Patterns of Integration and Disintegration in Central and Eastern Europe

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Rapid economic growth and increasing income are essential elements of domestic political stability and friendly relationship with neighboring countries. Economic difficulties, the growing share of the poor, or the unexpectedly slow progress of living standards have often given rise to social unrests, political instability, or the emergence of populism and nationalism. Historical experience also warns that economic hardships that destroy perspective and cause domestic political turmoil have also led to international conflicts. Dynamic economic development helps keep people content, and in periods of growth politicians are less tempted to pursue populist and/or nationalistic policies. The correlation between political stability and economic growth is often questioned, but it is certain that economic development and growth is a crucial factor in domestic and international political and economic stabilization.[1] Under adverse economic circumstances, politicians can easily mobilize hatred against neighbors, other countries, international organizations or foreign firms. This has had a long record in Central and Eastern Europe (CEE), and developments here have also been adumbrated by the recent and distorted nation building processes. (Bibo, 1976) As the experiences with the Eurozone crisis demonstrate, the relationship between economic crisis, nationalism and populism can be very strong in other peripheral countries, as well.

The reconciliation of disputed relations between countries that have several conflicts (political, ethnic, territorial, historic, economic, etc.) with each other requires the fulfilment of several preconditions. Favorable and supportive international environment, the political willingness of country leaders, and mutually beneficial economic development are fundamental in the process. Growing economy and strengthening economic cooperation that supports development can help to solve conflicts between neighboring countries and regions. Long-term positive impacts of economic cooperation and integration, however, cannot be taken for granted. Economic history proves that countries

1 For example: Gunhild Gram Giskemo, Exploring the relationship between socioeconomic inequality, political instability and economic growth. Why do we know so little? CMI: WP 2012: 2. [online form:] http://www.cmi.no/publications/file/4379-exploring-the-relationship-between-socio-economic.pdf

belonging to the one and the same geographic area are not necessarily each other's key or natural economic partners. The similarity of economic and political priorities tends to promote cooperation more than the heritage of a shared past or geographical proximity, especially if it is coupled with low level of development, parallel economic structures and comparative advantages. If we consider the reconciliation between France and Germany through economic integration after World War II as a model for other regions, we must understand why and how it worked, and what the similarities and differences are relative to the reality of Central and Eastern Europe today.

1. Economic considerations

Central and Eastern Europe (CEE) has experienced a very deep economic and political transformation since the beginning of the 1990s. The early years of transition were characterized by big hopes for a quick and successful development. The opportunity for democratic transformation and catching-up was opened wide for these countries. The international community, including the EU and the United States, showed interest in the transformation of the region for several reasons. From a geopolitical perspective, the transformation was of tremendous importance, as it confirmed the end of the Cold War; the bipolar global system was replaced first by a unipolar superpower system and later gave way to a multipolar or a new bipolar system. This also signaled the weakness of the Soviet Union (and later Russia), as it was not able to prevent this transformation and was soon mired in a serious and long-lasting economic and political crisis that undermined its international position. After the dissolution of the Soviet Union during the 1990s, Russia remained very weak, both economically and politically. The power vacuum and the transformation in Central Europe made the establishment of a new international economic and security structure possible. The new economic and political pattern that started to develop within the region was based on the liberal market economy model, with the objective of opening up markets and integrating the region into the world economy and the North Atlantic security structure. Not least because of the political and economic changes in this part of the world, thought- provoking theories were formulated on the new world order and future global transformations, including the *end of history* or the *clash of civilizations*.

"From Latin America to Eastern Europe, from the Soviet Union to the Middle East and Asia, strong governments have been failing over the last two decades. And while they have not given way in all cases to stable liberal democracies, liberal democracy remains the only coherent political aspiration that spans different regions and cultures around the globe" (Fukuyama, 1992, p. XIII). "During the cold war the world was divided into the First, Second and Third Worlds. Those divisions are no longer relevant. It is far more meaningful now to group countries not in terms of their political or economic systems in terms of their level of economic development but rather in terms of their culture and civilization" (Huntington, 1993, p. 23).

By introducing the market economy framework and adopting the principles of democracy, it was believed that countries would automatically enter upon a path leading to a rapid convergence with the richer countries after a relatively short period of transition. Such a belief explains the "one-size fits all" approach of the Washington Consensus on which the approach to the transformation of the region was based, and which was unanimously supported by international organizations and many scholars. On the other hand, the original idea of the Washington Consensus was based on the poor Latin American economies, not East Central Europe (Williamson, 2000).

