltrated into the Montenegrin intelligence community. In June 2014, an anonymous source from the NATO HQ in Brussels assessed that around 25-50 agent of the Montenegrin National Security Agency (ANB) may be double agents. Seven years before the allegation, Sergei Lebedev the director of Russia's Foreign Intelligence Service (SVR) took a visit to the then Russia friendly Montenegro. To avoid future infiltration, in 2015 February the Montenegrin Parliament amended the law on ANB vetting and recruitment (Radio FE, 2014).

10. Macedonia

Since the declaration of independence Macedonia is a pro-Western country, but in the last couple of years Moscow has used soft-power to shape events according to their playbook with less rather than more success. Since 2015, Macedonia has been in a political crisis, which seems to get solved with the current socialist government of the country. Although Russia tried to capitalize on the opportunities and intensify ethnic tensions in the country, they could not manage to escalate the political conflict into clashes between Albanian and Macedonian groups. However, the influence they exerted was so significant that it contributed to an almost two year-long deadlock.

10.1. Economic relations

When it comes to economic relations between Russia and Macedonia, their influence is growing but from a low starting point. The FDI investments of Russia were EUR 27 million in 2015, which was infinitesimal compared to Austria's EUR 500 million number (CDS, 2018 p.2). Russian companies in 2015 realized four times the revenue they did in 2006, with EUR 212 million. Nonetheless, this number only amounts to 1% in the Macedonian economy (ibid p.1), and almost half of it is generated alone by Lukoil (ibid, p.3).

Most of the imports coming to Macedonia from Russia are natural gas and oil derivatives. However, gas only accounts for 4,7% of Macedonian energy consumption, thus the dependence on Russia is not that determinant in this case (Bechev, 2017 p.218). To deepen the cooperation energy field, in 2013 July Macedonia and Russia agreed that Russia accepts Soviet-era debt of €42 million for a joint stock company of Macedonia and Gazprom to connect a pipeline to the former Yugoslav republic (ibid, p.80). As a further point, in 2012 Russian pharmacy company Protek opened a new factory in Macedonia (Bieri, 2017 p.13).

In 2014 Macedonia did not join the EU sanctions against Russia similarly to Serbia and Bosnia Herzegovina in the hopes of intensified economic relations with Russia (Bieri, 2015 p.1). Capitalizing on this opportunity, the agricultural products of Macedonia became more attractive and competitive on the Russian market. Thus, Macedonia included agricultural, dairy and meat products in its export portfolio, but the strict food regulations and high import tariffs of Russia prevented the intensification of trade between the countries (CDS, 2018 p.4).

10.2. Political relations

The most recent attempt by Russia to interfere in Macedonian domestic politics was in 2015, after a group of journalists released a report at the headquarters of the largest opposition party, the Social Democratic Party (SDSM) in Macedonia. The report was the result of 670 000 illegally recorded conversations carried out by the national security services of Macedonia. The document argues that the governing party VMRO and Gruevski, the then prime minister were trying to control top officials in the public administration by using the national security services to tap their phones. However, the Kremlin-friendly media painted the reality as if it was another "color revolution" backed by the West (Bechev, 2017 p.81).

As another noteworthy point, after the clashes in Kumanovo on 9 May 2015 between Skopje's security forces and Albanian radicals, Sergei Lavrov linked the interference to Albania and Bulgaria as an attempt to partition Macedonia. He added that the EU is backing the project of a Greater Albania, while the Albanians blamed Russia for the chaos. Hashim Thaci, the president of Kosovo and former leader of KLA named Russia as the greatest threat to the Balkans, apart from radical Islamism and the refugee crisis. Although by July 2015 all parties in Macedonia agreed to hold elections, Moscow through RT and Sputnik continued the disinformation campaign. However, in reality the conflict was triggered by the release of tapes proving the corruption in Gruevski's government, and Russian propaganda just tried to distract attention (ibid).

After the 2016 elections, VMRO's Gjorge Ivanov, the president of Macedonia stirred up the political crisis. VMRO won 51, while SDSM won 49 seats out of the 120 mandates in the parliament. SDSM attempted to form a coalition with an Albanian Partner, the Democratic Union of Integration (DUI) who had 10 seats but president Ivanov did not let the coalition form a government. The EU and the US urged Ivanov to allow the forming of a coalition between the SDSM and the Albanian partner. This stalemate assured a perfect opportunity for Russia to step in with the accusation that the West was trying to support the creation of a Greater Albania, which threatened the status quo in the Western Balkans. On the one hand, Russia's message to its own citizens had been that Macedonia, Bosnia-Herzegovina and Kosovo were all American projects serving Western interests and they must be prevented from entering NATO and EU. On the other hand, Moscow tried to address the Macedonian public as well by saying that the US supports a coup to separate the Albanian from the Macedonian parts of the country and the Kremlin is the defender of the Macedonian unity (Bugajski, 2017).

After all, Russia could not prevent the opposition coming into power in May 2017. On November 15 the Macedonian Parliament gave preliminary approval to recognize Albanian as the official language of Macedonia and the new Prime Minister Zoran Zaev from the Social Democrats kicked off a democratic change in the country (Radio FE, 2017). Indeed, the democratic transition was in full contradiction with Russian aims in this country; thus, the Russian attempt to push Macedonia into a long-term political crisis has failed so far.

Besides, on June 4, 2017, based on classified documents obtained from the Macedonian secret service the Guardian revealed that Russian spies were involved in spreading Russian propaganda in Macedonia for a decade. The influence operation began in 2008 and aimed to isolate the country from NATO and the EU. According to the document, the Kremlin's goal was to make Macedonia energy wise "exclusively dependent" and to control the Balkan through strategic partnership with its countries. To assure this, Russia's SVR foreign intelligence service-based agents in Skopje and the Russian Embassy also hosted four GRU agents, from military intelligence. The Embassy also oversaw the foundation of around 30 Macedonian-Russian "friendship associations" and opened a Russian cultural centre in Skopje. Furthermore, they financed the construction of Russian styled Orthodox churches and crosses in the country (Guardian, 2017b).

11. Kosovo

The first and foremost aim of Russia in Kosovo is to distance the Albanian and Serbian population from each other and to burden the post-conflict consolidation between the parties. For Belgrade Russia remained the only major power, which it can use to impede Kosovo's international recognition. Since the EU facilitates the Belgrade-Pristina Dialogue as a precondition of EU membership, the sole actor who can prevent the full international recognition of Kosovo is Russia (Kallaba, 2017 p.20). That remains a question how far it is beneficial for Russia because maintaining the tensions between Kosovo and Serbia blocks the euroatlantic integration of both countries; however, having

Serbia as a Trojan horse in the EU may be more of use for Moscow. Nevertheless, the channels Moscow is using to maintain tensions between Pristina and Belgrade are: the strong reliance on the Serbian Orthodox Church, disinformation through the media, blocking Kosovo's membership in international organizations and backing the creation of an Association of Serb Municipalities to decentralize Kosovo's decision-making system.

To capitalize on soft power, Russia donated $2 million to UNESCO to support the restoration of four Serb Orthodox churches in Kosovo and they offered to send Russian Monks to support activities in Kosovo. However, UNESCO is also a platform to block Kosovo's recognition by accusing Pristina of being a threat to the Orthodox religion and its infrastructure (ibid, p.12-13). As another form of soft power the Russian influence is widely channeled through media propaganda in the Serbian speaking parts of Kosovo. Sputnik and RT broadcast in the Serbian language spreading the narrative that the Kosovar government is a threat to the Serbs existence. The other popular theme of the pro-Russian news coverages is that Kosovo is a failed state, thus unable to function. The government of Kosovo so far has been unable to establish an independent Serbian media in Kosovo; therefore, the local Serbs do not even have the chance to rely on alternative sources. Not only the Serbian language Sputnik and RT news present a negative picture of Kosovo but their English, French and German versions as well (ibid, p.26).

