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PART II

A Central European Mystery: A Look at the Costs and Benefits

BUDAPEST, Hungary **October 1996**

By Christopher Ball

Hungary and Romania want to join NATO. In order to do that, the West, led by the United States, has demanded that they meet five requirements:

1. show a commitment to protecting democracy and ensuring minority rights;
2. create a market economy;
3. achieve civilian control of the military;
4. upgrade the military to meet NATO standards;
5. achieve good neighborly relations.[1]

Both countries have been working to meet these five criteria. While the first four criteria are largely domestic issues, the fifth requires the two countries to cooperate. This is something not always so easy in a region where historical differences run deeply. In the case of these two countries, achieving good neighborly relations has been complicated by the fact that there are officially two million ethnic Magyars[2] living within the borders of Romania.

After the breakup of the former Yugoslavia and the ensuing war, point five took on added importance as the West became increasingly interested in avoiding other possible ethnic conflicts (for example, possible conflicts between Magyars and Romanians). In order to prove that requirement five was met, the West demanded that the two countries sign a basic bilateral peace treaty. The details of the treaty were generally left up to the decision of the two countries involved. The only requirement was that it should guarantee minority rights for the Magyars in Romania and guarantee that neither country try to change their mutually-shared border. This, however, proved to be a very difficult task.

Hungary didn't want to include a confirmation of the current border because it had already been confirmed in past agreements, but insisted the treaty include strong provisions guaranteeing special rights for the Magyars in Romania. Romania refused to include special rights for the Magyars, but insisted on confirming the current border. For years, the two countries carried out discussions and debates over these issues, but were unable to reach an agreement until the Summer of 1996.

The final version of the treaty confirmed the current border and included special rights for the Magyar minority in Romania, but the latter point was footnoted

1. These five points as I state them here in this order were elaborated during Secretary of Defence William Perry's visit to Hungary in the Spring of 1995.

2. Magyar is the ethnic name for Hungarians. It is actually the word Hungarian in the Hungarian language, but is often used in English-language literature dealing with Hungarian (Magyar) minority issues. The term Magyar, then, refers to the ethnicity of a person and the term Hungarian refers to the citizenship of a person. I too will use the word Magyar with this meaning in order to add a bit of clarity.

out of the treaty, thus nullifying any possible effect.

In part one of this report, I explained the Hungarian-Romanian treaty from what one might call a "ground view." Looking at the treaty from there, in the thick of things, every word dripped with cultural-historical meaning and every action was open to multiple interpretation. My goal here is neither to explain these interpretations, nor to approve or disapprove of the treaty itself. My goal is rather to approach the issue from an economic point of view, applying basic economic concepts used to analyze rational human behavior. Specifically, I'm using the concepts of costs and benefits to explain why the treaty was suddenly signed in the Summer of 1996.[3] My hope is to offer a more-or-less unusual way of looking at international activity in addition to the approaches used in other fields such as political science and law.

COSTS AND BENEFITS

In general, people think of costs in the simple terms of money, or price. For example, a jar of peanut butter costs $4.50. Economists expand the concept of cost to include more than just price. Economists usually include "opportunity costs" to estimate the real value of something. The opportunity cost of something is simply the cost of what has been given up by taking one action rather than another. The opportunity cost of buying the peanut butter would be not using that $4.50 in some alternative activity, like going to the movies or buying a magazine.

A typical example of this is the opportunity cost of going to work. The opportunity cost of going to work is said to be that of not staying at home with one's family or engaging in any other non-work activity (for example, fishing, boating, painting one's house, shopping, etc.). The opportunity cost of not working would be one's salary. Parents often use the opportunity-cost concept when telling their children *not* to waste time watching cartoons, and that "their time would be better spent reading." They have implicitly included the concept of opportunity costs (and associated benefits) into these statements.

While the opportunity cost of reading is not watching cartoons (or playing outside, or doing anything other than reading), it is clear that the choice between the two actions is not indifferent. The difference is the benefit derived from the action undertaken. It is clear to the parent that the benefit derived from reading is higher than that derived from cartoon watching. One other interesting point should be noted here: the parent recommends that the child read. This means that after weighing the costs (*i.e.* not watching cartoons) and the benefits (better grades in school, to take a tangible example), the parent feels that the benefit outweighs the cost and thus recommends the child engage in the activity of reading. We may not be able to express this choice in precise monetary terms as we could with the decision not to work, but the same kind of rational-decision process is occurring here.