Systemic changes and sudden liberalization caused the collapse of the domestic economies and a surge of unemployment due to problems of competitiveness and market loss. The transformational recession was further burdened by the lack of institutions able to manage the transition. This resulted in massive bankruptcies during the early years of transition as part of the structural change. Several non-viable firms with state aid survived those later prompted costly consolidation programs (Kornai, 1994). Consumers instantaneously wanted to satisfy pent up demand after decades of scarcity, creating very profitable opportunities for foreign firms selling consumer goods. In addition to flooding the market with imported products, promising investment opportunities opened up for large firms to take over domestic markets from insolvent local firms through privatization or create export-oriented greenfield investments attracted by cheap labor, and cost-related incentives also increased from early nineties. This rush of Western business into the region resulted in several positive structural changes and a number of negative consequences described elsewhere in several studies and analyses.[2]

The significance of the transition from geopolitical, security, macroeconomic and business perspectives made Central Europe a challenging and interesting region to analyze for at least a decade. The broader East European region also attracted international attention. In South East Europe, the breakup of Yugoslavia triggered a chain

2 See for example: "From plan to market: The transition process after 10 years" (contributors: Berend I., Svejnar J., Berglöf E., Welfens P., Gomulka S., Kopits G., Malle S., Menzinger J., Grigoriev L., Landesman M., Hare P., Nagy A., Elman M.), *Economic Survey of Europe*, No. 2/3 (1996). The assessment of the transition based on the Washington consensus and the impacts of the chosen transformation method in individual countries is still quite controversial.

of unexpected events in Europe and led to unsolved political and economic difficulties including the birth of still non-viable states. Political and economic developments in the territory of the former Soviet Union remained complex, not to mention political changes that could threaten the democratic transitions, like the one in Slovakia during the Meciar government. The North Atlantic political, economic, and security policy interests were very strong during this period and resulted in active Western involvement in the region's affairs with the aim of stabilization.

However, the situation later changed and around the millennium international attention started to turn to other critical issues such as terrorism or the rapid growth of several large emerging markets threatening the leading role of advanced countries in global competition and international organizations. The new developments changed international power relations slowly but continuously and attracted much broader interest than the economic and political developments in Central Europe. When membership in the European Union had become certain for several countries in the region, their importance declined even further. Even the term Central Europe started to lose its relevance and the region was sometimes considered as Eastern Europe, or simply as the EU new member states. The term Central Europe may be justified if it has a different economic or geopolitical significance from East and West. By entering the EU, it was thought that these countries would undeniably become part of the West, and no longer referred to as Central Europeans, but rather as Hungarians, Slovaks, etc. This explains continuous efforts, for example, to find common ground for joint interests in the V4 cooperation. For a while there were expectations that new member states would frame a common Central European interest within the EU. But it soon became clear that the formulation of common interests and their successful coordination was relevant only for a limited number of issues. For example, the Visegrad four did not elaborate any priority of as great importance as integration into the EU and the NATO during the pre-accession period. There are initiatives in energy policy, Eastern Partnership, or the Western Balkans, and in common research areas. However, none of them has achieved a real breakthrough. In addition, they have not been able to formulate strong proposals regarding the future of the EU.

The diversity across this part of Europe was indisputable already at the beginning of the economic and political transformation in the eighties and nineties. The economically most developed area included the Central European countries (Czechoslovakia, Poland, Hungary, and Slovenia) that embarked on the road of economic transformation very quickly, and were also eager to seek integration with the European Union as soon as possible. Economic relations in terms of trade between these countries had fallen to a historically low level as a result of the transformational recession, rapid trade reorientation, the lack of confidence in each other, uneven growth patterns and the different sequencing of economic reforms. The Baltic countries, Romania and Bulgaria entered a similar transformation track later, and they were able to join the European Union either in 2004 and 2007 respectively. In Eastern Europe, the breakup of the Soviet Union had caused an economic crisis in the successor states, which in turn completely cut off their previously existing economic ties with each other.[3] The severe economic downturn in the post-Soviet area lasted far longer and was deeper than in the Central European region. The trends in Western Balkan countries were partly similar to that of the post-Soviet countries because of the disintegration of the federal state. The break-up of Yugoslavia was followed by a bloody war, ethnic cleansing, political and economic conflicts with lasting effects. The once economically integrated country fell apart; economic backwardness was on the rise, and unsustainable structures and states continued to be formed in some parts of this region. In addition, the transformation of the economy was slow, barriers to trade emerged between the countries that had gained independence, and foreign investment avoided the region because of high political and economic risks.