To disintegrate the country and support Serbian separatism Russia built up a good relationship with Serbian parties in Kosovo and supports the political representation of Serb Municipalities in the country. Putin's United Russia increased its ties with Srpska Lista, which has three ministers in the current government of Kosovo. The Russian party stated openly that Srpska Lista guarantees Serbian sovereignty over Kosovo (ibid, p.28). In the last months the Russian Ministry of Foreign Affairs critiqued Kosovo for not proceeding with the establishment of the Association of Serb Municipalities but Kosovo fears, that the new administrative entities could serve as bastions of Russian influence (ibid, p.27).

Strengthening this fear, before the local elections on October 22 2017, the leaders of Kosovo Serbs gathered in Moscow for consultations. The Serbs in the country feel left in the lurch by the EU because the talks mediated by Brussels propose the further integration of North Kosovo to the Kosovar state structures. Thus, when the Belgrade-Pristina talks began some local Serbs even asked for Russian citizenship (DW, 2011). The demand was obviously unrealistic, but Russians supported Serbian attempts to slow the pace of North-Kosovo's integration into Kosovo because they deemed it as part of Serbia.

As another noteworthy point, Russia set up pro-Kremlin structures in North-Kosovo right after they gained independence in 2008. The organizations became active in 2012 during demonstrations and clashes between Albanians and Serbs and according to certain unconfirmed assumptions they already have the logistical support of the Serbian-Russian Humanitarian Center in Niš (CEAS, 2016 p.8-9). One of the many organizations present in the northern part of Kosovska Mitrovica is the Kosovo Front. The body was founded in 2008 and was registered with the Business Registers Agency of Serbia, which still operates in Northern Kosovo. The group has supporters in Russia, Ukraine and Belarus and on top of that, it has a branch in Moscow. The leader of the group is Aleksandr Kravčenko, a Russian volunteer in the Yugoslav wars. The Kosovo Front has 11 700 followers on Facebook and in 2014 the organization called the citizens of Serbia to join the "army" of Novorossiya. Apart from the Kosovo Front, he edits the website Srpska.ru (ibid, p.86-87).

Conclusion and recommendations

Most of the challenges the Western Balkans is facing are not caused by Russia, but they are a result of the West's failures and negligence towards the region. When Russia sees an opportunity to step in, they attempt to capitalize on opportunities as they did in Montenegro or Macedonia; however, their attempts are not always successful. It is expected that after the failed attempts to influence politics in Skopje and Podgorica the Kremlin will try to work out a grand strategy for the Western Balkans, with the leadership of Nikolai Patrushev.

Russia's tools are limited because Moscow cannot offer an alternative to EU membership for the countries in the region, but they use soft power successfully to influence public opinion. Having an impact on the public mindset is mainly successful in the Serbian speaking parts of the Western Balkans, but leads to less success in Albanian, Bosnian, Montenegrin and Macedonian territories. Thus, Russia uses emotions and values derived from religion and assumed fears of the Serbian population, which is directed towards regional adversaries, whose politics is being destabilized this way. The influence exerted by Russia outlined in the previous chapters does not necessarily exceed the Western influence in all of the analyzed aspects because the EU and NATO has an advantage in financial and military cooperation, but there is a threat that the region turns towards Russia if the EU and the US do not show some willingness for a deeper engagement. Hence, remedying the problems would require an increased Western presence in the economies, politics and military sectors of the Western Balkans. By doing that, the West could rebuild the trust lost with the EU's enlargement fatigue and gain influence over media structures, energy policy, interoperability in the military and with all of that, over the mindset of local people.

The Western Balkans is at the moment not in the spotlight of US foreign policy and is also out of the EU's focus due to Europe's inner problems coupled with migration and integration. This opportunity is well recognized by Moscow and they are keen on establishing proxies in the region who can be built upon in case the EU integration of the Western Balkans gets impetus again. Therefore, based on its rich resources the West should consider six points to offset Russian attempts to derail the Western Balkans from the democratization path and to prevent the spillover of Russian activities to EU member states with Eurosceptic governments and electorates:

- Countering the increased Russian economic activity in the region, the EU and the US should incentivize firms to make investments in the Western Balkans, so that the locals would not be so exposed to Russian money. In doing so the dead car manufacturing business and the technical expertise stemming from the former Yugoslavian arms industry could be capitalized on and the currently unemployed labor force should be transformed into precious human capital, which the region is thirsty for.

- Although the countries in the region are not in need of vast amounts of gas but their consumption is dependent on Russia. As the US is at the moment assisting Croatia in developing its LNG infrastructure to diversify the EU's gas supply, this project should be extended to the Western Balkans so that the Russian energy companies would function in a competitive environment.

- Since Serbia is a militarily neutral country, the West cannot complain about their cooperation with the Russian army as long as they are doing exercises with NATO as well. However, NATO should push Serbia to modernize its army based on NATO standards. In doing so, they would increase the interoperability in the alliance and decrease the demand for Russian military equipment in the arms market. Furthermore, NATO presence in Kosovo should be increased to reassure the local population about the US engagement in the region and also to win the sympathy of local Serbs, who look at the peacekeeping forces in Kosovo as a safety belt for their cultural heritage.

- The embeddedness of Russian media structures in the Serbian speaking parts of the Western Balkans shapes public opinion in a way that is conducive to Russia. To counter that, Western news agencies should consider developing Serbian speaking broadcasting in the region, otherwise the locals remain exposed to exclusively anti-Western narratives spread by RT and Sputnik based reports.

- The US has a role in re-engaging the region in two ways: firstly, the State Department and US Senators should consider more frequent visits to the region, meeting state officials so that the needs of the local economies can be measured. The increased attention would help create trust between the counterparts and also in the public opinion. Secondly, US companies should be motivated to invest in the region to create an infrastructure that connects the countries of the Western Balkans, so that the stirred tensions supported by Russia can be offset by regional cooperation.

- At the moment EU membership seems so distant that Western Balkan leaders do not dare to risk their positions with deep reforms required by Brussels. Thus, the EU should go further with EU integration of Montenegro and Serbia, so that the remaining countries of the region could look at it as a role model motivating reforms and deterring them from Russian friendly behavior.

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EU BUDGET AND EU POLICIES: EXISTING AND MISSING LINKS, POTENTIAL RESTRUCTURING[5]

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Abstract

The article presents the development of the expenditure side of the EU budget and examines its existing or missing linkages to EU common policies that have also gone through a substantial development. A brief summary of the key objectives of a budget (partially valid for the EU budget, as well) is followed by the presentation of the key issues at the „beginnings" as well as of the changes during the financial perspectives since the Delors I. package. This part is followed by the presentation of the current reform ideas and their potential consequences for EU budget expenditure.

Key words: European Union, budget, expenditure, common policies

1. Introduction

The EU budget was originally created in order to secure the financing of the common policies agreed upon the Member States. These common policies have been the result of an agreement on the basis of necessities and compromises at a given time. The development of the integration process and the changes of the external environment made new policies possible and necessary. The EU budget, however, could only partially follow this development, not least due to the attitude of the Member States paying increasing attention to their balance vis-à-vis the EU budget. This attitude has gradually pushed the original objective of (co-)financing jointly agreed common policies into the background.

In this article, we present the development of the expenditure side of the EU budget and examine it from the point of view of its linkages to EU common

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policies. After a brief summary of the basic (potential) objectives of a budget (partially valid for the EU budget, as well), we present the development of the structure of the expenditure side of the EU budget: after a brief presentation of the key issues at the „beginnings" (the first 18 years from the beginning of the functioning of the own resources system to the first major structural reform of the EU budget), we present systematically the changes during the financial perspectives since the Delors I. package. The systematic overview of past changes is necessary not only for the presentation of the development of the expenditure side of the common budget (and thus for showing the changes in the presence of common/community policies), but also for providing a context to (and a basis for a preliminary evaluation of) the current reform ideas of the European Commission; we tackle these ideas focusing their potential consequences for the EU budget. The article ends with concluding remarks.

