

# Transcarpathia – Ukraine's Westernmost Region and a Gateway to Central and Western Europe<sup>1)</sup>

## I Introduction to the Region

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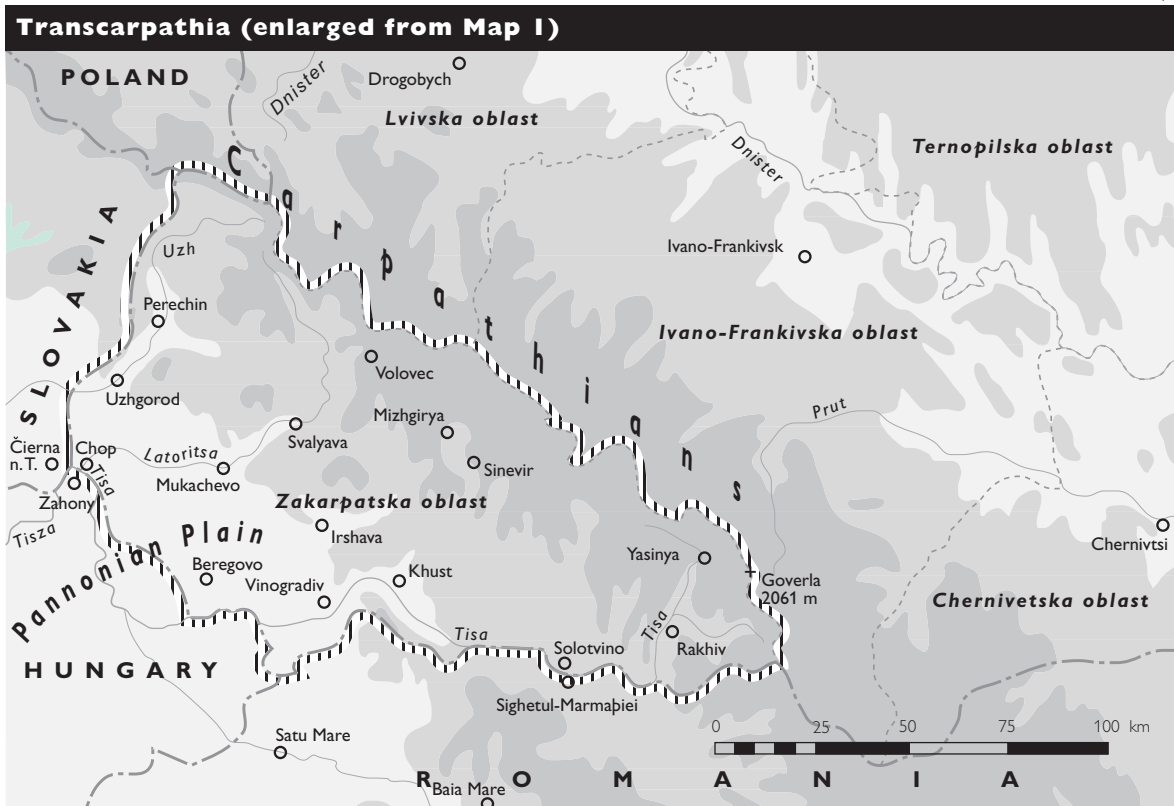
Transcarpathia – although only about 500 km to the east of Vienna – is a largely unknown region. Transcarpathia – also called Carpatho-Ukraine, Subcarpathian Rus, or Subcarpathian Ruthenia – covers an area of 12,800 km<sup>2</sup> and has about 1.3 million inhabitants. The region lies in the far west of Ukraine, on the western slope of the Carpathian mountains; part of it stretches into the lowlands of Pannonia (the Danubian Basin). It is officially called “Zakarpatska Oblast” and constitutes the westernmost Ukrainian administrative region. To the west and south, Transcarpathia borders on Slovakia, Hungary and Romania; it possesses a small strip of border with Poland, while adjacent Ukrainian oblasts (Lvivska Oblast and Ivano-Frankivska Oblast) lie on the eastern side of the crest of the Carpathian mountains. Zakarpatska Oblast is thus surrounded on three sides by EU accession candidates (see map 1).

The upper reaches of the Tisa (Tisza) river run through the region whose southeastern part displays a largely alpine character. About half of Transcarpathia is covered by forests. Most inhabitants of the oblast are Ruthenians

Map 1



- 1 A substantial part of the information on which this article is based was gathered during an excursion to Transcarpathia in June 2001 in which the author took part. The excursion was organized by the Austrian Institute of East and South-East European Studies (Österreichisches Ost- und Südosteuropa-Institut – OSI).
- 2 Foreign Research Division, Economic Analysis and Research Section, OeNB. I am grateful for comments from Doris Ritzberger-Grünwald, Peter Backé, Jarko Fidrmuc, János Kun, Thomas Reiningger and Irene Mühlendorf. The views expressed in this article are those of the author and do not necessarily coincide with those of the Oesterreichische Nationalbank.



Source: Österreichisches Ost- und Südosteuropa-Institut (Austrian Institute of East and South-East European Studies).

or Ukrainians with Ruthenian dialects; furthermore, there is a relatively large Hungarian ethnic minority (about 12% of the population). Other smaller minorities are Russian, Romanian, Slovak, Roma and German-speaking. The most important cities are the regional capital of Uzhgorod (near the western border of the region, population: 127,000), Mukachevo (more centrally located, population: 89,000) and Khust (further to the east). Agriculture, forestry and related industries dominate the regional economy. The region has few mineral resources, among them iron and nonferrous ores, lignite and rock salt (near the town of Solotvino in the southeast). But mineral and thermal waters are abundant. Very little even general literature on Transcarpathia is available to the Western public.

Throughout its history, Transcarpathia has been a politically and economically peripheral land, in fact continually a borderland, a relatively poor region that has never surpassed a quite modest level of economic development (Beaudoin, 1999, p. 11). For many centuries under Hungarian, then Austro-Hungarian rule, Transcarpathia became part of the Czechoslovak Republic in 1919, was annexed again by Hungary in 1939 and incorporated into the USSR in 1945. Since 1991, Transcarpathia has been an administrative region of independent Ukraine. Feudalism and remnants of feudal structures remained dominant in Transcarpathia until the beginning of the 20<sup>th</sup> century. But local industrial development (furniture, small-scale metallurgy, chemical plants, artisan trades) started to gain some importance in the final decades of the 19<sup>th</sup> century. Public infrastructures were improved in the

interwar period. Still, agriculture and forestry dominated the economy at least until the mid-20<sup>th</sup> century. Rural poverty has been a persistent feature of the region.