Economic cooperation faced extreme difficulties all around the area, but its prospects differed from country group to country group. The development of economic relations with Russia or between the successor states of the Soviet Union was held back significantly because of the prolonged crisis. In addition, fear of the rise of the Russian power as a sort of economic or political threat was never dispelled. In the nineties – after a short risky event in 1991 – Russia ceased to be an international economic or political threat because of the ensuing economic and political mess that had evolved after the break-up of the Soviet Union. But Russia has never given up its willingness to reassert influence in some parts of the area. Following the millennium, its power began to increase in the post-Soviet territories due to its rapid economic growth. What is more, its intention to influence international developments in this part of the world also intensified considerably, and by 2010 it was a priority. This change should not be disregarded when we discuss economic cooperation and integration issues in the region.

When economies are expanding, and the income of the population is growing, tensions and conflicts are less likely to be exploited by politicians to secure political gains because they do not need to resort to such means to win the elections. Economic hardships, however, can easily lead to the rise of populism and nationalism; problems

3 Trade suffered an extreme fall in terms of both volume and value. For the CIS, internal trade declined by over 80 percent between 1991 and 1993. Source: External trade statistics of the Central Bank of Russia.

that under the surface continue to be key features in several countries and in the CEE – as historical experience showed – can be very extreme. Scapegoating others because of the economic misfortunes – an activity that has a long tradition in the less developed Central and Eastern European region – is an important feature in national politics. Sometimes it is the standard instrument deployed in political fight, and this can be dangerous in a region where democratic transformation is not strongly rooted. This problem is increasingly characterizing the conflicts in the European Union, too, where the most recent economic crisis has brought hidden conflicts to the surface. In addition, Russia does not seem to be interested in a strong democratic and successful economic transformation in its neighborhood, as this can have a negative effect on the authoritarian Russian system, as well. This may influence the future economic cooperation and integration pattern in various countries in Central and Eastern Europe.

2. The legacy of the past

The history and development of the European Union in recent decades can provide several examples where economic problems increased tensions between countries. This was the case, for example, during the seventies when the oil price shock hit the European economy; or the current Eurozone crisis, when politicians embarked on scapegoating each other's country. Greece accuses Germany for the inappropriate construction of a Eurozone that favors countries with higher competitiveness, while Germany blames southern countries for their inappropriate budget policy, slow modernization process and problems regarding competitiveness. Other countries criticize their firms for investing in other countries (cheaper production locations), because it causes job cuts in home countries. Economic crisis generally calls for protectionist economic policies even in countries that otherwise promote the idea of free trade, competition and integration.[4]

In these periods of crisis, the institutions of the European integration were able to reconcile internal relations between member states by formulating visions, long-term plans with the aim of increasing competitiveness, or improving economic performance. Vision in most cases was based on deeper economic cooperation, such as the creation of customs union and later the single market, the enlargement of the EU with new markets in Central Europe, and the formation of the Economic and Monetary

4 Although open protectionism has not increased significantly in the developed world, more sophisticated methods have been introduced. See: 10th Report on G20 Trade and Investment Measures, (WTO-OECD-UNCTAD, December 2013) [online form:] http://www.oecd.org/daf/inv/investment-policy/10thG-20TradeInvestment.pdf

Union. A similar pattern is unfolding today again when the momentum of integration is sought in a deeper form of economic cooperation, such as the setting up of a banking union or possibly the fiscal union. It is not by chance that virtually all papers dealing with the future of the EU/Eurozone stress the priority of renewed economic growth, more jobs and strong fiscal discipline. We may rightly conclude that in the development of the European Communities and the European Union, economic visions and plans have played an outstanding role with the final goal of achieving peace and sustained development. From this perspective, economic cooperation and rapid economic growth are the most important means of supporting political and development objectives and solving conflicts between neighboring countries.

While stronger economic ties or broader economic opportunities have worked well in developed Western European countries, economic integration and cooperation between less developed countries have been less successful. This is clear in the most recent crisis in the Eurozone, which caused fierce debates between its members. Despite the conflicts, large financial packages prevented the economic collapse of several structurally weak countries. Solving these problems would have been much more complicated without the existence of the Eurozone. It can be argued, nevertheless, that the economic problems of the Southern EU countries have been caused by the existence of the Eurozone, but one can only speculate on the course economic development would have taken in less competitive countries, had the Eurozone not been established. Several examples confirm that economic cooperation among underdeveloped, capital scarce countries with a low technology level has not been successful in terms of achieving a sustainable, long term economic growth. In most of these initiatives, the main objective was to create a strongly protected market instead of to carry out integration into global economy. The idea behind these attempts was that less developed countries needed sufficient time to strengthen their economic structure and competitiveness before they enter the global, liberalized market. However, these attempts have always faced the same burden: lack of capital, the inability to get the latest technologies, and the scarcity of qualified labor force. This explains why the import substituting cooperation and integrations that have mostly been established between less developed countries since the fifties proved unsuccessful; the intra-industry trade remained feeble, and the benefits from economies of scale and increased competition did not become tangible. It is generally true that rapid economic development can materialize if more developed countries are integrated, or less developed countries establish economic cooperation with more developed countries as long as a cautious and step by step market opening strategy is applied. As a result, the reconciliation of political and related problems in these integration efforts was short-lived, and any initial favorable result soon vanished after the limitations of economic development and growth became obvious. The conclusions drawn from these early and unsuccessful integration efforts among less developed countries triggered the need for a modernization center (an “anchor”) that often lie outside the strict boundaries of the given region, and whose modernization impact could support the creation of a competitive and rapidly growing economy provided that trade policy instruments are used properly. This is the issue of asymmetrical liberalization in foreign trade, which was the case for example in Association Agreements concluded between Central European countries and the European Union at the beginning of the nineties.