2. Economic policy objectives and effects of the budget

In general, the budget reallocates the revenues of the state (or of a sub-state/supra-state organisation) in order to be able to finances its expenditures. Revenues are typically constituted by taxes, customs duties and different kinds of contributions; in the case of specific organisations, the revenue structure can also be different.

The (state) budget has three main economic policy effects: stabilisation, allocation and redistribution. Being conscious of the importance of these effects, states use the budget as an active tool of economic and social policy. The direct active macroeconomic role of the state budget emerged in the 1930s as a reaction to the Great Depression of 1929-1933; since then, states also use this tool in order to reach specific economic objectives.

The above general statements are only very partially valid for the EU budget. The reason is that the EU is not a state. In fact, it is a specific international organisation which is closer to a federation than to a centralised structure – however, it is, far from any type of state (being at the same time much more complex than a "simple" international organisation. This unique nature of the integration has consequences on its financing, as well: the tasks and principles described above appear only partly in the EU budget.

The main objective of the EU budget is to finance – in most cases, to contribute to the financing of – EU common policies, agreed upon by the Member States. Its limited size does not allow for the full financing of common policies, still, with its contribution, the EU budget is able to contribute to the development of the integration in the fields where the Member States judge this contribution important.

3. EU budget expenditure: trends and figures

As the development of the integration process has shown considerable differences in different periods, it is not surprising that the development of the EU budget has also reflected these differences. In order to make these differences and the steps taken in the different periods as visible as possible, we tackle the characteristics of the expenditure side of the EU budget in a chronological order, period by period.

3.1. The beginnings: from the domination of CAP to the need for more structural operations

In the first decades of the European integration process, the Common Agricultural Policy (CAP) expenditure was one of the major sources of budgetary conflicts between member states. CAP expenditure still represents close to 30% of the total expenditure of the EU budget; earlier, its share was much higher (in the 1970s, in general, well over 70% - see Table 1 for some characteristic figures). At a time when other common policies had not yet been developed, this expenditure heading had a decisive role on which Member States could see themselves as "winners" and "losers" of the budget.

Obviously, Member States having important agricultural production were more likely to enjoy substantial CAP support than those where agriculture was less important, or in some cases even marginal. The whole story of the UK rebate is also related to this issue; however, there have also been other aspects of the conflicts related to CAP expenditure.

Differences in the structure of agricultural production (related e.g. to the typical farm size and/or the agricultural products produced in the countries) have also resulted in considerable differences in CAP support. Generally, big farms have been more likely to be able to fulfil the requirements in order to be eligible for support, while this can be a much more difficult task for smaller producers. As a result, countries with bigger average size of agricultural units have had better chances for access to more CAP support.

Product structure has also been an important factor. Due to differences in product structure, it could happen that a country with a developed agricultural sector could get more financial support than a country of similar (or even bigger) size with a relatively similarly important but less developed agriculture. As a result, it has been possible for a rich Member State to get more support for its agricultural production than a poor one, while the relative size of their agriculture has been similar (e.g. Denmark and Portugal in the 1990s).

Problems of the CAP have always been intensively discussed, when the member states have tried to get to an agreement on the future of the EU budget. The regular occasions for this debate since 1988 have been the discussions over the mid-term financial perspectives.[6]

The 'monopolistic' situation of the CAP as the by far most important expenditure item of the EU budget was not seriously challenged until the 1980s. Structural operations became somewhat more important after the first enlargement round in 1973, due to the increased territorial and structural differences in the enlarged community. The big jump forward, however, was as a consequence of the Southern enlargement in the 1980s: after the accession of Greece (1981), Portugal and Spain (1986), the territorial and structural differences were substantially increased.

The challenges (and even their anticipation) stemming from this situation have caused turbulences around the EU budget; together with other factors, they were also there behind the deepening of the 'crisis of community finances' (already present since the accession of the UK) in the first half of the 1980s.[7]

The importance of this expenditure heading has been increasing gradually; the big jump forward was made in the late 1980s; from 1988, the Delors I. package has confirmed and systematised the changes.

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[6] In fact, with the exception of the 2007-2013 financial perspective. Of course, CAP was important then, too. However, French President Jacques Chirac and German Chancellor Gerhard Schröder agreed in 2002 on CAP expenditure until 2013. The other Member States – even if they were not happy with the way the issue had been handled – have at last approved the agreement. As a result, the negotiations on the financial perspective 2007-2013 did not include a full-fledged discussion of CAP expenditure (representing at that time close to half of total EU budget expenditure).

[7] On the causes and consequences of this crisis, see European Commission (2014), pp. 25-32.

Table 1. EU budget expenditure by main expenditure areas in selected years before the Delors I. package (payments, euro million, current prices)

Expenditure area/Year	1970	1975	1980	1985
EAGGF Guarantee	3108,1	4327,7	11291,9	19727,8
Structural Actions, of which:	95,4	375,3	1808,5	3702,9
EAGGF Orientation	58,4	76,7	314,6	685,5
ERDF	-	150,0	793,4	1610,0
ESF	37,0	148,6	700,5	1407,4
Research	63,4	115,9	364,2	677,9
External Actions	1,4	250,9	603,9	963,8
Administration	115,3	364,0	829,9	1304,8
Reimbursements and others	1,6	383,1	958,9	1490,1
Total	3385,2	5816,9	15857,3	27867,3

Source: Commission européenne, 2000, pp. 29-30.

3.2. The Delors I. package:1988-1992[8]

On the basis of its two documents issued in 1987 (on the conditions of the successful realisation of the objectives of the Single European Act and on the system of financing the common budget), the European Commission has made its proposals regarding the future orientation and spending of the CAP and of the Structural Funds; the proposals have also dealt with the overall reform of the common budget. It was in 1988 that the reform package (known today as the Delors I. package) was approved and entered into force; since then, it has become a cornerstone in the history of EU finances.

The overall objectives of the Delors I. package have been threefold:

- "Introducing additional resources into the financing of the common budget, in order to assure its smooth functioning in the period 1988–1992;
- On the expenditure side, a considerable increase of the weight of structural operations on the one hand, the limitation of the increase of agricultural expenditure on the other hand;
- A fairer burden-sharing of the member states in the financing of the common budget, so that the shares of the contributions of the member

[8] The description under points 3.2-3.5 uses the wider analysis (including also other aspects of the EU budget) of Szemlér, 2006 as a basis; the analysis of the present paper focuses on the expenditure side of the EU budget, contains additional (newer) information and figures (tables).

> states correspond better to their relative economic development level and power." (Szemlér, 2006, p. 4)

Focusing on expenditure, it is important to note that the ceiling for financing (from 1.15% to 1.20% of the EU total GNP regarding payments; regarding commitments, the ceiling for 1992 was established at 1.30% of EU total GNP) has been increased; the potential increase in spending has made stronger financing of key activities possible.[9]

In order to reduce the tensions accumulated before 1987, ensuring budgetary discipline was of key importance. The Council and, later on, the inter-institutional agreement signed by the Council, the European Commission and the European Parliament) has called on increased discipline regarding all institutions and all categories of expenditure.

The management of financial tensions and discipline require careful planning. In this respect, one of the biggest innovations of the Delors I. package has been the establishment of the institution of the mid-term financial perspective. The first financial perspective (a multiannual framework providing the key figures for the main expenditure items, leaving only 'fine-tuning' for the annual budget negotiations) has been prepared for a five-year period (1988-1992) in order to enhance the stable, predictable and harmonic functioning and development of the common budget.