When people make such cost-benefit decisions, they are making economic decisions, and I intend to use the basic concepts of costs and benefits to explain the signing of the treaty between Hungary and Romania.

LOOKING AT THE TREATY

The United States said that in order to join NATO, Hungary and Romania must sign a treaty signifying that they have friendly neighborly relations with one another. The benefit here is clear: NATO membership. The cost is also clear: signing a treaty. But while the benefit for the countries outweighed the perceived cost, it is not at all clear that each government had the same perception of the costs, which were very high in political terms. In order to better understand the situation, we must look at the costs from the point of view of each government involved — the Romanian government led by then-President Ion Iliescu and the Hungarian government led by Prime Minister Gyula Horn.

For both governments, one of the costs associated with this treaty was the loss of nationalist support. For the Hungarian nationalists, it meant signing away their Magyar brethren in Romania to the Romanians who were sure to smother their Magyar national heritage. For Hungary, therefore, the only acceptable treaty would be one that included special rights for the Magyars in Romania, including some form of autonomy for them. For the Romanians, however, the notion of Magyar autonomy threatened a possible breakup of the Romanian state, possibly one day leading to the inclusion of Transylvania (where most Romanian Magyars live) in Hungary. For Romania, the only acceptable treaty would be one that reconfirmed the existing border.

So much for cost. Let's look at the benefit side. In Hungary, professionals and parliamentarians generally agree that joining NATO would be a good thing. Joining the Atlantic Alliance would bring security and the symbolic re-union of Hungary with the western community, its long-lost family.[4] The average citizen in Hungary is not yet convinced. As a matter of fact, Hungary has one of the lowest public-support levels in the region for joining NATO. According to the European Union's EUROBAROMETER (a survey that tests opin-

3. My analysis here is not academically rigorous by any standard and should be properly worked out elsewhere. I am doing that in my free time, but will not be presenting my more academic model in any of my reports as they are not the best medium for that.

4. This is actually a major issue with most of the NATO-hopeful countries, with the possible exception of Poland. The case of Poland is slightly different since its long border with Russia keeps the Poles security conscious. They nevertheless place a very high value on joining NATO and thus the West, from which they feel they have been unnaturally separated throughout history.

ion in 19 Central and East European countries), only 32% of Hungarians were in favor of Hungary joining NATO. A surprising 22% were against and the rest were undecided.[5] Since it is not possible to know what groups constitute the 32% and 22%, it would not be safe to base the cost of the treaty on the benefit of NATO inclusion. For example, what if the same 32% that was in favor of NATO inclusion was also extremely nationalist and wanted Hungary to take Transylvania back from Romania? Then, for the nationalists, the cost of the treaty (seen as giving away the Hungarians in Transylvania) would outweigh the benefit of joining NATO. It is not a likely scenario, but the fact that it is a possible one left Hungary in a difficult position. Pushing forward with the treaty was risky, with the possibility of very low political benefits.

In sum, the current Hungarian government had little to gain and little to lose by signing a basic treaty with Romania. The natural impulse was to publicly support NATO inclusion while merely continuing discussions about the treaty.

This last point brings up one last cost associated with all contracts and treaties: the transaction cost. "Transaction costs can be defined as the costs of information and bargaining, and of defining, policing and enforcing property rights and contracts. In short, they are the frictions associated with transacting."[6] The transaction cost required to reach a mutually-acceptable agreement on the two major points of contention (autonomy rights and confirmation of the border) proved to be too high, in my opinion. The Hungarian government, caught in the uncertain balance between unclear costs and benefits, was encouraged not to sign the treaty due to the high transaction cost of enforcing an acceptable agreement.

Romania was in a similar situation. From a public-opinion point of view, NATO inclusion was as big and exciting an issue in Romania as it was small and boring in Hungary. According to the same EUROBAROMETER report, Romania has the highest support level for joining NATO of all the 19 countries surveyed. Ninety-five percent of the polled population supported Romania's inclusion in NATO. Clearly, the leader who could push Romania toward NATO would also enjoy widespread popular support.

On the cost side as well, much more was at stake than in Hungary. The ruling government in Romania, then led by Ion Iliescu, enjoyed a high level of support from Romanian nationalists who strongly opposed any special rights for Magyars in Romania. While the benefit was potentially high, the cost of possibly losing nationalist support was also very high for the Iliescu

Ion Iliescu

Government. In the end, since both costs and benefits were high in Romania, the Romanian government was left in essentially the same situation as Hungary's: undecided.

