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## **Regional Cooperation in southeastern Europe**

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Regional cooperation in Southeastern Europe (SEE) is of even greater importance today, in the aftermath of the Kosovo conflict, than a few years ago. The various initiatives to stimulate regional cooperation in SEE in the 1990s have not yet led to any significant results. On the contrary, the *lack* of regional cooperation has seriously undermined peace and stability in SEE, contributing to several armed conflicts in the region, including the most recent war in Kosovo March through June 1999. Not surprisingly, the international community's latest initiative, the Stability Pact for Southeastern Europe, adopted 10 June 1999 in Cologne, again relies on regional cooperation as one of the most important instruments for bringing lasting peace and stability to this part of Europe.

This paper discusses some aspects, primarily economic, of regional cooperation in SEE. For the purposes of this paper, SEE will include seven transition countries: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic of Macedonia (FYROM), Romania and the Federal Republic of Yugoslavia (FRY), although Slovenia will also occasionally be considered. The paper first examines the question of economic integration in SEE by looking at past and present trade links among SEE countries. It then considers various initiatives aimed at stimulating regional cooperation, including EU policies toward the SEE region. Finally, the paper discusses the main reasons that closer economic ties among SEE countries should actively be encouraged, followed by some concluding remarks.

## HOW INTEGRATED IS THE SEE REGION?

How integrated is the SEE region today? This question can not be properly addressed without taking into account the historical context, namely the level of integration in SEE in 1989 on the eve of transition, and the major political and economic developments that have fundamentally influenced relations among SEE countries in the 1990s.

When the transition to a market economy began in 1989, the general situation in SEE was very different than it is today (see Table 1). At that time, five countries in the SEE region were in an economic union within the Socialist Federal Republic of Yugoslavia (Bosnia and Herzegovina, Croatia, FYROM, Slovenia and FRY, then represented by the two republics Serbia and Montenegro) and as such, had substantial trade and other economic links. Yugoslavia was the most developed and the largest country in SEE, in

terms of both territory and population. Because of its specific position in international economic relations, it was less dependent than its SEE neighbors on trade with the other socialist countries (Uvalic, 1992). Bulgaria and Romania for several decades had been members of the CMEA (Council for Mutual Economic Assistance) and therefore had a higher proportion of trade with the other socialist countries, especially Bulgaria, the country most dependent on intra-CMEA trade. Finally, Albania was the most closed economy in Europe. After abandoning CMEA in the early 1960s, it followed its own autarkic development strategy for many years and had limited economic links with the rest of the world, including its closest neighbors.

In 1989 relatively little trade existed among SEE countries (see Table 1). In the case of Bulgaria, 13.4 per cent of its exports went to and 6.5 per cent of its imports came from the other two major SEE countries, Romania and Yugoslavia.<sup>1</sup> Regional trade was even less important for the rest of the SEE countries. The share of the three SEE countries in Romania's exports and imports in 1989 amounted to only 3.2 per cent and 4.4 per cent, respectively, and even less in Yugoslavia's (2.1 per cent of the exports and 2.2 per cent of imports). These very low shares of mutual trade show that despite geographical proximity, the SEE region in 1989 was not at all economically integrated, *except* for economic links within former Yugoslavia. At that time, the SEE region actually consisted of two subregions: the first, relatively integrated, encompassed the economies of the six republics of former Yugoslavia, and the second, characterized by very weak mutual trade links, comprised the other three SEE countries. Trade flows between the two SEE subregions were negligible.

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<sup>1</sup> Bulgarian foreign trade with Albania in 1989 is not considered, since no data is reported in IMF statistics; it is possible that the amounts were negligible.

**Table 1. Some indicators on SEE countries in 1989**

|                 | <i>Area<br/>(in 000 sq.<br/>km)</i> | <i>Population<br/>(mln 1990)</i> | <i>GDP/cap<br/>(1989<br/>US\$)</i> | <i>Exports to<br/>CMEA<br/>%</i> | <i>Imports<br/>from<br/>CMEA<br/>%</i> | <i>Exports to<br/>SEE<br/>%</i> | <i>Imports<br/>from SEE<br/>%</i> |
|-----------------|-------------------------------------|----------------------------------|------------------------------------|----------------------------------|--|---------------------------------|-----------------------------------|
| <b>Albania</b>  | 28.7                                | 3.2                              | 723                                | 46.3                             | 44.8                                   | n.a.                            | n.a.                              |
| <b>Bulgaria</b> | 110.9                               | 8.9                              | 2,320                              | 83.0                             | 71.5                                   | 13.4                            | 6.5                               |
| <b>Romania</b>  | 237.5                               | 23.2                             | 1,730                              | 40.5                             | 38.5                                   | 3.2                             | 4.4                               |
| <b>SFRY</b>     | 255.8                               | 23.8                             | 2,490                              | 29.9                             | 26.3                                   | 2.1                             | 2.2                               |

Source: Uvalic (1997c) based on various sources (World Bank, OECD, UNECE, IMF, EIU).<sup>2</sup>

Therefore, in 1989, the most integrated part of the SEE region was former Yugoslavia — paradoxically, since many political and economic problems had for years pushed in the opposite direction. Since the mid-1970s, rising regional autarky and fragmentation characterized the Yugoslav market, evidenced by increasing sales on the local markets, duplication of plants in many sectors, impediments to the mobility of capital and labor across republican borders and weak interrepublican integration of enterprises (Uvalic, 1993). Nevertheless, interrepublican trade in former Yugoslavia has always represented an important part of overall trade for all its republics. Throughout most of 1970-89, “exports” to other Yugoslav republics were more important than exports abroad, suggesting that Yugoslav republics were more integrated among themselves than with the outside world (Uvalic, 1993).<sup>3</sup> A recent study (Udovicki, 1996) showed that market forces had strongly resisted Yugoslavia’s political segmentation; the level of integration among former Yugoslavia’s regions was found to be similar to that of countries inside a common market (for example, the EU),<sup>4</sup> while the estimations permitted the author to refute the hypothesis of increasing autarky in the Yugoslav republics. Other studies have also shown that the level of economic interdependence among Yugoslav republics was greater than usually sustained on the basis of purely political arguments (Hinic, 1994).