The Soviet authorities exploited the regional forests in a comprehensive, but inefficient way. Clear-cutting was often practiced, and environmental matters were taken into account even less than in the past. The resulting land erosion aggravated recurring floods. The collectivization of Transcarpathian agriculture was accomplished in 1950. In the 1950s the Soviets also started to rebuild and enlarge the existing meager tourist infrastructure (sanatoria, rest homes) and create some holiday resorts. In the 1960s and 1970s the central planners implanted some consumer goods and machine building industries in the oblast. Four important oil and gas pipelines were built through the region in the postwar period. The last one, finished at the beginning of the 1980s, transported natural gas to Western European markets (and continues to do so). This underlines the strategic importance of Transcarpathia as a transport link to Central and Western Europe.

## **2 Transcarpathia in Comparison to Other Ukrainian Regions: Peculiarities, Strengths and Weaknesses**

After the dissolution of the Soviet Union, the collapse of central planning and of the CMEA foreign trade organization of the former socialist countries, Ukrainian independence at end-1991 ushered in a protracted and difficult period of market-oriented economic reforms. This period was accompanied by a decade of economic contraction, which in Ukraine, according to official statistics,<sup>1)</sup> only came to an end in 2000, when GDP increased by a hefty annual 6.0% (after a decrease of 0.4% in 1999). In the first half of 2001 the GDP expansion accelerated to 9.1% (year on year). Ukraine is a centralized state in which most public and budgetary activities are concentrated at the central state level. The country consists of 24 oblasts (provinces), among them Transcarpathia (Zakarpattia, Zakarpatska Oblast), the capital city Kiev (Kiiv) and the Autonomous Republic of Crimea (Avtonomna Respublika Krim).

*Transcarpathia, all in all, constitutes a relatively low-income and economically less developed region of Ukraine.* Its share in the total territory of the country is 2.12% and its population share on January 1, 2000, amounted to 2.58%. In 1989, Transcarpathia's share in Ukraine's population had amounted to 2.43%.<sup>2)</sup> These latter population data are important benchmarks against which the numbers below can be measured. Some systematic statistical comparisons between Transcarpathia and Ukraine are given in table 1. As the table shows, *gross value added* in Transcarpathia amounted to 1.34% of Ukrainian gross value added in 1996 and 1.37% in 1998. Gross value

1 The source of the following data and comparisons in this chapter is *Derzhavnyi komitet statistiki Ukraini (2000)*. This source, however, does not give estimates for the size of the informal sector, which is known to be substantial in Transcarpathia and Ukraine. The next chapter will attempt to shed some light on the informal sector.

2 The small rise of this share is due not so much to a rise in the number of inhabitants of the region, which went from 1.25 million in 1989 to 1.28 million in 2000. It is rather related to the decline of Ukraine's population from 51.7 million to 49.7 million during this period.

added per Transcarpathian inhabitant thus only came to about 54% of the country's average, the lowest of all Ukrainian regions.<sup>1)</sup> Household money income and expenditures were likewise far below average, although they slightly caught up from 1997 to 1999. Transcarpathia has been a long-standing net recipient of regional subsidies from the authorities in Kiev.

On the other hand, it appears that economic recovery was somewhat quicker in Ukraine's westernmost region and that economic activity there may have reached the turning point already in 1998 or 1999. Transcarpathian industrial output by 1996 is reported to have fallen to about 30% of its level of 1990, whereas overall Ukrainian industrial production was "only" halved. This appears to reflect the country's uneven contraction throughout the 1990s, with a shrinking economy being increasingly dominated by base industries (power, fuels, steel, etc.) at the expense of the manufacturing industries (Clement, 2001, p. 16). Given that Transcarpathia's industrial structure was characterized by the latter branches, it was one of the regions to bear the brunt of contraction. But in the following years, developments were partly reversed, and Transcarpathia recorded a swifter industrial recovery. Textile production reached a high level, and in 1999 the region produced almost a quarter of Ukrainian knitwear. But shoe manufacturing apparently suffered the opposite fate. Still, on the whole, manufacturing and light industry seem to be leading the industrial recovery, with these activities responding favorably to the devaluation of the last two years, and Transcarpathia benefiting from it.

In 2000 the industrial structure of the region was dominated by the woodworking industry (38% of output), followed by the food industry (25%), light industry (12%) and engineering and metalworking (9%). The region's share in Ukraine's agricultural production grew over the entire decade. This is particularly true of the meat, milk and potato output. Transcarpathia accounts for almost 7% of Ukrainian forestry production. In 2000, about 4% of the country's private farms were located in its westernmost region. Transcarpathia's share of employment in collective agricultural enterprises steadily declined throughout the 1990s. Despite this structural improvement, the authorities point to the continuing problem of agricultural overpopulation and shortage of cultivated land.<sup>2)</sup>

Fixed capital investment, while recovering in the late 1990s, has always been below average in Transcarpathia. The same goes for the availability of public and private telephones. But residential construction, particularly private construction, expanded strongly in 1999. Almost 10% of all residential buildings put into service in rural areas of Ukraine were located in Transcarpathia. The region accounted for only 1.5% of all exports and 1.3% of all imports of the country in 1999. Its share of attracted FDI comes to about 2.3%. In 1999, 2.7% of Transcarpathian industrial output was produced by private firms, as opposed to merely 0.2% in all Ukraine. In 1999 Transcarpathia was one of the leading regions with respect to privatization activities.

1 *The next poorest jurisdictions were Chernivetska Oblast (Czernowitz province) and the City of Sevastopol.*

