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**ECONOMIC ASPECTS OF
EUROPEAN AND REGIONAL INTEGRATION:
THE CASE OF THE BALKANS**

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Paper presented at the conference on "Regional Cooperation and Reconstruction in South-East Europe"
Rome, 29-30 October 1999

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Attempts to establish regional cooperation are not a new phenomenon in the Balkans. In the inter-war period, regional cooperation was promoted through a series of Balkan Conferences, which focused on economic issues and intended to create a Balkan Union. This process, however, broke down, because it failed to resolve political problems, such as the question of minorities and the rise of competing blocs within the region. During the Cold War, regional co-operation was promoted by some Balkan countries, primarily in the sphere of security, but again, it was doomed to fail due to different bloc considerations.

The post-Cold War era experienced a resurgence of regional patterns of interaction in the Balkans as a means to promote stability, security and prosperity. Selected Balkan countries were included in broader regional co-operation schemes such as the Central European Initiative (CEI) or the Black Sea Economic Cooperation (BSEC) already in the early 1990s. Since the mid-1990s, regional schemes specific to Southeastern Europe have been established and reactivated with external (Southeast European Cooperative Initiative/Royaumont Process) or indigenous support (Balkan Conference for Stability and Cooperation).

The Southeast European Cooperative Initiative (SECI) was launched in December 1996 by the United States. It aims to coordinate region-wide planning in infrastructure, energy, communications, trade facilitation and environmental issues as well as to promote private sector investment. Membership includes all countries of the region, except the Federal Republic of Yugoslavia, as well as Hungary and Moldova. Italy, Austria and the USA are also members; and they support the initiative with financial contributions, whereas the UN Economic Committee for Europe provides technical expertise.

The primary external actor promoting regional cooperation in the Balkans has been, undoubtedly, the European Union. In addition to signing many bilateral trade and economic cooperation agreements with countries of the Balkan subregion, in 1996 the EU defined a regional approach towards the former warring parties of Yugoslavia, FYR Macedonia and Albania. The policy lays out conditions that these countries must fulfil in order to qualify for improved trade access to EU markets, financial aid, and the deepening of institutional relations with the EU. An important element of this conditionality is their readiness to engage in cross-border cooperation with each other.

There are already concrete signs indicating that the EU may be now be ready to undertake a central role in the reconstruction of the Balkans. They include the initiative which led to the adoption of the Stability Pact for Southeastern Europe as well as the proposals on the Stabilisation and Association Process for the countries of the Western Balkans. The new Commission should be expected to act as a driving force. Yet, there is still a big gap between general declarations of intent and hard commitments, both in terms of financial

resources and institutional perspectives. As the sight of wretched refugees and bombed sites fades away from our television screens, there is indeed a danger that politicians in the prosperous countries of Europe will shift their attention to other domestic priorities, thus leaving the Balkans trapped once again in the vicious circle of economic misery, crippled democracy and insecurity, which has been repeatedly made worse in the past by destabilising foreign interventions.

For the EU to play an effective stabilisation and modernisation role in the region, it will require:

- political will
- financial resources
- innovative ideas.

It will have to offer a clear prospect for the progressive integration of all countries concerned into the European system, even though it will have to make clear that full membership of the EU is not likely to happen before long. The Union needs to enlarge its membership in stages, eventually incorporating all European countries which may wish to join, without sacrificing the goal of ever deepening integration. Generosity and flexibility will need to be combined with conditionality and continuous monitoring. This in turn means that a regional approach is not incompatible with differential treatment of individual countries as a means of rewarding success, as long as it is based on some generally applicable rules. Thus, an EU regional approach to the post-communist Balkans should in no way be interpreted as a means of delaying the accession to the EU of countries such as Bulgaria and Romania, which are in this respect far ahead of any other country in the region, although still quite a long distance from becoming full members.

One important general question concerns the relationship between increasing participation of the Balkan countries in European integration on the one hand and co-operation/integration at the regional level on the other. There is certainly no incompatibility between the two processes. On the contrary, they should be viewed as closely linked to each other and mutually reinforcing; and the EU should ensure that they remain so.

Regional co-operation/integration is desirable for economic, political and security reasons. But given the history of the region, it may have to proceed at a modest pace, at least initially, and even more so, as long as final political settlements accepted by all parties concerned are pending, especially as regards parts of former Yugoslavia. Past experience seems to suggest that the emphasis, at least in the early stages, should be on low politics, thus offering large scope for the old Monnet method. One thing should, however, be made clear: regional co-operation/integration can never be a substitute for integration in the wider European system. The region is too small in economic terms and peripheral in geopolitical terms, and none of the countries concerned would accept such an alternative. Table 1 shows the relative importance of trade of individual countries of the Balkans with the EU (Germany and Italy being singled out as major trading partners) and Russia. Table 2 contains figures on intra-regional trade. The contrast is very sharp indeed: intra-regional trade will have to start from a very low basis.