<sup>2</sup> In reporting trade shares with the CMEA countries, it should be noted that problems of pricing of intra-CMEA trade, which essentially makes it non-comparable with non-CMEA totals, render estimation of these trade shares very hazardous.

<sup>3</sup> The only exception was 1983, when the relative share of exports for all Yugoslav republics was higher than interrepublican trade, but this was due to particular circumstances. The widening trade deficit and enormous foreign debt had compelled Yugoslav authorities to implement an austerity package in the early 1980s, which provoked a serious economic crisis and forced all republics to try to increase exports to foreign markets as much as possible (Uvalic, 1992: 10-16; Hinic, 1994: 93).

<sup>4</sup> As suggestively remarked by the author, “Yugoslav regions exhibited an unfortunate level of economic interdependence — high enough to make a trade war extremely costly, but not high enough to make it impossible” (Udovicki, 1996: 455).

In 1987, the last year for which data on interrepublican trade is available, “exports” to the other republics represented 13 per cent — 29 per cent of the gross material product (GMP)<sup>5</sup> of the individual republics, and as such were more important than foreign trade for all republics, except for Serbia and Slovenia (see Table 2). It should be noted that the oscillations in local, interrepublican and foreign trade were closely related to export performance. In times of deteriorating external conditions, the existence of alternative internal markets (in the other republics) was an important factor compensating for the temporary loss of foreign markets (Uvalic, 1993).

**Table 2. Trade by destination of Yugoslav republics in 1987 (in per cent of GMP)**

| <i>Republics of SFR Yugoslavia</i> | <i>Deliveries to the local market</i> | <i>Deliveries to markets of other republics</i> | <i>Deliveries abroad (Exports)</i> |
|------------------------------------|---------------------------------------|---|------------------------------------|
| <i>Bosnia &amp; Herzegovina</i>    | 56.1                                  | 24.2  | 19.8                               |
| <i>Croatia</i>                     | 67.0                                  | 18.7  | 14.3                               |
| <i>Macedonia</i>                   | 60.8                                  | 21.4  | 17.8                               |
| <i>Montenegro</i>                  | 57.5                                  | 25.0  | 17.5                               |
| <i>Serbia (with K &amp; V)</i>     | 69.0                                  | 13.4  | 17.6                               |
| <i>Serbia proper</i>               | 62.3                                  | 17.4  | 20.3                               |
| <i>Kosovo</i>                      | 64.6                                  | 24.0  | 11.4                               |
| <i>Voivodina</i>                   | 58.1                                  | 28.8  | 13.1                               |
| <i>Slovenia</i>                    | 57.5                                  | 20.3  | 22.2                               |

Source: Uvalic (1993), based on data of the Serbian Institute of Statistics.

Since then, several important political and economic events have fundamentally changed the overall situation in SEE. The transition to a market economy and multiparty democracy has led to important systemic changes in SEE former socialist countries, including radical reforms of the foreign trade system and substantial trade liberalization. Other important events have accompanied the transition. In 1989 the G24 group of countries — the EU in particular — decided to actively support the transition in former socialist countries with a series of measures, including major trade liberalization and various forms of financial assistance. The dissolution of the CMEA in 1991 directly affected primarily Bulgaria and Romania and fundamentally changed their trade orientation. The disintegration of Yugoslavia in 1991-92 led to the creation of five

<sup>5</sup> GMP, or “social product” in Yugoslav terminology, is the value added of “productive” sectors of the economy, thus

separate countries, so that quite contrary to the general trend of trade liberalization elsewhere, the newly created states introduced restrictions on trade with their former trading partners.

These developments contributed to important changes in regional economic groupings, the position of individual SEE countries and their trade patterns. Over the past decade, the EU has emerged as the most important trading partner for the large majority of — though not all — SEE countries (see Table 3). Albania, Bulgaria and Romania very quickly reoriented trade from their traditional partners toward primarily the EU. SFR Yugoslavia, thanks to many years of preferential access to European Community (EC) markets, already in 1989 traded mostly with the EC. The majority of its successor states have also made the EU their most important trading partner. Given that most SEE countries have substituted traditional trading partners almost exclusively with non-SEE countries (primarily the EU), the already marginal links between countries of former Yugoslavia and the other SEE countries have in no way been strengthened, while trade links among Albania, Bulgaria and Romania have become even weaker.

Here it is of interest to consider the SEE as a single regional trading partner and compare its relative importance for SEE countries with that of the EU (see Table 3).<sup>6</sup> Although the figures are approximate, as there is still no comprehensive source of foreign trade statistics for all SEE countries, they nevertheless demonstrate that in 1998, for Albania, Bulgaria and Romania, trade with other SEE countries was of marginal importance. On the contrary, for most countries of former Yugoslavia, trade with other SEE countries represents a rather significant portion of overall trade. The breakup of Yugoslavia in 1991-92 led to the end of many traditional trade links, the introduction of trade and other barriers, several military conflicts, embargoes and the imposition of various other restrictions, which all contributed to a drastic reduction in the overall level of trade among the newly created states. Yet, despite reductions in absolute trade levels, most successor states of former Yugoslavia have maintained some trade with their former trading partners, and in a few cases, such as Bosnia and Herzegovina and FRY, rather significant amounts (see Table 3).

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excluding “nonproductive” sectors such as education, health, defense, banking and other services.

<sup>6</sup> Slovenia is also included in the analysis, due to past trade links with the other countries of former Yugoslavia.