An additional factor regarding the success and failure of regional integrations concerns the “soft factors of production” that may or may not have been accumulated in past centuries (Yue, 2009). An obvious example for the importance of soft factors is the first and almost two-decade long development of the European Communities. World War II caused enormous losses in terms of both human and physical assets. The tradition of capitalist production, the experience and the capability of creating and using modern technologies, and the accumulated intangible resources such as knowledge were, however, still significant in Western Europe. This backdrop made the rebuilding and modernization of the economies after the war easier, and facilitated cooperation in the framework of economic integration. In addition, the financial transfers of the Marshall Plan had an equally important role in revitalizing economic development and growth in Western Europe.

This positive backdrop was missing in the CEE at the beginning of the economic and political transformation. The legacy of forced economic cooperation (Council of Mutual Economic Assistance – CMEA) before the nineties in Central Europe also had a negative impact on future economic cooperation perspectives. Russia, the most powerful partner within the CMEA, was economically underdeveloped; a situation that differed from the previous periods when Central Europe maintained strong economic relations with economically more advanced partners, such as Austria or Germany. Many central European countries profited from the favorable terms of trade position vis-a-vis the Soviet Union by selling manufactured goods and processed agricultural products in exchange for cheap natural resources and energy (Köves–Oblath, 1994). But these favorable terms of trade position could not resolve the problems of the (dis) incentive system that cut the need and the possibility for modernization in the manufacturing industries.[5] The cooperation system also stipulated unnatural terms and

5 The shortcomings and contradictions of the operation of the socialist economic system are still best described by Kornai 1980.

conditions under which economic partners were selected. The negative impact of the lack of incentives to improve quality and competitiveness was further worsened by the trade restrictions imposed by advanced countries, which had cut CEE countries off from the most competitive technologies.[6] This economic system was coupled with the Warsaw Pact, a political-military alliance that was governed by the Soviet Union, and which imposed great limitations on the sovereignty of individual countries.

In the light of such precedents, aversion to economic and political cooperation among the countries in the region was a natural reaction after the fall of Communism. None of them was intent on taking steps that may have brought economic/political ties closer since this would have necessarily been coupled with the depressing memories of times before the change of regime. What is more, the socialist version of integration, the community of Socialist states had little meaning for people; therefore, the breaking of ties between members of the communist elite had automatically meant that the vast majority of cooperation initiatives became a thing of the past.

3. Boosting economic cooperation in Central Europe

Beside the current economic circumstances, the negative experiences of the pre-transition period justified why these countries had turned towards other regions immediately after the systemic changes. It was expected that by establishing strong trade and capital relationships with developed countries, especially with the European Union, and by gaining better access to their markets, an automatic structural adjustment and technology development could quickly modernize the Central European economies. The ideological background to this rapid liberalization and trade reorientation was based on the Washington consensus, according to which the liberalization of the economy would deliver benefits to all participating countries independently from their level of development. However, instead of quick and significant benefits, the double pressure stemming from the collapsed demand in the former CMEA markets and the trade liberalization with the West, a number of local firms went bankrupt, or many of them faced very difficult problems in the short run.

Basically, three country groups were identified by the middle of the nineties. The first group consisted of Poland, Czech Republic, Hungary and Slovenia; the second

6 The most important element of the restrictions was the so-called COCOM (Coordinating Committee for National Export Control) lists, which forebode western firms to sell technology to socialist countries in order to prevent them in using it for military purposes.