2 *Zakarpatska oblasna derzhavna administratsiya (2001b, p. 13).*

Table 1

<b>Transcarpathia as a Share of Ukraine: Various Indicators</b>			
Indicator	Transcarpathia	Ukraine	Transcarpathia as a percentage of Ukraine
Territory (in km <sup>2</sup> )	12,800	603,700	2.12
Population (1989, million)	1.252	51.452	2.43
<b>Population (January 1, 2000, million)</b>	<b>1.284</b>	<b>49.711</b>	<b>2.58</b>
Gross value added (actual prices, UAH million)			
1996	932	69,287	1.34
1998	1,138	82,834	1.37
Industrial output (real)			
1990	100	100	
1995	38	52	
1996	30	50	
1998	38	49	
1999	47	51	
Consumer goods output (1999, actual prices, UAH million)	311.4	20,995.6	1.48
of which: food	116.9	12,030.6	0.97
nonfood, incl. light industry	155.7	6,935.2	2.25
Textile production (in million m <sup>2</sup> )			
1998	5.7	89.9	6.34
1999	0.5	50.2	1
Knitwear production (in million m <sup>2</sup> )			
1995	2.0	27.0	7.4
1998	1.1	6.6	16.67
1999	2.3	9.7	23.71
Agricultural production (comparable prices, UAH million)			
1990	759	48,629	1.56
1995	606	31,634	1.92
1999	548	23,603	2.32
Gross harvest of grain (in thousand tons)			
1990	306	51,009	0.6
1995	197	33,930	0.58
1999	176	24,581	0.72
Gross harvest of potatoes (in thousand tons)			
1990	337	16,732	2.01
1995	327	14,729	2.22
1999	378	12,723	2.97
Meat production (in thousand tons)			
1990	67	4,385	1.53
1995	49	2,294	2.14
1999	47	1,695	2.77
Milk production (in thousand tons)			
1990	375	24,508	1.53
1995	352	17,274	2.04
1999	363	13,362	2.72
Forestry output (1999, UAH thousand)	35,377.2	521,292.2	6.79
Private farms (number, beginning of year)			
1996	1,054	34,778	3.31
2000	1,400	35,884	3.9
Fixed capital investment (comparable prices, UAH million)			
1990	1,063	55,368	1.92
1995	143	16,097	0.89
1999	169	12,197	1.39
Fixed capital investment in residential construction (comparable prices, UAH million)			
1990	168	8,970	1.87
1995	54	3,353	1.61
1999	74	2,173	3.41
Retail trade turnover (UAH million)			
1995	231.7	11,964.0	1.94
1999	511.0	22,151.1	2.31

Table 1 cont.

<b>Transcarpathia as a Share of Ukraine: Various Indicators</b>			
Indicator	Transcarpathia	Ukraine	Transcarpathia as a percentage of Ukraine
Commercial bank credits extended to economic entities (1999, UAH million)	77	11,783	0.65
Exports of goods (1999, USD million)	169.5	11,581.6	1.46
Imports of goods (1999, USD million)	158.8	11,846.1	1.34
Direct foreign investment (cumulated, USD million)			
end-1998	64.9	2,810.7	2.31
end-1999	73.8	3,247.9	2.27
1/4/2001	91.5		
Small-scale enterprises (number)			
1995	1,512	96,019	1.57
1999	5,774	197,127	2.93
Entities by type of ownership after privatization (beginning of 2000, number)			
private	511	13,189	3.87
collective	1,144	53,512	2.14
Unemployment rate (1999, %)			
overall	12.4	12.0	
urban	14.3	14.3	
rural	10.8	6.3	
Average annual number of employees in collective agricultural enterprises (in thousand)			
1990	87	3,481	2.5
1995	39	2,926	1.33
2000	16	2,319	0.69
Household money expenditures (UAH million)			
1997	716	47,932	1.49
1999	1,041	59,518	1.75
Sanatoria and rest facilities with medical care (places)			
1990	4,509	154,484	2.92
1995	4,307	158,507	2.72
1999	4,073	154,782	2.63
Hotels: capacity (number of beds)			
1995	2,606	130,869	1.99
1999	2,363	104,224	2.27
Registered crimes (thousand)			
1990	3.5	369.8	0.95
1995	7.6	641.9	1.18
1999	6.6	558.7	1.18
Reforestation of forest stock (hectares)			
1990	2,825	37,458	7.54
1995	2,348	38,441	6.11
1999	2,258	38,582	5.85
Emission of pollutants into the atmosphere:			
– stationary sources (thousand tons)			
1990	38.2	9,439.1	0.4
1995	13.2	5,687.0	0.23
1999	7.0	4,116.0	0.17
– mobile sources (thousand tons)			
1990	106.3	6,110.3	1.74
1995	23.5	1,796.5	1.31
1999	37.7	1,747.0	2.16

Source: Derzhavniy komitet statistiki Ukraini: Statistichniy Shchorichnik Ukraini za 1999 rik (State Statistics Committee of Ukraine: Statistical Yearbook of Ukraine for 1999), Kiev 2000.

Migration movements into and out of Transcarpathia (according to official data) in 1999 were below average (in relation to inhabitants). But out-migration clearly prevails. The unemployment rate (according to surveys) is slightly above the national average, especially in rural areas. The ratio of jobless persons to vacant jobs is much higher in Transcarpathia than in the country as a whole, although this seems to have improved in 2000. With respect to tourism, Transcarpathia remains equipped above-average with the infrastructure of sanatoria and rest facilities with medical care. This cannot be said of hotels, but the region has recently moved nearer to the average. The incidence of registered crimes remains below average in Ukraine's westernmost region. Environmental pollution due to accidents appears to be minor. The emission of pollutants into the atmosphere is also below average.

Given the above figures, the Transcarpathian economy will hardly take off until productive investment recovers substantially.

### **3 Selected Features of the Oblast's Contemporary Economic Development**

#### **3.1 Recovery and Privatization of Agriculture**

Whereas in 1990, Transcarpathian agricultural production accounted for about 1.6% of total Ukrainian farm output, this share (measured on the basis of comparable prices) expanded to 2.3% in 1999 and in all probability rose further in 2000 and 2001. The share of private farms in Transcarpathia in the total number of Ukrainian private farms grew from 3.3% in 1996 to 3.9% in 2000. However, the share of the former in total private cultivated land remained modest. The region's share in the number of employees in collective agricultural enterprises declined from 2.5% (which would correspond to its population share) to 0.7% in 2000.

The comeback of farming activity in Transcarpathia is certainly also related to an acceleration of privatization in recent years. A presidential decree of December 1999 allows former members of collective farms to leave with their share of land and property. In April 2000, Ukraine's collective farms were officially disbanded or transformed into private cooperatives. Furthermore, Transcarpathia appears to be one of the few regions of the former USSR and Ukraine where private agricultural skills were not wiped out or severely compromised in the decades following the traumatic Soviet collectivization of the beginning of the 1930s. As pointed out above, agriculture was collectivized in Ukraine's westernmost region only in the second half of the 1940s. Therefore, more people have some living memory of private agricultural activities in Transcarpathia than in other regions.