Regarding expenditure, the limitation of CAP spending was seen as one of the main issues. In order to achieve this, the growth rate of agricultural expenses has been limited: it could not be higher than 74% of the growth rate of the total EU GNP. The treatment of agricultural stocks has also been modified; depreciation rules were of key importance in this respect. A monetary reserve has also been created in order to handle the effects (if necessary) of the changes in the USD/ECU exchange rate.

The other big issue related to expenditure has been the reform of structural operations. The objective has been to ensure the coordinated, effective and efficient use of the Structural Funds. The importance of the issue dramatically increased in the 1980s, as a result of the southern enlargement(s) of the EU.

The reaction has been a rapid increase in the financing of structural operations (see Table 2). It is also important that the package has included some key principles (concentration, programming, partnership and additionality) as well as a system of objectives for the use of the Structural Funds. The funds

[9] Of course, this step also required financing: the introduction of the GNP-resource (today: GNI-resource) has been of key importance in this respect.

could be used – in a co-ordinated form – in order to finance actions focusing on these objectives.

Table 2. Key figures of the financial perspective 1988-92 (based on the Interinstitutional Agreement of 29 June 1993 on budgetary discipline and improvement of the budgetary procedure)

Appropriations for commitments (million ECU at 1988 prices)	1988	1989	1990	1991	1992
1. EAGGF Guarantee	27 500	27 700	28 400	29 000	29 600
2. Structural operations	7 790	9 200	10 600	12 100	13 450
3. Policies with multiannual allocations (IMPs, research)	1 210	1 650	1 900	2 150	2 400
4. Other policies	2 103	2 385	2 500	2 700	2 800
of which: non-compulsory	1 646	1 801	1 860	1 910	1 970
5. Repayments and administration	5 700	4 950	4 500	4 000	3 550
(including financing of stock disposal)	1 240	1 400	1 400	1 400	1 400
6. Monetary reserve	1 000	1 000	1 000	1 000	1 000
Total	45 303	46 885	48 900	50 950	52 800
of which: compulsory	33 698	32 607	32 810	32 980	33 400
of which: non-compulsory	11 605	14 278	16 090	17 970	19 400
Payment appropriations required	43 779	45 300	46 900	48 600	50 100
of which: compulsory	33 640	32 604	32 740	32 910	33 110
of which: non-compulsory	10 139	12 696	14 160	15 690	16 990
Payment appropriations as % of GNP	1.12	1.14	1.15	1.16	1.17
Margin for unforeseen expenditure	0.03	0.03	0.03	0.03	0.03
Own resources required as % of GNP	1.15	1.17	1.18	1.19	1.20

Source: European Commission, 2008, p. 39.

3.3. Consolidation and fine-tuning: The Delors II. package (1993-1999)

The proposal of the European Commission for a new inter-institutional agreement as well as for a new financial perspective has put emphasis on the actualisation needs that occurred due to the following reasons:

- "The financial consequences of the reform of the Common Agricultural Policy in 1992 had to be taken into account;
- The experiences of the Structural Funds had to be evaluated, new regulation had to be formulated;
- The efficient functioning of the Single European Market as well as the international role of the Community necessitated changes;
- The consequences of the Treaty of Maastricht had to be handled adequately: the management of the Cohesion Fund and the financing of new Community tasks." (Szemlér, 2006, p. 6)

As a result of the agreement reached between the Member States at the European Council in Edinburgh on 11-12 December 1992, a gradual increase of the ceiling for own resources has been approved, according to which for 1999, the ceiling was established at 1.27% of EU GNP regarding appropriations for payments (including 0.01 % points reserved for unforeseen expenditure), at 1.335% of EU GNP regarding appropriations for commitments.

Modifications on the expenditure side (see Table 3) included the following measures:

- Agriculture: The limit of the increase of expenditure remained valid, and concerned all CAP expenditure. Monetary reserves (to handle the effects of possible changes in the USD/ECU exchange rate) decreased to ECU 500 million/year from 1995;
- Structural operations: The financing of this expenditure heading increased by 75% until 1999 (1992: ECU 17 billion, 1999: ECU 30 billion). Concentration has increased in structural operations (the weight of Objective 1 (focusing on the neediest regions of the EU has increased). The Cohesion Fund has been created; its objective has been to provide help to the least developed Member States (at that time: Greece, Ireland, Portugal and Spain) in developing infrastructure in the period of preparation for the Economic and Monetary Union (EMU);
- Internal policies: expenditure increased by 30% during the 7-year period; priorities were research and development (about 2/3 of total expenditure for internal policies) and Trans-European Networks (TEN).
- External actions: Two new reserves have been introduced: the so-called emergency and guarantee reserves. Expenditure for this heading increased by 55% between 1993 and 1999.
- Administration: Strict budgetary limits remained in force for this heading.

Table 3. Key figures of the financial perspective 1993-1999 (appropriations for commitments (million ECU at 1992 prices)

	1993	1994	1995	1996	1997	1998	1999
1. Agricultural guideline	35 230	35 095	35 722	36 364	37 023	37 697	38 389
2. Structural operations	21 277	21 885	23 480	24 990	26 526	28 240	30 000
— Cohesion Fund	1 500	1 750	2 000	2 250	2 500	2 550	2 600
— Structural Funds and other operations	19 777	20 135	21 480	22 740	24 026	25 690	27 400
3. Internal policies	3 940	4 084	4 323	4 520	4 710	4 910	5 100
4. External action	3 950	4 000	4 280	4 560	4 830	5 180	5 600
5. Administrative expenditure	3 280	3 380	3 580	3 690	3 800	3 850	3 900
6. Reserves	1 500	1 500	1 100	1 100	1 100	1 100	1 100
— Monetary reserve	1 000	1 000	500	500	500	500	500
— External action							
● emergency aid	200	200	300	300	300	300	300
● loan guarantees	300	300	300	300	300	300	300
Total appropriations for commitments	69 177	69 944	72 485	75 224	77 989	80 977	84 089
Appropriations for payments required	65 908	67 036	69 150	71 290	74 491	77 249	80 114
Appropriations for payments (% GNP)	1.20	1.19	1.20	1.21	1.23	1.25	1.26
Margin for unforeseen expenditure (% GNP)	0.01	0.01	0.01	0.01	0.01	0.01	
Own resources ceiling (% GNP)	1.20	1.20	1.21	1.22	1.24	1.26	1.27
Pro memoria: total external expenditure	4 450	4 500	4 880	5 160	5 430	5 780	6 200

Source: European Commission, 2008, p. 56.

The period 1993-1999 brought some new challenges that added to the actualisation needs we have already listed. Despite these challenges (the Europe-wide recession in 1992-1993 and the management of the enlargement with Austria, Finland and Sweden in 1995) the Delors II. package proved to be successful. It consolidated the achievements of its predecessor, and it was able to adapt the reforms to the new – partly visible in advance, partly unforeseen – challenges of the 1990s.

3.4. Preparing for the Eastern enlargement: 2000-2006

Beyond the 'traditional' challenges, the 2000-2006 financial perspective had to deal with an unprecedented event: the Eastern enlargement of the EU. The main difficulties at the time of the preparation of the financial perspective for the period 2000-2006 can be summarised as follows:

- "Decisions had to be taken at the same time on the mid-term financial perspective and on the reform of the Common Agricultural Policy and of the structural operations;
- Due to the stability requirements of the Economic and Monetary Union (the Maastricht criteria), there was no readiness for increasing the ceiling of own resources;
- The problem of unbalanced positions vis-a-vis the EU budget has become more important (concerned more member states) than before;
- The budget had to provide adequate resources for the eastward enlargement of the EU; to make this task even more complicated, the time and the magnitude of enlargement was unknown." (Szemlér, 2006, p. 8)

In July 1997, the European Commission published the document "Agenda 2000: For a stronger and wider Union" (European Commission, 1997), in which it outlined its ideas regarding the mid-term future development of the European integration process as well as the financing of the future (already enlarged) EU. The debates lasted almost two years, and it was in Berlin, 24-25 March 1999 where the European Council fixed an agreement regarding the financial perspective 2000-2006. Concerning expenditures, the most important elements of the agreement have been the following:

- The stabilisation of Community finances: The ceiling of 1.27% of Community GNP remained valid for payments, while expenditure for the EU-15 decreased from 2003 (to 0.97% of total EU GNP in 2006); thus, both spending on enlargement and budgetary discipline regarding the old Member States were part of the solution. The practical reason of such a solution was that a part of earlier commitments was to be paid in the period 2000-2006; for new commitments, due to the already mentioned reasons (net positions, budgetary discipline) a stricter limit has had to be applied.