group of Romania, Bulgaria, Slovakia, the Baltic States; and the third, most laggard region comprised the remaining countries of the former Soviet Union and the war-torn Western Balkan countries. In this period, countries in the first group were the quickest to transform their economic structures. The building of regional relations in Central Europe was discouraged by the fear which countries in the region shared, namely that Western Europe may consider strengthening cohesion and economic ties within the region as an alternative to EU integration. Several policy makers were afraid that proposals for a Central European economic integration were only aimed at postponing or substituting EU membership. Soon it was clear, though, that the developed world treated the Central European region as a whole, and was reluctant to deal with the countries therein one by one. It was partly this notion that motivated the launch of economic and political cooperation that led to the birth of the Visegrad group and eventually to the establishment of CEFTA (Central European Free Trade Agreement). CEFTA was launched in March 1993 with the objective of creating free trade between Central European countries that were aiming to become members of the EU. Membership in CEFTA is open to European countries that are members of the WTO, and have Association Agreement with the EU. As the first semi-institutionalized cooperation effort, the Visegrad Group primarily aimed at the coordination of security policy, most importantly against the Soviet Union, later Russia. One of the most important events that prompted cooperation was that in January 1991, the Soviet interior forces launched military action against Lithuania which demanded independence. This made it clear that the Soviet Union still posed a real threat to the region. However, it became obvious very soon that, after the dissolution of the Soviet Union, Russia was no longer considered a threat. This considerably undermined the need for further political coordination between the Visegrad countries, and instead, we find the first signs of economic cooperation amongst themselves (Köles, 2011).

CEFTA was without a doubt the greatest influential economic cooperation system out of all institutionalized initiatives in the nineties across Central and Eastern Europe. In contrast to the politicians, who did not really wish to build deeper political or economic relations in the region, it was clear to all economic experts that bringing economic ties closer was inevitable after the drastic loosening of relationships in the early nineties (Dunay, 2003).

Statistics proved that trade turnover between the countries had significantly fallen, which was to cause severe problems sooner or later. The purpose was to establish free trade between the states concerned, in order to improve market access to each other's market and to provide the participating countries with trade preferences similar to those offered by the Association Agreements in order to avoid unwanted trade diversion. The agreement became relatively successful soon after its birth. The expansion of merchandise trade between the CEFTA countries since the second half of the nineties was supported by several factors. First of all, GDP growth speeded up considerably towards the end of the nineties, and it continued in the pre-accession years, too. In the meantime, the tariff cuts and the elimination of quantitative restrictions gradually proceeded. Growth performance had been quite uneven across the region in the nineties, but mostly from the end of the decade, business cycles and thus the growth pattern became much more synchronized. The favorable growth performance and the continuous liberalization, plus the positive pre-accession perception of the countries improved trade performances.

Integration with each other gained further momentum with the EU accession of the countries in question. Within a large single market, trade shares started to increase in each other's business. The classical benefits of the integration into a large market started to be evident. Furthermore, the activity of foreign firms within the region intensified. Foreign direct investments became the main driving force behind technological development and structural modernization. They largely contributed to the increase of the intra-industrial trade within the Central European countries through their network of subsidiaries. Integration through the system of transnational firms became a very important driver in the region.

Micro-level cooperation has been playing an underlying role in shaping the economic flows in the region. Already at the creation of the CEFTA, it was important to see what strategies TNCs (transnational corporations) would adopt in the region. Many expected that the larger market would encourage the emergence of production units that would sooner or later target the entire regional market, and with the lifting of restrictions hampering trade and capital turnover, their supplier network would also be expected to cover the countries concerned. For the CEFTA region, the optimal solution seemed to be that different TNCs would increasingly rely on regional resources, and the cheaper, semi-finished products of domestic companies working in the region would play a more important role in supplies. Another important development in the corporate sector was related to the role of small business investments in the neighboring region, which were often based on ethnic relations. The pioneering country in this regard was Hungary, due to the large ethnic Hungarian groups in Romania and Slovakia. Last but not least, by around the millennium, regional corporations also began to rise. From the perspective of economic theory, when the development level reaches a certain threshold, countries enter the international economic relations as capital exporters. Central European countries reached this stage very soon, and they became capital exporters earlier than expected. At the same time, their capital export was considered premature. However, we have to emphasize that globalization has changed this original capital export pattern, and emerging, or less developed countries embarked on a "premature" phase of capital exports. Examples like the Central European countries, China, or some Latin American countries proved this change of pattern.