CHANGING THE COSTS AND BENEFITS

In my opinion, two major factors caused the change in costs and benefits that finally persuaded Hungary and Romania to sign a treaty. The first was the precedent set when Hungary and Slovakia signed a bilateral treaty to settle issues similar to those existing between Hungary and Romania. The second factor were elections at the local and national level in Romania.

In order to join NATO, Hungary was also required to sign a treaty with Slovakia to demonstrate that neighborly relations were friendly. The treaty with Slovakia was intended to settle many of the same problems as those between Hungary and Romania. Chief among these problems was again the issue of minority rights for Hungarians in Slovakia. A large number of Magyars live in Slovakia, but not as many as live in Romania. The Hungarian-Slovak treaty included several provisions for minorities, and opened other avenues for future cooperation between the two countries. The U.S. highly praised both countries for signing the treaty.

Then Slovakia began to pass harsh anti-minority laws (mostly in the areas of mother-tongue use and education) in direct violation of the treaty. Not a hand was raised by the international community. Encouraged by the lack of international response, Slovakia passed more and more laws that were anti-minority and, in general, anti-democratic.[7]

One problem with international treaties is that they lack an adequate and systematic enforcement mecha-

5. "Central and Eastern European EUROBAROMETER 6 (1995) press release," Budapest, March 18, 1996.

6. Veljanovski, Cento. "The Economics of Law: An Introductory Text," the Institute of Economic Affairs, 1990, p.

7. For one example of the measures being passed in Slovakia, see: "Slovakia Protests Hungary's Criticism of New House Rule of Language", Hungary Report, No. 2.16, October 7, 1996. Also see, "The Slovak State Language Law and the Minorities: Critical Analyses and Remarks." Minority Protection Series, No.1, Minority Protection Association, Kossuth Publishing, Budapest, 1996.

nism. Each country is a sovereign state that, in the end, can act as it chooses. The only real punishment it can receive is political isolation from the rest of the world, military attack by another country and/or economic sanctions.[8] These penalties are, however, by no means standardized, and usually require a major power to implement them, acting as police, judge and jury. That major power these days is usually the United States.

When Slovakia passed the negative laws, violating the treaty between it and Hungary, neither the US nor the European Community did anything. They issued warnings and offered suggestions for improvement, but no real punitive action was taken. Minorities in Slovakia filed official complaints and asked for western assistance to help get Slovakia back on track, but nothing was ever done by the international community. The fact that the treaty was meaningless sent a very strong signal to Hungary and Romania. It was clear that they, too, could sign a treaty that would most likely be ignored and left unenforced.

The precedent set by the Slovakian-Hungarian treaty meant that many of the contentious points in the Romanian-Hungarian treaty could be left out, without the West taking much notice. For Hungary, this meant the treaty could include a reconfirmation of the border without fear of it being taken seriously. For Romania, this meant it could include special minority rights (and then footnote them out, thus nullifying them) without any eyebrows being raised in the West. In cost-benefit terms, this meant that both countries could greatly lower the costs but still reap all the benefits (*i.e.* western praise and inclusion in NATO).

The 1996 elections that prodded Romania into signing came in the summer at the local level, and in the fall nationally. During the Summer elections, Ion Iliescu's party lost many local races. This spelled trouble for the national elections in the Fall. Also, unexpectedly, many of the ardent Romanian nationalists, including many business owners, had swung toward the opposition coalition party, the Democratic Convention of Romania, in the local elections.[9] When the once-secure Iliescu party began to lose support, those voters (95% of the population) who supported NATO membership suddenly became worth going after. In other words, the cost-benefit structure had suddenly changed in favor of signing, and Romania was ready to negotiate.

The result: a treaty that was largely empty and worded to avoid anything that might actually restrict the two countries, reflecting the fact that enforcement was unlikely. Mr. Iliescu's decision to be flexible had the effect of lowering the transaction costs for Hungary. In the end, the treaty was signed in all its emptiness.

THE MORNING AFTER

After the treaty was signed, the entire international community praised both countries. The US even began to suggest that despite its problems, Romania might now be considered a serious candidate for early inclusion into NATO, something previously unheard of. With US representatives discussing Romania and NATO in the same sentence, Iliescu's party jumped in the polls — but in the end it was not enough. On November 5, 1996, Iliescu's party was voted out Parliamentary majority by democratic election. Two weeks later, during the run-offs for President, Mr. Iliescu was voted out of power as well. He was replaced by the candidate from the Democratic Convention of Romania, Emil Constantinescu.