- Main expenditure categories:

  - Agriculture: The framework (EUR 298 billion for the 2000-2006 financial perspective) has become lower than the amount initially proposed by the European Commission. The ceiling of expenditure on agriculture has been based not on the guideline, but on the calculated questions taking into account reform measures (SAPARD expenditure has also been part of the calculation). Sub-ceilings have been introduced for market intervention expenditure and rural development.

Intervention prices have decreased less than they would have done according to the initial proposal of the European Commission. As a consequence, the amount accessible for compensation for the price decrease has also become smaller.

Some proposals of the Commission related to agricultural expenditure have not been accepted: The co-financing of direct payments by the Member States (one of the potentially fundamental changes in the proposal) has been rejected as well as the degressivity (in time or according to farm size) of direct payments.

- Structural operations: The amounts agreed upon have become considerably smaller than the figures of the initial proposal of the European Commission. Under the financial perspective 2000-2006, EUR 195 billion have been accessible for the Structural Funds, while for the countries entitled to support from the Cohesion Fund EUR 18 billion (beyond Structural Funds transfers) has been available for the same period. The proposals of the European Commission related to the concentration (the modification of the system of the Objectives – a reduction of their number) and distribution of the Structural Funds as well as related to the regulation concerning their utilisation have been accepted.

- Other expenditure categories: Considerably lower ceilings than initially proposed by the European Commission for internal policies, external actions and administration have been agreed upon. The amounts proposed for the pre-accession funds (PHARE, SAPARD and ISPA) as well as the estimated budgetary costs of enlargement have been accepted without changes (the only difference between the figures for these items in the Agenda 2000 and in the Presidency Conclusions of the 1999 Berlin European Council are due to the different prices used (1997 prices in the Agenda 2000, 1999 prices in the Presidency Conclusions).

The preparation for the Eastern enlargement has also necessitated an innovative technical solution for the way the financial perspective has been planned. Table 4 presents us with the financial perspective of the EU-15; in this table, the Eastern enlargement has been 'separated' from the expenditures planned for the EU-15 (but these expenditures have included the financing of the pre-accession funds – these can be conceived as a special form of action of the EU-15 outside the EU). A separate table, presenting the hypothetical financial perspective for the EU-21 has also been prepared.

Table 4. Financial perspective of the EU-15, 2000–2006 (EUR million, 1999 prices, appropriations for commitments)

	2000	2001	2002	2003	2004	2005	2006
1. AGRICULTURE	**40 920**	**42 800**	**43 900**	**43 770**	**42 760**	**41 930**	**41 660**
CAP expenditure (excluding rural development)	36 620	38 480	39 570	39 430	38 410	37 570	37 290
Rural development and accompanying measures	4 300	4 320	4 330	4 340	4 350	4 360	4 370
2. STRUCTURAL OPERATIONS	**32 045**	**31 455**	**30 865**	**30 285**	**29 595**	**29 595**	**29 170**
Structural Funds	29 430	28 840	28 250	27 670	27 080	27 080	26 660
Cohesion Fund	2 615	2 615	2 615	2 615	2 515	2 515	2 510
3. INTERNAL POLICIES	**5 900**	**5 950**	**6 000**	**6 050**	**6 100**	**6 150**	**6 200**
4. EXTERNAL ACTION	**4 550**	**4 560**	**4 570**	**4 580**	**4 590**	**4 600**	**4 610**
5. ADMINISTRATION	**4 560**	**4 600**	**4 700**	**4 800**	**4 900**	**5 000**	**5 100**
6. RESERVES	**900**	**900**	**650**	**400**	**400**	**400**	**400**
Monetary reserve	500	500	250	0	0	0	0
Emergency aid reserve	200	200	200	200	200	200	200
Guarantee reserve	200	200	200	200	200	200	200
7. PRE-ACCESSION AID	**3 120**	**3 120**	**3 120**	**3 120**	**3 120**	**3 120**	**3 120**
Agriculture	520	520	520	520	520	520	520
Pre-accession structural instrument	1 040	1 040	1 040	1 040	1 040	1 040	1 040
PHARE (applicant countries)	1 560	1 560	1 560	1 560	1 560	1 560	1 560
TOTAL APPROPRIATIONS FOR COMMITMENTS	**91 995**	**93 385**	**93 805**	**93 005**	**91 465**	**90 795**	**90 260**
TOTAL APPROPRIATIONS FOR PAYMENTS	**89 590**	**91 070**	**94 130**	**94 740**	**91 720**	**89 910**	**89 310**
Appropriations for payments as % of GNP	1.13%	1.12%	1.13%	1.11%	1.05%	1.00%	0.97%
AVAILABLE FOR ACCESSION (appropriations for payments)			**4 140**	**6 710**	**8 890**	**11 440**	**14 220**
Agriculture			1 600	2 030	2 450	2 930	3 400
Other expenditure			2 540	4 680	6 440	8 510	10 820
CEILING ON APPROPRIATIONS FOR PAYMENTS	**89 590**	**91 070**	**98 270**	**101 450**	**100 610**	**101 350**	**103 530**
Ceiling on appropriations for payments as % of GNP	1.13%	1.12%	1.18%	1.19%	1.15%	1.13%	1.13%
Margin	0.14%	0.15%	0.09%	0.08%	0.12%	0.14%	0.14%
Own resources ceiling	**1.27%**	**1.27%**	**1.27%**	**1.27%**	**1.27%**	**1.27%**	**1.27%**

Source: European Council, 1999, Table A.

The reason for this differentiated handling of the enlargement has been the unknown date and magnitude of the enlargement (when, how many and which countries will join?). By ring-fencing the figures for enlargement, the EU has made sure of two important things: 1. the amounts planned to finance the enlargement could not be used for other purposes; 2. the eventual changes in the enlargement scenario (the scenario used for the financial perspective was that 6 countries (the so-called Luxembourg Group)[10] would join the EU

[10] Cyprus, the Czech Republic, Estonia, Hungary, Poland and Slovenia.

on 1 January 2002) could not endanger the realisation of the financial perspective for the EU-15 (without the figures for enlargement). As it turned out, this flexible solution had not only theoretical, but also practical importance: instead of 6 countries joining the EU on 1 January 2002, 10 countries[11] have become EU Member States on 1 May 2004. The financing of enlargement has been modified, while the financial perspective of the EU-15 (without the original figures of enlargement) has smoothly been realised.

3.5. Competitiveness in focus: 2007-2013

The negotiations on the 2007-2013 financial perspective have been full of tensions. Six net contributor countries (Austria, France, Germany, the Netherlands, Sweden and the UK have sent a letter to the President of the European Commission (Romano Prodi) on 15 December 2003 stating that they were not ready to accept a budget exceeding 1% of EU GNI. The letter was an early warning about the intensity and the nature of the debates that we could witness in the following two years.