All these factors – the accession to the European Union, the operation of transnational corporations, the internationalization of local firms, including SMEs (small and medium enterprises) and the rise of regional multinationals – have contributed to the intensification of economic cooperation. At the same time, it is still obvious that the previously existing problems have not been solved, despite integration into the EU that created consistent regulation on doing business, which certainly contributed to better relations. This is partly due to the insufficient economic growth and convergence in many countries. After the economic crisis, beginning in 2007-2008, economic and social problems gave rise to emerging nationalism and populism. In addition, the support for European integration also declined in several countries. Falling popularity may lead to the denial of the core principles and values of the EU and may also strengthen the need for inward looking, protectionist approaches. The open dissatisfaction with regional multinational firms clearly indicates the delicate situation and suspicion in Central Europe.[7]

4. Central Europe and Russia

Besides the economic cooperation within the Central European region, equally important and controversial is the subject of the relationship with Russia. The collapse of the Soviet Union caused the breaking up of the highly integrated economic space at the beginning of the nineties. As the federal state also functioned as a fiscal Union, financial transfers to less developed republics were significant, reaching between 5 and 30 percent of GNP in the Central Asian Countries. This fiscal revenue was a very important resource for investments that were a precondition for growth. The cutting of these transfers had very negative immediate impact on net beneficiary countries. Implicit price subsidies were reduced or eliminated, including energy prices. Formal customs and trade barriers were introduced making legal commerce difficult. In addition, informal trade and transit barriers became common (corruption). Several Russians, many of them highly skilled, returned to Russia from other CIS republics, especially from Central Asia. They faced and caused significant problems of resettlement in an

7 For example, there has been a long dispute over the Hungarian oil firm (MOL) ownership share in the Croatian oil company (INA).

economically depressed Russia, and also impacted negatively on the knowledge base of the countries they had left behind. The migration issue also gave rise to ethnic problems in various countries. These changes were much more complex than those taking place in the Central European region, where independent and more developed countries were facing the challenges of economic transformation.

In contrast, the transition recession was less severe for the countries of Central Europe that were the least integrated into the Soviet system. Although they too suffered a disintegration shock, their own economic structures, production bases and geographical location made swift economic reorientation possible, and also facilitated the immediate start of integration into the world economy through FDI and trade flows. Trade and other economic relations between Russia and the Central European region experienced significant mutual decline. This was not only the result of the willingness of CEE countries to effect quick integration with the West, but Russia also turned to the West and tried to strengthen its economic relations with it. The trade reorientation with Russia started before the breakup of the country. In 1988, the share of the advanced countries had been already 20 percent, while the share of the CMEA countries went down to 60 percent in both exports and imports.[8] During the nineties, economic relations with Russia had virtually collapsed, except for the energy related exports (natural gas, oil products) leaving Russia and going into the region. Exports from Central Europe were hit badly by the collapse of domestic purchasing power and the economic crisis in Russia. The growing competition with western firms on the Russian market was an additional hindrance for firms of the region. The problems of trade also led to the bankruptcy of large heavy industrial and food processing firms in various countries that had been previously set up to supply the Soviet markets. These capacities have never been recovered, and the lost markets regained.

In the second half of the nineties, it became clear that trade and economic relations could be improved without having good political relations, as in the case of Poland.[9] Poland remained the only important player from Central Europe in Russia, due to its special relations with Ukraine and Belarus, and because of the Kaliningrad problem. While it was commonly believed that the decline in trade with Russia was closely connected to the loosening of political ties, the Polish business success seemed to

8 For details on the extent of trade collapse see, Kálmán Dezséri, Economic Relations Between Russia And The Central European Countries, Institute for World Economics, Hungarian Academy of Sciences, Working Papers, No. 111, August 2000

9 There was the famous “food for gas” program between Russia and Poland that helped Polish exports to Russia increase more significantly than from other countries of the region. It is an interesting addition that in 1997 Russia was the second most important destination of the Polish exports.

contradict this argument. The reluctance of businesses in other countries should have played a major role. The economic and financial crisis in 1998 hit exports to Russia much more severely than exports from advanced countries. The firms that could easily make up for the losses they suffered as a result of the falling exports to Russia were those that had enough capital to survive hard times or that owned state guarantees. Because most exporters from the region lacked these means, their market losses were relatively high. Expressed in terms of statistical data, the divergent ability in doing business with Russia was reflected by the fact that the region could only regain its pre-crisis export level by 2003-2004 while EU 15 exports were at the 1997 level already in 2000. The booming Russian economy coupled with increasing import demand helped the growth of exports to Russia probably more than any improvement in political relations. At the same time, however, the export success was not identical across the region as Poland and the Czech Republic proved to be more successful than others.

EU accession in 2004 and later the enlargement by Romania and Bulgaria in 2007 boosted exports from the region. This was mostly explained by the growing intra-industry trade of transnational firms operating in the CEE region, but the statistical impact was also significant. Before EU accession, export of TNCs from Central European subsidiaries were mostly counted in EU export as a result of firm level agreements between subsidiaries and their headquarters in the EU. After accession to the EU, this practice changed, and these exports were counted into the export of Central European countries. This statistical change also explains the sudden and radical modification of export structures in favor of manufacturing industries, since most of the FDI firms exporting to Russia were operating in this category. It is also interesting to observe that although the political relations generally improved and became more pragmatic from the part of the new member states, the biggest export growth was achieved by Poland that had far the worst relationship with Russia before the crisis in 2008 struck.[10] As a result of these changes, the exports from Central Europe to Russia started to behave similarly to those of the advanced countries after the crisis. Business operates according to business considerations that are influenced mostly by the general economic performance and the business environment. Political factors can be important in supporting business in Russia by state guarantees or other instruments. We may conclude upon these developments that a pragmatic approach towards Russia had business advantages instead of ideological ones, but its role in the pre-2008 crisis period should not be overrated (Ludvig, 2013).