Whether Constantinescu's election will increase the benefit — or decrease the cost — of Romania's admittance into NATO remains to be seen. ❑

8. A good example of all three of these might be the recent US-Iraq situation where we attacked militarily, kept Iraq politically isolated from the rest of the world and imposed harsh economic sanctions.

9. This point was only brought to light during recent interviews between the author and businessmen in Romania (November 1-4, 1996). At that time, many nationalistic business owners, who previously supported Iliescu, openly switched their support to the opposition party which later won the national elections, the Democratic Convention of Romania. The main reason cited was poor economic policy under President Iliescu and the promising economic proposals of the Democratic Convention of Romania.


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Fellows and their Activities

Adam Smith Albion. A former research associate at the Institute for EastWest Studies at Prague in the Czech Republic, Adam is spending two years studying and writing about Turkey and Central Asia, and their importance as actors the Middle East and the former Soviet bloc. A Harvard graduate (1988; History), Adam has completed the first year of a two-year M. Litt. degree in Russian/East European history and languages at Oxford University. [EUROPE/RUSSIA]

Christopher P. Ball. An economist, Chris Ball holds a B.A. from the University of Alabama in Huntsville and attended the 1992 International Summer School at the London School of Economics. He studied Hungarian for two years in Budapest while serving as Project Director for the Hungarian Atlantic Council. As an Institute Fellow, he is studying and writing about Hungarian minorities in the former Soviet-bloc nations of East and Central Europe. [EUROPE/RUSSIA]

William F. Foote. Formerly a financial analyst with Lehman Brothers' Emerging Markets Group, Willy Foote is examining the economic substructure of Mexico and the impact of free-market reforms on Mexico's people, society and politics. Willy holds a Bachelor's degree from Yale University (history), a Master's from the London School of Economics (Development Economics; Latin America) and studied Basque history in San Sebastian, Spain. He carried out intensive Spanish-language studies in Guatemala in 1990 and then worked as a copy editor and Reporter for the *Buenos Aires Herald* from 1990 to 1992. [THE AMERICAS]

Sharon Griffin. A feature writer and contributing columnist on African affairs at the *San Diego Union-Tribune*, Sharon is spending two years in southern Africa studying Zulu and the KwaZulu kingdom and writing about the role of nongovernmental organizations as fulfillment centers for national needs in developing countries where governments are still feeling their way toward effective administration. [sub-SAHARA]

John Harris. A would-be lawyer with an undergraduate degree in History from the University of Chicago, John reverted to international studies after a year of internship in the product-liability department of a Chicago law firm and took two years of postgraduate Russian at the University of Washington in Seattle. Based in Moscow during his fellowship, John is studying and writing about Russia's nascent political parties as they begin the difficult transition from identities based on the personalities of their leaders to positions based on national and international issues. [EUROPE/RUSSIA]

Pramila Jayapal. Born in India, Pramila left when she was four and went through primary and secondary education in Indonesia. She graduated from Georgetown University in 1986 and won an M.B.A. from the Kellogg School of Management in Evanston, Illinois in 1990. She has worked as a corporate analyst for PaineWebber, an accounts manager for the world's leading producer of cardiac defibrillators,and manager of a $7 million developing-country revolving-loan fund for the Program for Appropriate Technology in Health (PATH) in Seattle. Pramila is tracing her roots in India, and studying social issues involving religion, the status of women, population and AIDS. [SOUTH ASIA]

John B. Robinson. A 1991 Harvard graduate with a certificate of proficiency from the Institute of KiSwahili in Zanzibar, John spent two years as an English teacher in Tanzania. He received a Master's degree in Creative Writing from Brown University in 1995. He and his wife Delphine, a French oceanographer, are spending two years in Madagascar with their two young sons, Nicolas and Rowland, where he will be writing about varied aspects of the island-nation's struggle to survive industrial and natural-resource exploitation and the effects of a rapidly swelling population. [sub-SAHARA]

Teresa C. Yates. A former member of the American Civil Liberties Union's national task force on the workplace, Teresa is spending two years in South Africa observing and reporting on the efforts of the Mandela government to reform the national land-tenure system. A Vassar graduate with a *juris doctor* from the University of Cincinnati College of Law, Teresa had an internship at the Centre for Applied Legal Studies in Johannesburg in 1991 and 1992, studying the feasibility of including social and economic rights in the new South African constitution. [sub-SAHARA]

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