The main issues of the debate have been the following:

- Net positions (emphasised during the negotiations mostly by the Netherlands and Sweden).
- The UK rebate – the (then) UK Prime Minister Tony Blair has made clear that he is only ready to negotiate about a decrease/limitation of the rebate if this change is combined with a decrease in CAP expenditure.
- CAP expenditure – as the amounts accessible for the financing of the CAP have been agreed by France and Germany (and after them, by the other Member States) much earlier, the issue was not reopened.

In June 2005, the representatives of the Member States failed to find an agreement. Half a year later – under UK Presidency – a compromise was reached. Despite the important (partly symbolic) changes in the names of the expenditure items, the 'minimalistic' approach (concentrating on the net positions) resulted in minimal results. In fact, for the expenditure side of the EU budget, no systemic changes, but a high number of country-specific exceptions were reached.

If the operation can still be considered more than 'optical tuning', it is due to two important changes: 1. the appearance of competitiveness, and that as part of the first expenditure heading; 2. the change in the place of agricultural expenditure in the EU budget: both its position (from Heading 1 to a sub-

[11] The countries of the Luxembourg Group plus Latvia, Lithuania, Malta and Slovakia.

heading of Heading 2) and its size (losing the first place that it had always occupied before) reflect its diminishing (but, of course, still not at all negligible) importance (see Table 5).

The world financial and economic crisis has clearly shown that the efforts in order to consolidate the results of the European integration process (among them the most tangible result, the single currency) were far from being satisfactory. The task to draw the lessons of the crisis (or even crises) remained for the next financial perspective.

Table 5. Overview of the financial perspective 2007-2013 (appropriations for commitments, EUR million, 2004 prices)

	2007	2008	2009	2010	2011	2012	2013	Total 2007-2013
1. Sustainable Growth	51 267	52 415	53 616	54 294	55 368	56 876	58 303	382 139
1a. Competitiveness for Growth and Employment	8 404	9 097	9 754	10 434	11 295	12 153	12 961	74 098
1b. Cohesion for Growth and Employment	42 863	43 318	43 862	43 860	44 073	44 723	45 342	308 041
2. Preservation and Management of Natural Resources	54 985	54 322	53 666	53 035	52 400	51 775	51 161	371 344
of which: market related expenditure and direct payments	43 120	42 697	42 279	41 864	41 453	41 047	40 645	293 105
3. Citizenship freedom security and justice	1 199	1 258	1 380	1 503	1 645	1 797	1 988	10 770
3a. Freedom Security and Justice	600	690	790	910	1 050	1 200	1 390	6 630
3b. Citizenship	599	568	590	593	595	597	598	4 140
4. EU as a global player	6 199	6 469	6 739	7 009	7 339	7 679	8 029	49 463
5. Administration (1)	6 633	6 818	6 973	7 111	7 255	7 400	7 610	49 800
6. Compensations	419	191	190	0	0	0	0	800
TOTAL COMMITMENT APPROPRIATIONS	120 702	121 473	122 564	122 952	124 007	125 527	127 091	864 316
as a percentage of GNI	1.10%	1.08%	1.07%	1.04%	1.03%	1.02%	1.01%	1.048%
TOTAL PAYMENT APPROPRIATIONS	116 650	119 620	111 990	118 280	115 860	119 410	118 970	820 780
as a percentage of GNI	1.06%	1.06%	0.97%	1.00%	0.96%	0.97%	0.94%	1.00%
Margin available	0.18%	0.18%	0.27%	0.24%	0.28%	0.27%	0.30%	0.24%
Own-Resources Ceiling as a percentage of GNI	1.24%	1.24%	1.24%	1.24%	1.24%	1.24%	1.24%	1.24%

(1) The expenditure on pensions included under the ceiling for this heading is calculated net of the staff contributions to the relevant scheme, within the limit of EUR 500 million at 2004 prices for the period 2007-2013.

Source: European Commission, 2014, p. 85.

3.6. Competitiveness, reactions to the crisis: 2014-2020

The 2014-2020 financial perspective was born in turbulent times: as a result of the consequences of the 2008 world financial and economic crisis in general, and also as a result of the following crisis of the Eurozone (the sovereign debt crisis in some Member States), a reinforcement of the EU budget for unforeseen situations seemed logical, as well as the elaboration of systemic reactions to the lessons learned from the crisis.

These reactions have actually been realised – but even those that had (sometimes very important) direct financial consequences have not appeared in the EU budget.[12] The debates continued to focus on competitiveness: the document that has made the initial proposal of the European Commission public was entitled "A budget for Europe 2020" (European Commission, 2011)[13].

Table 6 presents an overview of the 2014-2020 financial perspective. In the names of the headings, we can discover some keywords of the Europe 2020 Strategy (smart, inclusive, sustainable), but in other respects, we cannot see major changes regarding the content of the items. There have been some visible changes in the shares of the individual expenditure items: while 'Economic, social and territorial cohesion' as well as 'Sustainable Growth: Natural Resources' (including CAP-related expenditure) have seen their share decreasing, all other headings have experienced an increase compared to the previous financial perspective (see Table 7).

Looking at the rate of increase, it has been high in the case of 'Competitiveness for Growth and Jobs' and 'Security and Citizenship'. In the case of the latter, an important reason is the low basis, but the increase still demonstrates the pressure for more attention (and also EU spending). In the case of 'Competitiveness for Growth and Jobs', we can see an expenditure item whose share in total expenditure (payment appropriations) has increased from 9.2% during the period 2007-2012 to 13.1% in the financial perspective for the period 2014-2020. However, even the increased share of 'Competitiveness for Growth and Jobs' means that about 0.0013% of EU GNI is spent for this item in the EU budget. Size does matter – and the limited size

[12] The big 'rescue packages' for the Member States in trouble have been put together well before the 2014-2020 financial perspective, but part of them already parallel with the preparations for the negotiations on it.

[13] Europe 2020 has been the – in many respects restructured – continuation of the Lisbon Strategy.

of the EU budget limits its contribution to the realisation of the EU's objectives.

Table 6. Overview of the financial perspective 2014-2020 (appropriations for commitments, EUR million, 2011 prices)

	2014	2015	2016	2017	2018	2019	2020	Total 2014–2020
1 Smart and inclusive growth	60 283	61 725	62 771	64 238	65 528	67 214	69 004	450 763
1a Competitiveness for growth and jobs	15 605	16 321	16 726	17 693	18 490	19 700	21 079	125 614
1b Economic, social and territorial cohesion	44 678	45 404	46 045	46 545	47 038	47 514	47 925	325 149
2 Sustainable growth: natural resources	55 883	55 060	54 261	53 448	52 466	51 503	50 558	373 179
Of which: market related expenditure and direct payments	41 585	40 989	40 421	39 837	39 079	38 335	37 605	277 851
3 Security and citizenship	2 053	2 075	2 154	2 232	2 312	2 391	2 469	15 686
4 Global Europe	7 854	8 083	8 281	8 375	8 553	8 764	8 794	58 704
5 Administration	8 218	8 385	8 589	8 807	9 007	9 206	9 417	61 629
Of which: administrative expenditure of the institutions	6 649	6 791	6 955	7 110	7 278	7 425	7 590	49 798
6 Compensations	27	0	0	0	0	0	0	27
Total commitment appropriations	134 318	135 328	136 056	137 100	137 866	139 078	140 242	959 988
As a percentage of GNI	1.03 %	1.02 %	1.00 %	1.00 %	0.99 %	0.98 %	0.98 %	1.00 %
Total payment appropriations	128 030	131 095	131 046	126 777	129 778	130 893	130 781	908 400
As a percentage of GNI	0.98 %	0.98 %	0.97 %	0.92 %	0.93 %	0.93 %	0.91 %	0.95 %
Margin available	0.25 %	0.25 %	0.26 %	0.31 %	0.30 %	0.30 %	0.32 %	0.28 %
Own Resources Ceiling as a percentage of GNI	1.23 %	1.23 %	1.23 %	1.23 %	1.23 %	1.23 %	1.23 %	1.23 %

Source: European Council, 2013, p. 46.