10 Export from Poland to Russia increased by tenfold between 2000 and 2007, much faster than from any other country in the region. It is even more striking in the light of Russian import ban in 2005 and the Polish veto regarding the start of EU-Russia agreement. The conflict was solved only by 2008.

After the crisis, however, new trends seem to be unfolding. Russia has recently regained her economic power, and fears from it have also started to increase. Several scholars and analysts believe that Russia is not in a position to gain much more power in Eastern Europe and that the Russian economic performance in the long-run is not at all clear. What is more, the country has to face the problems of the unfavorable demographic change and the difficulties regarding economic diversification. We should warn that these analyses are only partly justified and they are underestimating the role Russia can play (Berman 2013). The cause of this underestimation has much to do with the unnoticed changing geopolitical picture, which has been discussed more widely only recently, and an increasing number of studies warn about this, especially after the EU's failure on Eastern Partnership.[11] In addition, even the unfavorable economic signs of the future Russian development may be misleading if we refer to the growth performance of the past decade, or some other long-term economic analyses on Russia.[12]

The position of individual countries regarding their relations with Russia is different for several reasons. Many of the countries in the region are dependent on Russian energy or business relations, although to a varying extent. The very large energy and export dependency of Belarus and Ukraine on Russia due to close technology ties with it and low competitiveness explains their approach and dilemmas over the future directions these countries may take. Their situation is further complicated by the authoritarian political system. In addition to achieving economic penetration and economic integration into the Eurasian space, they can also increasingly act in the interest of Russia in stopping the spread of Western-style democracy through economic means, perhaps even in countries where democracy seemed to be solidly rooted.

Russia has been able to strengthen its position in international relations and to take part in halting the enlargement process. (Hamilton, 2013) The country clearly demonstrates that its purpose is to regain its economic and political importance

11 The case of the Eastern Partnership and the conflict of interest surrounding it is a manifestation of much broader problems. These are all related to the geopolitical and economic situation prevailing in the entire Central and Eastern European region. The perception is that EU accession does not seem to be unequivocally successful. Further expansion of the EU enjoys minimal support in the European Union and the EU is perhaps more unpopular than ever before in the eyes of its own residents.

12 In 1999, the McCinsey Global stated that the long-term growth potential of Russia is about 8 percent yearly, which was quite accurate as between 2000 and 2013 the average yearly growth rate was above 6 percent. In 2006, the IMF estimated that the Russian long-term growth potential is about 6 percent. This growth prospect means that exporting to the Russian market can probably be very lucrative. The growing demand can give a very good opportunity to firms that are able to enter the market, and satisfy the domestic market need there.

in international matters, at least in its neighboring regions. Russia's efforts to reintegrate a part of the CIS will continue to strengthen as a number one priority of Russian foreign policy. After his recent presidential election, Putin strived to achieve a more complete reintegration of the CIS with Russian leadership as a number one strategic objective. Russia initiated the Customs Union within the Eurasian Economic Community in 2010 now called as "Single Economic Space", and with the final goal of creating an Eurasian Economic Union. The example of Ukraine clearly shows the intentions of Russia in neighboring or strategically important countries. In recent years, Russia has been a very active capital investor, mostly through state-owned enterprises, and not free from political objectives. Its role in the East Central European region, especially in the post-Soviet space is dominant and is also increasing in the more developed Central European region. This trend has to be taken seriously. Currently, there is a real threat that reconciliation through economic relations with Russia may involve the synchronization of political models to some degree, which does not mean the democratization of the authoritarian regime of Russia, but rather an adjustment to it. It was believed that Russia would take over the principles of liberal democracy and step by step become similar to the Western democracies. This proved to be a completely wrong assumption. The economic rise of the country was coupled with the creation of a new, specifically Russian understanding of democracy: the ideology of sovereign democracy (Surkov, 2009, pp. 8-21). The content of this can be summarized as follows: (1) this is a democracy model according to which there is no political sovereignty without economic sovereignty; (2) Russia decides independently what is democratic and what is not. This idea has several objectives. It is a democratic cover of authoritarianism that aims to make it more acceptable at home and abroad alike. The other purpose is to offer an alternative to the Western concept of democracy in terms of the economic model, the principal values and human rights.