**Table 3. EU and SEE shares in total trade of SEE countries (in PER CENT) - 1998**

| <i>Country</i><br>(and sources)                              | <i>EU share in</i> |                | <i>SEE share in</i> |                |
|--|--------------------|----------------|---------------------|----------------|
|  | <i>Exports</i>     | <i>Imports</i> | <i>Exports</i>      | <i>Imports</i> |
| <b>Albania</b><br>(IMF; BH excluded)                         | 88.8               | 77.9           | 3.0                 | 7.2            |
| <b>Bosnia &amp; Herzegovina</b><br>(BH Central Bank & IMF)   | 21.9               | 29.5           | <b>66.6</b>         | <b>52.8</b>    |
| <b>Bulgaria</b><br>(IMF)                                     | 51.7               | 46.5           | 7.7                 | 3.4            |
| <b>Croatia</b><br>(IMF; Albania and FRY excluded)            | 48.7               | 62.6           | <b>25.2</b>         | <b>12.2</b>    |
| <b>FYR Macedonia</b><br>(IMF)                                | 50.3               | 46.4           | <b>23.4</b>         | <b>32.8</b>    |
| <b>Romania</b><br>(IMF; FRY excluded)                        | 64.6               | 57.9           | 1.9                 | 1.0            |
| <b>Slovenia</b> (IMF; FRY and imports from Croatia excluded) | 65.5               | 69.5           | 15.1                | 1.9            |
| <b>FR Yugoslavia</b><br>(Yugoslav statistics & IMF)          | 32.9               | 38.7           | <b>35.1</b>         | <b>16.3</b>    |

*Source:* In calculating these shares, we have mainly used data provided in the *IMF Direction of Trade Statistics Quarterly* (September 1999). Given that for Bosnia and Herzegovina and FR Yugoslavia IMF statistics are rather incomplete, they have been integrated with national sources: for Bosnia, unpublished data on foreign trade of both entities obtained directly from the Central Bank of Bosnia and Herzegovina in mid-January 2000, and for FR Yugoslavia, *Index* no. 1, 1999, Federal Statistical Office.

After the signing of the Dayton peace agreement in late 1995, there was a revival of trade, especially between Croatia and the Bosnian Federation, and between FRY and the Serb part of Bosnia and Herzegovina (Republika Srpska). Thus, in 1998, Bosnia and Herzegovina actually traded much more with the other SEE countries than with the EU, both in terms of exports (67 per cent) and imports (53 per cent); even higher shares were registered in 1997 (Gligorov, 1998). FRY in 1998 also exported more to other SEE



countries (35 per cent) than to the EU (33 per cent), though its imports from the EU (39 per cent) were more than double the share of imports from SEE (16 per cent), confirming its enormous import dependence, primarily on the EU. There are no other cases where the SEE share of trade exceeds the EU share, though in a few cases it is not insignificant. For FYROM, 24 per cent of its exports and 33 per cent of its imports in 1998 were from other SEE countries. Croatia actually exported more in 1998 to the other SEE countries (25 per cent of the total) than FYROM, but imported much less (only 12 per cent of the total). For Slovenia, trade with SEE countries is much less important, yet this country in recent years somewhat increased its share of exports to the SEE region, from 14.9 per cent in 1995 to 17.1 per cent in 1997 (though the share again fell to 15 per cent in 1998).

As indicated, the reported figures on mutual trade in SEE may not be fully accurate, not only because different sources of data had to be combined but also because the quality of statistics on foreign trade of SEE countries is highly unsatisfactory. In various publications reporting foreign trade in SEE, Bosnia and Herzegovina and FRY are either not taken into account or the data is incomplete or out-of-date.<sup>7</sup> These and other omissions (see notes on sources in Table 3) automatically distort total trade figures for all SEE countries, particularly of the two countries that today are major trading partners (Bosnia and Herzegovina and FRY), and consequently also the respective shares of their trade with other SEE countries and with the EU. It is not surprising, then, that even important political documents contain incorrect statements.<sup>8</sup>

Also, due to the recent wars and trade embargoes imposed in the SEE region, there has been a substantial amount of smuggling, especially across some of the “soft” borders (for example, between Serbia and Republika Srpska, Albania and Kosovo, Croatia and Herzegovina). Consequently, a portion of the trade among some SEE countries is illegal, sometimes occurring in the form of barter, which is not registered. The reported

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<sup>7</sup> A main problem is that officially published foreign trade statistics of Bosnia and Herzegovina are still incomplete. The figures used to calculate the shares in Table 3 are unpublished estimates, obtained directly from the Bosnian Central Bank in mid-January 2000, which seem more accurate than data reported in other publications. Due to such an unsatisfactory state of Bosnian foreign trade statistics, in the publications of international organizations (for example, IMF September 1999 or UNECE 1999, Table 1.3.1), a portion of Bosnian trade, usually between Republika Srpska and FRY, is not taken into account, even though the amount is substantial. Similarly, Yugoslavia’s foreign trade is only partly included in these publications. Thus, IMF statistics include no data on Yugoslavia’s trade with some SEE countries that are today among its major trading partners. Gligorov *et al.* (1999) present the most complete and updated picture of intraregional trade in SEE, though they also do not include recent data on Bosnian-Yugoslav trade (see Table 3, p. 59).

statistics, therefore, probably underestimate the actual amount of regional trade in SEE. These considerations have important implications for the level of intraregional SEE trade today, undoubtedly higher than is usually concluded on the basis of rather incomplete statistics.

The war in FRY significantly disrupted trade in all SEE countries in 1999. By destroying or damaging the infrastructure, transportation and communication lines in FRY, NATO bombardments further divided SEE, creating trade, ecological and transportation disturbances throughout the region. However, precisely because of these regionwide consequences of the war, there is major interdependence among the SEE countries today (Minic, 1999). At the same time, additional disintegration has taken place in FRY. After the end of the 1999 military conflict, it practically lost territorial control over Kosovo, whereas Montenegro is steadily moving towards full independence, especially after the November 1999 decision to introduce the Deutschmark as a parallel currency.