Local farmers have doubtlessly reacted swiftly to the privatization decrees. Most of them have obviously opted to reestablish individual family farms. Some are still receiving titles to their land. The return to private agriculture is often done in a quite hands-on manner. A number of villages in Transcarpathia exhibit the ruins of collective farm buildings and installations that have been physically destroyed, while sometimes only a short distance from these ruins new private farm houses are springing up (with some of them probably using the bricks of the defunct kolkhoze buildings). Although land cannot be sold yet, leasing to private operators has increased. As of mid-

2001, the draft Land Code was still before the Ukrainian parliament. Once adopted, it would allow farmers to trade land and to use it as collateral, which should stimulate finance for agriculture.

In the high country, cultivated land stretches to areas in higher altitude than in comparable alpine regions, which would be dominated by pastures. This would underline the importance of subsistence activities in the mountains. After the Gorbachev anti-alcohol campaign in the mid-1980s had led to the destruction of an estimated 80% to 90% of vines in Transcarpathia, vineyards are slowly recovering. Now new sorts of wines are being produced in the area, too. Stimulated by agricultural production, local food processing activities are gaining momentum. Forests are generally in state ownership, but forestry licenses can be granted to private businesses. Like in the case of food processing, the oblast authorities are attempting to attract more wood processing activities to the region.

### 3.2 Floods and Reconstruction

Transcarpathia has been a victim to floods not only since Soviet times, but for centuries. Apart from the above-mentioned Soviet legacy, there are probably also other important reasons for the floods. According to the oblast administration authorities,<sup>1)</sup> a study by a commission of the Ukrainian Academy of Sciences points to two main reasons for the floods: global warming and a regional climate of abundant rain. The most recent major floods occurred in November 1998 and March 2001. The inundations also ravaged parts of northeastern Hungary.<sup>2)</sup> Despite the key importance of woodcutting activities for the regional economy, they have been somewhat curtailed by the authorities in recent years, apparently in response to environmental concerns.

Some anecdotal evidence would suggest the effects of recent floods to be considerable, but not outright catastrophic, at least not at the overall regional level. While some villages in the mountain valleys as well as the lowlands have been hit hard, it seems that the better-off lowland settlements are more successful in coping with the calamities. Some of the lowland villages most damaged by the 2001 flood are currently witnessing busy and intensive private reconstruction activity.<sup>3)</sup> At least in these cases, people have obviously not resigned. On the other hand, given the lack of means and insufficient external assistance, the survival of a number of settlements in the high coun-

1) As explained by officials of the Economic Department of Zakarpatska Oblast at a meeting with the excursion team in June 2001.

2) To illustrate the devastating effects of the floods, here is the account of a news agency report on the flood of March 2001: "Following the recent floods, 251 villages in the Transcarpathian region of Ukraine remained partly under water on Friday morning ... Seven people died in the floods, 1,600 houses were destroyed, 12,000 people were evacuated, three villages lost their electricity and six telephone exchanges were put out of action ... Sixteen road stretches with a total length of 61.1 kilometers have been damaged. Six road bridges have been destroyed, and nine villages cut off. Railroad traffic has been stopped along five stretches" (Ukraine: In Transcarpathia 251 villages remain partly flooded. Interfax News Agency – Daily News Bulletin, March 16, 2001). As of September 2001, 10,000 people were still homeless as a consequence of the floods (Ukraine: Government Provides Additional UAH 25 Million to Enable Zakarpattya Region to Handle Aftermath of March Flooding. Ukrainian News, September 17, 2001).

3) This refers e.g. to the village of Tekovo (Vinogradiv Rayon) on the Tisa, which the excursion team visited.

try is apparently seriously threatened.<sup>1)</sup> NATO announced recently that it planned to hire experts to carry out research work in the region as part of a pilot project to help Ukraine create an effective flood protection system in the Tisa river valley in the Carpathians.<sup>2)</sup>

### **3.3 Shuttle Trade with Transcarpathia's Western Neighbors, Border Controls and the Informal Economy**

Although foreign trade, as measured by official statistics, does not play a significant role for Transcarpathia and its population, so-called "shuttle trade" in all evidence does. As the word suggests, such cross-border trade tends to be carried out by individuals "shuttling" back and forth, in fact fulfilling private trade arbitrage functions between countries featuring considerable price, tax and/or income differences. In Russia, such traders are called "chelnoki." After the collapse of the USSR, the previously strict official travel regime was relaxed between Ukraine (and some other CIS countries) on the one hand and most central European countries on the other. Therefore, since 1992 shuttle trading between Transcarpathia (and other Ukrainian border regions) on the one hand and Poland, Slovakia, Romania, and particularly Hungary, on the other, expanded strongly. The intensity of shuttle trading with Hungary is favored by good travel connections within the Pannonian plain, the relative proximity of large cities (including Budapest) and, probably, the ease of communication between the large ethnic Hungarian minority living near the Transcarpathian border and Hungarians.

The most important shuttle trade comprises the sale of (often smuggled) Ukrainian alcohol (vodka), cigarettes and gasoline in Hungary and Slovakia and the purchase of various consumer goods and durables in the latter countries.<sup>3)</sup> At least until the beginning of 2000, an average of around 20,000 Ukrainian shuttle traders a day are reported to have passed into Hungary, Slovakia or Romania. Moreover, many Ukrainians are legally or illegally employed on farms or building sites across the border. More than 100,000 people (no less than 15% to 20% of the workforce) of Transcarpathia are estimated to – at least temporarily – work illegally outside the country. They reportedly earn up to USD 250 a month, about six times what they would receive in Ukraine.<sup>4)</sup> This may generate a major injection of money and resources into the Transcarpathian economy. Representatives of the oblast administration actually estimate that shuttle trade makes up an amount equal to the entire amount of official foreign trade and that the informal sector in fact doubles measured economic activity and income.<sup>5)</sup>

1 *Ein Paradies – von Katastrophen geschlagen. Aufzeichnungen einer Reise durch die ukrainischen Karpaten. Neue Zürcher Zeitung, August 14/15, 1999, p. 6.*

2 *Ukraine: NATO will ein Pilot-Projekt über Schaffung eines wirksamen Schutzsystems gegen Hochwasser in der Karpatenregion am Fluss Tisza ausführen. ITAR-TASS, August 6, 2001.*

3 *For instance, cross-border trade of gasoline is reportedly triggered by the fact that the price in Ukraine is 40 cents per liter and in Hungary USD 1 per liter (as of June 2001).*

4 *Worried in western Ukraine. The Economist, October 2, 1999, p. 33.*

5 *These estimates were given by officials of the Economic Department of the oblast administration during the meeting with the excursion team.*

These stunning facts and assessments are in line with casual observations according to which official statistics classifying Transcarpathia as the poorest region of Ukraine seem at odds with reality. On the other hand, the informal sector is more or less strongly present everywhere in Ukraine, and official statistics generally fail to appropriately capture this. Still, the unique geographical position of Transcarpathia enabling ubiquitous border trade and labor migration probably reflects conditions conducive to a particularly large expansion of the informal sector. Sizeable earnings from the informal sector are likely to be a major source of financing of small business startups and investments in (legal or illicit) private initiatives and enterprises from agriculture to catering to tourism. This is of particular importance, given that bank credits to small enterprises, farms and households are quite scarce for various reasons (e.g. lack of information, insufficient creditor rights and unreliable contract enforcement). Another factor “stimulating” (the flight to) the informal economy is very high (income) taxation coupled with the instability of taxation rules.