Payment appropriations in the period 2014-2020 reach only 0.95% of EU GNI, while commitment appropriations just reach 1.00% of EU GNI (see Table 6). As a consequence, the total amount (of both payment and commitment appropriations) is smaller than in the previous financial perspective (calculated at 2011 prices for both periods; see Table 7).

Table 7. The expenditure side of the EU budget: 2014-2020 compared with 2007-2013 (in 2011 prices; structure of expenditures according to the headings of the 2014-2020 period)

	MFF 2014-2020	MFF 2007-2013	Comparison 2014-2020 vs. 2007-2013	
Commitment appropriations	*EUR mn*	*EUR mn*	*EUR*	%
1. Smart and Inclusive Growth	450.763	446.310	+4.5bn	+1.0%
1a. Competitiveness for Growth and Jobs	125 614	91 495	+34.1bn	+37.3%
1b. Economic, social and territorial cohesion	325 149	354 815	-29.7bn	-8.4%
2. Sustainable Growth: Natural Resources	373 179	420 682	-47.5bn	-11.3%
3. Security and Citizenship	15 686	12 366	+3.3bn	+26.8%
4. Global Europe	58 704	56 815	+1.9bn	+3.3%
5. Administration	61 629	57 082	+4.5bn	+8%
6. Compensations	27	n/a	+0.027bn	n/a
Total commitment appropriations	959 988	994 176	-35.2bn	-3.5%
as a percentage of GNI	*1.00%*	*1.12%*		
Total payment appropriations	908 400	942 778	-34.4bn	-3.7%
as a percentage of GNI	*0.95%*	*1.06%*		

Source: EU multiannual financial framework (MFF 2014-20), 2013, p. 3.

This is an unprecedented situation meaning that despite the deepening of the integration process (with EU policies becoming more and more complex) and despite the widening of the EU (with 28 Member States, the EU has more Members than ever before), the size of the budget has diminished in absolute terms. It means that today, four decades after the publication of the MacDougall Report (European Commission, 1977) that proposed a considerable increase of the relative size of the EU budget, we are far from even taking steps in that direction. Major reforms of the EU budget are still to be implemented.

4. 2017: Reform ideas concerning the expenditure side

It was in the middle of the 2014–2020 MFF that – as a reaction to the shock caused by the prospect of Brexit, after months of preparations – the European Commission published its 'White Paper on the Future of Europe' (European Commission, 2017a) on 1 March 2017. The document outlines five scenarios for the future development of the EU, ranging from a minimalist approach ('Nothing but the Single Market') through different scenarios (continuing the integration process more or less as it is managed now: 'Carrying on'; focusing on less areas: 'Doing less more efficiently'; allowing for differentiated (or multi-speed) integration: 'Those who want more do more') to a scenario of a considerable deepening of the integration with the participation of all Member States in all fields ('Doing much more together') (European Commission, 2017a, pp. 16–25).

During the months following the publication of the White Paper, the European Commission has published a series of so-called Reflection Papers, outlining in more detail the consequences of the various scenarios for different fields of the integration process. The 'Reflection Paper on the Future of EU Finances' (European Commission, 2017c) was published on 28 June 2017.[14]

The main characteristics of its scenarios (corresponding to the scenarios of the White Paper, with slight differences in their names) are presented in Table 8. We can see that under scenario 1 we can expect the EU budget to be about the same size as today. Scenarios 2 and 4 would result in an EU budget that is smaller than today, while scenarios 3 and 5 would result in a bigger EU budget.

The shares of the expenditure items are highly scenario-dependent. While (except for the 'idealistic' scenario 5) agricultural and cohesion expenditure are expected to lose from their actual shares (and potentially also in absolute terms), the future of the other items depends very much on the scenario applied.

[14] It has to be noted that two of the scenarios of the 'Reflection Paper on the Future of EU Finances' have closely been connected with the 'Reflection Paper on the Deepening of the Economic and Monetary Union' published by the European Commission on 31 May 2017 (European Commission, 2017b).

Table 8. Prospects for the large EU spending areas according to the 5 scenarios – by the European Commission

SCENARIOS	1 Carrying on	2 Doing less together	3 Those who want more do more	4 Radical redesign	5 Doing much more together
POLICY PRIORITIES	Taking forward current reform agenda	Mainly financing of functions needed for the single market	As in Scenario 1; additional budgets are made available by some Member States for the areas where they decide to do more	Financing of priorities with very high EU value added	Doing much more across policy areas
VOLUME	Broadly stable	Significantly lower	Somewhat higher	Lower	Significantly higher
COMPETITIVENESS	Slightly higher share	Same as in scenario 1 but significantly lower amount	Same as in scenario 1	Higher share	Higher share
ECONOMIC, SOCIAL AND TERRITORIAL COHESION	Lower share	Lower amount	Same as in scenario 1	Lower share	Higher amount
AGRICULTURE	Lower share	Lower amount	Same as in scenario 1	Lower share	Higher amount
SECURITY, DEFENCE, MIGRATION	Higher share	No funding	Higher share partly covered by willing Member States	Significantly higher share	Significantly higher share
EXTERNAL ACTION	Higher share	Lower amount	Higher share partly covered by willing Member States	Significantly higher share	Significantly higher share
ECONOMIC AND MONETARY UNION FISCAL CAPACITY			Macro-economic stabilisation function for euro area Member States		Macro-economic stabilisation function and a European Monetary Fund
REVENUE	Current system without rebates; other sources of revenue or fees finance the EU budget	Current system without rebates	Same as scenario 1; plus new policies financed only by participating Member States	Scenario 1 further simplified; new own resources	In depth reform beyond scenario 4; new own resources finance significant share of the EU budget

Source: European Commission, 2017c, p. 38.

The scenarios contain some potential new (or modified) expenditure items, thus pointing to different accents. It has to be noted that many more such items could be conceived[15]; the fact that the document of the European Commission includes some such items (Security, defence, migration (the new thing is that – as a reaction to the mass immigration to Europe – migration is named in the title of the item); Economic and Monetary Union fiscal capacity (something totally new)) means that they are considered seriously.

The rubrics related to the future of the EMU deserve special attention. According to scenarios 3 and 5, EMU can be equipped with support from the EU budget; under scenario 3, "macro-economic stabilisation function for euro area Member States", under scenario 5, "macro-economic stabilisation function and a European Monetary Fund" is mentioned. These options were subject to lively discussion during the second half of 2017; the discussion demonstrated that there is a non-negligible political support behind the ideas.[16]

5. Concluding remarks

The EU budget has the task of providing financial support to EU policies, jointly agreed by the member States of the EU. After the panorama of the development of the expenditure side of the EU budget during almost five decades, we can ask whether the EU budget is able to fulfil this task.

The answer to the question is a kind of 'yes, but'. The EU budget has contributed to the development of a number of key EU policies, helping the development of the integration process; CAP, structural and cohesion policies, lately competitiveness being the most important examples.

The budget could also (at least partially) follow the development of integration: this possibly is a reaction to (if not optimally, at least adequately) challenges such as the Southern and the Eastern enlargements. Despite all debates, tensions and changes, the functioning of the budget has been continuous, and, since 1988, this continuity has had no serious threats.

[15] See e.g. Szemlér–Eriksson, 2008 for ideas (stemming from a questionnaire survey and from country reports).

[16] The most spectacular evidence of this has been the speech of Emmanuel Macron on 26 September at the Sorbonne; speeches of EU leaders (including the President of the European Commission, Jean-Claude Juncker) and also reactions from Germany (including a non-paper from (former) Minister of Finances, a key figure of the history of the EMU, Wolfgang Schäuble) are also signs of the existence of political will to move forward in this respect; see Macron, 2017; Non-paper for paving the way towards a Stability Union, 2017.