Today, the SEE region is therefore even less economically integrated than a decade ago, but there are many reasons for this, including historical legacies. The fact that the SEE was not very integrated in 1989 — except for the area of former Yugoslavia — had been determined to a large extent by non-economic factors: historical, political, geostrategic and ideological (including the existence of the CMEA, the specific position of Yugoslavia and the autarkic policies of Albania). These factors were clearly more important than any purely economic interests in determining economic relations and trade patterns of SEE countries. Similarly today, economic interests may not be the primary factor determining trade flows in SEE. In addition to historical factors that once divided SEE, one must consider the recent military conflicts, embargoes and politically-motivated trade wars, which have had a direct impact on trade among SEE countries, contributing to a much lower level of trade than otherwise could have been the case.

#### INITIATIVES STIMULATING REGIONAL COOPERATION IN SEE

During the 1990s, a number of initiatives were introduced to stimulate regional cooperation among former socialist countries (Lopandic, 1999 or Simic, 1997). These can be divided into two broad groups. The first group, launched in 1988-92, was the result of the Socialist bloc's dissolution, and was addressed to a wider group of countries, not only to those in SEE. Among the most important were the Central European

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<sup>8</sup> For example: "At present, 60 per cent-90 per cent of the exports of the countries of Southeastern Europe are to the Union" (Finnish Presidency and the European Commission 1999: 4).

Initiative (CEI), the Central European Free Trade Area (CEFTA) and the Black Sea Economic Cooperation (BSEC). The second group of initiatives, launched after the end of the war in Bosnia and Herzegovina, was directed primarily at the SEE region. Among the most important were the Conference on Good Neighborliness, Stability, Security and Cooperation in SEE (CSEE), the Royaumont Process, the Regional Approach of the EU, the Southeast European Cooperative Initiative (SECI) and finally, the Stability Pact for SEE. In Table 4, the most important initiatives of regional cooperation are presented, as well as the participation of individual SEE transition economies in each.

**Table 4. Participation of SEE countries in multilateral initiatives of regional cooperation**

| <i>Country</i>                | <i>CEI<br/>(1989)</i> | <i>CEFTA<br/>(1992)</i> | <i>BSEC<br/>(1992)</i> | <i>CSEE<br/>(1996)</i> | <i>RP<br/>(1995)</i> | <i>EU-RA<br/>(1996)</i> | <i>SECI<br/>(1996)</i> | <i>SP<br/>(1999)</i> | <i>Total</i> |
|-------------------------------|-----------------------|-------------------------|------------------------|------------------------|----------------------|-------------------------|------------------------|----------------------|--------------|
| <b>Albania</b>                | +                     | -                       | +                      | +                      | +                    | +                       | +                      | +                    | 7            |
| <b>Bosnia and Herzegovina</b> | +                     | -                       | -                      | O                      | +                    | +                       | +                      | +                    | 5 + O        |
| <b>Bulgaria</b>               | +                     | +                       | +                      | +                      | +                    | -                       | +                      | +                    | 7            |
| <b>Croatia</b>                | +                     | -                       | -                      | O                      | +                    | +                       | O                      | +                    | 4+O+<br>O    |
| <b>Macedonia FYR</b>          | +                     | -                       | -                      | +                      | +                    | +                       | +                      | +                    | 6            |
| <b>Romania</b>                | +                     | +                       | +                      | +                      | +                    | -                       | +                      | +                    | 7            |
| <b>Yugoslavia FR</b>          | -                     | -                       | -                      | +                      | +                    | +                       | -                      | -                    | 3            |

CEI: Central European Initiative; CEFTA: Central European Free Trade Area; BSEC: Black Sea Economic Co-operation; CSEE: Conference on Stability and Good Neighbourliness in SEE; RP: Royaumont Process; EU-RA: European Union Regional Approach; SECI: South East Europe Cooperation Initiative; SP: Stability Pact for SEE.

+: Participant; -: Non-participant; O: Observer.

Source: Adapted from Lopandic (1999: 79) with some minor modifications.

Why have these initiatives not led to more substantial results, particularly in the SEE region?<sup>9</sup> Political hostilities among the countries of former Yugoslavia are obviously the main explanation: the revival of nationalism and the four wars that accompanied the breakup of the Yugoslav federation blocked many possible forms of cooperation among SEE countries (Uvalic, 1995). Another important reason is the exclusion of FRY from most of these initiatives (see Table 4), even though this country must play a key role in regional cooperation. It is a central SEE state, one of the largest, and involved in almost all the military conflicts in the region, thus contributing greatly to regional instability. Among other shortcomings, these initiatives were all imposed from the outside. Except for the CSEE, they were usually backed by limited financial and/or technical resources, and most were not comprehensive enough, being limited to one or a few areas.

Since the major responsibility for implementing the newest regional cooperation initiative, the Stability Pact, rests today with the EU, it is important to examine EU policies in

<sup>9</sup> For a detailed analysis of the advantages and limitations of these initiatives, see Lopandic (1999).

recent years. Instead of adopting a consistent, well-defined and long-term strategy for the entire SEE region at the beginning of the transition, the EU initially underestimated the political problems in the heart of the SEE region (former Yugoslavia). Later, constrained by other priorities and problems, it took action only once it was too late to prevent a new crisis. The absence of a comprehensive strategy for the Balkans meant that the EU applied ad hoc policies to each SEE country. These particularly disadvantaged most successor states of former Yugoslavia (see below). As stressed recently, “diversity and bilateralism have been the name of the game” (Gligorov *et al.* 1999: 38). Awareness that something had to be done on a regional basis came only after the end of the war in Bosnia and Herzegovina, resulting in the EU Regional Approach in 1996 for the five countries of the Western Balkans (Albania, Bosnia and Herzegovina, Croatia, FYROM and FRY). The EU Regional Approach strongly encouraged closer economic and political ties among these countries, but it appeared rather late (after four years of military conflicts); it remained vague (with no proposals for concrete programs of regional cooperation); it had limited financial backing; and perhaps most important, it offered no incentives to these countries to carry forward its main objectives.