In recent years there have been discussions among central European countries on the (re)introduction of visas for citizens of CIS countries, in particular for Ukrainians, owing to two main factors: The EU accession candidates have been increasingly confronted with the EU’s demand that future members should bring their visa policies into line with those of EU Member States. This refers especially to the Schengen agreement on passport-free travel within the “Schengen zone.” Another factor is the above-mentioned large number of illegal economic migrants from Ukraine and the apparent implication of many of these people in criminal activities (Duleba, 2001, p.14). Against this background, the Czech and Slovak governments introduced visa requirements for Ukrainians as from mid-2000. The Ukrainian government swiftly reciprocated the measure and introduced visas for Czechs and Slovaks from the same date.

The Hungarian authorities have greater reservations about introducing a visa regime for Ukrainian citizens, given the large minority of ethnic Hungarians (more than 150,000) in Transcarpathia and their contacts with Hungary. In April 2001 the Hungarian foreign minister announced that Hungary did not intend to introduce visas for Ukrainian citizens before accession to the Union. If by the time it joins the EU Hungary is obliged to introduce visas for Ukrainian citizens, Budapest will attempt to soften the regime, implying the establishment of additional border crossing points and the modernization of existing ones, the liberalization of the visa issuing procedure, the creation of more consulates, and the like.<sup>1)</sup> To date, Poland and Romania have not taken any specific steps with respect to the visa issue.<sup>2)</sup>

In June 2001 the Hungarian parliament adopted the “Act on Hungarians Living in Neighboring Countries” (Act LXII/2001), which bestows special

1 *Ukraine: Hungary will not introduce visas for Ukrainian citizens before accession to the EU. Interfax Ukrainian News (Interfax News Agency), April 18, 2001; Ukraine: Hungarian report views future Hungarian border guard, Schengen system. BBC Monitoring European – Political, July 31, 2001.*

2 *Poland will not tighten border controls with Ukraine in wake of terrorism. Interfax News Agency – Daily News Bulletin, September 18, 2001; Weikert (2001).*

rights on ethnic Hungarians living beyond the borders of the Republic of Hungary. The law i.a. makes available to those eligible a special identity card, a three-month work permit in Hungary on an annual basis, and some medical, educational and cultural benefits.<sup>1)</sup> While Slovakia and particularly Romania, which harbor large Hungarian ethnic minorities, have initially reacted negatively and protested against the enactment of the law, no strong reaction of Ukraine was recorded.

Whatever the consequences of the Hungarian status law, there can be no doubt that the introduction of visa regimes (even if in simplified versions) by Ukraine's central European neighbors would considerably complicate or even disrupt the life of shuttle traders and render illegal work more difficult, thus effectively dealing a blow to Transcarpathia's economic well-being. Up to a point, this can already be gauged from the initial effects of Slovakia's visa measure. The introduction of the visa regime in Slovak-Ukrainian relations is reported to have triggered a decline of about 75% in the number of people crossing the common border in the second half of 2000. Most of all, the measure affected inhabitants of the neighboring regions of Eastern Slovakia and Transcarpathia, including black marketeers and informal workers. Whereas petty crime has indeed shrunk, there are signs that organized crime may have largely evaded strict border controls.

At the beginning of 2001 the Slovak and Ukrainian authorities negotiated a slight easing of the visa regime. Apart from other clearly identified categories of citizens (e.g. diplomats, transport personnel, World War II veterans) residents of the 83 villages straddling both sides of the Slovak-Transcarpathian (Ukrainian) border were exempted from paying charges for visas.<sup>2)</sup> Furthermore, visa charges for people whose visits are of a "humanitarian character" (such as education, science, art, religious purposes, visiting relatives, visiting graves of cousins) were reduced by 50% (Duleba, 2001, p. 15).

Table 2

### Regional Structure of Transcarpathia's Foreign Trade

#### first quarter of 2001

Region/country	Exports		Imports		for comparison: Ukraine 2000	
	USD million	%	USD million	%	Exports	Imports
Total	59.42	100	47.78	100	100	100
CIS countries	1.15	1.9	0.89	1.9	30.8	57.6
of which: Russia	0.92	1.5	0.61	1.3	24.1	41.7
Austria	13.71	23.1	10.57	22.1	1.1	1.3
Germany	15.04	25.3	9.28	19.4	5.1	8.1
Hungary	11.89	20	10.98	23	2.3	1.2
Italy	4.31	7.3	4.6	9.6	4.4	2.5
Slovakia	3.27	5.5	1.98	4.1	1.6	0.9
Netherlands	1.57	2.6	0.85	2	1	1.1
Czech Republic	1.53	2.6	0.98	2	1.3	1.2

Source: Derzhavnyi komitet statistiki Ukraini – Zakarpatske oblasne upravlinnyia statistiki: Ekonomichne ta sotsialne stanovishche zakarpatskoi oblasti – Statistichnyi byuleten za sichen-kviten 2001 roku, Uzhgorod 2001, pp. 103–104; WIIW (ed.), *Countries in Transition 2001 – WIIW Handbook of Statistics*, Bratislava, 2001.

- 1 See text of the law on the website of the Ministry of Foreign Affairs of Hungary ([www.kum.hu/kulugy/fejlec/index2.html](http://www.kum.hu/kulugy/fejlec/index2.html)); EU: Hungary defends status law, EU urges consultations. Reuters News Service, July 17, 2001.
- 2 An individual Slovak entry visa reportedly costs no less than USD 200, a small fortune for an ordinary Ukrainian. – Ukraine: La Ruthénie, ou la tentative de créer la dernière nation d'Europe. *Le Temps*, May 22, 2001.

Still, according to most recent estimates, the number of Ukrainians passing the border to Slovakia has fallen by about two thirds since imposition of the visa obligations (Weikert, 2001).