Politicians may argue that economic cooperation supported by improved political relations is only a sign of healthy pragmatism which helps economic development, but in the light of the recent Russian aspirations, including its efforts to make the EU Eastern Partnership policy irrelevant, this strategy seems to be foolhardy. Despite the hopes of a changing mentality a few years ago, the strengthening authoritarian and anti-democratic politics reinforce the Russian disbelief in win-win business deals (Haukkala, 2009).

When significant business deals are concluded with Russia, one must consider the long-term political costs. It seems today that there is no government level economic reconciliation without long-term costs to be paid for dependence. Not surprisingly, a number of countries are looking at Russian investments in the Central European area with increasing caution and are trying to prevent them, particularly in certain sectors. On the other hand, Russian capital and industrial influence has been developing in crucial fields, such as the energy and the financial services sectors. This can be observed not only in post-Soviet countries, but in other regions, too.

An important development that can influence the future of economic links between Central Europe and Russia is that liberal democracy and its support seem to be backsliding in several countries. Anti-EU economic and political strategies in the countries shattered by economic difficulties and characterized by relatively poor economic outlook and declining standards of living, are on the increase. Central Europe and the countries that joined the EU in 2004 and 2007 are facing deepening risks that have been long forgotten. Energy resources, cheap loans, cooperation in the energy sector can all lead to an increasing dependence on Russia. The purpose of the Russian international economic strategy is geopolitical in nature, and it is coupled with long-term business benefits. It wants to regain its power and thus weaken the position of the European Union in this part of the World. Because of these perspectives, improving economic relations with a strong Russia today seems to be a double-edged sword. Economic benefits in terms of cheaper energy prices or improved access to the Russian market can be achieved. On the other hand, long-term prices may have to be paid for these short-term benefits.

After a two-decade-long period, when reconciliation with economic instruments did not show any special features or decided strategies, recent changes may now give rise to the question: what happens if reconciliation means something strange here, the core of which is convergence with the Russian authoritarian political model? Is there a real risk here, or should we rather consider the current and upcoming changes as the signs of pragmatism that are beneficial for both Russia and some of the Central European countries? The former socialist countries that are implementing different models of capitalism may today still be under Western influence, but the future is much more unpredictable than anyone would have thought during the period of the EU enlargement in 2004.

5. Conclusions

Prospects for reconciliation through economic integration vary a great deal in Central and Eastern Europe. The conditions and the characteristics of economic integration between the already EU member Central European countries are different from those of the post-Soviet area. An additional perspective relates to the economic relations between Russia and the "new" EU member states. Many countries openly express their fears of Russian influence in trade or through capital relations, regarding both direct investment and business loans. In the post-Soviet region, Russia's intention is to achieve economic reintegration. This policy is not without success as can be seen in the creation of the Eurasian Economic integration and the failure of the Eastern Partnership policy of the European Union. The post-Soviet region, except for the Baltic States is increasingly bound to Russia. In this integration, the key factor is the power with which Russia can assert its interests. These features significantly limit the applicability of the lessons that could be drawn for example from the French-German reconciliation through economic cooperation after WWII.

The problem in Central Europe is that the slow economic convergence of several countries in the region and the sluggish income growth has led to an overall dissatisfaction with the applied economic and political models and with the economic integration in the European Union. Although the EU created a uniform regulation and a single market for each of its new members, this has not been able to eradicate all the suspicions and problems within the accessed countries. Problems are appearing from time to time in different relations and are mostly related to ethnic minorities, economic interests, or national political interests serving economic objectives. On the other hand, it should be noted that, in most parts of the region, economic ties have become much stronger compared to the nineties. In this context, small- and medium-sized enterprises have played a positive and important role. The rise of regional, transnational firms triggered much more conflict, which clearly shows that Hungarians, Romanians or Croats cannot view the investments of large firms from their Central European neighbors without suspicion. The problems are even bigger if we consider the case of the Western Balkans, where the economic relations are still considerably burdened with political interests, corruption, ethnic conflict and unfinished state formations. This makes the consolidation through economic relations very difficult there. Until now, not even the prospective of EU accession could solve the problems, especially in Bosnia, Kosovo, or in the FYROM.

The relations between Russia and Central Europe are also at a crossroads. One of the crucial questions today is who can exert greater influence on Central European countries: the West or the East? Russia welcomes any deal and instrument that supports its economic penetration into the western sphere of influence. Some of the countries try to resort to pragmatism in order to benefit from stronger economic relations with Russia. It is, however, a very narrow and dangerous path. It is beyond doubt that in these relations Russia is the stronger party.

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