**Table 5. European Union measures sustaining transition in SEE countries**

|                                     | <i>Multilateral financial assistance</i> |  | <i>Trade arrangements with EU</i>                |
|-------------------------------------|--|--|--|
|                                     | Year of inclusion<br>in PHARE            | Total PHARE<br>aid 1990-95<br>(mln. ECU) | Type of trade agreement*<br>& year of conclusion |
| <b>Albania</b>                      | Dec.1991                                 | 332                                      | TECA: 1992                                       |
| <b>Bulgaria</b>                     | July 1990                                | 476.5                                    | AA: March 1993                                   |
| <b>Romania</b>                      | Jan. 1991                                | 607.7                                    | AA: Feb. 1993                                    |
| <b>Slovenia</b>                     | 1992                                     | 69 (1992-95)                             | TECA: 1993; AA: June 1996                        |
| <b>Bosnia &amp;<br/>Herzegovina</b> | 1996                                     | **                                       | ATP: 1996  |
| <b>Croatia</b>                      | Not yet                                  | **                                       | ATP: 1996  |
| <b>Macedonia FYR</b>                | 1996                                     | **                                       | TECA: June 1996 (in force<br>since 1998)         |
| <b>Yugoslavia FR</b>                | Not yet                                  | **                                       | ATP: 1997 (withdrawn in<br>1998)                 |

\*TECA: Trade and Economic Cooperation Agreement; AA: Association Agreement; ATP: Autonomous Trade Preferences taken over from the 1980 Trade and Cooperation Agreement with SFR Yugoslavia.

\*\*All countries of former Yugoslavia other than Slovenia have received a cumulative total of 166 million ECU over the 1990-95 period. Slovenia has also received part of this sum in 1990-91.

Source: Compiled by the author on the basis of various sources, in particular Bartlett (1997).

The disadvantaged position of most successor states of former Yugoslavia is immediately clear if we consider some of the principal measures applied by the EU to sustain the transition in former socialist countries (see Table 5). Whereas Bulgaria, Romania, Albania and Slovenia were included in the PHARE program by 1990-92,<sup>10</sup> the other four SEE countries either became beneficiaries much later (Bosnia-Herzegovina and FYROM in 1996) or are still excluded today (Croatia and FRY).<sup>11</sup> Only Bulgaria, Romania and Slovenia have signed Association Agreements with the EU, while Albania and FYROM have the more limited Trade and Economic Cooperation Agreements. Bosnia and Herzegovina, Croatia and FRY still have no permanent trade agreement with

<sup>10</sup> Former Yugoslavia was also included among PHARE beneficiaries for a short period in 1991, within the PHARE II Program, but these provisions were suspended after the country disintegrated.

<sup>11</sup> Croatia was formally included among the PHARE beneficiaries in 1995, but this provision was suspended after the military takeover of Krajina in August 1995.

the EU (though some trade concessions were approved in 1996-97).<sup>12</sup> As for accession to the EU, only Bulgaria, Romania and Slovenia have been accepted as official candidates, while even the *prospect* of EU membership did not arise for the other countries until 1999.

Perhaps such EU policies have not made a big difference in practical terms, if we consider that access to EU markets for many SEE products is already duty free and that substantial financial resources have entered this region through other channels (see below). Nevertheless, these policies have had a number of negative consequences (Minic, 1999; Uvalic, 1997a). The fact that EU policies were not backed by a comprehensive strategy for the Balkans has had a very deep psychological effect: throughout the 1990s, most of these countries felt they had been abandoned, rejected as potential EU members, disregarded for integration into Euro-Atlantic structures, and thus artificially excluded from Europe, where they feel they belong. Moreover, although EU conditionality is fully understandable politically, its economic consequences can not be ignored. It must be recognized that essentially favorable EU policies towards certain SEE countries and not others, and even the absence of measures sustaining transition (as in the case of Croatia and FRY), have had a direct impact on the economic performance and progress toward transition of individual SEE countries (Uvalic, 1997a and 1997b). The EU's highly differential treatment of individual SEE countries has also deterred successful implementation of the 1996 EU Regional Approach; strict bilateralism undermines the essence of such an approach.

These are some of the reasons why the newest phase of EU policies towards the SEE region is extremely important. For the first time in a decade, the Stability Pact adopted in June 1999 provides, in addition to "sticks," an important "carrot": the prospect of EU membership for the five SEE noncandidates. A linchpin of the Stability Pact is the new type of agreement that has been conceived for this group of SEE countries, Stabilization and Association Agreements (see Kretschmer 1999). Though much skepticism has been expressed lately regarding the Stability Pact, because of the exceedingly slow implementation of some of its initiatives, its political importance should not be underestimated. However, since the continued use of bilateralism based on strict conditionality will probably be unavoidable in the future, what seems extremely important is that the regional mechanisms envisaged by the Stability Pact are effectively implemented and elaborated with sufficient determination. Otherwise, the risk exists that, like the EU Regional Approach, the Stability Pact will fail in its main objective: to achieve permanent peace, stability and development throughout the SEE region.

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<sup>12</sup> The EU approved autonomous trade preferences to these countries in 1996-97, based on provisions of the Trade and Cooperation Agreement concluded in 1980 with former Yugoslavia.