### 3.4 Foreign Trade, Special Economic Zone and FDI

By comparison to other regions Transcarpathia is not a major center of foreign trade. With its favorable and strategic location, the oblast of course functions as a Ukrainian gateway to central and western Europe and vice versa (as the four important pipelines and the plans for a Trans-European transport corridor running through Transcarpathia amply demonstrate). But the region itself does not generate a relatively large amount of exports and imports, even if the above-mentioned official estimates of informal activities are factored in. Even if official data on Transcarpathia's exports and imports were doubled (while at the same time leaving figures on other regions unchanged), the area would still account for less than 3% of Ukraine's foreign trade turnover. Its share of FDI (less amenable to informal activities) amounted to 2.3% in 1999, which is somewhat below its share in Ukraine's population.

In 2000 (according to official statistics), Transcarpathia's most important export products were sawn timber, plywood, paper, furniture and other wood manufactures (about 30%), electrical machinery parts and accessories (25%), textile clothes, knitwear and knitted goods (20%), wine, cognac, mineral water, salt, wild fruit and berries, mushrooms and confectionery. The region's main imports include electrical and mechanical machinery and equipment (around 35%), cotton and textile fabrics and goods (15%), plastic and plastic manufactures (5% to 10%), alcohol, soft drinks, vehicles and oil products. Transcarpathia is therefore integrated into the international division of labor by exporting machine parts and importing finished machinery and equipment. Transcarpathia purchases foreign raw materials for its textile and clothing industry and sells garments and finished goods abroad. It largely draws upon its own resources to export timber and wood products, wine, mineral water, salt and the like. Approximately a third of Ukraine's furniture exports are estimated to come from Transcarpathia. The region's foreign trade balance has been slightly positive in recent years.

The most important external trading partners are *Austria*, Germany, Hungary, Italy, Slovakia, the Czech Republic, the U.S.A. and the Russian Federation.<sup>1)</sup> Transcarpathia is an important net provider of services, in particular transport services, to its foreign partners. As of end-1999, total accumulated foreign direct investment in Transcarpathia amounted to USD 73.8 million. By end-March 2001 it had grown to USD 91.5 million.<sup>2)</sup>

1 *In the first quarter of 2001, 23.1% of Transcarpathia's exports went to Austria and 22.1% of its imports came from Austria. Germany was the destination of 25.3% of the region's exports and the source of 19.4% of its imports. Hungary took 20.0% of its deliveries and generated 23.0% of its purchases. Italy follows with 7.3% and 9.6% respectively. – See: Derzhavniy komitet statistiki Ukraini – Zakarpatske oblasne upravlinnya statistiki (2001, pp. 103–104).*

2 *In contrast, as of January 1, 2001, total registered FDI (investment contracted/pledged but not necessarily already realized) came to USD 162 million. – See: Zakarpatska oblasna derzhavna administratsiya (2001a, p. 42).*

The most important branches of FDI were timber and wood processing, the food industry, domestic trade, the textile and leather industries and light industry. Hungarians, Americans, Austrians, Germans, Slovaks, Czechs and Russians are the major foreign investors. The largest and most renowned FDI ventures are the following: “Fischer-Mukachevo” (production of skis and hockey sticks), Eno-Mebli Ltd (located in Mukachevo; furniture), Sten Ltd (located in Mizhgirya; sawn timber, furniture), MOL-Zakarpattya (filling stations), Green Ray (canned food), Skilur (wine), Le-Go Ukraine (located in Chop; sewing goods, women’s clothes), Henkel-Uzhgorod Ltd (laundry detergents and domestic chemical products), Sanders-Vinogradovo (textile clothes). As of mid-2001, a project of Skoda Auto (a Czech firm owned by Volkswagen) and Avtotrading (a Ukrainian company) was in preparation to set up an assembly plant of Skoda cars in Transcarpathia. The plant was to launch production in the fall of the year.

In recent years, the Ukrainian authorities have attempted to render Transcarpathia more attractive for domestic and foreign investors by creating some fiscal investment incentives. At the beginning of 1999 the “Law on the Special Regime for Investment Activity in the Transcarpathian Oblast”<sup>1)</sup> came into force. This law grants special tax and customs privileges to investors who realize investment projects worth at least USD 250,000 in priority fields of economic activity as defined by the Council of Ministers of Ukraine. The law is valid for activities in the entire area of the oblast. The latter is not the case with respect to the “Presidential Decree on the Special Economic Zone ‘Zakarpattya,’”<sup>2)</sup> which was issued at the end of March 2001. This piece of legislation defines a territory of about 740 hectares comprising part of the border town Chop as well as places in Uzhgorod and Mukachevo (the airport and railroad interport). Upon registration as a subject of the Special Economic Zone (SEZ), the investor can claim specific profit tax, personal income tax and value added tax reductions as well as exemptions from customs duties for economic activities and processing carried out in the zone and imports and exports connected with these.

Table 3

### Structure of FDI<sup>1)</sup> in Transcarpathia

as of April 1, 2001

	USD million	%
Total:	91.54	100
of which:		
food processing industry	20.17	22.0
wood processing	18.95	20.7
domestic trade	17.93	19.6
textile and leather industry	10.02	10.9
production of machines and electrical equipment	4.08	4.5
hotels and restaurants	2.92	3.2
transportation	2.13	2.3

Source: Derzhavnyi komitet statistiki Ukraini – Zakarpat'ske oblasne upravlinnya statistiki: *Ekonomichne ta sotsialne stanovishche zakarpatskoi oblasti – Statistichnyi byulleten za sichen-krvten 2001 roku, Uzhgorod 2001*, pp. 85–86.

<sup>1)</sup> Cumulated.