With all these positive things in mind, we still cannot evaluate the fulfilment of the task positively. Despite all the positive developments, many fields of integration have had only minor shares in the EU budget or had no share at all; the most striking example for the latter is the absence of EMU from the EU budget. It has in most cases been very hard to achieve substantial changes in the structure of expenditure, even when changes in the world (and the resulting challenges) could have desired a firm reaction.

Considerations linked to net positions of Member States have led many times to compromises that have not solved the real (sometimes not even new) problems but only gained some time (of course, we should not deny that this can be in some cases also important, but if such solutions become rather the rule than exceptions, they can make the system less and less transparent and less and less open for reform).

In 2017, the European Commission and leaders of EU Member States expressed their intention to change the way integration is functioning today. At the moment, we don't know how far this momentum – born as a reaction to serious challenges – will bring the EU; one thing is clear: by now, it has created such an opportunity for reform that has not been seen in Europe for many years.

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Opinion & Reviews

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Europe – as the Germans manage it

Review of Paul Lever: Europe and the German Way. Berlin rules. I.B. Tauris & Co. Ltd, London, 2017

Following the Brexit-referendum it is especially timely to examine how the United Kingdom regarded and regards the development and the future of European integration, how it related to the changes of power structure within the European Union to the growing importance of Germany and how big a role this factor played in the outcome of the referendum and in the formation of the exit-conditions.

Sir Paul Lever, the author of the book, a former ambassador (between 1997 and 2003) of the UK to Berlin with wide-ranging diplomatic experience in the functioning of the European integration took on the task of presenting the British view.

"Now we're speaking German." The author opens with this quote by Volker Kauder, leader of the parliamentary group of the Christian Democratic Union (CDU) party, from his speech of November 2011. At the same time, it is one of the assumptions of the volume, whereby in the first twenty years of the European integration it developed the French way. Later, the German-French axis determined its path but by the creation of the internal market and with the introduction of the euro the economic giant Germany had a stronger political and controlling role. During the presidency of Francois Hollande – especially after France allied with Italy and Spain regarding the Fiscal Pact and put pressure on its former ally – Germany became the indisputable leading power of the European Union. This power is proven by the German key role in the management of the sovereign credit crisis in some member countries of the eurozone, in the handling of the conflict in the Ukraine or regarding the responses to the refugee crisis.

Germany, as the author claims, fundamentally owes it to herself and to the diligence, work ethics and to the planning competence of the German people that following the World War II ("Fleiss"). Germany could not only recover, but by establishing the unique model of the "Rhineland capitalism" based on American, French and Scandinavian examples, could become one of the leading economic powers in the world and the first in Europe. The key elements of this model are maintaining competition, creating a social partnership, realizing a practice-oriented education system in cooperation with companies, and an independent system of institutions (the independence is demonstrated by the location of the institutions: the Bundesbank in Frankfurt am Main, the Bundeskartellamt (Competition Authority) in Bonn and the Bundesverfassungsgericht (Federal Constitutional Court) in Karlsruhe). In becoming an economic powerhouse France played a role according to Lever as the French tried to use the strengths of the German economy in a way that the European integration could profit from them. In reality, it was Germany who mainly benefited from the realization of the internal market and of the economic and monetary union.

Germany planned its export expansion consciously supported by its Chambers. At the helm of the foreign daughter companies there were almost exclusively German professionals, likewise in the leadership of the concerns and in the supervisory boards as well. The employee representatives on the supervisory boards are also exclusively German, they are deciding on structural changes and on the closure of foreign production units. Several German corporations started out as family businesses and have become international corporations, but the headquarters of the company is still located in the leading German company.

In the same way, careful German planning could utilise the influx of large numbers of Italian, Greek, Yugoslavian and later Turkish guest-workers ("Gastarbeiter"). Following the 2004 enlargement of the EU, and the influx of Polish workers into the economy, Germany tried to organize the education and the employment of more than one million refugees arriving after 2015, even if the sentences of the Chancellor encouraging them were more and more criticised and regarded as a mistake.

The author borrows and adapts the title of the movie of the Finnish filmmaker Aki Kauriskämi and characterises Germany as "A Land without a Past". There is truly no other country with such a public recognition of past evil committed in the country's name. It stems from this fact that Germany did not really aspire to play a leading role in the foreign and security affairs of the European

Union, which is mainly dominated by the French-British duo at both European and international level. Also, Germany did not get involved in any armed conflicts for a long time. At the same time European integration provided the opportunity for this country without a past to face the past, and for the German people to feel equal to their European counterparts and to work for a common European future. The European Union is the guarantee for Germans of stability and security in Europe.

Lever is more convinced than the general consensus in the professional literature that the European Union, and its institutional system, is operating completely according to the German model and logic and is working practically under German control. In his opinion the European Council mirrors the German federal government, the European Parliament shows similar characteristics to the federal legislature (Bundestag), the Council can be compared to the federal council (Bundesrat), whereas the Court of Justice of the EU can be likened to the German constitutional court (Bundesverfassungsgericht). More importantly, besides getting the most representatives from Germany into the European Parliament, there was also the case that both the president and the leader of the largest political group of the EP were German representatives. We can find German leaders at the helm of several Directorates General of the European Commission and it is enough to think about the appointment of Martin Selmayr in 2018 to the position of General Secretary in the Commission. Maybe Levers claims sound slightly extravagant, but the German point of view is undoubtedly a determining factor in the decision making of the EU and the leading economic powerhouse is ever more convinced about the correctness of its path and decisions. The author's criticism is completely justified concerning not only Germany but also in wider sense the leading politicians of the EU and of its institutions: while the founding fathers had their vision and goals, now the European Union is concentrating on the actual challenges and even the supporters of the formation of the political union are not able to tell us exactly what they mean by political integration. Nevertheless, we cannot have illusions: all member states including Germany are trying to represent their own interests concerning the policies of the European Union.

The relationship between the "reluctant hegemon" and the "reluctant partner", as the professional literature calls Germany and the UK, was problematic even immediately after the WW II, the author here alludes to the decision of the leaders of the British occupation zone by which Konrad Adenauer lost his mayorship of Cologne. One notable exception could be the relationship between Gerhard Schröder and Tony Blair. According to Lever the German hegemony, the German resistance concerning the renegotiation of the British EU membership played a definite role in Brexit. At the same time Germany and German interests will have a definite say in determining the conditions of the Brexit which will have serious implications for the European Union and Germany as well. Lever says Germany will lose a natural ally regarding the common budget and foreign policy, and after the Brexit the role of France, as the sole EU member in the UN Security Council will strengthen in the field of the foreign and security policy.

At the end of the book the author arrives at a question about the future: what is to be expected in the EU under German leadership in the next 20 years? Lever foresees that an enlarged eurozone will form the core of the EU. The stability of the euro is a crucial point for Germany. To prevent illegal migration and to defend the outer borders the EU will have to bring forth common actions at the European level. A permanent military headquarters will be established in the EU which will take part in more low-intensity military operations outside the territory of the member states. The EU will certainly not become a transfer union, neither will there be a European bond, but the fiscal rigour will remain, and the German will try to continue the process of the tax harmonization. Berlin is not interested in the reform of the present institutional system of the EU, so, no development can be expected in this field. The assumption whereby that the single market of the services will not be fully established because of the adverse interests of Germany is debatable since Germany considers digitalization as one of the largest challenges concerning the competitiveness of the country and of the whole European Union. This is the point, the main economic challenge for Germany and for the EU, which is not discussed in the book.

The volume of the former British ambassador with personal experiences and stories from Germany is fairly a useful, informative, arresting and entertaining read for researchers, lecturers, students and for all interested in the connections of the European integration and the German path and model.