Crucial to these efforts to further promote stability and development in SEE is much more effective use of financial resources. If we consider the total funds directed toward the five countries in the Western Balkans, including EU, bilateral assistance and European Bank For Reconstruction and Development (EBRD) funds, we see that the amount has been quite substantial, more than 8.2 billion Euro in 1991-99 (see Table 6). The largest share of EC-EU resources has been in the form of humanitarian aid provided under the ECHO (European Community Humanitarian Office) program, almost 50 per cent of total EU funds. This contrast with the minimal amount provided by the European Investment Bank (EIB), extended so far only to Albania. Considering that the total nominal GDP (at market exchange rates) of these five SEE countries in 1998 was only around \$46 billion, the total they received in the 1990s actually amounts to as much as 18 per cent of their GDP (assuming approximately a 1:1 dollar/Euro parity). Since all these countries are poorer today than they were in 1989 (see Table 7 below), it is clear these funds have gone primarily into consumption and not into investment. Until now, Western assistance has helped these countries merely to survive, rather than to develop and prosper. To transform SEE into an economically prosperous region, it is extremely important that the 5.5 billion Euro envisaged for 2000-2006 as financial assistance to the region (see Finnish Presidency and European Commission 1999) is utilized to contribute much more to sustainable growth and development of all SEE countries.



**Table 6. EU Assistance to Western Balkans, 1991-99 (commitments, million EURO)**

|                                | <i>Albania</i> | <i>Bosnia &amp; H.</i> | <i>Croatia</i> | <i>Yugoslavia</i> | <i>Macedonia</i> | <i>Total (1)</i> |
|--------------------------------|----------------|------------------------|----------------|-------------------|------------------|------------------|
| <i>PHARE</i>                   | 616.4          | 754.5                  | 49.6           | 41.7              | 236.7            | 1,708.6          |
| <i>Humanitarian Aid</i>        | 41.2           | 1,032.1                | 290.8          | 262.8             | 45.7             | 1,908.7          |
| <i>Food Aid</i>                | 16.5           | -                      | -              | -                 | -                | 16.5             |
| <i>Balance of Paym.</i>        | 20.0           | 60.0                   | -              | -                 | 40.0             | 120.0            |
| <i>EIB</i>                     | 46.0           | -                      | -              | -                 | -                | 46.0             |
| <i>Other</i>                   | 122.8          | 221.2                  | 9.3            | 17.5              | 2                | 385.1            |
| <b><i>Total EC-EU</i></b>      | <b>862.9</b>   | <b>2,067.8</b>         | <b>349.7</b>   | <b>322</b>        | <b>324.4</b>     | <b>4,184.9</b>   |
| <b><i>EU Bilateral (2)</i></b> | <b>712.8</b>   | <b>507.9</b>           | <b>1,165.9</b> | <b>712.4</b>      | <b>178.2</b>     | <b>3,277.2</b>   |
| <b><i>Grand Total</i></b>      | <b>1,575.7</b> | <b>2,575.7</b>         | <b>1,515.6</b> | <b>1,034.4</b>    | <b>502.4</b>     | <b>7,462.1</b>   |
| <b><i>EBRD</i></b>             | <b>68.0</b>    | <b>70.0</b>            | <b>511.0</b>   | <b>0.0</b>        | <b>143.0</b>     | <b>792.0</b>     |

Notes: (1) Including EC multi-country programmes (total 258.2 Million Euro); (2) 1990-1997

Source: Bartlett (1999), based on EU Press Release PR 33/99 May 1999.

For this to become feasible, institutional support is essential. Effective reconstruction of the SEE region, in terms of sustainable economic development rather than just physical reconstruction of damaged houses, bridges and roads, must have as a key component the creation of new forms of regional economic linkages, as was the case in postwar Europe (Bartlett, 1999). Designed to foster regional integration, the Marshall Plan was backed by new Europe-wide regional institutions (such as the OECD and the European Payments Union) that facilitated intraregional trade. Regional structures designed to promote the expansion of trade and other economic links among SEE countries are needed. A multilateral credit mechanism should be created for extending credit facilities specifically for such purposes, backed by a credible financial organization (for example, the EBRD). Alternatively, as suggested in 1996 by the former governor of the National Bank of Yugoslavia, Dragoslav Avramovic, a common regional fund could be created. Its initial capital would consist of the still-undivided foreign exchange reserves of former Yugoslavia, which would serve as collateral to attract additional capital on international financial markets.

Regional cooperation in SEE has never been so important. A comprehensive regional strategy for SEE is timely and necessary; it must include all areas (economic, political, social, cultural) and all countries. A way must be found to include FRY in all current regional cooperation initiatives. Without it, no permanent regional solution is possible (Minic, 1999; Bianchini, 2000). The need for such an inclusive strategy stems from an increasing awareness that the Balkans' most relevant problems (stability, democracy, development) are strictly correlated and mutually influenced (Bianchini, 2000). Whereas closer cooperation in each of the areas would be beneficial in itself, an all-inclusive regional strategy could generate various spillover effects — closer cooperation in one area could facilitate and reinforce closer cooperation in others.<sup>13</sup>

Within such a comprehensive regional strategy for peace, democracy and development in SEE, there are several economic arguments why closer cooperation among SEE countries would be highly beneficial. Before exploring these arguments, it should be noted that SEE today is a highly depressed area. In comparison with more advanced transition economies, growth performance has been much less satisfactory. Most SEE countries are today much worse off than in 1989, with their GDP in 1998 representing 35 per cent-86 per cent of the 1989 level (see Table 7).