Trade liberalisation should be a key component of the new EU policy towards the Balkans. Improved access to trade can be more important than economic aid. Some immediate steps should include:

- As a minimum, the EU should offer tariff-free access for industrial exports from all countries in the region. This is in fact very close to what already applies. This measure could therefore be decided very soon (applicable from 1/1/2000?).
- Free access for agricultural exports from the countries of the region will be more difficult to obtain, given the highly protectionist character of the CAP. Liberalisation of agricultural trade is very important, since farming represents a large share of total production in many countries of the region. Liberalisation will, of course, depend on the pace of internal reform of the CAP. As a first step, there should be a generous increase in agricultural export quotas offered to the countries in the Balkans.
- There is now a big asymmetry in trade relations between the EU and individual countries in the Balkans, as expressed by the large deficits incurred by the latter. There is also, arguably, an asymmetry in terms of trade liberalisation between the two sides, working again at the expense of the Balkan countries, because of the restrictions imposed by the CAP in agricultural trade. If anything, this asymmetry needs to be reversed, in order to take into account the different levels of economic development of the two sides. Thus, the timetable for trade liberalisation should allow some breathing space for restructuring on the side of the partners of the EU. Admittedly, transition periods for adjustment are not usually profitably used. Instead, they often provide a convenient excuse for delaying painful decisions. However, immediate liberalisation of external trade in the Balkan countries would further exacerbate the already huge problem of unemployment, while also leading to the permanent closure of many inefficient firms, some of which could survive with proper and timely restructuring. A clear timetable of tariff liberalisation extending to five (?) years should be adopted.
- Liberalisation of intra-regional trade should be applied more easily, thus leading to the creation of a free trade area in the Balkans, which should become part of the wider European free trade area. This could start from the year 2000. However, given the structure and size of individual countries in the Balkans, the immediate prospects for growth in intra-regional trade should be relatively modest (see Table 2). In the context of intra-regional trade, improved relations among the successor republics of former Yugoslavia should allow for at least some part of the old intra-Yugoslav economic exchange to start again. On the other hand, the growth of intra-regional trade, as well as trade with the rest of Europe, very much depends on the improvement of transport networks.

In the world of mixed economies, and especially in the context of the EU and the preparation for accession, trade liberalisation should be intimately linked with regulatory alignment. A great deal of the effort in preparing the 11 candidate countries for full membership has been spent on the progressive alignment of national rules to the internal market *acquis* on the basis of the White Paper of 1995. Thus, the candidate countries have been required to undertake most of the regulatory adjustment prior to their accession; and

sometimes, at a not insignificant cost for them (e.g., environmental rules). The wisdom of this policy is under some doubt.

Although the harmonisation of rules is an essential part of the preparation for EU membership – and this should be clearly the long-term goal for all the countries of the Balkans – too much emphasis on it at an early stage would be counter-productive, given the much lower level of economic and institutional development of the Balkan countries. There is much basic institution building that will need to be done first.

Euroisation could have great symbolic significance as a way of linking the Balkans with EMU and the euro. The replacement of national currencies by the euro should, however, be a gradual process extending over a period of ten years and allowing for different speeds to cater for the special characteristics of individual countries. The progressive euroisation of the Balkan economies needs to be accompanied by technical assistance, financial aid and a whole range of internal reforms, especially as regards the financial sector.

Economic aid should be an integral part of the overall package to be offered by the EU to all the countries of the region. The launching of the Stability Pact needs to be followed by sizeable financial commitments on behalf of the EU and the other potential donors. The amounts committed until now are almost exclusively directed at physical reconstruction in Kosovo. *The European Agency for Reconstruction* (EAfR) should therefore take responsibility for the Balkan region as a whole, while also adopting a wide definition of the term reconstruction.