- 1) *Zakon Ukraini pro spetsialniy rezhim investitsiynoi diyalnosti u Zakarpatskiy oblasti (1998).*
- 2) *Ukaz Prezidenta Ukraini pro spetsialnu ekonomichnu zonu “Zakarpattya” (2001).*

Table 4

**The Most Important Foreign Investors in Transcarpathia****as of April 1, 2001**

	USD million	%
Total	91.54	100
of which:		
Hungary	16.40	17.9
U.S.A.	15.71	17.2
Austria	12.80	14.0
Germany	11.61	12.7
Slovakia	9.08	9.9
Ireland	5.95	6.5
Sweden	3.20	3.5

Source: Derzhavnyi komitet statistiki Ukraini – Zakarpatske oblasne upravlinnya statistiki: *Ekonomichne ta sotsialne stanovishche zakarpatskoi oblasti – Statistichnyi byuleten za sichen-kviten 2001 roku, Uzhgorod 2001, p. 87.*

As of August 2001, the investment law of 1999 has reportedly already been applied to more than 50 investment projects, whereas the SEZ decree has attracted pledges amounting to about USD 11 million. Given the very short period of validity of the SEZ decree, this small figure cannot yet be judged as disappointing. The oblast authorities expect additional capital expenditure of around USD 50 million in the year 2001 to be triggered by the special legal conditions for investment in Transcarpathia.<sup>1)</sup>

### 3.5 Tourism and Recreation

Given the beauty of its natural endowments, Transcarpathia certainly has a rich potential for tourism. The diversity of the landscape, vast forestlands, mountains, scenic river valleys, puszta-like plains and a temperate continental climate create conditions for year-round recreation, including skiing in winter. Ample mineral and thermal water resources have contributed to the development of health care and medical institutions. As referred to earlier, a modest infrastructure of tourist centers and sanatoria already emerged in Soviet times. Its geographic location makes Transcarpathia relatively easily accessible for car, bus and train tourists from e.g. Hungary, Slovakia, Poland, Austria and the Czech Republic. According to official information, some 300,000 people (mostly domestic tourists) visit Transcarpathia every year.<sup>2)</sup>

But since the collapse of the USSR it appears that the tourist and health care infrastructure inherited from the Soviet era has not received much investment. Transcarpathia's share in the total number of places in sanatoria and rest facilities with medical care in Ukraine is reported to have steadily declined from 1990 (2.9%) to 1999 (2.6%). On the other hand, the region's share of hotel beds increased in the second half of the 1990s. One of the reasons for the lack of investment in Soviet-era infrastructure appears to be that many of these facilities are owned by or assigned to the labor unions, which used to administer them (almost free of charge to patients) in the past but which now do not seem to have sufficient means at their disposal to finance necessary renovations and capital expenditures.

<sup>1</sup> Zakarpatska oblasna derzhavna administratsiya (2001a, p. 43).

<sup>2</sup> Zakarpatska oblasna derzhavna administratsiya (2001b, pp. 45–46).

This property rights situation has also contributed to blocking outside and foreign investment. The upper Tisa valley (in the southeastern corner of Transcarpathia around Rakhiv and Yasinya), which could eventually be a thriving ski and summer alpine holiday area comparable to e.g. Zakopane in Poland or Bled in Slovenia, has seen virtually no investment in recent years and a vast drop in numbers of visitors since the end of the organized sanatorium system (Boss, 2001, p. 29). However, today at least some sanatoria in the oblast partly work on a commercial basis, with visitors paying for their stays.

Bureaucracy is certainly an important factor confronting (foreign) investors in the region. Some elements of tourist infrastructure may need to be substantially overhauled or (re)created from scratch. There are few tourist offices (relegated to the biggest towns), and the few existing tourism brochures, leaflets and publications on interesting sights and places can be very hard to come by. On the other hand, some new private hotels, bed & breakfast establishments and restaurants have been springing up here and there. Prices are modest, and amateurism in service can be compensated by enthusiasm.

All in all, Transcarpathia with its natural treasures and relatively clean environment today presents itself in a pioneer stage of tourism development. While the old structures no longer function properly, new ones have yet to take their place. Obviously, huge efforts will be needed to improve the sector.

#### **4 Outlook: Transcarpathia, Ukraine and EU Eastward Enlargement**

The accession of Transcarpathia's western and southern neighbor countries to the EU is bound to considerably alter economic conditions for the oblast and its population. Hungary, the Czech Republic, Slovakia and Poland can be expected to join the Union just a few years from now. Romania may follow sometime after that. At least in the medium term, accession can be expected to generate additional economic growth in the new EU members. Ukraine and Transcarpathia stand to benefit from spillover effects of this additional growth. Transcarpathia borders on regions within the just mentioned countries that feature below-average income and above-average unemployment levels – regions that thus are relatively poor (Roemisch, 2001, pp. 6, 8). The prospect that the accession countries and their regions adjacent to Transcarpathia will receive at least some structural funds from Brussels should have a specific positive impact on demand for Transcarpathian and other Ukrainian goods and resources. On the other hand, the prospect of being left out of the integrating zone may likewise entail sizeable exclusion and trade diversion effects, especially for a “border economy” with the structural characteristics of Transcarpathia.<sup>1)</sup>

As mentioned in section 3.3, upon joining, future Member States will be asked to prepare for joining the Schengen zone and thus to introduce visa

<sup>1</sup> Regarding the overall effect, according to theory “even the excluded country can gain in absolute welfare terms – if the growth effects of integration are strong and insider-outsider trade costs are low,” as Manzocchi and Ottaviano (2001, p. 246) put it.

requirements for Ukrainians and other citizens of CIS countries. The Czech Republic and Slovakia already introduced their visa regimes in mid-2000; Slovakia softened its regime somewhat at the beginning of 2001. Hungary and Poland have not yet introduced visa regimes. If estimates of the oblast administration that the informal sector (particularly shuttle trade and illegal workers) accounts for a 50% share of total exports and of income of the region are accurate, a Schengen-type closing off of the border between the enlarged Union and Ukraine could have detrimental effects on the material well-being of Transcarpathians and western Ukrainians. These effects in the worst case could even spill over into a political destabilization of border regions. The impact would, of course, be less harmful if at least some of the shuttle trade and other informal activities were able to “evolve” quickly enough into “normal” wholesale/retail trading sectors, possibly with the financial help of Hungarian and other capital.