**Table 7. Growth performance of SEE transition economies**

|                  | <i>Real GDP<br/>in 1998<br/>(1989=100)</i> | <i>Year<br/>recovery<br/>began</i> | <i>Reversal<br/>in trend<br/>after<br/>recovery?</i> | <i>GDP<br/>average<br/>growth rate<br/>1991-95</i> | <i>GDP<br/>annual<br/>growth<br/>1997</i> | <i>GDP<br/>annual<br/>growth<br/>1998</i> |
|------------------|--|------------------------------------|--|--|---|---|
| <i>Albania</i>   | 86   | 1993                               | Yes (1997)   | -2.7   | -7.0                                      | 8.0                                       |
| <i>Bosnia</i>    | 35   | 1996                               | No   | n.a.   | 30.0                                      | 18.0                                      |
| <i>Bulgaria</i>  | 66   | 1994                               | Yes (1996)   | -3.6   | -7.0                                      | 3.5                                       |
| <i>Croatia</i>   | 78   | 1994                               | Yes (1999)   | -6.7   | 6.5                                       | 2.3                                       |
| <i>Macedonia</i> | 72   | 1996                               | Yes (1999)   | -9.6   | 1.5                                       | 2.9                                       |
| <i>Romania</i>   | 76   | 1993                               | Yes (1997)   | -2.2   | -6.9                                      | -7.3                                      |
| <i>FRY*</i>      | 51   | 1994                               | Yes (1999)   | -12.4  | 7.4                                       | 2.6                                       |

\*Gross Material Product.

Source: EIU (1996), EBRD (1999), UNECE (1999), EIU (2000).

<sup>13</sup> Many recent proposals follow these lines (see CEPS 1999; Gligorov et al. 1999; Emerson 1999; Minic 1999; Bianchini 2000).

At the heart of the SEE region is FRY, which by 1999 became the second poorest country in Europe. Only Albania has a lower GDP per capita (EIU 2000). Unemployment rates in SEE are much higher than anywhere else in Europe: 42 per cent in FYROM, 38 per cent in Bosnia and Herzegovina, effectively (though not officially) close to 50 per cent in FRY. The only country that has not experienced a reversal in the trend toward recovery is Bosnia and Herzegovina, while the country closest to its 1989 GDP level is Albania. Recent estimates suggest a further worsening in 1999 of macroeconomic indicators for several SEE countries, in particular FRY (Uvalic, 1999).

Presently, therefore, conditions for growth in SEE are not very favorable. SEE countries are small and underdeveloped. Economically, they are unimportant, and economic cooperation among most of them is weak. For years, they have been isolated due to sanctions and embargoes, closed borders, high tariff and nontariff barriers. Underdevelopment determines low purchasing power and thus impedes more intense trade, stimulating smuggling, illegal trade and the development of underground activities. By accelerating economic growth and development, regional economic cooperation could help the SEE region pull out of this vicious circle of backwardness.

The main economic arguments for regional cooperation fall within four areas: trade, the regional dimension of problems, investment and EU integration. These arguments are closely related. Intensifying trade and other economic links among SEE countries could contribute to economic recovery and growth, while faster development is crucial for the region's political and economic stability. Only if SEE countries become economically and politically stable are they likely to attract more private capital from abroad, and only if conditions for more sustainable growth and development are fulfilled, can these countries hope to integrate with the rest of Europe.

### **Trade**

One of the first steps for increasing economic links among SEE countries is to increase mutual trade. The majority of SEE countries already have more or less preferential access to markets of other regions yet maintain a number of trade barriers among themselves. Presently, there are no institutional arrangements through which they could exploit the potential of their own region for their own development (Kovac, 1998). Trade liberalization could increase regional trade flows, and if foreign trade were to increase sufficiently, it could create exceptionally strong impulses for economic development, with

both static and dynamic gains (Kovac, 1998). The potential for expanding trade exists among some SEE countries, primarily successor states of former Yugoslavia, given that most still trade with their former partners. The expected increase in SEE trade may turn out to be transitory, but it could nevertheless be highly beneficial. If we consider that over the last few years, SEE exports to the EU have been stagnating or declining — with the exception of Romania — sluggish export performance in Western markets could be compensated by increasing exports to SEE countries, with the additional advantage of lower transport costs. Some steps have already been taken in this direction, such as bilateral free trade agreements signed by a number of SEE countries.<sup>14</sup> As often suggested in recent proposals, a South European Free Trade Area (SEFTA) needs to be created as soon as possible.

### **Regional problems**

Especially after the 1999 military conflict in FRY, a number of common problems have emerged that will have to be resolved by all SEE countries jointly as part of the economic, as well as political and social, reconstruction of the region. Because of these common problems that today link all SEE countries much more than in the past, closer cooperation among the countries is urgently needed in all fields (infrastructure, transportation, Danube issues, migration, energy, ecological damages). These problems should be addressed in their regional dimension, requiring close collaboration of all SEE countries, otherwise they will be only partially resolved. Regional transnational projects are needed to rebuild railways, highways, other transportation routes and the communications network. The promotion of trade and economic development also depends to a great extent on efficient regional infrastructure networks, wherein reintegration of regional infrastructure could lead to important economies of scale. Such transnational projects of regional importance will require strong public policy, in which bridges, or the river Danube, need to be treated as public goods (Daianu, 1999).

### **Investment**

Only if SEE countries begin cooperating in different fields — liberalizing trade, implementing joint investment projects, intensifying other forms of cooperation — can major economic and political stability in the region be achieved, which could substantially improve its investment climate. Capital inflows from abroad are of fundamental

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<sup>14</sup> For example, Slovenia has signed a free trade agreement with Croatia and Bosnia and Herzegovina, as has FYROM with all countries in the region, including FRY, Bulgaria and Turkey. Bosnia and Herzegovina, on the other hand, reintroduced some restrictions on trade in 1998 with Croatia and FRY.

importance, considering the low level of savings and investment in all SEE countries induced by poverty, underdevelopment, general lack of capital and loss of confidence in the population. (Four SEE countries — Albania, Bulgaria, FYROM, FRY — have been involved in pyramid schemes in recent years). So far, foreign direct investment (FDI) inflows to the SEE region have been very limited due to high political risk, foreign partners' interest in other transition economies and the smallness of the markets (Romania is an exception). Over the last few years (1996-98), net inflows of FDI into SEE have actually *trebled* (see Table 8). Nevertheless, the cumulative total invested in seven SEE countries (excluding Bosnia and Herzegovina but including Slovenia) in 1989-98 amounts to only \$10.7 billion, barely 13 per cent of total FDI net inflows to 26 transition economies (including FRY), or 18 per cent of the total net inflows of \$58 billion to 14 CEE, SEE and Baltic countries. However, these seven SEE countries have all received more FDI on a per capita basis than the average for the 25 transition economies, while three — Croatia, Romania and Slovenia — have received more than the average net inflows for CEE, SEE and Baltic states (see Table 8).