The political decision to proceed with a comprehensive plan for reconstruction and regional co-operation in the Balkans will need to involve substantial sums of money over a period of years. The EU will have to operate within the budgetary ceiling of 1.27% of GNP until the year 2006. On the basis of present projections of expenditure, this ceiling does, however, leave considerable margin for manoeuvre. Given the small economic size of the region, even modest sums of money by EU standards would represent very substantial transfers for the recipient countries; and there is, of course, a limit to their absorptive capacity. At current market prices and exchange rates, the combined GDP of Albania, Bulgaria, Romania and the successor republics of Yugoslavia (excepting Slovenia and Croatia) is smaller than the GDP of Greece. In other words, it represents approximately 1% of the GDP of EU-15. Thus, annual transfers of the order of 3-5 billion euros to the whole area of post-communist Balkans should be within the limits of the budgetary ceiling of 1.27% for the period 2000-2006; and wisely used, this sum could make a great deal of difference in the region. On the other hand, there is considerable scope for additional funds to be made available in the form of grants from individual donors and loans through the EIB and international financial institutions.

The efficient use of funds will require strict conditionality and continuous monitoring. This in turn implies flexible management structures and a kind of operation which is human resource intensive on behalf of the donors. Thus, money will not be the only constraint. Lessons will have to be learned from the experience of aid to Bosnia-Herzegovina: the large sums of money spent until now, when they have not gone down the corruption drain, may have produced new bridges and schools. But they have hardly succeeded in creating the conditions for sustainable economic development. The

Commission will also need to learn from its own experience in providing structural aid. The experience with aid giving through the PHARE and TACIS programmes for the countries of Central and Eastern Europe and the former Soviet Union leaves something to be desired.

What follows below is an indicative list of priorities for EU economic aid:

Top priority should be given to the improvement of *public infrastructure*, and especially transport and telecommunications networks. Trade liberalisation both within the region and with the EU depends on it. The plans for the pan-European corridors, as an extension of trans-European networks (TENs), are already there. All the countries of the region now need to be involved in the process. The financing should combine official grants, loans as well as other schemes relying more heavily on the private sector. Today in the Balkans, infrastructural investment should be a powerful integrating factor, arguably the equivalent of coal and steel in Western Europe in the 1950s.

Balance of payments aid should be primarily the responsibility of international financial institutions. On the other hand, transfers through the EU budget should be directly linked to progressive euroisation and the *restructuring of the financial sector*, which will be absolutely crucial for economic development. Consideration could also be given to the EU undertaking part of the *social security* burden, especially if this is linked to further restructuring and the laying off of workers. Furthermore, special attention should be given to *private investment and the generation of new employment*, with particular emphasis on new technologies and SMEs. EU grants in this area should be primarily aimed at reducing the high-risk premium of new investment in the Balkans.

A major priority of EU aid should be the whole area of *institution building*. We have now learned from bitter experience that weak institutions and non-transparent rules explain much of the painful and largely unsuccessful transition of post-communist countries in the Balkans. Institution building should involve a great deal of technical assistance from other European countries. Basic groundwork should be followed by progressive harmonisation of rules in anticipation of EU membership.

Given the special characteristics of the Balkans, a good deal of EU aid should bypass central governments aiming at the strengthening of the private economy as well as *civil society and NGOs*. We need to strengthen pro-democracy forces in Balkan societies, which may act as counterbalance to the centralising and authoritarian tendencies of the state, and also forces which may help to build bridges across frontiers.

High consideration should be given to projects which extend beyond the frontiers of a single country, thus helping to lay the foundations of *Balkan co-operation* and starting mainly in areas of low politics. Transport, energy, telecommunications, water resources as well as visas, frontier control, drugs and organised crime are some examples of the kind of areas in which there is rich scope for Balkan co-operation, with the EU acting, when necessary, as a catalyst. Cross-regional training efforts and corporate support programmes should also be given priority. Regional co-operation should go hand-in-hand with closer integration of the Balkan countries in the EU.

Justice and home affairs already represent a significant part of EU legislation. The gradual lifting of restrictions on the free movement of people between the EU and the countries of the Balkans will have to be directly linked to an ever closer co-operation between the two sides, which should also include the fight against organised crime and drug trafficking.

This finally brings us to *institutional relations*, which should aim at reconciling the new regional approach of the EU with the traditional hub-and-spoke relation between the Union and individual associate members. The new agreements to be signed with those countries of the Balkans, which do not have as yet the status of associate and/or candidate member, should bring with them the institutional and other benefits of association with the EU, including institutionalised dialogue at different levels and gradual access/participation in different EU policies. The speed of integration of each associate member will, of course, vary depending on the ability to meet clearly defined economic and political criteria. At the same time, the new associate members, together with the old ones, will be invited to participate actively in different manifestations of regional co-operation, in which the EU as such will also play a part. The regional dimension of institutional relations should not be limited purely to low politics. It should also include periodic meetings at the ministerial level as well as annual meetings of the heads of state or government.