There appears to be no empirical study that tries to gauge or forecast the effect of EU enlargement plus Schengen border controls on Transcarpathia and western Ukraine. Moreover, Transcarpathia’s situation and characteristics do not seem to be readily comparable to those of regions adjacent to former EU entrants, like western Hungary or southern Bohemia and Moravia with respect to Austria or northwestern Russian oblasts with respect to Finland.<sup>1)</sup>

In any case, the question arises of whether economic exclusion effects can be countered or alleviated. Since, at least in the medium term, it will probably not be possible to do away with the Schengen visa obligations, any realistic efforts of the authorities would have to be directed toward improving the border-crossing infrastructure and enhancing its efficiency as much as possible. This might be achieved in different ways. Visa conditions could be made less restrictive and visa fees cut, at least for inhabitants of bordering territories (along the lines of the recent Slovak measure, but bolder). A number of additional border-crossing points could be opened and existing ones modernized, new consulates set up, bureaucratic procedures (where they exist) streamlined, the costs of issuing Ukrainian passports could be reduced and similar measures taken. Upgrading and increasing the suppleness of border-crossing infrastructure will certainly require financial assistance from the EU. Via Phare and Tacis programs, this assistance should be offered to staff and facilities on both sides of the future eastern border of the Union. Some first efforts in this respect have already been undertaken within the framework of the Tacis Cross Border Cooperation Program,

<sup>1</sup> For example, a comparison of the effects of EU accession and imposition of the Schengen regime by Austria (in the mid-1990s) on western Hungarian komitats with the impact of future accession and adoption of Schengen controls by Hungary on Transcarpathia would be misleading for a number of reasons. In the mid-1990s Hungary already had a free trade agreement with the Union (as part of its “Europe Treaty”), whereas Ukraine is far away from such an agreement. Western Hungary was much more integrated via formal economic ties, e.g. FDI, with Austria and Western Europe than Transcarpathia is today with Hungary. On the other hand, illicit trade and labor of western Hungarians in Austria was evidently less developed than the respective activities of Transcarpathians in Hungary today. Finally, the visa regime that Austria applied to Hungarians was in fact less restrictive than the one that the Hungarian authorities will probably be asked to subject Ukrainians to (or the one that the Slovak authorities have already introduced).

which was launched a few years ago and covers regional jurisdictions in CIS countries on the eastern side of the border (including Transcarpathia). But according to a report by the European Court of Auditors, the program has had very little impact so far and has suffered from delays, inadequate financing, lack of coordination with the Phare programs for candidate countries and other administrative obstacles.<sup>1)</sup>

The “Carpathian Euroregion,” founded in 1993, constitutes an organization aiming at improving transborder cooperation between adjacent administrative areas along or near the Carpathian mountain chain in five countries (Hungary, Poland, Romania, Slovakia and Ukraine). One of more than 100 “Euroregions” today, it was the first such entity founded only by Central and Eastern European countries. With the Transcarpathian oblast lying in the center of the Carpathian Euroregion, the latter may present an adequate forum for attempts to strengthen the border-crossing infrastructure. In contrast to the aforementioned individual EU programs, the Carpathian Euroregion covers jurisdictions on *both* sides of the border. Unfortunately, so far the Euroregion has not been very successful in intensifying transborder connections and relations (Duleba, 2001, p. 13; Verseck, 2001).<sup>2)</sup> Its activities do not appear to be high on the priority agenda of its member states. Perhaps EU eastward enlargement and its implications will make the entity’s activities more dynamic. But for this to happen, the Euroregion would probably need more encouragement and coordinated support from the EU itself (Batt and Wolczuk, 2001). The Carpathian Euroregion and other such entities straddling the eastern border of the enlarged Union could even provide a kind of decentralized institutional framework for EU regional “outreach” activities of various kinds to facilitate life in the borderlands.

Another element that could improve links between the enlarged EU and Transcarpathia and the rest of Ukraine would be the realization of the European Transport Corridor no. 5, linking Trieste, Budapest, Lviv, Kiev and Volgograd. In Transcarpathia and Ukraine, this project has not yet gotten off the ground, given the necessity to rehabilitate the existing Chop-Kiev highway and to renew the railroad line Lviv-Chop. Highway operating concessions to foreigners (as granted in Hungary) are not yet possible under Ukrainian legislation. A credit agreement between Ukraine and the EBRD according to which the EBRD will provide a loan of EUR 75 million to finance modernization of the Chop-Kiev highway was signed in December 2000, but has not yet become operable because Ukraine has not fulfilled all conditions attached to the loan.<sup>3)</sup> Two public enterprises were established a few years ago to facilitate goods transportation across Transcarpathia (and further through Ukraine): the automobile terminal Avtoport Chop (situated

1 For instance, work on improving the Zahony-Chop border-crossing point between Hungary and Transcarpathia/Ukraine (see map) only started in October 2000. See Europe Information service (2001).

2 For more general information on the Carpathian Euroregion and its activities, see Illes (1996); Slovakia: Foundation announces Carpathian Euroregion programs for 2001. SITA – Slovak Press Agency, March 5, 2001; <http://www.carpathianfoundation.org/languages/en/tcer.php>.

3 Transport – Cabinet Intends to Reform Financing of Roads. Ukrainian News, October 20, 2001.

in the SEZ “Zakarpattia”) and the firm Zakarpatinterport, which supplies various types of transport services.<sup>1)</sup>

In the long term, the visa issue may not be the decisive factor for the future of the Ukrainian “gateway,” “window” or “bridge” to Europe, as Transcarpathia is often called. Informal or illegal activities should not constitute a main pillar of any economy, although the future visa regime may also hamper some legal commercial activities. Schengen or not, major advantages of the oblast remain: its strategic transport location extending into central Europe, the beauty, originality and relative cleanness of its natural environment, its very low wage level (even in comparison to central European countries), combined with a good general level of education of the partly multilingual population.

These are strong arguments in favor of sizeable foreign direct investment in the region. Looking beyond accession, as new EU member countries converge to and finally “lock into” the euro, Transcarpathia (and Ukraine) could, on balance, find themselves in a position to gain in competitiveness, particularly wage competitiveness vis-à-vis its immediate neighbors. This follows from the continued exchange rate flexibility that the hryvnia will enjoy compared to the euro. On the other hand, a euro-triggered acceleration of FDI in the new member countries could further increase their productivity lead over Transcarpathia, thereby counteracting any gains in competitiveness via hryvnia depreciation.

The fact that not much FDI has yet found its way to Transcarpathia is obviously linked with the difficult investment climate in the region and Ukraine as a whole. Rendering the “Special Regime for Investment Activity in the Transcarpathian Oblast” more generous and beefing up the SEZ program would help.<sup>2)</sup> Encouragement from the European Union and from former CMEA trading partners-turned-EU members just across the border, showing from their own experience how things can be successfully done and improved and which things better to avoid, may facilitate the efforts of the central authorities in Kiev to move ahead with economy-wide structural and institutional reforms which could create the preconditions for unblocking investment flows and validating Transcarpathia’s comparative advantages. These measures would need to include simplifying and stabilizing tax legislation and the tax system of Ukraine, enhancing property rights and creditor rights, improving the efficiency of the court system and the reliability of enforcement of law.

1 *Zakarpatska oblasna derzhavna administratsiya (2001a, p. 35).*

2 *This would, of course, only constitute a second-best solution to improving the overall investment conditions in the country at large.*

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