Such a low level of FDI is a regional problem that will remain unresolved unless more permanent political and economic stability is achieved throughout SEE, which could be greatly stimulated by closer transnational cooperation. This is clearly illustrated by the case of FYROM. Although it has not been involved in any of the recent military conflicts in SEE, it has received the lowest amount of cumulative FDI among all SEE countries, a bit over \$240 million for 1989-98 (still more than FRY on a per capita basis).

**Table 8. Net Inflows of Foreign Direct Investment in SEE - 1989-98 (in million US\$)**

| <i>Country</i>   | <i>Cumulative FDI Inflows (1989-96)</i> | <i>Cumulative FDI Inflows (1989-98)</i> | <i>Cumulative FDI Per capita (1989-98)</i> |
|--|---|---|--|
| <i>Albania</i>   | 295                                     | 423                                     | 132  |
| <i>Bulgaria</i>  | 450                                     | 1,323                                   | 159  |
| <i>Croatia</i>   | 564                                     | 1,997                                   | 444  |
| <i>Macedonia, FYR</i>  | 38                                      | 242                                     | 121  |
| <i>Romania</i>   | 1,434                                   | 4,510                                   | 200  |
| <i>Slovenia</i>  | 731                                     | 1,192                                   | 596  |
| <i>Yugoslavia, FR</i>  | 0                                       | 1,010                                   | 95   |
| <b>TOTAL FDI in 7 SEE</b>  | <b>3,512</b>                            | <b>10,697</b>                           | <b>n.a.</b>                                |
| <b>FDI in 26 Transition Economies (mln. US\$) SEE share in total (%)</b>         | 42,002<br><b>8.36</b>                   | 82,148<br><b>13.02</b>                  | 80<br><b>n.a</b>                           |
| <b>FDI in 14 CEE,SEE, and Baltic countries(mln. US\$) SEE share in total (%)</b> | 30,708<br><b>11.44</b>                  | 58,461<br><b>18.30</b>                  | 184<br><b>n.a.</b>                         |

Source: EBRD, Transition Report Update (1997) and EBRD Transition Report (1999), except data for FR Yugoslavia, which is an EIU estimate (EIU, 1999a). The total FDI figures have correspondingly been increased by the sum added for FR Yugoslavia. However, the average figures for cumulative FDI per capita in 1989-98 are only for the 25 and 13 transition economies respectively, thus excluding FR Yugoslavia.

### **EU integration**

Regional cooperation in SEE could ensure smoother integration of SEE countries into the EU. By facilitating mutual trade, implementation of large investment projects and major inflow of FDI, faster growth could probably be achieved. This would reduce the income gap with respect to those who will enter the EU earlier, leading to faster future integration of SEE with other EU members. SEE countries must not have great illusions about quick entry into the EU, despite the boldness of some current proposals (CEPS, 1999; Emerson, 1999). During the past decade, EU enlargement has proceeded so slowly, that it will be 14 years (or more) since the fall of the Berlin Wall before even the first five CEE countries become EU members. The second round of EU enlargement will

require several more years of preparation. Thus, it is highly unlikely that the third round — when hopefully the remaining SEE countries will also join — can occur before the beginning of the next decade. Until then, SEE countries could continue to compete exclusively for expansion and penetration of EU markets, while neglecting neighboring countries, or they might choose to promote closer cooperation with other SEE countries, while strengthening their EU ties. The second alternative could prove much more advantageous over the next ten to 15 years.

Even if one were to reject these economic arguments for promoting regional cooperation in SEE and accept the view that there are only weak economic interests pushing in this direction, other extremely important non-economic motives exist for intensifying regional cooperation. The undefined status of Kosovo and bleak prospects for its early resolution make the peace established in mid-1999 extremely fragile, posing concrete political and security problems for the SEE region. Therefore, even if the SEE region today may not be very integrated economically, there are strong political reasons to promote closer economic integration. Just as political motives once divided SEE into two subregions, equally important political motives could integrate it today. The need to establish more permanent conditions for security, stability, peace and development in the region should be a major stimulus for closer cooperation among SEE countries in all fields.

## CONCLUSIONS

The time has come for SEE countries to abandon hostility and turn to cooperation in order to finish the “unfinished peace” that has characterized the Balkans the past decade (International Commission on the Balkans, 1996). Closer regional cooperation must be promoted primarily in the interest of the SEE countries themselves, but also in the interest of all Europe. Now that the EU has shown its interest in helping all SEE countries by providing them greater access to EU markets, major financial assistance and eventually membership, it is crucial not to waste this important opportunity (Cetinic, 1999: 132). Increased regional cooperation could help economic recovery, enhance security and political stability, diminish criminal and black market cross-border activities, open borders and stimulate trade links, FDI and development. For SEE countries, there are no alternatives in the medium run but to intensify regional cooperation, and this can only facilitate future integration with the EU.

Today there is widespread recognition that in SEE, regional problems require regional solutions, and therefore cooperation among SEE countries in all fields is necessary. The Stability Pact reflects this core conviction. A major problem during this past year has been the exclusion of Serbia from all international initiatives, but now that political change has taken place and the democratic opposition has come to power (on October 6, 2000), enabling the official admission also of FR Yugoslavia into the Stability Pact (on October 26, 2000), it will definitely be much easier to resolve many regional problems in SEE. As recently stressed at the Helsinki summit, nothing can substitute for the political will of SEE's states to cooperate among themselves (see Finnish Presidency and the European Commission 1999). And in Serbia today, it does seem that the political will for establishing closer ties with neighboring countries is finally there.



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